EXCESS PROFITS TAXATION*

Taxation has been defined as a method of raising revenue for a public purpose in which the community that pays it has an interest. It was also defined many years ago as the simple operation of taking a small portion from a perpetually accumulating mass, susceptible of almost infinite division. The latter definition may have had some merit in the so-called good old days. It could well be paraphrased now to define excess profits taxation somewhat as follows: "The complex operation of taking large portions from a disintegrating mass, susceptible of very little further division." Taxes are imposed for the support of a Government, in return for the general advantages and protection which the Government affords the taxpayer and his property. In the final analysis, taxation is the necessary compensation or premium payable by each one of us for the protection to our person and property which the State affords us, and for the liberties and the comforts which we enjoy under its protection.

The object of all taxation is to raise revenue, and excess profits taxation within its proper limits is, in wartime, the fairest and the best way to raise the money necessary to carry on total war as we know it today. Practically all businesses benefit directly or indirectly from war or from war-stimulated activities and on the merits of the tax itself, very little, if any, criticism can be levied against it. As to the amount of the tax, however, the situation is entirely different. It is obvious that the rate of excess profits taxation must not be such that the law of diminishing returns will apply, or that it can do irreparable harm to industries, to businesses and to the community in general. One of the principal objects of an excess profits tax Act is to prevent war profiteering apart from the need for revenue. One of the best arguments which can be advanced in support of it is that the Government is justified in taxing heavily the profits which its own activities have created.

Excess profits taxation is not new. During the last war, at least sixteen countries imposed this form of taxation. In Canada, the taxation was levied under the Business Profits War Tax Act which was repealed after the end of the war. Its operations were much criticized at the time. In the United States

*The present paper was prepared for delivery before the Commercial Law Section of the Canadian Bar Association at the 1942 Meeting which was cancelled owing to war conditions.

the Excess Profits Tax Act yielded for the years 1917 to 1922 inclusively, $7,113,581,410.00 and in one year, 1918, it yielded $2,505,565,939.00. In Great Britain, from 1915 to 1922, the tax yielded almost £1,185,874,000. and yet enormous fortunes were made in England, in the United States and in Canada during that period. In England in 1939, an excess profits tax was enacted which was restricted to the munitions industries but it was replaced in 1940 by a tax which applied to all businesses. In 1940, the United States enacted an Excess Profits Tax Act. In Canada, our Act was first enacted on September 13th, 1939, but it was entirely repealed in 1940 as and from the date of its enactment and a new Act was then enacted which was amended in 1941 and again in the recent session of Parliament which has just closed. Canada was the first country to impose an excess profits tax during the present war.

The name of the Act is misleading, in that it is not only an Excess Profits Tax Act but it is also an extension of the Income War Tax Act, because it provides for a substantial tax of, at least, the equivalent of 22% on all the profits of a corporation liable to the tax. The Income War Tax Act and the Excess Profits Tax Act are closely inter-related. The Income War Tax Act may be considered as the basic taxing Act upon which the Excess Profits Tax Act has been superimposed, and the jurisprudence and practice which have grown up in the last twenty-five years in regard to the Income War Tax Act are applicable in most cases in matters arising under the Excess Profits Tax Act.

The use of the word "Excess" in the title of the Act indicates, at once, that the Parliament of Canada has set a limit upon the profits of companies during wartime, because the meaning of the word "Excess" as found in *Corpus Juris* is "the quality or state of exceeding the proper or reasonable limits or measure, the state of going beyond limits", and in effect in enacting the Excess Profits Tax Act, our Parliament has definitely laid down that all profits which exceed the so-called standard profits (as defined in the Act) are profits which exceed the proper or reasonable limits and measure of profit that any person, individual or corporation subject to the Act should make during the war. In reducing the meaning of the word "Excess" to a mathematical basis, we find that Parliament has, in effect, very definitely laid down that any company subject to the Act cannot make an amount in excess of 155.69% of its standard profits, for the period prior to the 30th day of

June last, without being liable to excess profits tax, and that as and from the 1st day of July last by reason of the recent amendments the 155.69% maximum is now reduced to a figure of 116.66% of the standard profits. Any company, therefore, cannot now make more than 116.66% of its standard profits, as determined under the Act, as the 100% excess profits tax in force takes the excess. In the case of companies which file consolidated returns, the maximum profit which can be made is 117.41% of the standard profits.

All companies are also subject to the 18% tax imposed by the Income Tax Act, and a tax of 20% in the case where companies make consolidated returns. The Excess Profits Tax Act, as recently amended, provides that all companies must pay a tax of 12% on all their profits which, added to the 18% income tax, makes a total tax of 30% on all the profits, to which there is added the greater of (a) a 10% tax on the total profits or (b) a 100% tax on the excess profits after deduction of the Income Tax of 18% and the 12% excess profits tax. Consequently, every corporation starts out with a minimum tax of 40% in any event so that the net result is that no company can make, after taxation, more than 70% of its standard profits, and all profits over 116.66% are liable to the 100% excess profits tax.

