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C.P.-3649.

CABINET.

INDUSTRY AND THE WEIGHT OF TAXATION.

NOTE BY THE CHANCELLOR OF THE EXCHEQUER.

I desire to draw the attention of my colleagues to the accompanying memorandum on Industry and the Weight of Taxation, which has been prepared by the Board of Inland Revenue in consultation with the Board of Customs and Excise. It will be seen from the notes appended to the memorandum that the Board of Trade are in general agreement with the conclusions arrived at.

R. S. H.
Treasury, S.W. 1, January 24, 1922.

Memorandum written by the Board of Inland Revenue in consultation with the Board of Customs and Excise.

Taxpayers upon whom the brunt of direct taxation falls are now calling loudly for relief. The claim comes alike from the landowner, the man of business, the farmer, the employee, the professional man and the rentier, and alike from the rich and from those in the middle ranges of income. At the moment the cry is chiefly for reduction of expenditure, but it is not unlikely that the note will change, and the cry become one for a readjustment of the burden of taxation.

2. The general question of the readjustment of taxation, which is one of great importance and complexity, is not discussed here in its widest form, for instance, neither the justice nor the expediency of the existing scale of graduation of the Income Tax and Super-Tax as compared with possible alternative scales is discussed in detail. The purpose of the present note is to review (a) the existing basis of direct taxation, and (b) the ultimate incidence of the increased indirect taxation of the war period, with particular reference to their effects upon industrial activity and national prosperity as a whole, and to draw therefrom conclusions as to the expediency of immediate changes in the relative weight of direct and indirect taxation.

3. There is without question a very widespread opinion among business men that the present weight of taxation is injurious to industry, and through industry injurious to the national prosperity as a whole. For instance, Mr. Alderman and Sheriff H. J. de Courcy Moore, when entertaining a large company at "breakfast," in the Fishmongers' Hall, in the City of London, on the 28th September, 1921, said:—

"The liverymen of the City of London were peculiarly fitted to lead and influence public opinion, and it was to be regretted that at the present time they did not bear a larger share in the counsels of the State. In that event he was sure their influence would be directed to devising some means for lifting the heavy burden of direct taxation which was rapidly crushing out the commercial
life of the trading and manufacturing community. Manufacturing and trading interests were depressed and borne down by the weight of taxation. It was urged that there should be (1) relief of Income Tax, (2) abolition of useless places and sinecures, and (3) rigid economy in every public Department. That need existed to-day, for those who knew business could not fail to realise the grinding nature of existing taxation. It stifled enterprise, drove capital from the country, and made the life of the manufacturer and trader almost intolerable. (*Daily Telegraph,* September 29, 1921.)

This view is widely supported by the press, e.g.:

"The present system of taxation is stifling industry." (*Financier and Bullionist,* September 29, 1921.) And again, "High taxation is strangling industry. This high taxation has to be added to the cost of everything produced, and helps with dear coal and the collapsed foreign exchanges to drive British goods from foreign markets." (*Daily Mail,* September 29, 1921.)

4. These charges, while they naturally tend to be overstated, have, at the present time, a measure of justification, though the basis of their partial truth is often not clearly apprehended. At a moment when industry is endeavouring to keep itself afloat in the midst of an unparalleled depression, it finds itself subject, not merely to the normal duties, which on the basis of existing law it must expect continuously to bear, but to two very great and exceptional burdens in addition.

**I. THE PRESENT ABNORMAL BURDENS.**

5. In the first place, there is hanging over industry the whole weight of the Excess Profits Duty arrear. It is extremely difficult to estimate the amount of this arrear, but it seems probable that the net amount (after all repayments and reliefs) ultimately to be paid to and retained by the Exchequer will exceed £200m. True, industry is not at the moment paying this debt, mainly because it is unable to do so, but this fact only intensifies the burden. In only too many cases, the necessity of redeeming the debt hangs as an incubus over all business thought. In its effect upon the mind, it is like a mortgage, fixed in amount, upon assets constantly shrinking in money values.

6. The second burden is equally exceptional though its total weight is much less oppressive. Under the three years' average system upon which Income Tax is assessed upon the profits of trades and businesses, it must occur in a large number of cases this Christmas, that the Income Tax payable in respect of the profits of a business—so far from representing the normal 6s. in the pound—will swallow the whole, or more than the whole, of the profits of the year of assessment. Indeed, heavy charges of Income Tax will often be payable where heavy losses are at the time being sustained.

7. These circumstances arise directly from the abrupt transition from great prosperity to general depression or, in a number of cases, to utter adversity, and it would be useless to deny that for the moment the pressure upon industry of what may not unfairly be called arrears of taxation is grave. Some partial relief will be given by the proposals which have been approved by the Chancellor for the funding of some part of the Excess Profits Duty arrears.

8. It must be pointed out, however, that these present disabilities, great as they are, are transient, and at root they can only be remedied by heroic measures of a transient kind. For example, if it were possible to abandon the system of assessment on the three years' average in favour of a system of assessment on current profits, and to remit a large part of the Excess Profits Duty arrears, making corresponding repayments to businesses which have paid the whole of their duty, the whole complexion of the case would be changed. Although, of course, nobody would suggest that in the present condition of the Exchequer heroic measures of that kind could be contemplated, the transitory character of the present situation seems to need special

*The assumption on which this note is written is broadly that the Budget must be balanced, and that it cannot be balanced during the next few years if taxation is reduced.*
emphasis. Some small adjustment of the permanent basis of taxation would do very little to relieve the present anxieties of industry, while, in the future as a whole, it might be found to involve altogether disproportionate embarrassment to the Exchequer.*

9. In these circumstances it seems to the Board to be right, when considering the expediency of some limited adjustment of the permanent basis of taxation, to pay regard not to the momentary embarrassment of industry on account of arrears of taxes and depression of trade, but to the weight of taxation as it will fall upon trade so soon as the unparalleled conditions of the present have passed away. It is to this question that the remaining paragraphs of this memorandum are directed.

10. The point at issue is whether the present system of taxation in the United Kingdom will, on the restoration of reasonably normal conditions, clog the wheels of industry and thereby reduce the net aggregate of goods and services which is available for the economic welfare of the nation as a whole. From the revenue point of view, the matter can only be considered upon the hypothesis that every economy in expenditure will be made, and that the State is faced with the necessity of raising by taxation a given amount of revenue, not materially different from the normal produce of existing taxes at present rates. The crux of the question is therefore to be found in the comparative effects of the different taxes now in force, and the possibility of national advantage if changes are made in their relative weights, or if new taxes are substituted for old.

11.—EXISTING TAXATION.

11. Taxation is usually classified under two main heads—direct and indirect. Clear definition of these two kinds of taxes is a matter of difficulty, but, broadly speaking, direct taxes may be described as those of which the taxpayer is also the taxbearer, at least in the intention of the legislature. Indirect taxes, vice versa, are those of which the taxpayer is not the ultimate taxbearer, or is not intended to be. The difference between the two classes is therefore dependent upon the intended incidence.

12. In the United Kingdom, the line of division between direct and indirect taxes is broadly marked by the provinces of the departments entrusted with tax administration. Customs and Excise taxes are mainly indirect, and Inland Revenue taxes are mainly direct. In both categories exceptions are to be found, e.g., the Entertainments Duty should perhaps be treated as a direct tax, and some of the Stamp Duties are certainly indirect taxes.

13. In 1920-21, the total revenue amounted to £1,426, of which £1,032 was drawn from taxation. The balance, consisting mainly of interest on loans and capital transactions, does not affect industry for the present purpose. Omitting £7 received in respect of Motor Vehicle Duties (as more than this sum was paid to the Road Improvement Fund), there remains £1,025, which was collected as to £691 by the Inland Revenue Department and as to the balance of £334 by the Customs and Excise Department.

