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CONSIDERATIONS RESPECTING A FEDERAL RETAIL SALES TAX

PART C

Canadian Federal Sales Tax

British Purchase Tax

Australian Wholesale Sales Tax

Division of Tax Research
Treasury Department, Washington, D. C.
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CANADIAN FEDERAL SALES TAX

Division of Tax Research
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Canadian Federal Sales Tax

I. Introduction ^{1/}A. The turnover tax, 1920-1923

Canada first enacted a sales tax in May 1920. A rate of 1 percent was applied to the sales of wholesalers and manufacturers, and to imports. The tax was essentially a turnover tax in that it was applied at successive stages of production and distribution. For example, the tax was payable on the sale of leather by a tanner to a shoe manufacturer, on the sale of shoes by a shoe manufacturer to a wholesaler, and again when a wholesaler sold the shoes to a retailer.

The 1920 Act made no distinction between sales of articles domestically produced and sales of those imported. Moreover, no distinction was made between manufacturers' sales to wholesalers and those made directly to retailers. As a consequence, considerable opposition to the tax developed. Protests were made that the tax afforded an incentive for manufacturers to "by-pass" middlemen, and that manufacturers and wholesalers were placed at a disadvantage with retailers in respect to imports. Since the tax was of the turnover type, manufacturers and wholesalers paid a 1-percent tax upon importation and also a 1-percent tax on resale, while retailers paid only the 1-percent tax on imports. As a result of the protests the law was amended (June 17, 1920) and sales of manufacturers made directly to retailers were taxed at 2 percent. A similar change was also made in the sales tax on imports: the tax on importations by retailers was increased to 2 percent in order to place them on an equal basis with manufacturers and wholesalers who paid a 1-percent tax upon the sale of imported goods as well as a 1-percent tax upon their import.

On May 10, 1921, the tax on sales of domestic goods by manufacturers and wholesalers was increased to $1\frac{1}{2}$ percent. The tax on sales by manufacturers who sold directly to retailers and thus by-passed wholesalers was raised to 3 percent. The rate on importations by manufacturers and wholesalers was increased to $2\frac{1}{2}$ percent, and on importations by retailers to 4 percent. Thus, the rates applicable to imported goods were 1 percent greater than

^{1/} See Appendix I, summary of changes in the rates and form of the Canadian sales tax, 1920-1942.

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the rates on goods produced in Canada. On May 24, 1922, when the sales tax rates were again increased, this differential was raised to $1\frac{1}{2}$ percent.

These changes, however, did not silence the critics. One of the most important criticisms of the tax was that it applied not only to the same article at each of the various stages of production, but that it also was pyramided through the application of rigid mark-ups to the sales price which included the tax. The critics also pointed out that since the tax was levied at several points of transfer there was an incentive for business to integrate and thereby limit the multiple effects of the tax.

B. The single-stage tax, 1924-1942

To meet these criticisms the law was amended January 1, 1924. Under the revised law, the tax was imposed on imports and manufacturers' sales of finished articles. ^{1/} That is, the tax was to apply only at one stage in the processes of production and distribution; generally, upon the finished merchandise when it passed from the manufacturer to the wholesaler. This aim was achieved by imposing the tax only when the goods were transferred from a licensed to an unlicensed purchaser. All manufacturers were licensed, while wholesalers were permitted to obtain a license only under certain conditions. The tax was not imposed on goods imported by a licensee, or on sales of partly manufactured goods, except on sales to unlicensed purchasers. The rate under the 1924 law was 6 percent.

There was and has continued to be a long list of exemptions from the tax. In recent years the need for additional revenue has made it necessary to remove from the list of exemptions items such as electricity, gas, and building materials.

There have also been frequent changes in the rates ^{2/} but the general principles of the 1924 law are still in effect. The present

^{1/} Sales or imports of partly manufactured goods by a licensed manufacturer or wholesaler to another licensee were exempted from tax. See Office Consolidation, The Special War Revenue Act and amendments to date, June 1943, published by the Department of National Revenue, Excise Division, Ottawa, Canada; section 86(2).

^{2/} Appendix I.

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tax rate of 8 percent has been in effect since 1936. ^{1/} This is significant in so far as it shows that a nation which has had a relatively long experience with a well established sales tax has not chosen to increase the rates during a war emergency but has sought additional revenue from increased income and excess-profits taxes and excises.

Although the scope of the sales tax has been extended, its relative importance in the Canadian Federal tax structure has declined during the war period. In the fiscal year 1939-40, more than 29 percent of the total Federal tax revenue was produced by the sales tax, while for the fiscal years 1942-43 and 1943-44 it is estimated that only about 10.8 and 9.3 percent, respectively, of the total tax revenue will come from the sales tax.

C. General acceptance of the tax

Opposition to the tax diminished after it was changed to the single-stage form. Today there does not appear to be any great pressure for repeal of the tax. Consumers are passive, and although manufacturers desire the eventual repeal of the sales tax, they are not demanding any major changes during the war period.

The prower attitude of manufacturers toward the tax is illustrated by a brief prepared by the Canadian Manufacturers' Association in connection with the Hearings of the Royal Commission on the Dominion Provincial Relations, in which they pointed out some of the demerits of the tax. Some of the principal arguments against the tax were that it (a) increased prices to consumers; (b) increased manufacturing costs, selling costs, and overhead; (c) made the manufacturers tax collectors; (d) discriminated against manufacturers who produce and sell a complete product; ^{2/}

^{1/} Although prior to June 23, 1942, fur skins and pelts were taxed under the sales tax at the rate of 12 percent of the current market value of the dressed and dyed furs, they were removed from the general sales tax and are now subject to a 25-percent excise.

^{2/} "In addition to having to pay the tax on the sales of his taxable product a manufacturer is compelled by law to keep proper books and records of all transactions, which necessitates additional clerical staff, and he must pay the tax to the Government in many cases long before he is paid by his customer. The cost of keeping the records, of making monthly returns, the carrying charges on the amount of tax paid to the Government, and the loss on bad debts is a burden imposed on those manufacturers who manufacture and sell completed taxable products.

"The manufacturer of a semi-manufactured product which is the raw material of another licensed manufacturer, for example, the manufacturer of pig iron, leather, etc., does not have to pay the Government any tax on his sales as the customer of such a manufacturer buys these articles free of tax because these materials are for further manufacture."

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(e) discriminated between one section of an industry and another section of the same industry; 1/ and (f) that it increased the costs of government.

D. Extension of administrative authority

Three factors that have contributed a great deal to the success of the Canadian sales tax are: (1) the capacity of the majority party to obtain changes in taxation as contained in the Finance Minister's Budget Speech, (2) the extent of the authority delegated to the administrators of the sales tax, and (3) the good sense with which discretion is exercised by the sales tax administration. This combination of factors has enabled Canada successfully to cope with and to avoid many of the difficulties usually associated with a general sales tax.

E. Canadian experience and a Federal sales tax in the United States

Although the available information indicates that the Canadian Federal sales tax is a smooth-working mechanism, it should not be concluded that a similar tax would work equally well in the United States. Firstly, the United States is more highly industrialized than is Canada. Secondly, due to the separation of legislative, executive, and judicial powers here, there would be lacking the administrative flexibility achieved under the Canadian political system. Consequently, the problem of effectively administering a Federal manufacturers' sales tax can be expected to be appreciably more difficult than is indicated by Canadian experience.

A Federal sales tax must be considered as a long-time or permanent levy and not as a short-time emergency tax. 2/ A Federal manufacturers' sales tax comparable to the Canadian tax would require an administrative staff so large as not to warrant its creation on a temporary or emergency basis. In addition, there is the question

1/ For example, vegetables canned by the farmer, whether the farmer sells them himself or disposes of them through a commission house, are not subject to the sales tax when production is not in excess of ten thousand one-pound cans or their equivalent per annum. Canning factories, however, must operate under license and pay tax on their entire output.

2/ See also the testimony of Adams, T. S., and Alvord, E. C., House Hearings, 72d Cong., 1st sess., Revenue Act of 1932, pp. 260, 266.

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of delegation of powers providing for administrative flexibility. Administrative flexibility would be absolutely essential under a Federal manufacturers' sales tax in order to obtain a tolerable degree of uniformity in tax base. For example, manufacturers' sales to retailers and consumers have to be revalued back by some method of discounting in order to get a tax base that is comparable to manufacturers' sales to wholesalers. For instance, the Canadian regulations with respect to sales of clothes and wearing apparel specify that on sales to ordinary retailers "manufacturers may account for the sales tax on these sales less a discount of 10 percent." ^{1/} "Manufacturers who operate retail stores or retail departments selling direct to individual users may account for sales tax on the transfer of these goods to such departments or stores on the regular list price to the user less a discount of 30 percent..." ^{2/}

The above illustration shows how the Canadian sales tax authorities through their broad administrative powers are able to achieve a tolerable degree of uniformity in the tax base. Under a high tax rate, the competitive inequalities that would arise due to a relatively inflexible administration of a Federal manufacturers' sales tax would be highly unsatisfactory if not intolerable to industry. It is significant to point out that in order to raise a substantial amount of revenue from a Federal manufacturers' sales tax, the tax rate would be such as to require the maximum of taxpayer equity. ^{3/}

F. Federal manufacturers' sales tax and price control

1. Canadian viewpoint

Canadian tax officials have taken the position that since the general price ceiling has become effective they cannot recommend, as a matter of sound economic policy, an increase in the general sales tax rate. It is believed that an increase in the general sales tax would introduce an entering wedge for general changes from the price ceiling and perhaps result in an inflationary spiral of prices. The Minister of Finance in his Budget

^{1/} Circular letter No. 783-C Revised, issued by the Minister of National Revenue, effective November 1, 1941.

^{2/} Ibid.

^{3/} "Federal Manufacturers', Wholesale, and Retail Sales Taxes," a memorandum prepared by the Treasury at the request of the Committee on Ways and Means, House of Representatives, Revenue Revision of 1942, vol. I, p. 348, Table 1.

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Message of June 23, 1942, stated that "the imposition of the price ceiling has added conclusively to the weight of argument against general rather than selective increases in consumption taxes."

2. United States viewpoint

In the United States, officials of the Treasury and the Office of Price Administration have taken a position with respect to a general sales tax similar to that of the Canadian tax officials. It is feared that a general sales tax (particularly the manufacturer and wholesaler types) would rupture price ceilings and unduly burden the Office of Price Administration with complicated administrative problems. It is the opinion of O.P.A. Administrator "that general commodity taxation and price control do not go together."

II. Structure of the tax

A. Taxpayers

The Canadian Federal sales tax is essentially a manufacturers' sales tax. Section 2(c) of the Act contains an omnibus definition of "manufacturer or producer." This section is fortified by section 85 (f) which includes among other things "any packer of olives and any commercial artist," and section 86(3) which is designed to cover business transactions by fiduciaries, etc. Coupled with section 85(a) (definition of sales price) and section 98 (power to determine fair price), the definition of manufacturer prohibits anyone from avoiding tax as determined by the Minister of Revenue, in spite of corporate split-ups or dummy organizations and the absence of arm's length transactions.

All manufacturers are required to be licensed and certain wholesalers may be licensed. Active taxpayer accounts are between 28,000 and 29,000, of which about 800 are wholesalers.

Although the Canadian Federal sales tax is a manufacturers' sales tax, certain wholesalers may be granted a license in order to enable them to resell partly manufactured goods tax free. The policy is to license only wholesalers primarily engaged in the resale of raw materials or partly manufactured goods. If a wholesaler was not in possession of a license on September 1, 1938, no license will be issued to him unless 50 percent of his sales for the three months immediately preceding his application were exempt from the sales tax. 1/ "A licensed wholesaler or jobber does not pay sales tax on goods imported or purchased by him, where the goods are for

1/ Section 96(1).

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resale, provided he quotes his license and certifies that the goods are for resale. But on the goods for his own use, tax is payable at the time of entry at customs or at the time of purchase as in such cases he is not permitted to use his license." ^{1/} The licensed wholesaler is also liable for sales tax when he delivers taxable goods to unlicensed firms or to licensees for their own use. ^{2/}

These taxable sales by licensed wholesalers are valued for tax purposes not at sales price but at cost to the wholesaler, to put them on the same basis as manufacturers' sales. There are two alternative methods by which licensed wholesalers may state the cost: (1) they may show on the duplicate of each sales invoice the actual cost or duty-paid value of each taxable item on the invoice and recapitulate these costs and values at the end of each month and pay the tax at the current rate on the total; or (2) they may deduct a percentage ^{3/} from their taxable sales to determine their taxable cost or duty-paid value of the merchandise sold.

Each taxpayer must file a monthly return for the taxable sales of the preceding month. The return must be filed and the tax paid not later than the last day of the first month succeeding that in which the sales were made. ^{4/}

^{1/} See Sales Tax - Canada. The Special War Revenue Act as amended with regulations issued by the Department of National Revenue and with rulings and regulations re sales tax and other excise taxes, compiled and edited by R. N. McCormick, published by the Canadian Manufacturers' Association, June 1937, p. 23.

^{2/} Section 86(1)(c).

^{3/} The percentage is arrived at in the following manner: a reconstructed trading account statement is prepared covering the entire wholesale business for the 2 preceding years by adding to the inventory, at the commencement of the period, the 2 years' purchases at cost and the duty-paid value of imported goods and deducting the inventory at the close of the period, thus determining the taxable cost of goods sold; this figure is deducted from the gross sales of the 2-year period and there is determined the percentage necessary to apply to sales to reduce them to taxable cost. At the close of each wholesaler's fiscal year he is required to recalculate the percentage by omitting the oldest year's business and substituting results of his business for the year just closed to determine the percentage to be used for the ensuing year.

^{4/} Section 106(4).

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^{4/} Section 106(4).

B. Tax base and tax rates

1. Tax base

Under the Canadian sales tax it is intended to tax all sales of finished goods on the basis of manufacturers' sales prices. For tax-base purposes the law is inclusive rather than exclusive in that all sales by manufacturers of finished articles are taxed unless exempted by law or by regulation.

In general, the manufacturers' sales price is the price for which the manufacturer regularly sells taxable goods to bona fide wholesalers in the ordinary course of business.

a. Sales price

More specifically, the sales price for purposes of calculating the amount of sales tax is the manufacturers' sales price exclusive of the sales tax but inclusive of any charge for advertising, financing, servicing, or warranty. When goods are sold in bond the sale price also includes excise duties. ^{1/} For some items, the sales price also includes any excise tax levied thereon. ^{2/}

With respect to installment or conditional sales, the tax is computed on the basis of the sales price and is payable at the end of the month following that in which the sale is made. This rule is followed even though the manufacturer's terms specify payment in sixty, ninety, or more days. Delay in payment of the tax is granted, however, in certain cases. For example, where installments are paid as the work progresses, as in the building of a power plant or a paper mill, or in contracts where the ownership of the merchandise sold does not pass to the purchaser until completion of the contract.

b. Valuations determined by the Minister

There are many cases, however, where it is difficult to determine the manufacturers' sales price because no actual market transactions occur at that level. For example, when goods are leased

^{1/} Excise duties, for example, are collected on distilled spirits and tobacco sold in bond.

^{2/} For example, matches, cigarette papers and tubes, playing cards, and wines.

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there is no sales price which can be used in computing the sales tax. When goods are produced for use and not for resale a valuation must be made. Sales by manufacturers direct to retailers and consumers also require tax base determinations.

To cope with these situations the Minister of National Revenue is empowered to determine valuations for purposes of the sales tax when goods are leased, when goods have a royalty imposed on them, when "goods are manufactured by contract for labor only" and do not include "the value of materials that enter into the same or under any other unusual or peculiar manner or conditions," and when "goods are manufactured for use by the manufacturer or producer and not for sale." 1/ Where a manufacturer sells similar articles both to wholesalers and retailers, no valuation problem arises since the sales to wholesalers in the normal course of business establishes the base price for tax purposes. However, where a manufacturer sells exclusively to retailers it is necessary to determine the "wholesale price" for purposes of calculating the sales tax. To cope with this situation, manufacturers selling only to retailers apply a discount to their sales price. The discount is determined by the Minister, and is based on industry-wide studies of prices of manufacturers selling similar articles to wholesalers. In all cases where the manufacturer has not established the "wholesale price" for his taxable goods the Minister may determine the value on which the tax may be calculated. 2/ For instance, in the case of chain store outlets, mark-ups on similar articles not manufactured by a chain store organization are determined by the Minister and these mark-ups are used to discount the retail selling prices of articles manufactured by the chain. A number of special regulations covering unusual industries also have been issued. For example, the sales price of ice cream for tax computation purposes is \$1.10 per imperial gallon.

The Minister also has the power to determine the fair price for tax purposes whenever in his "judgment" the sales price is less than the fair price and "the taxpayer shall pay the tax on the price so determined." 3/ In this connection, it also should be noted that the law precludes dividing of price and attempts to avoid tax by providing that the sales price "shall include any charges for advertising, financing, servicing, warranty or any

1/ Section 87.

