

5567



AN
COIMISIÚN UM CHÁNACHAS
IONCAIM
(COMMISSION ON INCOME TAXATION)

AN TRIÚ TUARASCÁIL
(THIRD REPORT)



DUBLIN:
PUBLISHED BY THE STATIONERY OFFICE.

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Houses of the Oireachtas



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 COMMISSION IN CHARGES
 LINCOLN
 (COMMISSION ON INCOME TAXATION)

Houses of the Oireachtas

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To Dr. James Ryan, T.D.,
Minister for Finance.

CHAPTER I

INTRODUCTION

1. Our terms of reference invite us to enquire generally into the present system of taxation of profits and income and to recommend "such amendments of the law as appear desirable and practicable." At the same time we are asked to recommend alternative means of raising revenue if it is considered that income taxation "should be terminated or modified in any manner involving loss of revenue."

(in whole or in part)

INCOME TAXATION

by

ALTERNATIVE TAXATION

<i>Tax revenue</i>	<i>Percentage of tax revenue</i>
(a) customs duties, including special import levies	41.9
(b) excise	22.6
(c) death duties	2.8
(d) stamp duties	2.5
(e) water taxation	5.5
(f) income tax	20.1
(g) gift tax	1.8
(h) corporation profits tax	2.8
Total	100.0

The full terms of reference are as follows:

"to enquire generally into the present system of taxation of profits and income, its scope and incidence, including the provisions for collection and for the prevention of evasion, its effects on the national economy and the equity of its incidence; to recommend such amendments of the law as appear desirable and practicable; and if it is considered that the taxation of profits and income should be terminated, or modified in any manner involving loss of revenue, to recommend alternative means of raising equivalent revenue."

REPORT ON
SUBSTITUTING
(in whole or in part)
INCOME TAXATION

ALTERNATIVE TAXATION

Houses of the Oireachtas

8

To Dr. James Ryan, T.D.,
Minister for Finance.

CHAPTER I

INTRODUCTION

1. Our terms of reference invite us to enquire generally into the present system of taxation of profits and income¹ and to recommend "such amendments of the law as appear desirable and practicable." At the same time they require us to recommend alternative means of raising revenue if it is considered that income taxation "should be terminated or modified in any manner involving loss of revenue."

We now submit a report on this matter.

2. The Exchequer revenue receipts in 1959/60 were made up as follows:

<i>Tax revenue</i>	£	<i>Percentage of tax revenue</i>
(a) customs duties, including special import levies ...	44,956,000	41.9
(b) excise duties ...	24,236,000	22.6
(c) death duties ...	2,994,000	2.8
(d) stamp duties ...	2,640,000	2.5
(e) motor taxation ...	5,912,000	5.5
(f) income tax ...	21,627,000	20.1
(g) surtax ...	1,932,000	1.8
(h) corporation profits tax ...	3,031,000	2.8
Total	107,328,000	100.0

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"to enquire generally into the present system of taxation of profits and income, its scope and structure, including the provisions for collection and for the prevention of evasion, its effects on the national economy and the equity of its incidence; to recommend such amendments of the law as appear desirable and practicable; and if it is considered that the taxation of profits and income should be terminated, or modified in any manner involving loss of revenue, to recommend alternative means of raising equivalent revenue".

Non-tax revenue

Land Commission annuities ;
 interest received on
 Exchequer advances ;
 receipts from postal, tele-
 graph and telephone
 services, etc.

£

22,527,000

Exchequer revenue for
 1959/60

129,855,000

As can be seen from the above, income taxation amounted to almost 25 per cent. of the total tax revenue.

3. Non-tax revenue is not available as a substitute for income taxation, as even if an increase were made in some of the payments that provide non-tax revenue this would be equivalent to including a tax element in them. If, therefore, income taxation were replaced it would be necessary to have recourse to taxation in some other form.

TAX REVENUE		
41.9	44,956,000	(a) customs duties, including special import levies ...
22.6	24,236,000	(b) excise duties ...
2.8	2,994,000	(c) death duties ...
2.2	2,640,000	(d) stamp duties ...
2.2	2,912,000	(e) motor taxation ...
20.7	21,627,000	(f) income tax ...
1.8	1,932,000	(g) surtax ...
2.8	3,031,000	(h) corporation profits tax ...
100.0	107,328,000	Total

The full terms of reference are as follows:
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CHAPTER II

SOME CHARACTERISTICS OF A GOOD TAX SYSTEM

4. A tax system should primarily be considered as a whole, although this does not preclude examination of each component of it. Certain taxes when regarded individually may be severely felt, yet collectively they may constitute a reasonably satisfactory and equitable taxation system. The general picture has to be taken into consideration.

5. A characteristic of an ideal tax system, but one which is almost unattainable in present-day circumstances, is simplicity. Many have placed such value on simplicity as to advocate that taxation should be limited to a single subject-matter such as land, or rents, or fuel. They argue that if, for example, fuel is taxed the tax is eventually passed on from the producers to the consumers, and so to the mass of the people. But any tax of this nature would have to be charged at a high rate to produce the revenue required and might result in a very unequal distribution of taxation. Moreover, the anomalies which any single tax may create are likely to offset one another in great part under a system of multiple taxes. It is, however, apparent that in a country of small population and limited resources there are at least administrative advantages in keeping the number of taxes as few as possible.

6. Opinions differ as to whether it is, on balance, desirable that taxes should be consciously felt by those who pay them. Some hold that there is a great advantage in the form of taxation that brings home to citizens that they themselves have to pay for the benefits that flow from the expenditure of public revenues. Others, probably the majority, take the view that the balance of advantage is in having taxes that can be collected with the minimum of inconvenience to the taxpayer.

7. Although the primary purpose of taxation is to finance the public services, taxation is also utilized nowadays for economic and social purposes, such as to reduce the consumption of some goods, to divert expenditure from one class of goods to another, to provide price supports, and to help in solving balance-of-payments problems. There are conflicting views as to the extent to which taxation should be used for such purposes, and what adjustments in taxation are the most appropriate in particular circumstances.

8. Among the major objectives of social and economic policy at present are full employment and the avoidance of inflation, and it would naturally be desirable that taxation should not impede the attainment

of these objectives. It is however almost impossible to select a tax that would not have, at least in the short term, some adverse effect on employment, and many taxes are criticised on the ground that they have an inflationary effect.

9. The principle that taxation should, as far as possible, be equitable in its incidence receives universal support; yet this is far from easy to put into practice because, in the complexity of modern life, it is difficult to determine what is the equitable distribution of tax amongst those whose personal and financial circumstances are different, and how tax payable by impersonal entities such as limited companies should compare with tax on individuals.

It was long held that taxation should be roughly proportional to incomes, but in many quarters viewpoints on this matter have changed since Adam Smith wrote in his "Wealth of Nations" that

"The subjects of every State ought to contribute to the support of government as nearly as possible in proportion to their respective abilities, that is, in proportion to the revenue which they respectively derive under the protection of the State".

Enlightened opinion does not now regard as entirely equitable a system of taxation that is "in proportion to the revenue" or incomes of the citizens. The more acceptable view is that there should be some increase in the rates of taxation according as incomes increase; in other words that taxation should be progressive.¹

10. There is on occasion some conflict between achieving equity in taxation and furthering through taxation economic or social objectives, because when tax exemptions and reliefs are granted to further such objectives the yardstick of taxable capacity has to be laid aside. The resulting advantages, or potential advantages, are deemed to outweigh any loss of equity that arises.

¹A tax is regarded as *progressive* when the tax payable per unit of income increases as incomes increase; it is *proportional* when the tax payable per unit of income is the same for large incomes and small; and it is *regressive* when the tax payable per unit of income decreases as incomes increase.

CHAPTER III

INCOME TAXATION

11. It may be helpful to give a brief historical note regarding income taxation in Ireland and to outline the taxes on profits and income that are now in operation here.

Income tax

12. Income tax was introduced in Britain in 1799, and, apart from a relatively short break after the Peace of Amiens in 1802, was reimposed each year up to 1816 when it was discontinued. It was, however, introduced again in 1842.

Income tax was first imposed in this country in 1853, the tax code being almost identical with the British one; and it has been continued in both countries ever since. Since 1922 the many changes made in the British income tax code were frequently followed by similar changes here, although the Irish system has deviated from the British in some respects.

13. The statute law on income tax in Britain and Ireland was consolidated in 1918, and the consolidating act of that year, the Income Tax Act, 1918, still forms the basic law on income tax in this State.¹ That act has however been altered and added to by more than forty subsequent enactments—the British Finance Acts, 1919 to 1922, inclusive, the Irish Finance Acts, 1923 to 1959, inclusive, and some provisions in other statutes.² In addition to these acts there have been numerous Court decisions regarding their interpretation. The result is that nowadays only a tax specialist can become familiar with all the intricacies of the law on income tax.

It is estimated that for the present year, 1960-61, there are about 175,000 individuals and about 6,500 limited companies liable to income tax.

Surtax

14. Surtax, originally termed supertax, was first imposed in Britain and Ireland in 1909. It was then charged only on those whose total income exceeded £5,000 per annum, but the tax was payable, at a fixed rate of sixpence in the pound, on the excess over £3,000 per annum. Graduated rates of surtax were introduced in 1914, and graduation has since then been retained in this country and in Britain. As with income tax, the rates of surtax and the exemption limits have been varied from time to time.

¹The income tax law was again consolidated in Britain in 1952.

²e.g., the Provisional Collection of Taxes Act, 1927.

Since 1922 Britain and the Six Counties form a single fiscal unit for income taxation as well as for purchase tax and customs and excise duties, other than for some minor licence duties.

In 1957 an innovation was introduced in the British surtax code of deducting certain personal allowances,³ in addition to the statutory exempt margin, in ascertaining the amount of income chargeable to surtax; and in 1959 a similar change was made in this country. Surtax is now chargeable on the amount of a person's total income for any year that exceeds £2,000 together with the personal allowances granted for income tax. When a person's income is determined for income tax it is then a simple matter to compute the surtax, if any, payable by him. There are at present about 5,000 persons liable to surtax.

Corporation profits tax

15. Corporation profits tax was first imposed in Britain and Ireland in 1920. It was a levy at a fixed rate on the profits of companies⁴ in excess of £500 for any year. This tax was discontinued in Britain after some years,⁵ but it has been retained here, with occasional changes in the rate of tax and in the amount of the exempt margin. The tax is payable by a company whose profit for any accounting period of twelve months exceeds £2,500, the tax being ten per cent of the excess over £2,500.⁶ Companies are liable to both income tax and corporation profits tax, but a small number of companies trading in the State which are managed and controlled in either Britain or the Six Counties are liable to British rather than Irish income tax.⁷ They are, however, liable to corporation profits tax on profits arising here. About 1,600 companies are liable to corporation profits tax.

³i.e., the amount by which the personal allowances for income tax exceed the personal allowance to an unmarried person.

⁴Subject to certain exceptions as set out in F.A. 1920, sec. 52(3) as amended.

⁵There is, however, in Britain and the Six Counties a "Profits Tax", supplementary to income tax on bodies corporate and un-incorporate (excluding partnerships). This superseded a similar tax, known as National Defence Contribution, which was first imposed in 1937.

⁶The rules governing the computation of profits chargeable to corporation profits tax are almost the same as for income tax, but corporation profits tax is deducted in calculating the amount of a company's income that is chargeable to income tax. For instance, if a company's profits for a year (before deducting income tax) amount to £10,000 the corporation profits tax is as follows:

	£	£
profits	10,000	
exempt margin	2,500	
corporation profits tax	7,500 @ 10% =	750
The income tax is then:		
profits	10,000	
less corporation profits tax	750	
	9,250 @ 7/- =	3,237 10s.
Total tax		3,987 10s.

⁷Under the "Double Income Tax" Agreement, 1926, with Britain (as amended).

The latest year for which a published analysis is available of the yield of income tax is 1957-58. The net revenue obtainable from the assessments made in that year has been estimated as follows:⁸

	Net tax payable £	Percentage
Schedule A: income from ownership of buildings and land	1,572,500	6.6
Schedule B: income from occupation of land	100,900	0.4
Schedule C: income from government securities paid through agents	647,500	2.8
Schedule D: income from trades and professions, investments, and business lettings	14,253,900	60.0
Schedule E: earnings of employees, office-holders, etc.	7,176,600	30.2
Total tax	£23,751,400	100.0

16. Precise information is not available showing the amount of income tax payable by companies, but it would seem that, of the yield of £14½ millions approximately under Schedule D for 1957-58, about £11 millions were payable by them, the balance being payable mainly by individuals and partnerships.

17. The total tax payable by companies on assessments made for 1957-58, including income tax under both Schedule D and Schedule A and corporation profits tax, was about £15 millions; the total tax payable by individuals and partnerships, including income tax and surtax, was apparently about £14 millions.⁹ It should be stressed that these are only approximations; an exact analysis is not available to us.

18. It is not possible however to distinguish clearly between the effective income tax liability of limited companies and that of individuals. The income tax charged on companies includes tax on distributed profits which the companies recover when paying the dividends;¹⁰ in other words the effective income tax liability of limited companies for 1957-58 was less than the £15 millions indicated above.

⁸Annual Report of the Revenue Commissioners, Year ended 31st March, 1959 (Pr. 5281).

	£
⁹ i.e., total income tax payable on 1957-58 assessments	23,751,400
total surtax payable on 1957-58 assessments, say	2,250,000
	26,001,400
less income tax payable by limited companies (under Schedules D & A), estimated	12,000,000
Balance payable by individuals, partnerships, etc.	14,001,400

¹⁰They also recover in this way any tax they pay on "charges", such as interest on loans or debentures.

19. From an examination made some years ago by the Revenue Commissioners of the accounts of a large number of Irish companies it appeared that the dividends declared amounted to about one-fourth of the profits assessable to income tax.¹¹ The published Stock Exchange information does not indicate that there has been any appreciable change since then in the proportion of profits distributed in dividends; hence, on a rough estimate, close on £3 millions of the income tax charged to limited companies is the shareholders' tax rather than that of the companies themselves.¹²

20. A private company is usually under the control of a small number of individuals, perhaps a family; this further blurs the distinction for taxation purposes between companies and individuals because the tax charged on a private company is in effect a tax on those who immediately control it.

21. The number of individuals who are liable to income tax, estimated at about 175,000 for 1960-61, looks small in a country with a population of 2.9 millions,¹³ but the number at work, according to the most recent published information, i.e., for 1959, is about 1,112,000.¹⁴ Of this number 420,000 are engaged in agriculture, forestry and fishing, and under present law very few of them are liable to income tax. (The great majority of farmers would not be liable even if income tax was charged on their actual profits instead of on notional profits.)

Moreover, on the basis of the allowances now granted for income tax, a person whose total income, if all earned income, does not exceed £6 per week is exempt;¹⁵ a married man is exempt if his and his wife's total income, assuming it is all earned, does not exceed £10 per week or thereabouts; and a married man with two children is exempt if his and his wife's total income, again assuming it is all earned, does not exceed £845 per annum or thereabouts. Many are exempt from tax

¹¹This examination related to the year 1950, and covered about 3,000 companies out of the 5,700 companies then registered (finance, co-operative and a small number of other companies being excluded). As the number of companies registered had increased to 8,320 by 31st December, 1958, the information regarding dividend payments in 1950 has to be treated with some reserve in its application to present-day circumstances.

Of the 8,320 companies on the Irish Register of Companies at 31st December, 1958, 7,946 were private and 374 were public companies. These exclude companies in the course of removal from the Register.

At 31st December, 1958, the paid-up share capital of the private companies was about £92 millions, and of the public companies about £60 millions; total £152 millions.

A characteristic of private companies is that their Articles of Association contain restrictions on the transfer of shares. Unlike public companies they are not required to submit a balance sheet yearly to the Registrar of Companies. A private company may normally be formed by two persons; seven are necessary to form a public company.

¹²If any shareholder is not liable to the full amount of the tax deducted from his dividends he may claim a refund from the Revenue Commissioners.

¹³*Census of Population of Ireland, 1956* (Pr. 3983).

¹⁴*Economic Statistics issued prior to the Budget, 1960* (Pr. 5482) pages 22 and 27.

¹⁵Most unmarried female employees earn less than £6 per week and are exempt; and a number of male workers who are engaged in non-agricultural activity (particularly those between 14 and 20) earn less than £6 per week and are exempt.

because they are entitled to deductions or reliefs for, e.g. life assurance premiums. Of the remainder some manage to avoid coming under the notice of the Revenue Commissioners, but broadly it may be said that it is because incomes are relatively low, as compared with the personal tax allowances, and to some extent because income from land is assessed on a notional basis, that the number of persons liable to income tax is so small.

The merits of income taxation

22. It is necessary to distinguish between the character and the weight of taxation, and, when comparing taxes on income with other forms of tax, to have in mind a system of income taxation based on a reasonably up-to-date code of law. Income taxes can vary greatly according to the rates at which they are charged and the allowances and reliefs granted in computing the tax payable, and it is difficult therefore to discuss income taxation independently of these matters.

23. There is no fully satisfactory way of computing a person's taxable capacity, but one of the best tests of taxable capacity is the income test. If, for instance, one person has an income of £x per annum while another has an income of £5x per annum, these income figures normally indicate the resources each has, first to meet his essential needs, and secondly for less essential needs or for savings. The amount left over after providing for essential personal and family requirements might properly be regarded as an index of taxable capacity.

24. A tax charged on a surplus of this nature has only to be compared with a tax on expenditure, such as on tobacco or alcohol, to make one realise how much more closely can a tax on incomes be related to taxable capacity.¹⁶ One person may spend as much as £40 on tobacco during the same time as another with a similar income and equal responsibilities spends only £5 on it, and in this way one pays about £27 in tax on tobacco while the other pays about £3. Each person is however liable for a similar amount of income tax, and this appears to conform more closely to general notions of equity than a tax on expenditure.

25. The following illustrates how readily income taxation can be adapted to the varying circumstances of individual taxpayers. (The rates taken are those for 1960-61, and it is assumed that the income is all earned.)

	Total income	Income tax payable
	£	£ s.
(a) an unmarried person with no dependent relative	400	23 2
an unmarried person with one dependent relative	"	2 2
a married person	"	nil

¹⁶As stated later, income alone is not a complete index of taxable capacity.

	Total income	Income tax payable
(b) an unmarried person with no dependent relative	£ 600	£ s. 75 12
an unmarried person with one dependent relative	„	54 12
a married person with no dependent relative	„	19 12
a married person with one dependent relative	„	nil
(c) an unmarried person with no dependent relative	800	128 2
an unmarried person with one dependent relative	„	107 2
a married person with no dependent relative	„	72 2
a married person with one child	„	30 2
a married person with two children	„	nil
(d) The personal allowance to a widowed person exceeds by £25 that granted to an unmarried person		
(e) If a person pays, say, £40 per annum in life assurance premiums to an Irish company on a policy taken out after 21st May, 1953, he normally gets a reduction in tax of $\frac{2}{3}$ of £40 @ 7/-		= £9 6 8
If he pays £40 per annum in premiums to a foreign company he normally gets a reduction in tax of $\frac{1}{2}$ of £40 @ 7/-		= £7 0 0

26. The income tax system can be used to encourage different forms of saving and investment. For instance, there is at present a provision that interest (up to a certain maximum) on deposits in banks carrying on business in the State is disregarded for income tax purposes,¹⁷ and the dividends on many Irish stocks and shares are subject to a reduction of twenty per cent for income tax and surtax if the investments are in the beneficial ownership of individuals solely resident in the State.¹⁸

27. Generally it is possible within the income tax system to adjust the tax liability to widely varying circumstances, and to provide incentives of social or economic import.¹⁹ To do so some complexity is unavoidable in the law and procedure applicable to income taxation.