* At first sight it may appear that the severity of the burden of the moment could be considerably mitigated if assessment on the preceding year basis were substituted for the three years' average. If this were done prospectively for the current year, the effect on industry as a whole and on the Exchequer would be negligible, for the total assessments for 1921-22 approximate to the total profits made in 1920-21. Its sole effect would be to give relief to concerns which did badly in 1920-21 at the expense of concerns which did moderately well in that year. If the change were made in the next budget, to come into force for 1922-23, it would cost the Exchequer some £30, and thus destroy any prospect of balancing that year's accounts. Either of these courses would moreover only touch the fringe of the problem. The embarrassment of business lies in the discrepancy between assessments in 1921-22 and profits in the same year, and a change from the three years' average to a preceding year basis would not at the moment give industry any material help. To give relief on the current year basis retrospectively for 1921-22 would cost the Exchequer nearly £50, and it would almost inevitably have to be continued for the following year, 1922-23, when it would cost perhaps another £30. Finally, a remedy which deals only with the abnormal operation of the Income Tax in a period of trade depression without diminishing the debt of the Excess Profits Duty arrears is very partial and is unlikely to strike the imagination of business men or to provide any substantial relief to their difficulties.

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III.—EFFECTS UPON INDUSTRY OF EXISTING DIRECT TAXES.

14. The £m691 of Inland Revenue duties was made up as follows:

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estate Duty</td>
<td>£41,229,000</td>
</tr>
<tr>
<td>Succession Duty</td>
<td>£1,210,000</td>
</tr>
<tr>
<td>Legacy Duty</td>
<td>£5,250,000</td>
</tr>
<tr>
<td>Corporation Duty</td>
<td>£40,000</td>
</tr>
<tr>
<td><strong>Total Death Duties</strong></td>
<td><strong>£47,729,000</strong></td>
</tr>
<tr>
<td>Land Tax</td>
<td>£650,000</td>
</tr>
<tr>
<td>House Duty</td>
<td>£1,900,000</td>
</tr>
<tr>
<td>Land Values Duties</td>
<td>£20,000</td>
</tr>
<tr>
<td>Companies' Capital Duty</td>
<td>£6,037,000</td>
</tr>
<tr>
<td>Cheque Duty</td>
<td>£3,475,000</td>
</tr>
<tr>
<td>Transfers</td>
<td>£3,747,000</td>
</tr>
<tr>
<td>Conveyances</td>
<td>£6,077,000</td>
</tr>
<tr>
<td>Receipts</td>
<td>£1,330,000</td>
</tr>
<tr>
<td>Marine Policies</td>
<td>£908,000</td>
</tr>
<tr>
<td>Bills of Exchange</td>
<td>£1,800,000</td>
</tr>
<tr>
<td>Other Stamp Duties</td>
<td>£3,219,000</td>
</tr>
<tr>
<td><strong>Total Stamp Duties</strong></td>
<td><strong>£26,591,000</strong></td>
</tr>
<tr>
<td>Income Tax</td>
<td>£338,865,000</td>
</tr>
<tr>
<td>Super-Tax</td>
<td>£55,281,000</td>
</tr>
<tr>
<td>Corporation Profits Tax</td>
<td>£650,000</td>
</tr>
<tr>
<td><strong>Excess Profits Duty</strong></td>
<td><strong>£219,181,000</strong></td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td><strong>£562,967,000</strong></td>
</tr>
</tbody>
</table>

15. Excess Profits Duty has now been repealed, so that in a general discussion of the effect of taxation upon industry its effects need not be examined. As the Excess Profits Duty constituted a deduction in computing Income Tax profits, the amount of Income Tax and Super-Tax above (£m339 and £m55) should be regarded for the present purpose as increased by the amount of Income Tax and Super-Tax on the Excess Profits Duty so deducted. This would increase the Income Tax by £m80 and the Super-Tax by £m10, and thus alter the total Inland Revenue to £m562 (£m691 less £m219 Excess Profits Duty, plus £m80, Income Tax and Super-Tax).

(A.) Death Duties.

16. Little needs to be said of the Death Duties. The Estate Duty is levied on the occasion of the passing of property by death. The influence of its weight on the saving of wealth, whether the fruits of industrial effort or otherwise, is extremely difficult to determine.

Generally speaking, it is not considered that the influences which stimulate men to accumulate large fortunes during their lives are materially affected by the payment of taxation after their death. The recipients of wealth passing on a death, whether that wealth has been subjected to Estate Duty or the other death duties (Succession Duty and Legacy Duty) are not likely to reduce their industrial activities just because they have received less than would have been the case in the absence of such taxation. Indeed, if the taxation has any influence on their action, it is likely to be a beneficial one, stimulating rather than slackening their pursuit of wealth. There is, however, the further question whether the payment of Death Duty (at a high rate) on the occasion of the death of a single owner of a large business may not seriously impair the financial resources of the successor by whom it is to be carried on. This point, while it has some validity, is subject to important qualifications. The number of large private businesses so held is comparatively small; the owners of most of them—as has been established on a recent statistical analysis—

*Though the yield of Inland Revenue duties for 1920-21 thus adjusted to eliminate the Excess Profits Duty, is taken in this note as a basis for judging the weight of taxation on industry, it is thought, though the matter is somewhat conjectural, that the probable normal yield of future years is more likely to be in the neighbourhood of £m500.*
usually possess in addition a considerable volume of other wealth out of which the Death Duty can be paid without trenching upon the business capital. In the rare cases where such businesses pass on death on two or more occasions at short intervals of time, the difficulty referred to would indeed be gravely accentuated; but in such cases the law provides for a mitigation of the burden of duty normally imposed.


17. These taxes are not of sufficient weight to call for detailed analysis here.

(C.) Stamp Duties.

18. Of the Stamp Duties, those on Companies' Capital, on Cheques, on Marine Insurance Policies and on Bills of Exchange are indirect taxes affecting industry. While they have been long established, and their incidence is thus well settled, the rates of duty (with the exception of the rates on Bills of Exchange) have been raised in the last year or so. Their approximate normal future yield may be about £15 to £10 annually, so that they are not negligible. On the other hand, they are shifted to the great body of consumers, and their distributed weight on any individual consumer is very small. Their main drawback is the impediment they offer to industrial and commercial transactions with its accompanying possibility of friction and annoyance to those who pay them in the first place. Companies' Capital Duty should perhaps be specially noted as a duty which, on the one hand, does not tend to be passed on to the consumer and, on the other hand, by reason of its recent quadruplication, does no doubt discourage reconstructions and other financial operations in industry. If the revenue could be spared, or raised by other means, there would, it is thought, be much to be said for sweeping away those stamp duties which particularly affect business operations, e.g., the stamp duty on bills of exchange, on cheques and on receipts, and, in particular, now that a specific tax (the Corporation Profits Tax) is imposed on the profits of limited liability companies, the Companies' Capital Duty. But in existing conditions, of course, these taxes must remain.

(D.) Income Tax and Super-Tax.

19. The greatest Inland Revenue tax is the Income Tax and Super-Tax. Its yield is so huge—now estimated at £385 for the current year 1921–22—and individual taxpayers are so numerous, that it has become the type and symbol of British taxation.

20. The income on which tax is paid arises at many sources. Excluding the yield which is derived from the rent or annual value of lands, buildings, &c., from the profits of farming, the interest on public debts (of foreign States and Dominions, as well as of the United Kingdom), from Dominion and foreign dividends, from salaries, wages, and professional earnings, and from bank deposit and other interest, it may be roughly said that the net amount of Income Tax (Schedule D) (excluding Super-Tax) drawn from the profits of manufactures, trades, &c., amounts for 1920–21 to about £230 out of the £419 (£339 plus £80) shown in paragraph 15. The lower future level of industrial profits now anticipated would reduce this figure to, say, £150 during the next few years. It is this figure which has to be considered in relation to industry.

21. The persons carrying on industry fall into the following classes, viz.:—

(a.) Public joint stock companies.
(b.) Private joint stock companies.
(c.) Individuals, either trading on their own sole account or in partnership.
(d.) Local authorities.