As any Excess Profits Tax Act can only, from the very nature of its name, be based upon profits which are above a certain level, there has to be determined some way at which to arrive at the basic level of profits beyond which the tax applies. The labourer is worthy of his hire and it is a recognized rule in every democracy that every person is entitled to a fair and reasonable profit. The difficult question from the excess profits tax point of view is whether fair and reasonable profits should be determined on the basis of the capital invested or employed in the business or on the basis of earnings, and particularly if they are to be determined on the basis of capital, what should or should not be included as capital. In the Act which was enacted in 1939, Parliament gave each taxpayer his option to choose to be taxed upon one of two bases — First: On profits in excess of 5% of the amount of capital employed by the taxpayer in the business at varying rates, commencing at 10% and extending up to 60%, or, Second: 50% on profits in excess of the average annual income of the taxpayer for the years 1936 to 1939 inclusively.

The Act of 1939 was more or less a makeshift Act. It was drafted in a hurry to meet a public demand that war profiteering should be curbed, and it was anticipated at the time that extensive amendments would be made, so that its complete repeal in 1940 caused no surprise. With its repeal the capital basis of determining excess profits was dropped in favour of the income or revenue basis.

It is obvious that some companies require large capital to yield small earnings, and other companies require only a small capital to yield large earnings. It is difficult, if not impossible, to tax all companies fairly on a basis of the amount of capital employed in the business. A tramways company, before it can make a five-cent or a ten-cent fare, requires a capital investment of probably many millions of dollars, whereas a bond dealer or an insurance firm requires a relatively small capital outlay to make in many cases very large profits. It is impossible to fix a set return of say 8% upon capital whether it be the net equity capital, invested capital, or capital on any basis and begin to be fair to all persons, because any fixed return will be too low for some and too high for others, bearing in mind all the varying factors which each industry or business must contend with. On the other hand, a tax which is based on earnings alone is probably fairer, in most cases, if the law allows reasonable standard profits or normal earnings before applying any excess profits tax. It prevents war profiteering more effectively than a capital basis because it taxes the increase in earnings over the average earnings and generally such increase represents the extra profits resulting from wartime activity or stimulation. The criticism levelled at the 1939 Act was that a corporation had the choice of being taxed upon either basis and, naturally, and rightly so, the corporation would choose the basis resulting in the least taxation. In effect, therefore, the first Act really suffered from the evils inherent to both methods, and the taxing authorities did not stand to benefit from what was good in either method in view of the fact that the taxpayer had the option. That is the criticism which is levied at the United States Excess Profits Tax Act which incorporates both methods and which gives the taxpayer the option. Some authorities claim that the result will be that the yield in the United States from the tax will be most disappointing and that the Act will fail of its purpose and will not prevent excess profits.

Although our 1940 Act adopted an average profits or earnings basis, yet in default of any better method a capital base was provided for the purpose of determining the standard profits of depressed and new businesses. The average earnings basis discriminates in favour of companies with large earnings during the basic period, because those large earnings remain protected, whereas companies which did not do so well during the basic period are subject, on a comparative basis, to heavy and perhaps oppressive taxation. Young companies which are just getting into their stride during the standard period are also heavily penalized by the Act and their natural development is prevented or circumscribed. Any basis of excess profits taxation is bound to produce inequality. The theory behind an average earnings basis is that if companies were able to survive with the income which they made during the base years, they should be able to survive an excess profits taxation which purports to tax only profits in excess of the standard profits of the base years, but the weakness of the Canadian Act, however, is that it does not limit itself to excess profits taxation, but it applies a minimum tax of 22% upon all profits, which tax should form part of the Income Tax Act and not any part of the Excess Profits Tax Act, and which tax imposes a very heavy burden upon companies before the excess profits burden is applicable.