2/ Regulations under the Special War Revenue Act, Department of National Revenue, Excise Division, January 1942, article 6.

3/ Section 98.

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other charges of a similar nature contracted for at the time of sale whether these items be charged for separately or not." ^{1/}

c. Valuation in the case of imports

A further problem of valuation arises in connection with imported goods. The Canadian sales tax is imposed on the sale price of goods imported into Canada as well as on goods produced in Canada. The tax is "payable by the importer or transferee ... at the time when the goods are imported or taken out of warehouse for consumption," ^{2/} except where the goods are imported by a licensed manufacturer or licensed wholesaler free of tax. Consequently, no market price is obtainable for purposes of computing the sales tax on imported goods. As a result, the tax is computed upon the duty-paid value of the article. Duty-paid value is the value determined for the purpose of calculating an ad valorem duty and it includes the amount of the customs duty. ^{3/} For some items, like cigarette papers and tubes, matches, playing cards, and wines, the duty-paid value includes the excise tax levied thereon. ^{4/}

2. Taxable goods and tax rates

All sales by licensed manufacturers are taxed at 8 percent, except articles produced by the blind and the deaf and dumb in Canadian institutions established for their care or under the control or direction of such institutions which pay only a 4-percent tax.

The tax applies to finished goods imported into or manufactured in Canada, but the finished goods of one manufacturer may be used as cost goods in the production process of another; hence the Canadian sales tax does not apply to finished consumers' goods only. For example, building materials, fuel oil, lubricating oil, dies, abrasives, cutting tools, and certain plant machinery and equipment are taxable.

^{1/} Section 85(a).

^{2/} Section 86(1)(b).

^{3/} Section 85(b).

^{4/} Excise tax as used here does not mean the "special excise tax" of 3 percent on the duty-paid value of goods imported into Canada from general tariff countries. Neither the sales nor the excise tax applies on the "special excise tax" on importations.

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3. Exemptions

a. Articles specifically exempted

A large number of specified articles are exempted from the sales tax. It is impractical to list all of them 1/ but some of the most important may be classified as follows:

- 1) Foods, with certain exceptions (see Appendix II).
- 2) Products of the primary industries; farming, mining, and fishing; also the equipment used in these industries.
- 3) Materials used by religious, charitable and health organizations.
- 4) Printed matter and articles used for educational purposes.
- 5) Articles used by the diplomatic corps.
- 6) Coverings and processing materials, with certain exceptions (see Appendix II).
- 7) Miscellaneous items.

b. Partly manufactured goods and consumables

Under the Canadian sales tax, partly manufactured goods and materials consumed in the process of manufacturing are exempted. Permanent and semi-permanent equipment, however, are taxed.

The law provides that the "Minister shall be the sole judge as to whether or not goods are 'partly manufactured goods' within the meaning of this section." 2/ It is not clear that this authority is also extended to the determination of what materials are exempted under section 89(1), Schedule III, wherein exemption is provided for "materials (not to include abrasives, lubricating oils, fuel oils, or non-permanent plant equipment) consumed,

1/ See Appendix II for a list of the more important items exempted. For a complete list, however, reference must be made to the law and regulations.

2/ Section 85(c).

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otherwise than by waste or wear in the process of ... production of taxable goods." Apparently, a great deal of discretion is used by the Minister in determining such tax exemption. The administrative bench mark is that the materials must actually be destroyed in use before coming within the classification of "consumed."

Section 97(1) of the Act gives the Minister additional authority to enforce his determinations with respect to partly manufactured goods and materials consumed. It provides that "if it appears to the Minister" that a licensee is evading tax, "the Minister may require" that the tax apply to "any material specified by the Minister" when sold to any licensee or any class of licensees he specifies, whether the materials are domestically produced or imported. Later "a deduction may be made" if the licensee proves such materials have been used in the manufacture of an article which is subject to the tax and on which the tax has been paid. ^{1/}

c. Articles purchased by governments and their agencies

(1) Purchases by the Crown

Purchases by the Crown are not taxable under the Canadian Federal sales tax unless specifically mentioned in the statute.

(2) Dominion Government

When taxable goods are sold to or imported by the Dominion Government or a department thereof, the sales tax applies. Furthermore, taxable goods sold to any Commission or Board appointed by or operating under the authority of the Federal Government are subject to sales tax. ^{2/}

(3) Provincial governments and municipalities

The sales of taxable goods to provincial governments or a department thereof are taxable if the goods are for resale. There are two basic reasons why these transactions are taxable: first, they are taxable by reason of state monopoly, such as liquor and public utilities; and, second, by reason of competition with private industry. However, sales to or imports by the provincial governments or departments thereof for their own use are exempt from the sales tax.

^{1/} Section 97(2).

^{2/} Sales Tax - Canada, op. cit., p. 38.

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Where taxable goods are sold to or imported by provincial railways, commissions, universities, boards, and public utilities, the sales tax applies except in specific instances where the Department of National Revenue has ruled otherwise. ^{1/} The untaxed exceptions are commissions and boards operated entirely by provincial governments such as civil service commissions and old age pension boards.

In order to prevent discrimination against unlicensed wholesalers or other dealers who have purchased goods from licensed manufacturers or wholesalers, the law permits the departments of Provinces and certified public hospitals to make tax-free purchases through unlicensed wholesalers or dealers, provided certain procedural requirements are followed. ^{2/}

Taxable goods sold to or imported by a municipality are subject to the sales tax. ^{3/}

d. War materiel

Various rulings have been made with respect to the application of the sales tax on war materiel. For example, a refund of the sales tax is granted on permanent and nonpermanent plant equipment imported into or manufactured in Canada, if the purchase has been approved by the Department of Munitions and Supply on behalf of the British Government or the governments of Allied Nations and which has been or is to be paid for by these governments; provided further that the equipment is to be actually used directly in the manufacture of munitions of war covered by contracts placed through the Department of Munitions and Supply for the accounts of these governments. ^{4/}

Military stores, munitions of war, and other articles owned by the government of any of the Allied countries and which are to remain the property of such government are exempted from the sales tax. ^{5/}

^{1/} Sales Tax - Canada, op. cit., p. 39.

^{2/} Goods must be shipped directly from the licensed manufacturer or wholesaler. Proof of direct shipment together with a certified copy of the exempted purchaser's order, bearing the certificate applicable and the license number where required, must be filed in the office of the licensed manufacturer or wholesaler.

^{3/} Sales Tax - Canada, op. cit., p. 38.

^{4/} See Commerce Clearing House, Canadian Tax Service, 64-182, Circular Letter, pertaining to Munitions, sections A and B.

^{5/} Order-in-Council P. C. 53/8097.

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Also exempted are articles consigned directly to officers and men of His Majesty's Imperial Navy for their own personal use or consumption on board their own ships. 1/

Contractors may manufacture or purchase permanent and non-permanent 2/ plant equipment to be used in the production of aircraft or parts thereof for the Government of the United Kingdom without payment of the sales tax when ownership in the equipment is vested in the United Kingdom Government, provided a certificate is completed on the shop order showing such information as the Government requires. 3/

Contracts for munitions of war placed in Canada by the British or Allied Governments are exempt from sales tax. Military, naval and air force uniforms manufactured for the United Kingdom or any Allied Government also are exempt from sales tax. 4/ Sales of uniforms to the Canadian Government, however, are taxable.

For a complete coverage of all exemptions, reference must be made to the law and to the list of regulations issued by the Minister of National Revenue. 5/

e. Ship's stores

Under the Act, sales tax refunds "may be granted to a manufacturer, producer, wholesaler, jobber or other dealer on goods sold hereafter as ship's stores." 6/

f. Exports

The sales tax is not payable on goods exported 7/ except that the sales tax is "payable on the sale of spirituous and fermented

1/ The Special War Revenue Act, Customs Tariff, item 708.

2/ "Permanent or nonpermanent plant equipment" is held to mean machinery and nonmechanical equipment of a permanent character, and patterns, jigs, dies, machines, and hand tools, and similar equipment of a non-permanent character, to be used in the production of aircraft and parts thereof.

3/ Regulations; Circular No. 840-C, issued April 30, 1941.

4/ Order-in-Council P. C. 53/8097.

5/ See the Special War Revenue Act and Amendments, June 1943, published by the Department of National Revenue, Excise Division; also Regulations issued by the Department, January 1942.

6/ Section 105(2).

7/ Section 86(2)(a).

liquors, other than wine, unless such goods are exported in bond by the manufacturer thereof and foreign landing certificates satisfactory to the Minister are produced as proof that said goods have landed at the place designated in the export entry," 1/

In cases where sales tax has been paid on domestic goods that subsequently are exported under regulations prescribed by the Minister a refund may be granted. 2/

A refund of the sales tax may be granted "when imported goods which are free of customs duty and which are found not to be according to order, are exported under customs supervision within three months from the date of the customs entry." 3/ A refund of the sales tax may also be granted "when, in the case of imported goods, customs duty has been refunded on exportation." 4/

g. Imported goods that compete with goods produced in Canada

The Act allows a refund or a reduction not to exceed 25 percent of the sales tax paid on goods manufactured or produced in Canada, when similar goods may be imported into Canada free of customs duty and evidence satisfactory to the Minister is produced that the Canadian goods are at a disadvantage in competition with the imported goods. 5/

This section, however, has little, if any, practical significance since it has been applied in only one or two cases.

h. Articles produced by certain individuals

All articles manufactured or produced by the labor of the blind or the deaf and dumb in institutions in Canada established for their care are subject to only 50 percent of the tax. 6/

i. Exemption of small manufacturers

The Act grants the Minister of National Revenue authority to exempt "any class of small manufacturer ... selling his product

1/ Ibid.

2/ Section 91(2)(b).

3/ Section 91(2)(c).

4/ Section 91(2)(a).

5/ Section 92.

6/ Section 89(2).

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exclusively by retail." 1/ Articles purchased by such exempt manufacturers are taxable. The Minister also has authority to withdraw this exemption privilege. 2/

The 1924 Act provided exemption from tax of manufacturers with sales of less than \$10,000. This flat statutory exemption was effective for about six months. Ever since, however, the small-manufacturer exemption has been within the discretion of the Minister. The notable fact of the use of this authority is that the administrators draw a line of exemption to fit the particular industry. Thus lumber manufacturers selling less than \$3,000 per year are exempted, whereas retailers of lumber who operate wood-working plants are exempted only if the annual sales of goods of their own manufacture do not exceed \$1,000. 3/ Merchant tailors are exempted without a sales limit.

Administrative control is exercised by listing the type of manufacturers exempted; by restricting the privilege to those who do not use certain forms of business organization or methods of sale; by listing the nature and use of the articles exempted; by exempting firms whose sales are below a specified level; and by limiting the privilege to manufacturers "when selling exclusively by retail." 4/ This is an important administrative authority, the use of which has limited the number of active taxpayer accounts to about 28,000 or 29,000.

1/ Section 95(2).
2/ Section 95(3).
3/ Regulations, article 11.
4/ Section 95(2).

III. Yield

The tax yield and the significance of the sales tax in the tax structure of the Canadian National Government are indicated by the following table:

Total tax revenue, sales tax revenue, and sales tax revenue as a percent of total tax revenue, Canadian National Government, fiscal years 1938-1944

(In millions of dollars)

Fiscal year	Total tax revenue	Sales tax revenue ^{2/}	Sales tax revenue as a percent of total tax revenue
1937-1938	\$ 449.2	\$138.1	30.7%
1938-1939	436.3	122.1	28.0
1939-1940	468.2	137.4	29.3
1940-1941	778.2	179.7	23.1
1941-1942	1,360.9	236.2	17.4
1942-1943 ^{1/}	2,135.9	230.0	10.8
1943-1944 ^{1/}	2,431.0	225.0	9.3

Source: Canada, House of Commons, Debates, March 2, 1945; p. 876, and p. 6 of Appendix.

^{1/} Official estimates made by Finance Minister, March 2, 1943.

^{2/} Exclusive of refunds.

The decreases in sales tax revenue in relation to total tax revenue for the fiscal years 1941-1942, 1942-1943, and 1943-1944 are due to very substantial increases in excises, income, and excess-profits taxes. The fact that Canada after many years of experience with the sales tax increased the excises, income, and excess-profits taxes during the war emergency period instead of increasing the sales tax is particularly significant.

As the war continues and the production of civilian goods declines, further decreases may be expected in the percentage of total revenue attributable to the sales tax unless sales tax rates are increased appreciably and exemptions reduced.

IV. Administration of the tax

A. Administrative organization

The Canadian Federal sales tax is administered by the Department of National Revenue, which is headed by the Minister of National Revenue. Under the Minister of National Revenue are the Commissioner and Assistant Commissioner of Excise. The characteristics of the system of administration are peculiar to the Canadian law and the customs machinery as established in Canada, and the plan of organization probably is not suitable for the United States.

B. Auditing

Canada maintains a relatively large staff of auditors to check collections and prevent evasion of the tax. These auditors also check on excise tax payments but the sales tax audit provides by far the greater part of the work. In the course of time every licensee is audited. There are about 225 members on the auditing staff or about one auditor for every 125 or 130 taxpayers.

C. Cost of collection

The cost of administering the sales tax is estimated to be about $2\frac{1}{2}$ or 3 percent when yield is about \$100 million. Costs are minimized by using existing customs or port offices personnel and equipment. Collection costs of customs, excises, and sales taxes in fiscal year 1941 were 1.76 percent of collections; and for the first ten months of fiscal year 1942 collection costs for the three groups were about 1.3 percent.

D. Invoices

A licensed manufacturer or wholesaler "when selling to retailers or consumers is not required to show the tax as a separate item on the invoice." However, when a licensee sells to an unlicensed wholesaler or jobber, the purchaser must be furnished with a written invoice which shows the sales tax as a separate item. 1/ These licensed sellers charge their customers a separate amount on their invoices as "sales tax" (or use any wording which suggests that the item represents tax or a percentage equivalent to the rate of tax in effect) and the amount charged exceeds the tax paid, the difference is required to be paid to the Government by the licensed seller. 2/

1/ Regulations, article 10.

2/ Section 119.

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E. Most difficult administrative problems

The Canadian tax officials are of the opinion that the most difficult administrative problems are those associated with (1) determination of value for tax purposes, (2) whether or not an article is taxable, and (3) freight allowances, where taxpayers get their freight-in and freight-out records confused, whereas only outgoing freight is deductible from sales price. ^{1/}

V. Incidence and tax burden

A. Shifting of the tax

In the absence of special studies, the discussion of tax shifting and its effects on costs and prices of Canadian manufacturers necessarily must be general and based on theoretical considerations. At the time the tax was introduced the costs of manufacturers were raised by the amount of the tax. ^{2/} It is reasonable to assume that the selling prices of manufacturers also were raised in accordance with the increased costs. In addition, it is likely that wholesalers and retailers applied their ordinary mark-up percentages to their higher purchase prices and, as a result, their final selling prices were raised by an amount greater than the tax. It would appear, therefore, that prior to the great price disturbances consequent to the war, the general level of prices in Canada probably was higher by the amount of the tax and its pyramiding than it otherwise would have been. It is probable, however, that there are notable exceptions to this general statement.

At present, all prices are subject to over-all price ceilings. Accordingly, should the tax be increased, shifting of the increase to consumers could occur only with the approval of the Wartime Prices and Trade Board. The effects of any increase in tax, therefore, would depend on the Board's policies.

B. Multiple taxation

The intent of the law is to delimit multiple taxation. This is accomplished by exempting partly manufactured goods and many other cost goods used in commerce, industry, and agriculture. Not

^{1/} Regulations, article 22. See, however, article 15(6).

^{2/} Subsequent changes in tax rate (both upward and downward) would also effect cost and price changes.

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all producers' goods, however, have been excluded from the scope of the tax. For example, abrasives, certain plant equipment and machinery, lubricating oil, and building materials are taxable. In so far as producers' goods are taxed, the final sales prices of taxed articles tend to be increased by more than the amount of tax imposed directly on the sale of such articles, and there is also a tendency to raise the price of finished articles that are exempted from the tax. Moreover, the taxation of plant equipment and similar types of producers' goods tends to encourage manufacturers to use methods of production requiring relatively less taxable capital equipment. However, since the tax rate is only 8 percent and important classes of machinery and equipment are exempt, the effect of the tax upon production methods probably is not important.

C. Tax burden

Notwithstanding the exemption of certain necessities of life, such as bread, butter, eggs, etc., ^{1/} the low-income groups bear a substantial share of the sales tax burden. The need for additional revenue during the war has made it necessary to extend the tax to articles and services, such as gas and electricity when used in the home. The extension of the tax to such items tends to make the tax more regressive than it had been theretofore. Although some foods are exempt, the tax is imposed on many foods after they have been processed. For example, canned vegetables, canned fish, meats and poultry unless fresh are subject to the sales tax. Clothing and shoes also are taxable.

