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Steven A. Bank
1@1.com

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WHEN WE TAXED THE PYRAMIDS

STEVEN A. BANK*

I. INTRODUCTION

One of the more anomalous structural features of the corporate income tax is the dividends received deduction,[1] which permits a corporation to deduct from income an amount equal to some or all of the dividends it receives in its capacity as a shareholder of another domestic corporation. At first glance, the provision seems to be justified by the general sentiment against taxing corporate income more than twice. If this is the explanation, however, the dividends received deduction is underinclusive because some intercorporate dividends are only partially deductible. As currently drafted, the amount of the deduction is based on the degree of a shareholder's control. Dividends are completely (100%) exempt if a corporate shareholder owns at least 80% of the distributing corporation,[2] 80% exempt if the ownership interest is less than 80% but at least 20%, and 70% exempt if the ownership interest is less than 20%.[3] If avoiding triple (or more) taxation was the rationale, it is not clear why all intercorporate dividends would not be completely exempt from further taxation. Given partial deductibility and the importance of degree of control, it is therefore natural to conclude that the dividends received deduction is less about a concern over multiple layers of taxation and more about substance-over-form concerns. In other words, it is about differentiating true dividends from distributions that are really just shifts in money from a corporation's right pocket to its left pocket. If that is the explanation, however, the dividends received deduction is overinclusive because it applies to very small investments in another corporation where the distribution really does move money from one tax-

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1. I.R.C. § 243.

2. *See id.* §§ 243(a)(3), (b), 1504(a)(2).

3. *Id.* § 243(a)(1), (c).

payer to an entirely different taxpayer. Thus, a corporation that owns a single share of stock in a large public corporation still can exclude 70% of the dividend from income.

The incoherence of the current tax treatment of intercorporate dividends is a product of its historical development. As described by the few commentators who have examined the history of intercorporate dividends taxation to any extent, its origins can be traced back to the New Deal.[4] In the Revenue Act of 1935,[5] corporate income was for the first time subject to graduated marginal rates. In announcing the progressive rate scheme, President Franklin Delano Roosevelt noted that to prevent the evasion of the new graduated rates through the use of subsidiaries, each of which had income below the thresholds for the application of the higher rates, it would be necessary to impose a tax on intercorporate dividends. Intercorporate dividends went from being fully exempt to being only 90% exempt. In theory, this change was designed to discourage any attempts to evade the new graduated system. In reality, however, the additional effective tax burden was too small to be a significant deterrent in most cases given the alternative of having a corporation's income subject to the top corporate rates.

The underlying rationale for taxing intercorporate dividends was more about discouraging the formation and continued existence of certain large corporate groups, or "pyramids," than it was about closing a loophole in the graduated rate scheme. The name for these controversial corporate structures derived from their multilevel corporate chains of ownership in which the investors at the top of the pyramid were able to leverage a relatively small investment in one corporation in order to exercise power and influence over a large group of subsidiaries at the bottom of the pyramid. As economist Randall Morck observed, this pyramidal structure was "believed to facilitate governance problems, tax avoidance, market power, and dangerously concentrated political influence."[6] Although the resulting tax burden from the introduction of intercorporate dividend taxation was too small to force an immediate change in organizational structures,[7] it

4. *See, e.g.*, David R. Francis, *The Taxation of Intercorporate Dividends: Current Problems and Proposed Reforms*, 64 TAXES 427, 430 (1986); George Mundstock, *Taxation of Intercorporate Dividends Under an Unintegrated Regime*, 44 TAX L. REV. 1, 9-10 (1988); Daniel C. Schaffer, *The Income Tax on Intercorporate Dividends*, 33 TAX LAW. 161, 163 (1979); Michael J. Maimone & G. Frank Riley III, Note, *Taxation of Intercorporate Dividends: A Missed Opportunity for Tax Reform*, 7 VA. TAX REV. 777, 779 (1988).

5. Revenue Act of 1935, Pub. L. No. 74-407, 49 Stat. 1014.

6. Randall Morck, *How to Eliminate Pyramidal Business Groups: The Double Taxation of Intercorporate Dividends and Other Incisive Uses of Tax Policy*, 19 TAX POL'Y & ECON. 135, 136 (2005).

7. *See* Steven A. Bank & Brian R. Cheffins, *The Corporate Pyramid Fable*, 84 BUS. HIST. REV. 435, 443-45 (2010) (finding in a study of SEC filings between 1936 and 1938 of

was part of a multifaceted campaign against corporate pyramids that included changes in tax laws, securities laws, and the enactment of the Public Utility Holding Company Act.[8]

Not only was the intercorporate dividends tax primarily about this campaign against pyramids, it was tied as much—or more—to a prior move to repeal the consolidated return. Formerly a requirement for corporate groups to prevent evasion of the war profits and excess profits taxes,[9] the consolidated return had become merely an option for affiliated corporations as of 1921. By 1932, however, growing concern about the use of holding companies had led Congress to consider reforms to make such structures less desirable. Initially, corporate groups had to pay a penalty tax to file a consolidated return, and then in 1934, the privilege was revoked entirely for most corporations. A companion proposal to tax intercorporate dividends, however, was narrowly defeated. The continued existence of the full exemption for intercorporate dividends after 1934 appeared to be an end-run around at least one aspect of the consolidated return repeal. In 1935 and 1936, Congress reduced the exemption for intercorporate dividends in order to bolster the concerted action against holding companies.

This original rationale for the taxation of intercorporate dividends soon became unnecessary. Starting in the 1940s, concern about pyramidal structures lessened as reorganization began to occur under the Public Utility Holding Company Act, which had also been enacted in 1935. In 1942, the consolidated return privilege was revived, and all penalties were eliminated as of 1964. Consequently, Congress moved away from an intercorporate dividends tax and back toward the exemption concept that had existed prior to 1935.[10] In the time since, however, the provision has neither returned to its roots nor fully embraced a scheme based on degree of control. In Part II, this Article examines the history of the tax treatment of intercorporate dividends, focusing on both the failed attempt to repeal the dividends received deduction in 1934 and then its reduction in 1935. Part III

corporate shareholders owning more than 10% of the stock of another corporation that more than 80% of corporate shareholders remained unchanged, and of the corporate shareholders that changed their holdings, the number of purchases of increased shares virtually matched the number of sales).

8. *Id.* at 439, 448; Public Utility Holding Company Act of 1935, Pub. L. No. 74-333, 49 Stat. 803.

9. *See infra* text accompanying notes 36-40.

10. The use of the word "exemption" is a reference to the effect rather than the means of accomplishing that end. The partial or full exclusion of intercorporate dividends has sometimes been accomplished through an exemption, sometimes through a credit, and more commonly through a dividends received deduction. There is no clear explanation for the difference, but one commentator has suggested that it was a difference in "nomenclature only." Mundstock, *supra* note 4, at 7 n.28.

describes the evolution of the dividends received deduction after the New Deal, taking special note of the changes in circumstances regarding the treatment of consolidated corporate groups. Finally, the Article concludes by discussing the possible future of the tax treatment of intercorporate dividends and the proposals that have been raised for its reform.

II. ORIGINS

A. 1909

The idea that a corporation could hold stock in another corporation was a relatively new phenomenon in America at the turn of the century. New Jersey was the first state to enact a statute broadly permitting corporate ownership of other corporations in 1889, and other states were slow to follow.[11] Even as late as 1916, Professor Maurice Wormser reported in his corporate law treatise that "it is generally held in this country that a corporation has no power to subscribe for or to purchase stock in another corporation, unless such power is expressly given in its charter or is reasonably implied in it."[12] Otherwise, a corporation could bypass any charter restrictions on its purpose by purchasing stock in a corporation undertaking an unauthorized line of business.[13] Perhaps to get around such *ultra vires* objections, investors created the holding company. Wormser noted:

> In recent years there has come into existence a class of corporations known as holding companies. These corporations are organized exclusively for the purpose of acquiring and holding stock in other corporations. Their validity has been upheld in some states, including New York, but in others, notably Illinois, they have been condemned because of their tendency to create monopolies.[14]

Critics of excessive business consolidation during the first decade of the twentieth century were especially concerned about the development of holding companies, which they viewed as an abusive stock

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11. CHRISTOPHER GRANDY, NEW JERSEY AND THE FISCAL ORIGINS OF MODERN AMERICAN CORPORATION LAW 42 (1993); CHARLES S. TIPPETTS & SHAW LIVERMORE, BUSINESS ORGANIZATION AND CONTROL: CORPORATIONS AND TRUSTS IN THE UNITED STATES 213 (1932). Prior to affording general statutory authority, some states permitted corporate stockholding under special charters or in statutes targeted at specific industries. WM. L. CLARK, JR., HANDBOOK OF THE LAW OF PRIVATE CORPORATIONS 183 (I. Maurice Wormser ed., 3d ed. 1916). For example, in 1853 New York granted telegraph companies the authority to own stock in other telegraph companies as part of a program to facilitate interstate telegraph holding companies. RONALD E. SEAVOY, THE ORIGINS OF THE AMERICAN BUSINESS CORPORATION, 1784-1855, at 198-99 (1982).

