

The Taxation of Business Profits

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"To my accounts of the whole year till past twelve at night, it being bitter cold, but yet I was well satisfied with my work, and above all, to find myself, by the great blessing of God, worth £1,349, by which, as I have spent very largely, so I have laid up above £500 this year above what I was worth this day twelvemonth"

SAMUEL PEPYS (Dec 31st, 1664)

A Temporary Tax.

The taxation of income by the State in order to raise revenue was first introduced by William Pitt in 1799 as a crisis measure during the Napoleonic Wars. In 1802, on the conclusion of the Peace of Amiens, it was repealed, and in 1803 was re-introduced when war again broke out. In 1816 it was again repealed amid great rejoicing, and it is said that a future Lord Chancellor of England, Lord Brougham, assisted in stoking the public bonfire in Old Palace Yard, Westminster, which burned the complete records of the hated impost.

In 1842, in face of intense opposition, the Income Tax was re-imposed as a temporary measure. For many decades of the nineteenth century the annual budget held out hopes that the tax would be repealed once more. Gladstone in his budget speech of 1861 said, "If the country is content to be governed at a cost of between £60 million and £62 million a year, there is not any reason why it should not be so governed without the income tax . . . If on the other hand it is the pleasure of the country to be governed at a cost of between £70 million and £75 million a year, it must be so governed with the aid of a considerable income tax." The tax has not been dropped for any year, since 1842, and its characteristic feature of being imposed for one year only has been repeated year after year for more than a century. Two world wars have clamped the tax firmly on society and, if it were possible to abolish it now, the social change—resulting from its abolition would amount to a revolution.

Almost every state today imposes a tax on income as a basic source of revenue and the more highly organised states are virtually dependent upon its yield in order to carry on government. Gladstone's idea of keeping it as an iron reserve with which to fight wars—he held that 5d. in the £ was a just rate of tax—is gone forever. In his day the tax brought in about one-sixth of the British revenue: today it is the source of almost one-half that revenue. In Ireland taking Income Tax, Sur-Tax and Corporation Profits as being a single tax the yield to the Exchequer is the considerable sum of £26,362,000. Furthermore, the state no longer looks upon income taxation simply as a source of revenue. Sir Stafford Cripps believed that its effect of levelling out income was even more important, and it is now gene-

rally regarded as the chief instrument for ensuring redistribution of wealth in the modern state. The tax is also a direct factor in economic policy operating to curb inflation when a high standard rate is imposed or to stimulate purchasing power when the tax is lowered. Despite the importance of the income tax as a source of revenue and as a social and economic weapon in the hands of the state, it is doubtful whether its full implications have ever been properly studied. There is certainly room for such a study on Irish Income Tax.

Income Tax codes have many common features in all countries where the tax is imposed, perhaps the most significant being complexity. It seems impossible anywhere to write of it in simple, readable prose. In highly organised states, like Britain and America, it is wholly incomprehensible except to those in daily contact with it, and even an agricultural state like New Zealand (which incidentally treats farming profits as business profits) can explain the operation of the tax only in a closely printed volume of over three hundred pages. Complexity seems to be a direct result of the "temporary" nature of the tax. If it had been decided upon as a permanent tax, no doubt a clear balanced code would have been evolved. Instead we have one hundred and fifteen years of statutes aimed at stopping up gaps in the original plan or at giving random concessions to particular taxpayers. To add to the complication of haphazard legislation there has been perpetuated the mistaken policy of having fine points of the tax law decided in the ordinary courts. There are now over three thousand rulings from the higher British Courts to be studied alongside the Finance Acts of one hundred and fifteen years, many of the legal decisions being impractical, or contradicting previous decisions.

I do not believe that the idea of a simple straightforward code of income taxation is an illusion. What is required in Ireland is that we should abandon the British code and take a fresh look at our system of taxation, bearing in mind our own problems.

Business Profits as Income.

In the early years of income tax the greatest yield came from Schedule A or Property Tax, and for a long time the description property tax was applied to all income tax. Nevertheless the law set out from the beginning to trap income of every kind. Arthur Hope-Jones in his work on "Income Tax in the Napoleonic Wars" (Cambridge *Studies in Economic History*) attributes the growth in the yield of tax from business profits to the activities of the Surveyors of Taxes (now called Inspectors) who had power to raise surcharges (additional assessments) where they suspected the returns of profits were understated, and who were encouraged in their work by being remunerated on a percentage basis. It is curious, and I think a fair criticism of the whole taxation code, that not even to-day has any attempt been made to take business profits out of the definition of income for tax purposes. There are very many statutes giving special treatment to the conception of business profits as income and these serve to illustrate that in practice the profits of a business are sometimes distinct from income as received by an individual. The lumping of profits as income with all the forms of income which

are easily identifiable as such, salaries, fees, dividends, royalties and the like has led to many anomalies and apparent inequities. For example, the preservation of capital is essential to a business and replacement of fixed assets is a business expense before taxation, but no similar provision is available in the taxation of salaries or dividend income

