THE CORPORATION AS A DEVICE FOR
THE AVOIDANCE OF FEDERAL
INCOME TAXES

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One of the more controversial and widely discussed aspects
of the current Federal tax structure is the present tax on cor-
porate net income. Among the criticisms made of the corporate
net income tax is that the structure facilitates the avoidance of
personal income taxes through the retention of earnings by the
corporation. It is the purpose of this article to describe how
this particular flaw in the Federal tax structure has evolved since
1909 (the beginning of our present corporate tax structure) and
how the Congress and various administrations have sought to
deal with the matter. The concluding section will discuss briefly
a few of the major proposals (now current) looking toward a
solution of this problem.

In 1909, the Congress enacted a one-percent tax on the net
income (in excess of $5,000) of corporations, joint stock com-
panies, and associations, exclusive of amounts received as divi-
dends from corporations subject to the tax. In view of the
Supreme Court’s action in Pollock vs. Farmers Loan and Trust
Company in 1895, holding an income tax unconstitutional, the

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1 The reference here is to the regular corporation income tax, as distinguished
from the excess profits tax which currently (March 1953) forms an additional
levy on corporate income. This article is concerned with the continuing problem
of corporate income taxation, rather than with the emergency situations which
on three occasions have given rise to excess profits tax legislation.

2 The possibility of avoidance of personal income taxes is only one of many
difficult aspects of the present corporate income tax controversy. However, no
attempt will be made in this brief article to touch upon these other aspects of
the debate.

3 36 Stat. 112.
Congress in 1909 warily described the new levy as an "excise tax with respect to the carrying on or doing business," i.e., a tax on the act or privilege of doing business measured by net income in excess of $5,000, rather than as a tax directly on the income itself. The Supreme Court eventually (1911) upheld this measure.⁵

By 1913, the necessary number of states had ratified the sixteenth amendment to the Constitution, and the Congress was able to enact income tax legislation without the subterfuge which characterized the 1909 measure. The result was the Act of October 3, 1913.⁶ A tax of one percent was imposed upon the "entire net income" of corporations, joint stock companies and associations, and insurance companies (partnerships were specifically excluded).⁷ The new tax was made effective as of March 1, 1913, and the 1909 excise measure was terminated as of February 28, 1913.⁸ In this manner, some continuity of corporate income taxation was attained.

The 1913 measure also imposed a tax on personal net incomes consisting of a "normal" tax of one percent and an "additional income tax" (i.e., surtax) at rates graduated from one to six percent.⁹ Corporate dividends were excluded from the normal-tax base (but not from the additional or surtax base) where the corporation in question was itself subject to the one-percent corporate levy.¹⁰ Thus, under the 1913 law, the corporate levy might be regarded as a rather crude withholding-at-source device for the normal levy on personal incomes.

It was quickly recognized that a corporation might be used as a screen, standing between corporate income accruing to the interest of shareholders and personal income taxation by reason of the failure of directors to make the requisite dividend decla-

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⁶ 38 Stat. 114. This measure, like the 1909 legislation, was also a combination tariff and income tax bill.
⁷ *Ibid.*, Section II (G) (a).
⁸ *Ibid.*, Sections II (G) (c) and IV (S).
⁹ *Ibid.*, Sections II (A) (1) and II (A) (2).
¹⁰ *Ibid.*, Section II (B).
¹¹ "Crude," inasmuch as there was no provision for "refund" in the case of a shareholder receiving dividends but at the same time not having an aggregate income large enough to be subject to any tax.
ration. Here was the essence of the troublesome problem of "improperly accumulated surplus." Under the 1913 law, the equivalent of the normal levy would be collected in any event through the imposition of the accompanying one percent corporate levy. What might be avoided was the additional tax (surtax) on personal income.12

As a result of Senate amendment, the following provision was inserted:

For the purpose of . . . additional tax [i.e., surtax] the taxable income of any individual shall embrace the share to which he would be entitled of the gains and profits, if divided or distributed, whether divided or distributed or not, of all corporations, joint-stock companies, or associations however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided or distributed; and the fact that any such corporation, joint-stock company, or association, is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business shall be prima facie evidence of a fraudulent purpose to escape such tax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business.13

Thus, in our first significant income tax law, we sought to deal with the problem of "improperly accumulated surplus" by the simple expedient of treating shareholders in such cases as if they were partners, including in their incomes (at least for surtax purposes) their pro rata shares of corporate profits, whether distributed or not.14 The effect was to look to the individual share-

12 The problem was less serious in 1913 than it was later to become because (a) corporate dividends were not included in the normal tax base; hence, the problem was only that of the possible avoidance of the surtax; and (b) surtax rates (one to six percent) and surtax exemption ($20,000) were relatively lenient.

13 38 Stat. 114, Section II (A) (2).

14 This early "partnership" treatment, in the special case of "improperly accumulated surplus," is particularly interesting in the light of the discussion following World War II concerning the feasibility and desirability of a "partnership" approach to the whole subject of corporate income taxation. It might be
holders, rather than to the corporation, for a settling of accounts when the corporation had been found guilty of excessive retention of earnings. This "partnership" approach continued to be the method employed until the Revenue Act of 1921.\footnote{15} What may be considered the permanent shift of emphasis from shareholders to the offending corporation itself took place in 1921. The Revenue Act of that year provided for a tax of 25 percent (over and above the ordinary corporate income levy) on the net income of "any corporation . . . formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders or members through the medium of permitting its gains and profits to accumulate instead of being divided or distributed."\footnote{16} However, it was further provided that, by common consent of all stockholders, the corporation could elect to be treated as a partnership for tax purposes.\footnote{17}

The immediate reason for this shift seems to have been the Supreme Court's 1920 decision in \textit{Eisner vs. Macomber}.\footnote{18} Some pointed out, in passing, that the adoption of a "partnership" approach to the present-day problem of the corporate income tax (whatever new problems such an approach might create) would do away with the problem of personal income tax avoidance which is the subject of this article. See Section 3 below.

\footnote{15} For intervening legislation, see Revenue Act of 1916, 39 Stat. 756, Section 3; War Revenue Act of 1917, 40 Stat. 300, Section 1206 (2); Revenue Act of 1918, 40 Stat. 1057, Section 220. The War Revenue Act of 1917 (Section 1206 (2) (b)) imposed an additional tax of ten percent on corporate earnings not distributed to shareholders, except such as were "actually invested in the business or . . . retained for employment in the reasonable requirements of the business," or invested in obligations of the United States issued after September 1, 1917. If the Secretary of the Treasury found that any portion of such surplus retained on claim of need was "not reasonably required in the business," the tax was 15 percent. The Revenue Act of 1918 made it unnecessary for the government to show that a corporation had been fraudulently availed of for the purpose of preventing the imposition of additional taxes on shareholders' net income.