12. CLARK, *supra* note 11, at 183.

13. JAMES WILLARD HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970, at 45 (1970).

14. CLARK, *supra* note 11, at 185.

consolidation technique designed to evade the Sherman Antitrust Act.[15] By 1912, the Democratic Party platform specifically proposed to limit the ability of states to permit holding companies and interlocking directorates.[16] After the election, William C. Redfield, the Secretary of Commerce in President Woodrow Wilson's new administration, publicly stated that corporations should "not hold stock in the competing companies, and that neither a person nor a corporation shall at the same time own a controlling interest in two or more competing corporations."[17] Eventually, these statements led to a bill proposing to bar corporate acquisitions of stock in other corporations whenever "the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition, or to restrain such commerce . . . or to tend to create a monopoly."[18] The Clayton Act, as the bill was called after passage in 1914,[19] was too ambiguously drafted to be viewed as a substantial impediment to holding companies, but it did reflect the prevailing sentiment against such structures in the pre-World War I era.[20]

This controversy over corporate holding companies was looming during the debates over the 1909 corporate excise tax—often considered the forerunner of the modern corporate income tax because the amount due was a function of the corporation's income.[21] The original bill introducing the excise tax included an exemption for dividends received from another corporation,[22] but this was attacked as a de facto tax exemption for corporate holding companies. During deliberations over the 1909 corporate excise tax, Insurgent Republican Senator Moses Clapp of Minnesota introduced a motion to repeal the exemption of dividends paid by corporate subsidiaries to their parent

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15. HARLAND PRECHEL, BIG BUSINESS AND THE STATE: HISTORICAL TRANSITIONS AND CORPORATE TRANSFORMATION, 1880S-1990S, at 66 (2000). As Lawrence Mitchell has written, "[t]he trust structure was no longer a subterfuge. The holding company transformed it into a perfectly legal device." LAWRENCE E. MITCHELL, THE SPECULATION ECONOMY 31 (2007).

16. PRECHEL, *supra* note 15, at 66.

17. *Id.* at 66-67 (citation omitted).

18. *Id.* at 68.

19. *Id.*; Clayton Act, Pub. L. No. 63-212, 38 Stat. 730 (1914).

20. PRECHEL, *supra* note 15, at 68.

21. Payne-Aldrich Tariff Act of Aug. 5, 1909, Pub. L. No. 61-5, § 38, 36 Stat. 11, 112.

22. In a carefully scripted exercise, the corporate excise tax was introduced in the Senate by Senate Finance Committee Chair Nelson Aldrich as an amendment to Senator Henry Cabot Lodge's motion to substitute an inheritance tax for Democrat Joseph Bailey's income tax bill. It was drafted by Senator Elihu Root and Attorney General George Wickersham under the close supervision of the President, and it was "carefully scrutinized" by the Senate Finance Committee as part of a campaign by the President to make the bill more likely to pass through Congress. ROY G. BLAKEY & GLADYS C. BLAKEY, THE FEDERAL INCOME TAX 45-47 (1940).

holding companies.[23] Clapp complained that the bill "permits the organization of holding companies and exempts such holding companies from any tax where their capital is invested in the stock of subordinate companies."[24] Senator Nelson Aldrich, a Republican from Rhode Island, objected:

> No holding company or any other company is exempted . . . . This proposition simply, in the case of corporations which have paid the tax once and whose stock is held by another corporation, permits the second holding corporation or the corporation holding the stock to return an exemption on account of that first payment. In other words, it does not enforce double taxation upon these various corporations. Every corporation must pay the tax, and if it is paid once, this act says in effect it shall not from necessity be paid a second time.[25]

Anti-holding company legislators used the words of the bill's sponsors, which had been carefully drawn to avoid constitutional scrutiny after the Supreme Court struck down an income tax in *Pollock*[26] in response to such argument. New York Senator Elihu Root, one of the principal drafters of the corporate excise tax bill, had said earlier in the session that "it is not the profits that would be subject to the tax, but the privilege or facility of transacting the business through corporate form."[27] Jonathan Dolliver, an Insurgent Republican from Iowa, recited that quote and went on to say:

> If, then, this is not an income tax, if it is not a tax on earnings, if it makes no difference where the money comes from that flows into the corporate treasury, on what theory are we, who sit here representing the American people, exempting from the burden of this tax not little corporations, because they can not afford to pay it, but great corporations, many of them grown so great that they trample under foot the laws of the United States, and have in some instances turned our Government itself into a farce through its impotency in dealing with their pretensions?[28]

Clapp echoed Dolliver's argument, noting that because this was an excise tax on the privilege of operating in corporate form, rather than a true income tax where double taxation might be a valid objection, "there can be no reason . . . why a great holding corporation, organized to buy a controlling interest in other corporations, should es-

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23. 44 CONG. REC. 3877 (1909).

24. *Id.* at 4228.

25. *Id.* at 4231.

26. Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601, 635-37 (1895) (noting that the decision striking down the 1894 income tax as unconstitutional would not preclude imposing an excise tax on the privilege of doing business).

27. 44 CONG. REC. 4230 (1909).

28. *Id.*

cape any taxation for the privilege or right of being a corporation and engaging in the business of operating and dominating other corporations."[29] After futile debate between Aldrich and several Insurgent Republicans over the issue, Aldrich announced he was going to accept the amendment in order to move on to the rest of the bill.[30] Proponents of Clapp's proposal to tax intercorporate dividends suspected that Aldrich expected it "to be sacrificed in conference," but Aldrich insisted he would carry forth the views of the majority.[31]

As it turns out, the Insurgent Republicans were right to be suspicious of Aldrich's motives because Clapp's amendment was stricken during conference proceedings.[32] When Representative Sereno Payne, a Standpatter Republican from the holding company-friendly state of New York, reported back to the House regarding the conference proceedings, he was asked why the exemption for intercorporate dividends was reinserted.[33] Payne responded that "[t]here is no reason in the world why a corporation that owns stock in another company should pay a double tax upon those holdings. It is not equitable, it is not right, and it ought not to be exacted. [Applause]."[34] Payne noted:

> When it comes to the breaking up or absorption of a company in order to get rid of competition by another company, I will go to the full length in preventing it; but I am not in favor of using the taxing power for that purpose, and, of course, a tax of 1 per cent would not accomplish any purpose in that respect.[35]

Critics of the growing influence of holding companies assailed the result, declaring that "[t]his exemption of the giant concerns that draw enormous tribute from combinations of lesser companies is regarded by many as the most pernicious feature of the bill."[36]

B. 1913–1921

Notwithstanding the strong repudiation of intercorporate dividend taxation in 1909, the anti-holding company movement described earlier may have ultimately gotten the upper hand because the exemption for intercorporate dividends was not imported from the corporate excise tax when the first post-Sixteenth Amendment income tax was adopted in 1913.[37] Although unpopular among businesses, this was

29. *Id.* at 4228.
30. *Id.* at 4233.
31. *Id.*
32. BLAKEY & BLAKEY, *supra* note 22, at 49.
33. 44 CONG. REC. 4696 (1909).
34. *Id.*
35. *Id.*
36. *Dividend Tax Now in Bill*, LAFOLLETTE'S WKLY. MAG., July 31, 1909, at 14.
37. Revenue Act of 1913, Pub. L. No. 63-16, § II, 38 Stat. 114, 116.

accepted in part because of the low stakes. As Columbia economist Edwin Seligman reported to the American Economic Association's Committee on War Finances, "[t]his was possible, although unjustifiable, when the rate of the income tax was only 1 or 2 per cent."[38]

Once the U.S. entered World War I, the stakes increased and the tax treatment of intercorporate dividends became more intolerable for many businesses. With the corporate income tax rate tripling from 2% in 1913 to 6% in 1917, coupled with a 1916 levy that imposed a tax of fifty cents per $1000 of capital stock outstanding, which disproportionately affected corporate groups, some holding companies even considered reorganizing to lessen their burden.[39] In response, Congress in the War Revenue Act of 1917 adopted a tax credit for the receipt of intercorporate dividends.[40] This credit was merely partial relief, however, because it only covered the 4% surtax imposed under the Revenue Act of 1917 passed earlier in the year, and it did not cover the 2% tax that had been adopted in the 1916 Act. The *Wall Street Journal* noted that the intercorporate dividend tax credit, "commendable as it was, did not go far enough and resulted in much confusion."[41] In 1918, Congress went the final step and permitted corporate shareholders to deduct the full amount of intercorporate dividends from income.[42] Seligman called it "simple justice," with the deduction amounting to a complete exemption of the dividends.[43]

This Congressional focus on the tax treatment of intercorporate dividends was part of a broader review of the taxation of corporate groups. Originally, affiliated corporations were not permitted to file a single, consolidated tax return that combined the profits and losses of each member of the group.[44] All corporations were taxed separately on their own profits and losses, regardless of their common ownership and control. This may have disadvantaged some companies seeking to offset the gains of one member of the corporate group with the losses of another member, but as one businessman later noted, "[T]he rate of income tax on corporations was very slight, and it probably did not make very much difference one way or the other

38. *Seligman Reports on War Finances*, N.Y. TIMES, Dec. 28, 1918, at 14.

39. *See, e.g.*, *New Taxation to Spur Corporate Reorganization*, WALL ST. J., Oct. 21, 1916, at 5 (describing an announcement by Distillers Securities Corporation that it planned to merge all of its subsidiaries into its parent company to reduce its capital stock burden).

40. War Revenue Act of 1917, Pub. L. No. 65-50, § 4, 40 Stat. 300, 302.

41. *Justice to Corporations Begins to Appear*, WALL ST. J., May 14, 1918, at 10.

42. Revenue Act of 1918, Pub. L. No. 65-254, § 234(a)(6), 40 Stat. 1057, 1078 (1919).

43. *Seligman Reports on War Finances*, *supra* note 38, at 14.

44. Walter A. Staub, *Consolidated Returns*, *in* THE FEDERAL INCOME TAX 188 (Robert Murray Haig ed., 1921).

whether there was a consolidated return or a series of returns for the members of one business family."[45]

In 1917, the introduction of excess profits taxation made the separate entity approach more advantageous for some corporate taxpayers, at least with respect to the excess profits tax. Through intercompany charges between affiliated corporations, such as management fees or the price paid for items supplied by one company to the other, a corporate group could manipulate its profits so as to avoid or greatly minimize its exposure to the excess profits tax. Initially, the Treasury issued regulations authorizing the Commissioner of Internal Revenue to require consolidated excess profits tax returns "[w]henever necessary to more equitably determine the invested capital or taxable income."[46] Congress followed up in the Revenue Act of 1918 by requiring consolidated income tax and excess profits tax returns for corporate groups in which at least 95% of the stock of each of the corporations within the group was owned by one or more of the other corporations in the group and a common parent corporation owned at least 95% of the stock of at least one member of the group.[47] This was apparently welcomed by the business community, since even under the Treasury Regulations "most corporations identified themselves as eligible for consolidated filing and filed the consolidated return, probably because the resulting consolidated return reduced their tax."[48] According to one report, 75% of all corporate tax collected in 1917 came from companies voluntarily filing consolidated returns.[49] Thus, although the move to require consolidated returns

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45. *Revenue Revision, 1934: Hearings Before the H. Comm. on Ways & Means*, 73rd Cong. 523 (1934) [hereinafter *1934 House Hearings*] (statement of John G. Buchanan, Armstrong Cork Co.).