From the point of view of state revenue the tax yield from assessments on business profits in Ireland and elsewhere is the largest source of income tax revenue, although the exact figures are not distinguished either here or in Britain. For 1954/55 the income tax yield in Ireland is given in the following table taken from the Report of the Committee of Inquiry into Taxation on Industry

Schedule A · Ownership of Property ..	£1,476,000
Schedule B · Farm Profits ..	105,000
Schedule C · Investment income collected by Banks, etc.	588,000
Schedule D · Business and Professional profits, investment income, etc	13,480,000
Schedule E · Salaries and Wages	5,713,000
	£21,362,000

A curious feature of this table, not, so far as I am aware, adverted to elsewhere, is the fact that the yield from Schedule A or property tax is largely an illusion. The bulk of the tax must be collected from the high valuations on business properties and the Schedule A Assessments on these properties are concurrently allowed as deductions in computing the business profits. If the Schedule A Assessments were withdrawn neither the Exchequer nor the business firms owning the properties would lose or gain in the tax, the assessment Schedule A balancing exactly the deduction from the profits, except for a small advantage—one-sixth—enjoyed by mills and factories. This is an important point in the argument that Schedules A and B Assessments could be abolished with comparatively little effect on the total yield from taxation, and if all rents were treated as income and farm losses eliminated in repayment claims the Exchequer would probably gain

It is not possible to arrive at the exact yield of tax under Schedule D provided by assessments on business profits, but an estimate for 1953/54 can be arrived at as follows —

	<i>Tax Yield</i>	
Profits of Manufacturing Companies ..	£5,090,000	(Taxation Commission Report)
Corporation Profits Tax on same Companies	1,330,000	(do)
Total Corporation Profits Tax	2,710,000	(Report of Revenue Commissioners)
Corporation Profits Tax on non-Manufacturing Companies	1,380,000	
Corresponding Income Tax on non-Manufacturing Companies	5,280,000	(Simple proportion)

This gives an income tax yield from business profits of companies making assessable profits over £2,500 per annum of £10,370,000. If all kinds of businesses are taken into reckoning a total yield of £12,000,000 from business profits might be expected. To this figure we should add £3,000,000 for Corporation Profits Tax (the 1954/55 yield) and if we readjust for Schedule A Assessments as indicated earlier a further sum of approximately £1 million should be added. We would then have the over-all picture of the yield from income taxation in Ireland as follows :—

Business profits	£16,000,000
Salaries and Wages	5,713,000
Professions, Sundries and Investment Income		2,068,000
Sur-tax (also part business)	2,000,000
Property tax and farming	581,000
		<hr/>
		£26,362,000
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The picture may not be exact in detail but gives the correct prominence to the yield of tax on business profits in the Revenue Accounts of the State, and is in accord with the information given in Table 50 of the Taxation Commission Report (Estimated percentage Distribution of Income Tax Liability Over Various Sections of the Community).

A further point should be mentioned. The number of worth-while assessments producing the figure of £16,000,000 must be well below 5,000—the number of Corporation Profit Tax assessments is less than 2,000—whereas the number of assessments to produce the £5,713,000 from Salaries and Wages is 136,000. The figures imply that a comparatively small number of business assessments produces the bulk of the revenue. If the Sur-tax payers were treated as a special class and removed from the 136,000 Schedule E tax payers, it is probable that the replacement of Schedule E by a simple wages tax collected by a stamp on a card would yield as much, if not more, revenue to the State

Annual Profits or Gains

The charging Rule of Schedule D of the Income Tax Act, 1918, applies income tax to the annual profits or gains arising or accruing to any person from any trade. Person includes bodies of persons such as companies limited or unlimited, associations, clubs, societies, and in fact anything that constitutes a legal entity. Income Tax is an annual tax imposed on annual profits or gains so that in simple language every person owes to the Revenue in respect of each fiscal year tax on the profits or gains made within that year.