The United States Excess Profits Tax Act which was enacted in 1940, gives the taxpayer an option — that is an annual choice between two methods. One option is based on the average earnings during a base period — that is during the years 1936 to 1939 inclusively — which is similar to our own Act, and the other method is the invested capital basis. Under the average earnings option the tax credit is figured by taking 95% of the average annual earnings before the normal income tax for the four fiscal years commencing January 1st, 1936. This credit is deducted from net income before provision for surtax, normal and excess profits taxes and the excess, if any, is subject to the excess profits tax rates. An allowance is made for an increase in invested capital by granting an exemption of 8% on the amount of such increase. The invested capital option provides a credit of 8% on the first $5,000,000.00 of invested capital and 7% on any amount in excess of this figure. Invested capital is defined as equity capital plus 50% of borrowed capital. This credit is deducted from current net income before provision for taxes and after adding back 50% of interest charges on borrowed money. The excess is then subject to the excess profits tax rate. Allowance is made for increase in new capital by allowing the increase of new capital to be included in the invested capital base at 125% of its value. In 1941, an interesting amendment was made to the United States Act which was designed to help what were termed "growth companies". By this amendment total net earnings before taxes for the years 1936 and 1937 are deducted from the total net earnings before taxes for the years 1938 and 1939. One half of the resulting difference is then added to total net earnings before taxes for the years 1938 and 1939 and the total is divided by two to determine the average earnings. The tax credit is 95% of the result. If, however, the resulting figure should be higher than the net earnings before taxes for any one of the base years, then 95% of the highest earnings year must be used. This credit is applied against income before taxes and the excess is subject to excess profits tax.

In Great Britain the excess profits tax is based upon average earnings and not upon invested capital. The base years there are 1935, 1936 and 1937, and the taxpayer has the option of choosing the earnings of the year 1935 or 1936 or the average earnings of the years 1935 and 1937, or of the years 1936 and 1937 but not of the years 1935 and 1936 together, or 1937 alone. Pre-war excess profits tax in Germany was based also upon the average earnings basis while the pre-war excess profits tax in France used an invested capital basis. In Australia, upon the introduction of their excess profits tax Act, an invested capital basis was also used. New Zealand uses an average earnings basis for its excess profits tax.

The most important thing in any Excess Profits Tax Act which uses an average earnings base is the fair and reasonable determination of the average earnings or standard profits as they are called in our Act. In the 1939 Act, the tax was based on the profits in excess of the average income of a taxpayer as determined under the Income War Tax Act for the four years 1936 to 1939 inclusively, or for the four fiscal periods of the taxpayer ending in such years or for such of such years or fiscal periods during which the taxpayer may have been in business, taking into account profits and deficits. This basic period of four years resulted in many objections being made because none of those four years was for most companies a good year when compared to the years between 1920 and 1939. The majority of companies made profits in the years 1936 to 1939, and those years were probably the best years since 1930 for most companies. It would have been unfair to the taxpayer to have chosen any years between 1930 and 1936 and unfair to the Government to have chosen the years between 1925 and

1930. In the United States, it was even suggested that the base years should be 1924 to 1927 inclusively, but obviously such a base would have created too much confusion and difficulties. In the last war, Germany and Austria averaged the earnings of the three years out of the five years preceding the outbreak of the war by excluding the best and the worst years, which appears to have much merit.

The first question which arises under the Act is "What is an excess profit?" and the Act gives a definition which, for conciseness, could not be improved upon. Excess profits are defined as meaning that portion of the profits of the taxpayer in excess of the standard profits. It is not difficult, therefore, to determine in most cases what the excess profits are because before their amount can be determined it is necessary to ascertain the standard profits. In fact, the determination of the standard profits is the most important part of the Act, being of its very essence, after, of course, the charging provisions.

Profits in the case of a corporation or a joint stock company for any taxation period means the amount of net taxable income of the corporation or the company as determined under the provisions of the Income War Tax Act in respect of the same taxation period except that where the 100% tax is applicable, a dividend deemed to have been received by certain companies from a company which is being wound up or re-organized, is not included in the profits. In the case of a taxpayer other than a corporation or a joint stock company, profits means the income of that taxpayer derived from carrying on one or more businesses and before any deductions are made therefrom under any of the provisions of the Income War Tax Act.

In attempting to fix standard profits of taxpayers, the Act had three classes of corporations to consider; first of all, corporations which were in business during the years 1936 to 1939, the standard years; secondly, the corporations which commenced business after the 1st of January 1938, which are termed the new businesses; and thirdly, the corporations which, during the standard period, did not earn a fair return on their investment and which are termed the depressed businesses.

