

# The Public Control of Corporate Power: Revisiting the 1909 U.S. Corporate Tax from a Comparative Perspective

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*The origins of U.S. corporate taxation are often associated with the 1909 corporate excise tax. Scholars who have investigated the beginnings of this levy have mainly focused on the legislative history of the 1909 corporate tax to argue that it was either an expression of the Progressive Era impulse to regulate large-scale corporations or an attempt to use corporations as remittance devices to collect taxes aimed at wealthy shareholders. This Article broadens the conventional historical accounts of the emergence of American corporate taxation by revisiting the 1909 U.S. corporate tax from a comparative perspective. The aim is to look both below and beyond the American nation-state to determine how and why U.S. state governments and other Western industrialized nations tried to tax corporations at the turn of the twentieth century. This Article investigates a small slice of subnational*

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*and transnational comparative examples: corporate tax laws and policies in a few representative nineteenth-century industrializing American states, and in turn-of-the-century England and Germany. Building on the well-known insights of comparative business history, this Article contends that historically-determined political interests, social ideas, and cultural beliefs help explain the American obsession with disciplining large-scale business corporations through the use of nominally punitive tax laws and policies. Comparative-historical analysis shows how differences in the organizational structures of big businesses across place and time have led to variations in political economy that were ultimately expressed in the legal ideas and cultural attitudes toward corporate capitalism. These variations, in turn, shaped the transnational distinctions in corporate tax law and policies. Greater attention to the comparative-historical development of law and political economy may help us understand the stubborn persistence of American corporate taxation, particularly in the face of recent global changes and the relentless economic critiques of the double taxation of corporate income.*

### INTRODUCTION

In the late nineteenth and early twentieth centuries, the large-scale business corporation came to dominate American law and political economy. Led by the likes of Standard Oil and U.S. Steel, colossal industrial corporations wielded a great deal of power and authority in American public life.<sup>1</sup> These large-scale, bureaucratized corporations employed hundreds of thousands of individuals, and controlled a great deal of American private property. Indeed, by the end of the 1920s, the small, local, proprietary family-firm appeared to be a relic of bygone days. In its place emerged the signature marker of American industrial capitalism: the modern business corporation, complete with distinct organizational units managed by a hierarchy of salaried executives.<sup>2</sup>

Contemporaries reacted to the growth of big business with tremendous

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1 GLENN PORTER, *THE RISE OF BIG BUSINESS, 1860-1910* (1973); MORTON KELLER, *REGULATING A NEW ECONOMY: PUBLIC POLICY AND ECONOMIC CHANGE IN AMERICA, 1900-1933* (1990); OLIVER ZUNZ, *MAKING AMERICA CORPORATE, 1870-1920* (1990); ALAN TRACTENBURG, *THE INCORPORATION OF AMERICA: CULTURE AND SOCIETY IN THE GILDED AGE* (1982).

2 ALFRED D. CHANDLER, JR., *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS* (1977); LOUIS GALAMBOS, *THE PUBLIC IMAGE OF BIG BUSINESS IN AMERICA, 1880-1940* (1975); MARTIN J. SKLAR, *THE CORPORATE RECONSTRUCTION OF AMERICAN CAPITALISM, 1890-1916* (1988); DAVID BUNTING,

ambivalence. Some celebrated the enormous industrial corporation as the ideal of economic efficiency, as the essential vehicle for mobilizing capital and implementing the lessons of scientific management. Consequently, the leaders of these corporate enterprises were often lionized by admirers as visionary, industrial statesmen.<sup>3</sup> Others were more suspicious of these new corporate behemoths and the men who led them. Tapping the deep-seated American antimonopoly tradition, critics characterized large corporations as rapacious financial predators that disregarded the rule of law and common morality in their relentless efforts to expand and entrench their economic empires. Critics feared that the concentration of economic and political power amassed in these large business corporations would threaten republican values and the core ideals of a liberal democracy. Detractors thus denigrated the men who led these businesses as a "gang of thieves," or as unscrupulous and ruthless "robber barons."<sup>4</sup>

The social tensions that accompanied the rise of American corporate capitalism were reflected in the contemporary debates over the appropriate tax treatment of business corporations. Economic experts, lawmakers, and concerned citizens contemplated how or even whether corporations should be taxed. In many ways, this was not a new concern. To be sure, large business corporations had been in existence in the United States since the birth of the republic — mainly in connection with transportation. As the creatures of special state charters, these early corporations were not only imbued with a public purpose, they were also liable to a variety of subnational levies, particularly the general property tax that dominated state and local government revenues.<sup>5</sup>

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THE RISE OF LARGE AMERICAN CORPORATIONS, 1889-1919 (1987). On the importance of Chandler's work to the development of modern business history see Richard R. John, *Elaborations, Revisions, Dissents: Alfred D. Chandler, Jr.'s, The Visible Hand After Twenty Years*, 71 *BUS. HIST. REV.* 151 (1997).

3 See, e.g., ALLAN NEVINS, *STUDY IN POWER: JOHN D. ROCKEFELLER, INDUSTRIALIST AND PHILANTHROPIST* (1953); MAURY KLEIN, *THE CHANGE MAKERS: FROM CARNEGIE TO GATES, HOW THE GREAT ENTREPRENEURS TRANSFORMED IDEAS INTO INDUSTRIES 2-3* (2004).

4 CHARLES FRANCIS ADAMS, JR. & HENRY ADAMS, *CHAPTERS OF ERIE AND OTHER ESSAYS* 30 (Boston, Osgood & Co. 1871), *quoted in* THOMAS K. MCCRAW, *PROPHETS OF REGULATION: CHARLES FRANCIS ADAMS, LOUIS D. BRANDEIS, JAMES M. LANDIS, ALFRED E. KAHN* 16 (1984); MATTHEW JOSEPHSON, *THE ROBBER BARONS: THE GREAT AMERICAN CAPITALISTS, 1861-1901* (1934).

5 JAMES WILLARD HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES, 1780-1970* (1970); HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW, 1836-1937* (1991).

The federal taxation of corporations, however, took on greater salience at the turn of the twentieth century for two principal reasons. First, this was the time of the great merger movement which led to the consolidation of many of the nation's largest industrial corporations — a consolidation that fueled both the hopes and anxieties related to the rise of American corporate capitalism.<sup>6</sup> Second, the turn of the century was also the high-water mark for U.S. tax reform. It was then that progressive activists were seeking to supplant the existing national system of indirect and regressive import duties and excise taxes with a more equitable regime of direct and graduated taxes.<sup>7</sup> In their efforts to transform the American system of public finance, reformers intimately linked the public control of corporate power to the construction of a fair and effective system of taxation. As one concerned citizen, writing to tax authorities in 1910, concisely explained, "The two great administrative problems before our people at this time are, first, the control of corporate wealth, and, second, the establishment of a rational system of taxation."<sup>8</sup>

The twin aims of regulating corporations and reforming the existing tax structure are generally part of the conventional explanations for why the U.S. federal government adopted a corporate excise tax in 1909. Scholars who have investigated the beginnings of U.S. corporate taxation have sought to uncover the original intent of the 1909 tax by exploring the high-level political debates of American national lawmakers. Accordingly, the standard historical narrative has developed along two paths. One story focuses on how populist and progressive anxieties about the growth of corporate power and prevailing juridical conceptions of corporate personality led congressional leaders and President William Howard Taft to use the tax as a regulatory tool to publicize and control the wealth and power of corporate managers and owners.<sup>9</sup> An alternative account suggests

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6 NAOMI R. LAMOREAUX, *THE GREAT MERGER MOVEMENT IN AMERICAN BUSINESS, 1895-1904* (1988); RALPH L. NELSON, *MERGER MOVEMENTS IN AMERICAN INDUSTRY, 1895-1956* (1959).

7 SIDNEY RATNER, *AMERICAN TAXATION: ITS HISTORY AS A SOCIAL FORCE IN DEMOCRACY* (1942); W. ELLIOT BROWNLEE, *FEDERAL TAXATION IN AMERICA: A SHORT HISTORY* (1996); STEVEN R. WEISMAN, *THE GREAT TAX WARS: LINCOLN TO WILSON — THE FIERCE BATTLES OVER MONEY AND POWER THAT TRANSFORMED THE NATION* (2002).

8 Letter from H.S. Wilson to Nils P. Haugen, Wis. Tax Comm'r (Sept. 1, 1910) (Box 56, Nils P. Haugen Papers, The State Historical Society of Wisconsin, Madison, Wisconsin).

9 JOHN D. BUENKER, *THE INCOME TAX AND THE PROGRESSIVE ERA* (1985); RATNER, *supra* note 7; Marjorie E. Kornhauser, *Corporate Regulation and the Origins of the Corporate Income Tax*, 66 *IND. L.J.* 53 (1990); Reuven S. Avi-Yonah, *Corporations, Society, and the State: A Defense of the Corporate Tax*, 90 *VA. L. REV.* 1193

that because most legal theorists at the time viewed the corporation as simply an aggregation of individuals, and not as a separate legal entity, lawmakers used the corporate tax primarily to raise revenue; corporations, according to this view, were merely collection agents or withholding devices used to remit taxes aimed primarily at individual shareholders.<sup>10</sup> The existing legal and political historiography, thus, frames the scholarly debate over the beginnings of U.S. corporate taxation around the competing claims of regulation versus remittance.

American national lawmakers were not, however, the only policymakers struggling with the question regarding how and why corporations ought to be taxed, or with the more fundamental concern about the role of corporations in a capitalist democracy. Government officials in earlier periods and in other nation-states confronted similar issues. The application of subnational American property taxes to corporations, for example, had long been a perennial and vexing issue throughout the nineteenth century. And as state governments experimented in the late nineteenth century with new forms of taxation, as substitutes for the failing property tax, the taxation of corporations remained a central concern. Likewise, the United States was not the only developed country dealing with the existence of large-scale business corporations. Other Western industrialized democracies faced similar concerns about the growth of big business and the application of tax laws and policies to these large organizations.<sup>11</sup>

This Article revisits the 1909 U.S. corporate tax from a comparative perspective. The aim is to look both below and beyond the American nation-state to determine how and why U.S. state governments and other Western industrialized nations tried to tax corporations. For the sake of brevity, this Article investigates only a small slice of subnational and transnational comparative examples: corporate tax laws and policies in a

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(2004) [hereinafter Avi-Yonah, *Corporations, Society*]; Avi-Yonah, *Why Was the U.S. Corporate Tax Enacted in 1909?*, in 2 *STUDIES IN THE HISTORY OF TAX LAW* 377 (John Tiley ed., 2007).

10 Steven A. Bank, *Entity Theory as Myth in the Origins of the Corporate Income Tax*, 43 *WM. & MARY L. REV.* 173 (2001); Steven A. Bank, *A Capital Lock-In Theory of the Corporate Tax*, 94 *GEO. L.J.* 889 (2006); Steven A. Bank, *Entity Theory as Myth in the U.S. Corporate Excise Tax of 1909*, in 2 *STUDIES IN THE HISTORY OF TAX LAW*, *supra* note 9, at 393 [hereinafter Bank, *Entity Theory*].

11 CHRISTOPHER J. SCHMITZ, *THE GROWTH OF BIG BUSINESS IN THE UNITED STATES AND WESTERN EUROPE, 1850-1939* (1995); MANSEL G. BLACKFORD, *THE RISE OF MODERN BUSINESS IN GREAT BRITAIN, THE UNITED STATES, AND JAPAN* (1998); ALFRED D. CHANDLER, JR., *SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM* (1990).

few representative nineteenth-century industrializing American states, and in turn-of-the-century Britain and Germany.<sup>12</sup>

Yet even this brief comparative analysis places in bold relief the U.S. preoccupation with taxing capital, and more specifically with taxing business corporations. Not only did leading American state governments attempt to apply their property taxes to corporations, but as states and commonwealths reformed their fiscal structures, corporations consistently remained at the center of their taxing efforts. Similarly, U.S. national lawmakers in the early twentieth century also focused on corporations as they designed and adopted new federal levies. By contrast, other Western industrialized nations, like England, refrained from imposing levies directly on corporations, and certain German states such as Prussia attempted to mitigate the potential double taxation of corporate income.<sup>13</sup>

The national emergencies occasioned by the two world wars, of course, forced nearly all combatant nations to reconsider their fiscal policies, but the comparative divergence in corporate tax laws and policies has remained remarkably resilient. Indeed, to this day the United States remains comparatively unique. Whereas the United States has, for the most part, maintained a "classical" system of taxing corporate income twice,<sup>14</sup> most industrialized nations including the United Kingdom and Germany have adopted the U.S. style of corporate taxation only for limited time periods, adhering instead to some degree of relief from the double taxation of corporate income.<sup>15</sup> This contrast yields an apparent historical paradox: the United States, the alleged capitalist bastion of laissez-faire political economy, seems

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12 For a succinct comparative history of the beginnings of income taxation in these countries see generally Bernard Grossfeld & James D. Bryce, *A Brief Comparative History of the Origins of Income Taxation in Great Britain, Germany, and the United States*, 2 AM. J. TAX POL'Y 211 (1983). Since German tax policy at the time varied by province, this Article focuses on Prussia, the largest and most industrial of German states, as the leading representation of German corporate tax policy.