¹⁷F.A. 1956, Sec. 3 (The banks concerned are named in the act. The interest must accrue to an individual).

¹⁸F.A. 1932, Sec. 7, as amended.

¹⁹e.g., allowance for insurance against certain hospital expenses, wear and tear allowances, and "initial allowances" on purchasing plant or machinery.

28. Wealth can so quickly beget wealth that the taxation of income arising from it helps to restrain inordinate accumulations of income and capital. (This is quite different from the matter of careful husbanding of resources.) Among the directive principles of social policy enshrined in Bunreacht na h-Éireann is the following :

“The State shall, in particular, direct its policy towards securing

* * *

That the ownership and control of the material resources of the community may be so distributed amongst private individuals and the various classes as best to subserve the common good”²⁰

In consonance with this it is generally agreed nowadays that it is necessary to make some redistribution of private resources, and income taxation provides one means of doing so.

29. Over the past twenty years many governments have imposed income taxation at rates of over fifty per cent, and at critical times up to even ninety per cent. They did so not merely to raise revenue but also to apply fiscal and economic controls to the extent that was thought desirable.

30. That taxes based on incomes are a suitable and practical means of providing revenue is supported by the fact that at present income tax is operated in advanced countries everywhere. It is noteworthy also that in post-war years the extension of income taxation has been recommended by some technical-assistance missions to underdeveloped countries, working under the aegis of the United Nations.

31. Income taxation is, however, more suited to some countries than to others. It may be difficult to administer satisfactorily when the economy of a community, or of any sector of it, contains a predominantly non-monetary element, because those concerned may frequently have no money to pay income tax or because the large non-monetary part of their incomes is not readily susceptible of measurement, either in terms of the quantities of home-produced goods they consume (or barter) or in terms of the money values of these goods.

32. In this connection the following extract from a recent United Nations publication, setting out the conditions desirable for income taxation, is of interest :

“The first condition is the existence of a predominantly money economy. The subsistence farmer cannot be satisfactorily reached by an income tax, not so much because he does not have money to pay—that may mean that he cannot pay a tax of any kind—as because the greater part of his real income cannot be satisfactorily assessed. Even highly skilled administrators have made little progress towards including the value of home-produced

²⁰Article 45. 2., Bunreacht na h-Éireann.

and consumed foods in the taxable income of farmers. In many under-developed countries these products and others obtained by barter make up a major fraction of the total real income of large segments of the population. Admittedly these groups are usually the poorest in the society, and failure to subject them to direct taxation may not be seriously objectionable from the equity point of view. It does, however, encourage use of other taxes".²¹

33. A reasonably high standard of literacy is necessary among taxpayers and potential taxpayers if income taxation is to be administered effectively.²² No matter how simplified a tax system may be it is necessary to complete an annual return of income from all sources ; and in order to determine one's income a certain amount of account-keeping is often required. On the other hand, the consumer who pays a purchase tax or an excise duty has no returns to complete.

34. Income taxation cannot operate satisfactorily unless there is an efficient system of administration and unless there is a ready acceptance by the citizen of his obligation to pay whatever taxes are imposed by the lawfully appointed government. The development by all citizens of a right attitude to taxation is sometimes retarded by imperfections in the tax system employed and sometimes by prejudices of a historical or political nature, but a greater consciousness of tax responsibilities could be developed by removing major inequities, by simplifying income tax procedures and making them more intelligible to taxpayers, and by insistence on the impartial application of the law to all concerned.

Representations received regarding income taxation

35. We received many submissions that income taxation is unsuited to this country, that the rate is too heavy, or that the law needs substantial change. We quote hereunder representative extracts from them.

36. *The Institute of Chartered Accountants in Ireland :*

"The Institute of Chartered Accountants in Ireland does not consider that the present system of taxation of incomes and profits (i.e. direct taxation) should be abolished. It is of opinion however that it should be radically modified, and that a much smaller proportion of total taxation than heretofore should be collected by means of direct taxation.

"It considers that the present system of direct taxation is unsatisfactory for the following reasons :

- (a) It retards saving, making it well-nigh impossible for individuals or companies to save.

²¹*Taxes and Fiscal Policy in Under-Developed Countries*—United Nations Publication, 1955. *I.H.L.*, page 20.

²²According to the *United Nations Statistical Year-Book*, 1957, many parts of Asia, Africa, and South America have illiteracy ratios of over 50 per cent. A general tax on incomes would probably be unworkable in these areas as the necessary returns could not be satisfactorily completed by large numbers of those who would be liable to tax.

- (b) It is not conducive to increased production as it acts as a disincentive to employers, self-employed persons and employees alike.
- (c) Although theoretically paid out of profits, direct taxation does in fact raise the cost of exports and its reduction would stimulate exports.
- (d) It is costly and difficult to collect, and the equivalent amount of tax could more easily and cheaply be collected (especially from the lower-income groups) when income is being spent rather than when it is being earned.
- (e) There is unfairness in the incidence of direct taxation through evasion and through the difficulty of assessing persons changing employment, etc.
- (f) It is unfair to persons who have to pay large medical or educational expenses out of taxed income.
- (g) Its reduction and the introduction of some forms of sales tax would facilitate the participation by this country in a Free Trade Area."²³

37. *The Federation of Trade Associations :*

" . . . the present system of income tax assessment is completely outmoded and unsuited to this country's requirements. The principal objection to the system is the fact that large numbers of the population are able to evade the payment of income tax with the result that those who do pay such tax are being asked to bear far more than their fair share of the taxation burden. It is hoped therefore that, as a result of the Commission's examination of the problem, some system of taxation will be found which will ensure that this burden is equitably distributed.

" In this connection we suggest that the Commission should examine, on an actuarial basis, the desirability and feasibility of substituting for the present system a consumers' sales tax. As distributors, the members of the organisations represented in the Federation might not entirely welcome the sales tax, but it is felt nevertheless that an actuarial investigation would be desirable to ascertain if such a system of taxation would be more satisfactory than the present one."²⁴

(The Federation of Trade Associations includes R.G.D.A.T.A., the Irish Motor Traders' Association, the Society of Irish Electrical Traders, the Irish Jewellers' Association, the Wireless Dealers' Association, the Hardware and Allied Traders' Association of Ireland, the Irish Drug Association, the Confectioners' and Fruiterers' Association, the Irish Retail Tobacconists' Association, etc.)

²³Submission, 24th October, 1957.

²⁴Submission, 3rd December, 1957.

38. *The Irish Conference of Professional and Service Associations :*

"We are of opinion that, on general principles, assuming it is possible to have a system which is equitable in its incidence, and bears proportionately to income on all members of the community, there can be no great objection to the taxation of income, given the need of the State for a revenue which cannot adequately be obtained from other sources.

"If, however, through political expediency or political pressure, such a system cannot be introduced and made to operate—if, therefore, in effect the existing system with its manifold defects were not to be radically revised we are strongly of opinion that, in the interests of social and distributive justice, grave consideration should be given to the abandonment of the system of taxation of income."²⁵

39. *The Association of Chambers of Commerce of Ireland and The Federated Union of Employers :*

"... one-sixteenth of the population provide almost thirty per cent. of the total State revenue in addition to their contribution in indirect taxation. Obviously the entire basis of income taxation is unsuited to this country. It is submitted that the Commission should investigate the present income taxation structure in relation to the tax burden generally and express its views as to the equitable apportionment of State expenditure over the various sectors of the community."²⁶

40. *The Irish Banks Standing Committee :*

"... It is submitted that the entire basis of income taxation in Ireland should now be radically altered so as to extend its incidence over a much wider sector of the population ; or, alternatively, that the proportion contributed in this form of taxation should be substantially reduced so that the overall burden of State expenditure is more equitably shared by all sections of the community. Either proposal should have the effect of reducing considerably the level of income taxation borne by existing taxpayers which is the main evil of the present system.

"It is considered that the long-term effects of taxation on business liquidity will become progressively more serious. As the replacement of assets is a gradual process it seems probable that industry has not yet felt the full impact of plant renewal on its liquid resources. The present level of taxation is having considerable adverse effects on risk assumption. . . .

"... It is felt that the present level of income taxation is seriously hampering economic development by discouraging in-

²⁵Submission, 16th November, 1959.

²⁶Submission, March, 1958.

creased industrial activity. Indeed it is considered that an increase in indirect taxation might be less harmful to the national economy than the existing system of income taxation at its present level."²⁷

41. *The Irish Institute of Secretaries :*

"The present system of taxation should be abolished and replaced by a purchase tax.

"Direct taxation is a direct taxation on products and is no incentive to production, thus dangerously retarding the progress of the country and helping to promote emigration."²⁸

42. *The Committee of the Dublin Stock Exchange :*

"The general level of taxation (on business concerns) is considered to be too high, especially when seen against the background of a country which is trying to improve and expand the number of industries within its boundaries. The effect of the existing taxation system is to deter enterprising management and ownership from expanding. . . .

"The incidence of taxation on professional and business people in this country has reached the proportion of a dangerous burden. The middle-class section of society represented by these people is an essential element to the stability of any democratic State. There can be no doubt that large numbers of this section of the community are leaving the country, especially the younger qualified professional and business generation. One of the factors affecting this unfortunate exodus of talent is the prospect of ever-increasing taxation.

"Expert examination should be given to the possibility of a retail sales tax for operation throughout the country on a flat rate. This tax need not be severe but quite a small rate would be more than sufficient to make up any lost revenue from adjustments to the general scale of income tax, sur-tax and estate duty. A sales tax would give far greater incentive for savings than the ordinary type of direct taxation. Direct tax must be paid by the individual, however anxious he may be to save, but a sales tax is only incurred if the individual makes a purchase. This type of tax is widely operated on the continent of Europe and some countries where the economic conditions more closely resemble those of Ireland than the conditions in Great Britain upon which our system of taxation is based."²⁹

43. *The Civil Service Alliance* (a federation of civil service associations):

"In view of the difficulties inherent in the operation of any income tax scheme in this country, it is suggested that the Commission should seriously consider its abolition in favour of some

²⁷Submission, April, 1958.

²⁸Submission, 21st August, 1957.

²⁹Submission, 31st May, 1957.

other more suitable system of tax collection (such as a more wide-spread purchase tax system) if such an alternative could ensure that all sections of the community would bear a fairer share of the general tax burden. If abolition of income tax is not thought feasible, it is suggested that the Commission should recommend that the proportion of revenue collected under the heading of income tax should decrease over the years so that the emphasis would gradually come to be placed on other sources of revenue.

"It is contended that indirect taxes are more easily met by members of the community than is income tax, particularly since income tax on individuals is often payable in large amounts. . . . For this reason it is submitted that greater emphasis should be placed in future on indirect taxation."³⁰

44. *The Irish Wholesale Drapers' Association :*

"Introduced originally as a war-time measure, and intended as a temporary one, income tax has yielded and is yielding so much revenue that to abolish it almost smacks of heresy.

"While the rates of tax remained low it could be regarded as burdensome, but at present-day rates it takes the form of penalty. At no stage could the tax be justified from an economic point of view as it penalises industry in every form, but in its present primitive state it merits consideration for either extreme modification or complete abolition.

"From the point of view of collection the work involved is very great and, as has happened with changing money values, many workers formerly exempt are now liable, which has increased the cost of collection. It is doubtful, apart from showing lower-paid workers that there is such a thing as income tax, if there is any point in collecting sums varying from £1-£10 per annum. There is a substantial amount of work both in compiling returns and in assessing and collecting these amounts.

"Indirect taxation (in Britain and Ireland) apart from these taxes common to both countries (tobacco, wines and spirits, entertainment, etc.) mainly differs in the purchase tax. Purchase tax was a temporary expedient resorted to during the Second World War which has lingered on in Britain at varying rates and covering different commodities—originally intended for luxury goods, but covering many essentials. This tax is collected by wholesalers, and is charged on the net wholesale value of the goods after deduction of cash discount. The wholesaler accounts for, and renders payment to the Government quarterly *whether he has been paid or not*, but is permitted to reclaim any amounts which he can prove to be a bad debt. This form of taxation would be strongly opposed by my members; it is grossly unfair in that one section of the trading community is saddled with the burden of collection,

³⁰Submission, 17th February, 1958.

necessitating a drastic change in its bookkeeping system, and a greatly increased office staff, in addition to which it needs to employ considerable extra finance to carry the burden of slow payers.

"It is evident to all wholesalers that to carry the burden of . . . purchase tax under the present permitted margins in our trade would spell complete and absolute ruin, and is not to be tolerated.

"The whole trend of taxation in both Britain and Ireland is to become more and more complicated, and therefore costly, and any major change should aim at simplification by direct tax on commodities in the luxury and semi-luxury class, as near to the source of supply as possible. This principle applies particularly to a country such as Ireland, traditionally opposed to taxation.

"If income tax is to be retained at all, the minimum income level should be stepped up considerably, e.g. say a single man, £500 and married with one child, £800. Rates of tax to be levied on a graduating percentage basis on incomes above this amount, such things as personal allowance and earned income allowances being eliminated, e.g. say 10% on the first £200 rising by 5% on each £200 to a maximum of 40%.

"In so far as corporations are concerned, the suggested maximum (40%) would apply but C.P.T. (corporation profits tax) should be abolished.

"As mentioned in the beginning, income tax is not a desirable tax and these suggestions are really a "half-way house" pending abolition. The aim should be to tax people on what they spend, and not on what they earn. There would be wonderful advantages to be gained if there was no income tax. All hoarded untaxed savings would find their way back into commercial activity and into investment in Government Loans, etc. People with capital would settle down in Ireland and new capital and new industries would be attracted to our island on a vast scale."³¹

45. *The Royal Institute of the Architects of Ireland :*

"The Institute has considered the terms of reference of your Commission. It believes that the present system of income taxation is inequitable in its incidence and extravagant in cost of administration. It believes that income taxation should be abolished and replaced by a more equitable tax calculated on spending. Certain new taxes, easy of collection, might be imposed; for example, on bicycles and matches and on hotels, restaurants and boarding houses so that tourists might contribute to the State revenue. Certain taxes imposed at present might be increased. It is urged that a simplification of the method of taxation in order to minimise as far as possible the cost of collection must be achieved.

³¹Submission, 15th August, 1957.

"If income taxation is to be retained the present system, whereby under 150,000 persons pay it, should be amended so as to ensure that the tax falls equitably on all over a certain income level.

"Taxation should not act as a deterrent to initiative. It is submitted that the present system whereby incomes over £1,500 per annum are subject to additional taxation does act as a deterrent, and as a spur to emigration."

"The Institute strongly recommends that whatever system of taxation is adopted, special care be taken to ensure that its collection be accomplished with the minimum cost. The present system, it is felt, is burdened with an outmoded and increasingly expensive collection system."³²

46. From these submissions and representations made by individual citizens it is clear that there is great dissatisfaction in this country with the present system of income taxation. It will be noted however that most of the submissions did not indicate how the taxation of incomes could be wholly replaced, nor have we found any satisfactory complete alternative to it. We formed the general opinion that the heavy rate rather than the system of income taxation was responsible for the widespread criticism, and that there would be much less criticism if the rate of tax were not so high.

47. A limited company whose profits exceed £2,500 in any year now pays in income taxation 41.5 per cent of the excess over £2,500.³³ It is difficult to compare this rate with those in Western European countries owing to differences in the tax systems, and particularly in the concept of income. The Irish rate is apparently less than in many of them, but not significantly so, and it must be remembered that in some of these countries industry in post-war years has been more buoyant than in Ireland, and better able to bear heavy taxes. The re-investment of profits so necessary for business and industrial development is greatly restricted by a high rate of tax. Ninety-five per cent of Irish companies are privately owned, and have normally to rely on their own resources to increase their capital in order to expand their activities,³⁴ so that it is desirable that the maximum share of their profit should be available to them for re-investment.

It is stated in "*Economic Development*" that "High taxation is one of the greatest impediments to economic progress because of its

³²Submission, 29th August, 1957.

³³ i.e., taxable profits, say, £1,000	
corporation profits tax, 10%	£100
income tax on £900 (£1,000—£100) @ 7/-	£315
total tax on £1,000	£415 = 41.5 per cent.

³⁴Private companies usually find it too expensive to raise additional capital by arranging for a public issue.

adverse effects on saving and on enterprise."³⁵ It is also stated in that publication that "Unless our taxation is relatively light this country can scarcely hope to attract foreign capital, enterprise, and organisational competence."³⁶

In our opinion it is important at the present time to promote favourable conditions for the introduction of capital and organisational competence into Irish industry, and we regard an easing of direct taxation as a worthwhile step in that direction.

48. Great stress is now being laid on the importance of increasing exports, but the Irish exporter, or potential exporter, is at a disadvantage compared with many of his competitors abroad because the home market on which most Irish industries are based is so limited, and because his transport costs are heavier. A reduction in the rate of direct taxation would at least partly compensate for these disadvantages.

49. The incidence of income tax on individuals, as distinct from companies, is also heavy, and there is much to be said for lessening it.

In 1938-39 an unmarried man with a total earned income of £200 per annum was liable for £4. 13. 9. income tax. The equivalent of this at mid-February, 1960, was £530 and on that sum an unmarried person is now liable for £57. 4. 6. income tax. In 1938-39 a married man with a total earned income of £300 per annum was liable for £2. 16. 3. income tax. On the equivalent at mid-February, 1960, i.e., £794, he is liable for £70. 10. 6. income tax.³⁷ On many persons, particularly those with low incomes, income tax as a percentage of income has been more than doubled since pre-war on equivalent incomes although the net receipts from taxes under the care and management of the Revenue Commissioners expressed as a percentage of national income was 20.7 per cent for 1957-58 as compared with 15.6 per cent. for 1938-39, an increase of much less than double.³⁸

A married man having an earned income of £2,650 (the equivalent of about £1,000 pre-war) now pays £651, or 24.6 per cent, in income tax and surtax, against 13.4 per cent pre-war. This is an increase of 83.6 per cent on income taxation pre-war against an increase of about 33 per cent in the proportion of all national income taken in taxes under the care and management of the Revenue Commissioners.

³⁵*Economic Development* (Pr. 4803) page 21.

³⁶*idem*, page 23.

³⁷Minister for Finance in reply to a Parliamentary Question, 9th December, 1959, Official Report, Vol. 178, Cols. 1007, 1008.

The Consumer Price Index at mid-February, 1960 was the same as at mid-August, 1959 (on which the reply was based).

³⁸In 1938-39 these taxes amounted to £24,606,000
i.e., 15.6 per cent of the national income, amounting to ... £157.4 millions
(See *Annual Report of the Revenue Commissioners, Year ended 31st March, 1940*, and *Irish Statistical Survey, 1955*.)

In 1957-58 they amounted to £97,129,000
i.e., 20.7 per cent of the national income £470.1 millions.

(See *Annual Report of the Revenue Commissioners, Year ended 31st March, 1958*, and *Irish Statistical Survey, 1958*.)

This was an increase of 32.7 per cent over the 20-year period in the percentage of national income absorbed by the taxes referred to.

A person's marginal rate of tax, i.e., the amount payable on each extra pound he earns, is greater than the effective rate of tax on his total income; and it is the marginal rate that is relevant in considering the disincentive effect of tax on work. There are not many who have earned incomes exceeding, say, £3,000 per annum but a number of those who have could be very valuable from the aspects of organisational ability, managerial competence, and employment-promotion. Some may question if it is good national policy to have a rate of income taxation that in certain instances reduces nominal earnings by as much as one-half.³⁹ Even for those who are not liable to surtax a rate of seven shillings in the pound, or 35 per cent, on taxable income could be regarded as a strong disincentive to work and enterprise; and tax is charged at this rate on the taxable incomes of, for instance, a single man whose earnings may not greatly exceed £6 per week. Generally speaking a high rate of tax can encourage tax avoidance and may also lead to tax evasion.