The definition of standard profits was introduced into the Act in 1940, amended in 1941 and again recently. They now mean the average yearly profits of a taxpayer in the standard period in carrying on what was in the opinion of the Minister the same class of business as the business of the taxpayer in the year of taxation. Property in any form received by a taxpayer deemed to be the payment of a dividend from a company which is being wound up or re-organized is included as forming part of the profits for the purpose of the 12% or the 10% tax but not for the 100% tax. In the case of new or depressed businesses, standard profits are the profits as ascertained in accordance with the provisions of section 5 of the Act which I shall refer to later. In effect, standard profits for companies in business during the base years mean the profits in the standard period from the 1st of January, 1936, to the 31st of December, 1939. One very important amendment was made in 1941 which altered the basis of computation of the standard profits and which brought relief to many taxpayers. Previously thereto the taxpayer had to take the profits in the four years in question and divide them by four and so arrive at his standard profit. By the amendment of 1941, any taxpayer whose profit in any one of the years was less than 50% of the average of the profits for the remaining years of the standard period had the right to select the remaining years as his standard period. Let us suppose that a company made $100,000.00 per year in 1936, 1937 and 1938 but that in 1939 its profits dropped to $10,000.00. The total profits for the four years amounted to $310,000.00 and prior to the amendment a taxpayer would divide that figure by four, leaving a standard profit of $77,500.00 yearly; but after the amendment the taxpayer was entitled to leave out the profits of 1939 for the purpose of his calculation so that he would take the profits only of 1936, 1937 and 1938, a total of $300,000.00 and divide by three, which would leave him with a standard profit of $100,000.00, an improvement of $22,500.00 yearly, which is a very substantial benefit to the taxpayer with the present 100% excess profits tax.

In arriving at the standard profit, the losses in any one year cannot be deducted from the profits of the other years except under the 50% rule; for example, if out of the four years a taxpayer lost money in two of them, he could drop one of those years under the 50% rule but he could not drop the second year so that consequently he would have to divide the profits of his other two years by three to arrive at his standard profit.

One question which has presented itself to many companies is the case where the fiscal year differed from the calendar year. The fiscal years of many companies do not correspond with the calendar year and, therefore, companies whose fiscal years ended prior to September, 1939, did not participate in the upward surge of profits which took place in the last quarter of 1939. In order, therefore, to fix the standard profits of all companies on the same basis of time, the Act provides that profits shall be deemed to have accrued on an equal daily basis throughout any fiscal period or portion thereof which fell into the four year period so that on this basis the profits of any company for the standard period can be ascertained. All taxpayers are, therefore, on the same basis in so far as the basic period is concerned.

The law provides that where there has been any increase or decrease in capital since the end of the standard period, then an amount of 7½% per annum of such capital can be added to or subtracted from the standard profits on account of the alteration in capital. This provision for re-adjustment of standard profits incidental to the increase or decrease of capital is, of itself, a recognition by the Act of the fact that the amount of capital in a business is a factor which must be always taken into account in endeavouring to arrive at an average earning basis. With regard to companies, such increase or decrease of capital must be accompanied by an equivalent alteration in capital stock. The Act similarly provides for an adjustment on the basis of 7½% for increases or decreases in capital during the standard period. In the United States, 8% is allowed on the increase or decrease in such capital. The rate of 7½% is too small for many companies and, at the very best, probably only sufficient for most companies. First grade bonds which offer security of capital can now be bought at prices yielding around 3% to 4% and with the heavy income tax and other taxes, there is not much incentive to taxpayers to add new capital to their business if the return is only going to yield them very little above what they would get in investment in bonds of the first grade, particularly as in bond investment there is very little risk involved. In any event, whether the rate be 7½% or any greater one, that rate will always have to be an arbitrary one, but the higher the rate is, the less harm will result to the taxpayer. A lower rate may mean less immediate revenue to the Government, but eventually such loss should be more than equalized by the fact that more people will be disposed to take the risks inherent to increased capital participation for the sake of the extra profit if that profit is attractive enough, which can only result in an increased volume of business and in a greater amount of taxes from a greater taxable mass. Canada cannot remain static. It is a country which is only in the commencement of its full development; a country where capital has a great role to play in that development, and it is unwise to stifle or prevent the employment of new capital by oppressive taxation. Before leaving the subject of standard profits, it should be pointed out that if the capital has increased by 33⅓% a taxpayer has the right to apply to the Board of Referees to be ranked as a new business for the purpose of having his standard profits determined.

From the legal point of view, the provisions for determining the standard profits of companies which were in existence in the years 1936 to 1939 are not of much practical consequence in most cases, because under the Act and its interpretation, the determination of those profits to a large extent is mathematical calculation, but the determination of the standard profits for new and depressed businesses is of more importance to the profession. The law lays down that any business which commenced on or after the 1st of January, 1938, must be treated as a new business, and in connection with determining the standard profits of new businesses, the capital basis is used. The question as to what is capital is, therefore, a most important one. The Act says that capital means capital as computed in accordance with the first schedule of the Act and the first schedule provides rules for determining capital which will always be a source of much trouble and argument, but of no litigation because of the arbitrary provisions of the Act which prevents recourse to the courts, which I shall refer to later.