This statement is very well appreciated by the general public without perhaps its understanding the particular significance it has in practice. We all of us wonder at times whether certain reputedly wealthy men have paid their full income taxes because we cannot believe that it is possible to-day to become wealthy after payment of tax. The Revenue looks at the taxpayer in the same way, and to the Revenue mind capital is wealth accumulated after payment year

by year of the exactly correct tax applicable to each year's income. The Revenue eye falls on wealth, querying its source and the amount of tax paid yearly in its accumulation unless the wealth can be explained by windfalls of a non-income character. Hence the wealthy man, if such there be, is not safe at any time and least of all in his final estate account from an investigation that would seek to probe out his exact annual income during his life time and the amount of tax he paid thereon. This attitude towards the citizen explains why we all, even the least likely of us ever to accumulate wealth, must sign annually a statement declaring that we have or have not all sorts of income, and one feels that this annual statement is an irritating superfluity for some one hundred and thirty thousand of our people who obviously will never know any kind of real wealth. The diarist Samuel Pepys, was happier than he knew on that New Year's Eve of 1664 when Income Tax was not even dreamed of.

For income other than from trades (which includes everything in the nature of a trade from manufacture to betting shops) annual income is arrived at without any difficulty. There can be very little doubt about the exact amount of a wage or salary earned in a year, or the exact income from an investment. But a great deal of doubt and difficulty arises as to the annual profit or gains from a trade, and a little reflection will show this. If a trader's year is the calendar year and he buys stock in February which is still on his shelves in December, how should he value it in order to arrive at his profits for the year? If he has sold extensively on credit, how should he value his outstanding debts? If he has spent money for the long-term advantage of his business, as he inevitably shall, how much of this money should he charge against the profits of the year? If we could find simple answers to these and similar questions a great amount of ground would be covered in simplifying income tax for trade and industry; but one often doubts whether the determination of exact annual profits in business is possible at all.

Profits for Taxation.

The Courts were quick to decide that the annual profits of a trade were those arrived at by the ordinary commercial principles of trading, reinterpreted in accordance with the income tax rules. The fundamental rule is Rule 3, Cases *I* and *II*, Schedule D, Income Tax Act, 1918, which was part of the 1842 Act as subsequently amended. It is explained in some detail in an addendum by the Revenue Commissioners to the recent report of the Committee of Inquiry into Taxation on Industry. The Committee comments in its report on this matter of reinterpretation of commercial profits in accordance with Rule 3 as follows (pars. 175 and 176):

“Finalising the numerous ‘add backs’ that may be necessary in adjusting commercial profits for taxation undoubtedly creates a great deal of extra work and trouble for the taxpayer and the Revenue—and the effort expended is very often not commensurate with the actual tax involved. Our general impression is that the majority of the witnesses, especially those representing professional associations, availed of the present

enquiry as the first opportunity offered, to draw attention to these matters, without however pressing them on us as serious deterrents to industrialists in particular.

On consideration we have come to the conclusion that the extent to which these miscellaneous items constitute deterrents of any real magnitude to productive industry as a whole, is a relatively minor one, and would not justify their detailed examination in this report. Generally speaking, they affect all other economic groups, liable to income tax, Schedule D, and corporation profits tax equally with industry, and, in our view, could more appropriately be dealt with in the course of a comprehensive enquiry into income taxation generally."

It will be seen that the Committee felt that the effort expended in re-interpreting commercial profits in the light of Rule 3 was very often not commensurate with the actual tax involved. The Committee did not pursue its enquiries into the question whether the Revenue would lose much by disregarding Rule 3 and such enquiries would call for a great deal of research. This paper proposes to consider the justification, if any, of the principles on which Rule 3 is based in the frequently recurring instances of difference between Revenue practice and the normal business practice. It may be said, however, that a wide sample of computations from 100 firms suggests that about two per cent. of the business tax yield comes from the add-backs.

The readjustments of business profits to give Revenue profits come under the following main heads excluding for the moment depreciation provisions —

- (1) Charitable subscriptions.
- (2) Personal expenditure charged through the Accounts.
- (3) Reserves and provisions against anticipated expenditure and anticipated losses.
- (4) Expenditure regarded as of a recurring nature by business and as of a capital nature by the Revenue.

It is time, I think, that subscriptions should be allowed without question to business, at least to limited companies. A limited company, having no soul to save, cannot have charitable impulses, and these subscriptions are rarely given for other than business purposes even if only as advertising. In any event other taxation codes, notably the United States and Canadian codes, admit charitable donations up to a certain figure, and we in Ireland could follow suit without any appreciable loss in revenue. It should be made illegal to charge private expenditure through a business account, or alternatively, obligatory in all certified accounts to show private expenditure in a separate account, or simply add it to the salary or drawings of the individual concerned. At this stage, it may be mentioned that any serious revision of the income tax code must give attention to the form of accounts to be sent to the Revenue, and could very usefully be taken in conjunction with a revision of accountancy practices. In a small country, such as ours, standardised accounts for Revenue purposes would very likely become standard for all purposes.