50. The tax on investment income is heavier than on earned income. For instance an unmarried man having £500 per annum from investments pays £93.2 income tax against £49.7 on earned income of a similar amount.

A married man having £3,000 per annum from investments pays £958 income tax and surtax, against £800 if the income were all earned.

An unmarried person whose sole income is £5 per week (£260 per annum) from investments is liable at 7/- in the pound on the excess over the personal allowance of £234 per annum.

The tax now payable on incomes in Britain and the Six Counties is not much greater than that on similar incomes here.⁴⁰ At some periods in the recent past the tax payable in certain ranges of income and family circumstances was indeed higher in Ireland. On this matter it was stated in *Economic Development* that the high level of taxation here had "upset the traditionally advantageous relationship between this country and Britain as regards the incidence of taxation on individual incomes."⁴¹ This has to some extent been remedied by the two Finance Acts of 1959 and by certain proposals in the Budget for 1960. A further reduction in the income tax rate would, in our opinion, provide some encouragement to the introduction of foreign capital from which benefits would accrue to the Irish economy and, in course of time, to the Irish Exchequer.

51. There are some demerits, apart from its weight, in income taxation as now operating in this country. These include its com-

³⁹If a married man had £3,000 per annum and could readily earn extra money he would pay in tax a minimum of 42.5 per cent, or 8/6d., out of each extra pound he earned. If he had £7,000 per annum he would pay in tax a minimum of 65 per cent, or 13 shillings, out of each extra pound he earned.

⁴⁰The British rates were exceptionally high during and for some years after the last war, but they have been gradually reduced since then. The standard rate of income tax, which was 10/- from 1941 to 1945 inclusive, was reduced to 7/9 for 1959-60 and has remained at that figure for 1960-61. The maximum amount allowable for earned income relief has been increased from £150 in the period 1941-1946 to £1,550 for 1957-8 to date.

⁴¹Op. cit., page 23.

plexity, its cost, and the necessity on occasion of making close enquiries into personal affairs in order to compute the amount of income chargeable to tax.

52. We have already referred to the complexity of our income tax system, a complexity that is almost unavoidable when income taxation has to be adapted to the varying circumstances of individuals and of industrial and commercial life. A self-employed business man normally finds it very difficult to understand the many technical problems that arise in ascertaining the income tax payable by him.⁴² It is symptomatic of the complexity of income tax that it is necessary to enclose a lengthy statement of explanatory notes and instructions with each personal return of total income that is issued for completion.

53. The cost of administering income taxation is about £1 million, i.e. about ninepence per pound of revenue received; this compares with about fivepence per pound of customs and excise revenue.⁴³

In addition to the administrative cost there is the cost to the taxpayers themselves of clerical work and audit. Much of this cost would be incurred even if there were no income taxation, but many traders and professional men keep accounts for the sole purpose of complying with income tax and surtax requirements.

54. Apart from the matter of complexity many business and professional men have to prepare and send to the tax office each year an account showing the net profits earned; and if the account contains a number of estimates, or appears unreliable, a taxpayer may be requested to submit his personal bank records for examination. As trading accounts often contain debits that are partly of a business and partly of a non-business nature, enquiries on personal matters are sometimes necessary in order to eliminate the non-business debits. To check the adequacy of business drawings it is frequently necessary to investigate a taxpayer's personal and family expenditure. Moreover the information on tax returns extends to details regarding children, dependants, insurance policies, and other personal matters, owing to the wide ramifications of the income tax system.

⁴²These problems arise in connection with wear and tear; initial allowances; industrial buildings allowances, balancing allowances, balancing charges, and deductions for renewals, obsolescence, and replacement of plant or machinery; changes in partnerships; changes in terminal dates of accounts; double taxation agreements; "charges" on income; distinguishing between capital and revenue expenses; the "Schedules" and "Cases" under which income tax is charged, etc.

⁴³The 1959/60 revenue from income taxation amounted to about £27 millions, so that the cost was one twenty-seventh of this, or 9d. in the pound.

The customs and excise revenue was about £69 millions in 1959-60, and the administrative cost was rather less than £1½ millions, or about 5d. in the pound. A great part of the customs and excise is collected in large sums from manufacturers, importers, and wholesalers and this helps to keep the cost of collection low.

(Even though one form of taxation is more costly to administer than another, cost is only one of a number of considerations that have to be kept in mind in assessing the merits of different taxes. The reasons for having a particular tax may outweigh the disadvantage of its administrative cost.)

A PURCHASE OR SALES TAX

56. Most of those who advocate either the abolition or the reduction of income taxation have suggested as an alternative a purchase tax or a sales tax. It will be seen from the representations already quoted that consideration of a purchase tax as a substitute for income tax has been favoured by many trade associations whose members would probably have to incur a certain amount of trouble in connection with a purchase tax if it were introduced.

57. The terms "purchase tax" and "sales tax" are applied almost indiscriminately to a tax on the value of goods bought and sold, whether the tax is collected from those who sell the goods by wholesale or from those who sell by retail. These terms are also applied to "multiple-stage" taxes and "added-value" taxes (see Appendix). For convenience of reference the term "purchase tax" is used in this Report. It is probable that if any such tax were introduced in this country the balance of advantage would be in a purchase tax that is collectible at the wholesale rather than the retail stage. We refer to that matter later.

A purchase tax could be either an alternative to income taxation or a supplement to it. However this Commission is concerned only with a purchase tax as an alternative, or part alternative, to income taxation.¹

The estimated revenue from taxes on income for 1960/61 amounts to about £29 millions—so that if a purchase tax were to replace all income taxation it should yield about £29 millions.

The total of personal expenditure (including expenditure by visitors) in the State for 1959, at current retail prices, excluding taxes paid on personal incomes, was about £470 millions.² This however includes expenditure on many types of goods and services that would not normally come within the scope of a purchase tax, for example, basic foods, rent, travel, essential services, and goods such as tobacco and alcoholic drinks which are already subject to heavy customs and excise duties.

58. The wholesale value of all purchases made by retail establishments for 1958, the latest year for which that information is available, amounted to about £230 millions,³ and if a tax at 15 per

¹See terms of reference, page 1, footnote.

²*Statistical Abstract*, 1959 (Pr. 5012) page 252 and *Economic Statistics issued prior to the Budget*, 1960 (Pr. 5482) page 25.

³Census of Distribution, 1958 (*Irish Trade Journal*, March, 1960). The figure of £230 millions is made up of £210 millions as per the 1958 Census of Distribution (which was on a sample basis, the returns being expanded using grossing factors derived from the fuller 1956 Census) and an estimated £20 millions in respect of retailers who did not submit returns as required by the 1956 Census.

cent. were imposed on all these purchases it would provide a revenue of about £34 millions. But in this total of purchases there are some classes of goods to which a purchase tax could not apply, such as tobacco and intoxicating liquor.⁴ Various classes of food are also included, and while there may be no great objection to a tax on non-essential foods, a tax on staple foods would fall too heavily on those with smaller incomes. In any case there is such a large amount of farm produce consumed on farms without process of sale that it would be inequitable to tax similar produce when sold retail. A tax on fuel would probably be regressive, and therefore undesirable. A tax on books would be undesirable on educational and cultural grounds.

Furthermore, there would be obvious drawbacks in having a purchase tax on exports, or on goods or materials essential to agricultural production or industrial manufacture. A tax on production would automatically increase production costs.

If the goods referred to above were excluded from a purchase tax there would remain a range of consumer purchases the wholesale value of which is about £65/75 millions yearly. This would provide a reasonable base for a purchase tax if it was thought advisable to introduce it.

59. The following are the principal advantages claimed for a purchase tax:

- A. The person who pays a tax as part of the cost of an article is not usually as conscious of the tax as he is of income tax the amount of which is set out on a demand note or pay-slip. Hence payment of purchase tax would cause less loss of satisfaction than an equivalent payment of income tax.
- B. A purchase tax, unlike income tax, allows an option of spending either on taxable articles or in non-taxable ways such as education or books, or of deferring spending and investing the money so saved.
- C. There is less scope for evasion of purchase tax than income tax.
- D. A purchase tax is a flexible instrument for effecting changes in social and economic policy.

60. The following disadvantages are ascribed to a purchase tax if it were introduced here:

- E. It would be regressive, that is, it would fall more heavily on those whose incomes are small.
- F. It would be inflationary.

⁴According to the *Irish Statistical Survey, 1958* (page 62) the expenditure on alcoholic drinks and tobacco in 1958 was estimated at £74 millions at retail price. This was equivalent to about £56/57 millions wholesale.

- G. It would adversely affect Irish manufacture and Irish exports; and if levied on wholesale values would cause price increases greater than the tax itself.
- H. It would have an unsettling effect on trade before and sometimes after the annual Budget.
- I. A purchase tax imposed on selected classes of goods would encourage persons to change to other, perhaps less desirable, forms of expenditure.
- J. If the rates of purchase tax varied for different classes of goods the cost of administration would be high.

We now comment briefly on the points listed above, having in mind a tax charged at a moderate rate on the goods in the range of £65/75 millions wholesale value already referred to.⁵

61. A. "The person who pays a tax as part of the cost of an article is not usually as conscious of the tax as he is of income tax the amount of which is set out on a demand note or pay-slip. Hence payment of purchase tax would cause less loss of satisfaction than an equivalent payment of income tax."

It is general experience that when some benefit is obtained in the course of paying tax it makes the payment less unpleasant.

The following extract from a representation to the Commission emphasises the ease with which, as compared with income tax, taxes included in the retail price of consumer goods can normally be collected.

"The worker who smokes a package of cigarettes a day and (moderately) drinks, say, two pints of beer daily pays in duty annually £62 thus:

	s. d.
Duty on cigarettes	2 1 (on 20)
Duty on beer, say, 8d. a pint (depending on its gravity)	1 4
Total	3 5
Duty per annum	£62

Yet the worker does not seem to worry about this. He has paid the Exchequer £62 absolutely, but in paying it he has the satisfaction of consuming commodities representing to him immediate tangible values. For the same reason he usually pays entertainment tax with equanimity. Payment of direct tax on his income is, on the contrary, from his standpoint, entirely divorced from association with material benefits".⁶

⁵i.e., excluding tobacco, intoxicating liquor, petrol, food, books, fuel, light, exports, and materials essential for agricultural production and industrial manufacture.

⁶Representation from *Mr F. M. Maguire*, Auditor, South Mall, Cork—September, 1958.

62. It is argued on the other hand that a tax such as income tax helps to impress upon citizens that they really pay for the State services, and that in this way income taxation promotes an interest in public affairs. Nevertheless, we have little doubt that many of those who have to pay taxes would prefer taxes that are included in their day-to-day expenditure on goods to taxes payable on demand.

63. B. "A purchase tax, unlike income tax, allows an option of spending either on taxable articles or in non-taxable ways such as on education or books, or of deferring spending and investing the money so saved."

A tax on spending, of its nature, discriminates in favour of savings. This is very desirable as savings, apart from their advantage to the community, help to provide financial security and in this way to promote a sense of personal independence. In the income tax system there are certain indirect incentives to save and invest, but a purchase tax more strongly discourages spending on inessentials because, unlike income tax, purchase tax is charged on the amount that is spent, and no more.

A purchase tax allows some freedom of choice in expenditure, and although in practice this may be limited it is a consideration that is highly valued by many taxpayers.

64. Some incentives to saving that income taxation is intended to provide are at times ineffective. For instance exemption is granted, subject to certain conditions, on the interest (up to a specified maximum) on personal bank deposits, but if a person transfers, say, £1,000 from stocks and shares to a deposit account (and thereby gets the bank interest free of tax) there is no saving as a result of the transfer. Again a reduction in income tax is normally granted for life assurance premiums paid, but when a person pays such premiums out of a capital account, e.g. a bank deposit, he is merely transferring assets from one fund to another, and making no real saving. A taxpayer may even pay an insurance premium by increasing his bank overdraft, in which case he becomes eligible for virtually a double income tax relief, on both the interest to the bank and the insurance premium.

In any event income taxation at present affects only about one sixth of the working population (roughly 175,000 out of 1,112,000 persons) so that the limited scope it provides for encouraging savings can scarcely compare with that provided by a purchase tax, which would affect a much greater number of persons.

65. An important objective of financial policy nowadays is to promote the accumulation of capital for investment, with a view to increasing employment and improving standards of living. If income taxation is heavy it tends to impede capital formation, but a purchase tax supplies a direct incentive to make savings, and so far as it succeeds

it helps to provide capital accumulation, and the benefits that flow from it. A purchase tax is, however, unlikely to have a significant effect on savings if it is charged at a low rate or rates.

66. C. "There is less scope for evasion of purchase tax than income tax."

In Britain and the Six Counties purchase tax is collected almost at the beginning of the chain of distribution, i.e. from the wholesale rather than the retail trader. This allows little scope for evasion as the number of firms liable to purchase tax (and which have therefore to be supervised for that purpose) is comparatively small. Here too a tax charged at the wholesale stage would be collected from a relatively small number of firms,⁷ and if the rates of purchase tax were moderate the urge to evade it would naturally be less than if charged at, say, 30, 40 or 50 per cent as in Britain. Furthermore if a purchase tax coincided with a reduction in income taxation the urge to evade income tax would be lessened so that, on the whole, a purchase tax would probably result in less evasion of tax obligations.⁸

67. D. "A purchase tax is a flexible instrument for effecting changes in social and economic policy."

A purchase tax provides an effective method of encouraging either a reduction in the purchases of those consumer goods that may be subject to tax or a change in the pattern of spending on such goods. Unlike income tax changes, which normally take some months before they are felt, purchase tax changes usually have an immediate effect on prices. A government might find this of advantage in many circumstances. If for instance a purchase tax were imposed, or increased, on imported consumer goods, it might help to lessen balance-of-payments difficulties; or if in a period of trade recession some rates of purchase tax were lowered this would release spending power, and so cushion the economy against a temporary shortage of money in circulation. Similarly, an increase in purchase tax rates could provide an effective check on personal expenditure whenever money was over-plentiful. A purchase tax could also help to divert expenditure from certain goods to others; in Britain it has sometimes been used for this purpose.

⁷According to the Census of Distribution, 1956, there were about 2,400 establishments engaged in the wholesale trade, as against about 40,000 in the retail trade—*Irish Trade Journal*, September, 1958 and September, 1959.

There were about 4,400 establishments engaged in industrial production in 1957 (the latest year for which published information is available). Excluding establishments engaged in the production of goods which would clearly be outside the scope of purchase tax, e.g., food and fertilizers, the maximum number of establishments engaged in industrial production to which a purchase tax would apply would be about 2,500. This does not exclude such establishments as distribute their goods to wholesalers only; the statistics available are not sufficiently detailed to give this information.

It is probable that the number of establishments that would be directly concerned with a purchase tax as envisaged by the Commission would not exceed 3,000 or thereabouts.

⁸The subject of income tax evasion will be dealt with in a later report.

The flexibility of the tax is not, however, an unmixed blessing. It causes a certain amount of trade uneasiness and at times trade dislocation. Furthermore, governments nowadays are not short of instruments of economic policy, such as tariffs, subsidies and quotas, although a purchase tax would probably be more effective than any of these where the matter of external trade did not arise and where subsidies were not appropriate.

We now turn to the suggested drawbacks of a purchase tax, set out under heads E to J in paragraph 60.

68. E. A purchase tax "would be regressive; that is, it would fall more heavily on those whose incomes are small."

Whether or not a purchase tax would be regressive would depend on the classes of goods taxed and the rates at which the tax was charged. It appears from the Report on the *Household Budget Inquiry, 1951-52*,⁹ that a tax charged on essential foods would be regressive, but that a tax on many other foods would not, and that, while a tax on household non-durable goods would be slightly regressive, a tax on household durables¹⁰ and semi-durables would probably be progressive. It can also be deduced from the Report that a tax on clothing would be progressive.

69. In the Report on this Inquiry the information regarding household incomes and expenditure was set out in a number of ways, one of which was average expenditure per household, households being classified according to income-per-person. (Income per person was ascertained by dividing the total household income by the number of persons in the household, including children.)¹¹

Households were divided into four groups,

those in which income-per-person was under 30/- per week

"	"	"	"	"	"	"	30/- to 50/-	"	"
"	"	"	"	"	"	"	50/- to 80/-	"	"
"	"	"	"	"	"	"	80/- and over	"	"

⁹*Household Budget Inquiry, 1951-52* (Pr. 2520). This Inquiry covered 148 cities, towns and villages, but not the exclusively rural areas.

¹⁰Durable goods include furniture, radios, refrigerators, cookers, etc.; non-durable goods include soap, polishes, disinfectants, etc.

¹¹In calculating income all income of a regular nature was taken into account including pensions, income from property, recurring payments from relatives abroad, Social Welfare payments, and the imputed value of home-produced food and of meals supplied by employers.

Items not of a regular nature such as gifts and betting receipts were not included (Inquiry, page XVIII)

70. The average weekly expenditure per household in these four groups on the goods listed below was as follows:

		Weekly income per person in household			
		Under 30/-	30/- to 50/-	50/- to 80/-	80/- and over
Weekly expenditure (shillings)	(a) Clothing	9.27	20.72	35.08	48.66
	(b) Household durable and semi-durable goods	1.05	2.98	7.41	13.07
	(c) Household non-durable goods	1.78	2.22	2.53	2.73
	(d) Miscellaneous goods excluding the above and excluding food, drink, tobacco, fuel, light, etc.	1.72	3.62	4.36	7.72

Total weekly household expenditure		116.22	178.92	245.01	338.41

(Report, Table 3)

Taking the total weekly household expenditure as roughly equivalent to total weekly household income, the income ratios for the four groups are $1 : 1\frac{1}{2} : 2 : 3$. These compare with expenditure-per-household ratios on the different classes of goods as follows :

	Weekly income per person in household			
	Under 30/-	30/- to 50/-	50/- to 80/-	80/- and over
<i>Weekly household expenditure ratios;</i>				
(a) Clothing	1	$2\frac{1}{4}$	4	$5\frac{1}{4}$
(b) Household durable and semi-durable goods	1	3	7	13
(c) Household non-durable goods	1	$1\frac{1}{4}$	$1\frac{1}{2}$	$1\frac{1}{2}$
(d) Miscellaneous goods (as before)	1	2	$2\frac{1}{2}$	$4\frac{1}{2}$

These figures when compared with the household-income ratios, $1 : 1\frac{1}{2} : 2 : 3$, indicate a regressive trend in expenditure on household non-durable goods, a slightly progressive trend in expenditure on clothing and miscellaneous goods, and quite a progressive trend in expenditure on household and semi-durable goods.

71. The average expenditure **per person** in the groups referred to was as follows :

		Weekly income per person in household			
		Under 30/-	30/- to 50/-	50/- to 80/-	80/- and over
Weekly expenditure per person (shillings)	(a) Clothing	1.87	4.60	9.11	15.75
	(b) Household durable and semi-durable goods	0.21	0.66	1.91	4.07
	(c) Household non-durable goods	0.36	0.49	0.65	0.85
	(d) Miscellaneous goods (as before)	0.35	0.72	1.13	2.50

(Report, Table 21)

The corresponding ratios of expenditure per person are (approximately) :

		Weekly income per person in household			
		Under 30/-	30/- to 50/-	50/- to 80/-	80/- and over
(a) Clothing		1	2½	5	8½
(b) Household durable and semi-durable goods		1	3	9	19½
(c) Household non-durable goods		1	1½	1¾	2½
(d) Miscellaneous goods		1	2	3¼	7

Calculated on this basis, expenditure under all heads shows a more progressive trend than on the basis of expenditure per household.¹²

72. As stated in this *Household Budget Inquiry* (page xxx),

“ The expenditure on all groups of commodities increases appreciably with increasing household income per person, the total expenditure in the highest group being almost three times that in the lowest. The increase is most marked in the case of clothing and Sundries in which household expenditure in the highest group is over five times as great as in the lowest. . . . When converted to rate-per-head the difference in expenditure between the income groups is even greater than for the rate per household, the total

¹²When considering the matter of progression in income taxation it is the individual rather than the household or the family that is usually taken into account.