\footnote{16} 42 Stat. 227, Section 220.

\footnote{17} Ibid. This "partnership option" did not appear in the Revenue Act of 1924. The 1926, 1928, 1932, and 1934 Acts provided that no penalty tax would be imposed if the shareholders, at the time of filing their returns, included their \textit{pro rata} shares of the corporation's earnings in those returns. The 1936 Act contained a somewhat similar provision. The 1938 and subsequent Acts have accomplished the same result by means of the consent dividends credit. See \textit{Internal Revenue Code}, Section 28; also, Jacob Mertens, \textit{The Law of Federal Income Taxation} (Chicago, Callaghan and Co., 1943), Volume 7, Section 40.24.

\footnote{18} 252 U. S. 189. In this case, the Court held that stock dividends are not
doubt on this point, in fact, seems to have been present during the consideration of the 1917 Act, even before the Court’s action in \textit{Eisner vs. Macomber}.\textsuperscript{10}

In 1924, the penalty rate on the corporation was increased from 25 to 50 percent.\textsuperscript{20} The effect of this increase was to make the penalty tax greater than the maximum surtax rate applicable to dividends received by shareholders. Under the 1924 Act, the maximum surtax rate (applicable to surtax net income in excess of $500,000) was 40 percent. The increase came about through Senate amendment following a recommendation from the Senate Finance Committee for “a more effective check upon this method of evasion of surtaxes.”\textsuperscript{21}

From 1924 to 1934, there were no significant changes. The 50 percent rate remained unchanged in this decade, during which ordinary corporate and personal income tax rates reached their post-World-War-I lows in 1929 and then began their climb toward the World-War-II highs.\textsuperscript{22}

In 1934, the Revenue Act of that year made two significant changes in the penalty tax, viz., (a) the tax was, generally speaking, to be confined to corporate net income less dividends actually paid during the taxable year (instead of being confined, as previously, to total net income) and (b) the flat rate of 50 income subject to tax because, \textit{inter alia}, such dividends do not represent a breaking off of part of the corporation’s assets for the purpose of paying the dividends. Since the Court seemed to be posing “severance” as a test of income to the individual shareholders, the Congress accordingly had some qualms about taxing undistributed (even though “improperly accumulated”) earnings to the individual shareholders. See \textit{Report of the House Ways and Means Committee, House Report 350, 67 Congress, 1 Session, pp. 12-13}. It is interesting to note that the Civil War income tax legislation contained a “partnership” penalty for offending corporations, which provision was upheld, in 1870, in \textit{Collector vs. Hubbard}, 12 Wall. 1. This decision, however, did not become a precedent in later cases.

\textsuperscript{10} See Senator Simmons’s remarks, 55 Cong. Rec. 5966.

\textsuperscript{20} 43 Stat. 253, Section 220.

\textsuperscript{21} \textit{Report of the Senate Finance Committee, Senate Report 398, 68 Congress, 1 Session, p. 26.} A minority report, submitted at the same time, commented: “In actual result, however, such penalty provision has been and will be for all practical purposes a nullity.”

\textsuperscript{22} For intervening legislation, see Revenue Act of 1926, 44 Stat. 9, Section 220; Revenue Act of 1928, 45 Stat. 791, Section 104; and Revenue Act of 1932, 47 Stat. 169, Section 104.
percent was changed to 25 percent of the first $100,000 and 35 percent of the remainder of corporate net income less dividends paid. The 50 percent rate was described as "too high to be readily enforceable," a rather curious conclusion unless the congressmen who made this observation meant that such a rate caused internal revenue officials to become faint-hearted in dealing with inordinately miserly corporations.

For purposes of this discussion, the Revenue Act of 1934 was important for another reason: it provided for a surtax on undistributed income of personal holding companies. In general, these have been defined as corporations with 80 percent or more of their income derived from the ownership of property (interest, dividends, rents, royalties, etc.) and with 50 percent or more of their stock being held in the last half of the tax year by five or fewer persons. Actually, such corporations form a very special case under the broader problem of "improperly accumulated surplus," and the decision to give them special treatment was probably a wise one. In any event, corporations subject to the personal holding company surtax were exempted from Section 102 (the designation, since 1934, of the provision in income tax legislation covering improperly retained earnings).

That the Congress was, at this time, concerned with the general problem of accumulation of earnings by corporations is demonstrated not only by the passage of the personal holding company legislation in 1934, but also by the enactment of legislation in 1936 imposing a surtax (at rates ranging from seven to

23 48 Stat. 680, Section 102.
25 48 Stat. 680, Section 351.
26 "Perhaps the most prevalent form of tax avoidance practiced by individuals with large incomes is the scheme of the 'incorporated pocketbook.' That is, an individual forms a corporation and exchanges for its stock his personal holdings in stocks, bonds, or other income-producing property. By this means, the income from the property pays corporation tax, but no surtax is paid by the individual if the income is not distributed." Report of the House Ways and Means Committee, House Report 704, 73 Congress, 2 Session, p. 11.
27 Section 351 of the 1934 Act taxed such companies at 30 percent on the first $100,000 of "undistributed adjusted net income" and at 40 percent on the remainder. The rates are currently (1953) 75 percent on the first $2,000 and 85 percent on the remainder. See Internal Revenue Code, Section 500.
27 percent) on undistributed profits.\textsuperscript{28} Such a tax (with relatively minor exceptions) was to apply to all earnings remaining after payment of the corporate income tax and dividends, and not (as in the case of Section 102) just to "improperly accumulated" earnings. However, the new levy was in addition to, not in replacement of, the Section-102 penalty, the only concession being that Section-102 rates would be 15 and 25 percent (instead of 25 and 35 percent, as had been provided in the 1934 Act) where, and as long as, the corporation was also liable for an undistributed profits assessment.\textsuperscript{29}

As far back as 1917, the Congress had given serious consideration to the imposition of a general undistributed profits tax. The Senate Finance Committee reported in that year:

Neither the existing law nor the House bill imposes a surtax upon the undistributed earnings of corporations. Under both the House bill and existing law the normal tax of the corporation and the normal tax of the individual is the same. In these conditions the earnings of the corporation escape surtax until distributed among its shareholders. The situation seemed to your committee to bring about an inequality between the corporation and the individual which should be remedied as far as practicable.\textsuperscript{30}

The Congress did not, in the 1917 legislation, go so far as to adopt an unqualified undistributed profits tax. Instead, in addition to the "partnership" penalty provided in the 1916 Act, and continued by implication in the 1917 Act,\textsuperscript{31} there was levied:

\textsuperscript{28} 49 Stat. 1648, Section 14.