No data are available which show specifically the effects of the sales tax upon the cost-of-living index, but a comparison of the articles exempted under the sales tax with the items included in the Canadian cost-of-living index indicates that a small percentage (perhaps less than 25 percent) of the cost-of-living items are exempt from the sales tax. In view of the above circumstances, a substantial amount of the sales tax burden falls upon the low-income groups.

^{1/} See Appendix II.

appendix 1: Summary of changes in the rates and form of the Canadian sales tax, 1920-1942

From -	To -	Domestic sales	Importations
May 19, 1920	June 16, 1920	1% on sales by manufacturers. 1% on sales by wholesalers.	1% on importations
June 17, 1920	May 9, 1921	1% on sales by manufacturers to wholesalers. 1% on sales by wholesalers. 2% on sales by manufacturers to retailers or consumers.	1% on importations by manufac- turers and by wholesalers. 2% on importations by retailers or consumers.
May 10, 1921	May 23, 1922	1½% on sales by manufacturers to wholesalers 1½% on sales by wholesalers. 3% on sales by manufacturers to retailers or consumers. Except lumber, upon which tax was 2% on all domestic sales.	2½% on importations by manu- facturers and by wholesalers. 4% on importations by retailers or consumers. Except lumber, upon which tax was 3% on all importations.
May 24, 1922	Dec. 31, 1923	2½% on sales by manufacturers to wholesalers. 2½% on sales by wholesalers. 4½% on sales by manufacturers to retailers or consumers. Except lumber, upon which tax was 3% on all domestic sales.	3-¾% on importations by manu- facturers and by wholesalers. 6% on importations by retailers and consumers. Except lumber, upon which tax was 4½% on all importations.
Jan. 1, 1924	Apr. 10, 1924	6% on sales by manufacturers or producers. (3% on a restricted list.)	6% on importations. (3% on a restricted list.)

Appendix I: Summary of changes in the rates and form of the Canadian sales tax, 1920-1942
(continued)

From -	To -	Domestic sales	Importations
Apr. 11, 1924	Feb. 17, 1927	5% on sales by manufacturers. (2½% on a restricted list.)	5% on importations. (2½% on a restricted list.)
Feb. 18, 1927	Feb. 16, 1928	4% on sales by manufacturers. (2% on a restricted list.)	4% on importations. (2% on a restricted list.)
Feb. 17, 1928	March 1, 1929	3% on sales by manufacturers. (1½% on a restricted list.)	3% on importations. (1½% on a restricted list.)
Mar. 2, 1929	May 1, 1930	2% on sales by manufacturers. (1% on a restricted list.)	2% on importations. (1% on a restricted list.)
May 2, 1930	June 1, 1931	1% on sales by manufacturers. (½ of 1% on a restricted list.)	1% on importations. (½ of 1% on a restricted list.)
June 2, 1931	Apr. 6, 1932	4% on sales by manufacturers. (2% on a restricted list and 2% on a restricted list of commodities produced or manu- factured in Canada.)	4% on importations, (2% on a restricted list.)
Apr. 7, 1932	Mar. 21, 1933	6% on sales by manufacturers. (3% on a restricted list and 3% on a restricted list of commodities produced or manu- factured in Canada.)	6% on importations. (3% on a restricted list.)
Mar. 22, 1933	Mar. 22, 1935	6% on sales by manufacturers. 3% on articles manufactured in Canada by labor of blind persons.	6% on importations.

Appendix I: Summary of changes in the rates and form of the Canadian sales tax, 1920-1942
(Concluded)

From -	To -	Domestic sales	Importations
Mar. 23, 1935	May 1, 1936	6% on sales by manufacturers. 3% on articles manufactured in Canada by labor of blind or deaf and dumb persons.	6% on importations.
May 2, 1936	June 24, 1940	8% on sales by manufacturers. 4% on articles manufactured in Canada by labor of blind or deaf and dumb persons.	8% on importations.
June 25, 1940	Oct. 1942 (Current)	8% on sales by manufacturers 4% on articles manufactured in Canada by labor of blind or deaf and dumb persons. 12% on dressed and dyed furs until June 24, 1942	8% on importations.

Source: For 1920-1936, The Canada Year Book, 1938; 1936-1942, Special War Revenue Act and amendments, August, 1942.

Note: Sales tax is payable by purchaser to manufacturer or wholesaler.

Appendix II: Exemptions

Some of the most important articles exempted from the Canadian Federal sales tax may be classified as follows:

Foodstuffs

Bread, butter, cheese, cream, eggs, honey, ice, lard, sugar, apples, baker cakes and pies, fish and fish products, flour, fresh meats and poultry, maple syrup, milk, and fruits and vegetables in their natural state.

Products and equipment of the primary industries; farming, mining and fishing

Hay, hops, straw, animals (live), poultry, logs, hides, wool, fertilizer, poultry and stock feeds, farm and forest products produced and sold by the individual settler or farmer but not including lumber.

Farm machinery and equipment, such as engines, tractors, milking machines, cultivators, harrows, rakes, seeders, ploughs, harvesters, orchard equipment, wagons, windmills, etc.

Equipment and products of mines and quarries, such as cars and appliances used in mines, crushed stone and gravel, gold and silver, ores of metals of all kinds, sand, gravel, and field stone.

Marine and fisheries supplies, such as boats and materials used in their manufacture and repair; cotton duck; sail twine; manila fibre; ships used in Canadian coasting trade; sinkers, floats, and travel kegs when used exclusively in fisheries, not including these articles for sportsmen's purposes.

Materials used by religious, charitable, and health organizations

Insulin; radium; artificial limbs; braille; donations of clothing and books for charitable purposes, memories and monuments erected in memory of soldiers who fell in the Great War; and articles and materials used by any bona fide public hospital.

Printed matter and articles used for educational purposes

Printing and educational matter, such as manuscripts; newspapers; books used for instructional purposes, magazine and literary papers regularly issued; printing paper and ink used in producing magazines;

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photographs, paintings, pastels when used for nonadvertising purposes; textbooks authorized by the Department of Education; and phonograph records used for instructional purposes.

Government and diplomatic corps

Articles used by the Governor General; articles imported for the personal or official use by Ministers and Consuls of foreign countries; and official stationery imported from England.

Coverings and processing materials

Coverings used exclusively for covering goods not subject to sales tax and materials to be used exclusively in the manufacture of such coverings; fire brick, plastic refractories, high temperature cement, fire clay and other refractory materials used in the repair or construction of a furnace or kiln, and materials used or consumed exclusively in the manufacture of fire brick or refractory materials; materials (not to include abrasives, lubricating oil, fuel oils or nonpermanent plant equipment) consumed otherwise than by waste or wear in the process of manufacture or production of taxable goods.

Miscellaneous items

British and Canadian coins, foreign gold coins; electricity except when used in dwellings, fuel other than in liquid form; lasts, patterns, and dies for boots and shoes; natural gas and gas manufactured from coal or oil for illuminating or heating purposes except when used in dwellings.

WORKING-PRESS REPORTERS.

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WASHINGTON, D. C.**

BRITISH PURCHASE TAX

Division of Tax Research
Treasury Department, Washington, D. C.
June 18, 1943
as revised October 9, 1943

British Purchase Tax

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British Purchase Tax

I. Introduction

A. Origin

In April 1940, Sir John Simon, then Chancellor of the Exchequer, in his budget message to the House, recommended the establishment of a tax entirely new to English experience -- a levy which he called the purchase tax. Essentially this proposal was a form of sales tax, imposed at the wholesale level, on a wide range of specified commodities, at uniform rate. However, at the time, no specific rate was recommended. The purposes of the levy, as outlined by Simon, were (1) to add to Government revenue and (2) to check consumer spending as a means of lessening inflation dangers.

The wholesale level was chosen in preference to the retail level in the belief that the latter "would involve the recording of and accounting for an enormous number of transactions, many of them very small, and would interfere in many ways with the ordinary carrying on of busy retail trade." ^{1/} A general turnover tax was rejected because of the unequal number of sales among various business organizations and industries in the transfer of goods from point of initial production to final users and consumers. No particular mention was given to a manufacturers' sales tax in discussions by the House of Commons.

B. Opposition and revision

Very considerable opposition developed immediately upon the presentation of the suggestion. The center of the opposition was the Labor group in the House of Commons. Opposition was based primarily on the inclusion of many necessities, such as clothing. Unsympathetic comment also came from other sources. The London Economist, for example, characterized the proposal as interesting and ingenious, but maintained that the relatively small yield would not justify the supposedly extreme administrative difficulties. Others attacked the proposal as a tax measure that would aid inflation rather than check it.

^{1/} House of Commons Parliamentary Debates, 360:75, April 23, 1940 (Sir John Simon).

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Early in July 1940 the proposal was submitted in bill form, without details as to rate schedule or date of commencement, but with a list of exemptions. Fear of Labor opposition caused postponement of consideration of the bill and subsequently the bill was withdrawn. The new Chancellor, Sir Kingsley Wood, however, revised the proposal and resubmitted it as a part of the supplementary budget on July 23, 1940. The basic modification was the replacement of the uniform rate principle by a differential rate schedule, the rates being lower on "necessities" than on "luxuries." The basic rate in the new bill was 33-1/3 percent, with a reduced rate of 16-2/3 percent on certain articles considered to be virtual necessities.

C. Enactment and introduction

Substitution of the differential rate schedule for the uniform rate eliminated most of the effective opposition and the bill was enacted in August 1940. The Treasury, after conducting the registration of those subject to the law, set the effective date as October 21, 1940. In general, the tax was introduced without serious administrative difficulty despite many misgivings. Due to the lapse in time between its adoption and the date it became effective, however, a large amount of forward buying was done in order to avoid the tax. ^{1/} Wholesalers were not sympathetic to the levy. The Association of British Chambers of Commerce urged revision to provide collection from the retailer. The Trades Union Congress sought exemption of additional "essentials," especially clothing. In addition, claims that the tax led to profiteering were occasionally raised.

D. Modifications

In order to lessen the burden of the purchase tax on the low-income groups, further exemptions were made during 1942 and 1943. The Finance Act of 1942 provided for the exemption of utility clothing and, later in the year, Treasury orders further exempted utility boots, utility shoes, and utility furniture. The Finance Act of 1943 also exempted all utility cloth as well as textile articles of a kind used for domestic purposes, soft furnishings, and haberdashery. To make up part of the revenue lost from these exemptions and to discourage consumer expenditures on luxuries, a number of articles formerly taxed at 33-1/3 percent were placed in a new 66-2/3 percent rate group in 1942 and subsequently raised to 100 percent in 1943.

^{1/} Forward buying was not a problem when the higher rates of 66-2/3 percent and 100 percent were introduced in 1942 and 1943 because the new rates became effective immediately upon the announcement of the changes.

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E. Present position of the tax

The British appear to have accepted the purchase tax in part because of war psychology and willingness to sacrifice. However, the direct impacts of war, including substantial decreases in the standard of living, rationing, and price controls, have dominated the British economy to such an extent that the purchase tax apparently has been a relatively unimportant additional war factor either in trade or in the life of civilians.

Although the range of taxable goods is great and the rates of tax are high, the expected yield in the 1943-44 fiscal year is only £90,000,000, or about 3.1 percent of the total estimated tax revenue, including customs receipts. With the extension of the number of exemptions and the decrease in the volume of sales of taxable items, ^{1/} the tax is likely to become an even less significant part of the tax structure.

II. Structure

A. Taxpayers

The liability for the tax rests on those concerns which are registered under the law. Registration is required of all manufacturers and wholesalers selling taxable goods in amounts greater than £500 per year. ^{2/} The figure was originally £2,000; the reduction to £500 was made in November of 1941 because of competitive difficulties between registered and nonregistered firms. For example, in some cases small wholesalers could not buy tax free and thus had to advance the money for the tax until the articles were sold, while their larger competitors bought tax free and paid tax only after the time of sale. In other cases, small manufacturers gained an advantage over their competitors since they could sell tax free, having paid tax only upon materials. When the materials were of such nature as not to be taxable at all, the small firms escaped tax entirely.

^{1/} For example, in January and February 1943 the sales value of sports and travel goods decreased 17.3 percent in comparison with the same period in 1942. Similarly, sales of expensive hardware decreased 10.8 percent. The supply of these goods has fallen so greatly that the total value of the sales has decreased in spite of the increase in their prices caused by the purchase tax.

^{2/} Large retailers, such as chain store systems, may also be required to register for purposes of administrative convenience in collecting tax.

There were about 40,000 registered firms when the exemption was £2,000. Available information does not yet indicate the number of additional registrants consequent to the decrease in exemption to £500.

Collections are made on a monthly basis.

B. Tax base and tax rates

1. Tax base

The tax applies normally to the sales price of specified goods sold by wholesalers and manufacturers to retailers for resale or to anyone for final use or consumption. Deviation from this general principle is to be found in certain instances;

a. Some large retailers are registered and thus enabled to buy tax free. Tax apparently applies when the goods are transferred to the retail units.

b. Goods imported into the country for use of the importer are taxed at time of importation.

The tax normally does not apply to sales of articles which are to be resold at wholesale, nor to sales of materials used in further manufacture. The tax does not apply to used merchandise, when records are properly kept, unless their repair and reconditioning has made them virtually new articles.

2. Taxable goods and tax rates

The tax applies only to sales of goods specified in the Act as taxable rather than to sales of all goods except those specifically exempted, as is true in the case of the Australian wholesale sales tax and the Canadian manufacturers' sales tax. The taxable articles are listed in general groups of related commodities. As indicated in the attached table, the coverage is very broad; only a limited number of classes of commodities, such as food, are not mentioned at all. Some items falling within the taxable classes are specifically exempted.

At present, there are three rates. The basic rate of 33-1/3 percent applies to articles considered to be neither semi-necessities nor obvious luxuries. A second group of articles, considered to be virtual necessities, is taxed at a reduced rate of 16-2/3 percent. The maximum rate of 100 percent, introduced in the April 1943 revision of the tax, applies to articles considered to be luxuries. The following table indicates the taxable groups, the principal items subject to the reduced, basic, and maximum rates, and the articles specifically exempted. All articles not falling within any of the listed groups are not subject to the tax.

Classes of goods subject to purchase tax; goods subject to maximum, basic and reduced rates; and goods in the taxable classes specifically exempted

	(1)	(2)	(3)	(4)
Taxable group	: Principal items : subject to : maximum rate : (100%)	: Principal items : subject to : basic rate : (33-1/3%)	: Principal items : subject to : minimum rate : (16-2/3%)	: Principal items : exempted
1. Garments and footwear	Fur and silk articles	Headgear, gloves, and patterns for making apparel	Non-utility clothing, except children's clothing	Utility clothing, children's clothing, utility shoes and boots, utility haberdashery
2. Cloth and other fabrics	Articles of silk, velvet, lace; rugs and carpets	Kapok, feathers, down, etc., linoleum and other floor coverings		Utility textile articles of a kind used for domestic purposes, soft furnishings and travel rugs; utility cloth
3. Furs	All fur articles			
4. Chinaware and pottery		Articles used for domestic purposes, except as specified in col. 3	Articles used in serving and preparation of food and drink	
5. Glassware	Cut glass, glass mirrors	Articles used for domestic purposes, except as specified in col. 3.	Articles used in serving and preparation of food and drink	
6. Furniture		Domestic and office furniture		Utility domestic furniture; hospital furniture; barber, dentist, and theater chairs; school furniture

Classes of goods subject to purchase tax; goods subject to maximum, basic and reduced rates;
and goods in the taxable classes specifically exempted

continued - 2

	(1)	(2)	(3)	(4)
Taxable group	: Principal items : subject to : maximum rate : (100%)	: Principal items : subject to : basic rate : (33-1/3%)	: Principal items : subject to : minimum rate : (16-2/3%)	: : Principal items : exempted
7. Heating, cooking and lighting appliances	Hair waving and dyeing machines	Domestic and decorative lighting fixtures, domestic cooking and heating appliances		Miners' lamps, hurricane lamps, ships' lanterns
8. Cutlery	Electric razors	Articles suitable for domestic or personal use		Knives for tradesmen's use and for use in machinery; horse, sheep, and garden shears
9. Hardware and turnery	Garden furniture and ornaments	Lawn mowers, garden rollers; articles used for domestic or office purposes, except those specified in cols. 3 and 4	Enamelled hollow ware for domestic purposes	Household brooms and brushes; builders' hardware and fixtures; farmers' and artisans' tools
10. Luggage	All leather luggage, wallets and purses			Cardboard and paper boxes; laundry and tradesmen's baskets
11. Cameras and photographic supplies	All except those exempt			Articles used for industrial purposes

Classes of goods subject to purchase tax; goods subject to maximum, basic and reduced rates;
and goods in the taxable classes specifically exempted

Continued-3

	(1)	(2)	(3)	(4)
Taxable group	: Principal items : subject to : maximum rate : (100%)	: Principal items : subject to : basic rate : (33-1/3%)	: Principal items : subject to : minimum rate : (16-2/3%)	: Principal items : exempted
12. Musical instruments and supplies; radios and gramophones	All except those specified in col. 2 and 4	Wireless receiving of domestic or portable types		Gramophones and records for the blind; transmitting sets
13. Clocks and watches; parts and accessories	articles made wholly or partly of platinum, gold, silver or gold plate	All others		Stop watches, time clocks
14. Toys, games, sporting goods and gymnastic equipment		All items except those exempt		Fireworks; painting and tracing books
15. Jewelry and imitation jewelry, semi-precious stones, articles of ivory, etc.	All jewelry and imitation jewelry, etc.			Specialized church ornaments when not made of precious stones or metals
16. Ornamental and fancy household goods, smokers' requisites	Articles suitable for domestic or personal use; artificial flowers; photographic frames and albums	Articles made of celluloid, bakelite or other plastics; ash-trays, pipes and other smokers' requisites, cigarette papers		Glass frames; wreaths; mechanical lighters

Classes of goods subject to purchase tax; goods subject to maximum, basic and reduced rates;
and goods in the taxable classes specifically exempted

8.