13 MARTIN DAUNTON, TRUSTING LEVIATHAN: THE POLITICS OF TAXATION IN BRITAIN, 1799-1914, at 210-18 (2001); MARTIN DAUNTON, JUST TAXES: THE POLITICS OF TAXATION IN BRITAIN, 1914-1979, at 89-94 (2002) [hereinafter DAUNTON, JUST TAXES]; PETER A. HARRIS, CORPORATE/SHAREHOLDER INCOME TAXATION (1996).

14 In recent years, the U.S. has provided some relief from double taxation by taxing shareholder returns on corporate profits (dividends and capital gains) at lower rates. See Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 752.

15 HUGH J. AULT & BRIAN J. ARNOLD, COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS, 273-77 (2004); VICTOR THURONYI, COMPARATIVE TAX LAW 281-85 (2003); HARRIS, *supra* note 13.

to have embraced a rather punitive approach to taxing business corporations and their owners.<sup>16</sup>

What explains the apparent historical paradox of American corporate tax exceptionalism? Why were U.S. lawmakers, during the formative development of the income tax, preoccupied with taxing business corporations? The vast and growing scholarship on comparative-historical law and political economy suggests that the specific structure of American economic and political institutions may provide part of the answer.<sup>17</sup> One explanation suggests that comparative differences in dividend policy attributable to the greater separation of ownership and control of large American corporations may explain the divergence in corporate tax policy.<sup>18</sup> Another implies that a historically-specific American political response to concentrations of economic power may have fueled the path-dependent origins of the U.S. income tax.<sup>19</sup> Still other accounts focus on political institutions to argue that the dispersed and fragmented nature of American political power has affected tax policy,<sup>20</sup> and that the lack of a centralized

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16 Legal historians have identified similar paradoxes in contrasting nineteenth-century Anglo-American trust law. *See, e.g.,* Joshua Getzler, *Transplantation and Mutation in Anglo-American Trust Law*, 10 THEORETICAL INQUIRIES L. 355 (2009).

17 For a sample of the broad literature on comparative-historical political economy see generally ANDREW SHONFIELD, *MODERN CAPITALISM: THE CHANGING BALANCE OF PUBLIC AND PRIVATE POWER* (1969); *CREATING MODERN CAPITALISM: HOW ENTREPRENEURS, COMPANIES, AND COUNTRIES TRIUMPHED IN THREE INDUSTRIAL REVOLUTIONS* (Thomas K. McCraw ed., 1997); *VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE* (Peter A. Hall & David Soskice eds., 2001).

18 Steven A. Bank, *The Dividend Divide in Anglo-American Corporate Taxation*, 30 J. CORP. L. 2 (2004). Comparative differences in corporate governance may be explained, as Colleen Dunlavy has recently contended, by institutional variations in the intergovernmental division of policymaking power and in the diversity of shareholder rights across place and time. *See* Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholding Voting Rights*, 63 WASH. & LEE L. REV. 1347 (2006); Colleen Dunlavy & Thomas Welskopp, *Myths and Peculiarities: Comparing U.S. and German Capitalism*, 41 BULL. GERMAN HIST. INST. 33 (2007).

19 Kimberly J. Morgan & Monica Prasad, *The Origins of Tax Systems: A French-American Comparison*, 114 AM. J. SOC. 1350 (2009). For more on how historical American political responses to concentrated economic power shaped the structure of U.S. corporate governance see generally MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* (1994).

20 SVEN STEINMO, *TAXATION AND DEMOCRACY: SWEDISH, BRITISH, AND AMERICAN APPROACHES TO FINANCING THE MODERN STATE* (1993). In a variant of this view, the American legal historian, Robert Stanley, has argued that the origins of the U.S. income tax can be traced to a "centrist" political ideology that used the income tax to placate

and hierarchical authority has cultivated a costly and debilitating American system of "adversarial legalism."<sup>21</sup>

Prominent among the standard institutional explanations is the historical interaction of politics and business. As a variety of scholars have demonstrated, American statecraft has long been distinguished by its antagonism towards big business. The early arrival of American managerial capitalism in the mid and late 1800s preceded and in some ways compelled the development of the modern regulatory and administrative state. As a result, a unique American divide between private enterprise and public administration began to develop.<sup>22</sup> Although antitrust law is generally the policy arena that scholars have explored to substantiate this claim,<sup>23</sup> the tensions between American government and big business can also be clearly seen in the evolution of U.S. subnational corporate tax policy and transnational comparisons of corporate tax laws and concepts.

A primary focus on political and economic institutions, however, only explicates part of the story. Institutions do not just suddenly appear. They are created and composed of individuals and groups with specific interests, ideas, and cultural beliefs. And, perhaps more importantly, institutions change and develop over time as they interact with other groups and institutions, and respond to changing historical conditions. Thus, while it is vitally important to examine how institutional frameworks mediate political interests, social ideas, and cultural beliefs, these interests, ideas, and beliefs in turn also shape institutional frameworks.<sup>24</sup> Put differently, political, social, and cultural factors are endogenous to institutional explanations of

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more radical calls for redistribution. ROBERT STANLEY, *DIMENSIONS OF LAW IN THE SERVICE OF ORDER: ORIGINS OF THE FEDERAL INCOME TAX, 1861-1913* (1993).

21 ROBERT A. KAGAN, *ADVERSARIAL LEGALISM: THE AMERICAN WAY OF LAW* (2001); DAVID VOGEL, *KINDRED STRANGERS: THE UNEASY RELATIONSHIP BETWEEN BUSINESS AND POLITICS IN AMERICA* (1996).

22 Alfred D. Chandler, Jr., *Government Versus Business: An American Phenomenon*, in *BUSINESS AND PUBLIC POLICY 1* (John Dunlop ed., 1980); see also the essays contained in *REGULATION IN PERSPECTIVE: HISTORICAL ESSAYS* (Thomas K. McCraw ed., 1981). "Because two sets of administrative hierarchies grew at different periods of time for different reasons to carry out different functions with different objectives, two quite different cultures appeared," explained Chandler in his classic essay. "The work, attitudes, and perspectives of the business manager and the civil servant became and remained almost as distinct and separate as those of the humanist and the scientist." See Chandler, *supra*, at 4.

23 See, e.g., Thomas K. McCraw, *Rethinking the Trust Question*, in *REGULATION IN PERSPECTIVE*, *supra* note 22, at 4-5.

24 James T. Kloppenburg, *Institutionalism, Rational Choice and Historical Analysis*, 28 *POLITY* 125 (1995).



the American approach to taxing business corporations. In the context of the comparative history of corporate tax policy, this means that attending to the historically-determined political interests, social ideas, and cultural beliefs may help explain the American obsession with disciplining large-scale business corporations through the use of punitive tax laws and policies.<sup>25</sup>

Before turning to the comparative analysis, this Article begins in Part I with a brief summary of the 1909 corporate excise tax, succinctly recapitulating the conventional accounts about the beginnings of American corporate taxation. Part II turns to the subnational story to explain how and why leading American states and commonwealths attempted to tax corporate property under their respective general property taxes; how they searched for alternative corporate taxes; and how even newly-created state income taxes were applied to business corporations. This analysis shows that state-level lawmakers purposefully used tax policy in a punitive manner not only to make corporations more transparent, but also to check the growing power and authority of corporate capital.

Part III is devoted to briefly exploring transnational comparisons between the United States, England, and Germany. It focuses on how differences in the organizational structures of big businesses in the three countries led to variations in political economy that were ultimately expressed in the legal ideas and cultural attitudes toward corporate capitalism. These variations, in turn, shaped the differences in corporate tax laws and policies. Part III begins by contrasting the U.S with Britain. In the latter country, a form of family managerial capitalism and an intertwined public/private sector pervaded British ideas and beliefs to the point that it was often assumed that corporations were simply aggregations of individuals. Consequently, English lawmakers were loath to adopt the American system of corporate taxation, which they did only briefly in the early 1920s and again in the late twentieth century. Part III also investigates Germany, and more particularly the Prussian experience with corporate taxation, to explicate how differing commercial organizational capabilities, business-government relations, and

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25 If one conceptualizes jurisprudence and economic thought as subsets of national cultures and traditions, the conventional narratives of American corporate taxation can be seen as cultural histories of taxation. Scholarly debates over regulation versus remittance often turn on the meanings of corporate personality, and such conceptions of the corporation are perhaps embedded in differing cultures and traditions. For more on the comparative-historical importance of political power, national culture, and economic policymaking in the late nineteenth century see generally FRANK DOBBIN, *FORGING INDUSTRIAL POLICY: THE UNITED STATES, BRITAIN, AND FRANCE IN THE RAILWAY AGE* (1994).

beliefs about corporations interacted with the pressures of fiscal federalism to shape corporate tax policy. Finally, the Article concludes by considering the possible long-term implications of the U.S.'s unique historical role in corporate taxation.

### I. REGULATION VERSUS REMITTANCE: THE STANDARD ACCOUNTS OF THE ORIGINS OF THE 1909 CORPORATE TAX

The Tariff Act of 1909 contained a national tax on the legal privilege of doing business in corporate form. More specifically, the law required "every corporation, joint stock company or association, organized for profit and having a capital stock represented by shares" to pay a "special excise tax with respect to the carrying on of doing business."<sup>26</sup> The tax was set at an annual flat rate of one percent on net income above \$5,000, and even applied to all foreign corporations engaged in business in the United States.<sup>27</sup> The multiple legislative rationales behind the 1909 tax have provided modern scholars with sufficient evidence to ascribe different meanings to the origins of the American regime of corporate taxation. Whereas some scholars have focused on the regulatory aspects of the law, others have emphasized how the mechanics of the measure suggest that the tax was aimed mainly at shareholder, not corporate, wealth and power.<sup>28</sup>

The 1909 tax was not, however, the first national levy on business corporations. From the Civil War to the Spanish-American War, national lawmakers in the late nineteenth century experimented with several temporary corporate taxes. Yet none of these early measures seemed specifically designed to capture the taxpaying ability of corporations *qua* corporations. The Civil War income tax, for example, applied to business profits, but mainly as an indirect means to tax individual shareholders.<sup>29</sup> Similarly, the short-lived 1894 income tax, which was declared unconstitutional the following year,<sup>30</sup> imposed a two percent tax on the net

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<sup>26</sup> Tariff Act of 1909, ch. 6, § 38, 36 Stat. 11, 112-13.

<sup>27</sup> The law excluded "amounts received by [corporations] as dividends upon stock of other corporations." *Id.*

<sup>28</sup> See sources cited *supra* notes 9-10.

<sup>29</sup> Act of June 30, 1864, ch. 173, § 117, 13 Stat. 223, 281-82. The law provided that "the gains and profits of all companies whether incorporated or partnership . . . shall be included in estimating the annual gains, profits, or income of any person entitled to the same, whether divided or otherwise." *Id.*

<sup>30</sup> *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895).

income of all corporations, but because dividends from taxable corporations were excluded from shareholder income and because the levy was also imposed on undistributed corporate income, the law was essentially a crude form of withholding — a remittance method for taxing shareholder wealth.<sup>31</sup>

The 1898 excise tax on the sugar- and oil-producing industries, enacted in response to the funding needs of the Spanish-American War,<sup>32</sup> was perhaps the first instance of a national levy imposed on "the occupation or privilege of doing business" in specific industries.<sup>33</sup> Yet, in its final form the law operated as a blatant, rifle-shot provision aimed at taxing the gross profits of the American Sugar Refining Company and the Standard Oil Company.<sup>34</sup> Thus, even this temporary wartime tax, which was upheld by the U.S. Supreme Court,<sup>35</sup> provides ample evidence for the dueling interpretations of the roots of American corporate taxation. On the one hand, the statute's legislative history and its general application to all sugar and oil refinery businesses, not just corporations, suggest that lawmakers were not singling out corporations as regulatory targets, but rather that they were using the excise levy as a proxy to tax the owners of sugar and oil companies, and hence generate the revenue necessary to prosecute a war.<sup>36</sup>

On the other hand, if the ultimate targets of the tax were specifically Standard Oil and American Sugar, two of the largest and most powerful industrial corporations in America at the time,<sup>37</sup> then perhaps the 1898 excise tax was a forerunner of the legislative attempt to control the wealth and power of corporate capital. Moreover, since the 1898 law did not contain disclosure requirements, lawmakers seemed less concerned about transparency as a form of public control, and more interested in using the levy to curb the growing profits of specific corporations.<sup>38</sup> The early versions of American national taxation thus provide mixed guidance on whether the beginnings of U.S.