The creation of reserves and provisions against anticipated losses (e.g. bad debts) and anticipated expenditure is a clear point on which Revenue and business practice are at variance. The Revenue principle repeats that income tax is an annual tax on the exact profits of the fiscal year and that the allowance of reserves against anticipated losses cuts across that principle. Furthermore, Rule 3 is explicit on the point. The business view, supported by accountancy principles, is that it is essential to be conservative about profits and all doubtful debtors, doubtful stocks and heavy anticipated expenditure should be reserved against when the Balance Sheet is being struck. If income tax were not an annual tax for one year only, but a long term tax, the difference between the two attitudes to reserves would more or less disappear since, if the losses materialise they will be allowed, if they do not, the reserves will come back into profits. There is a limit to the provisions any business will make against anticipated losses and these provisions are really for the purpose of safeguarding future profits. Instead of the negative approach of Rule 3 a positive approach permitting certain reserves against anticipated losses or expenditure which should be shown openly on the accounts should be considered.

Another fundamental principle of the present taxation code intrudes here and requires careful thought. It is something of a joke that the Courts in attempting to define income tax got no further than that it was a tax on income. It has always been clear that the tax is not and cannot be construed as a tax on capital and the step from reserves on a Balance Sheet to an issue of capital is a short one. Here again a very simple protective safeguard could be given to the Revenue; and if all reserves against current expenditure or anticipated losses were required to be shown openly, and their subsequent distribution or return to profits made a subject of tax if not already taxed, the difficulty could probably be overcome.

It is true that the Irish industrialist seeks a great deal more than this. He claims on good grounds that industry is financed to a large extent from profits ploughed back and that these undistributed profits should be tax free. They are used for further capital development and to meet additions, extensions, improvements and alterations of fixed assets to keep his factory abreast of the most modern techniques in his industry. The taxation report puts these undistributed profits as giving as high as 36 per cent. of the total business tax yield so that any remission of tax on such profits must be very costly to the Revenue (36 per cent. of £16 million is (£5,760,000)). Here again intervenes the attempt to make the tax code do something it was never intended to do. In effect the industrialist's plea is a request for subsidies out of the income tax or at least a plea to regard annual income as not income if it is utilised for capital purposes. It is a plea which should be considered apart from any reorganisation of the tax code. The British system, for other reasons, has a differential of 25 per cent. in corporation profits tax on distributed profits as distinct from undistributed profits and this indicates an awareness of the distinction between the two profits for taxation purposes. The Committee of Inquiry investigated this problem very fully but could make no recommendation altering the present system. My

proposal is a minor relaxation of the tax impost against reserves for current expenditure, and is aimed chiefly at simplifying taxation procedure with no ultimate loss to the Revenue.

What is Capital Expenditure

The question of what is capital expenditure and what is revenue expenditure is the most difficult and contentious in industrial and commercial tax computations. Industry suffers most from the disputes it gives rise to, since any modern factory will annually pay out substantial sums on what could properly be regarded as maintenance but which will be disallowed for income tax purposes. Accountancy, as a profession, has not evolved any clear definition of capital expenditure. The accountant looks all the time to the Balance Sheet as a statement of assets and liabilities, and to his practical mind an asset should be something that has a realisable value for the shareholder or proprietor. Hence he will not normally approve of capitalising expenditure which does not create such an asset, for example, if £100 were spent on moving a machine from one part of a factory to another, it would not convey to the accountant that a new asset had been brought into existence by the spending of this sum. The Revenue mind would, however, have no hesitation in treating this sum as a capital expense. The Revenue approach is dominated by a few dicta of learned judges who were probably quite sound in interpreting the law of Rule 3, but could have very little idea of how their interpretation would work out in practice.

The most frequently quoted legal dictum is that which defines capital expenditure as bringing into existence an asset or an advantage for the enduring benefit of a trade. It is reasonable for the Revenue to say that the cost of moving a machine must create such an advantage. In practice a factory might find it essential to make frequent changes in the lay out of its plant and equipment, and if no new plant were acquired the management would not feel that it was carrying out capital work. According to Revenue practice such expenditure should be added to the value of the asset, and wear and tear claimed on it; and while the accountant will frequently do this he is doing so in conflict with his own principles of good accountancy. The Revenue mind on this question of capital expenditure is logical to a wearying extreme and the accountant finds himself adding into the cost of machinery such things as travelling expenses to inspect the machinery before purchase, installation costs, wages of employees fitting out the machines for use and even on giving them trial runs. To the Revenue mind all is capital except what is spent on earning the exact profits of a particular year and on this view they are putting into practice the ruling of the Courts.