Continued-4

	(1)	(2)	(3)	(4)
Taxable group	: Principal items : subject to : maximum rate : (100%)	: Principal items : subject to : basic rate : (33-1/3%)	: Principal items : subject to : minimum rate : (16-2/3%)	: Principal items : exempted
17. Toilet articles	All except as specified in col. 2	Brushes, combs, scissors, razors, etc., except when supplied as part of a set		
18. Perfumes, toilet preparations and soap	All except as specified in cols. 2 and 4	Toilet soap, shampoo, shaving cream, mouth wash, eye lotions, antiseptics		Household soaps
19. Drugs			All except those exempt	Essential drugs of a very costly character
20. Office machinery		All items		
21. Stationery supplies, greeting cards, diaries, calendars, picture post cards, paper articles		All except those exempt		Drawing, graph and tracing paper; wrapping paper; envelopes used as containers
22. Pictures, busts, figures, vases	Those produced in quantity for general sale			Scientific and display models

Classes of goods subject to purchase tax; goods subject to maximum, basic and reduced rates;
and goods in the taxable classes specifically exempted

9.

Continued -5

	(1)	(2)	(3)	(4)
Taxable group	Principal items subject to maximum rate (100%)	Principal items subject to basic rate (33-1/3%)	Principal items subject to minimum rate (16-2/3%)	Principal items exempted
23. Vehicles		All except those exempt		Buses, trolleys, ambulances, fire engines; miscel- laneous agricul- tural and industrial vehicles

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3. Exemptions

a. Goods not falling within the compass of the taxable groups are exempt. The principal groups of goods thus excluded consist of:

(1) Those considered to be absolute necessities, including food, coal, and utility services.

(2) Those already bearing high taxes, such as gasoline, tobacco, and drinks.

(3) Most industrial machinery and equipment, and materials.

b. Within the general groups of taxable goods some specific articles are exempted by provision of the schedule of the Act or by administrative regulation. (See examples in the table.)

c. Sales of goods by registered manufacturers or wholesalers to registered wholesalers for resale, or to manufacturers as materials for further manufacture are not taxable.

d. Also exempted are goods sold for export by registered manufacturers and wholesalers. When goods are exported after tax has been paid, a rebate is allowed subject to certain conditions.

e. Sales by manufacturers or wholesalers whose total sales of taxable goods are less than £500 per year are exempted.

f. Purchases by certain government departments from registered sellers are not taxable. In addition, registered contractors and subcontractors who are the agents of registered contractors engaged directly in supplying such departments may purchase tax free otherwise taxable articles. However, unregistered contractors are not extended this privilege. ^{1/}

The Commissioners have power to determine whether particular articles are taxable or not. Already several lists of taxable and exempt goods have been issued to lessen the number of questions and the amount of uncertainty respecting individual items. These lists become effective if not rejected by the House of Commons within twenty-eight days after issue.

^{1/} In the awarding of contracts, however, the departments attempt to adjust the bid prices of tax-paying contractors for purposes of equity.

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4. Valuation

The tax is intended to apply to the wholesale selling price of taxable goods. When goods are sold by wholesalers to independent retailers, the actual sale price is used for tax purposes. When goods are transferred without sale, or the Treasury believes that the price is not a normal one, the Commissioners can determine the proper price for tax purposes. For example, when a retail store is controlled by a manufacturer, the price at which goods are sold by the manufacturer to the retail store may be far below the normal wholesale price, and the price must be raised for tax purposes to prevent evasion. In case of dispute, a referee selected by the Chancellor renders a decision, which is final.

III. Yield

The original estimate of annual yield at the time the revised measure was proposed in July of 1940 was £110,000,000. For the remaining five months of the 1940-41 fiscal year the yield was estimated at £40,000,000. Due, in part at least, to forward buying, the actual yield during this period was only about £26,000,000.

The following table shows the yield of the purchase tax in relation to the yield of other British taxes for the years 1941, 1942 and 1943.

Fiscal year	: Total : Total		: Purchase tax as		
	: Purchase:	: excises:	: receipts:	: percent of -	
	: tax	: and	: from	: Excise : Total	
	: : customs:	: taxes	: and	: receipts	
	: (millions of pounds)	: Customs :	: from taxes		
1940-41	26.2 a/	529.0	1,358.8	5.0	1.9
1941-42	98.5	704.0	1,962.0	14.0	5.0
1942-43	110.5	884.8	2,482.6	12.5	4.5
1943-44	90.0	975.5	2,873.5	9.2	3.1

Source: Financial Statements of 1941-42, 1942-43, and 1943-44.

a/ Receipts are for November 1941 through March 1942.

It would seem from the yield of the purchase tax that it is not too significant a part of the tax structure. Either the tobacco or liquor duties, for example, returns a larger yield than the purchase tax.

The estimated yield of the tax for the fiscal year 1943-44 of £90,000,000, a reduction from the yield of the previous year, is due to a further increase in the scarcity of taxable articles and to the increased number of tax-exempt articles.

IV. Administrative problems

The introduction of a general sales tax into the tax system of any country necessarily requires increase in administrative personnel and creates administrative problems which require solution. In the case of the British purchase tax, the position of the chartered accountants and certain factors arising out of the war situation apparently have lessened the number and seriousness of these problems. The chartered accountants in Great Britain consider themselves to be servants of the government as well as agents of the firm employing them. Accordingly, their work increases greatly the amount of taxpayer cooperation. The very serious war situation apparently has greatly increased the willingness of taxpayers to cooperate with the Commissioners in the desire to avoid controversy and litigation with regard to interpretation of the tax. The scarcity of goods, the bombings of stores and houses, and the limitations on transport are problems so much more important than technicalities of the purchase tax that possible controversies which in peacetime would attract serious attention are now largely forgotten. Extensive price fixing and the limitations on travel of individuals have served to limit price competition and to lessen the significance of such competitive inequalities as may be created by the tax. Finally, standardization and price and margin controls in themselves tend to simplify administrative determinations respecting tax base.

Although the foregoing factors have facilitated the introduction and operation of the new tax, the basic administrative problems outlined below remain.

A. Determination of sales at wholesale

The basic principle is that only sales by registered firms (wholesalers and manufacturers) to unregistered firms (retailers) are taxable. But while in general this principle is satisfactory, it is not without qualification. Two types of transactions require exception from the general rule:

1. Sales by registered firms to other registered firms for use by the buyer are subject to tax. The administrative provisions designed to insure this inclusion require that buyers must show at time of purchase that goods are being bought for resale or for use as materials for manufacture; otherwise the tax is applied.

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2. Transfers of goods to retail stores owned and operated by wholesalers or manufacturers are taxed at the time of transfer of goods to the retail unit, even though there is no bona fide sale, in order to avoid placing at a competitive disadvantage the independent retailers who must supply the working capital to cover the tax.

B. Determination of goods subject to tax

The law specifies the generic classes of goods subject to the levy. Consequently, it has been necessary for the Commissioners to issue detailed lists enumerating exactly which articles within the classes are subject to tax and which are exempt. For example, watch fobs are listed as included in the "clock" class subject to the levy; time clocks to record arrival and departure of employees are not. Some of the regulations are very detailed. For drugs and medicines, about 300 items are specified as exempt. In some cases, exemption is controlled by the intended use of the article. Thus, fishing nets to be used for commercial fishing are exempt; those to be used for sport are taxed.

The principal difficulties created by the problem of determining taxable goods are:

1. The time required for administrative decisions.
2. The arbitrary distinctions that must be drawn between closely related goods at the same time that attempts are being made to avoid competitive disturbances in industry.
3. The uncertainty as to whether specific articles are taxable or exempt and the difficulty to taxpayers in keeping track of goods subject to different rates of tax and goods exempt.

C. Determination of wholesale value

The law specifies wholesale value as the tax measure. However, varying business practices introduce difficulties in regard to the administrative determinations of proper wholesale value.

1. In the case of transfer without sale, the proper wholesale sales value must be determined. Determination of tax measure in this case is not difficult when articles are standardized or when similar goods are actually selling at wholesale. If these conditions do not obtain, the determinations are difficult.

2. In the case of sales to retail outlets controlled by registered wholesalers and manufacturers, the prices may not represent true wholesale value. Accordingly, adjustments are necessary.

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3. In the case of sales by registered wholesalers or manufacturers directly to consumers, the sale price may be at the retail level rather than the wholesale level. To use the actual price in such a case would impose undue tax burden. The attempt is made to adjust the retail price to the customary wholesale price for the same goods. When this kind of determination is impractical, a percentage figure equal to customary retail mark-up is subtracted.

4. Even in the case of arm's-length sales to retailers adjustment of sales prices is often necessary. This is true in the cases of:

a. Sales by registered manufacturers to retailers or commercial users made at the same prices at which sales are made to registered wholesalers. Here, the prices for tax purposes, according to the regulations, ^{1/} must be raised to the usual wholesale-retail sales level.

b. Quantity discount prices. Unusually high quantity discounts may not be deducted for tax base purposes, although normal quantity discounts are deductible.

c. Sales at cash discount. Ordinary cash discounts may be deducted whether the buyer takes advantage of them or not.

d. Sales at prices which do not include delivery costs. Delivery expenses must be added to the sales price for tax base purposes, whether such charges are included in the sales price or not, and whether the seller actually delivers or not. In the latter case, either a normal "delivered" price is used or an amount is added equal to "normal" delivery charges.

V. Incidence and tax burden

A. Shifting to the retailer

The levy normally can be expected to be passed on to the retailer immediately by the addition of the amount of the tax to the wholesaler's price. There is no provision in the law which attempts to force this shifting, but since the tax constitutes a substantial cost increase, the sellers cannot be expected to absorb it in whole or to any substantial extent.

^{1/} Notice No. 79, March 1941.

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It is possible that in some cases the tax may cause loss in sales and secondary readjustments in prices to offset higher costs and lower sales volume. But with the situation one of wartime scarcity of goods, it is unlikely that the tax could be responsible for additional serious contraction in sales volume.

There is some opinion, however, that the high luxury tax has the effect of either forestalling or absorbing abnormal profits on luxury articles in very short supply. The reasoning is that in the absence of rationing and effective price control, the prices of luxury articles would inevitably rise to what the market would bear. Thus, producers and distributors of the scarce goods would make abnormal profits per unit of sale. The 100-percent luxury tax, however, tends to absorb the abnormal profits since selling prices to consumers probably are no higher under the tax than they would be without it.

B. Shifting to consumers

The retailer can normally be expected to pass on to the consumer both the tax and any secondary price increase. Under the law the wholesaler is required to show separately on the invoice to the retailer the amount of tax on each transaction, so that the retailer may himself add the tax only to the retail prices of taxable goods. Failure to do this would tend to defeat the intent of the law to tax only certain goods. Although diffusion of tax burden to untaxed goods is still possible with such provisions, it is less likely than would be the case if the tax were only indicated to the retailer as a lump sum. The retailer may quote the tax separately to the consumer but is not required to do so. In practice, retail prices apparently are quoted inclusive of tax.

C. Pyramiding

Although the law says nothing about the action of the retailer in regard to the tax, it was apparently the intent of the government not to permit retailers to make their margin on the tax. The separate quotation provision was designed in part to check such pyramiding. In addition, immediately after the tax went into operation the Central Price Regulation Committee issued a regulation designed to prevent the application of the old retail mark-up percentages to the tax. The retailers were required to lower their mark-up figures on the basis of a table supplied in the regulations. This table was constructed in such a way that the new mark-up figure applied to purchase price including tax would raise retail prices only by the amount of the tax. Thus a retailer formerly using a 20 percent mark-up must now use one of 16 percent on goods subject to the 33-1/3 percent rate. Enforcement was left to users and consumers who have the privilege of reporting pyramiding violations to local price control bodies.

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However, the Committee did authorize retailers to readjust mark-ups to cover higher cost from lower sales volume caused by the tax. The need for this was indicated by the Secretary of the Retail Distributors Association at the time the tax went into operation. The importance of tax-induced loss in sales, however, seems to be remote under present British supply conditions. In peacetime, such mark-up adjustments, under high tax rates, could raise prices significantly more than the amount of the tax.

D. Multiple taxation

The intent of the law is to avoid multiple taxation. This largely is accomplished (a) by excluding from the scope of the tax such articles as industrial machinery and equipment, (b) by exempting materials for manufacture (that is, materials wrought in and attached to articles in the process of manufacture), and (c) by exempting many articles used in commerce and industry when they come within the scope of the taxable classes of goods. However, office furniture, business machinery, and office supplies (with exceptions) generally are taxed. To the extent, therefore, that such articles are taxed, the costs of producers and distributors are increased and the final sales prices of taxed and untaxed articles also tend to be increased. The extent of the exemptions is so broad that multiple taxation under the purchase tax appears to be relatively unimportant.

E. Tax burden

Because of the inclusion of some necessities, low-income groups bear a small portion of the purchase tax burden. It must be remembered, however, that almost all of the articles and services that bulk large in low-income budgets are excluded. Even before the exemption of utility clothing, utility cloth, utility furniture and certain textile articles, it was estimated by the Treasury that 80 percent of total consumers' expenditures were made for tax-exempt goods and services, with an additional 12 percent for articles subject to the 16-2/3 percent rate. According to an independent study based on the 1941-42 law, the estimated burden of the tax on a family of four varied from about 2 percent of earned income for those having incomes of £100 to 0.1 percent on incomes of £50,000. ^{1/}

Under present exemptions, a larger percentage of consumer expenditures will be made for tax-exempt goods. Moreover, with the further increase in the tax to 100 percent on luxury articles, a greater part of the tax load probably will be shifted to upper income consumers.

^{1/} G. Findlay Shirras and L. Rostas, *The Burden of British Taxation*, Cambridge, The University Press, 1943, Table 10, pp. 52-53.

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Government subsidies along with price control of food ^{1/} and other essential commodities have succeeded in effectively stabilizing the cost of living at about 125 to 130 percent of the prewar level. The benefits accorded to the low-income groups by this price stabilization policy must be recalled when considering the burden, usually slight, imposed on them by the purchase tax. As a matter of fact, purchase tax collections in the fiscal year 1942-43 are expected to be only about half the cost of subsidy payments needed to stabilize prices. ^{2/}

^{1/} Price control now covers about 90 percent of the food expenditures of the average housewife.

^{2/} In the April 1943 Financial Statement, Sir Kingsley Wood stated that the cost of the subsidies was running about £180 million per year.

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AUSTRALIAN WHOLESALE SALES TAX

Division of Tax Research
Treasury Department, Washington, D. C.
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The Australian Wholesale Sales Tax

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The Australian Wholesale Sales Tax

I. Introduction

A. Origin

The Australian wholesale sales tax was introduced in 1930, primarily as a source of revenue to offset declines in customs receipts caused by the depression. Although excises on liquor, tobacco, and gasoline had been important sources of revenue for many years, no sales tax had previously been used in the Commonwealth, and very little consideration had been given to the possibility of the use of one. The legislation was drawn up by the government without cooperation of the business groups that became the taxpayers. ^{1/} Almost immediately after the tax became effective, serious criticism arose, primarily because of difficulties arising from administrative interpretations of the Act. As uncertainties have been cleared up by legislative amendments and administrative rulings and as taxpayers have become accustomed to the law, much of the criticism has disappeared. The greatly increased seriousness of the war situation confronting Australia in the last two years apparently has quieted the criticism that did remain, but perhaps only for the emergency period.

In contrast to the situation in other countries, little opposition has been manifested by labor groups. The exemption of many necessities and the adjustment of the basic wage level by the wage-fixing tribunals to cover higher cost of living caused by the tax would seem to have been responsible for acceptance of the tax by labor groups.