The effect of taxation must be considered separately for the first three classes. The fourth class, local authorities (e.g., municipal and other councils) may be ignored, as their industrial activities are mainly concerned with public utility undertakings, such as gas and water works, &c., which now barely yield a moderate return on their capital invested. The foundation of their existence is co-operative supply: the demand for their products and services is normally limited by the population of the area administered by the local authority; and the basis of their charges is cost of production, plus the service of the local debt incurred for their establishment. The normal characteristics of ordinary industry—competition, desire for large profits, wide markets, &c.—are not present.
22. The preponderant part of industrial activities in the United Kingdom is carried on by joint stock companies. For instance, in 1919-20 nearly 68 per cent. of the Industrial Income Tax profits assessed under Schedule D was earned by joint stock companies; again, the Board estimated in April 1920 that 77 per cent. of the Excess Profits Duty assessed was drawn from the like source.

23. These companies are either public companies or private ones. Public joint stock companies are those in which public ownership of shares is normally widely distributed, whereas private joint stock companies usually comprise a few shareholders only. No exact information is available from direct sources as to the proportions in which the total Income Tax profits of joint stock companies are attributable to public and private companies respectively, but it may be deduced with some confidence from the available data that some 55 per cent. of the total profits of all industry is earned by the businesses of public joint stock companies.

Public Joint Stock Companies.

24. The profits of these companies do not include the salaries, fees and commissions paid to directors, managers and all the officials of the company. The managing spirits of these companies do not bear the tax on the profits of the company, except in so far as they bear tax on the dividends arising from their personal shareholdings. Apart from this point (normally not a major one) they are assessed only in respect of their remuneration as employees of the company. It cannot be reasonably contended that they diminish their work and activities on behalf of the company because of the tax that the company bears on its profits, or even because they receive some proportion of that profit as dividends. Their chief interest and anxiety is to earn profits—as large as possible—to maintain or increase dividends and internal reserves, and so far as they receive commission on profits—(a very common practice)—to increase their personal earnings.

25. Passing from the question of salaries of officials to that of the profits of the business itself, it will be recalled that the bulk of the profits made are distributed as dividends to the shareholders, or as interest on the company's indebtedness, and from such interest and dividends (directly or indirectly) Income Tax is deducted at the full standard rate. Thus, the Income Tax which is paid by a company on that part of its profits which is distributed in interest and dividends is not borne by the company at all.

Each individual recipient of interest or dividend is liable to have the tax so suffered by him increased (by the addition of Super-Tax) if his income exceeds £2,000, or in the contrary event is entitled to have it reduced (by repayment) by reference to the amount of his own personal income and the effective rate of Income Tax thereon.

26. The enterprise of the company itself is not affected by the weight of income taxation, except only so far as the profits made are retained in the business as reserves. In 1919-20 the Board estimated that the total undistributed profits of all joint stock companies (of which the larger part related to public companies) amounted to some £163. Income Tax is paid thereon at 6s. in the £, amounting to £48, and the expansion of industry is undoubtedly affected. This point, which is an important one, is discussed further in paragraph 37 below. For the moment, it is sufficient to point out that the question of taxation hindering the expansion of industry is a totally different question from that of taxation throttling industry, for the latter implies the death of industry, while the former means only a reduced rate of expansion.

Moreover, the widespread practice of joint stock companies in retaining undistributed profits is a means of national saving which is constantly overlooked. Industry provides in this manner a good deal of its own needs for additional capital and does it internally, apart from the volition of its shareholders.

Private Joint Stock Companies and Individuals and Firms.

27. Private joint stock companies are to all intents and purposes partnerships with limited liability. Their Income Tax profits (like those of public joint stock companies) are computed after deduction of the salaries, fees, &c., paid to their working proprietors. On the other hand, in their case, the bulk of the profits assessed accrue to a small number of shareholders, who in most cases actively carry on the business. They may be reasonably considered together with private-
individuals and firms, subject to the one exception that undistributed profits* of private joint stock companies are not income in the hands of the shareholders, and thus do not swell the total income of individuals for purposes of either Income Tax or Super-Tax.

28. In the case of individual concerns and private companies (excluding from review the undistributed reserves of the latter), the Income Tax and Super-Tax are personal taxes. The persons affected feel the weight of taxation, but that weight varies from individual to individual according to his total income, the nature of the income, and his family responsibilities. The question is, whether that varied taxation checks enterprise. A strict economic analysis would point out that the so-called profits of business thus carried on consist, generally speaking, of three elements, viz.: (1) the gilt-edged rate of interest on the capital invested; (2) the remuneration for the individual's time and business ability or management; and (3) the remuneration for risk of the capital adventured.

29. In theory, the weight of taxation as it affects the first two elements is of no great importance, for the transfer of the capital to any other investment would involve the same liability to tax so far as the gilt-edged interest is involved, and entrance on a salaried post instead of independent business with an equal remuneration for business ability would not diminish the tax applicable to that element of profits.

In theory, therefore, attention must chiefly be directed to the effect of high income taxation on the third element, viz., the remuneration for risk. As tax falls on that remuneration, it diminishes the net yield in respect of risk, and therefore it tends to increase the gross remuneration which the taxpayer requires before he adventurs further business capital. But in practice a private trader does not analyse his profit into its various elements. He looks at the matter from a practical point of view, and if he feels that the weight of taxation makes a new adventure not worth while, he decides not to undertake it.

30. It becomes desirable, therefore, to consider in what class of cases this deterrent effect is likely to be realised. Take in the first place the case of a man who draws his entire income from a business of his own, which yields him between £500 and £2,000 a year, a range of income which covers a large section of those engaged in private industry or trade. Direct taxation of such incomes is not extremely heavy, for it is always less and often very much less than 25 per cent. of the total. Then again, under the present scheme of income taxation,† the net benefit to such a trader of a given increase in income is the same whatever his total income provided that the latter is not brought over £2,000 a year, the point where Super-Tax begins. Thus the net benefit to him of an increase in income of £500 a year will be £365 a year, whether his previous income was, say, £800 or £1,200. In this range of income, moreover, the last pounds of income tend to be of very great utility, inasmuch as they often represent a free spendable margin above existing commitments. For these reasons it is difficult to believe that in these medium ranges of income the existing rate of Income Tax is a serious deterrent to private business enterprise.

31. The case of a very rich business man is different. The greater the income the smaller is the utility which attaches to an increase of income, and, at the same time, owing to the effect of the present method of Super-Tax graduation, the greater is the percentage of that increase which is taken by the State. When a very rich man comes to consider, on the one hand, that if he adventures capital in enterprise, he will retain only perhaps one-half of his profits, and, on the other, that he must take the risk of depreciation, or even total loss, of his capital, he may well regard a high rate of taxation as a deterrent from adventure. But although this may be the case, it must not be forgotten that high taxation is not the only consideration which may deter a wealthy man from taking trade risks. The free moneys of such persons largely arise from a surplus of income over the amount needed to satisfy all their desires, and, therefore, quite apart from considerations of high taxation, they have little incentive to expand their income by adventure.

*These undistributed profits bear Income Tax but no Super-Tax. On the other hand, the total profits of an individual or partnership trader form part of his total income, whether he puts them back into his business or not. He must bear Super-Tax upon the whole of those profits, if his total income reaches the necessary point of liability. This fact gives an illegitimate advantage, tempered only by the Corporation Profits Tax, to these companies, and the Chancellor has asked to have remedial proposals laid before him for his consideration in this connection.

† Allowances for children, &c., are ignored here.
Incidentally, it must be borne in mind in considering the case of the very wealthy that not more than 1,500 persons pay Income Tax and Super-Tax at the rate of 12s. in the pound on even a small section of their income, though it is surprising to find how many persons are in the habit of speaking as if the taxation on the whole of their income reached that figure or something approaching it. The aggregate amount of income which is both taxed at the highest rates and also available for employment in business enterprise is limited.

