



Introduction

Over the last century, countries have typically followed either the United States model or the United Kingdom model in taxing corporate income. In the USA, corporations are subject to tax as separate entities under what is called the classical system. Income is taxed first to the corporation when earned and a second time to the shareholders when distributed as a dividend. This double taxation was mitigated to some extent in the USA by a 2003 reduction in the rate applied to the shareholder-level tax on certain dividend payments, but it left the basic double tax system intact. The UK system of corporate taxation has traditionally stood in sharp contrast to the US approach by integrating the corporate income tax with the taxation of shareholders. Although this integration could be effected through a variety of means, including a corporate deduction for dividends paid or a shareholder exemption for dividends received, the UK has historically integrated the corporate and individual income taxes through an imputation approach in which shareholders are provided a credit designed to offset at least a portion of the tax paid on that income at the company level. The amount of that credit has declined in recent years, but the UK has retained at least a hybrid approach to corporate income taxation.

This sharp divide between the US and UK approaches has not always existed. When income taxation was employed during the nineteenth century, both countries taxed corporate income in a system that was integrated with the individual income tax. It was only around World War I that the nations began to diverge as the USA moved to a classical system while the UK retained a largely integrated approach. Moreover, there have been several instances during the last century when the countries moved closer together, including most notably during the last decade or so. This book seeks to explore the history of British and American corporate income taxation in search of the factors that may help explain why they diverged and converged over the years and what this portends for the future of corporate income taxation in the two countries and around the globe.

The United States and the United Kingdom have always provided a strong basis for comparative study in the legal context. This is primarily because the two countries share a background in the common law method of jurisprudence. Moreover, as a former British colony, the USA inherited or adopted many of the laws and legal practices of the United Kingdom. For example, in Maryland the English common law retained precedential value after America became independent.¹ Because of these similarities, comparing the development of the law in the two jurisdictions is often considered instructive for understanding the circumstances under which they have diverged in their approaches.

In the tax arena, the basis for comparison between the USA and the UK is not as obvious. On the one hand, since tax is primarily a legislative and administrative, rather than judicial, undertaking, the shared common law background is less relevant.² Moreover, because the UK first adopted an income tax in 1799, there was little colonial experience to draw upon in the construction of an income tax system.³ On the other hand, each country at least experimented with an income tax during the nineteenth century and this became the centerpiece of each country's revenue systems during the twentieth century. Under Victor Thuronyi's modern classification of nations, the two countries would be considered members of distinct families of income tax laws and therefore appropriate objects of comparative study.⁴ The USA and the UK also have industrialized economies and well-developed capital markets, with frequent market interaction between businesses in both jurisdictions that trace to the founding of America, suggesting that a comparison of business taxation employed by each nation is particularly appropriate. Finally, the fact that the countries began with similar systems of business

¹ See, e.g., *A Declaration of Rights, and Constitution and Form of Government agreed to by the Delegates of Maryland*, November 3, 1776 at III:

‘That the inhabitants of Maryland are entitled to the common law of England, and the trial by jury, according to that law, and to the benefit of such of the English statutes as existed at the time of the first emigration, and which, by experience, have been found applicable to their local and other circumstances, and of such others as have been since made in England, or Great Britain, and have been introduced, used and practiced by the courts of law or equity . . .’

² William B. Barker, “A Comparative Approach to Income Tax Law in the United Kingdom and the United States,” *Catholic University Law Review* 46 (1997): 7, 8.

³ *Ibid.*

⁴ Victor Thuronyi, “Introduction,” in *Tax Law Design and Drafting* (Victor Thuronyi, ed.) (Washington, DC: International Monetary Fund, 2000): xxiv.

taxation and then those systems diverged (and converged) over the years, suggests both an inter-jurisdictional and a historical comparison may yield distinctive insights.

Thus, while the typical colonial grounds for a comparative US–UK study are less relevant, tax is still well suited to comparative analysis. Indeed, the early drafters of US tax legislation frequently looked to the United Kingdom as a model or source of inspiration or contrast.⁵ Similarly, post-World War II reformers in the UK have on several occasions looked to the operation of the US tax for guidance in modernizing the British version, most notably in 1965 when the UK adopted an American-style classical corporate income tax.