B. Development of rate structure

The rate structure has undergone a number of changes in the past; changes have been made nine times in the thirteen years the law has been in operation. Prior to November 1940 all taxable transactions were subject to a uniform rate which ranged as follows:

1930-1931	2-1/2%
1931-1933	6%
1933-1936	5%
1936-1938	4%
1938-May 1940	5%
May-November 1940	8-1/3%

The low initial rate was found to yield too little revenue and was raised to 6 percent. The rate was then gradually reduced to 4 percent in 1936 because of the improved financial position of the Commonwealth Government. The increases since 1938 have been made to provide more revenue for war purposes.

^{1/} The experience of Canada with a sales tax was drawn upon in the establishment of the Australian tax.

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In November 1940 a three-rate system, with rates of 5, 10, and 15 percent, was introduced to allow more revenue to be obtained from "luxuries" without raising the rate on other goods, especially semi-necessities, too heavily and to check consumption of goods requiring resources needed for war purposes. In October of 1941, the 15-percent rate was raised to 20 percent. In May of 1942, the 10-percent rate was raised to 12½ percent and the 20-percent rate to 25 percent. The 5-percent rate group was eliminated, 1/ and most of the articles were transferred to the exempt classes. An Amendment to the National Security (Supplementary) Regulations, effective July 21, 1943, provided for a 7½-percent rate of tax on sales of rationed clothing, linens, and soft furnishings. The purpose of this reduction in rate was to help keep living costs at the April 1943 level.

1/ This group, known as the "Second Schedule," was created in November 1940 out of classes previously exempt. From that date until October 1941 the principal classes in this group were:

1. Mining machinery and equipment
2. Irrigation equipment
3. Those foods not exempt
4. Most taxable printed matter
5. Building materials
6. Most drugs, medicines, and surgical goods
7. Scientific and educational goods for use in schools
8. Commercial fishing equipment

In October 1941, the government sought to eliminate this rate group entirely and transfer the classes to the basic rate group, at that time subject to a 10-percent rate. Apparently as a result of political compromise, the 5-percent group was retained but with most of its constituent parts, namely: mining and irrigation equipment, foods, printed matter, and building materials, removed. Most of the classes transferred out of this group were placed in the basic rate group; a few items (farm pumping equipment and some surgical appliances) were exempted. In May 1942, the 5 percent group was eliminated entirely, and all articles which had remained in it after the 1941 changes (drugs and medicines, scientific and educational goods, and commercial fishing equipment) were exempted.

In general, the use of differentiated rates has been designed to lessen the regressiveness of the tax by placing heavier rates on those articles generally considered to be luxuries.

II. Structure

A. Taxpayers

All firms making sales at wholesale and all manufacturers are required by law to register. Tax payments must be made by the registered firms on a monthly basis. "Sales at wholesale" are defined as sales by one merchant to another for purposes of resale by the latter, and sales to manufacturers of materials for use in manufacturing. 1/ The term "manufacturer" is defined very broadly to include all types of processors and assemblers as well as manufacturers in the usual sense of the term. 2/ Most payments are made by the wholesale firms, since the tax does not ordinarily attach at the point of sale by manufacturer to wholesaler. Retailers who make any wholesale sales are required to register even though they do most of their business at the retail level.

B. Taxable goods and tax rates

In general, the tax is intended to apply to the wholesale price of taxable goods at the point of the last wholesale sale. Normally the tax attaches when the goods are sold by a wholesaler to a retailer, or by a manufacturer to a retailer when the manufacturer sells directly to retail stores. When a manufacturer sells directly to consumers or industrial and commercial users, the tax attaches at the time the manufacturer transfers the goods to his retail outlets or, when this is not done, at the time of sale. The tax attaches also to the sale of goods to wholesalers when the latter intend to sell the goods at retail, and to sales at retail by wholesalers of goods which were originally purchased for the purpose of sale at wholesale. Goods imported into Australia by retailers and consumers are also subject to the tax.

The tax does not apply to sales of goods by manufacturers to wholesalers or others intending to resell the goods at wholesale, to sales made by wholesalers to other wholesalers, 3/ to sales by retailers of goods taxed at a previous sale, or to sales of materials to be used in manufacture. The intent is that the tax apply only once to any one good as it passes through the distribution channels.

-
- 1/ As indicated below, not all wholesale sales are taxable but, in general, only those made to retailers and to final users.
 - 2/ Primary producers, such as farmers and mining companies, would also be subject were it not for the fact that their products are exempt.
 - 3/ Unless the purchaser intends to resell the goods at retail.

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All goods 1/ are subject to tax unless specifically exempted. 2/ The present rate structure consists of three rates: a 25-percent rate applying to a specified group of luxuries and durable necessities, a reduced rate of 7½-percent applying to a select group of rationed goods, principally clothing and household linens, and a 12½-percent basic rate applying to all other taxable articles. The principal goods included in each rate group are indicated below.

1. Reduced rate group

The 7½-percent rate group consists of rationed commodities included in the definition of coupon goods, 3/ other than goods covered by any item in the Third Schedule to the Sales Tax. 4/

The commodities in the group are:

- a. Clothing
- b. Piece goods
- c. Household linens
- d. Soft furnishings
- e. Yarns

2. Basic rate group

The 12½-percent group, by far the most important, includes all items neither exempt nor specified in the 7½- or 25-percent groups.

1/ Services are not taxable.

2/ This feature is in direct contrast to the British purchase tax, under which only those goods specified as taxable are subject to the levy. The Australian sales tax is similar to the Canadian in this regard.

3/ Rationing Order No. 27. The term "coupon goods" means such rationed goods as are specified in the First Schedule, but does not include goods of the descriptions specified in the Second Schedule or bona fide secondhand goods.

4/ The Third Schedule consists of those commodities subject to the 25-percent rate.

The principal commodities in the group are:

- a. Almost all industrial, mining, and commercial equipment and machinery ^{1/}
- b. Automobiles, tires, and accessories
- c. Most durable consumption goods, such as furniture ^{2/}
- d. Nonrationed clothing (with very few exceptions)
- e. Building materials ^{3/}
- f. Taxable foods and household articles. Most basic essential foods are exempt; food articles taxable include pastry, canned vegetables, canned soups, sauces, relishes, desserts of all types, canned meat, canned fish, and numerous miscellaneous items ^{4/}
- g. A great many miscellaneous articles not falling into any specified group

This group includes the largest number of sales transactions. In 1940, before the list was greatly increased by the transfer of items from the eliminated 5-percent group, 75 percent of taxable sales were included in this group. Figures are not available for the current situation.

3. High rate group

The 25-percent rate group (Third Schedule in the law) is composed of goods considered to be luxuries, or goods the purchase of which can easily be postponed. The principal classes are:

-
- ^{1/} Mining equipment and machinery were exempt from 1932 to 1940 and subject to a 5-percent rate 1940-1941.
 - ^{2/} Some electrical appliances are taxed at the 25-percent rate.
 - ^{3/} These had been exempt for several years prior to 1940 and were taxed at the 5-percent rate 1940-1941.
 - ^{4/} Prior to 1940, almost all foods were exempt. In 1940, the exempt class was reduced somewhat by eliminating exemption of pastry, canned vegetables, canned soup, sauces, coffee, cocoa, fruit juices, and some other items. These groups were taxed at first at 5 percent; in 1941, they were placed in the basic rate class.

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- a. Jewelry and fancy goods
- b. Watches and clocks
- c. Cosmetics and women's toilet articles
- d. Men's toilet articles
- e. Fancy ornamental goods of all types
- f. Cutlery
- g. Luggage
- h. Musical instruments and radios
- i. Motion picture and photographic equipment
- j. Furs - except rationed fur garments
- k. Sporting equipment, toys and games
- l. Candy and ice cream
- m. Household electrical appliances
(refrigerators, washing machines, vacuum cleaners, lamps, etc.)
- n. Office machines
- o. Garden equipment
- p. Many paper products
- q. Cooking and heating appliances
- r. Floor coverings

It should be noted that in the past year production of most of the articles in this group has been stopped in order to free material and man for war purposes.

C. Exemptions

1. Goods specifically exempted

a. Certain basic necessities

- (1) Specified essential foods: 1/ bread, fresh meat and fish, dairy products, dried vegetables, dried and canned fruits, sugar, molasses and jam, certain cereals, flour, nuts, tea, and prepared baby foods 2/
- (2) Drugs, medicines, and surgical goods 3/
- (3) Fuel, power and light
- (4) Footwear

1/ Some items within this group are exempt only if produced in Australia.

2/ Fresh fruits and vegetables are exempt because they are primary products.

3/ From 1940 to 1942 the exemption was restricted to pharmaceutical preparations and life-saving equipment. The exemption was greatly broadened in 1942.

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b. A limited number of goods used in production consisting of:

- (1) Agricultural machinery, equipment and supplies
- (2) Commercial fishing machinery and equipment ^{1/}
- (3) Materials for use in making exempt goods ^{2/}
- (4) Nondurable aids to manufacture, for use by un-registered manufacturers, ^{3/} such as belt dressing, dyes, bleaching powder
- (5) Containers, other than those which can be returned to the seller
- (6) Industrial fuel and power

These articles are exempted in order to lessen multiple taxation. However, industrial and commercial equipment, and building materials are taxable. It is difficult to understand the distinction drawn between nondurable aids to manufacture and durable capital equipment, as both enter into cost of production.

c. Unprocessed primary products of Australian agriculture, mining, logging, and fishing. Imported primary products are not exempt whether they are processed or not.

The exemption of this group is made primarily for administrative reasons. Most of the products would not be taxed anyway. Some would be exempt as materials for manufacture (logs, ore, wool, cotton, wheat); others as fuel (coal); others as necessary foods (fresh fruit, vegetables, etc.). By exempting them directly as primary products much administrative expense and difficulty is avoided; yet little or no tax revenue is lost. If these goods were not exempt, registration of thousands of additional enterprises, including small farms, would be necessary.

^{1/} Taxed at 5 percent 1940-1942.

^{2/} Sales of materials which become physical ingredients of taxable goods are exempt because purchasers are allowed to quote their registration certificates, and thus avoid payment of tax, when buying materials.

^{3/} Those used by registered firms are exempted by quotation of registration certificate at time of sale, as explained below.

- d. Goods subject to heavy excises: tobacco, liquor, and gasoline
- e. Goods of educational and religious nature
 - (1) Books and periodicals
 - (2) Articles for use in churches
 - (3) Certain works of art
 - (4) Certain articles for use in schools and universities, such as scientific instruments and apparatus.
- f. Secondhand goods

These are exempted to avoid administrative difficulties.

2. Goods sold to government agencies, including materials sold for construction of private buildings for manufacture of goods for war purposes under government contract, and machinery used for the same purpose.

3. Goods sold by registered wholesalers and manufacturers to other registered firms when the latter quote their certificates of registration. Exemption of these transactions has the effect of excluding from the tax all wholesale sales made to those intending to resell the goods at wholesale, and all sales of materials which become physical ingredients of taxable articles. The law specifies that certificates are to be quoted in the following instances:

- a. Purchase or importation by manufacturers of materials to be used in, wrought into, or attached to goods being produced, in such a way as to form an integral part of the goods.
- b. Purchase or importation by manufacturers of aids to manufacture. These articles consist of nondurable goods used in any way in production other than as actual material.
- c. Purchase or importation by wholesalers of goods intended to be resold at wholesale.

These sales are exempted to avoid multiple taxation. The intent is that the tax shall be a single-stage levy, and not a form of multiple or turnover tax.

4. Goods exported or sold for export. Refund can be obtained if tax has already been paid on the goods. The exporter can get the refund whether he has actually paid the tax to the government or has borne it through higher purchase price of goods bought. To impose the tax upon exports would place Australian commodities at a relative price disadvantage in foreign markets and make it more difficult for Australia to maintain her export trade.

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5. Sales by small manufacturers

- a. Sales of goods manufactured and sold at retail by firms having annual total sales volume of less than £700. ^{1/}
- b. Sales of goods manufactured by a person in his own home if sales volume is less than £500 per year.
- c. Sales of goods by manufacturers whose sales tax would amount to less than £5 per year.

These exemptions are made primarily for administrative reasons.

The extent of the present exemptions is comparable to that of the original law and is greatly restricted in comparison to the exemption list of the period from 1936 to 1940. The original law exempted only primary products, fuel and power, a few basic foods, sales of goods for use as materials for manufacture or for resale at wholesale, sales to government agencies, and sales for export. As recovery from depression improved the financial position of the government, a wide range of goods was added. The principal classes were:

- (1) A great many foods not previously exempt
- (2) Drugs and medicines
- (3) Many goods used in production, especially
 - (a) Farm, mining, irrigation, and fishing machinery and equipment
 - (b) Building materials
 - (c) Nondurable aids to manufacture
- (4) Educational and scientific articles, including books and periodicals

By 1939, the exemptions had been increased to the point that only one-third of all sales transactions were subject to tax. ^{2/} With the coming of the war and the greater need for revenue and for reduced personal consumption, the exemption list was curtailed substantially. In 1940 and 1941, all machinery (except that for farm use) and building materials were made taxable, the list of exempt foods curtailed somewhat, and the number of drugs and medicines and educational and scientific goods exempted was reduced very drastically. In May of 1942, the trend was reversed slightly when fishing machinery, most drugs,

^{1/} £1,000 prior to 1941.

^{2/} Budget Speech, 1939-1940

medicines, and surgical appliances, and certain educational and scientific goods, formerly taxed at 5 percent, were exempted entirely. The rate reduction to 7½ percent, in July 1943, on certain rationed articles, in order to help maintain the April 1943 level of living costs also deviates from the previous trend.

D. Wholesale value

The intent of the law is that wholesale sales price, at the point of sale to the retailer, shall be the price for tax-base purposes. When there is no actual wholesale-to-retail price or the actual price does not appear to the Commissioner of Taxation to represent a normal price, the wholesale price is determined by the Commissioner.

The entire charge made to the buyer in the transaction is considered to be the price, even though some items, such as freight, may be invoiced separately by the seller. However, only actual charges are included. If the goods are sold on an f.o.b. basis, freight charges are not added. This is in contrast to the British purchase tax, which requires addition of delivery charges even though the seller does not deliver. The Australian method is simpler from an administrative standpoint; the British method is more equitable and less likely to disturb existing trade practices.

In the case of credit transactions, the actual price, not the cash price, must be used. This likewise is in contrast to the British law, which allows adjustment of credit prices to a cash basis. Cash discounts allowed in the case of cash transactions may be deducted from the tax base. The discount however must be figured on the price net of the tax.

E. Administration

The administration of the law is vested in the Commissioner of Taxation. The Commissioner has ample power to:

1. Determine liability for registration
2. Make price readjustments for tax base purposes when necessary
3. Determine whether or not articles fall into exempt or taxable groups
4. Determine the proper rate group in which an article belongs
5. Interpret provisions of the law dealing with quotation of certificates

The returns made by the taxpayers are audited by the Commissioner's auditors, usually on the premises of the taxpayers. If any question arises as to amount of tax due, the Commissioner may set the amount and the taxpayer must pay this amount unless he can disprove its correctness. The Commissioner has wide powers to insure collection; he can sue the taxpayer, a debtor of the taxpayer, or even the bank holding a taxpayer's

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account, to collect taxes due. A taxpayer leaving the country must get a certificate that all taxes due have been paid or arranged for before he can leave Australia.

The actions of the Commissioner in many cases have been carried to the courts, although in some cases the latter have overruled the decisions of the administrative body, the Commissioner has been upheld in most cases and litigation apparently has decreased as the tax has become more firmly established.

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III. Yield

The tax yield and the relative importance of the tax in the revenue system are indicated below.

Fiscal year	Sales tax yield	Sales tax expressed as percent of total Commonwealth tax revenue (including customs)
1930-1931	£ 3,472,854 ^{a/}	6.9%
1931-1932	8,425,067	15.6
1932-1933	9,369,276	16.7
1933-1934	8,695,689	15.4
1934-1935	8,554,076	14.6
1935-1936	9,432,483	14.8
1936-1937	8,008,427	12.8
1937-1938	8,023,886	11.6
1938-1939	9,308,334	12.6
1939-1940	12,196,175	13.5
1940-1941	19,792,680	15.8
1941-1942	26,830,085	15.0
1942-1943	28,772,557	11.2

Sources: Quarterly Summary of Australian Statistics, 1931-1941; Budget Speech, 1941-1942, 1942-1943; Receipts and Expenditures of the Consolidated Revenue Fund for the Year Ended June 30, 1943, p. 5.

^{a/} The law operated only 10 $\frac{1}{2}$ months of the fiscal year.

