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Letter from A. P. Richardson, Secretary, American Institute of Accountants, to Members and Associates of the AIA Re: Methods of Taxing War Profits Compared; Differences in Spirit of Legislation Which Cause English Industry to Accept a Higher Rate Than is Proposed Here, by George O. May, of Price, Waterhouse & Co. [Letter To the Editor of The New York Times].

A. P. Richardson

George O. May

American Institute of Accountants. Committee on Federal Legislation

To the Members and Associates,
American Institute of Accountants:

The Committee on Federal Legislation draws attention to the letter reprinted herewith and requests that it be brought at once to the notice of your Senators and Members of Congress. Here is an opportunity for the Institute to render a service in the cause of equitable taxation and public policy.

A. P. RICHARDSON, *Secretary.*

New York, Aug. 31, 1917.

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Methods of Taxing War Profits Compared.

Differences in Spirit of Legislation Which Cause English Industry to Accept a Higher Rate Than Is Proposed Here.

By GEORGE O. MAY, of Price, Waterhouse & Co.

To the Editor of The New York Times:

In the discussion of the pending finance bill reference is frequently made to the taxation of war profits in England. In general the position is stated to be that in England 80 per cent. of the excess profits are taken by the government, and there is, broadly speaking, no complaint, whereas here it is claimed that substantially lower rates of taxation will work incalculable harm to industry.

The statement as to England is, I believe, true, and the question, Why should there be such a wide difference in the attitude of business men toward taxation on the two sides of the Atlantic? is a fair and pertinent one. I do not think the answer is to be found in any difference of degree in willingness to make sacrifices, but that it is to be found wholly in the difference in the methods and spirit governing the determination of taxable profits in the two cases.

The English law proceeds on the theory of giving the taxpayer a liberal pre-war standard and dealing equitably with special cases, and with this basis assured the manufacturer has no valid ground for objection to taxation of his excess profits, however high it may be.

A comparison of the pre-war standards allowed shows that in England the manufacturer is given a choice of two years out of three, each of which was a

prosperous year in England. To protect the manufacturer in any special cases where the three years in question were not prosperous ones two alternatives are provided—either a choice may be made of four years out of six (if during the three years' period the profits of the business were 25 per cent. below normal) or a reasonable rate of return on capital may be claimed as the pre-war standard. The rate is fixed by the law at a minimum of 6 per cent. in the case of corporations, but a specially constituted board of referees has power to increase this rate in any given industry, and in practice the board has increased the rates allowed to 9, 10, 12, and in some cases 22½ per cent.

The finance bill now pending in Congress, on the other hand, fixes arbitrarily as the pre-war standard the average of the three years of 1911, 1912 and 1913, an average which is undeniably sub-normal in many industries, including such important industries as steel and leather, and without allowance for the fact that standards of values have completely changed since that period. The only alternative allowed is the average rate of earnings in the industry in which the corporation is engaged, which may give some relief in a few cases, but does not meet at all the cases of whole industries which suffered from depression during the three years in question.

As to the determination of taxable profits, the pending finance bill bases the taxation on the returns for income tax, subject only to adjustments in respect of dividends received from other taxable companies. The result is that in many cases taxpayers are denied the full deduction for interest which they have paid, they are required to pay tax on profits outside the regular course of business, and in other respects are taxed on a sum exceeding their true income. No provision is made for dealing with special cases where the law operates harshly.

On the other hand, the British excess profits tax law provides for modifications of the methods employed in ascertaining income for ordinary income tax purposes. It sets up special rules for determining the profits, but

gives power to the commissioners of inland revenue or the board of referees to modify these provisions in any case where it seems to them proper to do so by reason either of specific conditions recited in the act, such as the postponement, by reason of the war, of repairs; exceptional depreciation or obsolescence of assets employed in connection with the war; or the necessity in connection with the war of providing plant which will not be wanted for business after the war; or by reason of "any other special circumstances specified in regulations made by the Treasury."

Whenever a case of hardship is established the Treasury shows a willingness to provide for it in such regulations. For instance, it was recently represented to the Treasury that the method of valuing inventories, having regard to the rise in prices during the war and probable fall thereof on the conclusion of the war, would result in injustice, and the Treasury, after conferring with leading accountants, issued regulations to cover the case. These regulations provide that after the termination of the last excess profits period every corporation shall be given time to liquidate its inventories and shall have the right to adjust its returns for the last taxable year so as to take up in that year any loss that may subsequently have been sustained on such liquidation of inventories.

Another important feature of the British law which is entirely absent from the pending finance bill is its treatment of fluctuating business. If a corporation's profits largely exceed the pre-war standard in one year and fall short of that standard in the succeeding year, the corporation receives a corresponding refund of excess profits tax paid on account of the first year.

Another vital difference between the two bills is the provision as to the payment of the tax. Under the pending finance bill the tax is payable at the same time as the income tax. Many corporations which are making large profits have those profits in the form of increased inventories, accounts receivable, and even plants, and not in cash, and such corporations will be seriously embarrassed to meet the large tax payments required.

Under the British law taxes are payable two months after assessment, but the commissioners have power to allow payment to be made by instalments in such sums and at such times as they may fix, and in practice the commissioners have dealt liberally with the taxpayers under these provisions where they were satisfied that hardship would result from demand for immediate payment.

These are only some of the more important differences between the provisions of the two measures, but they are sufficient to indicate the difference in the underlying principles, and this difference is an essential factor in any comparison of the attitude of our manufacturers with that of the British taxpayers.

GEORGE O. MAY.

New York, Aug. 27, 1917.