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Income Tax and Depreciation

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more than the germ of a fuller system. That the whole question of land taxation raises serious issues, especially in respect to the position of land as an article, limited in quantity, and therefore acquiring a "scarcity" value, is a reason for caution in its treatment; but to those who accept the arguments of Mill and Cairnes, the grounds on which the taxation of increased land-value is based are sufficiently weighty to justify the proposed taxation of fresh increment value and reversions. The great complications surrounding the actual holding of land, and especially urban land, make the attempt to intercept some of the surplus value for the public use, without disturbing just claims, an extremely arduous task. A highly tentative measure, like the present, is probably the most in accordance with English traditions, as it allows a field for experiment, and does not involve any heavy loss to those coming under its operation. The very exaggerated claims put forward in some quarters as to the advantage of bringing land into the market will also be tested, without undue sacrifice. As a fiscal expedient the land taxes will not, in all probability, prove of service, unless they are carried much farther than is contemplated by anyone outside the circle of Socialism.

No really satisfactory judgment can be formed on the more technical parts of the Budget until the Finance Bill is introduced, for a good deal depends on the precise wording of the provisions of the projected law. The broad outline is easily discernible, and it leaves the impression of a scheme, framed on the lines of the policy shown in the whole course of recent liberal financial ideas. The limitation of indirect taxation to spirits and tobacco, the great expansion of the direct taxes, and the conception of obtaining funds for social reform, are so many indications of this character. As an agency for accomplishing the desired aims, the Budget chiefly fails in its excessive complication, and perhaps also in its want of proportion. Nearly every side of the revenue system is touched, but in a way that renders it hard to perceive the results to be expected. The great Budget of 1853 was, indeed, a vast and complicated performance; the conditions of that time were, however, entirely different, and Finance Ministers of the calibre of Gladstone are not easy to find.

C. F. BASTABLE

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#### INCOME TAX AND DEPRECIATION.

THE following is the text of a speech made by Mr. P. D. Leake on the occasion of a deputation to the Chancellor of the

Exchequer, December 16th, 1908, on behalf of the Income Tax Reduction League.

The second part of our petition shows that the present method of assessing Income Tax is inequitable and inexpedient, especially with regard to the insufficiency of the allowance for depreciation of wasting assets, and urges that more just and scientific methods should be employed.

We submit that, in assessing profits to Income Tax, allowance should be made for depreciation of all inherently wasting assets, where such depreciation arises out of, and is necessarily incidental to, the earning of such profits, and that the amounts of such depreciation written off in the books of account recording such profits be accepted as the measure of the actual depreciation, in the absence of evidence proving that such amounts are excessive.

Allowances of this kind, therefore, would not include the depreciation taking place in the hands of individual purchasers of such assets as leaseholds, patent rights, and similar sources out of which taxable profits arise, the sole foundation of such claims being some prior transfer of rights from one to another, whereas this class of property may be transferred by purchase from one individual to another without impairing the annual value or profit-earning capacity, which must in all cases be taxed in one sum at the source, a principle which is regarded by the highest authorities as necessary to the efficient administration of the Income Tax. Thus, although property of this kind represents an asset, to the individual, it is not an asset of an inherently wasting character. There is a perfectly clear line between the two classes of assets, though, unfortunately, it is very little understood. The true test is, I think, whether the asset necessarily wastes in the process of profit-earning, irrespective of particular ownership.

The question raised in our submission was not included in the reference, and does not in any way run counter to the conclusions arrived at by Lord Ritchie's Committee in 1905, as set forth in their Report. The terms of reference to this Committee were strictly limited, and included "The allowances made in respect of the depreciation of assets charged to capital account," but the Committee are careful to point out that their consideration only extended to changes or improvements which might well be made within the limits defined in the existing method of assessment of the Income Tax. The general principle and basis on which the tax is levied were outside the scope of their reference. Thus the Report deals only with the details of the administration

of the allowances of wear and tear of machinery, plant and ships, with a passing reference to the inadmissibility of the contention raised by some witnesses, that allowances should be made for depreciation of such assets as leaseholds, patent rights, and similar sources out of which taxable profits arise, but the sources of which do not necessarily waste in the process.<sup>1</sup>

It is universally admitted that the Income Tax Acts tax profits only, they are not intended to tax capital found in the company of profits. The profits taxable are not necessarily the profits of the individual taxed, but there must be profits arising; this is the important point. Sir Henry Primrose, Chairman of the Inland Revenue, in a memorandum which he submitted to Lord Ritchie's Committee, says it is from the titles of the Acts of 1842 and 1853 we obtain a definition of the Income Tax as a body of duties on profits arising from property, professions, trades and offices.