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31 Tariff Act of 1894, ch. 349, § 32, 28 Stat. 509.

32 Act of June 13, 1898, ch. 448, § 27, 30 Stat. 448 (1898).

33 31 CONG. REC. 5090 (1898) (statement of Sen. Horace Chilton, an early sponsor of the 1898 law). The 1898 levy, like the 1909 law, was specifically framed as an "excise" tax to comply with the *Pollock* decision's prohibition on unapportioned direct taxes. Bank, *Entity Theory*, *supra* note 10, at 396.

34 KOSSUTH KENT KENNAN, *THE INCOME TAX: METHODS AND RESULTS IN VARIOUS COUNTRIES* 275 (1910); Bank, *Entity Theory*, *supra* note 10, at 399.

35 *Spreckels Sugar Refining Co. v. McClain*, 192 U.S. 397 (1904).

36 Bank, *Entity Theory*, *supra* note 10, at 398-99.

37 In 1897, Standard Oil was the largest industrial corporation in the country, with over \$256 million in total assets, and American Sugar was the third largest with \$116 million in total assets. BUNTING, *supra* note 2, at 149.

38 Although neither Kornhauser nor Avi-Yonah examine the 1898 excise tax in detail, the historical record surrounding the sugar and oil excise taxes supports their claims

corporate taxation were rooted in regulatory desires or attempts to remit more effectively a shareholder-level tax.

The political and legal context of the 1909 tax itself, similarly, does little to settle the regulation/remittance debate. Like the 1898 tax, the 1909 levy was structured as an excise tax mainly to comply with the constitutional restrictions established by the Court's invalidation of the 1894 income tax and its support for the 1898 excise tax on sugar and oil production.<sup>39</sup> The legislative debates and political rhetoric underpinning the 1909 tax also demonstrate that key lawmakers held conflicting views about the new corporate tax — conflicting views that lend credence to each side of the competing standard historical interpretations.<sup>40</sup>

The differing interpretations of the 1909 tax can even be seen within single key pronouncements on the need for corporate taxation. Consider, for instance, President William Howard Taft's June 16th message to Congress recommending the 1909 corporate tax and a constitutional amendment permitting an income tax without apportionment.<sup>41</sup> By all accounts, Taft's leadership and his June congressional message played a pivotal role in the passage of the corporate tax.<sup>42</sup> In his message, Taft provided a variety of justifications for the new revenue bill. Citing to a "rapidly increasing deficit," the president called for tariff revision and the adoption of "new kinds of taxation" to help "secure an adequate income" for the growing federal government.<sup>43</sup> More specifically, Taft supported the corporate tax both for administrative reasons, as a possible proxy for taxing shareholders, and as a regulatory tool to publicize and expose the abuses of growing corporate power, and thus to control it. For administrative reasons, Taft supported the tax because it imposed "a burden at the source of income at a time when the corporation is well able to pay and when collection is easy."<sup>44</sup> As modern scholars have noted, the focus on sources of income and collection ease

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about the regulatory roots of the American corporate tax. See Kornhauser, *supra* note 9; Avi-Yonah, *Corporations, Society*, *supra* note 9.

39 Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429 (1895); *Spreckels Sugar Refining Co.*, 192 U.S. 397.

40 Kornhauser, *supra* note 9, at 94-113; Bank, *Entity Theory*, *supra* note 10, at 401-04.

41 U.S. PRESIDENT, TAX ON NET INCOME OF CORPORATIONS, S. DOC. NO. 61-98 (1909).

42 Taft's message is favorably quoted by all the leading accounts. See RATNER, *supra* note 7, at 286-87; BUENKER, *supra* note 9, at 106-08; Kornhauser, *supra* note 9, at 95-99; Avi-Yonah, *Corporations, Society*, *supra* note 9, at 1218-20; Bank, *Entity Theory*, *supra* note 10, at 405-13.

43 S. DOC. NO. 61-98, at 1.

44 *Id.* at 3.

implies that Taft believed the levy could be an effective indirect means to tax shareholder wealth.<sup>45</sup>

Other parts of Taft's message convey a different rationale, one that emphasizes the need for regulatory control of corporations as separate legal entities. At the outset, Taft explained that the levy "is an excise tax upon the privilege of doing business as an artificial entity," and hence "not a direct tax on property." He continued that "another merit of this tax is the federal supervision which must be exercised to make the law effective over the annual accounts and business transactions of all corporations." Taft acknowledged that the corporate form "has been of the utmost utility in the business world," but he also reminded Congress that "substantially all of the abuses and all of the evils which have aroused the public to the necessity of reform were made possible by the use of this very faculty."<sup>46</sup>

With American society still reeling from a financial panic linked to abuses in the banking industry and an earlier series of corporate scandals in the insurance industry,<sup>47</sup> Taft's address underscored the regulatory potential of a corporate tax. Indeed, the President spelled out how the tax in a "perfectly legitimate and effective" way could help the government, stockholders, and the greater public gain "knowledge of the real business transactions and the gains and profits of every corporation in the country." By making the inner dealings of big businesses more transparent, the corporate tax, Taft insisted, would be a "long step toward that supervisory control of corporations which may prevent a further abuse of power."<sup>48</sup> Taft's sustained emphasis on the public disclosure aspects of the law supports the interpretation of the 1909 corporate tax as a regulatory device.

Like Taft's message, the congressional debates surrounding the 1909 law evidence multiple justifications for the corporate tax.<sup>49</sup> Moreover, the

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45 Bank, *Entity Theory*, *supra* note 10, at 406 ("The notion that the corporation was a 'source' rather than the 'object' reinforced the tax's status as a surrogate for the income tax and the corporation's status as a surrogate for the stockholder."). Others have argued that Taft's express "reference to the corporation's ability to pay (as opposed to the shareholders') has a real entity overtone." Avi-Yonah, *Corporations, Society*, *supra* note 9, at 1219.

46 S. DOC. NO. 61-98, at 3.

47 MICHAEL MCGERR, *A FIERCE DISCONTENT: THE RISE AND FALL OF THE PROGRESSIVE MOVEMENT IN AMERICA, 1870-1920*, at 169-74 (2003); MORTON KELLER, *THE LIFE INSURANCE ENTERPRISE, 1885-1910: A STUDY IN THE LIMITS OF CORPORATE POWER* 12-14, 27-28 (1963).

48 S. DOC. NO. 61-98, at 3.

49 For a sample of the conflicting congressional justifications see generally 44 CONG. REC. 4415-98 (1909).

broader legal discourse about the shifting views of corporate personality and the unknown incidence of corporate taxes seemed to provide contending camps with additional, though contradictory, justifications for their respective positions. As the Columbia University philosopher John Dewey noted in 1926, the differing theories of what constituted a corporation were infinitely flexible, reflecting the contingency of abstract concepts. "Each theory," Dewey succinctly explained, "has been used to serve . . . opposing ends."<sup>50</sup>

Ultimately, the search for a singular, or even a dominant, explanation for the emergence of the 1909 corporate tax may be not only elusive, but perhaps even counterproductive. After all, tax laws — like nearly all legislation — frequently appeal to a variety of constituencies for a multiplicity of reasons. Just as Baptists and bootleggers could develop a peculiar alliance to support American prohibition, so too populist regulators and rational administrators could come together to back the 1909 corporate tax.<sup>51</sup> Lawmakers who harbored hostility towards large-scale business corporations and who viewed these economic organizations as independent legal entities could support the corporate tax as a means toward disciplining capital. At the same time, those who believed that corporations were mere conduits that helped generate economic prosperity could still back the corporate levy as an effective way to collect badly needed revenue from some of the country's wealthiest individuals. Simply put, regulating corporate power and remitting tax revenue were not necessarily mutually exclusive aims.

If one moves beyond the existing literature's focus on the formalistic regulation/remittance debate, a comparison of American national corporate tax policy with prior and other contemporary attempts to tax corporations may inform a broader query about the aims and achievements of U.S. corporate taxation. Although comparativist scholars frequently turn to transnational comparisons, contrasts between U.S. state-level laws and policies can also be a fruitful area of inquiry.<sup>52</sup> There was, of course, a great

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50 John Dewey, *The Historical Background of Corporate Legal Personality*, 35 *YALE L.J.* 655, 669 (1926).

51 Bruce Yandle, *Bootleggers and Baptists: The Education of a Regulatory Economist*, 7 *REGULATION* 12 (1983).

52 The early tax treatise writers consistently examined subnational as well as transnational comparisons as part of their comprehensive studies of taxation. See, e.g., EDWIN R.A. SELIGMAN, *THE INCOME TAX* (1914); KENNAN, *supra* note 34; HENRY CARTER ADAMS, *SCIENCE OF FINANCE, AN INVESTIGATION OF PUBLIC EXPENDITURE AND PUBLIC REVENUES* (New York, H. Holt & Co. 1898). More recently, scholars working within the framework of historical institutionalism have returned to the significance of subnational comparisons. See, e.g., ELIZABETH S. CLEMENS, *THE PEOPLE'S LOBBY: ORGANIZATIONAL INNOVATION AND THE*

deal of variation among American states and commonwealths, particularly in the tax treatment of business corporations. Nonetheless, because American state governments often acted as "laboratories of democracy," a brief analysis of how and why some of the leading industrializing states tried to tax corporations may clarify the general ethos of corporate taxation that was emerging in the United States at the time.

## II. THE SUBNATIONAL PERSPECTIVE: FROM CHAOS TO CONVERGENCE

Throughout the nineteenth century and well into the twentieth, American states imposed a number of levies on corporations. From a general property tax to licensing fees and franchise levies to income taxes, lawmakers consistently resorted to a variety of measures to raise revenue and regulate large corporate businesses. Although economic experts disagreed about who ultimately paid a tax legally imposed on corporations, the uncertainty of incidence did not prevent lawmakers from levying a variety of corporate taxes. Traditionally, the general property tax, which applied to the real and personal property of corporations as well as individuals, was the main source of revenue for subnational governments, generating a vast majority of annual state and local tax receipts.<sup>53</sup> Yet as the practical defects of this levy became more acute, state lawmakers turned to other sources of revenue. Leaving the property tax to localities, states experimented with a variety of other levies, but business corporations remained important targets of newly created taxes — not only because they were a lucrative source of revenue, but also because lawmakers were concerned about the growing concentration of economic power in these new gigantic organizations. Even when effective state-level income taxes began to take hold in the early twentieth century, corporations were central elements of these new revenue laws. The sustained state-level approach to taxing corporations shows how American policymakers have continued to view corporations as both a significant source of revenue and a potentially dangerous source of power.

Although the general property tax had long been the cornerstone of state

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RISE OF INTEREST GROUP POLITICS IN THE UNITED STATES (1997); R. RUDY HIGGINS-EVENSON, *THE PRICE OF PROGRESS: PUBLIC SERVICES, TAXATION AND THE AMERICAN CORPORATE STATE, 1877-1929* (2003).

53 As late as 1902, property taxes accounted for more than half of total state tax revenue. 5 *HISTORICAL STATISTICS OF THE UNITED STATES* 40 (Susan B. Carter et al. eds., millennial ed. 2006) (Series Ea247-275); John Joseph Wallis, *American Government Finance in the Long Run, 1790-1990*, 14 *J. ECON. PERSP.* 61 (2000).

and local revenues, the practical defects of the levy were notorious.<sup>54</sup> While real property such as land, buildings, and machinery was readily visible and theoretically easy to assess, personal property posed a much greater challenge. The general property tax in most jurisdictions covered a wide variety of ordinary personal goods, from furniture to utensils to clocks and watches. But, as the tax rolls of many states demonstrated, few taxpayers reported these items as part of their personal property holdings.<sup>55</sup> Not only did this form of evasion undermine the civic spirit of quasi-voluntary compliance,<sup>56</sup> but the inability to reach intangible personal property, particularly stocks, bonds and other financial assets — not to mention the salaries of the growing managerial class — was the property tax's greatest flaw.