46. Regs. 41, Art. 78, T.D. 2694, 20 Treas. Dec. Int. Rev. 294, 321 (1918). The authority for issuing this regulation was somewhat tenuous. One contemporary observer identified the authority as Section 201 of the Act of October 3, 1917, which provided:

> For the purpose of this title every corporation or partnership not exempt under the provisions of this section shall be deemed to be engaged in business, and all the trades and businesses in which it is engaged shall be treated as a single trade or business, and all its income from whatever source derived shall be deemed to be received from such trade or business.

Staub, *supra* note 44, at 189.

47. Revenue Act of 1918, Pub. L. No. 65-254, § 240, 40 Stat. 1057, 1081-82 (1919). Although enacted in 1918, it was made retroactive to 1917. Edward H. Green, *Aspects of the Problem of Income Taxation From the Standpoint of Corporations*, 10 TAXES 441, 443-44 (1932).

48. Jasper L. Cummings, Jr., *Consolidating Foreign Affiliates*, 11 FLA. TAX REV. 143, 172-73 (2011). Although the regulations were only meant to apply to certain groups of companies, the instructions to the excess profits tax return asked whether the return was a consolidated return, which Cummings speculates "may have indicated to taxpayers that filing a consolidated return was at their option." *Id.* at 172.

49. *Internal Revenue: Hearing on H.R. 8245 Before the S. Comm. on Fin.*, 67th Cong. 133 (1921) (statement of Professor T.S. Adams).

was initially prompted by concerns of excess profits tax evasion, the push for consolidated returns more generally was ultimately linked with Congress' move to exempt intercorporate dividends from tax to avoid the punishing effects of the high wartime surtax rates. When the excess profits tax was ended under the Revenue Act of 1921, Congress made consolidated returns optional rather than mandatory,[50] but the exemption for intercorporate dividends remained.

C. 1921–1934

In 1927, dissatisfaction with the consolidated return led the Joint Committee on Internal Revenue Taxation to recommend discontinuing consolidated returns.[51] Prompted by this recommendation, the House voted for the repeal of the privilege in 1928.[52] These moves, however, were primarily based on administrative rather than substantive concerns. Moreover, the Treasury worried that abolishing consolidated returns "would be a practical impossibility in view of the complexity of modern corporate business, and endless confusion in corporation tax administration would result."[53] Ultimately, Congress rejected the repeal option and authorized the Treasury to issue new regulations to clarify the application and operation of the consolidated return.[54]

Consolidated returns had survived, but not for very long. In 1932, Congress once again considered the issue of the propriety of permitting consolidated returns. In the House, Representative Clarence Cannon, a Democrat from Missouri, introduced an amendment to repeal the consolidated return privilege.[55] Rather than simply being a reprise of the administrative concerns that had prompted a similar proposal in the late 1920s, however, this repeal proposal was animated by concern about the evils of affiliated corporate groups such as corporate pyramids.[56]

This focus on the evils of corporate pyramids and other affiliated organizational structures reflected a growing concern that these practices had played a central role during the 1920s in crowding out small competitors and concentrating wealth and power in the hands of a few.[57] The principal feature of the pyramidal structure was that

50. Revenue Act of 1921, Pub. L. No 67-98, §§ 240(a), 301, 42 Stat. 227, 260, 272.

51. Cummings, *supra* note 48, at 177-78.

52. *Id.*

53. *Senate to Decide Fate of Tax Bill*, WALL ST. J., Dec. 21, 1927, at 18.

54. Roy G. Blakey, *The Revenue Act of 1928*, 18 AM. ECON. REV. 429, 435-36 (1928); Robert N. Miller, *The Taxation of Intercompany Income*, 7 LAW & CONTEMP. PROBS. 301, 306 (1940).

55. *See, e.g.*, 75 CONG. REC. 7124 (1932) (statement of Rep. Cannon).

56. *See infra* text accompanying notes 61-62.

57. *See, e.g.*, FREDERICK LEWIS ALLEN, THE LORDS OF CREATION 248 (1935) ("[I]f it

the owners could use a small investment to exert control over a vast empire.[58] In 1932, at the same time Congress was considering whether the use of consolidated returns was appropriate, Adolf Berle and Gardiner Means published their landmark work, *The Modern Corporation and Private Property*.[59] In this work, they explained that "[t]he owner of a majority of the stock of the company at the apex of a pyramid can have almost as complete control of the entire property as a sole owner even though his ownership interest is less than one per cent of the whole."[60] One prominent example of this was the Van Swearingen brothers, who accumulated control of railroad corporations throughout the 1920s via investments by their Allegheny Corporation holding company.[61] According to Berle and Means, "[b]y this pyramid an investment of less than twenty million dollars has been able to control eight Class I railroads having combined assets of over two billion dollars."[62] The presence of corporate pyramids was particularly pronounced in the public utility sector. One contemporary study of the period concluded that "[s]o great was the importance of pyramiding holding companies in the utilities industries in the decade from 1920 to 1930 that the terms 'holding company' and 'public utility company' became synonymous in the public mind."[63]

In the presidential campaign of 1932, Roosevelt promised to seek "[r]egulation and control of holding companies by Federal [P]ower [C]ommission and the same publicity with regard to such holding companies as provided for the operating companies."[64] Roosevelt declared that the failure of

> [t]he great Insull monstrosity, made up of a group of holding and investing companies and exercising control over hundreds of operating companies . . . has opened our eyes. It shows us that the development of these financial monstrosities was such as to compel

had not been for the lavish use of this logical extension of the holding-company device, many of the giants of the economic world would never have got their growth.").

58. Investors at the top of the pyramid used a variety of means to maintain control, including cascading holdings of bare majority ownerships, thin capitalization (with funds provided by preferred stock and debt), and multiple classes of stock (some of which are nonvoting). *See* JAMES C. BONBRIGHT & GARDINER C. MEANS, THE HOLDING COMPANY: ITS PUBLIC SIGNIFICANCE AND ITS REGULATION 147-48 (1932); WILLIAM Z. RIPLEY, MAIN STREET AND WALL STREET 317 (1927).

59. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

60. *Id.* at 73.

61. *See id.* at 23; BONBRIGHT & MEANS, *supra* note 58, at 256, 259; RICHARD SAUNDERS, JR., MERGING LINES: AMERICAN RAILROADS 1900–1970, at 64 (2001).

62. BERLE & MEANS, *supra* note 59, at 73.

63. CHARLES S. TIPPETTS & SHAW LIVERMORE, BUSINESS ORGANIZATION AND PUBLIC CONTROL 184 (2d ed. 1941).

64. *Text of Governor Roosevelt's Speech at Portland, Oregon, on Public Utilities*, N.Y. TIMES, Sept. 22, 1932, at 16.

> ultimate ruin, that practices had been indulged in that suggest the old days of railroad wild-catting, that private manipulation had outsmarted the slow-moving power of government.[65]

The concern was that the consolidated return helped facilitate anticompetitive behavior by holding companies. According to Representative Cannon, the consolidated return "penalizes David and assists Goliath."[66] Cannon went on to note that the consolidated return

> is a favorite device of the utilities. An electric company or telephone branch or transportation company pays little attention to the cost of installing new services. A railroad company can run a bus line at a loss, a streetcar company can operate a line of taxicabs, or a power company can preempt a new community at a loss. Through the benevolent provisions of this law they charge these losses against their profits elsewhere and reduce their taxes while destroying competition and monopolizing the market.[67]

Contemporary observers called the question of whether to repeal or severely tax consolidated returns "[o]ne of the hardest fought contests" during deliberations over the Revenue Act of 1932.[68] Acknowledging that "[t]he House is divided on this proposition," Representative Charles Robert Crisp, a Democrat from Georgia, successfully persuaded his colleagues to adopt a compromise proposal to subject corporate groups to an additional 1.5% tax for the privilege of filing a consolidated return.[69] At the urging of Andrew Mellon's replacement, Treasury Secretary Ogden Mills,[70] the Senate Finance Committee removed the penalty tax in the bill it reported on the Senate floor,[71] but a compromise was reached in conference. Congress elected to subject corporate groups filing consolidated returns to an additional three-fourths of 1% tax for the privilege of filing such a return in 1932 and 1933, and 1% in 1934 and 1935.[72] Supporters of repeal consoled themselves by noting that a penalty provision would test whether supporters of consolidated returns were correct as to their benefits. As House Speaker John Nance Garner—an advocate for repeal in 1928 and reportedly the behind-the-scenes leader of the 1932

65. James A. Hagerty, *Portland Cheers Speech: The Governor Cites 'Insull Monstrosity' as He Hits 'Interests,'* N.Y. TIMES, Sept. 22, 1932, at 1.

66. 75 CONG. REC. 7125 (1932).

67. *Id.*

68. Roy. G. Blakey & Gladys C. Blakey, *The Revenue Act of 1932*, 22 AM. ECON. REV. 620, 625 (1932).

69. 75 CONG. REC. 7126 (1932) (statement of Rep. Crisp).

70. *Text of Secretary Mills's Statement to Senate Finance Committee on Tax Bill*, N.Y. TIMES, Apr. 7, 1932, at 20.