There remains the considerable body of business men whose incomes range, say, from £2,000 to £20,000 a year, and are therefore liable to taxation on any increments of income, at rates rising from 7s. 6d. to 11s. in the £. As to these, it can only be said that it would be quite unwarrantable to assume that as the rate of Income Tax on possible profits becomes heavier, business enterprise of the more speculative kind is proportionately discouraged. Much depends on the circumstances of the individual concerned and on his particular character and disposition.

As a matter of fact, the great risks in industry (for example, in gold mining), are normally taken by public joint stock companies, where the bulk of the capital at stake belongs to a large number of shareholders (among whom very rich shareholders are proportionately few) and not to the few directing adventurers at the helm. The number of very rich men who engage in private enterprise is distinctly limited, and the validity of the view that taxation appreciably diminishes risky profit-bearing enterprise on their part is correspondingly restricted. So far as concerns the exceedingly large number of comparatively small men who engage in private trade, the risks they normally take are small risks rather than great risks, and in their case the weight of taxation is but a small deterrent from adventure.

Turning now to the possible investor with money at his disposal, whether his income falls within the medium or the higher ranges, the problem before him is whether to spend the money or to invest it, and if the latter, whether to invest in industry or otherwise. As regards the primary question of spending or saving, his decision will tend to be influenced by the general circumstances in which he finds himself, e.g., his total capital accumulation, his present income, his family, the time when he hopes to retire, and the other general causes which govern saving, rather than by the particular weight of the taxation attaching to his total income at the time of his decision. Whether he will invest in industry or something in the nature of a Government stock will depend largely on the return that he anticipates as the result of business enterprise. A competent business man is likely to secure a gross return of, say, 15 per cent., assuming a moderate risk only to be involved. The net return after payment of Income Tax, on every £100 of capital, will be £15, less £4 10s., i.e., £10 10s. net. On the other hand, the net return from Government stock, &c., is likely to be only £4 4s. (£6 interest, less £1 16s. tax). The advantage of personal industrial use of free capital will always—given average business ability—exceed that of any other use. But it is recognised that even in such cases high taxation may deter a man from pushing the employment of his capital to its maximum intensity.

If a taxpayer has no available capital, he may consider the expediency of borrowing in order to invest in industrial enterprise. In that case, his decision is likely to depend upon the relation between the net return after taxation and the amount of risk involved. The considerations already indicated as to the deterrent effects of taxation then become applicable.

Taxes—the share taken by the State for the maintenance of national activities, which are by hypothesis necessary activities—must come out of the capacity for saving, which Dr. Gustav Cassel defines as—

"The surplus of the produce of a society over and above the necessaries which such a society must consume in order to maintain its actual standard of efficiency. ("Nature and Necessity of Interest."")"
weight of taxation. The limits of possible expansion of industry are fixed (a) by the magnitude of the capacity for saving, and so far it is a truism that taxation curtails those limits in the absolute magnitude of the amount at any moment available to the private investor, and (b) by the disinclination to invest even that lesser amount owing to the diminished future return from it. But on the other hand, high income taxation does not always act in this direction, for it sets up a counter-current, for by diminishing personal spending power it inevitably stimulates a large number of individuals to new or greater earning activities in order that they may not lose their present and prospective standards of living and saving. This counter-current is probably very strong in the medium ranges of income and less strong in the highest ranges.

Possible Adjustments of Burden within the Income Tax Area.

38. It is not, of course, suggested that this necessary relation between taxation and savings is conclusive on the question whether the incidence of existing taxation is the most favourable one for fostering savings. Hence the question still remains whether the existing graduation of the Income Tax and Super-Tax as it falls upon incomes above the level of subsistence could advantageously be altered. For example, it is conceivable that national saving might be fostered if the weight of taxation on incomes between, say, £500 per annum and, say, £1,500 per annum, and also upon the highest incomes, were somewhat reduced and the balance made good by an increase of the rates of taxation falling on the intervening region. But any such proposal lies at present outside the range of practical politics, and need not be argued here.

Summary.

39. An endeavour has been made to show how the present taxation of income would affect industry in normal conditions, i.e., apart from the abnormal burdens imposed to-day by the arrears of Excess Profits Duties and by the working of the three years' average, and it may be desirable to summarise the conclusions reached. The Income Tax levied on the profits of public joint stock companies limits the expansion of industry, but only so far as the tax is charged upon the part of the profits put to reserve. Similarly, the Income Tax levied on the profits of businesses carried on by individuals, firms, and private joint stock companies limits the expansion of industry, but only in so far as it deters traders from undertaking new enterprise by reducing the net return on the capital employed. But amongst the exceedingly numerous incomes in the middle range, this deterrent effect is not large, and tends to be outweighed by the marginal utility of an increased income; it is chiefly operative in the comparatively rare but much advertised instances of very wealthy business men. For the rest, the argument comes back to this. Taxation eats into savings and so reduces the stream of wealth available for conversion into new capital. It thus hinders the expansion of trade. But, true as this is, the argument does not apply only or peculiarly to taxation of industry; it is of equal weight as regards the taxation of personal earnings, of wages, and of the income from all other kinds of investment, including British-owned investments in industry carried on abroad.

40. These conclusions would not, of course, be valid in all circumstances. The question is one of degree, and if the rates of Income Tax, instead of standing at their present figure, had been, say, 50 per cent. higher throughout the scale, the Board would not have hesitated to submit that at all costs an escape from that position must be found. But after the closest enquiry and consideration of the actual curtailment of opportunity, and the actual deterrent to action, as distinct from vague and generalised allegations, the Board are not prepared to admit that under existing conditions, apart from the question of arrears of taxation from more prosperous times, the disadvantages of the present rates are really greater than has been indicated.

Income Tax, Prices and Trade Depression.

41. In view of the statements persistently made that the present industrial stagnation is directly due to strangling taxation, it may be well to add an observation on the effect of Income Tax upon prices. It is urged, directly or indirectly, that a lightening of taxation will go far to remove the present conditions of trade; that prices are high because taxes are high; and that high taxes are added to high prices...
with the result that British goods cannot compete with foreign goods simply because of the higher taxation in the United Kingdom. A brief review of world conditions, which need not be attempted here, would show the shallowness of these views. Apart from the special circumstances affecting direct taxation at the moment, which are discussed above, Income Tax has no effect on the amount of profits (before taxation) secured by any trader, nor on the price at which he can sell his goods under ordinary competitive conditions. It is accepted by all economists that a general Income Tax on profits cannot under normal conditions be shifted. Profits are the difference between receipts (the price of the sale of goods) and expenses. Prices are determined by forces quite independent of, and exclusive of, taxation. In a seller's market, such as existed during the war, the seller fixes his price at the highest point he can get, and whatever the amount of an Income Tax, he obviously cannot get more than the highest price a buyer will bid. The effect of high taxation then was only to make the seller more zealous and persistent in his search for the highest price the market would stand. To-day, in a buyer's market, stocks manufactured at high costs (excluding taxation, for it is not a cost), are so heavy that their holders are extremely anxious to get rid of them. To do so they will not hold out for prices which they imagine will cover Income Tax. If that were the case, it would be difficult to explain the extraordinary fall in prices during the past nineteen months (the Statist index number of wholesale prices has fallen from 266 in April 1920 to 138 in October 1921), and the reductions in profit, or actual losses, which have accompanied this movement. Finally, in a normal market which is neither a seller's nor a buyer's and with a graduated Income Tax payable almost entirely by reference to the total income of an individual, Income Tax is only determinable after profit has been made, and also, for most profits, after they have been distributed to hundreds of thousands of shareholders. It is a common delusion of business men that they can and do add Income Tax to their costs, but on examination it invariably appears that it is not in fact done, on any recognised costing principles.

(E.) Corporation Profits Tax.