With the rise of American industrial capitalism, the inadequacies of reaching personal property, particularly corporate securities, became even more pronounced. Tax experts and political activists acknowledged the need for reform. As Columbia University political economist Edwin R.A. Seligman explained,

Governments everywhere are confronted by the question, how to reach the taxable capacity of the holders of these securities, or of the associations themselves. Whom shall we tax and how shall we tax them in order to attain a substantial justice? Perhaps no question in the whole domain of fiscal science has been answered in a more unsatisfactory way.<sup>57</sup>

Initially, state lawmakers had attempted to answer Seligman's query by applying the general property tax uniformly and consistently to all property and all taxpayers, individuals and corporations alike. Indeed, in theory, the general property tax was originally intended to be as comprehensive as

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54 CLIFTON K. YEARLEY, *THE MONEY MACHINES: THE BREAKDOWN AND REFORM OF GOVERNMENTAL AND PARTY FINANCE IN THE NORTH, 1860-1920* (1970); MORTON KELLER, *AFFAIRS OF STATE: PUBLIC LIFE IN LATE NINETEENTH CENTURY AMERICA* 114 (1977); GLENN W. FISHER, *THE WORST TAX? A HISTORY OF THE PROPERTY TAX IN AMERICA* (1996).

55 JOHN TEAFORD, *THE RISE OF THE STATES: EVOLUTION OF AMERICAN STATE GOVERNMENT* 43-45 (2002).

56 On the global historical importance of "quasi-voluntary compliance" to the effectiveness of tax systems, see MARGARET LEVI, *OF RULE AND REVENUE* (1988).

57 Edwin R.A. Seligman, *The Taxation of Corporations I*, 5 *POL. SCI. Q.* 269, 269 (1890) [hereinafter Seligman, *Taxation of Corporations I*]. Seligman was among the economic experts who underscored the uncertainty of determining the incidence of corporate taxes. See generally EDWIN R.A. SELIGMAN, *THE SHIFTING AND INCIDENCE OF TAXATION* (1892).



possible. In the antebellum period, "the distinguishing feature of the system of state and local taxation in America may be described in one sentence," declared Wisconsin political economist Richard T. Ely. "It is the taxation of all property, movable or immovable, visible or invisible, or real or personal, as we say in America, at one uniform rate."<sup>58</sup>

Northeastern industrial states such as New York and Pennsylvania led the way in trying to apply the general property tax to business corporations. While numerous commonwealths had taxed banks and insurance companies as part of broader legislation regulating financial companies,<sup>59</sup> New York imposed a property tax in 1823 that applied generally to "all incorporated companies receiving a regular income from the employment of their capital."<sup>60</sup> New York legislators reasoned that because such corporations were legal "persons," they — like any other individual citizen of the state — were liable to property taxes. Corporations doing business in the Empire State, therefore, paid a tax on their real property, including buildings and machinery, and an additional tax on their personal property, which consisted of the value of their capital stock, or what we would refer to today as their market capitalization. As Seligman explained, corporations "were required to make returns to the county officers of all their property and their capital stock, paying the tax themselves and deducting it from the dividends of stockholders." This implied that New York taxed corporate personal property twice: once at the corporate level, and then again at the shareholder level.<sup>61</sup>

Other states, by contrast, applied the general property tax only once to personal corporate property. Massachusetts, for example, taxed the real property held by corporations, but it left the taxation of corporate personal property to be assessed and collected via the personal property tax on shareholders.<sup>62</sup> The distinction between Massachusetts and New York typified the nineteenth-century lack of uniformity and the prevailing confusion over the potential double taxation of corporate income. Whereas some states held firmly to the juridical view that corporations were separate entities and hence responsible for the taxes on their property, both real and personal, other commonwealths like Massachusetts seemed to divide the tax on real and personal property between corporations and their shareholders, respectively.

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58 RICHARD T. ELY, *TAXATION IN AMERICAN STATES AND CITIES* 131 (New York, T.Y. Crowell 1888).

59 HIGGENS-EVENSON, *supra* note 52, at 15.

60 Act of Apr. 23, 1823, ch. 267, §§ 14-15, 1823 N.Y. Laws 390, 395 (1823).

61 Seligman, *Taxation of Corporations I*, *supra* note 57, at 271.

62 *Id.* at 273 (citing MASS. GEN. LAWS § 2, 158 (1832)).

Public finance experts bemoaned this lack of uniformity, even as they made economic arguments about the uncertain incidence of corporate taxes.<sup>63</sup>

Given the increasing defects of the general property tax, many states and commonwealths in the postbellum period began to move away from trying to adapt the traditional property tax to the growing number and variety of business corporations. Instead, they used a diversity of levies to try to capture a corporation's taxpaying capacity or its "ability to pay," a phrase advocates of progressive income taxes used regularly to rally support for their reforms. In 1868, Pennsylvania enacted one of the first general corporate taxes aimed not at corporate property but at the net earnings of all corporations operating in the state, as well as portions of capital stock distributed as dividends.<sup>64</sup> Although the levy was still described as a tax on property, it seemed to presage the coming of state corporate income taxes. Other states and commonwealths soon followed suit, but the tax base and rates for these corporate levies varied widely. With over a dozen different corporate tax bases employed by various states and commonwealths, national tax experts, who may have been looking to state taxation for cues on how to reform the federal fiscal structure, were bewildered by the unprincipled patchwork of subnational tax laws. By the early 1900s, such experts could confidently claim that "chaos" was "the only descriptive term applicable to existing conditions in Commonwealth taxation."<sup>65</sup>

Yet despite the tremendous variation, a brief analysis of state corporate taxes indicates that lawmakers and taxing authorities consistently kept corporations at the center of state-level tax policy. Political leaders throughout the country did not share the same conception of the corporation, nor did they agree on how to tax these business organizations and their shareholders, as the "chaos" of prevailing laws illustrated. But they seemed unified in their intentions to ensure that corporations contributed their "fair share" to state treasuries, whether through property taxes or other levies. Indeed, as state lawmakers equated large corporations with monopoly power, they were able to use corporate taxes to achieve the dual aims of raising

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<sup>63</sup> Edwin R.A. Seligman, *The Taxation of Corporations III*, 5 POL. SCI. Q. 636 (1890).

<sup>64</sup> Act to Revise, Amend, and Consolidate the Several Laws Taxing Corporations, Brokers, and Bankers, 1868 Pa. Laws 108, §§ 4, 6; Seligman, *Taxation of Corporations I*, *supra* note 57, at 299.

<sup>65</sup> U.S. DEP'T OF COMMERCE & LABOR, BUREAU OF THE CORPS., TAXATION OF CORPORATIONS II — MIDDLE ATLANTIC STATES 8 (1910). Seligman had earlier made the same claim in his characteristically eloquent style: "We have in the United States a chaos of practice — a complete absence of principle." Seligman, *Taxation of Corporations I*, *supra* note 57, at 269.

revenue and regulating business. Consequently, nearly every industrial state taxed corporations in some way.<sup>66</sup>

The centrality of business corporations to state tax policy was equally evident when states and commonwealths began searching for new forms of revenue in the early twentieth century, after many had relegated the tax on real property to localities.<sup>67</sup> As states and localities began to separate their respective sources of revenue, the earlier chaos of state taxation appeared to converge around the use of income and sales taxes as the main sources of state tax revenue.<sup>68</sup> Even then, lawmakers maintained their desire to make business corporations socially and financially responsible for the support of state government by keeping these corporations at the center of the new levies.<sup>69</sup>

As a division of fiscal sources took shape, states emphasized why they were the appropriate governmental unit to tax corporations. Corporations, after all, had long been the special creatures of state charters, and even with the advent of general incorporation laws, it was states and not localities or the national government that breathed life into corporations and gave them the special legal privilege of limited liability. The power of incorporation became a particularly pertinent issue when reform proposals supporting federal incorporation began to gain currency in the early twentieth century. A variety of economic and political interests favored federal incorporation both as a regulatory tool and as a way to rationalize the vagaries of a multiplicity of state corporate laws. Presidents Theodore Roosevelt and Taft both supported the measure, but it was proponents of states' rights who challenged federal incorporation as an assault on the time-honored American tradition of fiscal federalism.<sup>70</sup> Indeed, these opponents recognized that federal incorporation would not only undermine the political power of state governments, it would also threaten a valuable source of revenue, since state-level incorporation was one of the justifications for the numerous "franchise taxes," "license fees," and

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66 TONY ALLAN FREYER, *PRODUCERS VERSUS CAPITALISTS: CONSTITUTIONAL CONFLICT IN ANTEBELLUM AMERICA* 92-136 (1994).

67 YEARLEY, *supra* note 54; HIGGENS-EVENSON, *supra* note 52.

68 TEAFORD, *supra* note 55, at 135-37.

69 Even with regards to sales taxes, some state governments attempted to legislate the incidence of these rather ambiguous levies. See ROBERT MURRAY HAIG ET AL., *THE SALES TAX IN THE AMERICAN STATES: A STUDY MADE UNDER THE DIRECTION OF ROBERT MURRAY HAIG* 29-37 (1934).

70 Kornhauser, *supra* note 9, at 65-68; SKLAR, *supra* note 2, at 282-85; see also Melvin I. Urofsky, *Proposed Federal Incorporation in the Progressive Era*, 26 AM. J. LEGAL HIST. 160 (1982).

"corporate organization taxes" that littered state statutes. These levies were the price that corporations had to pay in exchange for the benefit and privilege of state incorporation. And it was a price state lawmakers believed they had a right to extract under the principles of American fiscal federalism — a point that national lawmakers opposed to the 1909 national corporate tax frequently highlighted.<sup>71</sup>

Policymakers also argued that because of the sprawling nature of modern business corporations, states had a comparative advantage in taxing corporations. The state ought to "tax all those industries and classes of property sometimes called 'corporate'" reasoned the California tax commission in 1906, because corporations exist across "many communities, serve all, and all contribute to its income."<sup>72</sup> Consequently, only state governments had the administrative and institutional capacity, the California commission self-servingly claimed, to handle the taxation of large-scale corporations in an equitable, uniform, and just manner.<sup>73</sup> In time, the growing national reach of business corporations would provide federal officials with a similar rationale to tax corporations. Based on the California commission's analysis, the Golden State pioneered the use of a multitude of corporate taxes as substitutes for the property tax at around the same time that Congress enacted the 1909 corporate tax. While national lawmakers were carefully constructing the corporate excise tax, legislators in Sacramento experimented with a variety of moderate levies on the gross earnings of different business corporations, particularly public utilities.<sup>74</sup> In the end, the slew of corporate levies did not turn out to be the revenue panacea that the California commission had anticipated, but the initial use of corporate taxes as substitutes for the failing property tax illustrates how business corporations were never far from the minds of lawmakers and taxing authorities.

Beside the institutional and administrative rationales, state governments focused on taxing corporations because doing so pleased particular political interests, namely small local businesses, and because big business was perceived to be a threat to republican values and democratic decision-making. As legal and economic historians have shown, the late nineteenth-century tensions between state governments and large-scale corporations were rooted in the desire to protect the economic interests of local merchants

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71 CHARLES J. BULLOCK, *SELECTED READINGS IN PUBLIC FINANCE* 350 (1906); TEAFORD, *supra* note 55, at 52.

72 REPORT OF THE COMMISSION ON TAXATION OF CALIFORNIA 77 (1906) [hereinafter CAL. TAX COMM'N].

73 *Id.* at 79-80.