On this particular point of what is capital expenditure and what is Revenue expenditure it is not easy to adopt an unbiassed attitude. Clearly, if the Revenue imposed no check on expenditure of this kind, business firms, and particularly industry, would become much more venturesome in spending money to try out new methods with existing assets. On a broad view this approach deserves encouragement and should not, on the whole, be costly in terms of tax, and should quickly pay out in dividends both to the State and industry. It

would partially fill a very obvious gap in our economy, which suffers from a lack of industries producing capital goods, would husband the country's resources, and encourage technical skill. Irish industry deserves the encouragement of being allowed to charge against yearly profits before tax the costs of adaptations of its productive assets, including buildings, which do not involve the acquisition or erection of new units. An Irish taxation code should follow accountancy principles in this matter of capital expenditure rather than tests laid down by a British enactment of more than a century ago for conditions radically different to our own—and in terms of simplification of taxation procedure the gain would be immense.

Depreciation and wear and tear.

Depreciation is not mentioned specifically in Rule 3, Cases I and II of Schedule D. Its disallowance for tax purposes is inferred from some of the clear negatives which that Rule carries, e.g. it cannot be allowed because it is not a disbursement or expense in the form of money wholly and exclusively laid out for the purposes of the trade.

The whole question of wear and tear and depreciation has been gone into very thoroughly in the report of the Taxation Committee and does not require any restatement in this paper. One might find fault with the final recommendations as being too conservative and again following too closely British practice. Indeed the ground was already so well covered in Britain that it was inevitable that British findings would be recommended here. It is a pity that the Committee did not find itself able to go further, if only on the plea that Irish conditions are not British conditions. The Committee was not insensible to this plea and set out many facts giving food for thought such as that single British Companies pay more income tax than is collected from the whole of Irish business profits. Again the Committee's terms of inquiry imposed on it the obligations to have regard to the general revenue position and it could not contemplate any serious drop in the income tax yield even for a few years, nor would it put industry on more favourable terms than the general body of taxpayers. Its report was in reality an interim report pending a general enquiry into income tax and its recommendations were interim only.

The Committee re-established what must be regarded as fundamental to all questions dealing with depreciation and wear and tear, namely, that it is impossible to get away from the original cost of an asset. Whether the asset is written off in three years or thirty years is in the long run immaterial, since industry cannot expect to be allowed depreciation in excess of the net cost of the asset, no matter how money values may change or new inventions affect intrinsic values. Any comparison between Irish rates of wear and tear and British rates shows that the immediate advantage of the latter is rapidly made up by the Irish system; anything extra like the investment allowance is more properly dealt with outside of the income tax code. Consequently if at some stage the public revenue were to face up to temporary losses, knowing that they would be subsequently recouped, there is much to be said for allowing business to fix its

own depreciation by reference to historical cost (original cost less eventual selling or scrap value) This is in essence the American system. The following table taken from the *Taxation Committee's Report* illustrates the difference between Revenue practice and business practice —

<i>Depreciation and Wear and Tear Allowances</i> 1951-53 (nearest £1,000)	<i>Plant and Equipment—years</i>
109 <i>Concerns</i>	
Average Balance Sheet Value before Depreciation	£3,757,000
Average Depreciation written off	407,000 (10.8%)
Average Revenue Wear and Tear Allowances	329,000 (8.75%)
83 <i>Companies</i>	

	1951	1952	1953
	£	£	£
Balance Sheet Value before Depreciation	2,466,000	2,546,000	2,754,000
Depreciation written off	274,000	285,000	307,000
	11.1%	11.2%	11.1%
Revenue Wear and Tear Allowances	217,000	230,000	252,000
	8.8%	9.0%	9.1%

The net cost to the Revenue of conceding business depreciation would obviously be small, and in my view it would have been preferable to have given way on this point rather than to complicate the present code by bringing in initial allowances. It is often overlooked by the Revenue that as many interests conspire to keep up profits as to understate them, e.g. business commissions, the test of management, the returns to shareholders are dependent on profits equally with the tax yield.

Developments in the Tax Code

Pressure of economic events in the nineteenth and twentieth centuries has led to interesting modifications of the tax code. The growth of limited companies and the increasing involvement of government in business affairs brought substantial concessions in regard to profit assessments. This aspect of the subject deserves special study as a preliminary step to a complete investigation of income taxation.