42. To complete the review of direct taxation, there remains for consideration the Corporation Profits Tax. It is laid upon the total income of all limited liability companies, at the rate of 1s. in the pound, subject to a maximum of 2s. in the pound on the total income less the total interest paid upon permanent loans. It is, therefore, the one tax in the British system of taxation which is specifically and truly a tax upon industry. Its yield for 1921–22 was estimated at £13,000, although owing to the trade depression and administrative difficulties that figure is not likely to be realised. With industry languishing, the tax no doubt does press upon the preponderant part of industry, viz., that part which is in the hands of limited liability companies. Its justification was based on the privilege of limited liability accorded by the State, and also upon the freedom of such companies' reserves from the burden of Super-Tax. If industry has a real claim for some relief from taxation, founded not upon a selfish claim for its individual interest, but upon the wider ground that such relief would be of benefit to the nation as a whole, it is here perhaps that a beginning should be made. In the absence of full information as to the amount of the undistributed reserves of limited liability companies out of which the tax will tend to be paid, it is difficult to pronounce upon this question. Inasmuch as the tax is laid mainly upon net profits of business, the principles enunciated above as respects the impossibility of including Income Tax in price would probably apply in very large measure, and particularly at such a time as the present, to this tax. Price here, as there, will tend to be determined by the marginal producer who is making no profits and paying no tax. Moreover, as there is a considerable volume of trade carried on by persons other than limited liability companies, there will in a normal market often be such competitive conditions as will tend to leave the incidence of the tax finally where it is placed, i.e., upon the limited companies paying it.

43. Perhaps economic principles, however, should not constitute the sole and final test. So far as the private limited liability companies are concerned, there is the more subtle ground of psychology, where the working proprietors of such companies, in the conviction that taxation really makes things not worth while, may persuade themselves into a restriction of their business activities, by reason of this special tax on their industry. If the state of the national finances permitted, and if the Company Law difficulties involved could be overcome, it might be wise to confine the Corporation Profits Tax to the public limited companies.
(F.) Taxation and the Service of the Debt.

44. One further aspect of the weight of direct taxation upon industry is constantly overlooked. That is the effect of taxation for the service and redemption of the internal债务. In 1921-22 the budget provision for interest on debt amounts to £345 million, which exceeds one-third of the total taxation imposed. In January 1920, when the war debt (excluding Savings Certificates, Treasury Bills, Ways and Means Advances and other debt) amounted to some £3,900 million, the Board estimated for the purposes of enquiring by the Select Committee on the Increase of Wealth (War) that the holdings of joint stock companies were about £1,300 million or one-third of the total. In addition, some considerable proportion of the interest on Treasury Bills was payable to these companies, either banks or trading companies. It has been estimated in paragraph 20, that out of a total normal revenue of say £900 million, some £150 million of income taxation, i.e., one-sixth, will be paid by industry as a whole during the next few years. When industry protests so loudly against the burden of direct taxation, it is only too apt to take account of the debit side (say £150 Income Tax and £25 Corporation Profits Tax), and to forget that there is a substantial credit (say upwards of £50 for joint stock industry alone) to be set off against the tax paid. This view of course treats industry as one unit, and is not applicable to the complaint of one trader, who holds no war stocks (either because he did not invest or because he is just starting in business), against taxation levied in order to pay interest on the war stocks held by another trader. Throughout the popular discussion of this question there is a tendency to treat taxation for the service of debt as though it were finally abstracted from production and so depleted saving power, whereas it actually returns to the community as war loan repayment and interest, and though redistributed, is available for the service of industrial capital requirements in the mass.

IV.—Indirect Taxation.

The Shifting of Indirect Taxation.

45. Indirect taxation in the United Kingdom, taking it as mainly represented by the taxes collected by the Customs and Excise Department, amounted in 1920-21 to £334 million. An approximate classification of this revenue shows that:—

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>60%</td>
<td>respect of liquor</td>
</tr>
<tr>
<td>17%</td>
<td>tobacco</td>
</tr>
<tr>
<td>15%</td>
<td>entertainments</td>
</tr>
<tr>
<td>8%</td>
<td>food</td>
</tr>
<tr>
<td>9%</td>
<td>other items, including manufac-tured articles</td>
</tr>
</tbody>
</table>

46. Indirect taxes, as explained above, are those of which the burden, although laid in the first instance upon some defined person, is not expected to remain there. The expectation and, indeed, the intention of the legislature is that the person first charged shall pass on the tax to other persons. Where this expectation is satisfied, the defined person who first pays the tax has no grievance against it. He includes the amount of the tax in his price for the article or service, to which the tax is attached, when he sells that article or service. He also normally includes a charge in respect of the use of the money which he has laid out in payment of the tax, and also, in many cases, a profit on the tax so paid, as remuneration for his services.

47. The business man might argue that, so far as the burden of indirect taxation cuts down the purchasing power of consumers, the vendor of articles or services so taxed is pro tanto damnified, or, alternatively, if the purchaser buys just as much of the taxed article as before, other business men may claim that the power to purchase the untaxed articles they themselves sell has been reduced. This contention would be valid, if it could be assumed that the abolition of indirect taxes could be carried out by the State without recourse to direct taxation. This assumption is, however, barred by the hypothesis above, namely, that the State needs to raise a definite sum. Particular industries may be damnified in comparison with one another in this regard, but that does not appear to be relevant to the question under examination, i.e., the effect of taxation on industry as a whole.

48. There is little doubt that the indirect taxes are shifted in the first instance, as intended, to the consumer. Grave doubts may, however, arise whether the view that indirect taxation is ultimately all shifted to the consumer is true, in the abnormal
circumstances of the post-armistice period. These doubts concern the wage-earning classes, who constitute the bulk of the population, and who, it may be presumed, bear or are intended to bear the greater part of indirect taxation. This matter is examined in the following paragraphs. For the reasons there explained, the Board incline to the view that, broadly speaking and subject to some qualifications as regards the period of abnormal trade depression, much of the increases in indirect taxation which have been imposed since the outbreak of war, and any which might be imposed now, have been and will tend to be largely thrown back on to the stream of production as far as they first fall upon the wage-earning classes.

Wage Earners and Indirect Taxation.

49. The share of the national dividend taken by the wage-earning classes depends upon many factors, but within certain margins the wages paid to labour are indeterminate. Where wage agreements and settlements are negotiated by strong combinations representing, on the one hand, employers' federations, and, on the other hand, labour unions, as, in fact, is the case in the main industries of the United Kingdom, the exact shares in which the excess of earnings over expenses other than labour is divided between capital and labour, between employers and employed, is a matter of bargaining. The limits within which this bargaining may take place in any industry are largely determined by general economic factors, such as the supply of capital and business ability, and the remuneration of labour in other industries, but the difference between the upper and lower limits so set is wide enough to permit of the influence of other considerations. Among these considerations a prominent place must be given to the conception of a living wage.­

50. It is an accepted conclusion based on the experience of the past, that in periods of rising prices, rates of wages tend to rise after, and not before or concurrently with, the rise in prices. Since the outbreak of the war, prices have risen year by year, but there is good reason to believe that rates of wages rose as a consequence of, and subsequent to, such increases in prices. Not until about the time of the armistice did the increase in average rates of wages catch up with the increase in the cost of living as measured by the Ministry of Labour index.

So far as a general statement can be made, we may say that rates of wages for the same work increased less rapidly than the cost of living in the first three years of the war, in the fourth year wages gained and their increase over four years was nearly that of the modified index. In 1918–19 wages gained rapidly and reached the official cost of living measurement, and they kept pace with it in the year 1919–20. (Dr. Bowley: "Wages and the Cost of Living, 1914–20.") The modified index spoken of is one compiled by the author.)

By July 1920 Dr. Bowley concludes that the general rough average of percentage increases in rates of wages for twelve large classes of labour had increased slightly more than the official cost of living index. In the “Labour Gazette” of February 1921, it is estimated that the average increase in rates to the end of 1920 was 170 to 180 per cent., as against the official cost of living index increase of 165 per cent., though it is suggested that if all increases could have been included the average percentage increase of rates might be a little lower.