74 TEAFORD, *supra* note 55, at 53-54.

and manufacturers.<sup>75</sup> Not only did state governments use licensing laws and antitrust legislation to curb the growing power of large national corporations, they also relied on the critical distinction between the taxation of domestic versus foreign corporations to support local businesses. Although states did not have the authority to tax the "franchise" or the "the right to exist as a corporation," they could and did tax foreign corporations frequently for carrying on business within their jurisdictions, as long as such franchise taxes did not interfere with interstate commerce.<sup>76</sup>

Likewise, subnational American tax laws and policies responded to social concerns about the growing economic and political power of large corporations. Throughout American popular culture, corporations were depicted as callous profit-maximizers oblivious to community interests and democratic ideals. Railroad regulators such as Charles Francis Adams, Jr. and novelists like Frank Norris revealed the financial and political chicanery that railroad owners and managers frequently engaged in as part of their unyielding desire for the acquisition of wealth.<sup>77</sup> When large national corporations attempted to influence state legislatures, lawmakers often responded by using tax policy to try to discipline corporate businesses. Many state tax commissions, for example, viewed corporations as competitors rather than clients. Accordingly, they tried to insulate legislators from business interests, while enhancing the authority of their own expertise in the process.<sup>78</sup> In the end, the institutional structure of American federalism, to be sure, gave state lawmakers an opportunity to exercise their power, but how and where such power was used would often be determined by political interests and cultural beliefs. Attempts to protect small, local merchants from large-scale competitors and the cultural antagonism towards big business demonstrated that despite the various ways in which states taxed corporations, these new economic organizations remained central to fiscal reform.

Though state tax commissioners may have sought to tax corporations as a way to consolidate their own power, autonomy, and prestige, the logic that underpinned their actions also paralleled a broader conceptual revolution regarding the meaning of taxation. In this way, corporate tax

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75 Charles W. McCurdy, *American Law and the Marketing Structure of the Large Corporation, 1875-1890*, 38 J. ECON. HIST. 637 (1978); Richard Sylla, *The Progressive Era and the Political Economy of Big Government*, 5 CRITICAL REV. 531 (1991); DOBBIN, *supra* note 25, at 58, 116.

76 EDWIN R.A. SELIGMAN, *ESSAYS IN TAXATION 182-84* (New York, Macmillan & Co. 1895).

77 ADAMS, *supra* note 4; FRANK NORRIS, *THE OCTOPUS* (1901).

78 TEAFORD *supra* note 55, at 51-54; HIGGENS-EVENSON, *supra* note 52, at 98-99.

policy was part and parcel of the broader intellectual currents sweeping through American progressivism. Like other political activists, progressive tax reformers contended that the dramatic changes wrought by modern industrialization and urbanization had undermined the traditional explanation for regressive and antiquated levies like the property tax. Given the tremendous interdependence of modern life, taxes could no longer be justified under a "benefits theory" as simply the price paid for government protection. Instead, reformers advanced what they believed to be a more equitable principle of taxation based on a citizen's faculty or "ability to pay." This principle promoted a more active role for the positive state in the distribution of fiscal burdens.<sup>79</sup> Taxing corporations based not on their property, but on their earning capacity, was one way to put into practice this new and emerging view of taxation.

In summarizing the development of state tax laws, national officials echoed the importance of taxing corporations according to their ability to pay. "There is a marked tendency in all these States toward making earning power the basis of taxation for quasi-public corporations," wrote George Clapperton of the U.S. Industrial Commission in 1901. "Properly directed, this must be regarded as the correct principle and capable of practical application to such corporations under existing industrial conditions."<sup>80</sup> While Clapperton's comments referred specifically to quasi-public corporations, or what we would today call public utilities, the principle soon spread to cover all corporations.

By 1909, federal tax officials conceded that even the precise definition of taxation itself had shifted. A tax, opined the U.S. Bureau of Corporations, "is a payment exacted by government as a source of general revenue and not as an equivalent of a specific benefit."<sup>81</sup> When it came to explaining the multitude of state-level corporate taxes, the Bureau admitted that there were still two prevailing theories justifying levies on corporations, but it emphasized that "the preference is commonly given to the theory that each person, natural or artificial, should contribute to governmental support according to his ability to pay."<sup>82</sup> Indeed, the Bureau contended that corporations provided "a place

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79 Ajay K. Mehrotra, *Envisioning the Modern American Fiscal State: Progressive-Era Economists and the Intellectual Foundations of the U.S. Income Tax*, 52 *UCLA L. REV.* 1793 (2005).

80 GEORGE CLAPPERTON, *TAXATION OF CORPORATIONS: REPORT ON SYSTEMS EMPLOYED IN VARIOUS STATES PREPARED UNDER THE DIRECTION OF THE INDUSTRIAL COMMISSION 8-9* (1901); *Favors an Income Tax*, *N.Y. TIMES*, Mar. 28, 1901, at 5.

81 U.S. DEP'T OF COMMERCE & LABOR, *BUREAU OF THE CORPS., TAXATION OF CORPORATIONS I*, at 3 (1909).

82 *Id.* at 7.

where the theoretically perfect test — ability to earn — can be applied in practice as a means of ascertaining the proper amount of taxes to be paid." Unlike individuals, for whom the ability to pay was difficult to measure and perhaps even more challenging to apply, corporations were uniquely situated to measure future earning power. "The market value of the stock depends not wholly upon past earnings, but also, and chiefly, upon the supposed ability to earn in the future," wrote the Bureau. As a result, corporations faced a special tax "burden which is theoretically correct and which is balanced by the advantages enjoyed," and one that "may well be taken into account when one discusses whether it is to the public interest to encourage the formation of corporations."<sup>83</sup>

The public interest in taxing corporations was perhaps most visible when state lawmakers turned to income taxes as a substitute for the property tax in the early 1900s. Even here, corporations were at the heart of policy innovations. To be sure, there was tremendous initial resistance to the introduction of a peacetime income tax at the state level — resistance that was, rhetorically at least, deeply rooted in American political culture. "A general income tax is un-American," proclaimed Carl Plehn on behalf of the California tax commission. "Our people have so much respect for labor that what is won by honest toil is regarded as sacred and not to be reduced by direction taxation."<sup>84</sup>

Plehn's focus on labor was telling. Although the first effective state income taxes were levied on both individuals and corporations, there was great concern among contemporaries that an income tax could be used to punish the working class. When Wisconsin imposed the first effective state-level income tax in 1911 with a graduated levy on personal and corporate incomes, supporters of the measure had to assure voters that the common laborer was not the target of the new income tax. "The man who depends upon his manual labor for a living will pay no income tax whatsoever," explained Nils P. Haugen, the Wisconsin tax commissioner. The new law did "not assess anybody unless he has some net revenue above the mere needs of existence."<sup>85</sup> This implied that wealthy individuals, many of whom were corporate shareholders, and, of course, corporate businesses would bear the brunt of the early Wisconsin income tax, as they did. Wisconsin reformers were thus able to rely on the peculiarly American valorization of

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<sup>83</sup> *Id.* at 16.

<sup>84</sup> CAL. TAX COMM'N, *supra* note 72, at 14.

<sup>85</sup> Nils P. Haugen, *The Wisconsin Income Tax*, 6 ST. & LOCAL TAX'N 324, 324 (1913).

labor over capital to implement what would become a model income tax system that other states and commonwealths would soon follow.<sup>86</sup>

From New York's 1823 corporate property tax to Wisconsin's 1911 income tax, corporations occupied a pivotal place in the development of state-level tax policy. Although in earlier periods state corporate tax policies consisted of a chaotic mix of revenue measures, by the late nineteenth century and into the early twentieth many states began to converge on a seemingly unified policy of taxing corporate earnings, as part of a broader attempt to substantiate a new socio-legal fiscal order based on a citizen's faculty or ability to pay. This apparent convergence can be attributed in part to institutional factors like the special role that state governments have played in the intergovernmental relations of American fiscal federalism. Equally significant were other socio-political determinants like the intentions of state lawmakers to insulate democratic decision-making from the potentially corrupting influence of big businesses, as well as the desire to protect small, local businesses from the domination of the colossal corporate enterprises that crisscrossed state lines. The latter stemmed from an antimonopoly tradition deeply rooted in American political culture. The American cultural aversion to concentrations of economic power may also explain why state-level income taxes appeared to target wealthy individuals and businesses rather than members of the working class.

From a present day perspective, the American subnational fascination with taxing large corporations may seem rather unremarkable. After all, if corporations were a rich source of revenue, or a threatening locus of political and economic power, one should not be surprised to see lawmakers wielding tax policy to tap corporate revenue or to control corporate power. Yet a transnational historical perspective on the development of corporate tax policy may suggest that perhaps the unique confluence of American institutions, culture, and ideas can also explain the U.S. propensity to use tax policy to try to discipline corporate capitalism. To be sure, U.S. lawmakers were steeped in a political culture that had long been suspicious of monopoly power. This tradition was evident not only in the way subnational governments consistently focused on corporations as targets of tax laws and policies, but also in the way that American lawmakers seemed especially receptive to academic theories about corporations as separate legal entities

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<sup>86</sup> JOHN D. BUENKER, *THE HISTORY OF WISCONSIN, VOL. IV: THE PROGRESSIVE ERA, 1893-1914* (1998); W. ELLIOT BROWNLEE, *PROGRESSIVISM AND ECONOMIC GROWTH: THE WISCONSIN INCOME TAX, 1911-1929* (1974); Ajay K. Mehrotra, *Forging Fiscal Reform: Constitutional Change, Public Policy, and the Creation of Administrative Capacity in Wisconsin, 1880-1920*, 20 J. POL'Y HIST. 94 (2008).



— entities that could, if not controlled, become significant threats to a functioning capitalist democracy.

### III. THE TRANSNATIONAL PERSPECTIVE: VARIETIES OF MANAGERIAL CAPITALISM, BUSINESS-GOVERNMENT RELATIONS, AND THEORIES OF CORPORATE PERSONALITY

While American lawmakers, at both the state and national level, were using corporate tax policy to try to curb the growth of big business and effectively raise revenue, their counterparts across the Atlantic seem to have had a rather different perspective on the emergence of industrial capitalism. For a variety of reasons, the United States and the United Kingdom seemed to occupy opposite ends of the comparative tax and political economy spectrum. First, material and historical distinctions in the two countries related to the rise of large-scale corporations led to fundamental differences in management structures within big businesses.<sup>87</sup> Second, because the British had a rich and strong civil service tradition, state bureaucratic and regulatory power preceded and in many ways shaped some of England's earliest and largest pre-industrial business corporations. Consequently, British political economy seems to have been more congenial to the interests of big business, or at least less antagonistic, than the environment in the United States.<sup>88</sup>

Finally, the differences in the structures of managerial capitalism and business-government relations were reflected in the legal theories that underpinned corporate, or what the British referred to as "company," law. In the United States legal theorists and jurists absorbed Germanic notions of corporate personality that reinforced the American cultural aversion to economic concentration; as a result, Americans were more willing to treat corporations as separate legal entities.<sup>89</sup> Meanwhile, lawyers and judges in

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87 Alfred D. Chandler, Jr., *The Emergence of Managerial Capitalism*, 58 BUS. HIST. REV. 473 (1984) [hereinafter Chandler, *Managerial Capitalism*]; see also CHANDLER, *supra* note 11. For a reinterpretation of Chandler's comparison of Anglo-American business history, see Geoffrey Jones, *Great Britain: Big Business, Management, and Competitiveness in Twentieth-Century Britain*, in *BIG BUSINESS AND THE WEALTH OF NATIONS* 102 (Alfred D. Chandler, Jr., Franco Amatori & Takashi Hikino eds., 1997).

88 Chandler, *supra* note 22; Thomas K. McCraw, *Business and Government: The Origins of the Adversary Relationship*, 26 CAL. MGMT. REV. 33 (1984).

89 Morton J. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173 (1985); Gregory A. Mark, *The Personification of the Business Corporation in American Law*, 54 U. CHI. L. REV. 1441 (1987); Ron Harris, *The*

England seemed oblivious to continental ideas about the collectivist nature of corporations, and consequently they maintained that corporations were merely agents of individual shareholders.<sup>90</sup> This triad of differences — differences in organizational structures, in the context of political economy, and in legal theory and culture — help explain the dramatic divergence in U.S. and U.K. corporate tax policy. It was thus a confluence of economic, intellectual, and cultural factors that channeled the U.S. in one historical direction toward a "classical" system of taxing corporate income twice, and sent the U.K. on an opposite path of integrating corporate and personal income taxes.