The capital with which the Act is concerned is the net equity capital or the net worth capital. The word "capital" is supposed to be derived from the Latin word "caput" meaning a "head", and as the head is the important part of a body, so is capital the important part of an enterprise or an industry. What is and is not capital is a matter of much dispute and for the purpose of any Excess Profits Tax Act, the necessity of defining it is obvious. It is necessary to get at the true value of the capital employed in order to determine a fair rate of return. The cost of assets of a company acquired by purchase on and after the commencement of a business forms part of capital. The value of such assets is taken at the price at which they were acquired and where the price was not a cash price, the value of the consideration at the time that it was actually given is deemed to be its price. Where cash was actually given, no question arises, but one of the difficult problems which does arise is in the case where assets were purchased for shares, which has been such a common practice. There is no limitation upon the nature of the assets to be valued. Goodwill, patent rights, copyrights, are all entitled to have a value placed upon them in determining the total value of the capital employed, if they were acquired for value. Actual value is the test. In so far as new businesses are concerned the problem of valuation which the Board is confronted with, is probably not very formidable because, at least, the assets were acquired since the 1st of January, 1938, but in determining the value of assets of depressed businesses, many difficulties have to be dealt with, particularly in the case where a business has been operating for twenty or thirty years and had the misfortune to be in the depressed class during the standard period or to have been re-organized, merged or consolidated. Accounts receivable less a proper reserve for bad debts, are taken at their full value and amounts of money or bank deposits actually used by the taxpayer in the business, are also allowed.

The first important deduction from capital is the amount of any Government subsidy contributed directly or indirectly by the Dominion or any Province towards the acquisition by the taxpayer of any asset of the company, which has been included as forming part of the capital of the company. In connection with its wartime construction and development programme, the Government of Canada has had to participate in business in a big way and has had to finance expansion which could not otherwise have been financed by individual companies. While it is probably fair to deduct the amount of any such government subsidy, such a company has undoubtedly assumed a larger risk as a result of employing the subsidy in its business, and a larger return on its capital would appear justifiable because of the risk and of problems arising from the management of a larger enterprise than would otherwise have been necessary if no government subsidy had been given. The acceptance of government subsidies is not welcome to all companies, particularly to well-managed companies with much peace-time production and efficient operation. Depreciation is also deducted from the value of the company's assets, in accordance with the practice and regulations of the Income Tax Department so that the value of any asset is only the depreciated value thereof. The rules of the Income Tax Department with regard to depreciation have been formulated since the 1st of January, 1917, and generally speaking they constitute a fair appraisal of the depreciating value of assets, and where they err, they err usually not on the side of the taxpayer. The Board of Referees is given the power to deduct such amount on account of depletion as it may deem fair and reasonable.

Debts and borrowed money are also excluded from forming any part of the capital. The question as to whether or not borrowed money should be included or excluded in determining the capital of a company is one which gives rise to much discussion, in respect of which there are weighty arguments for both sides. If a taxpayer legitimately borrows $10,000.00 from the bank to use for the purposes of his business, and he loses that $10,000.00 he must still repay his debt to the bank, but under our Act he is not entitled to make any return or profit in respect of it while it remains in the business. A taxpayer is entitled to deduct as an expense the interest paid on the borrowed money, but there is no incentive for him to borrow money to increase his business. The Government pays no part of the loss if borrowed money is lost and it deprives him of any prospect of profit on that capital. I suppose that the major portion of our industries today are working on war orders but war orders are not necessarily advantageous to every industry or business. They require in most cases capital outlays for new equipment to manufacture things which are difficult of manufacture and the equipment may be of no use after the war. An industry therefore may not care to borrow under the circumstances when it receives no consideration for the extra risk which it runs. In the United States Excess Profits Tax Act, half of borrowed money is allowed as forming part of the capital and interest on one-half of the borrowed capital is allowed as an expense. The reason for including borrowed capital as part of invested capital in the United States was to help small companies which had difficulty in obtaining capital from the sale of capital stock and because it was feared that over-expansion might be encouraged. In the last war the United Statse completely excluded borrowed capital. In England, borrowed capital is included as forming part of the total capital, but the interest paid on borrowed money is not allowed as a deduction in determining the earnings. An 8% return is allowed in England on new capital so that a company which comes within the provisions of the law in this respect, will benefit to the extent that the 8% return on the borrowed money exceeds the rate of interest paid thereon to the lender.