51. Prior to the movement towards lower wages that has taken place in the current year, it may therefore be taken that over a very large part of the employment field rates of real wages were generally equal to, if not slightly greater than, real rates in 1914. In other words, out of an equal general fund of consumable commodities and services, which constitutes the national income or dividend, labour was taking as great a share in 1920 as in 1914. Variations of total earnings of labour may be neglected for the present argument, for there are broad reasons to believe that absolute earnings tended to be larger in 1920 than in 1914, while, on the other hand, business men assert emphatically that output has fallen. If both these views are true, then labour’s share of the national dividend had increased both relatively and absolutely and not diminished.

52. It is therefore necessary to look at the nature of the expenditure covered by the Ministry of Labour cost of living index, and to see how far it includes goods subject to indirect taxation. So far as food is concerned, increases of cost due to increased indirect taxation are fully included in the cost of living index. Food is the main item of the index, accounting for 60 per cent. of the total. The indirect taxation on food has risen from £110 in 1913–14 to over £50 in 1920–21. Tobacco also is included in the cost of living index, in the miscellaneous items, which together
account for 4 per cent. of the total. Taxation thereon has increased from £m18 to £m55. The principal remaining goods and services on which indirect taxation is levied are alcoholic liquor and entertainments. Liquor taxation advanced from £m43 in 1913-14 to £m201 in 1920-21. The Entertainments Tax yielded nearly £m12 in 1920-21 and was non-existent in 1913-14. Neither of these is included in the calculations for the cost of living index. It is clear, however, that if wages are advanced pari passu with the increase in price of certain standard articles, those wages will advance sufficiently to cover equal increases in price of other articles, although those other articles are excluded from the standard. It follows that greater increases in price of the excluded articles will not be entirely covered by the advance in wages, and that smaller increases will give surplus advantage on the new wage. The price of alcoholic liquor has advanced proportionately more than wages, and entertainment costs have advanced less. Labour has thus no doubt borne part of the additional taxation on drink, but little of the additional taxation on entertainments.

53. Now as far as the increased rates of wages were sufficient to cover the increase in price of (taxed) commodities due to the element of heavier indirect taxation, so far labour was not truly bearing the increased taxation. To this extent the worker was receiving an equivalent quantity of consumable goods; he was paying more for them by reason of the heavier tax, but he was recovering that additional expenditure in his increased wage. The true incidence of the greater part of the heavier indirect tax rested therefore upon the stream of production from which both profits and wages are drawn; wages being free of the tax, it could only rest upon profits and/or salaries, as distinguished from wages.

54. The general conclusion drawn from these considerations is that labour has been successful, so far as indirect taxation affects the working classes, who constitute the majority of the nation, in throwing back on to profits and/or salaries a considerable proportion, though not the whole, of the additional taxation imposed during the war, which it was intended that labour itself should bear.

55. The foregoing observations are directed to the period up to the commencement of the movement towards lower wages on the current year. The question then arises whether, in the course of the downward movement of wages that has taken place during the current year, and in the continuation of that movement which the future may show, labour has been and will be successful in maintaining the advantage gained. It is understood that at least 2,000,000 wage earners (excluding Government employees) have their wages directly affected by the Ministry of Labour cost of living figures. In these cases, it would appear highly probable that labour will maintain its position as respects indirect taxation. Even where the cost of living index is not expressly adopted as a basis for the movement of wages, it undoubtedly exercised, on the minds of both employer and employee, a considerable influence in the downward adjustment of wages. So far as this influence finds expression in the new wage determined on any occasion, so far do the considerations set out apply.

56. The further question presents itself whether, if indirect taxation is now greatly increased, with a consequent rise, or arrest of the fall, in the cost of living, labour will still maintain its position vis-à-vis the cost of living index and thus in effect throw back the tax wholly or partly on to the richer classes. If an absolute rise in the cost of living be assumed, and if regard be paid exclusively to the temporary weakness of labour in face of the present trade depression, a negative answer would probably be returned. But, if on a longer view regard be had to the future beyond the existing state of trade, and to the power of organised labour in more normal conditions, it would be bold to assert that heavy additional indirect taxation could be kept upon the wage-earning classes in more than a modest degree.

V.—Conclusions.

57. From considerations set out briefly in the foregoing paragraphs has emerged a conclusion (from which we know of no escape), viz., that the common talk of taxation of industry is full of fallacies, and that popular psychology has no good ground in actual facts. There is only one pure tax on industry, and that is confined to industry carried on by limited liability companies. This is the Corporation Profits Tax, now estimated to yield £m20 in 1921-22, and, tentatively, £m25 in 1922-23. Viewed in relation to the profits and income on which it is laid—some £m550—it is obvious that the use of language such as ‘crippling,’ ‘throttling’ and ‘strangling’ is unjustified.
58. Those stamp taxes which might legitimately be regarded as impeding industry are of such old standing that their incidence is well settled, and little objection is nowadays raised to them.

59. It has been shown that the allegations that Income Tax "stifles industry" and "has to be added to the cost of everything produced" cannot bear examination in the light of accepted conclusions on the incidence of a graduated personal Income Tax. The charge that income taxation checks business enterprise and, by making men refuse to take risks, diminishes the national dividend has been reduced to the weight properly due to it.

60. The root of the demand for diminished direct taxation, it has been suggested, lies in the abnormal circumstances of the present trade situation; abnormal because the period of the basis of assessment and the period for due collection are the poles apart in their comparative prosperity. Industry has been and is still passing from the crest of the huge profit-bearing wave occasioned by the war down into the trough which inevitably follows such an expansion of industry as took place during the immediate post-armistice period. The system of income taxation on average profits of past periods, and the existence of large undischarged liabilities of special war profits taxation, is putting on present industrial profits an almost unbearable pressure. The direct remedies would lie in a remission of arrears of Excess Profits Duty (say, £m200), and a retrospective alteration of the basis of Income Tax assessment for the current year. The latter would give relief only if assessments were brought down to the level of profits in 1921-22, and then at a cost to the Exchequer of nearly some £m50. Neither remedy appears to be a practicable one.

61. The same result is sought by industry by a different route. Suggestions are pressed for a transfer of an appreciable amount of revenue from direct taxation to indirect taxation. The main conclusions of this note upon this subject may be summarised as follows:

62. It has been shown in paragraphs 48 to 56 above that there is good reason to conclude that increased indirect taxation, intended to be borne by the wage-earning classes, who constitute the majority of the nation, tends beyond a certain limit to be thrown back by labour on to the remuneration of investors and the salaried employers of industry. We are passing through a period in which reductions of wages are taking place and must continue to take place. How far in this process wage earners are maintaining or improving their absolute standard of living may be open to doubt; that they will strenuously fight to do so is obvious, and the progress of the fight will be largely affected by the movements of the cost of living. In the present temper of the wage earners, there is no doubt that an increase in the cost of living will immediately and sharply affect negotiations on the reduction of wages. This means that labour will attempt to fasten on to capital increased indirect taxation intended to be placed upon wage earners. If labour succeeds in this effort, industry will secure no real relief from taxation, while it will have to put up with all the inconveniences of the new indirect taxation. If labour fails, so that prices rise and the real wages of the earners fall, then their tendency to c'canny is likely to be strengthened, so that in the end industry may lose more by diminished output than it gains from diminished taxation.

63. Whether the attempt of labour to avoid the burden of increased indirect taxation will be immediately successful depends, it has been suggested, largely on the question whether trade will quickly revive; but, however this may be, the difficulties that this course is likely to lead to are obvious. More harm is done to the national dividend by wage disputes and lost working days than by any other means. On the one hand, direct taxation, as has been shown, only falls on profits when they have been made and does not raise the cost of production. Its damage to existing industry principally consists of a restriction of the expansion of industry. On the other hand, increased wages and, above all, embittered disputes as to rates of wages do raise the cost of production. For these reasons, it is a matter for anxious consideration whether a marked increase of indirect taxation may not at the present time prove far more injurious to industry than the continuance of existing taxes at their present rates.

Inland Revenue, Somerset House, January 1922.

* During the ten months from January to October 1921, inclusive, some 6,800,000 wage earners have borne reductions of wages, amounting to £4,379,000 a week.