Yet, if the United States and Britain represent two competing tax perspectives, Germany seems to occupy a peculiar intermediary position. In many ways, the corporate management structure of large-scale German industrial firms mirrored their American counterparts, though financial institutions played a much larger role in German management than in the United States.<sup>91</sup> In the realm of political economy, however, Germany with its strong civil service and bureaucratic capacity had many similarities with England; both lacked a stark distinction between the public and private realm. And in the area of corporate theory, German jurists, like American lawyers, seemed more willing to view corporations as separate legal entities. As a result, Prussian corporate taxes, on the one hand, paralleled and in some sense foreshadowed the American system of taxing corporate income twice. On the other hand, since the German culture of managerial capitalism was more concerned with fostering industrial cooperation, Prussian authorities did not appear preoccupied with punishing capital owners; thus, the Prussian fiscal system provided a modicum of tax relief to corporate shareholders. This commitment to mitigating the double taxation of corporate income placed Prussia squarely in-between the early twentieth-century U.S. and British corporate tax systems.<sup>92</sup>

### A. Contrasting the United States and England

In the United States, as we have seen, there was vast disagreement, especially during the debates over the 1909 corporate tax, about the proper role of corporations in the development of federal income tax policy. For those

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*Transplantation of the Legal Discourse on Corporate Personality Theories: From German Codification to British Political Pluralism and American Big Business*, 63 WASH. & LEE L. REV. 1421 (2006).

90 DAUNTON, *JUST TAXES*, *supra* note 13, at 93; Harris, *supra* note 89.

91 ROE, *supra* note 19, at 60-61, 171-73.

92 HARRIS, *supra* note 13, at 82-83.

who viewed the corporation as simply an aggregation of individuals, the appropriate tax treatment followed the tax treatment of partnerships: an income tax was imposed only on the owners of corporate capital, not on the business entities themselves. This view supported a pass-through model of taxation that was implemented as part of the Civil War and 1894 income taxes; both measures imposed a levy on the corporation as a proxy for a tax on stockholders.<sup>93</sup> With the emergence of American managerial capitalism, and the attendant separation of corporate ownership and control, the real entity view of the corporation seemed to gain traction just as the political antagonism towards big business increased. As a result, American lawmakers turned their focus more directly toward corporations.

Although scholars have disagreed about the meaning and intent of the 1909 U.S. corporate tax, nearly all concur that it marks a critical juncture in the path-dependent development of American corporate tax policy.<sup>94</sup> The modern American system of corporate taxation may not have been fully established until World War I, when the United States expressly eliminated the personal exemption for all dividends and thus began the deliberate and broadly based double taxation of corporate income.<sup>95</sup> Still, the 1909 corporate tax certainly signaled a major transformation in the way lawmakers envisioned the role of the modern business corporation in the new fiscal order.

In England, by contrast, there appears to have been a greater degree of continuity and consensus; not only in corporate tax policy, but in the broader historical conditions that shaped tax laws. The United Kingdom, for example, remained committed to a form of family capitalism that contrasted sharply with the modern managerial capitalism taking hold in the United States.<sup>96</sup> In England, there also appears to have been less antagonism between government and business because of the co-evolution of large pre-industrial

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93 Bank, *Entity Theory*, *supra* note 10, at 394-95; Avi-Yonah, *Corporations, Society*, *supra* note 9, at 1212-15.

94 See sources cited *supra* notes 9-10.

95 W. Elliot Brownlee, *Wilson and Financing the Modern State: The Revenue Act of 1916*, 129 PROC. AM. PHIL. ASS'N 173 (1985); W. Elliot Brownlee, *Historical Perspective on U.S. Tax Policy*, in DOES ATLAS SHRUG? THE ECONOMIC CONSEQUENCES OF TAXING THE RICH 44 (Joel B. Slemrod ed., 2000).

96 Although business historians have disagreed about when managerial capitalism finally replaced family capitalism in the U.K., most would concur that "prior to 1914 family dominance was very much the prevalent pattern in the U.K.'s public companies." Brian R. Cheffins, *Law, Economics, and the UK's System of Corporate Governance: Lessons from History*, 1 J. CORP. L. STUD. 71, 82 (2001). For more on the history of British corporate governance, see generally CHANDLER, *supra* note 11, ch. 7; LESLIE HANNAH, *THE RISE OF THE CORPORATE ECONOMY* chs. 7-9 (1976).

corporate enterprises and parliamentary power. Among British jurists and company law experts, moreover, there seems to have been less disagreement about the meaning of corporate personality, and hence some early consensus on the taxation, or rather non-taxation, of distributed corporate profits.

One of the most prominent differences between the U.S. and U.K. that may explain the divergence in corporate taxation was the contrasting corporate management structures that took hold in the two nations. While large-scale industrial business corporations in both countries came to the fore at roughly the same time by integrating mass production with volume distribution, there were conspicuous distinctions in the way that these economic organizations were managed. These differences may have had profound effects on the cultural perception of corporations and, in turn, on the way that public power was used to regulate business enterprises. Whereas in the United States a hierarchy of professional, salaried managers had by 1900 come to supervise and control the everyday operations of many large, integrated business corporations, in the United Kingdom industrialists seemed reluctant to relinquish control of their enterprises to non-family managers. British holding companies, for instance, frequently remained under the control of family estates or federations of family firms well into the mid-1900s. Even in the largest English business corporations, "owners continued to have much greater say in top management decisions than did their American counterparts."<sup>97</sup>

The British commitment to family capitalism may explain why English tax law continued to see companies as the agents of individual owners, rather than as separate entities, and why the English imposed only one layer of taxation on corporate income. If family owners were simultaneously the leading managers of corporate enterprises, it would certainly be easier to accept corporations as single agents, or as aggregations of individual shareholders. Without a rigid hierarchy of corporate managers mediating between the firm and a dispersed set of owners, jurists and tax experts could genuinely contend that, in England, a corporation and its owners were one and the same.

The identity between corporate ownership and control in England was also the product of long-term historical processes. Whereas in the United States the development of national administrative capacity came mainly after the rise of big business, in the United Kingdom the economic powers of large corporations co-evolved with the political powers of the public sector.<sup>98</sup>

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<sup>97</sup> Chandler, *Managerial Capitalism*, *supra* note 87, at 496; *see also*, CHANDLER, *supra* note 11.

<sup>98</sup> Chandler, *supra* note 22. On the rise of American national administrative capacity,

Consequently, big business was not seen as a threat to political power. In fact, large-scale business enterprises were conditioned from an early stage to look upon the state as their initial source of power. As economic and legal historians have demonstrated, in Britain the grant or concession theory of the corporation dominated legal doctrine and economic thinking for much of the eighteenth and nineteenth centuries. According to this theory, the privilege of incorporation was granted by the state, which made a concession of public power for private use and frequently granted monopoly rights. Unlike the American context, the concession theory in England led to the early creation of numerous comparatively large joint-stock business corporations.<sup>99</sup>

Indeed, large-scale pre-industrial corporations had long been a staple of British political economy. From the East India Company to the Bank of England to the numerous insurance and canal companies, British businesses regularly adopted the corporate form. Even when the Companies Act of 1844 institutionalized general incorporation, the concession theory of corporate personality continued to dominate, not only because parliament maintained the technical power to grant incorporation,<sup>100</sup> but because the British state, unlike the American, was relatively coequal with big business in size and power.<sup>101</sup> Thus, while the concession theory was dominant in both the U.S. and England, the historical sequence of material events, namely the early existence of large-scale British corporations, led to differences in the application of concession theory.

Indeed, the early continuity of concession theory in England and the material development of large business corporations alongside the administrative state may help explain why British authorities were less hostile to the emergence of big business. But as new ideas about corporate personality began to emerge, legal theorists in the U.K. and U.S. took notice, though with different implications. At the turn of the twentieth century, continental ideas about the collectivist nature of corporations as real or natural, not artificial, entities began to influence British and American legal thinkers.<sup>102</sup> The eminent British legal historian, Frederic W. Maitland, began translating the work of the German jurist Otto von Gierke, the leading continental proponent of depicting corporations as real or organic entities.

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see generally STEPHEN SKOWRONEK, *BUILDING A NEW AMERICAN STATE: THE EXPANSION OF NATIONAL ADMINISTRATIVE CAPACITIES, 1877-1920* (1982).

99 RON HARRIS, *INDUSTRIALIZING ENGLISH LAW: ENTREPRENEURSHIP AND BUSINESS ORGANIZATION, 1720-1844*, at 112-13, 43-45 (2000).

100 *Id.* at 112-14.

101 Chandler, *supra* note 22; McCraw, *supra* note 88.

102 Horwitz, *supra* note 89, at 179-80.

In the United States, the legal scholar Ernst Freund was doing the same for American audiences, as he incorporated Gierke's ideas into his classic monograph, *The Legal Nature of the Corporation*.<sup>103</sup> Although Gierke had little to say about business corporations, perhaps because they did not play a dominant role in German political economy when he was writing, his focus on the Teutonic roots of fellowship and association shaped real entity theory more generally, and in subsequent decades his ideas had a profound impact on the transplantation of Germanic ideas into other national contexts.<sup>104</sup>

If English and American legal thinkers were equally inspired by German concepts, they applied these ideas to differing economic conditions and political and legal cultures. In England, where large-scale corporations developed simultaneously and equally with the growth of the regulatory state and where family owners frequently retained control of large business corporations, Maitland's work seems to have had little immediate influence on British legal doctrine, especially in the context of corporate tax policy. To be sure, British legal culture and its complex interactions between legal academics and pragmatic judges may have restrained explicit judicial references to Maitland or Gierke and the legal conception of the corporation. But material economic circumstances, namely the types of English family corporations that shared power with a robust civil service, also shaped intellectual constructs of the corporation. Regardless of the cause, English judges seem to have taken it for granted that business companies were merely agents of individual shareholders.<sup>105</sup>

By contrast, American jurists embraced, however haltingly, Freund's elevation of the autonomy of corporations. Unlike their British counterparts, early twentieth-century American judges seem to have been more willing to turn to the work of treatise writers and legal academics. Freund's juridical notion of corporations as separate legal entities also resonated with the changing material conditions of American society and the antimonopoly tradition of American political culture. With big business preceding the rise of the active federal state, and the separation of ownership and control occurring earlier in the United States, it is no surprise that the theory of the corporation as a real entity was ascendant. Likewise, the notion of corporations having separate legal personalities corresponded with the

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103 ERNST FREUND, *THE LEGAL NATURE OF CORPORATIONS* (Chicago, Univ. of Chi. Press 1897).

104 Harris, *supra* note 89, at 1460-61.

105 *Id.* On the relationship between academic ideas and the British judiciary see generally NEIL DUXBURY, *JURISTS AND JUDGES: AN ESSAY ON INFLUENCE* 1-4, 61-116 (2001).

hostile intentions ascribed to these giant economic organizations. If the industrial corporation could be depicted as a greedy octopus seeking to extend its tentacles throughout American society, then surely such soulless economic entities could be seen as occupying a distinct space in the legal order.<sup>106</sup>

Nowhere perhaps was the Anglo-American variation more apparent than in the differing application of corporate law theories to corporate tax policy. While American jurists were writing volume after volume of dense treatises on corporate taxation, often focusing on those American states and continental jurisdictions that consciously taxed corporations as separate entities,<sup>107</sup> British legal experts had conspicuously little to say about the taxation of business corporations, or what they referred to as "companies." Indeed, the silence was deafening. Although there was some case law supporting the application of the British income tax to public companies, such as those created to manage navigable waterways,<sup>108</sup> English jurists seem to have taken it for granted that business corporations ought not to be taxed separately from their owners. Cultural distinctions and historically-rooted material differences between American and British conceptions of the corporation seem to have had a significant effect on tax policy.

Indeed, if one defines culture as the unstated beliefs and ideas of a particular group, the silence of British jurisprudence during this period is particularly revealing. According to the dictates of the early British schedular system of income taxation, corporations were clearly "persons" for the purposes of determining the residency of incorporated businesses.<sup>109</sup> But when it came to the potential double taxation of corporate income, the English income tax in effect exempted stockholders from the income tax when corporations were taxed on their "annual profits or gains" under the definitions of Schedule D.<sup>110</sup> British jurists did not generally explain why they believed that only one layer of tax ought to be imposed on corporate income, at least not until they began experimenting with their own form of an American-influenced "classical" corporate income tax in the 1920s.

In fact, up until the Great War, British lawmakers and legal scholars

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106 Mark, *supra* note 89, at 1465-66; DUXBURY, *supra* note 105, at 5-22; NORRIS, *supra* note 77.