\textsuperscript{29} Ibid., Section 102. As passed by the House, the bill would have limited Section 102 to personal holding companies, banks, insurance companies, foreign corporations, China Trade Act corporations, and corporations receiving a large portion of their income from sources within a possession. By Senate amendment, Section 102 was made applicable to every corporation except personal holding companies, and it was also made clear that the surtax on "improperly accumulated surplus" was to be in addition to the surtax on "undistributed profits." See J. S. Seidman, Seidman's Legislative History of Federal Income Tax Laws, 1938-1961 (New York, Prentice-Hall, Inc., 1938), pp. 234-235.


\textsuperscript{31} The War Revenue Act of October 3, 1917 (40 Stat. 300) was not a new bill, but rather an amendment to the Revenue Act of September 8, 1916 (39 Stat. 756).
... an additional tax of ten percentum upon the amount, remaining undistributed six months after the end of each calendar or fiscal year, of the total net income of every corporate... The tax imposed by this subdivision shall not apply to that portion of such undistributed net income which is actually invested and employed in the business or is retained for employment in the reasonable requirements of the business or is invested in obligations of the United States... Provided, That if the Secretary of the Treasury ascertains and finds that any portion of such amount so retained at any time for employment in the business is not so employed or is not reasonably required in the business a tax of fifteen percentum shall be levied, assessed, collected, and paid thereon.32

The idea of a general undistributed profits tax persisted, both in and out of the Congress.33 However, apart from the personal holding company legislation of 1934, and until 1936, the Congress always ended up by merely re-enacting the penalty sections having to do with improperly retained earnings. The general feeling seems to have been that the absence of a general undistributed profits tax definitely contributed to tax avoidance, but that the presence of such a tax might create more problems than it would solve.34

On June 19, 1935, President Roosevelt sent a surprise message on tax reform to the Congress, in the course of which he deplored unwieldy and unnecessary corporate surpluses.35 On March 3, 1936, another tax message stated in part:

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32 40 Stat. 300, Section 1206 (2) (b). See also footnote 15 above. Professor Hall has said of his provision: "This section... was not a general levy on all undistributed profits. Instead, it was designed to serve essentially the same purpose as Section II (A) (2) of the Tariff Act of 1913 and Section 3 of the Revenue Act of 1916, but in a different way... With this section operative, in conjunction with Section 3 of the Revenue Act of 1916, there was a 'double-barreled' threat to unreasonable accumulations of surplus." James K. Hall, The Taxation of Corporate Surplus Accumulations (study prepared for the Joint Committee on the Economic Report; United States Government Printing Office, Washington, 1932), p. 197.


34 A good example of this congressional hesitancy toward an unqualified undistributed profits levy is to be found in Senate Report 2156, 74 Congress, 2 Session.

The accumulation of surplus in corporations controlled by taxpayers with large incomes is encouraged by the present freedom of undistributed corporate income from surtaxes. Since stockholders are the beneficial owners of both distributed and undistributed corporate income, the aim . . . should be to seek equality of tax burden on all corporate income whether distributed or withheld from the beneficial owners.  

Specifically, in the March 3, 1936, message, the President made the following recommendations of interest here, viz., (1) repeal of the regular corporate income tax, the capital stock tax and the companion excess profits tax, (2) subjection of dividends to both normal and surtax, instead of surtax alone, as had been the case continuously since 1913, and (3) taxation of all undistributed corporate earnings at a rate that would yield approximately the same amount of revenue as would be yielded if corporate profits were distributed and taxed in the hands of stockholders.

There was a certain appeal of logic about the President's recommendations. Certainly, the "corporate tax problem," insofar as it was a problem of avoidance of personal taxes by shareholders, would have been solved in a manner which Section 102 (and its predecessor sections) has never been able to equal. Unfortunately, the recommendations were made in an atmosphere already heavy with the charges and countercharges of the Huey Long and Father Coughlin forces, the "radical new dealers" and the "economic royalists." There ensued about as hectic a period as has ever been witnessed in the history of American taxation.

Out of the melee emerged the Revenue Act of 1936. As indicated above, this measure did contain an undistributed profits tax. Otherwise, however, the presidential recommendations were significant by their absence, insofar as the finished bill was concerned. Dividends on stock were made subject to both normal tax as well as to surtax, as had been recommended; but the

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36 Ibid., volume 5, pp. 102-107.
corporate income tax, instead of being abolished, as had been recommended, was continued in force.\textsuperscript{38}

The key to the President's recommendations was the abolition of the corporate income tax; only with this alteration did the remainder of his recommendations become architecturally harmonious. The plan sketched in the March 3, 1936, tax message contemplated placing emphasis on income \textit{received} by \textit{individuals}; hence the suggestion that dividends be taxed in full, i.e., taxed by both normal and surtax schedules. At the same time, the corporation should not be used as a device for permitting avoidance of personal income taxes through accumulation of earnings in the corporation; hence the suggestion that an undistributed profits tax be levied at a rate calculated to yield, on the average, an amount equivalent to what would have been produced had such retained earnings been distributed and taxed as dividends to individual shareholders. Under this plan, the taxation of undistributed corporate earnings would have been not so much a primary tax as an enforcement and companion measure for the personal income tax, a means of forcing out into the open all earnings except those really essential to the corporation.

The retention of the regular corporate income tax destroyed the unity of this plan and probably justified Senator Byrd's description of the Revenue Act of 1936 as a "mongrel hybrid."\textsuperscript{39} There was a second result, viz., the final and complete divorcing of the personal income tax from the corporate income tax. The rough integration of these two measures under the Act of 1913 was dealt an initial blow in 1917 when the normal rate on personal income dropped behind the flat rate on corporate income.\textsuperscript{40} But as long as dividends were exempt from normal tax on personal incomes, there was some semblance of integration left.

\textsuperscript{38} 49 Stat. 1648. It should perhaps be noted that while the corporate income tax was continued in force by this law, its range of progression became 8-15 percent, instead of 12\(\frac{1}{2}\)-15 percent, as in the Revenue Act of 1935. The savings were on that portion of corporate net income below $40,000.

\textsuperscript{39} Blakey, \textit{op. cit.}, p. 423. It was Senate insistence which kept the corporate income tax, which, under the original House bill, would have been repealed as of December 31, 1935. The basis of Senate resistance seems to have been fear of revenue loss, an odd dingling to a "revenue" objective of taxation at a time when such an objective was probably impossible of attainment.

