

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

# Office Correspondence

To Mr. Despres

From Mr. Krost

Date July 25, 1940

Subject: The British Tax Structure

as Modified by the Budget of

July 23, 1940

### The British and American Tax Structures in 1939

Before the increases in taxes imposed at the outbreak of war in 1939, total taxes in Great Britain at all levels of government amounted to about 25 per cent of national income as compared with about 21 per cent in the United States. The distribution by type of taxation was, however, somewhat different in the two countries. In Great Britain, 37 per cent of public revenues consisted of income and death taxes, while in the United States only 26 per cent came from these sources. The largest single element, and the most important regressive element in the American tax structure, the property tax, was of much less importance in Great Britain because grants from the Central Government had gradually come to supplement and partly to replace taxes on property as a source of revenue to local governments. Taxes on residential property were about as high in Great Britain as in the United States, but there was no taxation of business property. Great Britain (like the United States) had heavy excises or custom duties on tobacco, liquor, sugar, and gasoline; there were heavy British taxes on tea, in contrast to the absence of taxes or duties on coffee in the United States; but Great Britain had no general sales taxes. Payroll taxes were of roughly equal importance in both countries.

Since the outbreak of war, there have been increases in the rates of every important tax in the British Government revenue structure

and an excess profits tax has been imposed. The Chancellor of the Exchequer, Sir Kingsley Wood, announced on July 23 further increases in the rates of existing taxes and the imposition of an extremely severe general sales tax, presented under the name of "purchase tax". The tax increases since the outbreak of War are estimated to yield \$1,500 million, about 7 1/2 per cent of the maximum national income, valued at pre-war prices. Meanwhile expenditures are proceeding at an annual rate of almost \$1 1/4 billion, or 70 per cent of the maximum national income, valued at pre-war prices. If this rate of expenditure is maintained an inflation of considerable magnitude seems inevitable; the first evidences of it are already visible.

Income Taxes Under the New Budget

The following table compares income tax liabilities of a married person with no dependents (with income wholly earned) in the United States under the rates of the Revenue Act of 1940 and in Great Britain under the rates proposed in the new British Budget. New York State income taxes have been added to the Federal taxes of the American taxpayer. For incomes drawn from capital gains and dividends, the comparison would be somewhat different since capital gains are not taxable at all under British law and dividends are not doubly taxed as they are in the United States. On the other hand, the British have no tax-exempt securities and tax the income of husband and wife as a single income.

Income	Taxes (Dollars)		Effective rate (Per cent)	
	Britain <sup>1/</sup>	U. S.	Britain <sup>1/</sup>	U. S.
1,000	38	--	3.8	--
3,000	658	31	21.9	1.0
5,000	1,366	164	27.3	3.3
10,000	3,546	828	35.5	8.3
50,000	30,996	17,328	62.0	34.7
100,000	73,496	50,376	73.5	50.4
1,000,000	882,995	792,584	86.3	79.3

1/ Conversion rate: £ 1 equals \$4.

The personal exemption for a single person in Great Britain is about \$400 as compared with \$800 in the United States; for a married person it is \$680 as compared with \$2,000 here and the exemption for each dependent is \$200 as compared with \$400 here. There is an earned income credit which corresponds roughly to the similar American credit. A single person with wholly earned income becomes subject to income tax in Great Britain if he earns as much as \$480 as compared with the corresponding level of \$890 in the United States.

The British income tax rate structure illustrates the point that a country that wishes to rely upon the income tax to cover a major portion of the cost of governmental services must impose heavy rates of tax upon incomes in excess of \$3,000 a year, that is to say, upon those families which belong to the upper 10 per cent of the income structure. The British taxes on incomes above \$75,000 are now the highest that have ever been imposed by any country. Income taxes in Germany now reach a maximum of 65 per cent on all incomes in excess of about \$30,000 a year.

The Excess Profits Tax

The present British excess profits tax was imposed in October 1939 to supplement a tax called the National Defense Contribution, which was merely a 5 per cent tax on business net income. The excess profits tax is levied on all enterprises, whether incorporated or not, with earnings of over \$4,000, except personal service enterprises. As initially imposed, the rate on profits in excess of standard earnings during the base period was 60 per cent. The base period may be, at the option of the taxpayer, the year 1935, or the year 1936, or the average of 1935 and 1937, or the average of 1936 and 1937. There is provision for administrative discretion to deal with cases of exceptionally low earnings in the base period; in such cases the administrative authorities may increase base period earnings to 6 per cent on equity capital, as determined by valuation of the assets of the business "as assets of a going concern". There is, however, no "ceiling" provision to substitute a maximum percentage return on capital for base period earnings for concerns whose profits in the base period were unduly high. Recent newspaper reports have stated that the rate of the tax has been raised to 100 per cent. It is possible that a liberal treatment of depreciation and other deductions from income and administrative generosity to exceptional cases may considerably reduce the income actually subject to this rate. With the information available, it is not yet possible to arrive at a conclusion as to the real significance of the 100 per cent rate.

Death Taxes

The following table compares tax liabilities for estates of varying sizes under the British Finance Act of October 1939 and under the existing United States estate tax as modified by the Revenue Act of 1940. Increases in the British rates are proposed in the new Budget but insufficient information is available to permit an adequate statement of the effect of the increases. The specific exemption under the American estate tax is \$40,000 plus an additional \$40,000 for insurance proceeds; the rate on the part of the estate in the first bracket subject to tax is two per cent. The exemption under the British legislation is £400 and the rate on estates in the first bracket subject to tax is one per cent.

Value of estate	Taxes (Dollars)		Effective rate (Per cent)	
	Great Britain	U. S.	Great Britain	U. S.
50,000	3,300	200	6.6	0.4
100,000	11,000	4,200	11.0	4.2
500,000	132,000	80,400	26.4	16.1
1,000,000	336,000	211,000	33.6	21.1
5,000,000	2,520,000	1,901,400	50.4	38.0
50,000,000	30,000,000	32,335,000	60.0	64.7

The American taxes exceed the British on estates of over \$25,000,000, but the number of estates of this size is so small that the rates at this level are of little practical significance from a revenue point of view.

The New Purchase Tax

The new purchase tax is a tax of the same type as the general

sales tax. Besides differing in name, it differs in the fact that it is collected in the first instance from wholesalers (who play a considerably more important role in the British marketing structure than they do in the American) and in that it levies a different rate on commodities classified as luxuries and on those classified as necessities. The proposed tax rate on luxuries is one-third of the wholesale price and the rate on necessities is one-sixth of the wholesale price. These rates will vary as percentages of retail prices from commodity to commodity, but, on commodities subject to a retail mark-up of 50 per cent (or  $33\frac{1}{3}$  per cent in terms of the retail price), the tax will amount to about 11 per cent on necessities and 22 per cent for luxuries. The list of necessities includes books and newspapers, thus breaking with an English tradition which dates back to the year 1836, when the use of taxes on newspapers as a means of political repression was successfully attacked by the rising Liberal party. The rates proposed for the purchase tax are more than twice as high as the rates which have been used for purposes of the general sales tax in any country in modern times.

#### Increases in Commodity Taxes

The taxes on tea, beer, tobacco, and admissions to entertainments have been drastically increased. The result of these increases is that beer of the cheapest quality will cost 15¢ a pint, cigarettes will cost 29¢ a pack and admissions to moving picture theaters will cost from 1¢ to 10¢ more than before the outbreak of War.