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CABINET

THE EXCESS PROFITS LEVY

Memorandum by the Chancellor of the Exchequer.

The Federation of British Industries has objected strongly to the imposition of the Excess Profits Levy and they have criticised it on a number of points. Representations have also been made by the Association of British Chambers of Commerce, the National Union of Manufacturers, the Institute of Chartered Accountants and a number of other bodies and individuals. I have also received representations from some of my colleagues and desperate distress signals from members of our Party.

2. We must go forward with this tax. It was an Election promise and it forms an integral part of my Budget proposals.

Nevertheless, I am anxious that any just claim should be met. This will mean a number of concessions which will reduce the net yield in a full year (that is, after allowing for the reduction proposed in the rates of Profits Tax) below the £100 millions originally estimated. There would be little effect this year as the Levy in general is not payable until next year.

3. Two possible courses of action are summarised in the Appendix to this paper under the titles Plan A and Plan B. Plan A involves concessions which reduce the net yield to about £70 millions in a full year; Plan B involves more substantial concessions on the Excess Profits Levy, but recovers part of the cost by giving smaller Profits Tax reliefs than I originally proposed, and reduces the net yield to about £80 millions.

4. On the whole I favour Plan A as involving a less radical departure from the basic principles of the Levy as I proposed them in my Budget Speech - particularly as regards the exclusion of 1950 from the standard; but if we take this course, we should also incorporate the proposals (from Plan B) to increase the percentage allowed on new capital and undistributed profits to 12% (with the corresponding increases in the allowances for mines and oil wells and borrowed money), and to increase the distributed rate of Profits Tax to 20%. The effect of this would be to leave a net yield of about £70 millions, below which we cannot afford to go if the new tax is to retain its essential features and to serve the purpose for which it was intended.

R.A.B.

Treasury Chambers, S.W.1.

28th APRIL, 1952.

APPENDIX

PLAN A

The standard years The trader would be permitted to base his standard on the average of the profits of any two of the three years 1947, 1948 and 1949, instead of being compelled in all cases to take the average of the three years, i.e. he would be allowed to take the average of 1947 and 1948, or the average of 1948 and 1949, or the average of 1947 and 1949. This would meet many of the criticisms about the rigidity of the standard, and would permit the exclusion of 1947 where that was a bad year.

Malaya and the Far East I promised special consideration to companies operating in Malaya and other territories occupied by the Japanese, and I would propose that they should be allowed to take as their standard the average of the profits of the two years 1949 and 1950.

Alternative standard based on net assets. I propose that a further alternative standard should be provided which the company can take where it was making no profits or only small profits in the standard period. This new alternative would be eight per cent of the net assets of the business valued (at the trader's option) either at the beginning of the standard period or at the beginning of the period of charge. Subsequent additions to the profits, whether in the form of undistributed profits or new capital, would qualify for the ten per cent allowance as in the case of other businesses. This should meet the criticisms which have been made of the existing alternative standards and fulfil the undertaking I gave on Second Reading.

The minimum standard I propose that the minimum standard should be increased from £2,000 to £5,000. This will mean that where there is one full time working director, the effective starting point of liability, allowing for the director's remuneration, will be £7,500 and where there are two £9,000. This will cut out about one-third of all companies from the charge.

Allowance for increased output of metal mines

Something must be done to help metal producers who in the national interest increase their output over that of the standard period as this increase in output represents the anticipation of a future profit. I propose, therefore, that the normal rate of profit on the additional output should be exempted from the Excess Profits Levy. This is a much more generous relief than was given during the last war when the relief was restricted to a percentage (varying from thirty per cent down to five per cent) of the normal profit on the additional output. It has been suggested that we should relieve from the tax the whole of the profit on the additional output, but there is no case whatever for relieving any excess profit made on additional output. The relief I suggest is both just and generous.

Borrowed money Under the present proposals the interest payable on borrowed money will be allowed as a deduction in computing profits, but the company will be given no allowance over and above this. It has been represented to me that borrowed money ought to be treated as "capital", i.e. it would qualify for an allowance of ten per cent but no deduction would be given for the interest paid. In view of the great advantage which borrowed money enjoys under the existing Profits Tax (an advantage which has led to undesirable developments in company finance), I am not prepared to go as far as this. I propose, however, that in addition to the allowance of the interest paid, borrowed money should qualify for an additional allowance of three per cent. This would mean that where the rate of interest was five per cent borrowed money would, in effect, qualify at eight per cent against the ten per cent given on share capital. Having regard to the Profits Tax advantage borrowed money enjoys this is fair treatment.

PLAN B

The standard years Under Plan B the trader would be permitted to base his standard on the average of the three years 1948, 1949 and 1950 if he preferred this to the averageof the years 1947, 1948 and 1949. The inclusion of 1950 would meet many cases of real hardship which could be met in no other way.

Malaya and the Far East Companies operating in Malaya and other territories occupied by the Japanese would be entitled, as under Plan A, to base their standard on the average of the two years 1949 and 1950.

Alternative standard based on net assets As under Plan A.

The minimum standard As under Plan A.

Allowance for increased output of metal mines As under Plan A.

Increased allowance on profits ploughed back into the business and on new capital. The ten per cent allowance proposed on new capital would leave little margin over and above the dividend which would have to be paid on the new capital and the Profits Tax on it. It would be desirable to increase the figure to twelve per cent. A corresponding increase should be made on profits ploughed back into the business, as the company which finances its capital development in this way should not be placed at a disadvantage compared with the company which raised its new capital on the market. The additional allowances of two per cent and four per cent given on metal mines and oil wells should similarly be raised to three per cent and six per cent.

Unless more generous allowances are given on new capital there is a real danger that new development will be impeded.

Borrowed money An allowance would be given on the lines suggested in Plan A, but the percentage would be four per cent instead of three per cent to correspond with the increased percentage proposed on share capital.

Profits Tax The rate of Profits Tax on dividends would be put at $22\frac{1}{2}\%$ compared with the $17\frac{1}{2}\%$ I proposed in the Budget. The $22\frac{1}{2}\%$ is still less than the existing rate which is equivalent to about 25%.