Despite the interconnectedness of the USA and the UK and the economic and business similarities, few scholars have examined the similarities and differences between the American and British income taxes in any systematic way. Edwin Seligman, one of the most prominent public finance economists of his day, compared income tax systems in a variety of countries, including the USA and the UK, in his seminal work *The Income Tax*.⁶ This book, however, was originally published before the modern income tax was adopted in America and even the second edition in 1914 only covered the very first post-Sixteenth Amendment statute. Moreover, Seligman's work was more broadly focused and was not concerned with a direct comparison between the two countries, let alone a comparison of the treatment of corporate income in the USA and the UK.

Harrison Spaulding published one of the earliest comparative studies of the modern US and UK tax systems in 1927.⁷ Spaulding, a Canadian lawyer who received a Ph.D. from the London School of Economics, described his study as “badly needed,” noting that although each country principally relied on an income tax as its main source of revenue, their respective understandings of income and the administration of an income tax differed greatly.⁸ From his 1920s-era perspective, one of the principal differences involved the pace of change in the two systems:

⁵ See, e.g., André Bernard, *Income Tax in Great Britain, Including a Description of Other Inland Revenue Taxes*, prepared for the Joint Committee on Internal Revenue Taxation (Washington, DC, 1928); Roswell Magill, L.H. Parker, and Eldon P. King, *A Summary of the British Tax System – With Special Reference to its Administration*, prepared for the use of the Joint Committee on Internal Revenue Taxation (Washington, DC, 1934).

⁶ Edwin R. A. Seligman, *The Income Tax: History, Theory and Practice of Income Taxation* (New York: Macmillan Company, 1911).

⁷ Harrison B. Spaulding, *The Income Tax in Great Britain and the United States* (London: P. S. King & Son, Ltd., 1927).

⁸ Ibid. at 5–6.

“If the British are slow to change the income tax, the Americans are sometimes apt to make important changes without sufficient deliberation.”⁹ While this may have paid insufficient deference to the dramatically shorter period of existence for the income tax in the United States and the upheaval occasioned by World War I – indeed, the British income tax might be similarly described from the perspective of the early nineteenth century right after the Napoleonic Wars – it did not miss the mark too greatly for the taxation of corporate income.

Spaulding briefly speculated on the possible explanations for why America took a different path in taxing corporate income, conceding that the reason for the divergence is “not entirely clear.”¹⁰ He identified at least three possible “contributing factors” that could account for the more entity-focused tax system in the USA. The first was a decidedly formal legal explanation. According to Spaulding, entity theory doctrine was “carried much farther than in Great Britain,” leading Americans to “see a corporation as a thing different from other taxpaying persons, and . . . as a thing peculiarly suitable for specially heavy taxation.”¹¹ The second was a reflection of the American experience with special corporate taxes on the state and local level, where corporations were subject to special franchise taxes, capital stock taxes, and other levies. Ostensibly, such taxes were the price businesses paid for the privilege of operating in the corporate form. Spaulding theorized that these taxes helped to familiarize the general public with the concept of entity-level taxation, even though the rationale for such taxation was different on the federal level.¹² Finally, the third explanation offered by Spaulding was that corporate shareholders in the USA were perceived to be wealthier and less deserving than those in British corporations. According to Spaulding, “[p]ersons living on small incomes derived from dividends are relatively fewer in the United States than in Great Britain, and, in any event, people in the United States who live on investment income without work are not regarded with much favour.”¹³ Based on the popular view that the corporate tax burden fell on shareholders, the public thus favored entity-level taxation in the USA as an indirect aid to progressivity.

One could quibble with each of Spaulding’s explanations. For instance, the first two were over-generalized in their descriptions of the treatment of corporations in doctrine and theory. There were many examples of an aggregate approach to corporations and corporate taxation in the USA throughout the nineteenth and early twentieth

⁹ Ibid. at 296. ¹⁰ Ibid. at 94. ¹¹ Ibid. at 92. ¹² Ibid. at 92–93. ¹³ Ibid. at 94.

centuries, both at the state level and at the federal level in the early income tax. The third of Spaulding's explanations may have been accurate as an historical statement about the wealth of corporate shareholders in the USA, but it was a reality that was quickly changing as stock ownership spread. Moreover, all of these explanations were made from the perspective of explaining the divergence in the USA and did little to help explain why the UK viewed the situation differently. Most importantly, though, is the fact that Spaulding's explanations were static. Intervening events belie some of these interpretations, including events that occurred in the few years before his account was published.