The failure of the revenue to increase between 1933 and 1939 was due to the reduction of rates and increase in exemptions during that period. The very substantial increases since 1939 have been due to higher rates, fewer exemptions, and some price increases. ^{1/} At

^{1/} Price increases in Australia have been less than in many countries. The retail price index of food, groceries, housing, clothing, and miscellaneous expenses rose from 90.8 in 1939-40 to 100.9 in December 1941 to 110.1 in April 1943 (1928-1929=100). Wholesale prices rose from 95.1 in 1939-40 to 110.1 in December 1941 to 124.4 in April 1943 (1928-1929=100). See Statistical Bulletin, Commonwealth Bank of Australia, May 1943.

present, extensive price and margin control, rationing, and shortages of goods, especially durable consumption goods, will likely prevent any further substantial increase in, and may even reduce, the yield.

IV. Administrative problems

The Australian sales tax has been the source of considerable difficulty to the administrators of the law and to the taxpayers. Criticism has quieted somewhat as time has gone on, and extremely serious war conditions of the last year have increased cooperation of the taxpayers. Prior to December 1941, the position of Australia was relatively secure; the entry of Japan into the war and the successful Japanese conquest of Singapore and the Dutch East Indies almost overnight placed Australia in a very dangerous position. War efforts have been greatly increased; prices and wages rigidly set; manpower conscripted for army and industry; and the whole attention of the country turned to defense against invasion. In such circumstances, administrative problems of the sales tax seem of little consequence. However, the problems of the tax have been important in the past and may well be again in the future.

The principal sources of difficulty have been:

A. Determination of last sale at wholesale

The intent of the law is that the tax shall apply at the last wholesale sale through which the article passes. Difficulty arises in carrying out this principle since determination of whether or not a particular sale is the last wholesale sale depends upon the intent of the buyer as to disposition of the article. If he intends to sell the article at retail, the previous transaction is the last wholesale sale and is taxable; if he intends to sell the article at wholesale, the previous transaction is obviously not the last wholesale sale, and the tax attaches at time of subsequent sale. If wholesalers and retailers did solely wholesale and retail business respectively, there would be no difficulty, but such is not the case. Wholesalers sometimes sell at retail; if they buy goods for this purpose, they must so indicate to the manufacturer and the latter must pay the tax. The manufacturer must pay the tax when he sells to a retailer. A retailer may sell at wholesale; to the extent that he does, he can buy tax-free and pay the tax at time of sale. As a result of these complexities, all wholesalers, ^{1/} most manufacturers, and some retailers must pay the tax on part but not on all of their sales. Thus, accounts and inventory records are complicated and danger of evasion is increased.

^{1/} Unless one should sell entirely to other wholesalers.

B. Determination of the status of a firm as a manufacturer within the compass of the law

The problem of whether or not a firm is a manufacturer is significant only in the case of firms making sales at retail, since in the case of firms making sales to other firms the sales properly taxable are taxable as wholesale sales regardless of whether or not the seller is classified as a manufacturer. In the case of firms selling at retail, however, the problem is important since in some cases tax evasion would occur if the firm selling at retail is not classified as a manufacturer. For example, a person canning fish purchased from a fishing enterprise and selling the product at retail would not be taxed unless he were classified as a manufacturer.

The law specifies that a manufacturer is one who engages in the manufacture of goods, including printers, publishers, lithographers or engravers. Manufacture is defined to mean production, including any act whereby an article commercially distinct from the parts or ingredients is formed. In practice, the definition has been construed very broadly to include all types of processing and assembling. In earlier years many cases of dispute arose; for example, questions were raised as to whether or not public stenographers and motorcycle assemblers were manufacturers. As the administrator and the courts have acted on the borderline cases, most firms have come to understand their status.

Difficulty has also arisen in regard to the position of firms making goods under contract for other firms. As the law stands at present, the contractors are not manufacturers if the firm with whom the contract is made supplies at least part of the materials and intends to sell the finished product. If all materials are supplied by the contracting firm and the goods are intended for use and not for resale by the other firm, the contracting firm is held to be the manufacturer.

C. Determination of materials for and aids to manufacture

Prior to 1936 aids to manufacture were not exempted and many problems arose as to whether a certain article became an essential constituent part of a product or was merely an aid to the manufacture of the product. Exemption of aids to manufacture, in 1936, simplified the problem somewhat. Many problems remain, however, in regard to accessories and parts, especially as to whether they constitute essential parts of the product. Likewise, borderline cases arise in regard to aids to manufacture. The intent is that only those aids consumed directly in manufacture, and thus not durable ones, should be exempt. But, in practice, it is not always easy to decide whether a certain article is consumed directly and uncertainty and necessarily arbitrary decisions result. Thus steel wool is held to

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be exempt; moulds and photographic plates are not. Likewise, articles that are exempt when purchased for use as "aids in manufacture" are not exempt when purchased for other purposes. For example, sponges bought to be used to apply dressing to shoes being manufactured are exempt; identical sponges bought to be used to clean the windows of the shoe factory would be taxable.

D. Determination of taxable goods

One of the greatest difficulties, especially in earlier years, has been that of eliminating uncertainty as to whether certain goods properly belonged in exempt or taxable groups. Numerous administrative rulings and increased detail in the law have been necessary. For example, 117 separate foods for infants and invalids are listed by brand name in the law itself. The exemption section of the 1938 sales tax volume containing the law and administrative rulings occupies 341 pages.

During the first few years of operation there was no single cumulative volume giving complete information on exemption rulings, and taxpayers often had difficulty in finding out the decisions on particular goods. In 1936 and 1938, complete indexed lists of all rulings were published. Monthly bulletins of current rulings are also provided.

Although uncertainty has been reduced as more and more cases have been ruled upon, it has not been eliminated. New products are constantly being developed and firms frequently must seek administrative rulings on these. Likewise, constant changes have been made in the scope of the exempt class.

Apart from uncertainty is the time and expense to business firms that is involved in segregating taxable and nontaxable transactions, keeping stock records, and quoting sales prices.

Finally, complications are introduced by the fact that exemption of goods imported is not the same as exemption of domestic goods.

E. Determination of proper rate group

Closely related to the problem of exemption is that of determination of the proper rate group in which an article belongs. This problem arose only with the establishment of the differential rate system in 1940. The problems of uncertainty, accurate record keeping, and evasion are similar to those created by the exemption of certain goods. From reports available, administration of the law apparently has been rendered much more difficult by the establishment of the differential rate system, despite war conditions which have led to increased willingness of taxpayers to cooperate.

F. Determination of wholesale value

When goods are sold by wholesalers to retailers or by manufacturers to retailers at regular wholesale-retail prices and the sale is at arm's length, with no control exercised by either party over the other, the actual sale price can be used for tax-base purposes. In the great majority of transactions this situation is to be found. In the following cases, however, price adjustment is necessary.

1. Sale of goods at retail by a manufacturer. The price used is:
 - a. The wholesale price charged by the manufacturer, if the latter sells the same goods at wholesale.
 - b. The price at which the manufacturer could buy similar goods from another manufacturer, if the former does not sell these goods at wholesale.
2. Sale of goods at retail by a wholesaler. The usual wholesale price is used.
3. Sale involving quotation by the manufacturer of two prices, one for materials, the other for labor. The sum of the two charges is taxable, even though services are not normally subject to the tax.
4. Transfer into stock to be sold at retail of goods not previously taxed. Manufacturers or wholesalers may produce goods, or buy goods tax-free on the basis of intended resale at wholesale, and then later transfer the goods to retail outlets owned by the firms, or into stocks of goods out of which retail sales are made. The tax applies at time of such transfer. The usual wholesale price of the goods is used for tax purposes. If the manufacturer has paid tax on all materials used, the tax base applicable when goods are transferred to retail stock is the wage cost plus 20 percent.
5. Application by wholesalers or manufacturers of goods for their own use. In the case of wholesalers, the tax is applied to the purchase price of the articles used. In the case of manufacturers, the usual wholesale sales price is used.
6. Import transactions. In the case of import transactions which are taxable at time of importation, 1/ the value for duty purposes plus

1/ Goods imported by unregistered firms, by any firms for resale at retail, or by manufacturers or other firms for use as equipment. In other cases the tax is paid when the goods are sold to retailers.

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20 percent is the tax base. ^{1/} The 20-percent adjustment is made to allow for usual wholesale margin.

7. Sales to controlled firms. The Commissioner has power to alter the sale price, when it appears to be lower than reasonable, to the usual wholesale level for similar goods.

V. Incidence

A. Consumption goods

1. Shifting to retailers

As explained above, the tax is paid ordinarily by the wholesaler on the basis of his sales to retail firms, or by the manufacturer who sells directly to retailers. The tax represents a substantial increase in cost to the taxpayer and almost certainly will be passed on to the retailer. The taxpayer is required to quote the tax separately to the retailer rather than to include the tax in the selling price. The seller is not required, however, to add the tax at all if he does not wish to. In earlier years, complaints by business men that some firms were absorbing the tax developed. This occurrence would seem to be the exception, however, especially under wartime conditions.

In cases in which the price increase causes substantial loss in sales volume and thus raises average cost of manufacturers and wholesalers, further price increases to cover the latter are likely. To the extent that these increases have been made in the past, they remain today. However, at present, if the tax were to be increased above current levels, price increases beyond the amount of the tax probably would be limited, if not prevented, by rigid price control.

2. Shifting to consumers

a. Prior to present price-control system

The incidence of the tax has been altered somewhat by introduction of rigid price control. Shifting in the situation prior to the establishment of control will be considered first. As indicated above, if wholesalers added the tax to the selling prices the retailers were confronted with higher purchase prices. Under usual retail pricing methods, the retailers probably would apply their relatively constant mark-up percentage figures to the new purchase prices. Accordingly, retail

^{1/} If the goods are customs free, the Commissioner of Taxation determines what their value for customs purposes would have been.

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prices probably were increased by an amount somewhat greater than the amount of the tax. ^{1/} The excess of price increase over the amount of the tax would serve to compensate the retailers for reduced sales volume and eliminate the failure of some of the firms, which otherwise would result if sales volume fell appreciably.

The sales tax law did not prevent firms from raising prices by an amount greater than the tax; it did specify, however, that a firm could not collect more than the amount of the tax by claiming it to be greater than it actually was. There is no requirement as to separate quotation of the tax by retailers.

Under the Australian wage-control system, however, further shifting was likely. The basic wage, upon which the actual wage of most workers depends, is adjusted automatically on a quarterly basis according to changes in the cost-of-living index. While many items, such as food, rent, fuel and power, which enter into the cost-of-living index are tax-exempt, there are some taxable goods, such as clothing, household hardware, supplies, and drapery, that are included in the index. Accordingly, any tax on these items would cause sufficient increase in wages to pass off the burden of the tax to others. Thus, low-income workers probably bore the sales tax only to the extent that they purchased taxable goods not included in the wage-fixing regimens. The burden probably was shifted to non-wage earners by reduction in profit earned and by higher prices caused by wage increases. ^{2/}

b. Under present price-wage control system

In September of 1939, limited price control was introduced, designed primarily to prevent profiteering. Attempt was made to keep margins of firms at the same levels as existed prior to 1939. In the case of commodities subject to control, price increases due to increased tax were limited to the amount of the tax, and any higher operating cost due to loss in sales had to be borne by the firm. In the Spring of 1942, the limited control was replaced by a much more complete control involving freezing of most prices at current levels. Thus, if the tax were to be increased again, price increases on all taxable goods would probably be limited strictly to the amount of the tax.

In regard to wage readjustments resulting from the tax, in February 1942, wages were also frozen at current levels subject to readjustments to cover cost-of-living changes. Because of the readjustments still made for cost-of-living changes, any tax increase

^{1/} Little information is available here as to treatment of the tax by the retailers.

^{2/} To the extent that the worker's cost of living is increased by these price rises, wages would again be raised.

on goods entering into the cost-of-living index would result in higher wages. Prices, however, would not necessarily be readjusted to cover higher wage costs ^{1/} and the inflationary tendencies would accordingly be checked. Furthermore, relatively few taxable items actually enter into the cost-of-living index. ^{2/}

B. Capital equipment; multiple taxation

Although the law exempts materials for and aids to manufacture, industrial machinery and store and office equipment of all types are taxed. Some of these goods, such as office machines, are taxed at the 25-percent rate; most are included in the basic 12½-percent rate group. These goods are sold usually from manufacturer to user; it is to be expected that the manufacturer will pass on the full amount of the tax to the purchaser. The cost of these goods, of course, enters into the costs and prices of the consumption goods produced. Accordingly, the purchasers of the consumption goods tend to bear not only the tax levied on such goods directly but also upon the equipment which has been used to produce them. Even buyers of tax-exempt goods may pay somewhat higher prices to cover taxes on equipment used to make these goods.

The inclusion of capital equipment within the scope of the tax may have been due to the administrative problems that would be encountered if they were exempted. An equal amount of revenue, however, could be obtained by a slightly higher rate on consumers' goods; the burden of the part of the tax on capital equipment tends to be borne by consumers anyway, and the application of the tax to capital goods tends to discourage the use of such goods in production and might interfere with optimum utilization of resources. It is true that exclusion of all goods entering into cost of production is difficult because some articles may be used for either production or consumption purposes, and the final use cannot be determined at time of wholesale sale. But similar problems exist in the case of aids to manufacture, which are exempt.

C. Tax burden

The intent of the law prior to the war was to exempt, so far as possible, basic necessities. As a result, a substantial part of the expenditures of the lower income groups bore no direct sales tax burden. Further, in the case of those taxable goods purchased by the working classes that enter into the wage-adjusting regimens, the

^{1/} The tax under the present price-wage control system would tend to reduce profit margins.

^{2/} As already noted, the tax rate has been decreased to 7½ percent on a number of rationed items entering into the cost-of-living index.

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basic wage rate is adjusted to cover price increases caused by the tax. Thus, in practice, the wage earners probably bore the direct burden of the tax only to the extent that they purchased taxable goods not included in the wage-fixing regimens. However, other low-income groups, such as farmers and retired persons living on relatively small investments, did not benefit from wage readjustments and probably bore a relatively heavier burden. Thus most of the tax burden probably was borne by the higher income groups with some burden on low-income groups other than wage earners.

With the coming of the war, exemptions were curtailed and an increased burden was placed on the low-income classes. It must be remembered, however, that even yet utility services, rent, and basic foods are not taxed, and thus very low income groups could not be burdened seriously by the sales tax. More recently, reduction in the tax has been used as a means of helping to stabilize living costs at the April 1943 level.

November 4, 1943

MEMORANDUM

TO: Secretary Morgenthau

FROM: Mr. Gaston

RE: Customs Examinations of Effects of Army and Civilian Personnel arrived from Abroad on Army and Army Transport Command Aircraft

We have been continually pressing Army authorities for fully satisfactory arrangements with respect to examination of baggage brought in on Army and Army Transport Command ships since the start of the war. Very early in the war we obtained an agreement that all such arrivals would be promptly reported to Customs authorities so that examinations could be made and Customs personnel was held ready to make the examinations, but there were many lapses and omissions. As a result of Customs pressure, Headquarters Army Air Forces, under date of September 29, 1943, issued new regulations entitled A. A. F. Regulation No. 46-2 superseding A. A. F. Memorandum 42-4 of January 19, 1942. This new regulation was worked out in cooperation with the Bureau of Customs. The first paragraph of the new regulation reads:

"1. General. All personnel, materiel, and mail on military aircraft under control of the Army Air Forces arriving in the United States, including its possessions and territories, or departing therefrom to a foreign country, including the Panama Canal Zone and the Virgin Islands, will conform with the applicable provisions of the U. S. Customs Regulations, insofar as military operations permit, with the following exceptions:" (The exceptions relate to (a) diplomatic immunity, (b) military security (c) military necessity.)

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The regulations cover the matter of couriers, passports, baggage and articles acquired abroad, air freight, Lend-Lease air freight, examination of communications, currency control and release prior to entry or clearance. Under the last-named subject it is provided that when Customs functions can not be completed prior to the scheduled time of take-off, Customs may hold for inspection personally-owned articles acquired outside the United States and non-official communications.

The complicated situation at Miami where three different fields are in use by the Army was the subject of a special investigation by the office of the Inspector General in cooperation with Customs and Immigration. Mr. Russell of the Bureau of Customs participated. The report lists eight different measures adopted to correct irregularities.

In this connection I ~~will~~ again call your attention to the Act of June 27, 1942, chapter 453, 56 Stat. 461, which permits the personal and household effects of any person in the service of the United States returning to the United States under orders to be brought in free of duty. Purchases by Army personnel for their own use are thus free of duty. We have, however, brought to the Army's attention several instances in which purchases made abroad for other persons were not properly declared.

It may interest you to know that our inspector at Washington Airport learned by overhearing a conversation between Army officers that Lieut. General Somervell was coming in from abroad on Tuesday and insisted upon examining his baggage. Objections were made by some of the officers at the Field, but General Somervell submitted to examination.