71. Blakey & Blakey, *supra* note 68, at 631; *House's Rates Increased*, N.Y. TIMES, Apr. 28, 1932, at 1; *Tax Bill Completed; Revised Throughout on Mills's Pattern*, N.Y. TIMES, May 7, 1932, at 1.

72. BLAKEY & BLAKEY, *supra* note 22, at 345.

repeal effort[73]—noted, "[i]f it is advantageous to them to file such returns they will pay the penalty. If there is no advantage in consolidated and affiliated returns, they will submit separate returns."[74] Thus, as part of a general increase in the corporate income tax rate from 12% to 13.75%, the rate for affiliated corporations filing a consolidated return was increased to 14.5% for 1932 and 1933.[75]

In 1933, the consolidated return issue was revisited. A subcommittee of the Ways and Means Committee issued a report on the prevention of tax avoidance in which it revived the earlier proposals of the Joint Committee on Taxation and the Ways and Means Committee to repeal the consolidated return.[76] According to the report, the primary impetus for addressing the consolidated return was the repeal under the National Industrial Recovery Act of the ability to carry forward net operating losses from one year to the next. The Subcommittee noted:

> In the past, when any corporation could carry forward a net loss from one year to another, the consolidated group did not have such a great advantage over the separate corporation. Now that this net-loss carry-over has been denied, the advantage of the consolidated return is much greater on a comparative basis.[77]

Commentators immediately assailed this recommendation as imprudent and unfairly penalizing most businesses for the abuses of a few. Godfrey Nelson of the *New York Times* noted that "[e]xisting law in respect of the filing of consolidated returns by affiliated corporations is amply justified on the ground of sound business practice and should be retained."[78] In hearings held before the House Ways and Means Committee in the aftermath of the subcommittee report, a representative from the Standard Oil Company of New Jersey testified that

> [t]here may be arbitrary allocations in consolidated groups to produce that result [of consistent loss offsets], but there are many other types of consolidations, natural vertical set-ups, as in our case, where there is every reason to have separate corporations for

73. *Garner Will Take Floor Today to Lead Fight for Tax Bill*, N.Y. TIMES, Mar. 29, 1932, at 1. In the debates over the 1928 Act, Garner also proposed a graduated corporate income tax rate scheme. *Senate to Decide Fate of Tax Bill*, *supra* note 53 (describing the graduated tax on corporations as "the brain-child" of Representative Garner). *See* Barbara Deckard Sinclair, *Party Realignment and the Transformation of the Political Agenda: The House of Representatives, 1925-1938*, 71 AM. POL. SCI. REV. 940, 943 (1977).

74. 75 CONG. REC. 7127 (1932).

75. Blakey & Blakey, *supra* note 68, at 622.

76. SUBCOMM. ON TAX REVISION, COMM. ON WAYS & MEANS, 73D CONG., PREVENTION OF TAX AVOIDANCE 10 (Comm. Print 1933).

77. *Id.*

78. Godfrey N. Nelson, *Consolidated Tax Held as Sound Plan*, N.Y. TIMES, Dec. 24, 1933, at N5.

> certain operations . . . , and it is not a case of taxation, because they would continue to exist regardless of the tax penalty, and do exist regardless of any tax penalty.[79]

Railroad representatives were particularly insistent that their business model was necessary, in no small part because of state and federal limits on consolidation.[80] Ben Dey, the general counsel of the Southern Pacific Co., a railroad company that both operated and owned the stock of sixty subsidiaries, urged

> that if the full committee approves the recommendation of the subcommittee I say to you in all fairness and on behalf of these railroad systems in the United States, only five or six of whom are making their way or are not on the verge of bankruptcy, that you should make an exception with respect to the parent company if it is engaged in interstate commerce as a common carrier, that it may come in and make a consolidated return for itself and its subsidiaries.[81]

Dey concluded that "it is impossible to put the railroads under this proposal without committing a terrific public crime. They simply cannot stand it."[82]

Although the Ways and Means Committee ended up only proposing an increased penalty tax for consolidated returns, repeal was again proposed in the Senate. Seeking to "strike at the holding company system," Progressive Senator William Borah introduced amendments to deny corporate groups the right to file consolidated returns and to deny any deduction for intercorporate dividends.[83] The proposal to repeal consolidated returns passed the Senate by a vote of forty to thirty-seven, albeit with an exception for railroad corporations, but the denial of the dividends received deduction was defeated by a vote of thirty-nine to thirty-three.[84]

The result was that the law was left in a bit of a muddle. Barring consolidated returns arguably did reduce one advantage of utilizing a holding company structure by denying a corporation the right to offset its gains from one subsidiary with the losses of another subsidiary.[85] By preserving the dividends received deduction, however,

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79. *1934 House Hearings*, *supra* note 45, at 518 (statement of M.E. McDowell, Standard Oil Co. of New Jersey).

80. *See, e.g.*, *id.* at 503-04 (statement of Jacob Aronson of the New York Central Lines) (arguing that the 1920 Transportation Act limited the ability of railroads to consolidate all of their lines and operations in a single corporation).

81. *Id.* at 484 (statement of Ben C. Dey, General Counsel, Southern Pacific Co.).

82. *Id.* at 486.

83. *Tax Bill Changes Offered by Borah*, N.Y. TIMES, Mar. 2, 1934, at 38.

84. *See Estate Tax Levy Raised $92,000,000 by Senate, 65 to 14*, N.Y. TIMES, Apr. 13, 1934, at 1.

85. *But see* Godfrey N. Nelson, *Corporations Hit by New Tax Policy*, N.Y. TIMES, May 6, 1934, at N9 ("Either because of misunderstanding or by reason of a superficial

holding companies could still pass income through multiple tiers without recognizing additional layers of taxation. Moreover, for those seeking to attack the Van Swearingen-style corporate pyramid, an intercorporate dividends tax was far more likely to be important because of the absence of a 95% control requirement as that which existed for consolidated returns. The seeming inconsistency would soon be resolved.

D. 1935–1936

On June 19, 1935, Roosevelt delivered a special Tax Message to Congress.[86] Right from the start of his message, it became clear that his focus was less about revenue and more about using tax to remedy certain perceived economic ills. According to Roosevelt,

> if a government is to be prudent its taxes must produce ample revenues without discouraging enterprise; and if it is to be just it must distribute the burden of taxes equitably. I do not believe that our present system of taxation completely meets this test. Our revenue laws have operated in many ways to the unfair advantage of the few, and they have done little to prevent an unjust concentration of wealth and economic power.[87]

After justifying a graduated corporate income tax rate scheme as one means of addressing the inequities of the concentration of wealth, Roosevelt went on to revive the tax on intercorporate dividends that had been defeated in 1934. He contended that it would serve as an anti-abuse measure for the graduated rates:

> Provision should, of course, be made to prevent evasion of such graduated tax on corporate incomes through the device of numerous subsidiaries or affiliates, each of which might technically qualify as a small concern even though all were in fact operated as a single organization. The most effective method of preventing such evasions would be a tax on dividends received by corporations.[88]

Business groups swiftly responded to the President's tax message and the proposals for reforming corporate taxation. In a report issued one month later, the Committee on Federal Finance of the U.S. Chamber of Commerce concluded, "The purpose of the proposed taxes is obviously to break up large organizations and to compel business

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knowledge of the practical use and operation of the consolidated return, this form of accounting has been erroneously associated with the freely denounced holding company or condemned as a device for the promotion of top-heavy capitalizations.").

86. Franklin D. Roosevelt, *Message to Congress on Tax Revision*, AM. PRESIDENCY PROJECT (June 19, 1935), http:www.presidency.ucsb.edu/ws/?pid=15088.

87. *Id.*

88. *Id.*

to conduct its activities by means of relatively small units."[89] Similarly, the National Industrial Conference Board observed that "[t]he Administration desires a program of taxation, the effect of which is primarily to tax or penalize size or bigness, wherever and in whatever form it may be found."[90]

During the hearings over the ensuing bill, businesses assailed any notion that the intercorporate dividends tax could be defended as a revenue or anti-abuse provision. Fred Clausen, Chairman of the Committee on Federal Finance for the United States Chamber of Commerce, pointed out that the maximum the proposed tax could possibly hope to raise at the 85% exemption rate would be $39.7 million, but even that assumed all dividends were taxed regardless of whether the corporation receiving it had any net income aside from the dividend.[91] At a 90% exemption, it effectively amounted to a 1.5% tax on dividends received.[92] Ellsworth Alvord, also of the U.S. Chamber of Commerce, added that "I do not know of anyone who admits that an intercompany dividend tax is sound. . . . [E]ven as a safeguard [against abuse of the graduated corporate tax rates] it is not necessary."[93] Alvord explained that "the hazards—the plain business financial hazards—of busting up a large corporation into a large number of subsidiaries far outweigh the gains which might be made by a saving in the graduated tax."[94]

O.G. Saxon, a Professor of Business Administration at Yale, was also dubious of the anti-abuse rationale, testifying that "[t]he President's objective of preventing evasion of the graduated tax could be obtained by requiring consolidated returns or some similar method."[95] Moreover, Saxon added that "[t]he proposal that dividends to corporations on shares of other corporations owned by them be taxed in order to avoid evasion through subsidiary or holding companies is so clearly discriminatory against investors in corporations and particularly in large corporations as to require little discussion."[96] Saxon predicted that "[i]t would have a deflationary effect on the stocks owned, for large-scale liquidation would likely ensue. Furthermore,

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89. COMM. ON FED. FIN., CHAMBER OF COMMERCE OF THE U.S., FEDERAL TAXATION: THE SUGGESTIONS IN THE PRESIDENT'S TAX MESSAGE 17 (1935).

90. NAT'L INDUS. CONFERENCE BD., THE NEW FEDERAL TAX PROPOSALS 29 (1935).

91. *Proposed Taxation of Individual and Corporate Incomes, Inheritances and Gifts: Hearing Before the H. Comm. on Ways & Means*, 74th Cong. 258-59 (1935) [hereinafter *1935 House Hearings*].