107 See, e.g., SELIGMAN, *supra* note 76; KENNAN, *supra* note 34.

108 *Mersey Docks & Harbour Board v. Lucas*, (1883) 8 App. Cas. 891; ARTHUR M. ELLIS, *A GUIDE TO THE INCOME TAX ACTS FOR THE USE OF THE INCOME TAX PAYER* (London, Stevens & Sons 1886) (citing 53 L.R.Q.B. 4).

109 ELLIS, *supra* note 108, at 92.

110 See, e.g., *Income Tax Act, 1842*, 5 & 6 Vict., c. 35, § 54 (Eng.).

seemed content to use the company income tax as an indirect collection device for a levy aimed at shareholders. Technically, the law imposed a tax on the "annual profits and gains" of a company "before any dividend shall be paid," but because shareholders were entitled to a credit for income taxes paid by the company, the law effectively created an imputation system. The company essentially remitted a tax that could be imputed to shareholders.<sup>111</sup>

The revenue demands of World War I and the social tensions that accompanied the global conflict placed great pressure on existing tax systems. Consequently, British lawmakers turned to a novel Excess Profits Duty, a graduated tax imposed on profits above a statutorily provided rate of return on capital.<sup>112</sup> The Excess Profits Duty began the English experiment with taxing corporations as separate legal entities. Unsurprisingly, British tax theorists justified the new company tax not on legal grounds, not on the principle popular in the United States at the time that corporations were separate juridical entities with their own ability to pay. Rather, the English used the "benefits theory" of taxation to contend that corporations ought to be taxed because they availed themselves of the benefits provided by the state. Josiah Stamp, the economist and Inland Revenue official, justified the separate tax on the grounds that the national state provided both the general economic environment that facilitated business prosperity, and the specific demand for wartime goods that created astronomical business profits.<sup>113</sup> By relying on the "benefits" theory of taxation, English theorists could continue to maintain that business corporations were merely agents rather than separate taxable entities with their own ability to pay.

After World War I, the British transformed the Excess Profits Duty into a general corporate income tax, but it was used only as a temporary measure to address the enormous postwar debt. Comparative tax experts like Harrison B. Spaulding explained later why the corporate income tax did not initially gain currency in England as a viable source of revenue. "Corporations, except for convenience of collection of the tax, are not treated as taxable entities. The underlying theory is that the income tax is to be imposed only on individuals and in accordance with their taxable capacity," wrote Spaulding. In England, this meant that

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111 SEAN REAMONN, *THE PHILOSOPHY OF THE CORPORATE TAX* 29 (1970); HARRIS, *supra* note 13, at 76.

112 DAUNTON, *JUST TAXES*, *supra* note 13, at 55-57; Martin J. Dauton, *How to Pay for the War: State, Society and Taxation in Britain 1917-24*, 111 *ENG. HIST. REV.* 882 (1996).

113 J.C. Stamp, *The Special Taxation of Business Profits in Relation to the Present Position of National Finance*, 20 *ECON. J.* 411 (1919).



A corporation is regarded merely as a device by means of which a number of individuals can conveniently do business, and it is not looked upon as a separate object of taxation. It is not in itself a potentially taxable person, but is an aggregation of persons who may or may not be taxable. It is necessary for some purposes that corporations be regarded as separate legal entities, but the British do not extend this conception to the field of income tax.<sup>114</sup>

Though tax commentators noted the contending conceptual views of the corporation that undergirded the difference in tax treatment, they also realized that, at bottom, this intellectual or cultural distinction was based on a long and peculiar material history of American antagonism between business and government. The U.S. treatment of corporations as separate legal entities was a doctrine, noted Spaulding, that "is so well settled, and has been established so long, that it has no doubt had its effect on the popular mind."<sup>115</sup>

Part of the reason for the American obsession with taxing corporations was surely the durable state-level U.S. tradition of taxing corporations. Yet, this tradition itself was rooted in the deep-seated American aversion to concentrations of economic power, an aversion that was expressed in the popular distrust of large-scale business corporations. "In any discussion of the development of ideas regarding corporations in the United States it must be remembered that they have frequently been regarded as possible or actual sources of evil, and accordingly are objects of suspicion," noted Spaulding. "Practically all 'big business' is carried on by means of corporations," and thus "there is a feeling that if corporations are heavily taxed the tax will fall most heavily on the wealthier part of the community." The counterintuitive nature of American corporate tax policy seemed readily apparent to contemporary observers like Spaulding: the purported home of anti-statism and laissez-faire political economy seemed surprisingly eager in using tax policy to discipline corporate capital. "While in the United States Socialism as a political creed has little following," concluded Spaulding, "yet in few countries have there been tax laws so pleasing to Socialists as those of the United States."<sup>116</sup> While the U.S. and the U.K., as Spaulding observed,

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114 HARRISON B. SPAULDING, *THE INCOME TAX IN GREAT BRITAIN AND THE UNITED STATES* 86-87 (1927).

115 *Id.* at 92.

116 *Id.* at 93-94. Modern British historians have bolstered Spaulding's interpretation: Corporate taxation did not have a purchase in British fiscal policy, for it contradicted the assumption that firms were agents rather than taxable entities. Corporation taxation did not, as in the United States, connect with hostility to

seemed to occupy opposite ends of the corporate income tax spectrum, other industrializing European nations such as Germany appeared to be paving a middle path between these two extremes.

### **B. German Organized Capitalism and an Intermediate Form of Corporate Taxation**

The German Empire (*Reich*) that emerged from the diverse array of principalities and free cities in the late nineteenth century was, like most modern Western nation-states, a country coping with the dislocations of industrialization. Although unified Germany, under the stewardship of Otto von Bismarck and Kaiser Wilhelm II, was a parliamentary, constitutional monarchy and one of the world's leading industrial powers (second only to Britain), a great deal of political and economic power was dispersed throughout the intergovernmental divisions of a federated state.<sup>117</sup> Nevertheless, the dominance of Prussia and Berlin were evident throughout the economic and social policies adopted by the *Reich* in the late 1800s. While tariffs and other indirect taxes remained a source of revenue for the central nation-state, Prussia led the way with direct taxes: in 1891 it enacted a moderately progressive, broadly based personal income tax that also applied to the income of business corporations. The corporate tax, though, provided a limited amount of relief from the potential double taxation of corporate income by permitting a deduction for a small percentage of a company's return on capital. As a result, Prussia seems to have set German corporate tax policy on its own special path (*Sonderweg*).<sup>118</sup>

There are many reasons why Prussian corporate tax policy may have ventured off onto a middle path between the extremes of American "classical" corporate taxation and the British system of proto-integration. One of the most salient factors was certainly the strong German tradition of viewing corporations as real entities. As we have seen, Gierke's ideas about corporations embodying the communal notion of fellowship were quite popular in mid-nineteenth century Germany, and these notions subsequently had a significant impact on American, if not British, corporate law and

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big business or with opposition to a federal income tax. On the contrary, the income tax was seen as the most equitable system of taxation.

DAUNTON, *JUST TAXES*, *supra* note 13, at 93.

117 MARK HEWITSON, *WILHELMINE GERMANY IN IMPERIAL GERMANY, 1871-1918*, at 40-60 (James Retallack ed., 2008); EDGAR FEUCHTWANGER, *IMPERIAL GERMANY, 1850-1918*, at 61-62, 104-05 (2001).

118 Grossfeld & Bryce, *supra* note 12, at 235-36; HARRIS, *supra* note 13, at 82.

tax policy.<sup>119</sup> Although Gierke's influence may have preceded the rise of big business in Germany, the concept of the business corporation as a separate real and legal entity created by the state's monopoly on the power of incorporation remained important for German legal thought.<sup>120</sup> As a result, it is unsurprising that Prussia and other German states employed a classical system of corporate taxation, imposing one levy on business corporations *qua* corporations, and a second layer of tax on the shareholders of such business enterprises. In that sense, Prussian corporate tax policy seemed to mirror certain aspects of nineteenth-century U.S. subnational business taxes, and the early twentieth-century national income taxes that imposed double taxation on the highest income earners.

Yet, if the salience of corporate personality theories in Germany and the United States can explain why the Prussian corporate tax resembled the American system, a puzzle remains as to why Prussian authorities provided some tax relief to commercial entities in the calculation of the first layer of corporate taxation. Since the antagonism between American business and government may explain why the early U.S. "soak-the-rich" tax laws treated capital owners harshly, an exploration of turn-of-the-century German political economy may help account for Prussia's intermediate type of corporate taxation. Scholars have long noted the unique form of "organized capitalism" or "cooperative managerial capitalism" that emerged in Germany in the late nineteenth century.<sup>121</sup> As business historians have demonstrated, the German experience with advanced industrialization paralleled that of the U.S., more so than the U.K. Because German business leaders, like their American counterparts, made the "three-pronged investment in manufacturing, marketing, and management essential to exploit fully the economies of scale and scope, they became first movers in many of the new capital-intensive industries, not only in their homeland but in all of Europe."<sup>122</sup> As a result, managerial hierarchies in the largest German firms emulated, to a certain degree, those found in the United States.

German big business was more distinctive, however, in other ways, which may have affected the broad contours of comparative tax policy. In terms of financing, German corporations relied much more heavily than American

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119 See *supra* text accompanying notes 103-06.

120 MORTON HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1870-1960: THE CRISIS OF LEGAL ORTHODOXY* 71-72 (1994).

121 CHANDLER, *supra* note 11, at 12. For a recent reassessment of the contrasts between U.S. and German political economy during the turn of the twentieth century, see Dunlavy & Welskopp, *supra* note 18.

122 CHANDLER, *supra* note 11, at 393.

or British companies on banks and other financial institutions.<sup>123</sup> Bankers in Britain, for instance, usually played a role in management decisions only when a firm or industry became severely distressed. Likewise, investment bankers in the United States became more involved with big business mainly during merger booms, providing new capital and strategic advice to top management.<sup>124</sup> By contrast, in the highly capital-intensive German industries, large banks provided critical early-stage financing and continued funding support, and as a consequence bankers were important corporate board members who participated in top-level business decision-making.<sup>125</sup>

The convergence of finance capital and commercial industrialism in Wilhelmine Germany was in many ways the function of a broader historical and cultural environment in which bureaucratic traditions and legal rules fostered a cooperative ethos, not only between firms, but also between state and economy. In some of Germany's largest corporate enterprises, such as the electrical manufacturing firm Siemens, the size and mentality of the managerial staff followed the pre-industrial bureaucratic traditions of the Prussian civil service. White-collar business managers were referred to as *Beamte*, or civil servants, because they complied with a state-bureaucratic model of decision-making and its strict lines of command and control.<sup>126</sup>

The private adherence to a formal, rational model of public bureaucratic management was rooted in the strong German civil service tradition. After all, the German railroads — those pivotal global harbingers of the modern industrial corporation — had been nationalized under Bismarck's rule, and thus railroads were in effect managed by the German civil service. In addition, since nationalization obviated the need for a federal regulatory commission, like the U.S. Interstate Commerce Commission, there was less opposition to the rate-making process in Germany, and hence less antagonism towards the rise of big business. In essence, as one leading German historian has noted, "the German rate setting mechanism was basically

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123 CHANDLER, *supra* note 11, at 398; ROE, *supra* note 19, at 171-73.

124 VINCENT P. CAROSSO, INVESTMENT BANKING IN AMERICA: A HISTORY 25-45 (1970).

125 CHANDLER, *supra* note 11, at 398. More recent historical investigations have called into question the extent to which the German "great banks" (*Großbanken*) monitored or controlled large-scale German firms. Dunlavy & Welskopp, *supra* note 18, at 42. Still, the historical contrast in corporate financing between Germany and the U.S. remains relatively pertinent.

126 JURGEN KOCKA, INDUSTRIAL CULTURE AND BOURGEOIS SOCIETY: BUSINESS, LABOR, AND BUREAUCRACY IN MODERN GERMANY 170 (1999); JEFFREY R. FEAR, ORGANIZING CONTROL: AUGUST THYSEN AND THE CONSTRUCTION OF GERMAN CORPORATE MANAGEMENT 15 (2005).

more parliamentary than juridical or adversary."<sup>127</sup> With German railroads leading the way in adopting a public civil service model of management, it is unsurprising that many of the largest German corporations followed suit.