Among the instances referred to above in which we made representations to the Army and later assessed duty are the following:

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(1) A soldier on the Mexican border took three comrades with him into Mexico to buy a \$400 tea set for a relative.

(2) An Air Force officer purchased eight amethysts in Africa as a service for a friend.

(3) An Army officer bought a Swiss wrist watch for \$50 in Havana and when he showed it to some of his friends in Washington, three of them, two Colonels and a Major, arranged to have similar watches bought for them and sent in by Army pouch.

Another statute in which you may be interested is that which permits a soldier abroad to send gifts not exceeding \$50 in value to relatives in the United States. So long as they are separate shipments there is no limit. A soldier could buy a \$50 gift every day for some relative.

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November 4, 1943

Meeting in Mr. White's Office
November 4, 1943
11:45 A.M.

Present: Judge Patterson and Mr. Neff of War
Department
Messrs. Dean Acheson and Kermit Roosevelt
of State Department
Mr. Coe of F.E.A.
Messrs. White and Friedman and Miss Kistler

Mr. White said that he wanted to tell Judge Patterson, while we were waiting for Mr. Acheson and Mr. Roosevelt to arrive, that the Treasury was probably not going to renew the 1941 Agreement with China and that we were thinking of selling gold in China to meet the Army's needs and to overcome the disadvantages of the official exchange rate. Judge Patterson expressed satisfaction with this proposal.

The first subject on the agenda was the question of cash payment for British plants being transferred. The Army presented figures to the effect that the value of plants already transferred totalled \$50 million. Mr. Coe said that they had figures from the British which were much higher and which showed \$40 million more of plants still to be transferred. Mr. White drew attention to the political aspects of the question; he stated that in view of the political developments during the past few weeks he wondered if the group did not think we should request the British for the plants as reciprocal aid basing the request on the political situation rather than on our desire to reduce the British balances.

Judge Patterson stated that he doubted if the War Department could carry out the directive, as their appropriations permit them to spend money only for facilities which the Army needs and some of the British plants in question (\$10 million of the estimated \$26 million still to be transferred) are no longer needed by the Army. Dean Acheson asked whether the Army could state outright that they don't want to take over any more of the British plants. Judge Patterson replied that this is what the Army would like to do, but they have a Presidential directive which they cannot ignore. He said that his proposal is to recommend to the President that the Army or some other Government agency discuss with the British the question of transferring these plants as reciprocal aid. Dean Acheson called attention to the fact that there was a third alternative; namely, that the negotiations be halted and no more plants be transferred. Judge Patterson said that he thought one of the justifications for the directive was the feeling here that the munition plants in this country should be owned by this Government and not by a foreign government, and that he thought letting things lie as they are would be

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the least desirable of the three alternatives. He stated, however, that he was not disturbed by Congressional reaction to the transfers and that at the time the directive was issued, there were good reasons for taking the step. Mr. Coe objected and said that F.E.A. is concerned about the political reactions and that the British apparently are too. It was agreed that the War Department should write a letter to the President stating that it had gotten the concurrence of this Committee asking the President to rescind the directive under which they are purchasing the plants and requesting his permission to discuss with the British the receipt of the plants as reciprocal aid.

In answer to Mr. White, Dean Acheson stated that he would not recommend repayment for the plants already taken over. He thought that if anything was to be done on the dollar balances, this was one of the least desirable possibilities.

Mr. White stated that we have a directive to limit the British balances, that nothing has been done so far to do so, that they are now so far in excess of the maximum we in the Treasury feel strongly that ways must be found of cutting them, and that one of the most politically expedient ways of doing so would be to request a refund of money on the plants already transferred. He stated that there were two questions now before the Committee, (a) should the balances be reduced and, if so, how? Dean Acheson said that he did not think the balances should be reduced, that the Committee should have the directive changed.

Mr. White asked Mr. Acheson if, on the assumption that the decision was not to take steps to reduce the British balances, he would agree to the review and possible elimination of such transactions as our purchase of fish from Iceland. There was some discussion of this transaction and of the motives lying behind the original requisition and the United States' responsibilities to Iceland. Mr. Acheson apparently feels that we have the ultimate responsibility toward Iceland and that if Britain refuses to pay cash or gold we would have to do so. Mr. Acheson said he had no objection to eliminating objectionable and freakish transactions from the Lend-Lease picture, but he did object to approaching the problem with the objective of bringing the British balances down to a particular level. He thought, as a matter of fact, that the British also would be willing to eliminate the questionable transactions. Mr. Coe reported that F.E.A. is reviewing transfers being made to Britain and is drawing up a list to be presented to the British of the least defensible lend-lease transfers with a view to eliminating the most objectionable.

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In reply to Mr. White, Judge Patterson said that the views of the War Department with respect to the policy of Britain's balances would be of no great value but he stated that he was of the opinion that freakish transactions are politically undesirable as much from the British point of view as from ours. He cited as the type of thing he had in mind our lend-lease airplanes to Britain while buying the aluminum which goes into the planes. He thought the bulk of the people would not question our lend-lease of military weapons but that problems would arise concerning the lend-lease of civilian items and the failure of Britain to give to us as reciprocal aid raw materials which go into lend-lease goods.

Mr. White, in reply to Mr. Acheson, stated that the determination of a politically desirable or an undesirable transaction could not be separated from the size of the balances. He pointed out that many things which could have been justified two years ago when the British balances were very low could no longer be explained as easily.

Mr. Acheson read a memorandum summarizing and commenting on the British point of view regarding their need for gold and dollars as a reserve against their mounting sterling liabilities. A copy of this memorandum is attached.

Mr. White said that the Treasury position is a very simple and easy one, that the Secretary had an understanding with Congress that the British would not have sufficient cash to purchase the goods needed and that if the British are to be allowed to build up their balances it is either for Congress or the President to decide. Judge Patterson agreed that at the time of the Lend-Lease Act the one thing Congress had in mind was Britain's lack of dollars and that without a doubt Lend-Lease was thought of by Congress as a mechanism of getting to Britain the weapons they needed.

It was agreed that a memorandum should be written to the President asking for a directive on this matter. Mr. White suggested that if the decision was to reduce the balances, refund of the money paid to the British on the plants taken over would be one of the easiest ways and one of the most politically desirable ways of reducing the British balances. Dean Acheson objected and seemed to think this would be an unpleasant proposition to negotiate with the British. He said he was sure we would find that the easiest way to reduce Britain's balances would be in areas in which we have control. There was some discussion of the need for an inventory of supplies in lend-lease countries but, as Mr. White pointed out, the need for such an inventory would be reduced if lend-lease assistance were reduced and the British forced to pay cash for many things now being received by them as credit lend-lease.

T. H. Kistler

November 2, 1943

UNITED STATES POLICY ON LIMITATIONS ON BRITISH GOLD AND
DOLLAR BALANCES

1. The Facts.

In January, 1943 the President approved a recommendation that, in the light of existing conditions, the British gold and dollar balances should be between 600 million and 1 billion dollars. This decision was made without British agreement.

Recently British reserves have exceeded 1 billion dollars; after certain deductions they now stand at 1 billion 200 million, and may be expected to increase at the rate of about 600 million a year. The provision as reciprocal aid of raw materials purchased by the United States Government would decrease this rate by approximately 200 million a year. It should be observed that the increase in British dollar balances is due entirely to the pay of American troops within the Sterling Area.

British short term liabilities, against which the gold and dollar balances are the only reserves, now stand at over 7 billion dollars. They are increasing, largely due to heavy cash expenditures in the Middle East and India, at a rate of about 3 billions a year.

2. The Treasury Proposal.

In a draft letter from the Secretary of the Treasury to Mr. Leo Crowley circulated by Mr. Harry White to the members of the Cabinet sub-committee on the dollar position of lend-lease countries, it is recommended:

"that immediate steps be taken to reduce the amount of civilian goods being lend-leased to the British Government by an amount sufficient to bring Britain's gold and dollar holdings to a level consistent with the January 1 decision."

The proposed reduction is estimated at 200 to 300 million dollars.

3. British

11/4/43 - Handed to Mr. White by Dean Acheson.

C O P Y

3. British Argument.

The British contend that the increase in their gold and dollar balances does not reflect an improvement of their financial position. On the contrary, their net overseas position is deteriorating at a rate of about \$2.5 billion a year. Some growth of their liquid reserves is, they argue, indispensable to the delicate system by which they finance the war on credit through a large part of the world. To allow such growth could not legitimately be criticized.

4. Comment on British Argument.

The British argument appears to be valid. Certainly it is unreasonable to set a hard and fast limit on assets without regard to liabilities. If a man had held \$100 in cash against \$500 in debts, one would not argue that his financial position had improved when he holds \$500 in cash against \$5,000 in debts.

The Soviet is believed to hold gold reserves nearly double the total British gold and dollar holdings, and to have no significant liabilities against them. Yet we have not therefore proposed to reduce lend-lease aid to the Soviet Union.

FBA has already informed the British that certain industrial equipment, the post-war value of which would be significant, would no longer be furnished under straight lend-lease after November 15. This would further reduce the probable rate of increase of their dollar holdings by about \$50 million annually and should eliminate most of the items subject to criticism.

5. Recommendation.

It is recommended that the present policy, restricting British gold and dollar resources under a rigid ceiling, be abandoned in favor of a policy which will permit those resources to increase in a given ratio to the short term liabilities against them. It may be that the existing ratio (about 1:6 or 7) will be adequate.

A statement setting forth the facts leading to this policy should be prepared for transmission to Congress or the appropriate Congressional committees. This would have to be framed so as not to endanger British credit in areas holding large sterling balances.

Meeting in Mr. White's Office with
Sir David Waley and Mr. Robertson
of the British Treasury,
November 4, 1943.

Sir David Waley and Mr. Robertson of the British Treasury called at their request. Waley had several matters to bring up, as follows:

1. He said that his Government was about to publish the White Paper on reciprocal lend-lease and that Lord Halifax was just informing the State Department of that fact. He wanted to know whether the Treasury had any definite comments to make. I replied that the Treasury preferred to leave that matter to the State Department and Lend-Lease at this time.

2. Waley said he understood that the question of British dollar balances and lend-lease was under some discussion and that his Government was somewhat embarrassed by not knowing exactly what was being planned. He wanted assurance that his Government would have an opportunity of being consulted before any definitive changes were to be made with respect to any changes in the policy or administration. I told him that the discussions were going forward in view of the new developments and additional information with respect to some of the lend-lease transactions, but assured him that before any definitive action was taken that he would be informed prior to the step. Waley wanted to know if there was any additional information his Government could supply us at this time. I said there was adequate information in the current material and in the memorandum which they had already submitted to furnish the basis of any discussion.

3. Waley said that he had just sent me a letter with respect to the stabilization loan to China. I explained that it had not yet come to my desk. I told him that our minds were running in the direction of not renewing the arrangement and in having the American member withdraw from the Stabilization Board, inasmuch as his presence on that Board was based on a stabilization arrangement. I said that I thought that we would indicate to the Chinese Government that we felt the conditions hardly warranted a renewal of the stabilization arrangement, particularly with the official exchange rate so completely out of line. I stated that we were also thinking of selling gold in China to obtain such currency as was needed for Government expenditures in China. Waley said that the views of his Government were contained in his letter to me to the effect that a continuation of the Stabilization Board would be helpful.

4. He asked whether he could make an appointment for Mr. Mahindra about silver for India. I told him I would be glad to do so and made one for Monday. Waley asked if we were able to accede to Mr. Mahindra's

Division of Monetary
Research

- 2 -

request and I replied that I doubted it. He laughingly replied that India had done a good job of getting the price of silver up and I said that was true, but that apparently the cost of living wholesale prices had shown a tendency to level off. He expressed the view that that was only temporary.

5. Waley said that his Government was pressing to hear from us about the terms under which we would use the currency deposited by French, Belgian, Dutch and Norwegian Governments for invasion purposes. I replied that I was to see the Secretary that afternoon and would probably have an answer for him on that point very soon.

6. Waley stated that he would also like to get our comments on his note with respect to the Belgian exchange rate so that his Government could send from London a joint reply to Belgium. I replied that our feeling was that the rate that Belgium had established was too high even in their own interest, but the discrepancy was not great enough nor the need to our armed forces of sufficient importance to outweigh the decision to have Belgium accept responsibility for the rate of exchange. Waley said confidentially that Finance Minister Gutt also felt that the rate was too high and it would be helpful if we could indicate that, that it would go far to strengthen Mr. Gutt's hand in pressing for a lower rate.

H. D. White

Memorandum on Meeting in Mr. Bernstein's Office,
November 4, 1943

Present: Messrs. Waley and Robertson for the British
Treasury
Messrs. Bernstein and Glodinning for the United
States Treasury

The meeting dealt with a number of subjects, principally the reorganization of the Saudi Arabian monetary system and the joint United Kingdom-United States gold sales program in India and the Middle East.

Professor Robertson referred to the previous inquiry by the United States Treasury concerning the supplying of sovereigns by the British against gold earmarked for them in this country for the purpose of meeting the expenses of our Legation in Saudi Arabia. He stated that he had received word from London that arrangements could be made whereby we could obtain sovereigns for gold earmarked here or perhaps riyals directly for dollars. He added that his information was not clear and that the details of the plan would have to be discussed later.

In regard to the arrangements for the minting of the remaining 7 million riyals for Saudi Arabia, Professor Robertson suggested that the dies be flown to Pretoria, South Africa, from India unless the United States desired to mint the coin here. He did not know whether silver was available in South Africa to begin minting at once but was of the opinion that the silver would have to be supplied directly from our stocks. Mr. Bernstein asked if the British would arrange for the shipping of the silver from New York in the event this plan were adopted. Professor Robertson thought that this arrangement would be satisfactory. It was agreed that the minting and shipping costs would be handled in this case as they were for the 8 million riyals minted in London and India.

The question of the reorganization of the Saudi Arabian monetary system was then discussed. Sir David Waley expressed the tentative British views on the subject as set forth from London (See attached cable from the British Treasury), namely, that Saudi Arabia should be included in the sterling block, maintaining its reserves 100 percent in sterling and pooling its other foreign exchange assets. This position was defended on the ground that Saudi Arabia's trade was largely with the sterling area. Mr. Bernstein stated that while he had not had the opportunity to talk over the details of a currency plan for Saudi Arabia with Mr. White, our tentative views were that the Saudi Arabian currency

might be backed by gold, sterling, dollars, and perhaps other acceptable foreign exchange.

Sir David Waley was insistent on the point that the reserves should be kept in a single currency to avoid exchange risks and no basis for agreement was reached. Sir David suggested that the discussions of this problem might better be handled in London. He asked that we submit a statement of our suggested plan for a Saudi Arabian currency system to the British Treasury.

The discussion then turned to the question of the joint British-American gold sales program. Professor Robertson stated that the British planned to sell 375,000 ounces of gold, plus additional gold up to this amount for us if we agreed, in the second three month's period beginning November 1 in the Middle East exclusive of Egypt. The share of the United States in the proceeds would be either our actual requirements for local currencies (not to exceed the proceeds of the sale of gold in any given country) or 1/2 the total proceeds whichever was the smaller. In India, the British proposed for the same period to sell 750,000 ounces for themselves and an additional 250,000 ounces for us. Mr. Bernstein stated that before taking action on this program, we desired to survey our needs for the local currencies in question; particularly in the Middle East.

Professor Robertson reported that the total gold sold in the Middle East exclusive of Egypt for the first three months was about 200,000 ounces; he said that he would furnish us with a detailed breakdown of the sales by countries shortly. Concerning the proceeds of the sales in Iran, Professor Robertson said that all rials acquired prior to September 23 had been used by the British. He proposed that we receive all of the rials sold subsequent to that date and all sold for an indefinite period in the future if we continued with the joint program and agreed to arrange for the transfer of the rials on hand to us at once for deposit either in the Lanque Mellie or in the Imperial Bank.

In reference to the Treasury proposal that we trade Syrian pounds acquired by Lend-Lease with the British in exchange for rials at the official rate, Professor Robertson stated that this plan would be impracticable from the British standpoint.

Sir David Waley made the suggestion that periodic meetings should be held between the British and the United States Treasuries to consider problems of mutual interest in the Middle East, et cetera.

C. D. Glendinning

Saudi Arabia

COPY NO 2

Dated: London
Rec'd: October 25, 1943
En Clair

I M P O R T A N T

From Treasury

CAMER SAVING 40

Addressed to Jeddah CAMER SAVING 1, repeated to Minister of State Cairo CAMER SAVING 2 and Washington.

My CAMER 12/not repeated to Washington./

Following are our views about permanent arrangements for Saudi Arabian currency. They involve some recapitulation, but we think it necessary to set out the position fully.