92. MARK H. LEFF, THE LIMITS OF SYMBOLIC REFORM: THE NEW DEAL AND TAXATION, 1933-1939, at 143 (1984).

93. *Revenue Act of 1935: Hearing on H.R. 8974 Before the S. Comm. on Fin.*, 74th Cong. 339-40 (1935).

94. *Id.* at 340.

95. *1935 House Hearings*, *supra* note 91, at 243.

96. *Id.*

there is no occasion for such a provision. The revenue yield would be comparatively small and there is adequate control today of stock ownership in competing corporations through the Clayton Act."[97]

Given the weakness of the tax evasion rationale for the intercorporate dividends tax proposal, it is not surprising that Treasury officials paid mere lip service to it and instead focused on the role the non-taxation of intercorporate dividends played in contributing to the growth of corporate pyramids. Robert Jackson, Counsel for the Bureau of Internal Revenue and a future Supreme Court Justice, noted that even outside of the economic and fairness concerns about pyramidal structures, "their effect on the revenue system is demoralizing and destructive of good administration."[98] According to Jackson:

> Tax law has for some years encouraged and almost subsidized the growth of these systems. Stocks of our domestic corporations, when held by parent corporations, have had almost the same status as to the tax exempt privilege that the Government has given to its own securities. There was a distinct incentive to corporations to acquire investments in other corporations, and once acquiring investments, there were, of course, the usual incentives to acquire control.[99]

Jackson argued that taxing intercorporate dividends would aid in the assault against corporate pyramids that had already begun with the withdrawal of the consolidated return privilege. He indicated that it "would be desirable as a means of encouraging the simplification of corporate structures. Intercorporate dividends are largely unnecessary transfers brought about and multiplied by complex corporate structures."[100] Jackson explicitly situated the intercorporate dividends tax in the broader campaign against corporate pyramids that started with the repeal of consolidated returns for most companies:

> Up until last year the Federal Government had done little or nothing to discourage such needless complexities. Last year a definite step was taken in this direction by the abolition of consolidated returns. The partial elimination of the exemption allowed intercorporate dividends would be a further step in this direction and would have the effect of discouraging the multiplication of intermediate holding companies and of encouraging the creation and maintenance of straight-forward capital structures that can be understood by the average investor and public official.[101]

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97. *Id.*

98. ROBERT H. JACKSON, TREASURY DEP'T, MEMORANDUM AS TO GRADUATED CORPORATION INCOME TAX AND INTERCORPORATE DIVIDEND TAX 30 (1935), *available at* http://archive.org/stream/memorandumastogr00jack#page/n5/mode/2up.

99. *Id.* at 33.

100. *Id.* at 34.

101. *Id.* at 35.

Even the revenue estimates looked better when the intercorporate dividends tax was viewed as an attack on multitiered corporate structures. In the context of a corporate pyramid, for instance, the effective rate might rise if a multitiered corporation actually distributed a dividend up several steps in the chain. According to one estimate, "the tax on intercorporate dividends would vary from 1½ per cent to 2⅝ per cent, if the tax applied to 15 per cent of such dividends. . . . In the case of pyramided complex holding companies, such taxes might amount to 8 or 10 per cent."[102] In specific cases, the tax burden of the intercorporate dividends tax on corporate pyramids might be even higher:

> In the case of one large public utility holding company with many subsidiaries, which the Treasury took for illustrative purposes, it was estimated that this tax would have amounted to 12 cents per share in 1930; in the case of a certain large industrial company with many subsidiaries, 5 cents a share in the same year.[103]

Not only was the intercorporate dividends tax consistent with the campaign against corporate pyramids, but it derived from a tax proposal that had been explicitly considered during the debates earlier in 1935 over the Public Holding Company Act.[104] In the House Committee on Interstate and Foreign Commerce, Representative Samuel Pettengill, a Democrat from Indiana, had proposed an explicit 2% tax on intercorporate dividends,[105] which he explained during the House hearings over the Revenue Act of 1935 as the equivalent of an exemption of 85% on dividends at a time when the corporate rate was 13.75%.[106] Pettengill later explained that he understood the Interstate and Foreign Commerce Committee lacked jurisdiction to consider a tax, but "it was our way of getting it to the attention of the committee, with the thought of later bringing it to the attention of the Committee on Ways and Means."[107] Economist Walter M.W. Splawn, special counsel to the Committee on Interstate and Foreign Commerce, had testified to that Committee that "[t]he most effective means of preventing pyramiding is to eliminate the so-called intermediary companies interposed between the operating company and the company at the top. Heretofore these intermediary companies have, in effect, been subsidized by the Federal Government

102. Roy G. Blakey & Gladys C. Blakey, *The Revenue Act of 1935*, 25 AM. ECON. REV. 673, 684 (1935).

103. *Id.*

104. At least one witness in the House Hearings for the tax bill makes reference to this. *See 1935 House Hearings*, *supra* note 91, at 327 (statement of Rep. Samuel B. Pettengill).

105. *See Public Utility Holding Companies: Hearing on H.R. 5423 Before the H. Comm. on Interstate & Foreign Commerce*, 74th Cong. 2214 (1935).

106. *1935 House Hearings*, *supra* note 91, at 329.

107. *Id.* at 328.

through exemption from taxes of dividends on their stock."[108] Splawn recommended that "[i]nstead of giving Government encouragement to intermediate holding companies through exemption from taxation, those companies should be required to pay taxes as though they were not tied in through stock ownership with a number of other corporations."[109]

Months before Roosevelt delivered his 1935 tax message proposing the intercorporate dividends tax as a means of stemming evasion of the graduated rate scheme, he had endorsed an anti-holding company proposal similar to Pettengill's for taxing intercorporate dividends. In January of 1935, Representative Sam Rayburn of Texas reportedly received White House support and approval for a proposed bill that would regulate and subject public utility holding companies to a penalty tax not unlike the one imposed on consolidated returns prior to 1934.[110] The prediction was that "the tax finally decided on will be such as to permit holding companies which have not weakened their structures through pyramiding to exist, while the public will be protected largely through the regulation, which will be of a character to prevent the rise of new holding companies."[111] Although the Public Utility Holding Company Act adopted later in 1935 substituted a total ban for the proposed tax penalty, the Administration remained committed to using taxes more generally as a check against corporate structures deemed to be abusive. Roosevelt merely made a strategic decision to subordinate the intercorporate dividends tax to the graduated corporate income tax rate proposal as part of an effort to simplify matters for the public by focusing primarily on the "unhealthy and mischievous concentrations of wealth."[112] Nevertheless, the connection between intercorporate dividend taxation and the assault on pyramids was already publicly established.

Moreover, there is evidence that Roosevelt was well aware of the connection between the intercorporate dividends tax and corporate pyramids when he made his proposal in 1935. In the President's Secretary's notes, which contain documents that the White House considered important and confidential, there is a memorandum titled "Intercorporate Dividend Tax."[113] The memorandum, which may have come from Treasury Secretary Henry Morgenthau, explained that

108. *Id.* at 328 (quoting Dr. Splawn in House Report 827, pt. 2, at 7).

109. *Id.*

110. *White House Backs Holding Unit Taxes*, N.Y. TIMES, Jan. 23, 1935, at 25.

111. *Id.*

112. LEFF, *supra* note 92, at 136 (quoting a letter from Felix Frankfurter to Roosevelt).

113. Intercorporate Dividend Tax, *in* Franklin D. Roosevelt, Papers as President: The President's Secretary's File (PSF), 1933-1945, Box 186 – Taxes, at 5 (undated 1935) (on file with the Franklin D. Roosevelt Presidential Library and Museum), *available at* http://www.fdrlibrary.marist.edu/_resources/images/psf/psfc0129.pdf.

"[t]here has not yet been incorporated in the new tax bill the principle, originated in the tax legislation of last year, of taxing intercorporate dividends so as to discourage holding companies. . . . An amendment to effect this tax has been carefully drafted in the Department of Justice and is ready for presentation to the Ways and Means Committee by [Robert] Jackson."[114]

Business leaders assailed this use of the intercorporate dividends tax as part of the campaign against corporate pyramids that began with the repeal of consolidated returns. Fred Clausen of the U.S. Chamber of Commerce noted that if the intercorporate dividends tax was aimed at breaking up holding companies, it was overinclusive in its application. As Clausen explained, "the proposal is not limited to taxing the dividends received by a corporation owning most of . . . the stock of another but applies to any holding of stock, no matter how small in percentage."[115]

Business arguments apparently prevailed in the House, which excluded the President's suggestion for an intercorporate dividends tax from its bill.[116] The House did indicate a willingness to consider the measure in a separate bill aimed at "discouraging chains of holding companies,"[117] however, suggesting that the majority wanted the proposal to be stripped of its thin façade as a tax evasion measure and discussed in its true context. Nevertheless, the intercorporate dividends tax was reinserted in the Senate bill in the form of an 85% dividends received deduction.[118] In Conference proceedings, the House agreed to accept the principle of intercorporate dividends taxation as part of the tax bill, but it successfully reduced the amount of the dividend subject to tax from the 15% proposed in the Senate to 10%.[119]

The following year, the question of intercorporate dividends taxation was again on the agenda as part of the consideration of the Revenue Act of 1936. Although much of Congressional attention was focused on a radical proposal to subject undistributed corporate profits to a penalty tax,[120] the bill reported out by the Ways and Means Committee to the House contained a provision that would eliminate the dividends received deduction altogether.[121] Ultimately, Congress

114. *Id.*

115. *1935 House Hearings*, *supra* note 91, at 258.

116. Blakey & Blakey, *supra* note 102, at 685.

117. *Id.*

118. *Id.*

119. BLAKEY & BLAKEY, *supra* note 22, at 381.

120. *See* Steven A. Bank, *Corporate Managers, Agency Costs, and the Rise of Double Taxation*, 44 WM. & MARY L. REV. 167, 170, 204 (2002).