\textsuperscript{40} 40 Stat. 300. See also footnote 11 above.
Since 1936, for better or worse, we have had two completely separate income taxes, one on personal income and one on the net income of corporations. Under this dual system of income taxation, the retaining of income by corporations, unless adequately checked and policed in some manner, constitutes a legalized but, sometimes, undesirable form of tax avoidance. Complete separation in 1936 did not, of course, create this problem; but the very act of completing separation (through subjecting dividends to normal as well as to surtax schedules) magnified the problem and placed a greater premium on the successful accomplishment of avoidance through retention of earnings.

It may, of course, be argued that where earnings are declared as dividends and then taxed in full under personal income tax schedules, there results double taxation. However, we are not concerned here with the problem of double taxation. Suffice it to say that the dualism produced by the Revenue Act of 1936 has created whatever burden double taxation may be said to impose.

The undistributed profits tax legislation of 1936 probably aroused as much opposition as any tax measure since the Excise Act of 1791 (with the resultant Whiskey Rebellion). Inside the Congress, opposition to undistributed profits taxation was especially in evidence in the Senate, which had somewhat reluctantly agreed to such a measure in the first place.

The Revenue Act of 1938 limited the taxation of undistributed profits to the calendar years 1938 and 1939, and during that time provided for a greatly reduced rate (from a maximum of 27 to 2½ percent). What was left of the tax was finally repealed outright in 1939. Roosevelt himself refused to sign the Revenue Act of 1938 (it became law without his signature) largely because of the emasculation of the undistributed profits.

— Raymond Moley wrote that the tax had "thrown the business community into paroxysms of fright." Quoted in Ratner, op. cit., p. 475. A somewhat more balanced view was given at the time in A. G. Buehler, The Undistributed Profits Tax (New York, McGraw-Hill, 1937).

— The Senate Finance Committee had expressed a preference for attempting to strengthen Section 102 over any experimenting with an undistributed profits tax. See Report of the Senate Finance Committee, Senate Report 2156, 74 Congress, 2 Session, p. 4.

— 52 Stat. 447.

— 53 Stat. 862.
tax. He eventually (1939) gave up his insistence on reviving and strengthening this tax only on receiving promises that Section 102 would be reinforced.45

Repeal of the tax on undistributed profits brought the situation back to what it was in the summer of 1936: so far as retained corporate earnings were concerned, there were Section 102 and the provisions covering personal holding companies. Of these two, the former was the more promising because of its broader coverage.

Section-102 rates were restored to 25 and 35 percent, i.e., the special rates of 15 and 25 percent, applicable to a company also subject to the tax on undistributed profits, were dropped. Much more important, however, was the inclusion of the following:

The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary.46

The provision quoted above was, in effect, the most important substantive change since Section 102 (or its equivalent) was first inserted in the income tax laws. Prior to 1938, it had been provided that either mere holding company (or investment company) status or accumulation of surplus beyond reasonable needs would be prima facie evidence of a purpose to avoid taxes on shareholders. The 1938 revision continued holding company or investment company status as prima facie evidence of intent to avoid taxes. As for unreasonable accumulation of earnings, it would still be necessary for the Bureau of Internal Revenue to show that the accumulation was unreasonable. Beyond that, the Bureau’s hand was strengthened, or at least so the Senate Finance Committee thought:

The proposal is to strengthen this section by requiring the taxpayer by the clear preponderance of the evidence to prove the absence of any purpose to avoid surtaxes upon sharehold-

45 Blakey, op. cit., pp. 446-448, 471-474. Actually, such tightening up of Section 102 as was possible had already been accomplished in the Revenue Act of 1938.

46 Revenue Act of 1938, 52 Stat. 447, Section 102 (c). The passage quoted was a Senate amendment. See Seidman, op. cit., pp. 43-44.
ers after it has been determined that the earnings and profits have been unreasonably accumulated. This will clearly shift the burden of proof to the taxpayer in such cases . . . Under existing law, an unreasonable accumulation is merely *prima facie* evidence of purpose . . . Consequently, it has been argued that the only effect of an unreasonable accumulation is to shift to the taxpayer the burden of going forward with the evidence relating to purpose. Under the amendment, however, it is clear that an unreasonable accumulation puts upon the taxpayer the burden of proving by the clear preponderance of all the evidence submitted that it did not have the purpose of avoidance.  

Since the change in Section 102, referred to in the two preceding paragraphs, there have been no significant developments worthy of mention in this paper, aside from the increase (in 1941) of Section 102 rates to 27 1/2 and 33 1/2 percent (from 25 and 35 percent).  

It can be said, therefore, that since 1938, there has been no further major effort made on the legislative front to deal with the problem of tax avoidance resulting from retention of corporate earnings. It therefore becomes necessary to survey (1) the actual workings and effectiveness of the structure which emerged in 1938 and (2) the major proposals which have been made since 1938 (and particularly since the close of World War II) for dealing further with this problem. The remaining two sections of this article will attempt to deal with these two subjects.

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From the historical sketch contained in the preceding section, the following conclusions may be drawn: (1) From the incep-

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47 *Report of the Senate Finance Committee*, Senate Report 1507, 75 Congress, 3 Session, pp. 4-5, 16. When asked on the floor of the Senate whether the revised Section 102 kept the principle of the tax on undistributed profits, Senator Harrison, Chairman of the Finance Committee, replied: "It is retained in Section 102 in as strong language as the experts could write and the committee could fashion." 83 Cong. Rec. 4967. As indicated above, however, the principle was apparently not retained to an extent sufficient to induce Roosevelt to approve the bill.

48 Revenue Act of 1941, 55 Stat. 687, Section 103. Other minor changes in Section 102 are to be found in the following: Revenue Act of 1939, 53 Stat. 862; Revenue Act of 1940, 54 Stat. 516; Revenue Act of 1942, 56 Stat. 798; Revenue Act of 1945, 59 Stat. 556; Public Law 378, 81 Congress, 1 Session; Revenue Act of 1951 (Public Law 183, 82 Congress, 1 Session).
tion of the present personal income tax (1913), legislators have been aware of the fact that the corporation may be a vehicle for tax avoidance. (2) With two exceptions, this problem has been met by imposing some kind of penalty on a corporation (or on its shareholders prior to 1921) retaining earnings for the purpose of easing shareholders' personal income tax burdens. This is the provision known as Section 102 of the Internal Revenue Code.49 (3) On two occasions the Congress has gone beyond the Section-102 approach. In 1934 personal holding companies were singled out for a tighter, more specific provision (now Section 337 and Section 500 of the Internal Revenue Code). While this provision seems to have worked rather well, it deals with a rather special type of case and, for that reason, is not discussed further here. The second occasion was the adoption in 1936, at the insistence of the administration, of the short-lived and ill-fated undistributed profits tax, which taxed automatically all undistributed corporate earnings and not just those deemed to have been "improperly accumulated," i.e., those withheld to aid one or more shareholders in their own tax accountings. (4) Since 1938 (when Section 102 acquired its present form), and aside from the special type of case covered by the personal holding company provision, the dual system of Federal income taxation has relied exclusively on the attempt to penalize improper retention of earnings as the answer to possible tax avoidance. It is to the administration (and the adjudication) of Section 102, especially since 1938, that we must turn next.