A few years after Spaulding's book appeared, Roswell Magill, an economics professor from Columbia who was then serving as special assistant to the Secretary of the Treasury, led the completion of a comparative study on the USA and the UK.¹⁴ This study, which was prepared for the Joint Committee on Taxation, was initially designed to focus on the administration of the British tax. It soon broadened, though, to encompass all relevant points of comparison between the two systems. Despite frequently interspersing US comparisons with the description of the British system, there was little attempt to highlight the difference between the two countries' approaches with respect to taxing corporate income. The study did note, however, that the "British have encountered the same trouble from the avoidance of surtaxes by incorporation that we have encountered in the United States," on account of the fact that in the UK only the income tax was paid on the shareholder's behalf at the company level while the surtax was only paid when income was distributed.¹⁵ So, in effect, this study was quicker to note the similarities between the two systems than to try to explain their differences, and in any case this was more an examination of the British system than a comparison of the two.

Perhaps the most serious attempts to compare the US and British approaches to corporate taxation came out during and immediately after World War II, when the USA and the UK were both in the midst of thinking about significant corporate tax reform.¹⁶ In 1943, George May,

¹⁴ Magill, Parker, and King, *A Summary of the British Tax System*. ¹⁵ *Ibid.* at 25.

¹⁶ For a general discussion of this period of corporate tax reform in the USA, see Steven A. Bank, "The Rise and Fall of Post-World War II Corporate Tax Reform," *Journal of Law & Contemporary Problems* 73 (2010): 207. For an example of the comparative push occurring at the same time, see e.g., [unsigned] "Some Techniques of Taxation in the United Kingdom," *Yale Law Journal* 52 (1942–43): 400 ("Today, when the tax structure of the United States is in violent flux, the tax system employed in the United Kingdom offers a valuable source of information and experience.")

an accountant with Price Waterhouse, wrote a brief article for the *Harvard Business Review* comparing the US and British systems of taxing corporate income.¹⁷ May attributed the difference in approaches primarily to the fact that the UK income tax preceded the development of the business corporation while the modern US income tax was enacted not only after the business corporation had begun to solidify its place in the economy, but during a period when corporations had “become important and were unfavorably regarded.”¹⁸ As a consequence, May maintained, “it is not surprising that our law fell into two sections: one levying taxes on individuals, and the other, levying taxes on corporations.”¹⁹

This notion that corporate animus was responsible for the development of the classical corporate tax in the USA is plausible. Indeed, it has achieved some supporters in modern tax scholarship.²⁰ Nevertheless, it does not quite fit the story’s chronology.²¹ While it was certainly popular at the turn of the last century to advocate the regulation of business corporations, the original formation of what would be considered the classical corporate tax in the USA arguably occurred during World War I when the corporate and individual rates separated. This was at a time when Congress was trying to balance the staggering need for revenue with a desire to protect corporate retained earnings from the rise in individual surtax rates. Moreover, even if the US Congress was motivated by the dangers of corporate growth in pushing for a separate corporate tax, it is not clear that May’s explanation holds for the UK as well. The business corporation may not have been prevalent at the turn of the nineteenth century in the UK, but the British decision to focus on the source of income rather than the identity of the recipient was likely

¹⁷ George O. May, “Corporate Structures and Federal Income Taxation,” *Harvard Business Review* 22 (1943): 10. Another article came out a few months earlier comparing British and American approaches to taxation, but it only devoted a few paragraphs to the comparison of corporate taxation as one of the examples it used to dispute the commonly held belief that the British paid more in taxes during the war than Americans: H. Arnold Strangman, “British and American Taxes,” *Taxes* 21 (1943): 207, 208.

¹⁸ May, *ibid.*, at 11. ¹⁹ *Ibid.*

²⁰ See, e.g., Reuven Avi-Yonah, “Corporations, Society, and the State: A Defense of the Corporate Tax,” *Virginia Law Review* (2004): 1193; Marjorie E. Kornhauser, “Corporate Regulation and the Origins of the Corporate Income Tax,” *Indiana Law Journal* (1990): 53, 136.

²¹ See Steven A. Bank, “Entity Theory as Myth in the US Corporate Excise Tax of 1909,” in *Studies in the History of Tax Law 2* (John Tiley, ed.) (Oxford: Hart Publishing, 2007): 393.

fueled by the broader moves toward a scheduler system of taxation, which helped preserve individual privacy, and toward a withholding system, which allowed individual taxes to be collected by a third party, rather than by the absence of income-producing entities. In any event, May offered what was more of a brief hypothesis in search of validation than a true explanation.