Once the Board of Referees has determined the amount of capital which is in the business, the problem of determining the standard profit is usually simplified. The Act provides that a taxpayer who believes himself to be in the depressed business class may compute his standard profits at a rate not to exceed interest at 10% per annum upon the capital employed. The Minister of National Revenue may accept this computation but, if not, he may refer the matter to the Board of Referees and the Board may allow an amount equal to the average yearly profits of the taxpayer during the standard period or equal to interest at the rate of not less than 5% nor more than ten per centum per annum on the amount of capital employed at the commencement of the last year or fiscal period of the taxpayer in the standard period. A recent amendment provides that the Minister shall have the right to assess the taxpayer in place of referring the matter to the Board. As various provisions of the Income Tax Act apply to the Excess Profits Tax Act, it appears that a taxpayer could appeal to the Exchequer Court from any assessment made by the Minister whereas if the assessment were made by the Board of Referees and approved in the manner provided by the Act it is final and conclusive. If the taxpayer is carrying on a new business, that is, a business commenced after the 31st of December, 1937, the Minister is obliged to direct the Board to ascertain the standard profits, and in such a case the Board determines them on the basis of an amount equal to a return on the capital employed by the taxpayer at the commencement of the first year or fiscal period in respect of which he is subject to taxation at the rate earned by taxpayers during the standard period in similar circumstances engaged in the same or an analogous class of business. The question of determining the profits of new businesses, therefore, is difficult and calls for an exhaustive study by the Board of the industry, trade or business concerned, before a fair level of standard profits can be fixed for a new entrant. The test is a very arbitrary one because a particular trade or industry might be composed of only two or three companies, all of which might have done poorly during the standard period by reason of mismanagement or other such cause, so that a new entrant would be penalized in his profits as a result of causes which would not be applicable to him. In the case of new companies, the limitation of 10% does not apply, and, theoretically, the Board has the power to grant and appropriate standard profits, bearing in mind all the circumstances. It is difficult to see how the Board could take into consideraton any other than the published figures of taxpayers in similar circumstances in determining the standard profits for a new company. Mr. Justice Harrison, Chairman of the Board, has stated that — "The

Board has come to the opinion that no uniform rate of return upon capital can be ascertained for any industry which would do justice to the diversified circumstances of all members of such industry" — which is a very fair statement of the situation and demonstrates the difficulties facing the Board.

The Board is also given broad powers to determine standard profits for taxpayers in the depressed or new business classes in cases where a capital standard is inapplicable because of the fact that capital is not an important factor in the earning of profits or it has become abnormally impaired, or due to other extraordinary circumstances is abnormally low, if the standard profits ascertained by reference to the capital employed would result in the imposition of excessive taxation amounting to unjustifiable hardship or extreme discrimination or would jeopardize the continuation of the business. The businesses intended to be covered by this provision are those of insurance brokers, real estate agents, stock brokers, etc., where, as a rule, very little capital is required. These companies depend upon the earning power of the individuals composing the companies. In cases of this class, the Board must have regard to the standard profits of competitors and must determine an appropriate standard, based upon two premises — (a) a low or impaired capital, and (b) the necessity of preventing the imposition of excessive taxation amounting to unjustifiable hardship or extreme discrimination or jeopardizing the continuation of the business.

The Act also provides for a special treatment for new gold mines and oil wells, which have come into production since the first of January, 1938. Gold mines and oil wells are both very important to Canada's war effort. Oil is what our war machine runs on, and gold is what we need to pay for the things we require to run our war machine. Consequently, the development of gold and oil in Canada is absolutely essential. The reason for the Lend-Lease programme of the United States was principally the inability of Britain to find the money to finance its war purchases and the reason for Canada's recent $1,000,000.00 gift to Britain was the same. Canada is one of the world's great gold producing countries and as gold will probably always remain the standard of value, irrespective of what theories are advanced relating to standards of value, it is urgent that Canada's gold supply be not only maintained but increased, not only for the war effort but for the re-construction which will come with peace. The necessity of oil during the war needs no comment, but when peace comes, the oil problem will disappear and we shall probably be back to the programme of restricting production, but not so with gold. The price of gold during the standard period was $35.38 an ounce, and its present value is $38.50 an ounce, so that it has increased $3.12 per ounce. Consequently, new gold mines are taxable for excess profits to a maximum extent of $3.12 per ounce, depending upon their expenses, and oil wells are taxable on a similar basis. The idea is to tax the increase in price of these products resulting from wartime activity but not to hinder or prevent the search for gold and oil which is a very expensive and hazardous business and in which fortunes can be easily and quickly lost. A recent amendment provides that the profits of any company derived from the production of base metals or strategic minerals which comes into production in the three calendar years commencing January 1st, 1943, shall be exempt from taxation for its first three fiscal periods after it comes into production. A similar exemption is contained in section 89 of the Income Tax Act and it applies to companies operating metalliferous mines which come into production prior to the 1st of January, 1943. The Minister of Finance in introducing the Budget stated that the exemption formerly granted under the Income Tax Act in this matter was being transferred to the Excess Profits Tax Act.