It was, for example, only after long trials of other methods that the present system of a theoretical business profit for assessment purposes, based on the profits of the preceding accounting year, was evolved. One interesting result of this has been to present business firms in most cases with one clear year's profits free of tax, but the proof of this is so technical that it is scarcely appreciated. The present system is nevertheless a complicated one, and from experience it can be said that it is not understood properly by business management. For the additional company tax, corporation profits tax, there are no basic years and very few complications as tax is paid in a straightforward way on the profits of the accounting year as

reinterpreted This also seems to be the American system for all tax. Perhaps the Revenue archives can disclose weighty reasons for maintaining the theoretical profits basis and if so they should be published It is impossible for the outsider to understand why two taxes on almost identical profits require two completely different systems of assessment

Of general financial interest here is the resulting fact that the income tax system compels business to carry permanently a substantial tax reserve on its Balance Sheets. This reserve comes to much more than one year's tax, since the tax on profits is not collected on the average until two accounting periods have passed. It does not seem right that Irish business in general should at any point of time be loaded with over twenty million of debt due to the State as is essentially the case. The American system avoids this extraordinary complication, and the State might solve some of its immediately pressing financial problems by a change over to the current payment system with some compromise on the old reserved debt

In the case of wear and tear as a compensation for the disallowance of depreciation the first concession appeared in 1878 and was further extended in 1907, 1918 and 1949. The 1918 Act also introduced the obsolescence provision which with wear and tear allows the full recoupment of original cost for all machinery replaced. Prior to 1878 it appears that allowances for depreciation were covered by the inference that the expense of replacement of a business asset must be conceded as a business expense and even to-day wear and tear is regarded as an alternative to replacement expense. As the Taxation Committee pointed out, the replacement provisions are rarely utilised and the wear and tear claim is general in profit assessments. This follows normal accountancy practice since any well-run business, particularly a factory, carries a plant register with depreciation provisions made annually against specific items of plant. The dual system of wear and tear and depreciation allowance leads to a great amount of unnecessary trouble and research when items of plant are disposed of; it requires of the Inspector of Taxes the keeping of what is in effect a separate plant register for all the businesses which he assesses to tax. It is unfair to expect this work of the Inspector and if the concession of allowing trades their own depreciation for tax purposes were accorded it should be accompanied by the obligation on all firms to keep a plant register up to date

Losses.

In no instance is the involvement of government with business more clearly illustrated than by the gradual recognition over the whole income tax period, of government responsibility to forego tax when losses were made equally with sharing in profits. In this respect the business firm has a considerable advantage over other taxpayers. A salaried man or a person living on investment income or on rents obtains no similar concession from the Revenue. No doubt it would require very special pleading to bring in the salaried man since the idea of losses in his case is hard to conceive. In the case of investment income, and particularly rents, losses are not unusual but are not recognised specifically in tax legislation.

The original Act of 1842 does not seem to have envisaged any allowance for losses except losses to property owners and farmers by flood or tempest. It did, however, provide in Rule 13 that where two or more trades were carried on by the same person he could set off a loss in one trade against a profit in the other, a provision still very much used in tax work to-day. In 1890 the concession that a loss would entitle the trader to claim back, for one year only, tax already paid on income to the amount of the loss was introduced so that if a loss is sustained in business there is immediate provision for relief against the previous year's tax actually paid under any Schedule of the Income Tax Acts. In 1929 a new concession was given whereby losses not utilised under Rule 13 or the 1890 Act (now Section 34 of the Income Tax Act, 1918) could be carried forward and set off against profits of subsequent years so that between Section 34 and the 1929 Act business firms obtained what amounts to a statutory six years claim for losses against other profits. Subsequent Acts extended these concessions further by, for example, excluding wear and tear allowances from the profits against which losses could be allowed, so that in effect wear and tear claims and losses displaced by wear and tear allowances can never become statute barred. The British system has gone further still, and not merely allows business losses to be carried forward to reduce subsequent profits without any time limit but in certain cases allows recovery of tax paid for three previous years instead of the immediately preceding year as in Ireland. Truly the Chancellor of the Exchequer from this and other evidence has married his direct taxation code to the fortunes of business for better or for worse and one wonders whether a similar marriage would be good or bad for a country like Ireland. Is it socially desirable that the State should rely as at present for about sixty per cent. of its tax revenue on less than five thousand assessments out of a population of three million people.

Conclusions.