121. Miller, *supra* note 54, at 303.

reduced the deduction from 90% to 85%, but it was changed from a deduction to a credit.[122]

III. EVOLUTION

Although the intercorporate dividends tax was not significant enough to actually disrupt corporate structures, it continued to loom large for both proponents and detractors in the years that followed. As Ellis Hawley observed, "the advocates of decentralization regarded the act as an opening wedge. The small tax on intercorporate dividends might someday evolve into a weapon that would eliminate useless and monopolistic holding companies."[123] This is precisely what worried opponents. A tax agent for Sears, Roebuck & Co. noted during a discussion of the issue at the 1938 Annual Meeting of the National Tax Association that

> [i]ntercorporate holdings will not be disposed of because of a tax of 2½% on the intercorporate dividends, if the investment is profitable. Therefore, in order to accomplish its stated purpose of forcing the discontinuance of intercorporate holdings, the government will be forced to increase the rates. It clearly follows that the trend of this kind of legislation leads directly to punitive measures, and regulation.[124]

As it turned out, this concern that the tax would continue to loom large was accurate, even if the prediction of increasing rates was not. In 1937, Robert Jackson declared that the tax had already succeeded in breaking up some holding companies, and he predicted that an increase in the tax would finish the job.

> [T]he privilege of paying dividends profits free of tax from one corporation to another, operated as a subsidy for the holding companies, one of the most favored forms of creating and operating monopoly. The recent repeal of this privilege and the substitution of an intercorporate dividend tax has already proved highly effective in dissolving holding companies, and undoubtedly an increase in that tax would prove an automatic discouragement of that particular type of antitrust violations.[125]

Roosevelt joined Jackson in advocating an increase in the intercorporate dividend taxation as a means of addressing anticompetitive behavior. In his 1938 Message to Congress regarding the Temporary

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122. *Id.*

123. ELLIS W. HAWLEY, THE NEW DEAL AND THE PROBLEM OF MONOPOLY 350 (1966).

124. A.R. Kaiser, NATIONAL TAX ASS'N, *Discussion of the Taxation of Intercorporate Dividends*, *in* PROCEEDINGS OF THE THIRTY-FIRST ANNUAL CONFERENCE ON TAXATION 439, 443 (W.G. Query ed., 1939).

125. Robert H. Jackson, Address, *The Struggle Against Monopoly*, 1937 GA. B.A. REP. 203, 206, *available at* http://www.roberthjackson.org/files/theman/speeches-articles/files/the-struggle-against-monopoly.pdf (last visited Jan. 30, 2014).

National Economic Committee, Roosevelt noted that "[t]ax policies should be devised to give affirmative encouragement to competitive enterprise," including "increasing the intercorporate dividend tax to discourage holding companies."[126]

Opponents tried to limit the application of the tax, but to no avail. In 1937, for example, the Twentieth Century Fund's Committee on Taxation proposed a version of the intercorporate dividends tax that was more narrowly tailored to discouraging corporate pyramids:

> The pyramiding of two or more holding companies is rarely necessary for operating purposes, and it facilitates manipulation. Accordingly, the corporation income tax might distinguish between the first intercorporate payment of dividends, and the second and subsequent intercorporate payment of dividends. That is, dividends paid to a holding company by the operating company would be exempt or taxed at a lower rate than dividends paid by one holding company to another. Such a tax would strongly discourage the pyramiding of holding companies and would discourage single holding companies only slightly—if at all.[127]

This proposal, however, fell on deaf ears. In 1939, business lobbyists successfully targeted many aspects of the New Deal tax program for repeal or revision, but it fell short in securing a reduction in the tax on intercorporate dividends.[128]

The beginning of the end for intercorporate dividend taxation as a means of attacking corporate pyramids came when the ban on consolidated returns was eased in 1942 and a 2% penalty tax similar to the one in place between 1932 and 1934 was revived.[129] Much like in 1917, this came on the heels of the adoption of an excess profits tax with the accompanying concerns about the need for consolidated returns to prevent profit shifting. Contemporary scholars had always viewed the ban on consolidated returns and the taxation of intercorporate dividends to be inextricably linked as policies against corporate pyramids. In 1940, Gerhard Colm, an economics professor and fiscal expert for the U.S. Department of Commerce, wrote that "[i]ntercorporate stockholdings have been used as a means for controlling corporations without necessarily involving full financial responsibility for the controlled corporations. Consolidated balance

126. FRANKLIN D. ROOSEVELT, MESSAGE FROM THE PRESIDENT OF THE UNITED STATES TRANSMITTING RECOMMENDATIONS RELATIVE TO THE STRENGTHENING AND ENFORCEMENT OF ANTI-TRUST LAWS, S. DOC. NO. 75-173, at 9 (3d Sess. 1938).

127. COMM. ON TAXATION OF THE TWENTIETH CENTURY FUND, INC., FACING THE TAX PROBLEM: A SURVEY OF TAXATION IN THE UNITED STATES AND A PROGRAM FOR THE FUTURE 182 (1937).

128. LEFF, *supra* note 92, at 273.

129. *See* Maimone & Riley, *supra* note 4, at 782. Consolidated returns were actually permitted again starting with the Revenue Act of 1940, but only for purposes of the excess profits tax. Mundstock, *supra* note 4, at 10.

sheets and tax exemption for intercorporate dividends permit free use of this device."[130] As a consequence, even before the ban on consolidated returns was lifted, one practitioner pointed out that reviving the consolidated return would make the intercorporate dividend tax incoherent: "if provision for consolidated returns of affiliated corporations should be restored to our taxation system, intercompany dividends *within an affiliated group* would be eliminated from tax consideration along with other intercompany transactions . . . ."[131] With consolidated returns once again permitted, this meant that intercorporate dividends between corporations affiliated by 95% stock ownership were completely exempt (beyond the 2% tax for the privilege of filing the return), while intercorporate dividends to stockholders owning less than 95% of the stock were only 85% exempt.

In 1964, the additional 2% penalty tax on consolidated returns was repealed, and consolidated returns once again became fully available.[132] This was part of a broader program to aid small business. Under the Small Business Investment Act of 1958, dividends received by small business investment companies were made 100% exempt.[133] In his 1963 tax message, President John F. Kennedy announced a proposal to further advance this policy.[134] Under the existing scheme, corporations were subject to a total rate of 52%, consisting of a 30% normal rate and a 22% surtax rate on earnings in excess of $25,000. Kennedy proposed to "flip" the normal and surtax rate, so that the first $25,000 of taxable corporate earnings—"the entire earnings of almost half a million small corporations" according to Kennedy—would realize a 27% rate reduction, while total taxes applicable to larger corporations would not change.[135] There was concern, however, that the benefit of the lower normal rate and the exemption from the higher surtax rate for the first $25,000 in income would not be confined to small businesses.[136] Large corporations already took advantage of the $25,000 surtax exemption by spreading their in-

130. Gerhard Colm, *Conflicting Theories of Corporate Income Taxation*, 7 LAW & CONTEMP. PROBS. 281, 288 (1940).

131. Miller, *supra* note 54, at 304.

132. Revenue Act of 1964, Pub. L. No. 88-272, § 234(a), 78 Stat. 19, 113 (1964).

133. Emanuel S. Burstein, *The Idiosyncratic Consequences of the Limits in Section 246(b) on the Dividends Received Deduction*, 13 TAX NOTES 1019, 1021 (1981). For more background on small business investment companies, see Mirit Eyal-Cohen, *Why Is Small Business the Chief Business of Congress?*, 43 RUTGERS L.J. 1 (2012).

134. John F. Kennedy, *Special Message to the Congress on Tax Reduction and Reform*, AM. PRESIDENCY PROJECT (Jan. 24, 1963), http:www.presidency.ucsb.edu/ws/?pid=15088.

135. *Id.* In 1964, he proposed that the surtax rate "be reduced to 28%, thereby lowering the combined corporate rate [from 52%] to 50%," and in 1965, the surtax and total rate would be reduced further. *Id.*

136. *See* Sheldon S. Cohen, *Election of Tax Free Intercorporate Dividends Under the Revenue Act of 1964*, 6 WM. & MARY L. REV. 167, 169 (1965).

come among multiple subsidiaries. The flipping of the normal and surtax rates, with the result that the surtax rate was much higher, only increased the incentive for abuse. Kennedy therefore explained that "[s]ince the $25,000 surtax exemption and the new 22% normal rate are designed to stimulate small business, this reduction should be accompanied by action designed to eliminate the advantage of the multiple surtax exemptions now available to large enterprises operating through a chain of separately incorporated units."[137] He proposed limiting affiliated corporate groups with 80% common control to one surtax exemption, which would effectively treat them as a single entity.[138] As enacted, multiple surtax exemptions were permitted, but at a cost of a 6% penalty, increasing the normal rate from 22% to 28% in these instances.[139] In return, the 2% penalty on consolidated returns was removed. As Kennedy explained, "if affiliated corporations are treated as an entity for the surtax exemption and other purposes, they should be permitted to obtain the advantages of filing consolidated returns without incurring the present tax of 2% on the net income of all corporations filing such returns."[140]

Much like the shift in attitude toward the consolidated return, Congress shifted from taxing intercorporate dividends under an anti-avoidance and anti-holding company rationale to permitting a more liberal dividends received deduction under an enterprise rationale, premised on the notion that the income was earned by a single enterprise.[141] Thus, at the same time that the penalty tax was dropped from the consolidated return, Congress de-linked the 100% dividends received deduction from the filing of a consolidated return, making it an elective stand-alone provision.[142] As enacted, the provision permitted corporations to receive dividends tax-free from a member of the same affiliated group, which was defined to include an 80% owned subsidiary.[143] In theory, this equalized the treatment of intercorpo-

137. Kennedy, *supra* note 134.

138. *Id.*

139. Revenue Act of 1964, Pub. L. No. 88-272, § 235(b), 78 Stat. 19, 125 (1964); Thomas D. Terry, Attorney, Internal Revenue Service, Panel Discussion on Certain Problem Areas Under the Revenue Act of 1964 at the William & Mary Annual Tax Conference 83-84 (1964), *available at* http://scholarship.law.wm.edu/cgi/viewcontent.cgi?article=1646&context=tax. For all affiliated groups but those with aggregate incomes close to $25,000, it was more advantageous to elect to incur the penalty in order to take multiple surtax exemptions. Charles L.B. Lowndes, *The Revenue Act of 1964: A Critical Analysis*, 1964 DUKE L.J. 667, 678.