When considering expenditure on food, rent, fuel, light, household durable and non-durable goods, and perhaps motoring, the household rather than the individual appears to be the more suitable unit. When considering expenditure on alcoholic drink, tobacco and, to a large extent, clothing, the individual appears however to be the more suitable unit.

expenditure per head in the highest group being almost five times that in the lowest. The contrast between the highest and lowest income groups is again most pronounced in the case of expenditure on clothing and Sundries, these being over eight times as great in the former as in the latter group."

Although it is some years since the Inquiry was made, the pattern of expenditure according to income groups is probably little different now from what it was in 1951-52.

73. The expenditure in the Six Counties, according to household-income groups, on certain classes of goods which might be subject to a purchase tax if introduced here can be seen from the following figures taken from a household budget enquiry for 1953-54.¹³

		Weekly income of household						
		Under £3	£3- £6	£6- £8	£8- £10	£10- £14	£14- £20	£20 or more
Weekly household expenditure (to the nearest penny)	1. Clothing and footwear	4/11	18/4	28/10	39/9	39/-	87/7	85/6
	2. Private motoring	nil	3d.	8/-	2/2	6/3	11/4	19/4
	3. Durable household goods	10d.	6/1	6/9	16/3	15/6	24/3	30/4
	4. Non-durable household goods ¹⁴ ...	1/-	2/1	3/-	3/3	3/5	4/4	4/10

(Report, Table 37)

74. Omitting the under-£3 income group because it is difficult to say what figure would represent an average income within it, and basing the household-income ratios on the mid-point for each of the other groups,¹⁵ the household-income ratios compare with the household-expenditure ratios as follows :

	Weekly income of household					
	£3- £6	£6- £8	£8- £10	£10- £14	£14- £20	£20 or more
Household income ratio (approx.)	1	1½	2	2¾	3¾	6 (say)
Household expenditure ratios;						
1. Clothing and footwear	1	1½	2	2	4¾	4¾
2. Private motoring	1	32	8½	25	45	77
3. Durable household goods	1	1	2¾	2½	4	5
4. Non-durable goods	1	1½	1½	1½	2	2¼

¹³Report of an Enquiry into Household Expenditure in 1953-54, Ministry of Labour and National Service (H.M.S.O., London, 1957).

¹⁴Soap, polishes, disinfectants, etc.

¹⁵If total expenditure per household were taken as an index of income per household this would show the expenditure as slightly more progressive than appears above.

From this it is seen that, for 1953-54 in the Six Counties, recorded household expenditure on private motoring increased more than proportionately to household incomes; household expenditure on clothing, footwear and durable household goods increased more or less proportionately to household incomes; and expenditure on non-durable goods increased less than proportionately to household incomes.

The general picture of household expenditure is not unlike that shown in the Report of the Household Inquiry for this State for 1951-52.

75. It does not follow that the trend of taxation on the classes of goods mentioned above would quite correspond with the trend of expenditure on them; there could be more tax payable per unit of expenditure on some goods than on others, and the taxes might affect the pattern of expenditure by certain householders. The Six-County information does, however, support the indications from the 1951-52 Household Budget Inquiry that a purchase tax on clothing and footwear, household durables and private motoring would **not** be regressive.

76. In any event regard should be had to the general tax structure rather than to a section of it when considering whether taxation is regressive. A particular tax could be regressive and yet the whole system might not be inequitable.¹⁶ Moreover, any consideration of this matter should take into account, at least in a general way, the extent to which the spending of tax revenues benefits different income groups. It is obvious, for instance, that persons with low incomes benefit most from social welfare payments, although, in addition to "vertical" distribution, from the well-off to the poor, there is also a good deal of "horizontal" distribution, i.e., from those within certain income groups to others in the same groups.¹⁷

77. On the whole it is clear from the available information that, even if the use to which tax revenues are put is left out of consideration, a purchase tax would not necessarily be a regressive tax and that a purchase tax on goods such as wearing apparel, motors and household durables would probably not be regressive.

78. F. A purchase tax "would be inflationary."

As a purchase tax is normally borne by the final purchaser of the goods, the tax increases the price he pays, and so his cost of living. It

¹⁶"All onerous taxes and rates must be judged in equity as a whole. Almost every onerous tax taken by itself presses with undue weight on some class or other, but this is of no moment so long as the inequalities of each are compensated by those of others, and variations in the several parts synchronise. If that difficult situation is satisfied the system may be equitable, though any one part of it regarded alone would be inequitable." *Memorandum on the Classification and Incidence of Imperial and Local Taxes*—Official papers of Alfred Marshall, Macmillan, 1926.

¹⁷Grants for university and secondary education and children's allowances paid by the Department of Social Welfare may be regarded as forms of horizontal distribution.

is suggested that if such a tax were imposed employees would claim compensatory pay increases, and that such increases would raise costs in industry, and lead to further price increases; in short that a purchase tax would cause inflation.

This might follow if a purchase tax were introduced at heavy rates and if, at the same time, it embraced anything like the greater part of personal expenditure. The exemptions from the purchase tax we envisage would, however, include food, fuel, light, books, newspapers, intoxicating liquor, tobacco, petrol, rents, services, rail fares, as well as most goods essential for manufacture and agricultural production. In fact of the total annual personal expenditure of about £470 millions retail only about one fifth would be affected by a purchase tax.

79. The British purchase tax, from which about £500 millions was obtained in 1958-59, and which was charged for that year at rates as high as 60 per cent (on wholesale values) did not increase the Retail Price Index by more than 1.5 points.¹⁸ In this country, too, a purchase tax from which were excluded staple foods, fuel, light, and goods essential to production and manufacture would apparently increase living costs by only a negligible fraction. We asked the Central Statistics Office what increase in the Consumer Price Index would result from a 10 per cent tax on the following,

(a) drapery and clothing, including footwear,

(b) motors and motor parts,

(c) sundry household and semi-durable goods.

We were informed that a 10 per cent tax on wholesale values would increase the Consumer Price Index by "about 2.2 points or about 1½ per cent".¹⁹ Such a tax would afford no justification for wage increases, and it should not be inflationary.²⁰

¹⁸Chancellor of the Exchequer in House of Commons, 7th April, 1959 (Hansard, Vol. 603, col. 55).

(The average Index of Retail Prices in Britain for 1958, to base January, 1956=100, was about 109. The percentage increase caused by the purchase tax was therefore slightly less than 1½.)

¹⁹Letter, 19 Bealtaine, 1960.

These figures have, it is stated, "been derived on the assumption that a change in wholesale values arising from the imposition of purchase taxes would change retail values in the same proportion."

²⁰According to the *Household Budget Inquiry 1951-52*, expenditure on children's clothing is less than 20 per cent of that on all clothing, and is not noticeably regressive. The Revenue Commissioners have indicated to us in some detail (letter, 19th January, 1960) the many difficulties that would arise in differentiating between children's clothing and clothing for adults, and it would probably be inadvisable therefore to make such a differentiation if a purchase tax were introduced.

Even if a more comprehensive tax at higher rates did tend to set in motion certain inflationary forces, the resulting decrease in the purchasing power of money would have some anti-inflationary effect. To the extent that purchase tax was paid there would be less to spend on purchases in general.²¹

80. As a purchase tax provides a stronger incentive to reduce consumption than income taxation a purchase tax is a better help to control inflation, particularly if the amount of tax is indicated in the purchase price—as British purchase tax on expensive articles usually is.

81. G. A purchase tax “would adversely affect Irish manufacture and Irish exports; and, if levied on wholesale values, would cause price increases greater than the tax itself.”

The contention that a purchase tax would affect Irish industry has not been put before us by any representative group. We are satisfied that it would have no adverse effect of consequence if the rates of tax did not exceed 10 to 15 per cent. Let us take a few examples.

A 10 per cent purchase tax on a car retailing at £500 would amount to about £42 (i.e., 10 per cent of the wholesale price, £417)²² making the revised price £542. A 10 per cent tax on a car retailing at £1,000 would amount to £83, increasing the price to £1,083. These purchase tax figures compare with yearly running costs and depreciation which may amount to £150—£250 depending on make, horse-power, user, etc.

A 10 per cent tax on a television set retailing at £75 would raise the price to about £81. A similar tax on a radio retailing at £25 would raise the price to about £27. Taking into account the facilities available for hire-purchase and “easy payments,” it is difficult to believe that these taxes would have any appreciable effect on sales.

²¹A price increase resulting from a purchase tax would be different from an increase constituting true inflation because it would not give rise to additional money incomes, assuming there was no consequent increase in employees' remuneration.

“An inflationary spiral involves increases in both commodity and factor prices, while a sales tax merely increases the prices of commodity prices relative to factor prices. The price increases reflecting a sales tax reduce the real purchasing power of the community below what it would otherwise be, just as does an income tax. The latter curtails spending by reducing disposable income, while the sales tax does so by raising the prices of consumer goods relative to factor prices.”

Sales Taxation, John F. Due. Routledge & Kegan Paul, 1957.

A purchase tax does not generate increases in factor prices, and so has an anti-inflationary effect, if wage increases are avoided and if the tax is imposed as little as possible on producer goods.

“Excise and sales taxes have positive results in curbing inflation, (1) by reducing purchasing power of given incomes at the market, (2) through the operation of a money illusion whereby consumers spend a given proportion of any disposable money income, regardless of prices, and (3) by funnelling the price rise into the government rather than directly into factor payments.”

Income Redistribution and Social Policy, a set of studies edited by A. T. Peacock, Reader in Public Finance, University of London. Jonathan Cape, 1958.

²²Assuming a gross profit of 20 per cent on wholesale price.

As a purchase tax would make possible a reduction in income tax there would be no net reduction in the aggregate amount available for spending on consumer goods. Even if purchase tax rates were high, so long as the purchase tax was a substitute or part-substitute for an existing tax it should not adversely affect the home market for goods of Irish manufacture.

82. Exports would not be directly affected by a purchase tax as they would be exempt. It is conceivable that if a tax at steep rates, such as some of those now in force in the Six Counties and Britain,²³ was introduced, the industries that supply the taxed goods might be affected and their exports, if any, might decline. A tax charged at steep rates is not, however, contemplated.

83. When a purchase tax is charged on wholesale values, retailers may increase prices by more than the purchase tax itself; they may apply a "mark up" to the full cost of the goods, including the tax. We understand that in the Six Counties and Britain the amount of the tax is indicated in the retail price of some articles,²⁴ and that the retailer's profit is then based on the cost exclusive of purchase tax; that there is no "mark up" on the tax. On other goods the price increases caused by the tax may exceed the tax itself; conflicting views have been put before us (in response to enquiries on the matter) regarding the extent to which this occurs.²⁵

84. The price increase would be less likely to exceed the amount of the tax if the tax rate was moderate; the increase in retailers' outlay caused by the tax would then be relatively small.²⁶ Moreover if there was keen competition the tax might not be passed on in full to consumers. We understand that competition is keen in most of the distributive trades so that, on the whole, the likelihood of any significant price increases in excess of the tax itself would, in our view, be remote.

85. H. A purchase tax "would have an unsettling effect on trade before and sometimes after the annual budget."

Since purchase tax was introduced in Britain in 1940 there have been many changes in its scope and in the rates of tax. Apparently some of these changes, and the prospects of changes, have had unsettling effects on certain trades during pre-budget and post-budget periods.

If a retailer felt that the tax on certain goods would be increased at budget time he would naturally purchase as much as possible of

²³These include purchase tax rates of 30—50 per cent (on wholesale values). Higher rates applied in previous years.

²⁴Examples are motors and fur coats.

²⁵This does not hold for other goods, presumably because many traders consider that there is less dissatisfaction on the purchaser's part if the tax is not indicated on sale tags or vouchers. Furthermore, retailers would probably find it troublesome, if not irritating, to have to set out the amount of purchase tax in the retail price of each taxed article of their trading stock.

²⁶We enquired from, amongst others, the *Federation of British Industries* and the *British Retail Distributors' Association Incorporated*.

²⁷The increase would at most be the retailers' mark-up on the amount of the purchase tax.

them before the increase took effect, and his later purchases would be correspondingly reduced. If however a reduction in the tax rate was expected he would restrict his purchases until after the Budget. If the tax rate on certain goods was lowered a retailer might make a loss, or suffer a reduction in his profit margins, on pre-Budget purchases; on the other hand if the rate was increased some retailers might make an abnormally large profit on pre-Budget purchases.

On the whole, substantial changes in purchase tax rates, or expectations of them, cause trade instability before, and sometimes after, Budget time.

86. The British Government some years ago appointed a committee to consider how this difficulty could be reduced. That committee²⁷ reported in 1953 that the complaints on the subject made by business firms were exaggerated. It made two recommendations, (1) that greater use be made of sale-or-return contracts to lessen the risk of losses by retailers, and (2) that when purchase tax changes were being considered by the Government it should keep in mind their effect on retailers; in other words that changes in purchase tax rates should be as few as possible. The committee rejected as impracticable a suggestion that traders holding tax-paid stocks should be compensated by the Exchequer for any losses incurred when the rate of purchase tax was reduced.

87. The unsettling effect of changes in tax payable on goods before they are retailed is not confined to a purchase tax; it is also inherent in taxes such as customs and excise duties. The difficulties caused are less when the rates of tax are low and rate changes are infrequent. If the purchase tax rates did not exceed 15 per cent there would be no great danger of losses by retailers because of budget changes or need for concern by them regarding the matter generally.

88. I. "A purchase tax imposed on selected classes of goods would encourage persons to change to other, perhaps less desirable, forms of expenditure."

If a purchase tax were charged on certain goods the public would naturally endeavour to avoid the tax by purchasing similar goods (if they could find such) not subject to tax. But these other goods would normally be taxed at comparable rates.

A like problem may occur in connection with almost all forms of taxes on expenditure such as motor taxation, customs and excise duties, and entertainment tax. If any of these taxes were increased the pattern of consumer expenditure might be changed, but there is no reason why the change should be to "less desirable" forms of expenditure. As already stated, governments sometimes use purchase taxes to discourage what they regard as undesirable ways of spending.²⁸

²⁷The Hutton Committee, as it was known, its chairman being Sir Maurice Hutton. (Report reference: Cmd. 8784.)

²⁸In Britain purchase taxes have frequently been varied for specific purposes. For instance in 1947, to conserve electricity, a 75 per cent tax was placed on space and water heaters; and in recent years reductions were made in the tax on jewellery and pianos to relieve unemployment in the industries in which these goods are made.

89. J. "If the rates of purchase tax varied for different classes of goods the cost of administration would be high."

The greater the number of rates of purchase tax the greater the cost of levying the tax, as a more extensive check of trading records would then be necessary. More documentation and more detailed particulars would be required of wholesale traders.

90. The Revenue Commissioners have estimated that it would cost £100,000—£150,000 to administer a purchase tax, charged at a rate of about 7½ per cent, on clothing, motor cars and motor parts, and sundry durable goods.²⁹ There would presumably be no appreciable increase in cost if the rate was 10 per cent or the tax base was somewhat wider. The administrative cost of a 10 per cent purchase tax producing about £6 millions revenue would, therefore, be about 2 per cent of the yield; and if the rate were greater the cost would be proportionately less. If the rates of tax were frequently varied the tax would be more expensive to administer, but even then the cost as a percentage of the revenue would be less than that of income tax which was in recent years about 3.43 per cent of the revenue received.³⁰ The cost of a purchase tax would, of course, be additional to that of income taxation, but it would be reasonable to expect a reduction in the latter if there was a reduction in either the number of taxpayers or the rate of tax. Although a reduction in the rate of income tax would not diminish the number of persons liable to it, there should be less urge to avoid the tax, thereby facilitating administration and helping to reduce its cost.

The administrative cost of a moderate purchase tax would not add greatly to the cost of the Revenue Commissioners' Department,³¹ and taking into account a possible saving on income tax administration, there might ultimately be no increase in the total cost.

Other alleged defects of a purchase tax

91. The points outlined above are those usually made for and against a purchase tax. Other arguments against a purchase tax are that it would make unduly high the already high ratio of indirect to direct taxation; that it would adversely affect the tourist trade; and that it is undesirable to introduce any new tax.

92. As regards direct and indirect taxation, two questions in particular may be posed; are the amounts of direct and indirect taxation susceptible of measurement, and what disadvantages arise because the ratio of indirect to direct taxation is high?

The traditional distinction between a direct and an indirect tax is that one tax is collected directly from the person liable for it, while the other is collected indirectly, e.g., from a manufacturer or

²⁹Letter, 30 Deire Fomhair, 1957.

³⁰Minister for Finance in reply to a Parliamentary Question, 20th February, 1958 Official Report, Vol. 165, Cols. 589 and 590.

³¹This is at present about £3 millions—*Estimates for Public Services, 1960/61* (Pr 5187) page 22.

wholesaler who then recoups himself when selling the goods. That distinction, which is primarily administrative, has lost some of its significance now that so much income tax is collected by deduction at the source.

A more meaningful distinction would be between taxes related to individual circumstances, such as personal income tax, and taxes not so related, such as those on tobacco and intoxicating liquor. Yet this distinction would not accord with current ideas on the subject; most of the income tax payable by limited companies should then be regarded as indirect, although all income taxation is usually regarded as direct.

93. The matter is further complicated by the problem of tax incidence. Part of the tax on profits of companies and business concerns is passed on to consumers,³² and to this extent income tax and corporation profits tax payable by companies are indirect taxes on the final purchasers of their products. It follows that countries where taxation of company profits accounts for a large share of the total revenue have more indirect taxation than is apparent from published statistics. About one half of all income taxation in this country is payable by companies, so that the matter of incidence is important in computing how much of our taxes should be regarded as indirect.

Indirect taxes, e.g. that on petrol, are in part charged to industry, and views may differ as to who ultimately bears the taxes on industry.

It is difficult therefore to make any satisfactory division of taxes into two classes, direct and indirect; and it is desirable when using these terms for purpose of comparison or contrast to indicate what precisely the terms are intended to connote.

³²See for example N. Kaldor's *Expenditure Tax* (George Allen and Unwin Ltd.), page 169:

"... provided sufficiently long periods are taken into account, the taxation of business profits *does* tend to get 'passed on', in the form of higher profit margins, and thus its true incidence is shifted from the shareholder to the general consumer. . . . To the extent that they (taxes) are shifted they become no different in their economic consequences from a general sales tax or turnover tax."

See also *The Corporation Income Tax* by Tax Foundation Inc., New York (1951), page 17:

"A tax on the pure profits of business corporations would be borne only by these corporations that make profits. As to its immediate effect, such a tax cannot be shifted.

"But this is only the immediate effect. Other changes take place after the tax is enacted, and its effects are taken into account by business men. The first effect of the tax is to reduce the general level of profits after tax to which investment and business have become accustomed; in other words to reduce the opportunity to make industrial profits. But it is the chance of profit that invites investment of capital and induces businessmen to undertake the task of planning and guiding industrial enterprise and assuming its risks. A tax on profits reduces this incentive. It tends to diminish industrial investment and industrial enterprise. The supply of produce is accordingly reduced, and their prices tend to rise. There is thus brought about a new equilibrium, in which the tax has been shifted, in part at least, to the consumers of the products of industry. This can result very promptly."

Many writers on American taxation take the view that between one third and one half of the income tax on limited companies in the United States is shifted to consumers. See e.g., *Federal Excise Taxes*, Project No. 40 (1956) pages 24 and 25.

See also *the effects of differential Tax Treatment of Corporate and Non-Corporate Enterprises*, Cesare Cosciani. O.E.E.C. (E.P.A.), February, 1959.