Section 102 imposes a penalty tax applicable to undistributed net income where a corporation is formed or availed of for the purpose of preventing the imposition of personal income surtax upon its shareholders or the shareholders of any other corporation. As one court has pointed out, "... avoidance per se is not prohibited. It is the purpose, the intention motivating a course of conduct, which is made controlling by the very words of the statute."50

49 Prior to 1934 this section was variously numbered in the several revenue bills. With the codification of Federal tax laws in 1939, the provision in question was continued as "Section 102." In general, hereafter, it will be referred to as such even where the reference is to one of the earlier (pre-1934) revenue bills.

50 Cecil B. De Mille et al., 31 B.T.A. 1161.
It should be rather obvious that where it is necessary to probe into the purpose and intent of a corporation's directors in reaching certain dividend decisions, a rather intricate administrative problem presents itself. The Section-102 levy is not an "automatic" one, under which the taxpayer-corporation assesses itself and files a return; instead, the levy is of a selective nature, such that each case must be weighed by internal revenue officials in the light of all the facts and circumstances in that case.\footnote{In other words, the Bureau of Internal Revenue makes the first move under Section 102. However, Hall's study reports at least five cases where corporations voluntarily assessed themselves and remitted to the Treasury the tax so calculated. \cite{hall1944}, p. 94, footnote 10.}

Section 102 (and its predecessor sections) has always provided that holding company or investment company status is \textit{prima facie} evidence of intent to avoid surtax.\footnote{As has already been pointed out, foreign and domestic \textit{personal} holding companies are now exempt from Section 102 by virtue of their being subject to the special personal holding company levies imposed under Sections 337 and 500, \textit{Internal Revenue Code}.} Prior to 1938, accumulation of surplus "beyond the reasonable needs of the business" was also \textit{prima facie} evidence of intent to avoid surtax. The Revenue Act of 1938, as pointed out in the preceding section of this article, made such unreasonable accumulations "determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary."\footnote{Revenue Act of 1938, 52 Stat. 447, Section 102 (c).}

The 1938 amendment undoubtedly strengthened the hand of the Treasury. In effect, the Treasury may make a finding of "unreasonable accumulation," whereupon the taxpayer-corporation must then prove ("by the clear preponderance of the evidence") that it did \textit{not} accumulate beyond its reasonable needs in order to avoid taxes on personal income of shareholders. Thus, the taxpayer-corporation must prove a negative, a task which, as one commentator has pointed out, "is often difficult even in the case of 'innocent' taxpayers."\footnote{\textit{Mertens, op. cit.}, Section 40.11.}
"investment or holding company" category.\textsuperscript{55} This type of case, however, does not now present the most serious situation; rather, it is the situation involving the operating company (as distinguished from mere holding or investment companies) which is of greatest concern today.

For purposes of Section-102 administration, two types of operating companies may be distinguished. There is, first of all, the corporation whose stock is held entirely by a small group of individuals, sometimes all members of the same family. There is, secondly, the corporation whose stock may be widely held but whose affairs are largely controlled by a minority group of shareholders. It has been the first type of operating corporation, rather than the second, which has usually been the object of Section-102 actions.\textsuperscript{56} That the second type is not entirely immune, however, is one of the points brought out in the course of the \textit{Trico} cases.\textsuperscript{57}

In the \textit{Trico} cases, there were as many as 2,000 stockholders, but six actually controlled the company. These six individuals were persons of means, and their tax bills, rather than those of the other stockholders, would have been most seriously affected by a more liberal dividend policy. That many of the remaining stockholders would not have been greatly affected taxwise by more liberal dividend policies (because of the smallness of their shareholdings) was not, in the opinion of the courts, a defense: "Even more detrimental . . . is the open and facile method of avoidance afforded, if the provision meant that a corporation could secure one impoverished stockholder not subject to the


\textsuperscript{56} Hall, \textit{op. cit.}, pp. 115-119.

surtax rates and thus laugh in the face of any practical effort to prevent surtax avoidance through corporate accumulations. We are satisfied that the section cannot carry the suggested meaning."  

One interesting by-product of the Trico cases, a result which may strengthen indirectly the Treasury's hand in enforcement of Section 102 against the second type of operating company mentioned above, was the suit brought by some Trico stockholders of the non-controlling group against the officers and directors who were the controlling group or its representatives.  

The defendants were accused of deliberately allowing earnings to accumulate in order to avoid Federal income taxes. While this case never actually went to trial, the New York State Supreme Court on December 23, 1947, approved an out-of-court settlement under which defendants agreed to pay into the corporation $2,390,000 and to declare a dividend in excess of $3,300,000.  

In any Section-102 case involving an operating company, the crucial question will be, did the company accumulate earnings beyond its reasonable needs? If the accumulation is deemed unreasonable, then, as already mentioned, it is up to the corporation ("by the clear preponderance of the evidence") to disprove the charge of interdicted purpose.  