<sup>1</sup> Inherently wasting assets include :—

*a*, Land, if sold and the proceeds carried to revenue account, and all natural material, such as timber, bodies of coal, and of all kinds of minerals, deposits of slate, stone, gravel, earths, oil, nitrate, etc., the fall in value being due in each case to the gradual reduction by sale.

*b*, Shaft sinking and development undertaken to obtain access to any such raw material, the fall in value being due to the gradual expiration of the useful life of the works.

*c*, Productive plant of all kinds, including buildings and the fixtures therein, and office and warehouse furniture. This heading covers all perishable material property owned by an undertaking and intended for use in profit-earning but not for sale, the fall in value being due to wear and tear and obsolescence.

*d*, Purchased terminable annuities, the fall in value being due to gradual repayment of principal included in each annual payment.

*e*, Purchased terminable concessions relating to any source of profit arising outside the United Kingdom, the fall in value being due to the fact that the concession is coming to an end.

But they do not include the following, which, although wasting in the hands of the individual owners, are not inherently wasting assets, or assets which waste irrespective of particular ownership, and allowance for such waste cannot properly be claimed :—

Leaseholds.  
Copyrights.  
Patent rights.  
Goodwill.

Besides the disallowance under the present scheme of Income Tax administration of the depreciation of so many inherently wasting assets, there are also unjust disallowances of many other inevitable expenses of profit-earning, including the following :—

*f*, Preliminary formation expenses of joint stock companies.

*g*, Cost of removal of business from one place to another.

*h*, Accidental losses not covered by insurance, occurring in the course of carrying on undertakings for profit.

*i*, Gifts or gratuities in the nature of payment for services rendered.

*j*, Cost of burdens imposed by law upon any class of undertakings.

McCulloch, in speaking of profits, says : "If the produce derived from an undertaking, after defraying the necessary outlay, be insufficient to replace the capital exhausted, a loss has been incurred, . . . if it is merely sufficient . . . there is no annual profit."

Whenever capital money or money's worth is invested in the purchase or acquisition of inherently wasting assets for the purpose of subsequently obtaining profit or income, whether the life of such assets be ten or 100 years it will be found that such payments are in all cases accurately described as payments made in advance on revenue account, and unless a near approximation to the outlay on such inherently wasting assets, which has wasted or expired within each year, is made and fully provided for out of gross revenue, no correct statement of profit and loss can be obtained ; so that in computing profits it is as necessary to charge to the revenue account a full and fair sum in respect of the outlay on inherently wasting assets, which has wasted or expired within the accounting year, and is commonly called depreciation, as it is to charge the revenue account with operative wages or any other expenditure which happens to involve the payment of cash in or about the particular year for which the profits are being computed.

An interesting consideration on this subject arises out of the memorandum referred to above, which was submitted to Lord Ritchie's Committee by Sir Henry Primrose. In discussing the meaning of "profits on trades," he says :—

"If we consider any trading enterprise at large, we should say that no enterprise should be pronounced profitable until it has been brought to completion, or, at any rate, to a position of assured permanence. Take, for example, a mining enterprise. Assume that it costs £100,000 to open and equip the mine, that the life of the mine is forty years, that its net earnings average £10,000 per annum for that period, and that at the end the equipment is valueless for any other purpose. Then the true profit on this enterprise would be  $£400,000 - £100,000 = £300,000$ . The above conclusion seems incontrovertible. But to apply it in administering the Income Tax is not simple, because it is an essential condition of the Income Tax that profits should be ascertained, not over the whole period of trading, nor even over long periods of trading, but over quite short periods."

"This feature was of special significance in 1842, and even up to the year 1874, because during the whole of those thirty-two years the tax was regarded as a temporary one ; and, no doubt, that fact inclined the framers of the scheme towards a rigorous exclusion of those costs of earning profits which did not actually

fall within the period for which profits had to be computed. However that may be, the scheme of 1842 and 1853 did severely confine allowances in respect of the cost of earning profits to such costs as fell within the period of computation."

Sir Henry Primrose refers above to the "scheme" of 1842 and 1853 as severely confining allowances in respect of the cost of earning profits to such costs as fell within the period of computation. The word costs, as used here, seems to refer only to that part of the expenditure which fell to be paid for in cash in or about the period of computation. I think it must be the original "scheme" as settled by the officials for administering the Acts and Rules, and not the words of the Acts and Rules themselves, to which Sir Henry Primrose refers; and in considering this scheme, which is now the law, it should not be overlooked that in the middle of last century, when the scheme was devised, trade was carried on principally by individuals, and the science of accounting was then scarcely conceived, and rarely advanced beyond the use of a cash book. Further, the tax was supposed to be of quite a temporary nature, and the difficulty of collection of this new impost must then have been very great, excusing, perhaps, the use of the roughest measures.