140. Kennedy, *supra* note 134.

141. *See* ANTONY TING, THE TAXATION OF CORPORATE GROUPS UNDER CONSOLIDATION 71-72 (2013). There was some legislation designed to address abuse of the dividends received deduction itself, but the focus on the perceived corporate governance abuse of the pyramidal structure had disappeared. *See* Mundstock, *supra* note 4, at 13-16.

142. *See* Mundstock, *supra* note 4, at 13-14.

143. *Id.*; Revenue Act of 1964, Pub. L. No. 88-272, § 214(a), 78 Stat. 19, 52 (1964) (en-

rate dividends for separate filers and consolidated return filers. In practice, however, the price for making such an election for separate filers was high and roughly equivalent to, or higher than, the costs of filing a consolidated return itself.[144] This led at least one contemporary observer to predict that "[i]t provides for an election to claim the 100% deduction, but the price in terms of disadvantages which must be accepted is so high that it is doubtful whether the provision will be used to any substantial extent."[145] Nevertheless, the move paved the way for the modern dividends received deduction that is scaled according to size of ownership percentage. Corporations owning 80% or more of another corporation were eligible for the 100% dividends received deduction, while corporations owning less than 80% of another corporation were eligible for the pre-1964 Act deduction of 85%.[146]

In the Tax Reform Act of 1986 and the Omnibus Budget Reconciliation Act of 1987, Congress put the finishing touches on the modern scheme. In 1986, the general intercorporate dividends received deduction was reduced from 85% to 80% for corporations that owned less than 80% of a subsidiary.[147] As both the House Ways and Means and Senate Finance Committee reports to the 1986 Act explained, the rationale for this change was that it was necessitated by the broader changes in tax rates under the 1986 Act.[148] Prior to 1986, the top corporate rate was 46%, and corporations eligible for the 85% dividends received deduction (i.e., those owning less than 80% of the shares of the subsidiary paying the dividend) were therefore subject to an effective rate of 6.9% (15% of the dividend subject to a 46% rate).[149] In the 1986 Act, the top rate was lowered to 34%. If instead the dividends received deduction had been maintained at 85% under the new lower top corporate rate, the effective rate on intercorporate dividends would have fallen to 5.1%.[150] The Staff of the Joint Committee on Taxation explained:

> Congress did not believe that the reduction in corporate tax rates generally should result in a significant reduction in this effective rate. Thus, the dividends received deduction has been reduced to

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acting I.R.C. § 243).

144. E. Randolph Dale, *1964 Act: Climate Improved for Multiple Corporations Despite Penalty Tax*, 20 J. TAX'N 264, 266-67 (1964). The price included a limit of only one surtax exemption for the affiliated group, one accumulated earnings credit, and one $100,000 estimated tax exemption. *See id.*; Cohen, *supra* note 136, at 179-80.

145. Dale, *supra* note 144, at 266.

146. *See* Burstein, *supra* note 133, at 1020-21.

147. Tax Reform Act of 1986, Pub. L. No. 99-514, § 611(a)(1), 100 Stat. 2085, 2249.

148. H.R. REP. NO. 99-426, at 244 (1985) [hereinafter 1985 HOUSE REPORT]; S. REP. NO. 99-313, at 221 (2d Sess. 1985) [hereinafter 1985 SENATE REPORT].

149. 1985 SENATE REPORT, *supra* note 148, at 221.

150. JAMES S. EUSTICE ET AL., THE TAX REFORM ACT OF 1986: ANALYSIS AND COMMENTARY 2-64 (1987).

> 80 percent, resulting in a maximum rate of 6.8 percent on dividends subject to the reduced top corporate rate (20 percent of the top corporate rate of 34 percent).[151]

In 1987, Congress completed the reform of intercorporate dividend taxation when it adopted a new 70% dividends received deduction for corporations receiving dividends from corporations in which they had less than a 20% stake.[152] During consideration of the 1986 Act, the House had considered a bill that created three tiers: 100% for dividends received from affiliates (i.e., 80% owned subsidiaries), 90% for dividends received from a small business investment company (down from 100% when the provision was enacted in 1958), and 80%, transitioning to 70% after the phase-in period, for all other intercorporate dividends.[153] In Conference, however, the Senate version was chosen.[154]

In the fall of 1987, the combination of the federal deficit concerns and the looming automatic budget cuts that would be triggered in the absence of new revenue led to a revival of interest in tax increases.[155] At first, President Ronald Reagan stood his ground "stumping the country saying he wants no tax increases."[156] The stock market crash in October, however, changed his tune.[157] Declaring that "I'm putting everything on the table," Reagan "abandoned his vow never to raise taxes and ordered his top aides to work with Congress in developing a deficit-reduction plan that 'keeps spending and taxes as low as possible.' "[158] Among the revenue raising proposals was to reduce the dividends received deduction from 80% to 75% for dividends from less than 20%-owned corporations. The House Ways and Means Committee justified the change under the enterprise rationale for the dividends received deduction, explaining that it "believe[d] that the present-law dividends received deduction is too generous for corporations that are not eligible to be treated as the alter ego of the distributing corporation because they do not have a sufficient ownership

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151. STAFF OF JOINT COMM. ON TAXATION, 99TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 274 (Comm. Print 1987).

152. *See* Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 10221(a)(1), 101 Stat. 1330, 1330-408.

153. 1985 HOUSE REPORT, *supra* note 148, at 244-45.

154. H.R. REP. NO. 99-841, at II-161 (1986) (Conf. Rep.).

155. Jeffrey H. Birnbaum, *Reagan Faces Deficit Showdown with Congress, Hard Choices of Paring Military or Raising Taxes*, WALL ST. J., July 16, 1987, at 56.

156. *Id.*; John H. Cushman, Jr., *Fee Rise Suggested to Reduce Deficit*, N.Y. TIMES, Sept. 28, 1987, at A1.

157. *The Budget Deficit Disgrace*, N.Y. TIMES, Nov. 20, 1987, at A38. *See generally* DIV. OF MKT. REG., U.S. SEC. & EXCH. COMM'N, THE OCTOBER 1987 MARKET BREAK xi (1988) (describing the volatility of the market in October 1987).

158. Jack Nelson, *Reagan Backs Off His Stand Against Increase in Taxes: Aides Will Meet with Leaders of Congress on Debt*, L.A. TIMES, Oct. 23, 1987, at 16.

interest in that corporation."[159] The Senate included no such reduction in the rate for intercorporate dividends, but in conference they agreed to adopt the House provision, with a reduction in the rate from 75% to 70%.[160]

IV. FUTURE

The reforms to the taxation of intercorporate dividends in the 1960s and 1980s primarily reflect the move away from the anti-holding company rationale of the New Deal and toward an approach influenced most prominently by a need for revenue. To the extent that the enterprise rationale continues to buttress the scheme, it does so in a blunt and largely unsatisfying fashion, with no differentiation in the percentage exclusion available for 79% corporate owners and 20% corporate owners.

In 2007, the Department of Treasury's Office of Tax Policy examined the dividends received deduction and found it particularly problematic because of the tax cascading effect.[161] This is the problem of running income up through multiple tiers of corporate ownership, each of which is only eligible for a partial dividends received deduction. According to the Office of Tax Policy's report:

> By failing to allow a full 100-percent deduction for all intercorporate dividends, the tax system can impose multiple layers of tax on intercorporate dividends, which leads to distortions in the allocation of investment by discouraging corporations from investments in other corporations that would be profitable in the absence of the cascading levels of taxes.[162]

The Office of Tax Policy calculated that under the 70% dividends received deduction, the additional layer of tax imposes an extra \$6.83 burden on every \$100 of corporate earnings.[163]

The evidence the Office of Tax Policy marshaled regarding intercorporate dividends supports the notion that the partial dividends received deduction is not all that productive. Of almost \$280 billion in intercorporate dividends issued in 2004, only \$51 billion, or less than 19%, were subject to taxation—and that includes dividends not eligible for the dividends received deduction at all, such as dividends from foreign corporations.[164] Of the nearly \$100 billion in intercorpo-

159. H.R. REP. NO. 100-391, pt. 2, at 1094 (1987).

160. *See* H.R. REP. NO. 100-495, at 965 (1987) (Conf. Rep.).

161. *See* OFFICE OF TAX POLICY, U.S. DEP'T OF THE TREASURY, APPROACHES TO IMPROVE THE COMPETITIVENESS OF THE U.S. BUSINESS TAX SYSTEM FOR THE 21ST CENTURY 76-77 (2007).

162. *Id.* at 76.

163. *Id.* at 77.

