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Sanders: Effects of Taxation on Executives. Hall: Effects of Taxation of Executive Compensation and Retirement Plans

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the general inaction of the American bar has been commented upon. Phillip L. Graham, publisher of the Washington Post, stated in a public address that the legal profession had failed to meet its obligation to support individual freedom and act as “America's ministers of justice.” He said that “By and large, the attitudes of the bar have indicated silent acquiescence in, and even occasionally affirmative support for, innovations affecting personal freedom that would have raised the collective hairs of this association straight on end not many years ago.”

The bar has always had two historical roles to choose between: the indifference to civil freedoms which led to wholesale distrust of lawyers during the American Revolution, the Jacksonian period and the latter part of the 19th century; or the defense of individual liberty which marked the John Peter Zenger sedition trial in 1735, the New York City Bar Association’s opposition to the Lusk Committee in the 1920’s and the 1947 Letter to President Truman from twenty-two faculty members of the Yale Law School protesting the promulgation of the loyalty order.

As Professor Commager phrased it, “Each generation has to vindicate these freedoms anew, and for itself.” Four members of our profession have reported the ragged status of our freedoms, and it is now up to the bar as a whole to lead the march to the mending shop.

Alan Furman Westin†


Until recently, the effects of taxation on personal initiative and corporate decisions have been largely matters for speculation. Some writers have consistently predicted dire consequences to the economy from any hoisting of tax rates. Others have asserted that tax changes would not have significant

3. 17 How. St. Tr. 675 (1735).
4. Statement of Special Committee of Association of Bar of City of New York, Reports, Vol. 21, 1920. The statement was directed to the legislature of the state of New York and was signed by Charles Evans Hughes, Morgan J. O’Brien, Louis Marshall, Joseph M. Proskauer and Ogden L. Mills.
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effects. Still others faced the issue squarely and admitted that, while theoretically there was much to be said on both sides, actually no one had ever made a factual analysis of the effects of taxation on business.

At long last, under the aegis of the Harvard Graduate School of Business Administration, a group of well-qualified economics and business professors is making a thorough inquiry into the effects of taxation on various aspects of the economy. The Harvard inquiry is broken down into separate studies which deal with tax effects in specific areas. These two books, part of the series, represent an appraisal of the effects of taxes on management incentive.

Generally speaking, there are two broad kinds of "incentive" which taxes may be assumed to affect in some degree. One is the motive to invest in new or expanded enterprises—either on the part of corporations or of individual investors. The other is the desire to put forward greater or less individual effort. While they are somewhat interwined, each may be delineated in some situations. Thus, in the case of a single small entrepreneur, it is often difficult to distinguish the motive to invest from the motive to exert greater or less personal effort. But the propensity of a large national corporation to invest is rather clearly a thing apart from the inclination of its officers to work more or less hard at their jobs. It is with the latter, the individual incentive, that Professors Hall and Sanders are almost exclusively concerned.

Professor Hall's study of tax effects on executive compensation and retirement plans is an intensive analysis of one aspect of the broader field surveyed by Professor Sanders. Together they attempt to analyze the effects of taxation on management incentive. Even in its broadest sense this is but a small aspect of the incentive problem as a whole. But the field of "management incentive" is narrowed considerably by the Hall-Sanders definition. While they give cursory recognition to the little executive in the big corporation and to the big executive in the little corporation, the bulk of their research is devoted to the big executive in the big corporation—chairmen of the board, presidents and vice-presidents of giant national enterprises. Thus the light these two books shed on the hotly-debated question of what high taxes are doing to the American System of Free Enterprise is faint at best.

Within their narrow sphere, however, the conclusions of the two books are illuminating. Both indicate that higher taxes have led to considerably less direct reduction of effort than the prophets of doom predicted. Sanders and Hall both rely to a great extent on the results of personal interviews. In such a subjective area as that of establishing individual reactions, probably no other technique is feasible. Sanders, in fact, asserts that any attempt at statistical compilations concerning executive behavior would be more misleading than useful. The authors thus confine themselves largely to reporting the results of their interviews and trying to discern general trends in the responses they received.

Professor Sanders concludes that a whole host of non-financial incentives operate to minimize any slow-down effects of increased taxation. He finds
that both increased government controls and growing difficulties in dealing with labor unions are far greater disincentives to many executives than is the reduction of income by increased taxes. But even "all these disincentives added together . . . are not sufficient to quell adventurous and vigorous spirits. What all history goes to show is again confirmed by a good deal of the evidence in this study, that difficulty, danger, and strenuous effort are themselves incentives to many men." ¹

In many respects Professor Hall's findings corroborate these conclusions. He too found that most executives feel that high personal income taxation has not reduced their efforts. However, he indulges in some fanciful reasoning to isolate certain indirect effects of higher taxes which he believes are deleterious to the economy. Thus he asserts that deferred compensation plans,² whose growth has been stimulated by increased taxation, tend to reduce the total output of goods and services. This results, says Professor Hall, primarily because they reduce executive mobility. This immobilizing effect is produced because many plans involve partial or complete forfeiture of accrued deferred payments if employment is terminated. Of course, these same plans have other consequences (e.g., possible increased efficiency resulting from prompt retirements and the encouragement of promotions from within the organization) which might well counteract any unhappy effects of reduced mobility. Professor Hall recognizes these, weighs them, and concludes that they only partially offset the stratifying influence of such plans in their effect on the economy. On the other hand, a similar analysis leads him to conclude that most retirement and profit-sharing plans increase the output of goods and services. Here increased efficiency due to profit participation and prompt retirement overcomes the effects of decreased mobility.

On the whole, Professor Sanders' book is more concerned with the direct effects of taxation on incentive. He reports the results of his interviews with little theoretical embellishment, simply recording how executives feel about such things as their day-to-day jobs and their own and their colleagues' mobility under increased taxation. One small section of the book even discusses how executives, in their personal investments, are reacting to higher taxes. Throughout the book, Professor Sanders' light and human approach saves the straightforward narration from becoming dull reading.

Professor Hall's work is probably of necessity a more speculative and theoretical project. And its inherent complexities virtually guarantee that the reading will not be easy. Certainly the exposition of the nature, growth, and tax treatment of the various kinds of executive compensation and retirement plans is as factual and plain-spoken as the discussion of such a compli-

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¹. SANDERS, p. 14.

². This term refers to "a special form of deferred-type compensation plan which provides definitely determinable periodic deferred payments to one employee, with the employer company making the payments directly to the participant." HALL, p. 6 n. 3.
cated subject can be. But Professor Hall frequently leaves the realm of reasonably verifiable fact to indulge in speculation about the *indirect* effects on the economy of the various types of plans. This seems hardly justifiable in a book which forms part of a survey whose basic objective is fact-finding. His field is difficult enough. Beclouding the reader's comprehension with a host of dubious inferences seems unwarranted.

These two books, narrow in their scope and, at best, tentative in their conclusions, evidence a healthy trend. All signs portend that high taxes will persist. By putting the discussion of their incentive effects on a factual, as opposed to an emotional, basis, Sanders and Hall have stimulated a more rational approach to the whole problem of taxation and the American Economy.

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