It must be accepted as a fact that a very large annual sum is levied on Irish business through what is called income taxation. There is also a strong case for cutting out the accumulated dead wood of tax legislation over the past one hundred and fifteen years in order to refit the tax code to Irish conditions. The American system of preparing an account of business profits (or asking the Revenue official to prepare it himself from the business books as is practised over there) and paying the tax promptly looks attractive as compared to the system we have inherited from Britain of theoretical profits based on trading for years other than the year of assessment. My main conclusion is that business profits should be removed from the conception of income and a proper code of assessment based on practical business experience and accountancy principles substituted. The attempt should be made to make business profits and Revenue profits mean the same thing as in the long run there can be no doubt that they are identical. A start could be made with public companies where the auditors' responsibility is great and an offer made to these companies that, provided certain safeguards are complied with, such as the disclosure of all reserves and the maintenance of a plant

register, their profits will be assessed to one tax only for their own accounting year on a clear percentage basis. In time, and as part of overdue company legislation, this could be applied to all limited companies with the appropriate safeguards.

There are certain reforms overdue in the other Schedules of the Income Tax Acts, such as the amalgamation of appointments into one assessment when held by the same individual, the substitution of a simple stamp on the card as wages tax instead of the complicated Schedule E system, and, I think, the complete abolition of Schedules A and B as survivals of a social age now gone from us. If these reforms can be allied to a simplification of the tax on business profits somewhat on the lines I have set out we would have gone a long way towards achieving an intelligible code of income taxation, and in doing so any loss to the Revenue in the short run (and this could be avoided) would be quickly made up after a few years. We are a small homogenous nation and ought not to be burdened with a complicated tax system but rather taxed in a way which will make us all realise immediately and intimately the problems of self-government.

I prefaced my paper with a quotation from that distinguished seventeenth century civil servant, Samuel Pepys. I should like to conclude it with a quotation from a distinguished Company Director of to-day and former civil servant, Lord Glenavy, taken from the *Taxation Commission Report* (page 100)

“Taxable profits . . . are those assessed by the Revenue Commissioners in pursuance of rarefied professional abstractions assembled into a legalised code, expensive to administer, which bears much sanctity for those engaged in its operation but is little concerned either for the health of productive capacity or for the actual problems of the producers themselves.”

DISCUSSION.

Senator Cox proposed the vote of thanks.

Mr. Howard Robinson. It is always a pleasure and a privilege to support a vote of thanks to a speaker to this Society. It is particularly so for me on this occasion, when the speaker is a member of my own, usually articulate, profession, and when he has dealt in such an interesting way with his subject.

I should like to join in praising the speaker for his excellent paper. I listened in vain for errors of fact, though I must say that I have yet to be persuaded that, in most cases, a firm gets away with one clear year's profit free of tax. It is true that it pays no tax on one year's profit, but then it pays twice on another year's profit. While in agreement with the speaker as regards his proposed reforms to the Income Tax code, I must confess that fundamentally I am in disagreement with him. He would cure out income tax code, where I, if I had my way would completely destroy it and substitute a sales' tax.

The speaker quoted with approval from Lord Glenavy's minority report on the Taxation of Industrial Profits. I go further. I agree with Lord Glenavy's entire report, although I must admit that before being able to do so, I first had to translate it into my own more pedest-

trian language. Lord Glenavy, you will recall, recommends the abolition of income taxation in this country, and this appears to me, one of the most commendable steps to meet our present economic difficulties

These difficulties arise, it seems to me, from the facts that since the war, we have consumed more than we have produced, we have invested more than we have saved, and we have invested almost entirely in non-productive, although socially desirable, capital goods such as hospitals and houses. I do not suggest that we were necessarily wrong in the direction we took, but I do suggest that the time has come to change this direction.

Our system of Income Taxation is calculated to continue rather than to correct these trends. Production is taxed, not consumption, and savings, out of business profits, for investment in productive capital goods are made impossible. When, to heavy Taxation on artificially calculated profits, are added the activities of the Prices Commission, the Fair Trade Commission, and the like, it is wellnigh impossible for industry to re-equip itself, as its assets wear out, much less to save and provide further capital.

In Great Britain, which suffers from an equally limiting Taxation system, conditions since the war have permitted industry to provide additional capital by ploughing back profits. It is not unusual among British Companies, to see a profit of say, 25 per cent. on capital, with a distribution of only 7 per cent. With a few notable exceptions, that is almost impossible in this country—besides being considered immoral. While in Great Britain therefore approximately 80 per cent of savings are, I believe, in the form of ploughed back profits—no such savings are being made in this country on anything like the same scale.

Even in times of stable prices, the meaning of terms such as profits or income, when used by the revenue authorities, bear little relation to the economic facts of life. Thus the revenue authorities do not concede that buildings ever wear out, and so, no allowance for depreciation of buildings may be charged in arriving at profits for tax purposes. Again, if a person purchases an annuity for say, seven years, the entire annual sum received is assessed to income tax, not withstanding the fact that the greater part of each receipt represents a repayment of the original purchase price.