Since that time enormous developments and changes have taken place in commerce and in the science of recording and computing profits, but the original scheme of administration of Income Tax still goes on, patched up by various amending Acts and official Orders, and complicated by a mass of case law, in which the judges have attempted to accommodate their view of the intention of the legislature to what may be called the common-sense view, a task which it must be admitted has proved an impossible one.

We submit that the old scheme is unscientific and unsuitable for the needs of the present time, and in the common interests of those assessing, and of those paying the income tax, we urge that, while this scheme continues to be the law, it may be made as little inequitable as possible by the following, amongst other, means:—

(1) By extending the allowance at present granted by the Act of 1878 in the case of machinery or plant to all other inherently wasting assets where such depreciation arises out of, and is necessarily incidental to, the earning of the taxable profits.

(2) By extending the term wear and tear used in the Act of 1878 to cover loss caused by obsolescence of all such wasting assets.

(3) By directing the surveyors of taxes to accept the duly

certified accounts submitted by taxpayers as being correct in the absence of conclusive evidence to the contrary.

The practice adopted by many surveyors of striking out from accounts submitted to them amounts charged upon a proper basis for wear and tear, and substituting often inadequate sums calculated by themselves upon an arbitrary percentage off the reducing balance of cost, is needless and irritating, and we think that surveyors should not generally mutilate properly prepared accounts presented to them, either in respect of wear and tear, or in respect of any other item properly charged thereto, especially having regard to the evidence which is now available for their use

The method of calculating wear and tear on the reducing balance of cost is wrong in principle, and we submit that surveyors should be instructed not to object to the use of the proper method, which measures the amount on the original cost of the machinery or plant based on the estimated efficient economic life, and not on the reducing balance of cost. This principle has been admitted in the case of ships.

We feel that the need for equitable and just methods of assessing income tax upon profits is constantly becoming more pronounced, and income tax is so valuable a means of raising revenue that it is manifestly of great importance the method of levying it should advance towards a sound and scientific basis. I believe that it might become a much needed instrument to encourage (rather than the reverse) sound finance and prudent management of business undertakings generally, and especially of the great industrial enterprises of the country, the control of which is passing more and more out of the hands of the actual owners into the hands of directors of incorporated companies, who are the agents of the small capitalists, and are naturally anxious to show good results.

The consideration of practical means of advance towards a sound and scientific basis for the levying of income tax raises many matters of detail, upon which there is much to be said from the point of view of the inland revenue, and much to be said from the taxpayer's point of view, and we think that great good might result from the establishment of a committee or some other means of intercourse between wide-minded and unprejudiced men of experience on each side, each member of such a committee would know much of his own side, and something of the other side, with whose difficulties and grievances he should be able to sympathise, and each should be genuinely anxious to see the income tax levied upon profits as it should be, or upon

amounts as nearly as possible approximating to profits, and should not be influenced by other considerations. Such a body, if well chosen, might, we think, do really useful work, and would be available as a committee of reference, and it is an inquiry by a committee of this nature which we venture to suggest to your favourable consideration.<sup>1</sup>

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#### TRADE UNIONS IN THE TINPLATE INDUSTRY.

THE changes that have occurred in the structure of labour associations in the tinplate industry during the past ten years are of great interest to the economist. The British industry, which is practically confined to South Wales and Monmouthshire, grew into importance during the period 1860-75. At that time a tinplate was a thin sheet of *iron* coated with tin; and the iron forge, the tinplate rolling mill, and the finishing department (or tinhouse) formed one factory. The rates of wages paid the men were determined partly by the custom of the district and partly by individual bargaining. The first association of workers of which we have evidence was formed in 1871 (during a period of rapid expansion of trade) and was confined to the western division, while it consisted of workers in all three departments. Uniform wage rates were granted in 1874. There is no evidence of a continuous association before 1887, but there appear to have been a number of temporary combinations.

Between 1883 and 1886 steel superseded iron as the raw material in the manufacture of tinplates, and steel factories, in which tinplate bars were made, were generally distinct from tinplate factories. The employés in the two factories were not so closely connected as previously, and steel workers became members of an independent association. Thus it was by a change in the character of the product that the process of disintegration was started. In the winter of 1886-7 a strike took place in Monmouthshire, which resulted in the formation of the South Wales, Monmouthshire and Gloucestershire Tinplate Makers' Associa-

<sup>1</sup> In defending the proposal to tax the capital value of ungotten minerals the Chancellor of the Exchequer said, May 12, "If they could value ungotten minerals for the purposes of purchase, was it not absurd to say they could not be valued for the purposes of taxation?" After this it will not be said that they cannot be valued for the purposes of allowance of depreciation, or fall in value, due to their gradual reduction by sale in computing taxable profits. The Income Tax Acts tax profits only. It is the hopelessly antiquated scheme of administration, formulated in the middle of last century under such different conditions of commerce, which is still used to compute those profits, and ill fits the needs of to-day.—*Note by Mr. Leake.*