164. *Id.* at 78.

rate dividends eligible for either the 100, 80, or 70% dividends received deduction, only $16.8 billion in intercorporate dividends were eligible for the 80 and 70% deductions.[165]

There appear to be several alternative methods that have been proposed regarding the taxation of intercorporate dividends. One possibility is to provide a 100% dividends received deduction for all intercorporate dividends. This was the system in place prior to 1935. In 1979, the American Bar Association's Committee on Affiliated and Related Corporations proposed returning to this approach, noting that the original purpose of the move away from a 100% deduction "was twofold: (1) to prevent the use of graduated corporate income tax rates by members of a single corporate group, that is, to prevent the use of multiple surtax allowances; and (2) to discourage the use of elaborate chains of public utility holding companies."[166] The Committee explained, "[i]t is highly doubtful whether the slight reduction in the dividends-received deduction from 100 percent to 85 percent achieved either purpose."[167] Moreover, at least in the case of the latter explanation, the culmination of the successful battle to eliminate public utility holding companies, which coincided with the repeal of the ban on consolidated returns, effectively shifted the focus away from anti-bigness.[168]

With respect to the concern that an unlimited dividends received deduction would be abused, several provisions have been enacted that target such abuse more effectively than the declining dividends received deduction percentage. In 1969, Congress moved to shut down one problem with affiliated groups of corporations in a graduated corporate rate scheme—the multiple surtax exemption.[169] The Revenue Act of 1964 had taken some steps against this practice by imposing a penalty tax for the privilege of claiming multiple surtax exemptions,[170] but in the Tax Reform Act of 1969, Congress shut it down altogether by limiting controlled corporations to one surtax ex-

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165. *Id.*

166. Comm. on Affiliated & Related Corps., *Summaries of Proposed Legislative Recommendations to Amend the Internal Revenue Code of 1954 to Apply a 100 Percent Dividends-Received Deduction to All Dividends Received by a Corporation from a Domestic Corporation*, 32 TAX LAW. 863, 864 (1979).

167. *Id.*

168. *See* Steven A. Bank, *Taxing Bigness*, 66 TAX L. REV. (forthcoming 2014) (manuscript at 36-37) (on file with author). *But see* Randall Morck, *How to Eliminate Pyramidal Business Groups: The Double Taxation of Intercorporate Dividends and Other Incisive Uses of Tax Policy*, 19 TAX POL'Y & THE ECON. 135, 169 (2005) (suggesting the taxation of intercorporate dividends might be used in other countries to combat the corporate governance problems of pyramidal structures).

169. Thomas R. White III, *The Tax Reform Act of 1969: Demise of Multiple Surtax Exemptions—When Too Much of a Good Thing Proved Its Own Undoing*, 16 WAYNE L. REV. 1353, 1358-60 (1970).

170. *See supra* text accompanying notes 136-39.

emption.[171] Of course, this type of abuse is driven primarily by the existence of graduated corporate rates that reward the splitting of income among multiple subsidiaries so none of them have incomes beyond the lowest rate.[172] Repealing the graduated rate scheme would reduce the tax incentives for utilizing such a structure.[173]

In the 1980s, Congress further strengthened protections against several other schemes designed to abuse the dividends received deduction, such as extraordinary dividends on stock held for less than two years.[174] These schemes were called "milking transactions" because the goal is to milk the profits of the subsidiary in a tax-free intercorporate dividend.[175] Congress also limited the ability of corporate parents to extract tax-free intercorporate dividends through debt-financed subsidiary portfolio stock purchases.[176] These transactions were concerning because the combination of an interest deduction and the dividends received deduction appeared to permit the corporation to shelter unrelated income or to subsidize a takeover.[177]

A second possible reform that has been proposed as an alternative to the current scheme for taxing intercorporate dividends, which stands at the opposite end of the spectrum from the first, would eliminate the partial deduction altogether.[178] The partial dividends received deduction was always an awkward combination with the repeal of the consolidated return, since the rhetoric of an intercorporate dividends tax was, in reality, still a 90% and then 85% dividends received deduction for corporations that were supposed to be considered separate in the absence of the consolidated return.

A version of this alternative was offered by Harvard professor William Andrews in his *Reporter's Study on Corporate Distributions* for the American Law Institute's Federal Income Tax Project on Subchapter C.[179] Andrews highlighted the difference between direct investments in controlled subsidiaries and portfolio investments in

171. *See* Tax Reform Act of 1969, Pub. L. No. 91-172, § 401(a), 83 Stat. 487, 599-604.

172. *See* Michael Aikins, Note, *Common Control and the Delineation of the Taxable Entity*, 121 YALE L.J. 624, 651-52 (2011).

173. *See* Bank, *supra* note 168, at 44-45 (suggesting that other incentives, such as those targeted at small businesses, would remain).

174. *See* Mundstock, *supra* note 4, at 15-17.

175. *Id.* at 12.

176. STAFF OF THE JOINT COMM. ON TAXATION, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, at 128-29 (Comm. Print 1984).

177. *Id.*

178. *See, e.g.*, Maimone & Riley, *supra* note 4, at 778-79 (proposing a repeal of the partial dividends received deduction for non-affiliated corporations, while retaining the 100% deduction for affiliated corporations).

179. *See generally* William D. Andrews, *Reporter's Study on Corporate Distributions*, *in* AM. LAW INST., FEDERAL INCOME TAX PROJECT: SUBCHAPTER C 487 (1982).

non-controlled corporations, suggesting that a full dividends received deduction made sense for the former type of investment, while there was no justification for a dividends received deduction for the latter type of investment.[180] According to Andrews, the problem with allowing even a partial dividends received deduction for portfolio investments is that it distorted investment decisions by preferring investments in corporate equity over other fully taxable forms of investment.[181] By contrast, for a direct investment, "the dividend-received deduction is not enough to effect a consistent and uniform elimination of double corporate taxation."[182] Rather than setting the dividing line between these two investments at the 80% ownership percentage under the current rules, however, Andrew proposed a more complicated scheme that would have allowed even a 10% ownership stake to be classified as a direct investment.[183] The American Law Institute, however, never adopted the recommendations contained in his *Reporter's Study*.[184]

There have been some proposals to tinker with the current partial dividends received deduction, but much like the 1987 reform they appear to be revenue-driven rather than based upon any conceptual notion of the proper tax treatment. In 2007, Charlie Rangel proposed reducing the 80% deduction to 70%, and reducing the 70% deduction to 60%.[185] Much like in 1986 and 1987, this was part of a proposal to reduce the general corporate rate from 35% to 30.5%.[186] In this case, however, the focus was not on maintaining the same effective tax rate, but on making the overall reduction in rate revenue-neutral. Nevertheless, this proposal has never been acted upon. Given the current push to reduce the corporate income tax rate in a manner that is either revenue-neutral or is part of a reform of business taxation that produces increased revenue,[187] however, Rangel's proposal or something similar may soon be revived by politicians seeking to pay for their own bills.

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180. *See id.*

181. *See id.* at 494.

182. *Id.* at 496.

183. *Id.* at 490. Andrews classified an investment as "direct" if "(i) the investor corporation own[ed] more than 50 percent of the common stock of the issuer for . . . [at least] one year; or (ii) the investor corporation own[ed] 10 percent or more of the common stock of the issuer and designat[ed] the holding as a direct investment; or (iii) the investment ha[d] ever been a direct investment [for at least one year] and ha[d] not been subsequently completely terminated . . . ." *Id.*

184. Maimone & Riley, *supra* note 4, at 790 n.46.

185. *See H.R. 3970 Tax Reduction and Reform Act of 2007*, COMMITTEE ON WAYS & MEANS (Oct. 29, 2007), http://waysandmeans.house.gov/media/pdf/110/summary%20for%20distribution.pdf.

186. *See id.*

187. *See Obama's 'Grand Bargain' with Obama*, WALL ST. J., July 31, 2013, at A12.

A complicating factor in any proposal for reform of the dividends received deduction is the globalization of modern corporations.[188] The basic rules limit the dividends received deduction to taxable domestic corporations.[189] There are exceptions, however, for dividends from foreign corporations arising out of earnings and profits accumulated while the corporation was still a domestic taxable corporation, and for dividends from a 10% owned foreign corporation with respect to the portion of the dividends that is U.S.-sourced.[190] Some companies have invoked these exceptions in the context of so-called "sandwich" structures involving a domestic corporation owning a foreign corporation that owns a domestic corporation.[191] Eventually, the Internal Revenue Service issued a private letter ruling to provide guidance for intercorporate dividends in this type of structure.[192] More recently, however, the Service has had to issue additional guidance to disallow abusive uses of the dividends received deduction involving controlled foreign corporations.[193] With reports suggesting that an increasing number of domestic companies are relocating outside the U.S. through reincorporation mergers, with either existing companies or shell companies,[194] these types of structures may become more important. Indeed, if an anti-holding company sentiment prompts a move to a less generous scheme for taxing intercorporate dividends, it is likely that multinational holding companies will be the twenty-first century version of the original corporate pyramids.

188. *See* Steven A. Bank, *The Globalization of Corporate Tax Reform*, 40 PEPP. L. REV. 1307, 1308-09 (2013) (describing the growth of multinational corporations and the globalization of corporate profits for domestic corporations).

189. *See* I.R.C. § 243(a).

190. *See id.* §§ 243(e), 245.

191. *See, e.g.*, Hal Hicks et al., *Sandwich Structures: The IRS Illuminates the Application of the DRD and Other Provisions*, INT'L TAX J., July-Aug. 2010, at 61, 61; John D. McDonald et al., *The Dividends-Received Deduction and Sandwich Structures*, TAXES, May 2010, at 5, 5.

192. *See* I.R.S. Priv. Ltr. Rul. 200952031 (Dec. 24, 2009).

193. I.R.S. Chief Couns. Mem. 201320014 (Jan. 18, 2013); *see also* Jasper L. Cummings, Jr., *The Substance of Dividends Received Deductions*, 140 TAX NOTES 603 (2013); Jeffrey L. Rubinger & Nadia E. Kruler, *Service Applies Substance Over Form Doctrine to Disallow Dividends-Received Deduction*, 119 J. TAX'N 13 (2013).

194. *See* Mark Koba, *Avoid U.S. Taxes by Forming a Merger Abroad*, NBCNEWS.COM (July 31, 2013, 5:23 PM), http://www.nbcnews.com/business/avoid-us-taxes-forming-foreign-merger-6C10810789.