I am in general agreement with the conclusions of the memorandum on "Industry and the Weight of Taxation."

DEFINITION OF A TAX ON INDUSTRY.

In order to avoid any misconception, it will be desirable, before commenting upon it, to state concisely what is understood to be the exact meaning of the idea of the taxation of industry which is discussed in the memorandum.

It is understood that a tax is regarded as a tax on industry in the sense intended in the memorandum if it has the effect of:

(a.) Discouraging the disposition to save and invest savings in industry; or

(b.) Discouraging people from doing as much in their businesses as they would have done otherwise.

Two Excluded Questions.

If this is a fair definition, two questions which might be confused with the problem examined in the memorandum are excluded, viz.:

1. The bearing of the taxation of labour on the country's production; and

2. The effect on the amount saved in the country of the appropriation of a large proportion of the national income by the Government, which may be regarded as distinct from the effect of a discouragement of the disposition to save out of any given net income.

As regards the first of these two excluded questions, it will of course be understood that very heavy taxation of the wage earners is apt to exert upon them so depressing an effect, either physical or mental, as to reduce the national income; and in this connection the significant fact pointed out in the memorandum may be noted, namely, that increased indirect taxes have, on the whole, been carried by increased wages (any depressing effect thus being avoided), though, of course, wages do not necessarily rise as indirect taxes are raised.

As regards the other excluded question, viz., the fact that the amount of capital that can be saved is necessarily reduced when the State increases the share that it takes of the national income, it may be observed incidentally that this holds with reference to all taxes and not merely with reference to an Income Tax. But it seldom or never happens that the whole of the contribution to the Exchequer is made at the expense of saving. People may and do work harder or spend less to make up for what they have to pay in taxes. Moreover, it has to be borne in mind that taxes cannot be regarded as a deduction from the national income in so far as their proceeds are paid back to nationals in the form of interest on loans; though it would be fallacious to maintain that on this account particular business is really taxed to the extent to which the taxes paid by it exceed the payments made to it on any Government stock held by it, for there is no reason to regard investments in Government stock as different from other investments in this respect.

We may now proceed to an examination of the specific question raised in the memorandum, viz., whether the taxes under review, and in particular the Income Tax, discourage the saving of capital for industrial investment and discourage enterprise. It will conduce to clearness to keep these two sides of the problem distinct.

Effect of the Income Tax on the Disposition to Save and Invest Industrially.

Here two questions are raised. The first is whether the Income Tax discourages saving, and the second is whether it tends to reduce the proportion of savings put into industry.

The determinants of saving are very obscure. On the one hand, it may be argued that if the rewards for saving (i.e., the interest on investments) are diminished by taxation, the inducement to save is diminished and there will therefore be a tendency to spend a larger proportion of income than before. But, on the other hand, there is [7706]
some reason to suppose that in a large number of cases the quantity of saving is
governed mainly by the importance of having a certain sum laid by, or a certain
income from investment. In so far as this is the case, the diminished yield from
saving will tend to increase the amount saved from a given income. It is impossible
to say which influence predominates, taking the community as a whole, but there is
much to be said for the view that within a wide range the degree of taxation does
not greatly affect one way or the other the proportion of a given income that is saved.
There remains, of course, the consideration referred to above, namely, that State
expenditure of most kinds takes away some wealth from the community, and less is
saved because there is less to save from, but, as has been argued, this consideration
relates to all forms of taxes and not merely to the issue raised in the memorandum.
To the above line of argument it might be objected that the wealthiest save most,
and that in their case the discouragement of saving is greatest (because of the Super-
Tax), while the personal necessity on their part not to relax the saving habit cannot
be represented as pressing. This is true, but it is not unlikely that the desire to
maintain the proportion of future to present means plays the part in the case of the
wealthy which is played by necessity, or at least prudence, in the case of the poorer.
As regards the question of whether the taxes under review are of such a nature
as to divert the stream of savings from industry to some other purpose (for instance
into State loans here and abroad), there is no apparent reason why this should be the
case. The taxes fall on incomes from investment regardless of the source from which
the income is derived, and therefore should have no effect one way or the other on the
direction of investment.
There is one argument in the memorandum relating to the above considerations
which seems doubtful, viz., the suggestion that a tax on the undistributed profits of
companies may be a tax on industry in the sense in which the other forms of the
Income Tax are not. In deciding on the proportion of earnings to be kept in the
business, companies must take into account the deductions to be made in the form of
Income Tax from what is so retained. They would be disposed to hold back all that
was necessary after payment of Income Tax. But it might be contended that they
are not really left with a free hand because their action is limited by what they feel
they must distribute to keep their shareholders satisfied in view of the Income Tax on
what is distributed. This contention goes to show, however, that the Income Tax on
shareholders is as much a check on the amount held back as the Income Tax on the
amount held back.
(As a matter of fact the Super-Tax should serve as an inducement to certain
companies to reserve in the business more than they would have done otherwise,
because Super-Tax is not charged on what is not paid out.) It is not denied, of course,
that the special exemption from taxation of reserved earnings would operate as a
direct encouragement of the retention of a large part of business earnings in the
business, but as against this there would naturally be some reduction of the amounts
saved by persons who would otherwise have received large dividends. On the whole,
however, saving and the extent to which it was devoted to industry would be
magnified.

Effect of the Tax on Enterprise.

We have to consider not merely the effect of the tax on the supply of capital
adventured in industry (as has been done above), but also the effect of the tax on the
use made of the capital, that is on enterprise. Thus, to take a simple case, a man
might have a large business of his own earning a large income for him, and might
be in doubt as to whether he should make some new departure, involving considerable
work and worry, or keep entirely to the old paths. If the profits from the action he
was in doubt about were to be diminished by one-half through taxation, he would
probably be less inclined to take it than he would be if he retained much more for
himself, in so far as his action was governed by considerations of personal gain—
though it is true that he might accept some unusual risks in a desire to keep up his
net income, particularly if his income were not very large. It is arguable, then that
the Income Tax, in its incidence on unearned income, may be an appreciable
discouragement of the enterprise which makes use of capital. Moreover, it is
arguable in addition that the Super-Tax, in its incidence on earned income, so far
as it discourages enterprise, discourages the enterprise of those who through their
success have shown themselves the fittest to direct the business of the country. The
same objection of course applies indirectly to Super-Tax on the unearned income
from new savings in so far as the new savings are made by anybody who is making
what extra he can out of his business in order to save—he thinks of his extra earnings as dividends resulting from their investment, and these are subject to Super-Tax.

This, however, is only one side of the case. On the other side, it may be contended that the thought of personal gain probably plays a much smaller part in determining the action of business leaders than is sometimes supposed. Anybody who has attained a certain position is naturally inclined to make the most of what can be done in that position regardless of pecuniary rewards.

It is instinct in man—and the instinct is fostered by competition—to achieve the most he is capable of achieving.

In this connection, it is argued in the memorandum that the Corporation Profits Tax is in a special sense a tax on industry, inasmuch as it falls on business of one particular type of organisation. But it may be doubted whether it has any large effect in discouraging enterprises of that type. The conveniences of being in the limited-liability form are so great that the tax is not likely to deter many businesses from assuming that form. It is true that those who derive their income from businesses not in this form pay tax at a lower rate, but against this there is the disadvantage of being without limited-liability protection as is argued in the memorandum.

**Effect of Income Tax on the General Level of Prices.**

The view that the Income Tax falling on businesses is passed on to costs of production and so to price, thus placing industries in this country at a disadvantage in international competition, is certainly fallacious. If only a few classes of industry were taxed, the taxation would have to be based on the price, to enable those industries to get sufficient capital, and the price of their products would rise in relation to the price of the products of the industries not so heavily taxed. But this cannot hold when all industries are subject to the same tax, because no disadvantage is suffered by one as compared with others. And in any event practical taxation problems are not complicated by having any appreciable bearing on the general level of prices, which is obviously settled by the supply of money and its rate of circulation in relation to the supply of what it is spent on. It is needless to go into the question of the way in which the forms of taxation can indirectly affect these determinants.