It is not possible in the short space of this article to analyze fully the problem of reasonable (unreasonable) accumulation of earnings. "The question of what are reasonable or unreasonable needs of business is always one of fact. The answer is rarely easy to find." The following are only a few of the possible evidences of unreasonable accumulation: in general, any evidence of excessive liquidity of assets as indicated by the ratio of cash and other liquid assets to total assets and the ratio of quick assets to current liabilities, as well as the amount of net quick assets; investment in large amounts of marketable

58 46 B. T. A. 346.
60 Ibid., p. 344.
61 The Dill Manufacturing Co., 39 B. T. A. 1023.
62 J. M. Perry and Co. vs. Commissioner of Internal Revenue, 120 F. 2nd 123.
securities;\textsuperscript{63} loans to stockholders where dividends might have been paid;\textsuperscript{64} accumulations of liquid assets allegedly for expansion, where the plans for expansion are vague or cannot be put into effect in the near future;\textsuperscript{65} the acquiring of interest in an unrelated business;\textsuperscript{66} the fact that the corporation has only one important shareholder or is controlled exclusively by one family.\textsuperscript{67}

There are also factors predisposing toward a judgment of "reasonable" in the accumulation of earnings and surplus: in general, Section 102 does not "contemplate that a business shall remain static; it must be assumed that any business shall have the right to grow," and "necessarily incident to the exercise of this right are the making and pursuit of plans both as to organization and as to finances which will permit the accomplishment of the contemplated development."\textsuperscript{68} The courts appear to be influenced somewhat by the fact that earnings, even if distributed instead of being accumulated, would not appreciably alter shareholders' tax liability.\textsuperscript{69}

What have been the results of Section 102? This is not an easy question to answer. It is not enough to cite statistics as to the number of assessments and the amounts successfully collected. Even more important would be the "unrecorded" results: the dividends that would not have been paid in the absence of Section 102, the factory buildings that were built

\textsuperscript{63} Helvering \textit{vs.} National Grocery Co., 35 B.T.A. 163, 92 F. 2nd 931, 304 U.S. 289.

\textsuperscript{64} William C. De Mille Productions, Inc., 30 B.T.A. 826.


\textsuperscript{66} Whitney Chain and Manufacturing Co. \textit{vs.} Commissioner of Internal Revenue, 3 T.C. 1109; 149 F. 2nd 936.


\textsuperscript{68} William C. De Mille Productions, Inc., 30 B.T.A. 826.

\textsuperscript{69} Charleston Lumber Co. \textit{vs.} United States, 20 F. Supp. 83. This point, of course, is not so much a disproof of "unreasonableness" as it is of the interdicted purpose. But the two, as a practical matter, cannot always be satisfactorily disentangled.
only as an alternative to allowing the Treasury the basis for an additional tax assessment, the extent to which corporations are financed by bonds rather than through additional equity financing because of Section 102, etc. These things are elusive and yet significant.

In recent years, three agencies have sent out questionnaires seeking information about the effects of Section 102. The first was the Brookings Institution questionnaire sent out to about 1000 manufacturing concerns in 1948. Then in 1949 came the questionnaire of the Tax Institute, sent out to about 1,700 tax lawyers and accountants, and that of the Joint Congressional Committee on the Economic Report, sent out to some 250 corporations.

One gets the general impression from the results of these questionnaires that Section 102 does have some effect in bringing about a more liberal dividend policy for corporations as a group; that it tends to "force" investment, especially during periods of high profits when "forcing" would tend to contribute to any existent inflation; and that such increased dividend and investment outlay is at the expense of liquid assets. The chief impact, as one would imagine, is on the profitable but closely held type of corporation. There have been complaints on such other points as the harmful publicity which may attend a Section 102 assessment that is litigated—particularly the necessity sometimes of revealing "confidential" information in court; the use of Section 102 by Treasury employees as a "threat" to force acceptance of other proposed settlements; the uncertainty of the meaning and application of Section 102 with resultant "court-made law"; the increased danger of directors' positions as a result of the Trico shareholders' suit; the assessment of the tax against all retained earnings, instead of only that portion actually deemed unreasonably retained; and the placing of the burden of the proof on the corporation, rather than on the government, to show that it was not guilty of purpose to avoid surtax.

Turning to the actual statistical results of Section 102, we find

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71 The Tax Institute, Economic Effects of Section 102 (Princeton, The Tax Institute, 1951).
that the Bureau of Internal Revenue, at the direction of the Joint Committee on the Economic Report, has made an analysis of actions taken by the Bureau under Section 102 during the period July 26, 1939, and December 31, 1949. During that period, deficiency assessments under Section 102 were proposed and made in the case of 514 corporations, involving a total of 919 assessable tax years. An additional 114 tax years were proposed but subsequently dropped. A total of $14,255,129 was actually assessed in these cases, out of a total of $20,073,001 originally proposed by the Income Tax Unit.

When it is noticed that the number of corporations against which Section-102 assessments were made during the period under consideration did not, in any year, exceed one fourth of one percent of the total number of corporations reporting net income, the volume of activity under Section 102 seems quite insignificant. This seems to be further supported by the fact that the assessments of $14,255,129 (under Section 102) were only about one third of one percent of total additional income and profits tax assessments of $4,375,699,000. Once again, however, it should be pointed out that the bare statistical facts about this tax are no satisfactory indication of its importance in the Federal tax structure.

Up to January 1, 1950, a total of 101 cases involving Section 102 had reached the Federal courts. Of these, the Treasury had 42 decided in its favor in the trial court and 50 decisions were adverse to its position. Of the remaining nine, three were decided in favor of the Treasury, appealed, then dismissed without decision on stipulation of parties; three were decided against the Treasury, appealed, then dismissed without decision on stipulation of parties; in one, decision was partly in favor of the Treasury, the case was appealed, then dismissed by circuit court of appeals without decision on stipulation of parties; and in two, the decision was favorable to the Treasury, but on appeal remanded without decision.

This does not seem to be a particularly outstanding record for the Treasury. The company which is assessed under Section

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73 Ibid., pp. 106-183.
74 $22,914,802 was the amount actually proposed originally, if one includes the 114 years later dropped.
75 Hall, op. cit., pp. 154-155.
102—its one of a very small number of companies—has, apparently, an even chance of escaping the assessment should it elect to go to court. Despite the toughening of Section 102 in 1938, it is probably true that the courts will usually try to give benefit of any doubt to the corporation in any question of what is "reasonable" accumulation of surplus. The Treasury, in a Section-102 case involving an operating company, is, in effect, seeking to substitute its own judgment about the use of earnings for that of the corporation's directors; and its finding that accumulation in a given case is unreasonable may itself be received by a court with a certain amount of reservation and unconscious resistance.

Apart from the special cases of the personal holding companies, the Federal Government today relies entirely on Section 102 to prevent the use of the corporation as a means of avoiding taxes on income of individual shareholders. This has been the outcome of a process which eventually led to the complete separation of the corporate and personal income taxes.

As long as this separation obtains, and particularly as long as personal income tax rates remain at present high levels, it is unthinkable that some such device as Section 102 should be lacking. In fact, it seems rather curious, in view of what has happened to personal income tax rates (i.e., to the "incentive" to attempt avoidance), that Section-102 rates have not risen since 1941. If one has a marginal rate of 70 or 80 percent, it may seem worth the risk involved to retain earnings; after all, 38½ percent under Section 102, plus eventual long-term capital gains treatment, is better than 70 or 80 percent, even if one gambles and loses.\(^7^6\)

Since the end of the war, there has been a considerable amount of discussion, not only of the tax avoidance aspect, but of the other aspects of corporate income taxation as well.