94. Confining ourselves to taxes levied by the central authority, and to those that are generally agreed to be either direct (such as income taxation) or indirect (such as customs and excise duties and a purchase tax) we now consider what advantages and disadvantages arise from having a preponderance of indirect taxes, and what effect would an increase in indirect taxes and a corresponding reduction in direct taxes be likely to have.

It is contended that indirect taxes are regressive and, as such, impose a disproportionate burden on the mass of the people. Generalisation of this kind can however be erroneous; the extent to which any indirect tax affects incomes of different amounts can vary greatly according to the scope and rate of the tax.

95. A tax on essential consumer goods tends to be regressive because the smaller a person's income the more of it he has to spend on such goods. Taxes on non-essentials are less likely to be regressive; many of them absorb a larger share of large incomes than of small incomes, mainly because persons with large incomes have proportionately more to spend on non-essentials. Even if a particular tax is regressive that does not necessarily make it a bad tax for it is the fairness of taxation generally, rather than of each element in it, that has to be taken into account.

96. It cannot be determined by purely scientific analysis whether taxation should be regressive, proportional, or progressive; it largely depends on the social philosophy of the country and the period. Viewpoints on this matter have changed a good deal over the past century.³³ It is generally accepted nowadays that taxation should be at least proportional to incomes. In many countries, as in our own, taxation of personal incomes is progressive, and so helps to counteract any regressive trends there may be in other taxes borne by income taxpayers.

97. The indirect taxes imposed by the central authority in this country, i.e. the customs and excise duties, provide much more revenue than the direct taxes, and a greater share of our central tax revenue arises from indirect taxation than in many other countries. But whether or not some indirect taxes are regressive, the information in the *Household Budget Inquiry*, 1951-52, (already referred to) suggests that this would not apply to the purchase tax we envisage.

³³The following is an extract from the conclusions drawn regarding progressive taxation in a recent closely-reasoned study:

"The case for progression, after a long critical look, . . . turns out to be stubborn, but uneasy. The most distinctive and technical arguments advanced in its behalf are the weakest. It is hard to gain much comfort from the special arguments, however intricate their formulations, constructed on notions of benefit, sacrifice, ability to pay, or economic stability. The case has stronger appeal when progressive taxation is viewed as a means of reducing economic inequalities."

The Uneasy Case for Progressive Taxation, Walter J. Blum and Harry Kalven, Jr., The University of Chicago Press (second impression, 1954) pages 103-104.

98. It is contended that indirect taxes cannot discriminate for personal circumstances. This is so, but it also holds to a large extent for direct taxes. The personal circumstances of shareholders in limited companies cannot be taken into account in determining the income tax payable on the undistributed profits of these companies, or in computing corporation profits tax; these taxes are not adjusted in any way to the taxable capacity of the individuals who ultimately bear them, whether shareholders or consumers.

99. While we regard as important the test of ability to pay inherent in personal income taxation, income is by no means a perfect index of taxable capacity. For one thing income can be defined in various ways. In this country it is rather narrowly defined for tax purposes; there are many sources of spending power that do not come within the income concept, such as capital gains and gifts. Furthermore there is taxable capacity in capital as distinct from income.

100. We have decided against recommending a tax on capital or a tax on capital gains,³⁴ but we feel that most of those who do not favour a tax on capital or on capital gains would agree that at least consumption expenditure out of such sources should, if practicable, be subjected to taxation. A purchase tax greatly facilitates this. It also helps to adjust the taxation balance in the case of those who, for whatever reason, avoid their due share of income taxation.

101. As regards the effect of a purchase tax on the tourist trade, the amount spent by visitors in 1958 has been officially estimated as £34.6 millions.³⁵ A precise analysis showing the amounts spent on specific goods and services is not available, but according to a survey made by Bord Fáilte Éireann for 1958 about 15s. 2d. out of every pound spent by visitors was on meals and drinks, travel in the State, entertainment, etc., all of which would not be subject to purchase tax. Of the balance, at least some share would be spent on goods such as tobacco and books which again would not come within a purchase tax.³⁶ The effect of such a tax on the tourist trade would clearly be almost negligible.

102. It has been suggested that a recommendation to introduce a new tax would facilitate an eventual increase in taxation. The contention is that a Commission recommendation could be made use of by a government to support the introduction of a new tax (a matter which it might otherwise find difficult) and that, although the tax might at first be in substitution for some existing tax it could readily be extended later on; or that an income tax reduction which it made possible might be gradually cancelled, leaving the community with additional taxation—and one extra means of imposing it.

³⁴These matters are discussed in Chapters V and VI.

³⁵*Irish Trade Journal*, December, 1959.

³⁶According to this Survey, and a reply by Bord Fáilte Éireann to an enquiry sent them, the estimated expenditure in 1958 by all visitors on "shopping", excluding entertainment, meals, and drinks, was £6 millions retail, i.e., about £4½ millions wholesale, and at least part of this would not be subject to purchase tax.

We are of opinion that suspicions and fears about our Report being a help to increase taxation should not in any way affect our recommendations. In this Report the question of an increase in taxation does not arise. In our terms of reference we have been invited to consider, in the context of a reduction in income taxation involving a loss of revenue, "alternative means of raising equivalent revenue", and we do not see how we could face this problem squarely if we did not consider all taxes, including new taxes, solely on the basis of their intrinsic merits and demerits.

Conclusions regarding a purchase tax

103. We have carefully considered the arguments for and against a purchase tax and we have decided that, on balance, a moderate purchase tax on a selected range of goods is desirable and practicable. We consider that the purchase tax should provide a revenue of at least £6 millions which would allow a reduction of about two shillings in the rate of income tax, i.e. from seven shillings, as at present, to five shillings.³⁷

104. Such a purchase tax would have little effect on the cost of living, especially of the low-income group, and compensatory increases in benefits under the Social Welfare Acts would not therefore be necessary. If however some increase in social welfare benefits were thought desirable a small fraction of the purchase tax (probably not more than one-fifteenth of it would be necessary) could be appropriated for that purpose.³⁸

105. A purchase tax at low rates would not have an inflationary effect or cause any serious dislocation of trade around Budget times, nor would it injure Irish industry or the tourist trade. Its administrative cost would be low. On the other hand, it would make possible a reduction in income tax that should greatly help the national economy.

106. We are convinced that the weight rather than the principle of income taxation is primarily responsible for the general dissatisfaction with it. Whatever hardships and inequities derive from the income tax system would be much less acutely felt if the rate were reduced to near the pre-war level (of about 4s 6d. in the pound). The problem of income tax evasion would also be lessened, for some part of this problem cannot be dissociated from the weight of the tax.

³⁷It was stated by the Minister for Finance in Dáil Eireann on July 15th, 1958 (Official Report, Vol. 170, Col. 482), that "the cost of reducing the standard rate of income tax by 6d. in the pound, with proportionate reductions in the reduced rates of income tax, is estimated at, approximately, £1,600,000 in a full year." On a pro rata basis a reduction of 2/- in the pound would cost about £6,400,000. Taking into account increases in incomes on the one hand and on the other the cost of the income tax reliefs and allowances granted in recent years, the cost of a two-shilling reduction in the income tax rate seems to be, on the information available to us, about £6 millions.

³⁸A tax producing £6 millions revenue (say £60 millions at 10 per cent) would probably not raise the Consumer Price Index by more than about 1½ per cent (see par. 79); and a 1½ per cent increase in all social welfare benefits, including children's allowances, old age pensions, unemployment benefits, etc., would apparently cost not more than £400,000. See *Estimates for Public Services, 1960-61*, Votes 56 and 57, page XIV.

The present income tax rate of 7s. in the pound is almost as high as it was during the years of the "Emergency" commencing with World War II, although the standard rate of income tax in Britain, which was increased to 10s. in 1941/42, has been reduced by 2s. 3d. to 7s. 9d., and in addition some millions of taxpayers are liable at less than the standard rate. It is desirable to widen the present differential between the Irish and British rates of income tax, so as to provide Irish industry with some compensation for the disadvantages from which it suffers because costs in industry where the domestic market is small are normally greater per unit of output than elsewhere and because, owing to our geographical situation, Irish exports have to bear relatively heavy expense on transport. A sizeable reduction in the income tax rate would also encourage the inflow of capital for the development and extension of Irish industry.

107. About 175,000 individuals, one sixth of the income-earning section of the community, pay in income tax and surtax about £16/17 millions,³⁹ out of the total tax revenue of roughly £100 millions, apart from paying their share of the various other taxes, including local rates. Some worthwhile reduction in income taxation is certainly desirable.

108. A criticism of purchase tax is that if it were used as a substitute for income tax it would relieve many unmarried persons at the expense of others who, because of their small incomes or personal circumstances, are not liable to income tax and should not be required to bear any alternative liability. Such criticism has however much less force than appears.

109. Many single persons liable to income tax have relatives or friends depending on them,⁴⁰ and it is probably for this reason that some are unmarried. If present earnings of £800 per annum and under are equated in money values (by reference to the Consumer Price Index) to earnings in 1938-39, there has been an increase of as much as 183 per cent in the income tax liability of single persons⁴¹ although the increase in the fraction of national income taken in Exchequer revenue receipts (excluding motor taxation) was only about 33 per cent in the same period.⁴²

It is probable also that unmarried persons without dependants, whose spendable income would be increased if income tax were reduced, would spend much of that added income on goods subject to either a customs or excise duty or a purchase tax. The total tax payable by that group would probably be almost as great as at present; yet from the representations made to us they would apparently prefer to pay more of their taxes in an indirect way.

In Britain and the Six Counties the clerical and administrative expenses incurred by traders in connection with purchase tax are

³⁹This includes tax deducted by Irish companies on paying dividends to their shareholders, the great majority of whom are resident in the State.

⁴⁰These are not necessarily "dependent relatives" within the meaning of the income tax acts.

⁴¹Minister for Finance in reply to a Parliamentary Question, 9th December, 1959; Official Report, Vol. 178, Cols. 1007/1008.

⁴²See footnote 38, page 25, showing the increase between 1938/39 and 1957/58.

normally deductible in ascertaining their profits for income taxation. We contemplate that this would be the position here also.

110. A purchase or sales tax is now part of the tax system in nearly all the countries of Western Europe⁴³ as well as in the United States, Canada, Australia, New Zealand and elsewhere. There are obvious advantages at the present time in having our tax structure as wide and flexible as it is in most of these countries. The future pattern of international trade may require some reduction in our protective duties (at present providing about £3½/4 millions yearly) in which case it would be of assistance to have an alternative source of revenue. Moreover the revenue from one particular commodity, tobacco, now amounts to almost £29 millions⁴⁴ (as much as income tax, surtax and corporation profits tax combined) and if for any reason⁴⁵ there was an appreciable falling off in tobacco consumption this would materially affect the tax yield. If, however, the fiscal machinery of a purchase tax were in operation there would be less need for concern in this matter.

111. We note that the Capital Investment Advisory Committee, in its Third Report, stressed the importance "of encouraging enterprise by changes in taxation and . . . increasing tax incentives for the investment of savings at home, for the investment at home of past savings now held overseas and for the attraction of foreign capital".⁴⁶ Our recommendation provides one of the most effective ways we can suggest (within our terms of reference) of achieving these desirable objects.

112. The reduction in income taxation we recommend would be greatly welcomed by all who are liable or possibly liable to income tax, including salary and wage earners and those who are self-employed—even though, taking purchase tax into account, many of them would probably pay as much tax as previously. The amount of purchase tax payable by those who are not liable to income tax would, in our view, be so small that there would be little real difficulty in payment. The total of about £6 millions would be payable by some one and a quarter million persons, not on a flat rate per person but broadly in proportion to their incomes—if not on a progressively increasing scale as incomes increase.

113. As regards the stage in distribution at which a purchase tax might be charged, it would be preferable to have it charged at the wholesale rather than the retail stage as the tax could be more easily collected and less easily evaded, the number of traders concerned being relatively small. Furthermore if the tax were charged

⁴³*Taxation in Western Europe*, Federation of British Industries, December, 1959 and *Sales Taxation*, John F. Due, Routledge & Kegan Paul, 1957.

⁴⁴Sales taxes are also widely used to provide revenue for local authorities in France, the United States, Canada, etc.

(Some of these taxes are not charged on sale of the complete article but on value added at different stages in manufacture.)

⁴⁵Minister for Finance in reply to a Parliamentary Question, 11th May, 1960; Official Report, Vol. 181, Col. 1030 (Unrevised).

⁴⁶e.g., fear of danger to health or a change in taste.

⁴⁷*Capital Investment Advisory Committee, Third Report* (Pr. 4688) paragraph 47.

at the retail stage many retailers would find it difficult to keep the necessary records, particularly those retailers who sell various classes of goods on which tax might be charged at different rates. It is however a drawback of a tax at the wholesale stage that difficulty arises in assessing wholesale value when a manufacturer distributes his goods direct to retailers; it is then necessary to determine a notional wholesale value so that the amount of tax, which is an ad valorem one, may be the same as that on similar goods distributed through wholesalers.

114. There are certain other alternatives to a tax charged at the wholesale stage, such as a tax charged at the manufacturing stage and a multiple-stage tax levied at each stage of production or distribution. In this connection the Revenue Commissioners have stated that

“Theoretically the retail stage is the ideal level, i.e. the tax would be charged on the actual price at which the commodity is sold to the final consumer. In practice however, because of the huge number of traders who would be brought within the tax net, a tax at the retail level would be costly and difficult of administration, and taxation at an earlier level is to be preferred . . . A tax at the wholesale level would seem to be feasible in this country. It would not be unduly expensive to administer and would be preferable to taxation at the manufacturing level”.⁴⁷

The matter is dealt with in greater detail in the Appendix.

We are of opinion that a purchase tax at the wholesale stage is, on balance, the most suitable for this country.

115. We accordingly recommend **the introduction of a purchase tax at a rate or rates of between 7½ and 15 per cent** on a base of **£65/75 millions** wholesale value, but in any event excluding

- (a) goods essential for agricultural production
- (b) goods essential for industrial manufacture
- (c) exports, agricultural and industrial
- (d) food, particularly essential food
- (e) fuel
- (f) newspapers and books
- (g) household non-durable goods
- (h) goods already subject to heavy customs and excise duties, e.g. tobacco
- (i) works of art, and goods that are primarily of a cultural nature.

We recommend **that the purchase tax be a part-substitute for income tax and that the revenue from it be used to reduce the rate of income tax.** The revenue which we recommend to be raised by a purchase tax, i.e. £6 millions at least, should permit of a reduction of about two shillings in the present rate of income tax, i.e. from 7/- to 5/-.

We are of opinion that, from both a social and an economic point of view, the great weight of advantage is in favour of this reduction in income tax and the adoption of a purchase tax as we have outlined.

⁴⁷Memorandum, 27th August, 1957.

CHAPTER V

A TAX ON CAPITAL GAINS

116. The term "capital gains" is applied to certain forms of profit or gain that are not within the concept of income as usually understood. The expression "income" is, however, defined in different ways, and the distinction between capital and income has become blurred by the complexity of modern industrial and commercial life—so much so that the question whether a particular form of gain is of a capital or an income nature for tax purposes is a recurring subject of contention and controversy.¹

117. The following are examples of capital gains.

- (a) A shopkeeper buys investments for £400 and later sells them for £600. His £200 profit is a capital gain.
- (b) A person sets up a business, and after a few years, having established a valuable goodwill, sells it as a going concern. The amount he obtains for the goodwill is a capital gain.
- (c) Debenture stock is bought (by a person who is not a dealer in investments) at its issue price, £97 per £100 stock, and is later sold for its full nominal value. The amount received in excess of the issue price is a capital gain.
- (d) A new school is built near a retail shop, and as a result the business expands. The shop is then sold for more than it would have been worth had the school not been built. This increase in market price is a capital gain.
- (e) An investment of £5 in Prize Bonds draws a prize of £1,000. This is a capital gain.

From these examples it can be seen that capital gains arise in a variety of circumstances, either through good fortune, a flair for speculation, or for other reasons. Capital losses also arise for various reasons.

118. In each of the examples given above the capital gains were actually received. A capital gain may however accrue to a person without being received or realized, e.g. when an increase occurs in the value of an investment which a person retains.

¹Illustrative of the difficulty in distinguishing between capital and income is the fact that income obtained in certain circumstances is closely akin to some forms of capital gains. For instance if a tariff was imposed on the import of a particular class of trading stock a distributor who had a large supply of it would find its market value enhanced, and he would then get an unexpected increase in his profit on selling it. The position would be rather similar if a trader succeeded by some lucky chance in purchasing goods at an abnormally low price, enabling him to make an exceptional profit on their sale.

119. In this country (which derived the framework of its income tax system from Britain) capital gains have never been brought within the scope of income tax. The concept of income that evolved in Britain in the nineteenth century was largely based on agricultural activity; income was looked upon as something that recurred fairly regularly, arising from annual harvests and from an unchanging source such as land, and the income could be readily distinguished from the source. Casual or unexpected gains did not fit into this picture, the view being held that such gains were not normally available for day-to-day consumption in the same way as income from the cultivation, or from the letting of land.

120. In Britain and Ireland up to the beginning of the first World War any gains that arose from isolated or infrequent transactions were not usually treated as income for tax purposes, even if the transactions were carried out with the object of making profit. Since then however some gains of this kind have been regarded as income but, owing to the varying circumstances in which they may arise, it is often difficult to say whether a profit on a single transaction divorced from a person's usual business is income within the meaning of the income tax acts.

121. In the United States of America capital gains are subject to income tax, but at a lower rate than for income as normally understood. During the last century land in the United States had not a social value similar to what it had in Britain, and rentals from land were much less general. "Capital gains" were continuously being made according as the country was developing, and for that reason the distinction between gains of an income and gains of a capital nature was never very marked. When therefore in 1894 income tax was introduced in the United States "gains from the sale of real estate acquired within two years, and the money value of gifts and inheritances" were specifically included as taxable subject-matter.² Since then capital gains of all kinds, with limited exceptions, have become chargeable to income tax in the United States.

Capital gains are also charged to income tax in many European countries, including France, Sweden, the Netherlands, Finland and Denmark.³

122. Capital gains are largely associated with dealings in stocks and shares. Usually only part of the net profits of limited companies (after providing for taxation) is distributed to shareholders and any profits retained augment companies' assets and are normally reflected in the market value of their equity shares. Other considerations may however tend to reduce share values—for instance, shortage of liquid capital for dividend payment, difficulty in selling small lots of shares, heavy charges for stamp duty, and commission payable on share transactions.

²A form of income tax had been imposed during the American Civil War, but this was terminated in 1873.

³In some countries the rate of capital gains tax is less than the rate of income tax.

123. Advocates of the taxation of capital gains argue that such gains increase a person's economic power; that they provide resources which he can save or use in much the same way as ordinary income, e.g. to buy a house for his family or to provide them with clothes or amenities. They contend that even when a capital gain has not been encashed it constitutes an addition to a person's economic resources, that he is more independent because he possesses an asset whose value is enhanced and which will, for example, provide greater security than previously if he is seeking a loan.

124. Stocks and shares increase in market value, and so give rise to capital gains, whenever investors take a more optimistic view than hitherto of the return that may be expected from them; the market value of investments is the discounted value of the returns that are expected from the investments. In this connection there are taken into account, among other things, interest rates and the risks that attach to specific investments. In the commercial world there is a continuous process of forming, and revising, expectations of company dividends, and this activity gives rise to capital gains, and at times capital losses.

Changes in the market values of investments can often be foreseen by those who study the available information, and any gains they make on dealings in investments are not unlike "earned income" for income tax purposes because these gains arise from reasoning, judgment, studied selection, and assessing various probabilities. If a person did similar work on behalf of others he would be entitled to a salary or fee.⁴ Such gains have little in common with "windfall" receipts from, say, a football pool or sweepstake.