In times of inflation (I am tempted to say, in normal times) the unfairness of our income tax code becomes even more marked. The Speaker is prepared to accept as reasonable, a wear and tear allowance based on the original cost of the asset concerned. I cannot agree with him. Industry and Commerce as a whole, and the individual business concerns that make up that whole, are continuing processes. They must, like a human body or other living organism, replace themselves. They must substitute new cells continuously in place of the old ones as they wear out, otherwise they die. Until a business replaces its actual physical assets, whether they be premises, plant and machinery, or stocks, as they are used up and wear out, it has made no profit, and unless you allow industry to do this, you will kill it.

I have much pleasure in seconding this vote of thanks

Professor Shields said that Mr Charleton had delivered an admirable lecture on which he should be congratulated. Throughout his paper, he discussed the recent Report of the Commission of Inquiry into Industrial Taxation. Unfortunately, its terms of reference were restricted by the proviso that its recommendations should have regard to the interests of the general body of taxpayers. This is a matter for the Minister for Finance and the Government when the report has been placed before them. The members of a commission should be free to consider the financial implications and different aspects of the subject under consideration.

The effect of this limitation is evident in the failure of the Commission to make any recommendation in favour of a differential tax on undistributed profits placed to reserve. The building up of reserves should be an essential duty of business firms, and should be encouraged by the legislature. It tends to strengthen their potential resources, is an antidote against inflation from which we suffer in this country, and is in accordance with government propaganda to save and invest in Irish industry. Some alleviation of taxation on retained profits that would not cause an undue burden on the National Exchequer would be productive of industrial development and lead to increased employment.

The percentage allowances granted by the Revenue Commissioners for plant and machinery should be re-considered with a view to the recognition of higher percentages. The replacement value of machinery purchased in 1956 would probably be about three times its cost in 1938. An element of realism should be introduced into our taxation code, especially as manufacturers to be successful have to use not only the most modern machinery, but also the most efficient management and methods.

Irish manufacturers have been urged for the last thirty years to enter the export market. This is merely lip advice given by public men who have no idea of the difficult problems with which business managements have to contend in preparing goods for export to a market highly competitive in price and standard of quality, in which the foreign manufacturer may have an advantage in manufacturing costs and long established custom. In most instances the Irish manufacturer is at a disadvantage with his foreign competitor in the latter's market, as he may have to import the raw materials with the consequent freight costs and those of the manufactured products. Some tax concessions should be allowed to our manufacturers who have previously catered for the home market, and are able to engage in an export trade.

The effects on prices of the present taxation on profits could have been considered by the Commission, particularly in cases of products where there is little or no competition and where there is open competition.

Mr Arnold Marsh said that his interest in the question of taxing industrial companies arose from national considerations. Industrial development was a necessity and the present taxation system was an obstacle to the growth of one of the things the country needed most. The profits of a company should not be treated as income unless they

became personal income. We should get the idea of company directors as trustees who, if they conducted a business successfully and made profits, could either convert the profits into personal incomes, which would be taxable, or save them by putting them into industrial expansion, which would be national development and should not be hampered. There were no people more ready to "save" in this way than the directors of industry.

He referred to what he called the sensational change in attitude revealed by the United Trade Union Organisation the previous week, which now wanted to liberate industry from taxes. The traditional view of the workers' organisations had been that the capitalists were "blood-suckers" who exploited the workers and deserved to be taxed to the limit. Probably the unions still had no interest in making the rich richer, but the view was developing that the workers should exploit the capitalists' business abilities in such a way as to make the wage-earners' position more secure and the openings for employment more plentiful. If this was so, last week's development marked a very important turning point, because official Labour's attitude would no longer be against the making and using of profits. He hoped the Union Congresses would become corporate members of the Society.

Mr. C. F. Smith in his contribution to the discussion made the following points

1. A country gets the taxes it deserves—therefore it is right that laymen should take a more active interest in our system.
2. I believe that income tax is the best, and inevitable, system to produce the revenue required from the backs most able to bear it. Most of the objections raised by other speakers to the tax would be answered if the rate—as Senator Cox said—could be reduced to, say 5/-.
3. A high tax rate is an incentive to evasion. Successive Ministers for Finance here have not followed the initiative of the U.K. Chancellor in initiating a drive against evasion.

The Special Investigation Department is undermanned, and the faith of the tax paying public, in the effective equity of our system, dwindles.

4. Drastic renovations require new legislation, but the paucity of leading cases in Eire renders the law uncertain, its operation, frequently unknown and largely unknowable.