While the German tradition of bureaucratic public management influenced the development of private modes of corporate governance and cooperative relations between state and society, the German legal system was even more significant in facilitating inter-firm collaboration and hence in cultivating a legal culture that viewed big business as working with, rather than against, the public interest. This broader legal culture of commercial cooperation, in turn, may explain why Prussian lawmakers sought to mitigate the double taxation of corporate profits. The most salient legal difference between Germany and other Western industrial nations at the turn of the century was the German encouragement of cartelization. Whereas the Anglo-American legal framework privileged competition and consolidation over cooperation and cartelization, German laws and courts enforced cartel agreements and other contractual arrangements among competitors as furthering the public interest.<sup>128</sup> The U.K. common law prohibited combinations in restraint of trade. And the U.S., with its long-standing antimonopoly tradition, not only demonized large concentrations of economic power, American courts refused to enforce cartel agreements and Congress enacted formalistic prohibitions like the Sherman Anti-trust Act explicitly barring inter-firm cooperative arrangements.<sup>129</sup>

By contrast, the German legal system encouraged inter-firm cooperation. The German Empire did not have any common law prohibitions or any legislative enactments against cartels. German courts, in fact, regularly upheld contractual arrangements whereby competitors set output, prices, and market allocations. When these contractual agreements proved insufficient, German firms frequently formed a more formal consortium or syndicate known as a "community of interest" (*Interessengemeinschaft*), which entailed more sophisticated and detailed pooling arrangements. Although these arrangements were often short-lived, the formal legalization of cartels set German law and political economy apart from the U.S. and U.K.<sup>130</sup>

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127 Detlev F. Vagts, *Railroads, Private Enterprise, and Public Policy: Germany and the United States, 1870-1920*, in *LAW AND THE FORMATION OF THE BIG ENTERPRISES IN THE NINETEENTH AND EARLY TWENTIETH CENTURIES* 604, 613 (Norbert Horn & Jurgen Kocka eds., 1979).

128 Dunlavy & Welskopp, *supra* note 18, at 50-52; DOBBIN, *supra* note 25, at 3, 87.

129 TONY FREYER, *REGULATING BIG BUSINESS: ANTITRUST IN GREAT BRITAIN AND AMERICA, 1880-1990*, at 25-26 (1992); Dunlavy & Welskopp, *supra* note 18, at 51.

130 Morton Keller, *Regulation of Large Enterprise: The United States Experience in Comparative Perspective*, in *MANAGERIAL HIERARCHIES: COMPARATIVE*

Similarly, differences in incorporation laws and corporate governance policies between Germany and the United States also influenced the contrasting structure of business organizations. In the U.S., incorporation laws were the ambit of state governments, which at the turn of the century competed intensely with one another to attract corporations by enacting lenient conditions for incorporation. This American state-level competition hastened the pace of incorporation and permitted such innovations as holding companies which facilitated mergers and eased the process of corporate consolidation.<sup>131</sup> Likewise, the American shift in shareholder rights away from a democratic notion of one vote per *shareholder* to the more plutocratic conception of one vote per *share* also permitted investors to purchase controlling power in corporations and thus enabled the concentration of economic power.<sup>132</sup> In the German *Reich*, by contrast, incorporation law remained a national prerogative with strict conditions. The imperial laws of incorporation set stringent requirements for the issuance of shares and the required amount of capitalization before granting legal powers. Moreover, although German law did not mandate shareholder voting rights, by the early twentieth century it was still common for many German firms to limit the voting rights of large shareholders. These two central differences in legal culture — in incorporation laws and in the degree of acceptable shareholder power — "made it much easier to merger companies in the United States and much harder to do in Germany."<sup>133</sup> Consequently, legal distinctions channeled American and German corporate capitalism onto two distinct paths.

The comparative contrast in management structures and legal cultures reflected broader and more fundamental distinctions in comparative political economy. While Alfred Chandler, Jr. may have been correct to identify German "cooperative managerial capitalism" as distinct from the American style of "competitive managerial capitalism," the

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PERSPECTIVES ON THE RISE OF THE MODERN INDUSTRIAL ENTERPRISE (Alfred D. Chandler, Jr. & Herman Daems eds., 1980); Jurgen Kocka, *Entrepreneurs and Managers in German Industrialization*, in THE CAMBRIDGE ECONOMIC HISTORY OF EUROPE, VOL. VII, THE INDUSTRIAL ECONOMIES: CAPITAL, LABOUR, AND ENTERPRISE 492 (Peter Mathias & M.M. Postan eds., 1978); CHANDLER, *supra* note 11, at 423-25.

131 CHRISTOPHER GRANDY, *NEW JERSEY AND THE FISCAL ORIGINS OF MODERN AMERICAN CORPORATION LAW* (1993).

132 Dunlavy & Welskopp, *supra* note 18, at 55-56.

133 *Id.* at 56. In the context of shareholder voting rights, even English company laws and norms adhered more to a democratic conception of the corporation, with limits on voting rights. Dunlavy, *supra* note 18, at 1360-61.

differences run much deeper than contrasting organizational capabilities and structures.<sup>134</sup> Indeed, German scholars have long noted how a particular type of "organized capitalism" characterized late nineteenth- and early twentieth-century German political economy. Beginning with the path-breaking work of Rudolph Hilferding, scholars have examined how the dense German interdependence of cartels, trade associations, and state intervention — through law and other means — not only led to greater cooperation between business and government, but rather fused "state and economy into a new system of domination and hegemony."<sup>135</sup>

The fusion of state and economy in Germany may explain why Prussian authorities in the late nineteenth century imposed a corporate tax that mitigated the "classical" system of double taxation. The Prussian Income Tax Law of 1891 imposed a levy on the income of individuals as well as "joint stock companies, shareholders' limited liability companies, and mining companies situated in Prussia."<sup>136</sup> Unlike the nineteenth-century U.S. statutes, which integrated the corporate and individual income taxes, the 1891 Prussian law explicitly imposed a double tax on corporate profits by taxing both retained and distributed profits, and by including dividends in the personal income of shareholders.<sup>137</sup> From the start, however, the Prussian law provided some relief from double taxation, though in a form that was different from other fiscal systems. Whereas the British used an imputation method to integrate fully the corporate and individual income tax during this period, and while the United States in the early twentieth century used dividend deductions and exclusions at the shareholder level to provide relief to lower-income taxpayers, the Prussian law provided corporations with a deduction for a small percentage of the company's return on capital.<sup>138</sup>

By providing relief at the corporate level, Prussian authorities would seem

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134 CHANDLER, *supra* note 11, at 12.

135 FEAR, *supra* note 126, at 18-19 (paraphrasing Hilferding); *see also* RUDOLPH HILFERDING, *FINANCE CAPITAL: A STUDY OF THE LATEST PHASE OF CAPITALIST DEVELOPMENT* (Routledge 1981) (1910).

136 Section 1 of the Prussian Income Tax Law of June 24, 1891. English translation provided in HARRIS, *supra* note 13, at 82.

137 Section 12 of the Prussian Income Tax Law of June 24, 1891. The 1891 Prussian fiscal reforms also relegated a business tax (*Gewerbsteuer*) assessed on business profits to local governments. Joseph A. Hill, *The Prussian Business Tax*, 8 Q.J. ECON. 77 (1893).

138 More specifically, the Prussian law calculated corporate taxable income "after deducting 3.5 percent of the share capital paid-in." HARRIS, *supra* note 13, at 83; HENRY J. GUMPEL & CARL BOETTCHER, *TAXATION IN THE FEDERAL REPUBLIC OF GERMANY* 129 (1963).

to have acknowledged that business corporations in Germany were part of a special mix of public and private associations working within a complex federal fiscal system. As one contemporary American tax expert explained, the Prussian fiscal reforms of 1891 appeared to be rooted in a desire to make taxation more equitable and an effort to reach a political compromise over the proper taxation of Prussian and foreign shareholders. "The double taxation of the Prussian stockholder may, perhaps, be defended on the principle of the higher taxation of funded incomes," wrote the political economist Joseph A. Hill, referring to income derived from capital as opposed to labor. Yet Hill realized that because the Prussian tax applied only to corporations and individuals situated in the state, the levy discriminated between Prussian shareholders who would be liable for the double tax and foreign stockholders who likely would not, unless their own state imposed a personal income tax. The Prussian law, Hill concluded, "appears to be simply a compromise between the desire to tax the foreign stockholder and the opposition which might be made against taxing the Prussian stockholder twice on the full amount of his dividends."<sup>139</sup>

Regardless of the motivations behind the Prussian corporate tax, in effect Prussia adopted a mixed system that taxed corporate income twice, but provided a degree of relief at the corporate level. Although this system was altered over time, especially during World War I, it remained durable until the mid-1920s when the centralization of political and fiscal powers led to the adoption of the German income tax of 1925, which eliminated any kind of relief, and thus created a fully classical system of double taxation of corporate profits.<sup>140</sup> By the end of the twentieth century most industrialized nations seemed to be moving toward some limited form of relief from double taxation, but during the early formative years of the corporate income tax — during the critical juncture at the turn of the twentieth century — Germany, the U.K. and the U.S. seemed to occupy distinct places on the spectrum of corporate income tax policy.

#### IV. CONCLUSION: THE POSSIBLE IMPLICATIONS OF AMERICAN CORPORATE TAX EXCEPTIONALISM

Early twentieth-century American corporate tax policy reflected the peculiar position that U.S. corporations occupied in the comparative history of law

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<sup>139</sup> Joseph A. Hill, *The Prussian Income Tax*, 6 Q.J. ECON. 207, 223 (1892).

<sup>140</sup> HARRIS, *supra* note 13, at 90-91.



and political economy. Long regarded as the creatures of state government charters, U.S. corporations were susceptible to American state and local property levies throughout the nineteenth and well into the twentieth century. Although states and commonwealths frequently disagreed over how to treat corporations, these increasingly large business organizations were never far from the center of subnational tax policy debates. Economic experts, even in this early period, acknowledged that the ultimate incidence of corporate taxes was frequently uncertain. Still, the ambiguity of who paid the corporate tax did not stop state and local lawmakers from using tax policy to try to protect local economic interests and to express the social antipathy towards monopoly power.

From a transnational comparative perspective, American corporate tax policy seems to have been even more preoccupied with using tax policy instrumentally to control corporate capital. Unlike their British counterparts, U.S. lawmakers followed the lead of German theorists and policymakers in viewing corporations not merely as the agents of individual economic actors, but rather as separate legal entities with significant social responsibilities. "Everywhere," wrote Edwin Seligman in his hugely popular *Essays in Taxation*, corporations "form a problem of increasing importance and present an admirable example of what is meant by taxation from a social rather than from an individual point of view."<sup>141</sup> This social point of view suggested that American society, working through the state, not only had a legitimate claim upon the profits and earning capacity of business corporations, but also a right to exercise public control over private power. The social conception of the corporation explained how corporate taxes could be both a form of antimonopoly-inspired regulatory control and a rational and effective method of collecting tax revenue. The social conception of the corporation also captured the ambivalence that characterized the American reaction to the arrival of big business; it explained why some contemporaries celebrated the large-scale industrial corporation as the harbinger of material progress, while others scorned it as a threatening source of concentrated economic power.

Scholars, to be sure, have long recognized the historical American antipathy toward concentrated power, both public and private. Business historians, in particular, have documented how and why the American relationship between government and big business has been marked by a comparatively unique tension over legitimate power and authority. That historically-specific tension may help explain how the United States could paradoxically embrace both a laissez-faire ideology and an aversion toward

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141 SELIGMAN, *supra* note 76, at 329.

monopoly power. The modest contribution of this Article has been to extend these well-known insights from transnational business history to the development of American corporate tax law. Doing so may shed some light on the stubborn persistence of American corporate taxation, particularly in the face of global changes and the relentless economic critiques of the double taxation of corporate income.

Yet uncovering the comparative historical beginnings of U.S. corporate taxation may also have broader implications. It may explain why American policymakers have been reluctant to experiment with other forms of taxation, such as the Value Added Tax — a levy that from a comparative perspective is conspicuously absent in the United States. Because the adoption of the 1909 corporate tax occurred during a critical juncture in the path-dependent development of American tax policy, this early and enduring commitment to using tax policy to discipline corporate capital may explain why American lawmakers have been unwilling, and perhaps unable, to turn to seemingly regressive forms of taxation to fund the growth of the federal state. Simply put, the blinders of punitive progressive corporate taxes may have foreclosed the contingent possibilities of other forms of tax and transfer systems. The limits as well as the achievements of the modern American fiscal state may thus be traced back to the beginnings of the 1909 corporate tax.