In the UK, a decade after May's article, Geoffrey Hornsey, a lecturer in law at the University of Leeds, offered a similar comparison of the US and UK corporate tax systems, along with the French system.²² This article offered little in the way of explanation for the differences among the three countries, other than to recount different legal decisions that affected the tax treatment of dividends and of the corporate entity itself. Hornsey conceded that "[i]t would be difficult, even if one felt tempted to try, to extract any broad principle from the necessarily abbreviated study of a topic which has so many facets," but concluded that "[t]he one striking fact which does emerge is the universality of the problems involved and the similarity of the solutions achieved."²³ Nevertheless, Hornsey provides some hint of the problem, and a possible means of reconciling the differences between the USA and the UK in their approaches to taxing the corporation, when he noted that it would be easier to advocate a uniform approach to corporate taxation "if only the relationships between companies and their shareholders were everywhere uniform."²⁴

Since the early 1950s, there has been little attempt to explain the divergence of the American and British corporate tax systems. Peter Harris, an expert on taxation on the Cambridge Faculty of Law, has written two major works that consider the question of corporate taxation more closely, but neither focuses on the explanations for the differences in the US and UK approaches to corporate taxation. In his exhaustingly detailed study of corporate taxation,²⁵ Harris principally examined the different forms of corporate/shareholder imputation methods in use around the world. He briefly discussed the ways in which the US system departed from the British system in the early twentieth century, but this was more of a description than an explanation. According to Harris,

²² Geoffrey Hornsey, "Corporate Taxation – A Comparative Study," *Modern Law Review* 16 (1953): 26.

²³ *Ibid.* at 33. ²⁴ *Ibid.* at 26.

²⁵ Peter A. Harris, *Corporate/Shareholder Income Taxation and Allocating Rights Between Countries* (Amsterdam: IBFD Publications, 1996).

“[a]lthough providing full dividend relief, the 1913 US income tax differed from that of the UK’s in some important respects,” noting that the British tax was refundable if the shareholder owed no tax while the USA only offered an exemption from further tax on the dividend.²⁶ Harris also considered the question of corporate taxation in his history of income taxation in common law jurisdictions.²⁷ One of his principal inquiries was “why are corporations treated as separate taxpayers from their shareholders?”²⁸ Given the focus on very early history, though, stopping in 1820, this had very little relevance for any modern comparison of corporate tax systems.

Several additional comparative tax history studies involving the United States have been undertaken in recent years,²⁹ but none has focused on comparing the US and the UK systems generally or on the taxation of corporate income in particular. Most recently, sociologists Kimberly Morgan and Monica Prasad compared the origins of the US and French tax systems, but they focused almost exclusively on the choice between income and consumption taxes and did not consider the structural differences in business taxation.³⁰ Similarly, Alexander Nützenadel and Christoph Strupp edited a volume that collected articles primarily on the history of taxation in Germany or the USA, but the emphasis was on tax and state-building rather than on the details of either system.³¹ Political scientist Sven Steinmo compared the American, British, and Swedish tax systems in 1993, with the political and institutional bases for the level of progressivity in each system serving as his departure point.³² Although he briefly discussed the taxation of

²⁶ Ibid. at 81–2.

²⁷ Peter Harris, *Income Tax in Common Law Jurisdictions: From the Origins to 1820* (Cambridge University Press, 2006).

²⁸ Ibid. at 5.

²⁹ The historical comparison of non-US tax systems has been more common. See, e.g., Richard Bonnedey, ed., *The Rise of the Fiscal State in Europe, c1200–1815* (Oxford University Press, 1999); Peter Mathias and Patrick K. O’Brien, “Taxation in Britain and France, 1715–1810: A Comparison of the Social and Economic Incidence of Taxes Collected for the Central Governments,” *Journal of European Economic History* 5 (1976): 601.

³⁰ Kimberly J. Morgan and Monica Prasad, “The Origins of Tax Systems: A French-American Comparison,” *American Journal of Sociology* 114 (2009): 1350.

³¹ Alexander Nützenadel and Christoph Strupp, eds., *Taxation, State, and Civil Society in Germany and the United States from the 18th to the 20th Century* (Baden-Baden, Germany: Nomos, 2007).

³² Sven Steinmo, *Taxation & Democracy: Swedish, British, and American Approaches to Financing the Modern State* (New Haven: Yale University Press, 1993).

corporate income in each jurisdiction, Steinmo offered little comparative analysis on the different methods of taxing corporations.