The Act contains provisions for an inventory reserve against future depreciation in inventory values for companies which are subject to the 100% excess profits tax. Under the Income Tax Act no inventory reserve is permitted. Every business man is subject to profit or loss in respect of changes upwards or downwards in the value of the stock in trade although our price control programme has controlled prices to some extent. It is probable that after the war we shall witness a large decline in inventory values similar to that which occurred after the last war when many businesses were ruined by the fall in prices. It must be borne in mind that companies which are subject to the 100% excess profits tax are also subject to an additional 30% taxation on standard profits, and other companies not subject to excess profits taxation are liable to 40% tax, in addition to a multitude of other taxes. In fact, the war has taken the profit out of business and if companies are not allowed to reserve adequately against inventory losses, business conditions may be very chaotic when the inevitable collapse comes after the war. The inventory reserve provision in the Act is an attempt to protect companies able to take advantage of it from inventory losses by reason of decline in values below 1939 values but there is no guarantee that prices will not go very substantially below 1939 values. The reserve allowable is only an amount equivalent to normal quantities on hand during the standard period and no allowance is permissible in respect of stock acquired in connection with the war effort above what would be normal upon a peace-time basis. Moreover, the reserve must be utilized within one year after the repeal of the Act and if not exhausted by then, it will be added back to the profit of the last year in which the Act was in force and taxed accordingly. Unless therefore the decline in inventory value takes place within the year following the repeal of the Act, which may not occur, this provision will not be of much assistance to business. It would appear that the heavy increase in taxation would justify a broader policy on the part of the Government with regard to this important matter, in order to assist industry and business in re-adjusting itself to a peace-time economy.

The Act exempts the profits of a profession from liability to taxation if the profits are dependent wholly or mainly upon personal qualifications and if little or no capital is employed. There is considerable jurisprudence as to what a profession is and the British Courts have distinguished a profession from a trade or business on the basis that a profession demands intellectual skill whereas a trade or business is substantially the production or sale or arrangements for the production or sale of commodities. A professional man has only his time, his brains and his ability to sell and as his time is limited to his working day, his profits are likewise limited. He receives income only while he works and illness, absence and such causes reflect themselves immediately in his remuneration, which may be large or small depending entirely upon his own individual efforts in most cases. At one time, theology, law and medicine were accepted as being the professions but the concept of a professional man has grown and for the purpose of the Excess Profits Tax Act there are many who come within this category including the clergy, lawyers, notaries, doctors, dentists, accountants, engineers, professional athletes, barbers, hairdressers, masseurs, chiropractors and others.

The Act accorded originally an exemption to small businesses which did not earn over $5,000.00 a year but under the recent amendment this exemption was limited to individual taxpayers and partnerships. Corporations in this category are now subject to the 12% tax but exempt from the 10% tax and 100% tax. There is a $5,000.00 exemption under the United

States Act and it is estimated that only 70,000 of the 500,000 corporations will be liable to taxation, the balance of about 430,000 being under the $5,000.00 level. Various other exemptions are accorded, such as to personal corporations, non-resident owned investment corporations, diversified investment corporations, municipal undertakings, labour organizations and generally the non-profit organizations set out in the Income Tax Act.

My remarks have dealt principally with the application of the Act to corporations but it applies equally to individuals and partnerships who reside or are ordinarily resident in Canada or who are carrying on business in Canada if they derive profits from carrying on business as defined by the Income War Tax Act. No tax is imposed upon a partnership as such under the Income Tax Act, under which the income of a partner is taxed as personal income of the partner in question but partnerships are now liable to a tax as such under the Excess Profits Tax Act. The English Act taxes individuals and partnerships but the American Act taxes corporations only. Partnerships and individuals are liable to the greater of (a) a 15% tax on all their profits or a 100% excess profit tax. In calculating their profits, deductions allowable under the Income Tax Act which are personal to the taxpayer such as the allowance for a wife and children, are not allowed; only so-called business deductions being permissible such as depreciation, depletion and so on. An allowance of $5,000.00 as salary is also granted but in so far as the 100% tax is concerned, this allowance means nothing as a similar deduction is made in computing standard profits.

One recent and very important amendment permits the deduction from profits during any taxation period of an amount equal to the revenue losses of the taxpayer in the immediately preceding year. This amendment has removed a very serious source of complaint.

Two provisions of the Act which require special comment are subsection (b) of section 8 and section 15. Subsection (b) of section 8 gives the Minister absolute power in his discretion to disallow any expense which he believes should be disallowed as being in excess of what is reasonable and normal for the business or which was incurred in respect of any transaction which in his opinion has artificially or unduly reduced profits. Section 15 gives the Treasury Board power to disallow for tax purposes transactions, which, in their opinion, artificially reduce taxation and have no reasonable business purpose other than that of avoiding or minimizing taxation. These are very broad powers which should only be exercisable by a court or by an independent tribunal. The right of appeal of every citizen to a court of justice or an independent tribunal should be preserved. Apparently these provisions are intended to prevent tax-avoidance by preventing abnormal or extravagant expenditures and to prevent tax-avoidance transactions. Unfortunately the dishonest and the honest taxpayer are affected equally by the exercise of such powers and neither has any recourse in case the Minister or the Treasury Board have erred in their decision.