125. If a capital gain that a person receives has accrued over a number of years it may be inequitable to treat the full gain as taxable in a single year because the recipient of the gain may have been exempt from income tax and surtax for some of the years over which the gain accrued, although liable to income tax, and perhaps surtax, on the income of the year in which the gain was received. If therefore realised capital gains were chargeable to income tax and surtax the total of these taxes might be much greater than if the gains were taxed from year to year according as they accrued.⁵

126. It is sometimes argued that as capital gains are less stable than ordinary income, and as a person's taxable capacity partly depends on the income he may reasonably anticipate (as well as on the income he receives) at least unexpected capital gains should be taxed lightly—if they are taxed at all. Yet the recipient of an unexpected gain can afford to pay more of it in tax because he could not have earmarked

⁴This type of work is carried on on a commercial basis by bodies such as unit trusts.

⁵The tax payable on the basis of realisation might sometimes be less than that payable on the basis of accruals, but this would be rare, especially if the gains realised were large.

the gain to pay current expenses. This viewpoint is largely accountable for the high rates of tax imposed in times of war or emergency on excess profits; these profits usually arise in fortuitous circumstances.

127. Capital gains are unreal gains if they reflect no more than changes in money values. If there is a general increase in prices causing an increase in the market value of assets this does not increase the purchasing power of those who own them because the sale price and purchase price of all assets are inflated concurrently. In practice however all assets do not share proportionately, or concurrently, in a rise in the price level, and for that reason the owners of some assets make real gains. But it is almost impossible to distinguish the real from the unreal gain attributable to rising prices. In some countries where capital gains are subject to tax a price index is used in an effort to eliminate the unreal element in gains arising from general price increases or from depreciation in money values.

128. Capital gains resulting from changes in interest rates are largely illusory; such changes alter the market value of an asset without altering the amount of income it produces. Assume a person holds £10,000 5 per cent bonds bought at par, on which he has been receiving £500 per annum; that the rate of interest falls from five to four per cent; and that he sells the bonds for £12,500, making a capital gain of £2,500. To maintain his income at its former level he should re-invest £12,500, including the capital gain. If he spent the capital gain he would have an immediate advantage over, say, a person who had an annual earned income of £500, but he could do so only at the cost of reducing his future income.

Equity may not be fully satisfied by exempting capital gains arising from changes in interest rates, but it would be less so by the indiscriminate taxation of such gains. In any event it would be difficult to decide how much of a capital gain should be attributed to changes in interest rates because in practice there is more than one rate; different parts of the capital market are differently affected when changes occur in interest rates.

129. It is generally thought that because some capital gains are of a windfall nature a greater proportion of them is saved than of income as normally understood. That in itself is not a strong argument for exempting capital gains from tax, but it is at least of some significance that taxing them might bring about a reduction in the amount of investments made out of savings.

130. A tax on capital gains would tend to distort the capital market because investors who might be liable to tax would not sell as freely as previously any assets on which a taxable capital gain would be made, and if they got tax relief on capital losses this would encourage sales of assets on which losses would be incurred, and so reduce the tax payable on capital gains. Although some clog on speculative activity in

investments could promote more stability in ownership and lead to a greater sense of responsibility among investors, nevertheless free marketability of stocks and shares is a valuable incentive to investment.

131. If capital gains were taxable equity would require that some provision should be made for relief on capital losses. In theory a person's capital losses should be fully deductible from his capital gains, but relief for losses is usually restricted on grounds of cost, and in order to discourage speculation at State expense. For instance a person liable to surtax could more readily afford to make a risky investment if the State bore the risk to the extent of the income tax and surtax he would be spared if he lost on the transaction.

If capital gains were taxed at a lower rate than income a reasonably liberal offset of capital losses could be granted without greatly reducing the revenue from capital gains. If however capital gains were taxed at normal income tax and surtax rates it would probably be necessary to limit the scope for offset of capital losses.

132. Reliable information is not available on which to estimate the revenue that might be obtained from a tax on capital gains, but the yield would clearly be small, and in the early years it would probably be negligible. A normal year's yield would not be forthcoming until long after the tax had been introduced as gains which accrued before the introduction of the tax would presumably be exempted.

133. An important consideration in this matter is that the State is so close to Britain and the Six Counties, where tax is not payable on capital gains, that a capital gains tax would be likely to deter holders of substantial capital from settling down here. It might also induce some of those who are now resident in the State and have not close ties with this country to make a change of residence. If a capital gains tax was in part-substitution for income tax or surtax there would be less danger of an outflow of capital but a consequent reduction in income taxation would be unlikely for some years, as the yield from a capital gains tax would be so small at the outset.

134. Death duties help to reduce what inequity there is in the exemption of capital gains, although capital gains spent or disposed of during a deceased person's lifetime normally escape death duties. So also do capital gains made by a corporate body, but the gains are likely to be reflected in the value of its shares and thus, indirectly and over a long period, the gains may become subject to tax on the death of the shareholders.

It must be remembered too that the State benefits to the extent of £200,000—£300,000 annually from stamp duty payable on dealings in stocks and shares.⁶

⁶ *Annual Report of the Revenue Commissioners, Year ended 31st March, 1959* (Pr. 5281) Table 60.

135. A capital gains tax would apparently be a difficult tax to administer effectively. It would be necessary to ascertain the cost and sale price of all assets sold by those liable or possibly liable to the tax, including the cost of any additions to, or improvements in, the assets after they had been acquired. It would be necessary to value retrospectively assets received as gifts, or under bequests, and subsequently sold. Various sources of information would have to be examined to obtain particulars of sales that might have resulted in capital gains or capital losses.

Owing to the irregular nature of many types of capital gain, and because realised gains often represent an accrual over a period of years, some form of averaging would probably be necessary for at least large capital gains, if chargeable to tax. Yet any form of averaging creates administrative difficulties, not least of which is in collecting tax on profits long after they have been earned.

136. If it were practicable to tax accrued rather than realised gains the tax would be payable at shorter intervals, and it would not discourage dealings in investments or other assets as does a tax on realised gains. But a tax on accrued gains creates such formidable administrative problems that it is generally regarded as impracticable.⁷

137. The Revenue Commissioners have stated that if the staff engaged in income taxation work had to be employed on a capital gains tax "the work of assessing and collecting other taxes on income and profits would most assuredly suffer to a material extent".⁸ Yet if such a tax were to be imposed its administration should, as a practical matter, be carried out by those who have experience in examining the returns of income and the accounts and other material on which income tax is computed.

As some compensation, the administration of a capital gains tax would facilitate indirectly, and ultimately perhaps to a large extent, the administration of income tax and surtax. The information obtained regarding capital gains and losses would provide a valuable check on income tax and surtax returns.

138. On the whole the disadvantages of a capital gains tax at the present time largely outweigh its advantages. It would create a good deal of inequity, no matter what modifications or safeguarding clauses were provided. It would affect the marketability of investments and encourage the outflow of capital. It would be difficult and costly to administer. The revenue from it would at best be doubtful, and for many years would probably be negligible.

The arguments that can be adduced in favour of this tax certainly highlight some of the imperfections in our system of income taxation, but **the grave disadvantages associated with a capital gains tax leave us no option but to recommend that it should not be introduced.**

⁷These problems mainly arise in connection with the valuing of stocks, shares, and other assets—to a much greater extent than for realised capital gains.

(There would also be the danger that assets might have to be sold prematurely to pay the capital gains tax.)

⁸Memorandum, 15th January, 1958.

CHAPTER VI

AN ANNUAL TAX ON CAPITAL OR WEALTH

139. An annual tax on capital is, *prima facie*, an attractive means of obtaining at least a part of the revenue required by the State. Many countries at one time or other imposed a tax on wealth, or on certain forms of it, and such a tax is levied in a number of European countries at present.¹

140. A tax on incomes serves the same purpose as a tax on capital so long as there is a similar income yield from the different forms of capital. If for instance each of two investments of £5,000 produces £250 income annually, a tax of 1 per cent on the investments provides the same revenue as a tax of 20 per cent on the income. This does not hold if the income from one investment is greater than that from the other.

There are many circumstances in which income derived from capital fluctuates in amount. One person may have £5,000 worth of gilt-edged securities from which he receives £250 per annum while another has £5,000 invested in a speculative enterprise from which he receives sums varying from £1000 in one year to nil in others. A tax on income alone, especially a tax at a progressive rate, may not of itself provide equity in the taxation of these two persons. Some form of a wealth tax would appear to be necessary as a supplement to, or part-substitute for, income taxation.

141. The following example further illustrates the desirability of supplementing the income test to determine taxable capacity.

Let us take three persons, A, B, and C, each having £5,000.

A invests the full amount in securities which provide an income of £250 per annum.

B invests £2,500 in securities, from which he gets £125 per annum, and £2,500 in a single-premium insurance policy on which a lump sum is payable on death, or after a specified number of years if he is then alive.

C invests £3,000 in securities from which he gets £150 per annum, and with the balance he purchases a life annuity of £75 commencing when he is 65 years.

A's yearly income is £250; B's income is £125; and C's income is £150, increasing later to £225.

It can hardly be said that these income figures, even over a series of years, bear a fair relation to the taxable capacity of A, B, and C respectively.

¹These include Norway, Sweden, Western Germany, Austria, Switzerland, and the Netherlands.

142. Capital can provide social and economic benefits, in addition to the income from it. Capital is a security against want, and capital enables a person to take part in many activities, pleasurable, enterprising, speculative, etc., which would otherwise be outside his reach. Hence it is that the owner of investments producing, say, £1,000 a year is normally much better circumstanced financially and socially than a person with a salary of £1,000 a year and no capital.

143. So far as taxation is a desirable agency for redistribution of wealth a tax on capital has the advantage over a tax on incomes that it is more pervasive, because capital is often invested in articles from which no income as normally understood is obtained (e.g. amenity assets such as works of art). Moreover a tax on capital would not have a strongly disincentive effect on enterprise as a tax on capital has less direct connection with present effort than a tax on incomes.

144. A tax on capital has however some serious disadvantages.

Such a tax reduces the available fund of capital unless the tax is paid entirely out of income, or unless it is accompanied by an increase in investment from savings or some other source.² This is admittedly a long-term consideration but it is no less unreal on that account.

145. An annual tax on capital is not part of the tax system in Britain and the Six Counties.³ If a capital tax were imposed here it might discourage the inflow of capital or the retention of capital in the country, and this could be particularly harmful to capital invested in Irish industry. If income tax was reduced when a tax on capital was imposed the capital tax would be less severely felt by those liable to income tax, but this would not apply to investments from which the income was nil or negligible. A tax on capital would affect savings in a more direct way than income taxation.

146. A tax on capital would be difficult and costly to administer.

It would be necessary to assess annually, or periodically, the market values or assets of various kinds. Investments quoted on a Stock Exchange could be readily valued, but not other investments. In valuing company investments which have not a market quotation regard should be had to the profit-history of these companies, the extent and nature of their reserves, and the prospects of dividend payments. Such problems already arise in making valuations for death duties, but with an annual tax on capital the work would be much greater than for death duty purposes.

²A tax on incomes, on the other hand, affects what has been described as "the fruit of the tree" rather than the tree itself, so that the tax does not normally reduce the stock of capital.

³Nor is there a tax on capital in France, the United States, or Canada.

147. It would be a troublesome and contentious matter to value holdings of land as there is little reliable information on which to do so. The valuations for rating would not greatly help as these were made over a century ago, and on an income basis; and there have been significant changes in fertility of land, apart from the fact that considerations such as tenure would have to be taken into account. Even if the tax were confined to those having, say, £4,000 capital or more it would be necessary to value, in addition to all the large holdings of land, many small holdings belonging to persons whose total wealth might exceed £4,000.⁴ Possibly as many as 100,000 holdings might have to be valued.

The valuing of house property and other assets would add greatly to the administrative work and expense, even if a wide range of personal effects were exempted from the tax.⁵

Precise valuation would admittedly be unnecessary as the rate of tax would scarcely exceed $1\frac{1}{2}$ or 2 per cent and if money values remained reasonably stable many valuations would not have to be reviewed each year. But even in the most favourable circumstances the amount of work necessary on valuation and the amount of controversy this work would cause would be intimidating in extent and cost. The initial valuation of assets would in itself be a formidable undertaking.

148. Death duties, although payable at irregular intervals only, serve some of the purposes of a capital tax, particularly as regards large accumulations of capital. As death duties are not payable during a person's lifetime they cause less loss of satisfaction than a recurring tax on either capital or income.⁶

149. We are of opinion that, despite some strong theoretical arguments in favour of an annual tax on capital, the arguments against it are much too formidable to justify our supporting any experimentation in that direction. **We regard a tax on capital as undesirable and impracticable.**

⁴There are in all close on 300,000 holdings of land each exceeding one acre. Of these, about 30,000 holdings have each a valuation of £60 or more. Taking into account the buildings on them, each holding would probably have a market value of at least £4,000.

⁵House property values could be affected by inflation or deflation; damage or neglect by tenants; a change in the nature of a locality; changes in tenure; changes in local rates, or in their trends; changes, or contemplated changes, in the law regarding rent restrictions; changes in income tax on buildings; changes in subsidies and grants by public authorities for repair or improvement, etc.

⁶There are other arguments for, and arguments against, death duties, but these are not relevant to the matter under consideration here.

CHAPTER VII

AN EXPENDITURE TAX

150. Many forms of expenditure are already taxed in this country. In an analysis of taxation under the three headings, taxes on income, taxes on capital and taxes on expenditure in the *Irish Statistical Survey 1958*,¹ compiled by the Central Statistics Office, the following are listed as taxes on expenditure:—

customs duties (including special import levies), excise duties, rates, motor vehicle duties, dairy produce levies, stamps, harbour tolls, dues, etc., wireless licence and other fees, and Post Office surplus.

151. These taxes on expenditure are not related to individual circumstances, nor do they exclude certain expenditure on essentials. They include taxes on some goods used in agriculture and industry, such as tractors and petrol.

As can be seen from paragraph 2, about 72.5 per cent of the Exchequer tax revenue receipts in 1959-60 arose from taxes on expenditure.²

152. The expenditure tax considered here is different from the taxes enumerated above. It is a personal tax on individuals, or families, based on the total amount spent each year—without differentiating between the goods or services on which the expenditure is incurred.

153. A tax of this nature has figured to some extent in academic discussions in taxation literature over the past century, but it was generally regarded as impracticable. Within the past decade interest in it has been stimulated by the persuasive advocacy of Mr Nicholas Kaldor, Reader in Economics in the University of Cambridge. He has endeavoured to show not only that an expenditure tax is superior in many ways to other taxes but that its administration would be less difficult than has been supposed. He concedes that the tax should not be imposed on the citizens in general and he would, at the outset, confine it to wealthy taxpayers. This could best be done, he says, (with reference to Britain) “by re-casting the present surtax whilst retaining the principle of charging on income in the case of income tax”.³

¹Pr. 5212 (Stationery Office); Table A.12.

² i.e., customs duties	...	...	41.9%
excise duties	...	...	22.6%
stamp duties	...	...	2.5%
motor taxation	...	...	5.5%
			72.5%

³*An Expenditure Tax*, Nicholas Kaldor. George Allen and Unwin Ltd., page 224.

157. In 1957 an expenditure tax of this nature was introduced in India, following a Report by Kaldor on Indian taxation generally;⁴ and since then it has been introduced in Ceylon.

In India a basic allowance of 30,000 rupees (£2250) is granted to each person. Expenditure on the following is exempt: works of art exceeding a certain price; products of Indian cottage industries; insurance premiums; contributions to provident and superannuation funds; gifts and donations; contributions to public charities; purchase and maintenance of buildings and of immovable property not owner-occupied; and (within certain limits) marriage and medical expenses; expenditure on maintenance of parents, and expenditure on educating dependants abroad.

There are some concessions for foreigners. Furthermore expenditure on furniture, jewellery, and other durables is spread over five years.

The tax applies to persons whose income (including that of any dependants), as reduced by the amount of income tax and supertax payable, exceeds 36,000 rupees (£2,700 approximately).⁵

The tax rates increase progressively from 10 per cent to 100 per cent of the taxable expenditure. These rates are based on net expenditure after deducting all exemptions, the basic allowances, and most direct taxes, including the expenditure tax itself. The rates would be much lower if expressed as a percentage of gross income.⁶

158. It is understood that, because of the liberal provisions for exemptions and reliefs outlined above, most of these who have a gross annual income of about £6,000 or under are likely to be exempt.

It has been stated regarding the Indian expenditure tax that:

“The basic objective of this tax is to provide an incentive for savings and to discourage excessive and ostentatious consumption. In introducing this tax revenue considerations were not of great importance. In fact substantial revenue is not expected in the initial stages, and it is estimated that only about 8,000 persons will be liable to pay this tax in the first year of assessment.”⁷

Advantages and disadvantages of an expenditure tax

159. As already stated, a person's ability to pay taxes might reasonably be related to what he has available for spending after providing the essentials for himself and his dependants; and while income is

⁴*India Tax Reform. Report of a Survey*, Nicholas Kaldor. Ministry of Finance, Government of India.

⁵The equivalent gross income (all earned) in this country for a single man with no dependants would be about £3,800.

⁶Assume a person has a total income of £4,000 on which the income tax payable is £1,000, and that the taxable expenditure after deducting income tax and other allowable deductions is £1,000. 20 per cent of the taxable expenditure is equivalent to 5 per cent of the total income, £4,000. This point is important when comparing an expenditure tax with surtax, which is charged on gross income without any deduction for income tax, surtax or other taxes on consumer goods.

⁷*Taxation and Foreign Investment*, National Council of Applied Economic Research, New Delhi. P. S. Jayasinghe, Asia Publishing House, Bombay, page 145.

a good general test of spending capacity, this test has limitations because capital has social and economic values apart from the income it produces.

160. A further difficulty regarding income is that it is an elastic concept, and there are conflicting views as to what it should comprise for tax purposes. Some hold that income should include gifts, winnings in sweepstakes, pools, etc., in fact everything that "comes in" and provides spending resources. In this country the income concept for taxation is rather narrow; it does not include gifts, gambling gains (by other than a professional gambler), capital gains, or winnings in pools or sweepstakes—although such receipts help to satisfy personal needs just as does a wage or salary. If personal income is regarded as personal consumption plus saving,⁸ some cognisance should be taken for income taxation of any receipts that can be used to provide consumer goods or services.

161. It may be suggested that if, for taxation, a particular definition of income is considered too narrow the widening of the definition is preferable to introducing a new tax. Kaldor regards this as unsatisfactory because, in his view, it is impossible to reduce to a common denominator the accruals from different sources of spending power, and because there is in any event an "element of inherent arbitrariness or immeasurability"⁹ in income, however defined. According to him,

"no definition of income, which is a plausible one for purposes of tax assessment, can measure taxable capacity. Accruals from the various sources cannot be reduced to a common unit of spending power on any objective criteria."¹⁰

162. On the matter of providing a common base for different sources of spending power, he states (developing the notion of a tax on expenditure) that:

"each individual performs this operation for himself when, in the light of all his present circumstances and future prospects, he decides on the scale of his personal living expenses. Thus a tax based on actual spending rates each individual's spending capacity according to the yardstick which he applies to himself. Once actual spending is taken as the criterion all the problems created by the non-comparability of work-incomes and property-incomes, of temporary and permanent sources of wealth, of genuine and fictitious capital gains resolve themselves; they are all brought into equivalence in the measure in which they support the actual standards of living."¹¹

⁸This is the view of many economists (including Kaldor).

H. C. Simons, an authoritative writer on income taxation matters, defines income as the sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights throughout a period, i.e., the sum of consumption and accumulation. (*Personal Income Taxation*, University of Chicago Press, page 50.)