This is not to suggest that modern tax scholars have refrained from cross-country comparisons. Indeed, quite the contrary. A number of comparative tax studies have been published in recent years,³³ spurring several commentators to call for a fundamental examination of the methodology of comparative tax study.³⁴ This renewed interest in comparative tax study, however, has neither been historical nor focused on the USA or the UK. While several articles have attempted to bridge the gap by comparing one or more aspects of the US and UK income tax systems,³⁵ there have been very few comparative tax histories. As Assaf Likhovski, one of the few authors to broach this subject, wrote, “comparative methodology has had little effect on the legal history of taxation or in tax law scholarship.”³⁶

One of the unique difficulties in writing a comparative legal history is that it has to proceed along two axes. The first axis is comparative, which involves describing the legal systems in existence in both countries and examining the points of similarity and difference, while the second axis is historical, which involves tracing the development of those legal systems

³³ See, e.g., *Comparative Income Taxation: A Structural Analysis*, 3d edn. (Hugh J. Ault and Brian J. Arnold, eds.) (New York: Aspen Publishers, 2010); Victor Thuronyi, *Comparative Tax Law* (The Hague, The Netherlands: Kluwer Law International, 2003); *Tax Law Design and Drafting*; William Barker, “Expanding the Study of Comparative Tax Law to Promote Democratic Policy: The Example of the Move to Capital Gains Taxation in Post-Apartheid South Africa,” *Penn State Law Review* 109 (2005): 703; Anthony C. Infanti, “Spontaneous Tax Coordination: On Adopting a Comparative Approach to Reforming the US International Tax Regime,” *Vanderbilt Journal of Transnational Law* 35 (2002): 1105.

³⁴ Omri Y. Marian, “The Discursive Failure in Comparative Tax Law,” *American Journal of Comparative Law* 58 (2010): 415; Carlo Garbarino, “An Evolutionary and Structural Approach to Comparative Taxation: Methods and Agenda for Research,” *American Journal of Comparative Law* 57 (2009): 677; Michael A. Livingston, “Law, Culture, and Anthropology: On the Hopes and Limits of Comparative Taxation,” *Canadian Journal of Law & Jurisprudence* 18 (2005): 119.

³⁵ See, e.g., William G. Gale, “What Can America Learn from the British Tax System?” *National Tax Journal* 50 (1997): 753; Joseph Guardino, “Comparative Tax Systems – United States v. Great Britain,” *International Tax Journal* 21 (1995): 31; Bernhard Grossfeld and James D. Bryce, “A Brief Comparative History of the Origins of the Income Tax in Great Britain, Germany and the United States,” *American Journal of Tax Policy* 2 (1983): 211.

³⁶ Assaf Likhovski, “A Map of Society: Defining Income in British, British-Colonial and American Tax Legislation,” *British Tax Review* (2005): 158, 159 n 4.

throughout some period of time. Accomplishing both of these tasks simultaneously is problematic. It is not easy to make comparative insights without first setting forth a full picture of the two systems, but it is even more challenging to make those comparative insights over the history of the two jurisdictions. A purely chronological approach simplifies things greatly, but potentially at the cost of identifying themes and common issues that extend over multiple historical periods. By contrast, a purely thematic approach provides the maximum flexibility for drawing comparative inferences, but can leave the reader confused because of a lack of understanding about the legal system and its sequential development.

This book tackles this two-axes problem by using a hybrid approach involving both chronological and thematic approaches. Part I of the book is chronological, setting forth the background for the development of the corporate income tax in the two countries over the last two hundred years. Chapter 1 describes the origins of corporate taxation in the two countries, first in the UK in 1799 and later in the USA during the Civil War in the 1860s. Chapter 2 and Chapter 3 then proceed to chronicle the evolution of each system over the nineteenth and twentieth centuries. The key insight from this part of the book is that both countries developed corporate taxation using an integrated system in which corporate income was generally subject to one layer of tax, but the USA diverged from the UK around World War I by moving to a classical corporate income tax.

Part II, unlike Part I, is thematic, exploring several possible explanations for the divergence, including profits, power over the corporation, and politics. Chapter 4 discusses how the growth of corporate profits forced both systems of income taxation to focus on the corporation in the nineteenth century and why this focus diverged and converged in the twentieth century. Throughout much of the nineteenth century, the business corporation was more closely related to the British East India Company in its behavior and governance than to the railroad corporations that would begin to dominate certain sectors of the American economy at the end of the century. For these early corporations, there was an expectation that all profits would be distributed each year as dividends and any additional capital needs would be satisfied through the debt or equity markets. Thus, it is not surprising that the corporation would be viewed as a convenient vehicle for taxation at the source when the first Anglo-American income taxes appeared in the UK and the USA in the nineteenth century. Both countries' systems reflected the desire to