A recent amendment to the Act provides for a refund to the taxpayer after the war of an amount equal to 20% of the profits above the point at which the tax calculated on the 10% basis equals the tax calculated on the 100% basis. The amount of the refund is a mathematical calculation. It is a compulsory saving scheme which is being tried out as an economic theory. The merits of it remain to be demonstrated. No interest is payable on the amount of the refund although refunds due under the Income War Tax Act to individual taxpayers bear interest at the rate of 2%.

The Act provides for the setting up of a Board of Referees for the purpose of aiding and advising the Minister in determining the standard profits of new and depressed businesses and in cases where a capital standard is not applicable. An address given by the Chairman of the Board, the Honourable Mr. Justice Harrison of the Supreme Court of New Brunswick, before the Ontario Division of the Canadian Bar Association in Toronto last February explains well its functions. My criticism is of the law and not of the Board. Mr. Justice Harrison stated that he found himself very much in agreement with the objections set out by Lord Hewart in his book "New Despotism" to the encroachments of bureaucracy upon the function of the courts. The decision of the Board is not final. It must be approved by the Minister of National Revenue and if he fails to approve it, it must be submitted to the Treasury Board for final decision. The decision of the Minister or the Treasury Board as the case may be is final and conclusive. The Minister of National Revenue sits on the Treasury Board and therefore sits in appeal on his own decision. The Minister of Finance who introduces excess profits tax legislation sits as Chairman of the Board. The Treasury Board is an executive body and not a judicial body. It is composed of the Minister of Finance and any five of the Ministers belonging to the King's Privy Council for Canada nominated from time to time for the purpose. It is in effect a committee of the Cabinet. The Excess Profits Tax Act has deprived the taxpayer of his appeal to the courts or to an independent tribunal in very important matters which is very definitely wrong and undemocratic. The decision of the Board of Referees should be final and conclusive and they should be set up as an entirely independent body free from any control of the taxing authorities to adjudicate as between the Minister and the taxpayer or else the ordinary recourse to courts of justice should be permitted. Encroachments of this kind which interfere with the free rights of a citizen to have recourse to the courts or an independent body are a wedge and a basis for the eventual destruction of liberty. As a war measure, encroachments upon liberty are justifiable in many cases but not in cases of this kind. It is the duty of every liberty-loving citizen immediately the war is over to do his part to sweep out of existence every encroachment upon the rights of personal freedom and liberty resulting from the war because if we fail to do this, our fight for our democratic way of life will have been in vain.

I have not endeavoured in my address to discuss jurisprudence and decided cases. The provisions of the Act are express and require factual treatment in most cases and I thought that a general review of the whole excess profits tax situation would be of much greater interest than a discussion of abstract problems of law which might arise thereunder. The excess profits tax is of great interest to all of us because directly or indirectly it affects or will affect each one of us. A confiscatory tax of 100% or 75% strikes deep into the life and living conditions of every person because it definitely affects our way of life. The necessity for heavy taxation is manifest. If excess profits taxation produces the money to win the war it is more than abundantly justified. Its chief critics claim that it will destroy initiative and hope, that it will undermine the very foundation upon which Canada has grown great industrially and commercially and that it will fail to accomplish its purpose. We are in the midst of a social revolution, a period of change from an order of things under which we have lived happily and prospered in the main. Money has been for the most part the aim and the goal of the order and unfortunately so. An excess profits taxation is one means of equalizing the scale but it would be very unfortunate if it destroyed our freedom of enterprise in doing so. The right to have private property is inherent to man as also is his right to use it subject to such control by the State as may be necessary to prevent its improper employment to the detriment of others. If democracy is to be preserved as our way of life, it can only be preserved as a system in which one is permitted to employ his own property at his own risk for gain or loss and if taxation prevents that, then we shall rapidly drift into some form of a socialistic, communistic or fascist State depending upon the character, the moral strength and type of the men who may be in control of things in the transition period. Excess profits taxation is a necessary war measure but its effects can go far beyond its announced purpose to raise revenue. It must not be allowed to damage our social fabric beyond repair because in winning the war we might lose the fruits of the peace if we destroy by taxation our industry, our trade, our commerce and our business, which are responsible in a large part for our magnificent war effort. The repeal of the tax immediately at the conclusion of the war is in any event a prime requisite.

FREDERICK T. COLLINS.

Montreal.