Others regard this definition as too wide, especially for taxation.

⁹Op. cit., page 25.

¹⁰Op. cit., page 47.

¹¹Op. cit., page 47.

163. It is difficult to formulate a generally acceptable definition of income, because income may include or exclude certain receipts and also because it is affected by lack of stability in money values. Kaldor stresses that this problem does not arise with an expenditure tax and that expenditure is a better measure of taxable capacity; that each individual effectively reduces to a common denominator all his receipts, from whatever sources they originate, according as he makes decisions regarding personal expenditure, and that therefore a tax on expenditure would provide a reasonably equitable basis of taxing spending power. It is clear from his writings that he has in mind not the full amount of a person's expenditure but the excess over what is required for essentials; and looked at in that light there is something attractive about an expenditure tax.

164. But the provision of equity in taxation is not the only virtue he sees in an expenditure tax; he holds that it can readily be used to tax extravagant expenditure, as measured by current ideas of extravagance. He stresses that those who spend heavily, and so exhaust a substantial amount of the community's resources, cannot be effectively taxed on their consumption by a tax on incomes; and that while a tax on capital, gifts, and capital gains would reduce the imperfections of income taxation an expenditure tax would provide a better solution of the problem.

165. It is often suggested that extravagant expenditure can be effectively taxed by taxing the commodities or services on which expenditure is usually made. But taxes on commodities cannot be adapted to individual circumstances, whereas Kaldor's expenditure tax can. Furthermore the expenditure tax does not differentiate between different forms of spending, e.g. on a television set, betting, yachting or tobacco; all are taxed alike—and this obviates having to distinguish between one form of luxury, or semi-luxury, and another. Kaldor's tax has the added advantage that it applies to expenditure on services such as meals and entertainment which cannot be easily taxed by other means.

166. An expenditure tax of its nature should encourage savings. To the extent that it succeeded the revenue would decrease, but the fiscal aspect of the tax is usually regarded as secondary to the social and economic aspects. This leads to consideration of the purpose of savings.

167. If savings are invested both the investor and the economy usually derive some benefit from them, but if savings are hoarded they furnish no stimulus to business enterprise—and an expenditure tax cannot distinguish between these two forms of savings.

Saving is largely a matter of deferring expenditure in order to provide for the rainy day, in which case saving would merely defer an expenditure tax if such a tax were in force. It might even happen that as a result of savings of this kind the tax would be transferred to a period when a person was less able to bear it; for instance a pensioner might be taxed during the years of his retirement on the expenditure of savings he had accumulated before he retired.

168. Difficulty in paying expenditure tax could also arise in cases such as the following:

A person has a total income of £3,000 per annum, of which £500 is from investments. He spends his income of £3,000 in the ordinary way.

Expenditure tax is charged on the excess of expenditure over £3,000 per annum.

In year 1 he wins £1,000, and in year 2 he loses £3,000, on betting. He has to sell some investments to pay his net losses of £2,000 over the two years.

His expenditure tax is computed as follows:

	£
Year 3 : income of year 2,	3,000
add betting expenditure	3,000

total expenditure	6,000
less exempt margin	3,000

taxable	3,000 @, say, 25% = £750

He has already lost £2,000 net, yet some twelve or eighteen months later he has to pay £750 tax on his betting losses.

Apart from possible difficulty in paying the tax there would be a strong urge to conceal expenditure to avoid heavy taxation that coincided with a financial loss. If however the tax could be effectively imposed it should provide a salutary check on excessive spending.

169. We have given some consideration to Kaldor's suggestion that an expenditure tax be substituted for surtax,¹² i.e. that a graduated expenditure tax be charged on those whose yearly personal spendings exceed the present limits of surtax exemption. Expenditure rather than income would then be the basis of surtax.

The revenue could not be greatly affected by a change of this nature as the surtax yield amounts to only about £2 millions yearly.

Particulars of total income of each person concerned would normally be available from the income tax records, but supplementary information would be necessary about receipts not subject to income tax and about liquid assets at the end of each year.

In practice the administration would have to check statements of purchases and sales of investments to ensure that particulars of important transactions were not omitted or supplied incorrectly. It would also be necessary to make at least periodical enquiries regarding the personal expenditure of members of a taxpayer's household in order to prevent, or at least minimise, evasion. For instance if a person "loaned" money to somebody not liable to expenditure tax the lender would escape tax on that amount and the recipient could then, by collusive arrangement, use the money to pay some of the lender's

¹²Op. cit., pages 224-42.

expenses such as for a family holiday. (This expenditure if incurred by the taxpayer himself would be subject to expenditure tax.) Similar transactions would, it is feared, become a fruitful source of tax evasion.

The administrative work on spreading over a number of years expenditure on durable assets such as a residence or furniture would be formidable.¹³ Records of the purchases and sales of such assets, and of additions and extensions to them, should be kept in official files for at least that number of years.¹⁴ Particular difficulty could arise in checking purchases and sales abroad; and this difficulty would increase as travel abroad became more general.

170. It is doubtful if the taxpayers concerned, or even any significant number of them, would prefer a tax of this nature to surtax. They would probably resent enquiry regarding their personal expenditure,¹⁵ and unless they could count on an appreciable reduction of other taxes they would be unlikely to welcome the change from surtax to expenditure tax.

171. While we have been impressed by certain attractive features of an expenditure tax, we would like to feel that it could be effectively administered with less need for enquiry regarding personal affairs than there appears to be at present. It is probable that the experience of it in India and Ceylon will provide a good deal of useful information regarding the practical problems, and may show how these problems, or many of them, can be solved.

172. The introduction of such a tax would at the outset create a feeling of uncertainty about its effects, and at least some wealthy taxpayers who would come within its ambit might remove themselves and their capital out of the country. On the other hand it seems unlikely that the tax would provide a sufficiently attractive alternative to surtax to encourage wealthy foreigners to take up residence here.

173. We do not therefore recommend the introduction of an expenditure tax as a substitute for surtax or for any other part of income taxation.

¹³Kaldor suggests that the purchase of residential property should be outside the scope of an expenditure tax but that income tax should be charged on the full rental value of the property. We have already recommended in our Second Report (Pr. 5119) that income tax under Schedule A be abolished on most residences that are owner-occupied, but different considerations would arise if an expenditure tax were introduced; expenditure on house-purchase could scarcely justify complete exemption from such a tax.

He also suggests that expenditure on articles of an amenity nature such as paintings, pictures, and jewellery should be exempted, but that an annual charge similar to Schedule A income tax should be imposed on "the flow of benefits which ownership confers", provided the administrative difficulties could be overcome.

¹⁴After a person had first become subject to expenditure tax it would be necessary to ascertain his expenditure over a series of past years on durable assets part of the cost of which should be included in his later expenditure, under the "spreading" system.

¹⁵The framework of the tax scheme in theory avoids direct enquiry of this nature but in practice a good deal of it would be unavoidable.

CHAPTER VIII

MISCELLANEOUS SUGGESTIONS FOR NEW TAXES

174. In representations made to us some other forms of taxation were suggested as substitutes for income taxation.

One suggestion was a tax on spending, or money circulation, as a substitute for all other taxes, direct and indirect, except three—surtax, an "excess profits tax", and an 8 per cent. tax on workers' earnings, shared equally by employers and employees.¹ (This latter tax was intended to finance social welfare expenditure.)

In this submission it was estimated that the turnover of money amounts to about £4,000 millions yearly, and a tax at 2½ per cent was suggested, yielding, on that estimate, about £100 millions.

175. Suggestions made in other submissions were (a) an ad valorem tax on cheques and bank lodgments, together with a charge for the use of legal tender and (b) a dual currency system under which a basic currency would be provided for essentials and a second currency for non-essentials, the rate of exchange between the two currencies to be determined by annual budgetary requirements.

176. We deem it unnecessary to incorporate in this report details of these suggestions or the many cogent reasons for their rejection. We carefully considered them all and **we concluded that they are quite impracticable.**

¹Submission, June, 1957—*Mr. S. Laverty*, 124 Leinster Road, Rathmines, Dublin.

He contended that the change in taxation which he proposed would leave citizens with more money to spend, but this is quite incorrect. The community would still have to contribute the same total sum to the Exchequer, leaving no scope for increase in net spending power. Furthermore a tax on money circulation could not be graduated according to individual circumstances, and the family man would be subjected to the same burden of tax on necessities as the man with no dependants purchasing more luxuries or semi-luxuries than the family man.

The administration of such a tax would be very difficult—and the opportunities for evasion would be widespread, particularly when large cash purchases were being made. For instance transactions between cattle jobbers, farmers, etc. could readily escape the tax. Among other practical difficulties would be the problem of checking and collecting the tax from small traders of every description.

If wages, salaries, insurance, dividends and exports were exempted, the tax base would be so reduced as to necessitate a much higher rate than 2½ per cent. (These exemptions were part of the proposal.)

We also considered a tax on expenditure on foreign travel and concluded that it too would be impracticable, and that even to the extent that it might be considered desirable the revenue would not be a worthwhile substitute for any part of income taxation.²

²Most of the expenditure on travel abroad relates to the sterling area. Of an estimated 2,097,000 visits in 1958 by Irish residents to or via Britain or the Six Counties (excluding movements by foot or bicycle) an estimated 1,844,000 were to the Six Counties, and only about one-eighth of these were for over one day. Private motor transport was used for an estimated 1,331,000 of these visits.—*Irish Trade Journal*, June, 1959, page 83.

There are no restrictions on movements of currency between here and the Six Counties or Britain, and some exchange control would probably be necessary if a tax on travel were to be imposed.

A levy on fares only would encourage people to buy tickets elsewhere, thereby affecting Irish transport companies and travel agencies.

A flat tax per head on each person leaving the country, apart from being inequitable and largely a tax on business travel, would be cumbersome to work, even if one-day visits to the Six Counties were excluded; and in any event the revenue would be small.

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

177. I. The Commission recommends the retention of income taxation as part of the tax system. In its opinion income taxation is, in principle, a good form of taxation.

II. None of the representations made to the Commission regarding income taxation contains any practical suggestion for a complete substitute for income taxation. The Commission itself has likewise been unable to discover any such substitute.

III. The Commission is satisfied that the existing criticism of income taxation arises mainly from the high rate of income tax and from the lack of choice in the spending or disposal of income to which income tax at a high rate necessarily gives rise.

IV. The Commission considers it very desirable that the rate of income tax should be reduced.

V. The Commission has examined the merits of—

(a) Purchase Tax (Chapter IV)

(b) Capital Gains Tax (Chapter V)

(c) Tax on Capital or Wealth (Chapter VI)

(d) Expenditure Tax (Chapter VII)

(e) Miscellaneous suggestions for new taxes (Chapter VIII)

and it has, for the reasons indicated in its Report, rejected the introduction of—

Capital Gains Tax (Chapter V, pages 51-56)

Tax on Capital or Wealth (Chapter VI, pages 57-59)

Expenditure Tax (Chapter VII, pages 60-66)

Miscellaneous new taxes (Chapter VIII, pages 67-68)

VI. The Commission however, by a majority, considers that the introduction of a limited Purchase Tax is both desirable and practicable.

VII. Our recommendation is that the limited Purchase Tax operate at rates between $7\frac{1}{2}$ per cent and 15 per cent on a base of £65/75 millions wholesale value (which is less than fifty per cent of the annual purchases by retailers) to raise an annual revenue of at least £6 millions.

VIII. We specifically recommend the exclusion from the Purchase Tax of

- (a) goods essential for agricultural production
- (b) goods essential for industrial manufacture
- (c) exports, agricultural and industrial
- (d) food, particularly essential food
- (e) fuel
- (f) newspapers and books
- (g) household non-durable goods
- (h) goods already subject to heavy customs or excise duties, e.g. tobacco
- (i) works of art, and goods that are primarily of a cultural nature

IX. We recommend that the Purchase Tax be a part-substitute for income tax and that the revenue from it be used to reduce the rate of income tax. The revenue which we recommend to be raised by a Purchase Tax should permit of a reduction of about two shillings in the present rate of income tax, i.e. from 7/- to 5/-.

X. Our view is that the limited Purchase Tax we recommend will be neither regressive nor inflationary, nor can it have any adverse effect on either industry or tourism.

XI. The reduction of income tax made possible by the adoption of this Purchase Tax should, in our opinion, have a tonic effect over the whole economy and should stimulate both the inflow of foreign capital and native investment in Irish industry.

Cearbhall Ó Dálaigh (Cathaoirleach)
Owen Binchy
John Busted
Patrick Cogan*
Alan P. Dempsey
F. N. Kelly

L. de Barra, Rúnáí
D. F. Cawley, Rúnáí Cúnta
31 Bealtaine, 1960

* With addendum, page 71

ADDENDUM

MR PATRICK COGAN

- (1) I fully agree with the Majority Report (which I have signed) except that the recommendation regarding purchase tax does not go as far as I think it should.
- (2) On this matter my colleagues take the view that local taxation is outside our terms of reference except so far as it is desirable to comment on it in connection with income taxation, but I regard this interpretation as unnecessarily narrow, and I take the liberty of outlining my views on purchase tax in a somewhat wider context. It is difficult to consider the incidence or equity of taxes imposed by one of the two taxing authorities in the State without considering those imposed by the other, and I feel that once a purchase tax is introduced it should be used to best effect as part of the total machinery of taxation—central and local.
- (3) I favour an extended purchase tax serving two purposes :
 (a) reducing, and stabilising, the incidence of local rates, and
 (b) granting still further reliefs from personal income tax.
- (4) Local rates are a very heavy burden on farmers and property owners generally.

The level of rates has been steadily increasing in most areas—so much so that they are now a serious deterrent to making extensions or improvements to property. When extensions or improvements are made increased valuations and increased annual charges for rates almost inevitably follow,

- (5) I recommend that the central authority should use a purchase tax
 (a) to reduce local rates by, say, £2 millions (roughly one tenth of the total rates now payable) and
 (b) to stabilise rates for a prolonged period; in other words if in future years the local authorities required further revenue, which they would normally obtain by an increase in rates, this should be collected by a purchase tax and then transferred to the local authorities.
 (Concurrently with this some anomalies in the rating system could perhaps be removed).

- (6) As regards income tax, I agree that the rate should be reduced to five shillings in the pound, but I also think that those who are in business in a small way, not making more than about £600 per annum, should be exempt from income tax. I consider that small traders would find it much easier to pay the equivalent of income tax in indirect contributions through a purchase tax, even on some articles on which tax payment might not be altogether painless. A purchase tax is a much more suitable tax on small and middle-class business men in Ireland than personal income tax. With a purchase tax they would have no need to worry, as many have now, about furnishing particulars of receipts and expenses or taking out accounts. They cannot easily evade purchase tax; and they can usually pay it in dribblets according as they make purchases. They can understand a purchase tax; most of them will never understand income tax.
- (7) Limited companies and those whose business is large are proper subjects for income tax, but small retailers, small cattle-dealers, etc., are not. In my view they are taxed more effectively, at less cost to the State, and at less expense and trouble to themselves, by a purchase tax.
- (8) I understand that if the present income tax exemption was increased to about £550-£600 per annum (assuming a standard rate of 5/- as per the Majority recommendation) and with personal allowances remaining unchanged—except perhaps for some marginal adjustments, and possibly some increase in allowances to married persons—it would cost about £2 millions. I consider that this sum might be provided by an extension of the purchase tax.
- (9) Goods of a luxury or semi-luxury character could if necessary be charged to purchase tax at a higher rate than 15 per cent. A tax of 25-30 per cent on wholesale values (say 15-25 per cent on retail values) would not be an unfair impost on goods such as television sets, high-powered motor cars, etc.
- (10) Broadly I consider that the purchase tax recommended should be at higher rates, particularly on luxury goods, and should if necessary be extended in range to provide a revenue of close on £10 millions, thereby reducing income tax by 2/- as recommended by the majority, and in addition
- (a) reducing local rates by, say, one tenth (i.e. approximately £2 million out of about £20 millions now payable) and stabilising them for a prolonged period; and
 - (b) relieving from income tax, at a cost of about £2 millions, those with small incomes who are now liable to income tax.

PATRICK COGAN

MINORITY REPORT

1. Though we participated fully in the discussions on alternative taxes with our colleagues and are in complete agreement with Chapter I (Introduction), Chapter II (Some characteristics of a good tax system), Chapter III (Income taxation), Chapter V (Capital gains tax), Chapter VI (An annual tax on capital or wealth), Chapter VII (An expenditure tax) and Chapter VIII (Other suggested systems of taxation) we are unable to sign the majority report of the Commission because of a fundamental disagreement with them on the question of the introduction of a purchase tax.

2. We accept the desirability of some reduction in the weight of income taxation, but we cannot agree that the imposition of a purchase tax is a suitable method of achieving this.

3. We reject our colleagues' recommendation that a purchase tax of between $7\frac{1}{2}$ and 15 per cent should be imposed on a wide range of goods to yield a revenue of at least £6 millions. The Majority Report has set out some of the advantages and disadvantages of a purchase tax. We, for our part, do not deny that a purchase tax can, in particular circumstances, have certain advantages, but we cannot accept that our colleagues have disposed of the many grave disadvantages that such a tax would have in the circumstances of our economy and against the general taxation background here.

4. The majority recommendation is to increase the burden of indirect taxation by £6 millions, and correspondingly reduce direct taxation, i.e. income tax. The effect of this would be to impose additional taxation on the great majority of people whose incomes are already too small to attract liability to income tax (and who would, therefore, get no benefit from the reduction in income tax).

5. The proportion of indirect taxation to total taxation in this country is already extremely high—almost certainly the highest in Europe.¹

¹In a paper read to the Statistical and Social Inquiry Society of Ireland on 8th April 1960, Mr. J. B. Broderick, Senior Statistician in the Central Statistics Office, gave the following figures showing the proportions of the current receipts of public authorities in 1957 obtained from taxes on expenditure:

Ireland	67.7 per cent
Italy	64.8 " "
France	52.2 " "
United Kingdom	45.4 " "
Norway	43.4 " "
Belgium	40.0 " "
Netherlands	31.1 " "
Sweden	29.7 " "

The imposition of a purchase tax would increase the proportion. Indeed, on the basis of central government revenue in 1959-60, indirect taxation would have amounted to 74 per cent of tax revenue if the majority's recommendation had been in operation last year. (The proportion in Britain was only 43 per cent.) We doubt if this represents an equitable distribution of the tax burden over the community.

6. Income tax has its faults but at least it endeavours to relate taxation to ability to pay, and in that way it is the fairest type of tax. A purchase tax cannot be devised so as to allow for individual circumstances. That proposed in the majority report has to be applied to a wide range of goods in daily use in order to secure the required yield. Obviously it must impose a more severe burden on families, and especially on those in the lower-income group. It suffices to point out that of the goods proposed to be taxed clothing amounts to almost one half, and goods in regular household use form a further large percentage.

7. It might, perhaps, be argued that a purchase tax on luxury goods would be desirable, but there are many practical objections to even such a restricted tax. There is the initial difficulty of deciding what constitutes a luxury—tastes are changing constantly, yesterday's luxury becoming today's necessity. Then the yield would be so limited—even with comparatively high rates—that it would not justify the setting up of new administrative machinery, and in so far as such goods might be imported, many are already subjected to relatively high import duties. If home manufactured, the effect of a purchase tax on employment could be serious.

8. It would be wrong to assume that persons in the middle-income group would necessarily benefit from the majority recommendation. A man with a wife and two children earning £1,000 a year would save £12 by a reduction of 2/- in the standard rate of income tax. If he spent 20 per cent of his income on goods subject to purchase tax (and this is a conservative assumption) he would pay £20 in tax (assuming a rate of 10 per cent)—a net additional impost of £8.