The most drastic proposal for the alteration of the corporate tax structure of the Federal Government is the "partnership" proposal. According to this proposal, shareholders should be treated as if they were partners in their company, i.e., the company should not be taxed as such (under a corporate income

\(^7^6\) The Tax Institute, op. cit., p. 78.
tax) and the partners (shareholders) should include their pro rata share of earnings (whether distributed or not) in their personal tax returns. From a purely theoretical standpoint, this proposal derives strength from the "economic power" concept of income developed by Simons (among others).\textsuperscript{77} Under such a proposal, the problem of avoidance would be eliminated.

Apart from Simons, the "partnership" proposal has had active support from Taylor\textsuperscript{78} and Hall,\textsuperscript{79} and has received qualified support from Groves.\textsuperscript{80}

Two major objections have been raised to this proposal. One of them is the practical problem of allocating to each stockholder his pro rata share of earnings in those cases where the corporation has a large number of stockholders and where stock changes hands often in active markets. But as Groves has pointed out, of the some half million corporations in the country, only a relatively small number "are large institutions with long lists of stockholders scattered over the country."\textsuperscript{81} It should be possible, therefore, to achieve partial integration of corporate and personal income taxes, i.e., to achieve it in all cases aside from the relatively small number of sizeable "public" type corporations.

The other major objection is a legal one. While there would seem to be some precedent for the "partnership" approach in the Civil War income tax and in the earlier versions of Section 102 itself, there is some feeling that the ghost of \textit{Eisner vs. Macomber} still lingers.\textsuperscript{82} No one can say what the Supreme Court would decide in this matter today, but the "corporate veil" is not completely impenetrable—the anti-trust laws are a case in point.\textsuperscript{83}

\textsuperscript{78} Taylor, \textit{op. cit.}, pp. 435-440.
\textsuperscript{79} Hall, \textit{op. cit.}, pp. 181-182.
\textsuperscript{81} \textit{Ibid.}, p. 56.
\textsuperscript{82} It will be recalled that the "partnership" approach in Section 102 was given up by the Congress because of the same doubt as to constitutionality.
\textsuperscript{83} Some persons have also questioned the "partnership" approach because of its possible effect on Federal revenue. It does not necessarily follow that the effect on revenue would be adverse; but even if such were the case, revenue need not be the prime consideration in the devising of a satisfactory tax system. See Taylor, \textit{op. cit.}, pp. 437-439.
Completely opposed to the "partnership" approach is the view that, even though we may have blundered into it, complete separation of corporate and personal income taxes is a perfectly natural result of the role which the corporation plays in the modern American economy. This is the conclusion of Goode.\textsuperscript{84} In the case of the large "public" type of corporation, at least, "less strain on the imagination is involved in the legal assumption that the stockholders and the corporation are entirely separate."\textsuperscript{85}

If this latter point of view is accepted, then we retain separation and focus attention on strengthening Section 102.\textsuperscript{86} During recent years, there has been considerable pressure to relax or modify, rather than strengthen, Section 102. As might be expected, this pressure has come from the business community, particularly from moderate-sized firms with a small number of shareholders, and from some (though by no means all) tax attorneys and accountants.\textsuperscript{87} Yet, in view of the separateness of personal and corporate income taxation, and in view of the fact that integration via the "partnership" approach (while extremely attractive) is not of likely occurrence in the near future, such modification would seem somewhat out of place.

There have been other proposals for the alteration of the corporate tax structure, but basically any change which might be made would involve the two alternatives sketched in the above paragraphs. The problem is that the level of income taxation has become quite heavy and the desire to reduce one's tax burden is a quite natural desire. The corporation can sometimes be a very effective device for this purpose. But society cannot, in justice to all, permit this to occur. We must, in order to solve this problem, either sweep aside the corporation altogether in the field of income taxation, or, while recognizing it, police its use by some such penalty tax as provided in Section 102.


\textsuperscript{85} Ibid., p. 25. Goode also advances several other arguments for a separate corporate income tax, such as "allocation of social costs" and "social control."

\textsuperscript{86} Hall, \textit{op. cit.}, pp. 13-14, 191-192.

\textsuperscript{87} An extensive Section-102 literature has developed in recent years. For a full bibliography, see Tax Institute, \textit{op. cit.}, pp. 302-308.
A PATTERN FOR DELAWARE'S
CONSERVATION OF NATURAL RESOURCES*

JOHN A. PERKINS †

The conservation movement in the United States began in the last half of the 19th Century. Even before the continent had been completely settled, farsighted conservative men like John Quincy Adams realized that its resources were not inexhaustible. Thinking men realized that the protection of the resources of man's physical environment against waste has always been a major problem of civilization. Thinking men knew that with the development of agriculture man sharply modified the existing flora and fauna and greatly accelerated the rate of land degradation. In the brief interval of recorded history, removal of forests and tillage with subsequent erosion of the soil have destroyed great areas of formerly useful land, especially in China, in the Mediterranean region, and in North America. In North America, dissipation of natural resources has been more rapid than in the Old World. Abundance of land led American pioneers to recklessness in tillage, results of which were serious in terms of wasted soil and invited eventual floods and water shortages. Today we speak of such people as mining the land instead of farming it. Forests were an obstacle to be hacked and burned away, and the waste in the exploitation of minerals was likewise great. The depletion of our natural resources in the United States has been considerably masked by the development of new sources of supply and the progress of techniques. Consider one example. The introduction of cracking in the refining of petroleum has doubled and trebled the percentage of gasoline obtained from the crude.

By 1895, scientists and statesmen alike were pointing out the folly of heedless waste and gradually during the next two decades

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conservation became a national slogan. In the first half of this century much national and state conservation legislation was enacted. These laws seemed to have two closely related objectives: first, to protect the remaining public domain against those who would loot it for personal selfish gain; second, to reduce the waste of timber, soil, minerals, game, fish, and water. Studies were also undertaken to survey, map, and classify the resources, particularly those on the public domain.

The strongest advocates of a policy of conservation are found in two groups: first, the nature lovers (sportsmen have been interested to a limited extent, and, if they are real sportsmen, they are in this category); and, second, the advocates of national defense. It is no wonder that President Theodore Roosevelt was a leader in the conservation movement, for he was both a great nature lover and an outspoken believer in national preparedness for the United States.