**Impressions, though mistaken, have Effects.**

Finally, it must be remembered that the whole of the above analysis holds only on the assumption that people's impressions about the effects of certain taxes correspond with the facts. We cannot argue about human affairs as we do about physical facts. If people's ideas are mistaken their mistaken ideas may produce economic consequences not unlike those that would be produced if their ideas were correct. There is undoubtedly a general impression at the present time that, while the country could stand in some form the taxation which is needed, the Income Tax is in some way putting a check on commerce and industry. No amount of argument, however inherently convincing, will remove this impression. And as the impression is there, the instrumental effect on trade and industry follows, for psychological reasons, pretty much the same as it would if the impression were correct. Consequently the country's trade and industry would probably benefit if the Income Tax could be somewhat reduced and some tax be substituted which was not seriously objectionable on the same or other grounds.

But it is questionable whether such a substitute can be found.

It was necessary to put this point, but it is equally necessary not to overstate it. Businesses have now been relieved of the Excess Profits Duty, and in view of this it is not unlikely that the prejudice against raising so much by means of the Income Tax form of taxation may die down in the near future.

(Initialed) S. J. C.

January 3, 1922.

**INDUSTRY AND BURDEN OF TAXATION.**

The general lines of the argument contained in the memorandum prepared for the Boards of Customs and Inland Revenue is one to which it would be difficult to take exception. The section relating to indirect taxation and wages would appear to need somewhat careful examination, however, before a detailed argument could
be accepted, though the general conclusion appears sound. A few remarks on this section are given later.

The real causes for the complaints made on behalf of industry at the present time are possibly different from those alleged by the spokesman of the industrialists. It would appear that incomes on which Income Tax and Excess Profits Duty have been assessed have, in fact, been secured, and that owing to deferment in collection of the taxes assessed, those into whose hands the profits have flowed have disposed of those profits in a manner which leaves them without adequate funds to meet the tax demands. It is submitted that the source of trouble is not the mode of taxation, and that the taxpayers who have had the privilege of using for their own purposes sums which are ultimately due from them as taxes, should be the last to complain of a procedure which has favoured them as against other classes of the community, and particularly that an attempt now to throw off on to other classes a part of the burden justly assessed upon them should not receive any excessive sympathy.

In these remarks it is assumed that the profits on which the taxes have been assessed have actually been made, and that the question is not one of charging to duty hypothetical profits. If this latter were the explanation of the situation the appropriate mode of treatment would have regard to this point. The present complaints, however, are understood not to have regard to the mode of assessing Excess Profits Duties, and to the depreciation of stocks in hand, which is a matter that has received attention and for which a remedy has been introduced.

A point of very considerable importance with reference to the reaction on industry of heavy taxation is the distribution of wealth and of income between persons of advanced years and persons in the more active period of life. Discouragement of active and energetic men engaged in the building up of fortunes may be of much greater importance to the welfare of industry than measures which evoke protest mainly from the more mature. The latter have, in large degree, formed habits which are not readily overcome. The systematic accumulation of wealth may proceed, even though the rate of return on the capital and the personal energies involved be less than would have furnished an adequate stimulus to independent effort while a fortune still remained to be made. Further, though the advice and guidance of the mature experienced minds in industry is of the greatest value, and while in some cases men of advanced years show a great readiness to undertake industrial risks, it is almost certainly true that the younger and more elastic intelligences are those which contribute most in the way of judicious venturesomeness in the expansion of business, whether industrial or mercantile.

The purpose of the preceding remarks is to stress the point that taxation which suppresses the energies of the relatively young, and taxation which evokes protest from the distinctly mature, may have, in practice, effects of widely differing importance, since the wealth and the income from which the State claims its share is in much greater degree in the hands of the elderly than in the hands of persons in what is commonly regarded as the prime of life. So far as concerns wealth, the evidence of the records of assessments to Estate Duty is very instructive in this regard. The Report of the Commissioners of Inland Revenue for the year 1914-15 contains tables which classify estates passing at death according to the magnitude of the estate and the age of the owner, and from this table it appears that about seven-eights of all property passing at death in England and Wales in a year which is likely to have included a somewhat unusual proportion of deaths to wealthy young men, was the property of persons of 55 years of age and upwards. Even of estates under £50,000, six-sevenths in value were recorded as owned by persons of 55 years and over, while the larger estates were, in quite overwhelming proportion, in the hands of these relatively elderly persons.

It is probably true that large incomes not associated with large property may be received in considerably more substantial degree by persons in the middle years of life than corresponds to the distribution of property just alluded to, but it cannot be without importance in reference to the real effect of taxation upon industrial progress, that property—and consequently the unearned portion of income—is overwhelmingly in the hands of persons whose habits have been formed, and who are likely to continue to devote themselves to those business pursuits which have become the habit of their lives, even though the monetary reward obtained by them should fall off in consequence of the burdens falling on the State, which involve heavy taxation of the citizens.

The point urged in the Memorandum of the Revenue Departments cannot be too strongly emphasised that taxation is a matter of persons, though their relation to
industry may serve as the basis of their individual assessments, and it is likely to
lead to grave error to yield to the habit of referring to taxation as being a taxation
of industry. Even the point brought out in the Memorandum that undistributed
profits are charged to Income Tax, may not be quite conclusive, since the effect of this
may be largely felt in the amounts of the distributions made to shareholders; that is
to say, that if the rates of taxation to Income Tax were substantially reduced it would
remain to be proved that the effect would be found in a larger total retained as
undistributed profits rather than in a disproportionate increase in the profits which
are distributed.

The problems of the shifting of taxation are extremely difficult to deal with
precisely, since the relations of classes involved are not free from complications
arising out of other than tax considerations. The question, for example, of whether
Income Tax can be transferred from intended bearer to other classes, is a question
depending on the economic situation; and just as, for a period at least, the owners of
businesses found themselves in a position in which they were able so greatly to increase
the charges for their products that Excess Profits Duty—and in many cases, more
than the amount actually paid in Excess Profits Duty—was transferred to consumers
of the goods, so, in a like situation would any burdens placed on the conductors of
industry be capable of transference by them to the users of their product. If, in fact,
the owners of capital and of managing ability are in a position to say that they will
not co-operate with other sections of the Community unless they receive, as net return
after all charges are met, at least a certain minimum, any additional charges that
may be placed on them will be transferable. The whole problem taken up in the
latter part of the Memorandum is complicated in this way, since, in the course of
the war, the wage earning classes of the Community claimed, and to a large extent
secured, a greater share in the total available stream of new wealth than had
previously fallen to them. It is at least possible that some of the discontent now
finding expression from the side of the managers of industry, is in
reality a discontent with the necessity for a new proportion between what
hand-workers receive and what brain-workers receive. Whether the economic
situation will, in the near future, permit the latter class to obtain as
large a proportionate share as before the war, remains to be seen; but if the
claims of the hand-workers for a fuller life can be made good by them, the managing
classes will have to adjust themselves to this new situation. If they refuse to
co-operate on these terms, the nation may be greatly impoverished before they realise
that it is better to give their assistance on less favourable terms than to have nothing
at all. Any charges not directly related to the current business of production are
naturally felt, at such a time of readjustment, as peculiarly burdensome, and it is
not difficult to induce careless thinkers to attribute most of their troubles to these
other charges. I should be disposed to say that it is the total burden of taxation,
rather than the particular form which it takes, which is the true reason for such of
the complaints made by industrialists as are well-founded, and the Memorandum of
the Revenue Boards very justly stresses the danger that may arise from an attempt to
redistribute the total of taxation so as to make more of it fall upon wage earners in
a fashion in which they will be directly conscious of the burden. The reduction of the
burden, rather than its redistribution (if by any means that is possible) appears the
ture direction in which to attempt to move, though there are rather narrow limits
to such movement unless it should prove possible to adopt measures resulting in a
serious decrease in the very heavy annual debt charges.

A. W. F.