9. Apart from those already mentioned, there are other objections to a purchase tax.

A purchase tax would be a burden on our home industries. If these industries are to export on any significant scale it is essential that such a handicap should not be placed on them. There is a basic relationship between home and export sales—both combined are the regulators of total output. The full benefits of the maximum spreading of costs would be denied if the further expansion of home demand was restricted by a purchase tax. If this were to happen export prices would become less competitive and our export trade suffer.

10. The Revenue Commissioners have informed us that "a sales tax must be viewed primarily as a device to bring within the tax net the products of Irish Industry".² Their memorandum goes on to point out that, by comparison with Britain, "there is less diversity and buoyancy here, less certainty of export outlets, and therefore, greater sensitivity of industry to any adverse influences on the home demand for its products". For these reasons we believe that it would be very unwise to hamper our industries by the imposition of a purchase tax.

11. The existence of a purchase tax over a wide range of goods could hardly be considered an added attraction to tourists. Whatever the material import of the tax it seems clear that it would have a considerable psychological effect on potential visitors to the country.

12. Purchase tax was originally introduced in Britain not primarily as a means of getting revenue as much as an economic weapon to curb demand at a time of inflation. Thus in an article in the O.E.E.C. publication, *The Influence of Sales Tax on Productivity*, (1957), it is stated that "the revenue aspect of this (purchase) tax has always appeared subordinate to its economic aspect". There is however no suggestion in the majority report that they advocate the imposition of a purchase tax in order to arm the authorities with an economic weapon to curb demand in any inflationary situation.

13. It is stated in the Majority Report, (par. 84) that a purchase tax imposed at wholesale values would be unlikely to result in price increases larger than the tax itself. This greatly underestimates the probability of a tax on wholesale values "pyramiding" through the application of mark-up percentages so that the increase in prices at the retail level would be greater than the original tax would warrant. There is evidence that this is what has happened in Britain. In a communication to the Commission the *Retail Distributors' Association Incorporated*, London, stated that "it is virtually universal practice today to apply the mark-up to the basic price, plus tax".

14. We are of opinion that price increases transmitted forward into the retail prices as a result of a purchase tax on wholesale values would far exceed the amount of the tax. We also have no doubt that the consequent increases in the prices of a very wide range of commodities would inevitably, and understandably, give rise to demands for increases in incomes, including wages and salaries, to compensate for the increase in prices. (A purchase tax under any disguise is a wage cut). The implications and consequences of a campaign for higher incomes so sparked off have not been given due weight by the majority.

15. Apart from the basic inequity inherent in a purchase tax arising from the fact that its incidence is not directly related to taxable capacity or to family circumstances, there is another aspect of this

²Memorandum, August, 1957.

question of equity which has been entirely ignored by the majority. It is well known that the higher the income the greater the proportion of expenditure that goes on "services", (e.g. meals in restaurants, foreign travel, etc.). Yet such expenditure, much of it of its nature of a non-essential and, many would say, of a "luxury" character, would not attract tax irrespective of the amount spent. But spending on children's clothing, for instance, would be subject to purchase tax at the full rate.

16. The imposition of a purchase tax would involve the setting up of new administrative machinery to add to the complex and wide-ranging tax machinery already at the disposal of the Minister for Finance. The temptation to a government to utilize the purchase tax machinery, once it was in operation, to extract increasing amounts of revenue by this means might not easily be resisted. The potential dangers of adding a new tax to existing taxes surely need not be stressed here. Once a purchase tax was introduced the pressure of events would lead to increases in its rates.

17. It has been suggested that a purchase tax would have the advantage of compelling those who do not pay income tax to contribute more to the revenue. The vast majority of those who do not pay income tax are exempt because their incomes are below the effective exemption limits when all allowances are taken into account. This applies to the agricultural as well as to the other sectors of the economy. Undoubtedly there are some who "evade" paying their proper income tax, but should the mass of low-income families be burdened with a purchase tax in order to ensure that this relatively small number of "evaders" pay more tax than they already do?

18. The majority have stated that a tax on spending such as a purchase tax gives the taxpayer a choice: he need not spend on taxed goods. But their recommendation on reducing the standard rate of tax depends on consumers continuing to buy taxed goods and so providing the revenue to make up for the reduction in income tax. Likewise they argue that a purchase tax would encourage saving. It would do so only to the extent that consumers refrained from purchasing taxed goods, in which case too the revenue would not suffice to offset the loss in income tax. These arguments seem to involve a logical inconsistency.

19. The Commission sought the views on the question of alternative taxes of a number of economists on the staffs of the National University of Ireland and the University of Dublin. The following are the views expressed by the three economists who so far have responded to the Commission's request:

Rev. W. Paschal Larkin, O.F.M.Cap., Professor of Economics, University College, Cork:

"The expediency of a general purchase tax is very controversial. Its suitability for this country is very questionable owing to our

low per capita income, and our rather static consumption habits. Even in England . . . there is a strong campaign for further substantial reductions in purchase tax, and its ultimate abolition”.

G. A. Duncan, Professor of Political Economy, University of Dublin:

“All (sales or purchase) taxes possess three qualities in common:

- (i) They are excise duties, falling with greater or less inequity according to their technical construction;
- (ii) They are regressive, since, to raise revenue in significant amounts, they must fall on articles of common consumption;
- (iii) They impose vast amounts of paper-work and accounting on traders, and consequently pre-dispose to evasion.

“I doubt if sales, purchase or turnover taxes have had a happy history anywhere, except as excises at wholesale level expressed specifically on easily traceable commodities—and then their produce is somewhat inflexible.”

David O'Mahony, Lecturer in Economics, University College, Cork:

“A purchase tax would tend to raise the cost of living and thus stimulate demands for increases in money incomes, which would in turn increase costs and thus impair our competitive position.”

It will be noted that none of these three economists expresses himself in favour of a purchase tax.

20. We believe then that, while a purchase tax has some points to recommend it, the arguments against its introduction here are so compelling that we cannot but dissent from our colleagues' recommendation.

P. A. Bolger
R. C. Flanagan
James Kavanagh
James Meenan*
Donal Nevin.

31 Bealtaine, 1960

* With addendum, page 78.

ADDENDUM TO MINORITY REPORT

by

MR JAMES MEENAN

I have signed the Minority Report rejecting the recommendation of a limited purchase tax. I must admit to having done so with some lingering reluctance because originally I was impressed by the apparent suitability of a purchase tax to an economy in which so many people still work without any contractual right to payment. Moreover, any tax which discourages expenditure must appear attractive in a country with so high a propensity to import as ours. Finally, there is at least a presumption that a system of tax which suited a commercial and manufacturing community engaged in the earning of wages, salaries and profits could not be fruitfully transplanted to a community largely composed of small family businesses and farms such as ours has been—whatever new character it may assume in another couple of decades.

But I can see no complete answer to the criticism that if a purchase tax is intended to raise an appreciable revenue it must be imposed on at least some commodities that are in common use and must therefore be highly regressive. If a purchase tax is intended, as in the recommendation of the Majority Report, to produce a limited sum only it either becomes some form of sumptuary tax, a notoriously unsuccessful species, or it becomes a matter of hit or miss between an immense range of commodities, all of which are equally liable to be chosen as vehicles of the tax or allowed to go free. The result must be to introduce a degree of arbitrariness which must be undesirable. The present state of confusion in our tariff system should be a sufficient warning of the manner in which official lists get left behind by changes in fashion, the progress of invention and all the forces which give flexibility to trade. Finally I cannot believe for a moment that the implied bargain of a reduction in the standard rate of income tax to five shillings in return for a limited purchase tax would be regarded as inviolable. Some day or other the standard rate would begin to inch upwards again and the final result would not be a redistribution of taxation but a new tax.

One can only balance disadvantages. It must be admitted that income tax is based on a coherent principle of taxation according to ability to pay, however confused the practical application of that principle may have become. The true grievance against income tax is that it is now so high and that there are so few signs that it will be reduced in any immediate future or by any appreciable amount from its war-time peak. That affects adversely the confidence of people that they will be able to make a living here for themselves and a home for their families. In the long run, the true remedy in my opinion is

to secure a progressive true increase in the national income so that the burden of income tax will be lightened. In the short run, so far as changes in the code of taxation can solve what is much more an economic and social, rather than a fiscal, problem it might be found more fruitful to reduce the present rate of progression of income tax, which is so great a disincentive to enterprise, than to introduce a new form of taxation for the sake of its superficial advantages.

JAMES MEENAN

1. Purchase taxes may be divided into three broad classes. (a) a single-stage tax charged on goods at some one stage in the course of distribution on production, whether the retail, wholesale or manufacturing stages be taken as a class, or as a series of stages. (b) a multiple-stage or cumulative tax, charged at a number of stages in production and/or distribution. (c) a tax charged not on the full value but on the value added at each stage in the process of manufacture, and possibly of distribution. (d) a tax charged on goods when they are sold, whether by the manufacturer or the retailer, or both, with the view of securing a progressive true increase in the national income. The single-stage tax is the most general, and it may be charged at more than one stage in the process of manufacture, or on a variable range of goods. It has not, however, been introduced in any of the countries mentioned above. In Britain, a tax of 4% is levied on the retail price of goods, and a tax of 1% is levied on the wholesale price. In France, Norway, and Sweden, as well as by various local authorities in the United States and Canada.

When tax is charged on the retail price, the rate can be lower than when the tax is charged on the manufacturer or wholesale price, as the retail price is greater. This form of tax has the advantage for retailers that it is not payable by them in advance of their making sales—unlike a tax at the wholesale stage which is effectively payable by retailers before they have sold the taxed goods. A retail tax has too the advantage for consumers, as compared with a tax charged at earlier stages in distribution, that there is no possibility of "pyramiding" of the tax, the cost of the tax to the consumer is never greater than the tax itself. A further advantage of a retail tax is that it is in practice "notified" to retailers, whereas a tax at the wholesale stage is not. A disadvantage of the retail tax is that small retailers may have a good deal of trouble in keeping the necessary records of sales, and for that reason its administration would be far more difficult than a tax charged at the wholesale stage. This difficulty is intensified if there are different rates of tax, requiring some classification of sales records. In this country a relatively large number of retailers have a turnover

¹ See para 83-4 of Report.

² Report of the Purchase Tax (Valuation) Committee (Cmd. 3830) H.M.S.O., London.

APPENDIX

DIFFERENT FORMS OF PURCHASE TAX AND SALES TAX

1. Purchase taxes may be divided into three broad classes,
 - (a) a *single-stage* tax, charged on goods at some one stage in the course of distribution or production, whether the retail, wholesale, or manufacturing stage
 - (b) a *multiple-stage*, or cumulative tax, charged at a number of stages in production and/or distribution
 - (c) an "*added-value*" tax charged not on the full value but on the value added at each stage in the process of manufacture, and possibly of distribution.
2. The single-stage tax is that in general use. It may be charged at more than one rate (as for instance the British purchase tax) or on a variable range of goods.
3. A single-stage tax charged at the *retail* level is operated in France, Norway, and Sweden as well as by various local authorities in the United States and Canada.

When tax is charged on the retail price the rate can be lower than when the tax is charged on the manufacturing or wholesale price as the retail price, and so the tax base, is greater. This form of tax has the advantage for retailers that it is not payable by them in advance of their making sales—unlike a tax at the wholesale stage which is effectively payable by retailers before they have sold the taxed goods. A retail tax has too the advantage for consumers, as compared with a tax charged at earlier stages in distribution, that there is no possibility of "pyramiding" of the tax; the cost of the tax to the consumer is never greater than the tax itself.

4. A disadvantage of the retail tax is that small retailers may have a good deal of trouble in keeping the necessary records of sales, and for that reason its administration would be far more difficult than a tax charged at the wholesale stage. This difficulty is intensified if there are different rates of tax, requiring some classification of sales records. In this country a relatively large number of retailers have a turnover

of less than £2,500 a year; out of 33,468 establishments that came within the 1956 Census of Distribution, 16,748, or roughly one half, were in this category.¹

5. A single-stage tax charged at the *wholesale* level is operated in Britain and the Six Counties, Switzerland, Australia, and New Zealand.

This form of tax obviates putting an onus on retailers of keeping records of sales, and the number of firms which have to account for the tax is much less than for a tax at the retail stage. Moreover as wholesale firms may be expected to have good sales records the assessment and collection of the tax should be comparatively easy.

The rate of tax at the wholesale stage has to be higher than the rate of a retail tax to produce a given yield. A tax on wholesale values may sometimes induce a rise in prices equivalent to a tax at the same rate on retail values but the Revenue would not get the benefit.²

If tax is charged at the wholesale stage administrative problems arise when goods are sold by manufacturers direct to retailers, and also when the wholesale price of goods varies with the quantities sold. It is necessary in such cases to determine notional wholesale values to provide uniformity of tax incidence, whatever the number of links may be in the chain of distribution and whatever the profit rates on sales of different quantities of any commodity.

In Britain, following a report in 1954 of a committee which examined this matter,³ reasonable adjustments are made to determine the basis of charge whenever the retailer enjoys a trade advantage as compared with other retailers.

6. A single-stage tax at the *production* level is operated in Finland, and also in Canada.

With this type of tax the number of firms which have to account for the tax is further reduced but the rates of tax must be higher than for a tax at the retail or even the wholesale stage as the tax base is smaller.

The earlier in the chain of distribution a purchase tax is charged the greater is the possibility of disparity in the tax incidence on consumers. This is a serious disadvantage of a tax at the production stage. A further disadvantage of such a tax is that it is in practice difficult to obtain a satisfactory definition of "production".

Much difficulty has arisen in connection with a tax at the production stage in collecting the full tax payable when sales are made at artificially low profits, or prices (e.g. by manufacturers to associated concerns engaged in distribution).

¹*Irish Trade Journal*, December, 1958, page 259.

²See pars 83-4 of Report.

³*Report of the Purchase Tax (Valuation) Committee* (Cmd. 8830) H.M.S.O., London.

7. A *multiple-stage* tax is operated in Western Germany,⁴ Austria, Luxembourg, and to some extent in Belgium, Italy, Turkey, and Holland.

Because tax is charged at each of a number of stages in production and distribution the rates can be much lower than for any single-stage tax. The cumulative effect may not differ from that of a single-stage tax, but the fact that the rate is low is probably useful psychologically and politically. When the rate is low the tax can be more readily charged on a wide range of goods, thereby making it easier to shift to the consumer—a desirable objective from the aspect of productivity.

8. A disadvantage of the multiple-stage tax is that it encourages integration of business concerns (because integration automatically reduces the number of stages at which tax is charged, and so the total tax payable). It can be argued that integration tends to increase productivity, but specialisation may also have this effect.

A tax such as a multiple-stage tax that blindly encouraged integration of business establishments would be regarded as undesirable on social grounds.

9. An *added-value* tax is operated in France.⁵ (In France there is also a retail sales tax on goods not subject to the added-value tax. This tax is administered by the central authority but the revenue is passed on to local authorities; it amounts to over 50 per cent of their total revenue. In addition there is a tax on a limited range of services.⁶)

The added-value tax consists of a series of partial levies spread over the processes of production and distribution. It may be computed in two ways, either by ascertaining the physical amount of added-value at each stage, and attributing a money value to it, or by subtracting the money value at the beginning of a production stage from that at the end.

⁴In Western Germany the basic rate of purchase tax is 4 per cent. Some necessities—gas, electricity, etc.—are exempt, and reduced rates apply to certain foods and to farm sales. Exports are exempt, but the calculations necessary to ascertain the amount of tax charged at the various stages up to that of export are sometimes rather arbitrary.

The liability of small farmers is on an estimated basis.

There are about 3 million taxpaying units, farmers comprising 30 per cent of the total number, and small handicraft producers about 23 per cent. (This tax provides over 40 per cent of the total Federal revenues.)

⁵In France the tax applies mainly to producers, wholesalers and building contractors. When making monthly returns taxpayers deduct from the tax due on their sales the tax paid on purchases during the previous month. For this purpose the tax on purchases has to be recorded on suppliers' invoices.

The tax applies to industrial and commercial transactions only—not to professions or agriculture. Certain products are exempt.

The tax does not operate at the retail level.

The "value" on which the tax is charged includes the tax itself. Where business is small the tax may be charged on notional instead of actual amounts.

The effective rate of added-value tax is at present about 24 per cent. The tax produces about 40 per cent of the total tax revenue.

The purchase tax in Italy is in part an added-value tax.

⁶Banking, transport, estate agencies and business agencies, etc.

The added-value tax has one major advantage, that it can be spread over the different stages of production and distribution without causing any serious financial disturbance. The ideal added-value tax should be at a single general rate if it is to be economically neutral, i.e. if it is to avoid bringing about any changes in relationship between the economic factors in a particular situation. (An added-value tax must be general and must be applied uniformly to all transactions if it is to avoid discrimination.)

An added-value tax is of its nature more complicated than any single-stage tax, and this probably accounts for the fact that it is so little used. If exports are to be relieved of the tax there may be great difficulty in computing the aggregate tax paid on commodities on which tax has already been paid at a number of stages.

10. Accepting that a single-stage tax would be the more suitable for this country, if a purchase tax were to be introduced here, it would seem that a tax at the wholesale stage is on balance preferable to a tax at the retail or the manufacturing stage. The fact that with a tax at the wholesale stage the number of traders affected would be less than one twelfth of those to whom a retail tax would apply (3,000/4,000 against 40,000/50,000) outweighs any disadvantages that might be attributed to e.g. possible "pyramiding" of the tax, trade disturbance on changes in tax rates, etc. With moderate rates of purchase tax such matters are unlikely to cause serious problems.

11. The tax at the *production* stage would not, it is thought be suitable for this country as imports form such a large proportion of consumer goods, and it would be difficult, with such a tax, to provide uniformity of incidence on imported and home-manufactured articles. Most of the minor disadvantages of a tax at the wholesale stage are increased if the tax is based on the production stage, and the compensating advantages are small.

12. The influence of purchase taxes on productivity has been the subject of close study in recent years, in particular by the European Productivity Agency of the O.E.E.C. A report published by that body in January, 1958, *The Influence of Sales Tax on Productivity*,⁷ contains an analysis of purchase tax systems in a number of European countries, with particular reference to their effect on productivity.

13. In this document productivity is expressed as the ratio of production to the factors of production—raw materials, energy, labour, and machine power—and consideration is given to devising a common unit of measurement to allow comparison of the various terms in the ratio. The method recommended is to convert each of the factors of production to its labour value, i.e. to take the wage cost of each of these factors.

⁷This Report was written by a consultant appointed for the European Productivity Agency of the O.E.E.C. (Project No. 315, Paris: January, 1958.)

14. Following a theoretical study of the matter the Report concluded that, to provide maximum productivity,

- (a) it is desirable that a purchase tax should be shifted in full to the consumer
- (b) it is undesirable to tax either energy or raw materials, or to have a multiple-stage tax, a cumulative tax or any tax which discriminates against machine power in relation to human labour. Furthermore the tax should not bear more heavily on capital goods than on labour.
- (c) where fiscal rather than social or economic considerations are paramount the most satisfactory tax is either a uniform general retail tax or an added-value tax charged at all stages in production and distribution; where this is not so, the preferred tax is that at the wholesale stage only, at selected rates (tax not to be applied to goods in the intermediate stages of production).⁸

A tax at the wholesale stage is not regarded as an obstacle to increased productivity, but it is stated that "it would not seem possible to evolve a system of taxation which would have a positive favourable influence on productivity", except one of highly discriminatory taxes.⁹

15. This O.E.E.C. Report does not touch on the practical problems of tax administration, but so far as it extends it supports the view that, even from the aspect of productivity, a purchase tax charged at the wholesale stage is probably the preferred form of tax in a country where social and economic considerations are not unimportant.

⁸The above conclusions disregard certain psychological and other factors not *directly* related to productivity, including concentration of industry and specialisation of industry.

⁹Report, page 73.

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⁹Report, para. 70.

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