American businessmen, long recognized as zealous in their efforts to root out waste and gain the goal of efficiency in their own enterprises, have not always understood that conservation was essentially an effort paralleling their own, with exactly the same philosophy. The conservationist would eliminate waste of natural resources and use them efficiently. Because conservation of natural resources by its very nature had to be undertaken by government, businessmen were often suspicious of it. They were easy prey to the propaganda of other men purporting to be their comrades in business. These other men were actually wasting and exploiting the common capital of all Americans, including that belonging to the legitimate businessmen. Naturally, these despoilers wished to be left strictly alone in doing as they pleased with our common capital. American businessmen should not be taken in by a common rallying cry against "Washington bureaucracy" or "petty local politicians" every time it is raised by those opposing the action of a government seeking to conserve our natural resources. They should look into the matters concerned to see where their individual interests lie, not only immediately but in the years to come. When businessmen do so, many of them will become the greatest advocates of conservation. Basically, the conservation movement seeks to maintain values, to safeguard and improve them, and to eliminate wanton waste.
It is little wonder that the Delaware Bankers Association should be the sponsors of this Delaware Conference on Natural Resources. The wonder is that this farsighted group of businessmen had not taken up the matter in earnest before. Congratulations to them.

In conservation policy matters, the national government has shown more initiative and resoluteness than have most of the 48 commonwealths. To review the record does not reflect the credit upon the states that a firm believer in states rights and the federal system would like to find. At least, we may say that today public responsibility of the state governments for the public's natural wealth is universally recognized and that sound principles of conservation have been developed by the more progressive commonwealths. Every state now devotes some attention to the conservation and development of its natural resources. But the signs are that the programs of the several states are far from adequate. The pattern of the laws in the several states shows that they are sometimes needlessly repressive, or—what is much more common—needlessly lenient, if not absent altogether. Enforcement is lax. The quality of staff of natural-resources agencies varies from efficient devoted public servants, protected by civil service, people who are well trained and paid accordingly, to the uninspired, inefficient quasi-professional payrollers who precariously hold their jobs by reason of partisan connections and of guessing election outcomes correctly. The latter are poorly paid. They inspire limited monetary outlays, and what is furnished is often largely wasted. Such personnel invites federal interference and even necessitates federal domination if real accomplishment is required by the urgency of the situation.

States having large territory with natural resources equally large and of the most dramatic types (great forests, coal and ore deposits) have been most prominent in legislating and organizing a conservation policy. Michigan will expend twelve or more million dollars next year, mostly in its great unified Department of Conservation. It is a good example. Ohio, with its highly integrated, all-inclusive Department of Natural Resources, is another. Indeed, when one looks at the Conservation Year Book for 1952, reads Clifford J. Hynning’s State Con-
servation of Resources and reflects on the accomplishments of a number of states, it may seem that Delaware has been almost unaffected by the conservation movement of the last half century.

This is not the case. It must be remembered that Delaware is a small state with natural resources of the undramatic variety, principally farm land and water, both salt and fresh. The greatest part of our conservation work has been, and should be in the future, accomplished through the State University, particularly in its Agricultural Extension and Experiment Station endeavors. The county agents of this Extension Service, in addition to working with the individual farmer, serve as Secretaries of the Soil Conservation District Committees; the Dean of Agriculture serves as Chairman of the State Soil Conservation Commission. The Experiment Station recognized some years ago that water, particularly groundwater, was a problem in Delaware. A research project was initiated which ultimately resulted in the creation by the last legislature of the Geological Survey, likewise located at the University. Marine fisheries have long been significant economically in Delaware. Teaching as well as research was needed in this field, too. The Marine Biology program was created by the last legislature. The legislature, in the marine biology example and in the Geological Survey, have followed the Land-Grant State University pattern, offering out of the University to the people of the state a rich program of higher education, and, at the same time, research and service to the industry of the state as well. Combining teaching and safeguarding of natural resources is a practical way for a small state like Delaware to cut down on duplication of expensive scientific specialists. It eliminates a lot of top-heavy administrative structure, and we would otherwise have too many chiefs and not enough Indians. Considering the percentage of our forests and forest products that are in farm woodlots on privately owned farms, Delaware might well have followed a similar pattern in forestry. Enthusiastic as I am, however, about conservation efforts, I do feel it would be a mistake for us to imitate too closely the pattern of the larger states.

Several other forward steps definitely related to conservation have been taken in Delaware in recent years: the creation of the
Commission on Water Pollution; the passage of a uniform state drainage law with a qualified engineer to administer it; the hiring of a technical staff for the Fish and Game Commission. There are other steps that should be taken. Although they are a later type of conservation effort than that conceived by Teddy Roosevelt and Gifford Pinchot, they too require their dynamic advocacy.

In the decade between 1940 and 1950, Delaware's population has grown at a rate exceeded by only 15 of the 48 states. Since 1950, the population has grown even faster. In recent years, Delaware has awakened to the fact that human resources are perhaps our most vital natural resource, hence an increased attention to education and public health. Our other important natural resources of land and water become even more precious as population increases within the limited area that is Delaware. Comprehensive resource plans are needed to make certain that Delaware makes the most of what it has. I am advocating planning—that tool of efficiency that American industry, not Russia, taught the world to value. Land-use plans are desperately needed and strict zoning is imperative. This is essential not only in New Castle County, but in the lower counties as well. If we proceed to use our land, as in so many instances it is being used now, in an indiscriminate and desecrating way, it will be just as wasteful as burning and butchering trees. Because we do not have zoning, rural slums and the wrong thing in the wrong place are destroying land values as surely as forest fire and flood and erosion ever could do it. State parks originated in the Yosemite area of California and around Niagara Falls in New York State. We have a natural wonder to protect, too,—man. But because our natural wonder is just man, we may be slow about acting. Parks and other recreation areas in the metropolitan New Castle County are even more needed than still wider areas for industry—that is, if we expect to have people still in Delaware—the kind of citizens Delaware has prided itself upon. Let us remember, people are the prime natural resource.

Our cities spill over into the rural areas and make them "rurban"—halfway between urban and rural. Arrangements must be made in these rurban areas for governmental services so necessary when people live closely together. If governments
do not furnish organized recreation, we have crime; if they do not furnish sewers, dumps, and incinerators, we have rats, disease, and death. The roadside litter on the semi-rural roads of New Castle County is a public disgrace as well as a health menace; the roadside is used as a dump because of failure of government either to require or to provide incinerators as an alternative. What is a problem in New Castle County today, becomes a more serious one tomorrow, and the day after it will be a problem in all parts of the state. Natural resources, widely conceived, do indeed demand attention.