2. The first consideration must clearly be the interests of Saudi Arabia itself. Trade of that territory is almost entirely with sterling area and by far the larger number of the pilgrims come from the sterling area. It is obvious that in the absence of other cogent reasons stability of exchange between currency of Saudi Arabia and sterling area currencies is in their best interests.

3. This has apparently been object of measures taken (wisely in our view) in the past (1) adopting sovereign as standard coin of territory; (2) after Great Britain went off gold standard, introducing new rial identical in weight, size and fineness with Indian standard rupee, silver content of which was then worth ninepence.

4. Whenever difficulties arise owing to appreciation of coin in circulation, due to an increase in its bullion value above its face value the normal remedy is to reduce the fineness of the coin or to introduce a different form of currency rather than to alter the parity of the currency from that decided upon for general reasons to that suggested by fluctuations in bullion prices.

5. It was for this reason that the Treasury proposed a note-issue based on sterling for Saudi Arabia (since the introduction of quaternary rials was said to be impossible) to be introduced at a time when sterling backing could readily have been made available from His Majesty's Government's subsidy.

October 25, 1943

6. Treasury have hitherto continued to treat Saudi Arabia as though its currency were still linked to sterling at old parity, in spite of appreciation of the rial coin, in the hope that some such solution might yet be feasible.

7. It may be that this is now impossible though we should prefer not to express a final opinion until after general discussion of financial position of Saudi Arabia with United States Government. If so Saudi Arabian currency may have to be allowed in future to fluctuate with the price of silver.

8. In this event there will be little or nothing that His Majesty's Government can do to help; for (1) we cannot peg price of silver in general or of a particular weight of silver bullion and should not attempt to do so. (The only sense in which His Majesty's Government would fix a rate or take any responsibility for a rate would be that it would be necessary to fix an official rate, monthly or quarterly, for our own internal purposes (like ation salaries, etc.): and this would of course be only a recognition of the actual rate arrived at e.g. by calculation from the price of silver in whichever was the appropriate market, e.g. Bombay). (2) We shall not be prepared to provide sovereigns in the increasing amounts which would be necessitated by substantial further rise in the price of silver in terms of gold. We observe with apprehension reference in paragraph 2 of Minister of State's telegram REMAC 160 to a substantial depreciation of sovereigns in terms of rials, possibly (though it is not clear whether the figures given in that paragraph purport to be equivalents) to 20 rials to the £.

9. It is fairly certain that the present exchange value of the silver rial is not due solely to the price of silver bullion in any of the surrounding countries but includes a scarcity element which will be affected by new supplies coming forward out of lend-lease silver. We think it clear that effect of this must be awaited before a final decision is taken.

10. The responsibility for making a change would of course, rest with Saudi Arabian Government and issue should be fully explained to Ibn Saud himself. He should realise in particular:-

- (1) That there is little or no prospect that conditions will obtain at the end of the war under which sterling backing could be provided otherwise than by Saudi Arabian Government itself out of funds obtained from pilgrims. You will be able to judge what are the prospects that this would in practice be possible.

October 25, 1943

- (ii) that value of rial in terms of neighbouring currencies will depend
- (a) on level of silver price in those countries.
 - (b) on continued elimination of scarcity element by further supplies of Lend-Lease silver to Saudi Arabia.
- (iii) That any substantial rise in price of silver, though it will cheapen imports into Saudi Arabia in terms of rials, will make it impossible for some of the poorest pilgrims to undertake the pilgrimage and will to this extent lessen rial revenues received from them and for any exports from Saudi Arabia. We should not regard it as safe to assume that some of the causes which operated to raise the price of silver to extremely high levels at the end of the last war may not operate also at the end of this war.
- (iv) Treasury have no knowledge of internal wage and price levels in terms of rials in Saudi Arabia and are unaware whether official recognition of a bullion exchange value for the rial would involve immediate alterations in wages, rents, etc. in Saudi Arabia. (In the long run, if price of silver were to rise substantially, especially if cost of cereals etc., from sterling area countries had at the same time fallen, the equivalent in terms of commodities of any rents, salaries, etc. fixed in rials might be so increased as to make it necessary to reduce all rial rents, salaries etc., if this could not be done by a change in the currency itself (see (i) above)).

11. We would be glad to have any information available about questions referred to in (iv); and to learn reactions of Saudi Arabian Government to considerations set out above.

CIRCULATION
Regular List
and Lord Keynes

copy 1r

CAMER SAVING 40

November 4, 1943

MEMORANDUM FOR THE PRESIDENT

All civilian goods being exported to French North and West Africa are now being paid for in cash by the French and this procedure is to be extended to cover shipments of civilian goods to other French areas. Military goods, however, are being supplied as credit lend-lease.

These payment arrangements were made on the assumption that the gold and dollar assets of the Central Bank and Government of France were not available to the French Comite. In our opinion, the use of these assets of France to pay for military goods now being made available for the equipping of a French Army on a credit lend-lease basis could easily be justified.

Through September 1943, we lend-leased \$220 million of goods and services to the French forces. (We also transferred \$75 million of civilian goods to French authorities.) By March 1944, military lend-lease assistance to the French is expected to total \$400 million.

According to the information available the French have over \$2.5 billion of gold and U.S. dollar balances, as follows:

(In millions)

Gold.....	\$ 2,300
In French Africa.....	\$935
In the British Empire.....	580
In the United States.....	500
In Martinique.....	285

Official dollar balances in U.S..... 340

Of this \$225 million was deposited for the account of the Central Bank and Government of Metropolitan France, \$85 million for the account of the French Treasury in Africa and \$23 million for the account of French Indo-China.

Private dollar balances in U.S..... 235

All but \$7 million of this amount is held for the account of residents of Metropolitan France.

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In view of the size of these gold and dollar holdings, it is recommended that our policy of lend-lease assistance to the French be reexamined with the idea of placing the entire program for the time being on a cash reimbursable basis.

a. Unless this is done, it would seem that we are granting the French more favorable treatment than the British.

b. Such a procedure would strengthen your bargaining position with the French.

c. It would be consistent with the objectives of lend-lease assistance.

d. It would contribute materially to the fulfillment of Congressional demands for reduction of government expenditures.

The modus vivendi with French North Africa contains a provision which would permit payment for military supplies.

HDW
HG; TMK:fl 11/2/43

Appendix A

Lend-Lease Exports to French Liberated Areas
through August 1943 as shown by export declarations

(The figures below do not include the value of lend-lease goods which were handled by the Army and shipped to North Africa on Army transports. These shipments were substantial during the early months)

(In millions of dollars)

A. By Principal Commodity Groups

Tanks and other vehicles.....	\$ 78	
Ordnance and ordnance stores.....	22	
Vessels and equipment for vessels.....	2	
Aircraft and aeronautical material.....	<u>2</u>	
Total - Military Goods.....		\$ 104
Foodstuffs and other agricultural commodities.....	37	
Industrial and other commodities.....	<u>34</u>	
Total - Non-Military Goods.....		<u>71</u>
Total - Lend-Lease Exports to French Areas.....		175

B. By Area

Algeria.....	133
French Morocco.....	24
French West Africa.....	8
French Equatorial Africa.....	4
French West Indies.....	2
Camerouns.....	2
Syria.....	1
French Comoros.....	1
All Other French Areas.....	<u>1</u>
Total.....	175

1/ Less than \$500,000.

FOREIGN ECONOMIC ADMINISTRATION
OFFICE OF LEND-LEASE ADMINISTRATION
FIVE-FIFTEEN 22d STREET NW.
WASHINGTON, D. C.

November 4, 1943

MEMORANDUM

To: The Honorable Henry Morgenthau
From: Bernhard Knollenberg
Executive Advisor to the Administrator
Subject: Executive Reports

Transmitted herewith, for your information,
are copies of the Executive Reports on lend-
lease operations, as of September 30, 1943.

CONFIDENTIAL
Executive Report No. 1

ALLOCATIONS, OBLIGATIONS AND EXPENDITURES
LEND-LEASE FUNDS APPROPRIATED TO THE PRESIDENT

Report as of Sept. 30, 1943

(Thousands of Dollars)

Appropriation Category	Adjusted Appropriations	Cumulative to September 30, 1943		
		Allocations	Obligations	Expenditures
Ordnance and Ordnance Stores	1,683,306	1,679,614	1,495,747	1,223,729
Aircraft and Aero. Material	2,679,625	2,667,886	2,491,108	2,007,211
Tanks and Other Vehicles	749,273	690,160	628,346	599,428
Watercraft	3,871,703	2,555,143	2,171,534	1,869,020
Misc. Military Equipment	353,288	353,273	303,140	234,931
Production Facilities	1,104,688	1,102,488	1,058,037	902,992
Agric. and Indust. Commodities	12,608,929	10,411,624	7,776,308	6,027,255
Servicing, Repair of Ships, etc.	790,818	624,113	467,197	454,971
Services and Expenses	800,000	408,896	304,158	237,181
Administrative Expenses	28,999	24,431	23,279	23,022
Total	24,670,629	20,517,628	16,718,854	13,579,740

Procuring Agency	Cumulative to September 30, 1943		
	Allocations	Obligations	Expenditures
War Department	5,742,286	5,282,427	4,571,727
Navy Department	3,239,841	2,445,952	1,843,514
Maritime Commission and War Shipping Admin.	2,437,458	1,979,231	1,920,965
Treasury Department	3,894,236	2,925,918	2,048,115
Department of Agriculture	5,185,586	4,069,953	3,182,365
Other	18,221	15,373	13,054
Total	20,517,628	16,718,854	13,579,740

October 25, 1943

CONFIDENTIAL
Executive Report No. 2

STATEMENT OF LEND-LEASE AID

Report as of Sept. 30, 1943

(Thousands of Dollars)

Type of Aid	Cumulative to		Month of	
	Sept. 30, 1943	Aug. 31, 1943	September	August
Goods Transferred	14,136,745	13,015,749	1,120,996	1,113,777
Servicing, Repair, of Ships, etc.	359,377	327,580	31,797	6,550
Rental of Ships, Ferrying of Aircraft, etc.	1,251,328	1,208,995	42,333	143,893
Production Facilities in U. S.	601,317	601,150	167	- 806
Miscellaneous Expenses	82,561	81,042	1,519	- 2,237
Total Services	2,294,583	2,218,767	75,816	147,400
Total Goods and Services	16,431,328	15,234,516	1,196,812	1,261,177

Data on Goods Transferred include value of goods procured from lend-lease appropriations to the President and to the War and Navy Departments.

Type of Aid	Cumulative to September 30, 1943				
	Br. Empire	China	U.S.S.R.	Other	Total
Goods Transferred	10,916,859	150,311	2,817,926	251,649	14,136,745
Servicing, Repair of Ships, etc.	250,301	1,711	57,843	49,522	359,377
Rental of Ships Ferrying of Aircraft, etc.	927,681	12,385	179,846	131,416	1,251,328
Production Facilities in U. S.	-	-	-	-	601,317
Miscellaneous Expenses	50,338	1,179	2,464	28,580	82,561
Total Goods and Services	-	-	-	-	16,431,328

October 25, 1943

CONFIDENTIAL
Executive Report No. 3

LEND-LEASE GOODS TRANSFERRED

Report as of Sept. 30, 1943

(Thousands of Dollars)

	Cumulative to September 30, 1943				
	Br. Empire	China	U.S.S.R.	Other	Total
Ordnance (Excl. Ammunition)	504,314	15,547	136,300	50,677	706,838
Ammunition and Components	1,094,562	22,188	305,996	25,029	1,447,775
Aircraft	1,198,310	48,748	610,427	42,012	1,899,497
Aircraft Engines, Parts, etc.	636,169	5,550	19,359	4,460	665,538
Tanks and Parts	1,336,106	923	259,708	27,154	1,623,891
Motor Vehicles and Parts	344,370	25,504	347,064	15,294	732,232
Watercraft and Parts	1,322,227	4,447	148,088	20,218	1,494,980
Foods	1,556,640	-	240,519	6,656	1,803,815
Other Agric. Products	373,773	41	4,219	-	378,033
Machinery	377,814	4,234	225,283	3,644	610,975
Metals	599,832	9,821	239,313	1,934	850,900
Petroleum Products	611,868	2,547	28,703	1,199	644,317
Miscellaneous Materials and Manufactures	960,874	10,761	252,947	53,372	1,277,954
Total	10,916,859	150,311	2,817,926	251,649	14,136,745

October 25, 1943

November 4, 1948

My dear Mr. President:

I am sending you herewith a report on the atrocities committed by the Germans in the Naples area, submitted to me by Colonel Edgar Erskine Hume.

Yours sincerely,

The President,
The White House.

del'd by
SSA J. Montgomerie
11/4/50

20 October 1943

Hon. Henry Morgenthau,
Secretary of the Treasury,
Care of Lieut. General Mark W. Clark, U.S.A.,
Headquarters, Fifth Army,
N A P L E S.

My dear Mr. Secretary:

In compliance with your request I give you herewith a brief report of acts of German cruelty and wanton destruction committed in Naples, chiefly during the three weeks before our capture of the city. This period is called "The Reign of Terror" by Neapolitans. I am, of course, not giving any instances of damage to the city or to individuals which took place as a result of acts of war (bombings, etc.). The things that I list were unnecessary from any military point of view.

OFFENSES AGAINST THE CITY
AS A WHOLE

1. Water Supply: When the Fifth Army reached Naples we found that there was an almost total failure of the water supply. People were carrying water in pails, jugs, bottles and every type of container. There was a small trickle of water from some of the hydrants but many persons standing in line were unable to receive enough to quench thirst. Naples had been famous for an abundant supply of pure water. The Germans had blown up the main aqueduct in seven places and all of the reservoirs save one had been drained. By chance an Italian had saved one reservoir by cutting the fuse after it had been lighted by departing Germans. Allied Military Government took charge of the remaining reservoirs and by rationing made the supply go as far as possible. The hardship on the people of Naples, particularly those unable to go for water was great and there was much suffering, until the supply was rationed and until we established water distribution points for water distilled from the bay. The Germans were well aware that there was ample facility for our bringing in water for the troops, as was done in the desert campaign, so that this destruction of the city supply was an act of cruelty against civilians, young and old. The enemy likewise destroyed the pumping plants, thereby making it impossible to raise the water, had any been available, to the higher parts of the city. The water mains in many parts of Naples were deliberately cut.

- 2 -

2. Sewage System: The pumping facilities of the sewage disposal system of Naples were destroyed. Thus, even had there been enough water to enable sewers to function, they would have been unable to do so because much of the Neapolitan sewage disposal depends not on gravity but on a series of pumps. The city is built on volcanic rock so that, even had there been space available for them, it was all but impracticable to dig latrines. The danger of epidemics of intestinal diseases, such as typhoid fever and dysentery, was obviously very great particularly at this season of the year.

3. Electric Light and Power Systems: Naples was in darkness when we took over. The Germans had destroyed both the generators of the current and likewise the transformers. The Italian metropolis depends largely on hydro-electric power not only for lighting, but for the water and sewage pumps, the mills for grinding wheat, the newspaper presses, the heating of buildings, cooking, and indeed practically all power machines. This was one of the most serious conditions we had to meet. By hard work by our engineers the current is now restored, in part, though we have had to follow a certain priority in allotting it at first.

4. Transportation System: The street car system was wholly out of commission both because the electric current had been cut off (see above) and because the Germans carried away or destroyed the greater part of the rolling stock. Buses also were taken away. A large number of them were found to the north of the city where the enemy, unable to carry them further, had burned them. There are of course no taxicabs other than a few old wrecks, and only a few horse-drawn vehicles in the city. People who are not physically strong enough to walk from one locality to another are practically prisoners. This has seriously affected the earning capacity of many. The Germans carried away every automobile, both passenger and truck, that they could find. In some instances they took only the tires and destroyed or abandoned the bodies of the cars. Ambulances and fire-fighting vehicles were not spared.

5. Communication Systems: The telegraph lines were put out of commission. The main telephone exchange was blown up. Fortunately the Germans overlooked two small subsidiary exchanges. By splicing the lines we were able to give the military authorities a limited number of lines within ten days. However business firms and private families are still without telephones. The Post Office was looted and destroyed (see below).

- 3 -

6. Demolition of Hotels: The group of magnificent hotels along the Via Partenope, facing Vesuvius, used to be one of the outstanding groups of such institutions in the world. Such names as the Excelsior, Vesuvio, Santa Lucia, Royal, etc., are known to travelers everywhere. These buildings, without exception, were blown up and fire set to what remained. They cannot be repaired. The only first-class hotel left was the Park Hotel (Parker's Hotel), which was mined (see below).

7. Blocking of Tunnels: There are a number of tunnels in Naples built to give ready access from one quarter to another at a saving of much hill climbing. These were blown up.

8. Bombing of Public Buildings: Besides the bombing of various public buildings for their immediate destruction, the Germans showed their usual cunning in setting time bombs so as to explode after our arrival, thereby both destroying property and causing human death and suffering. A few instances will illustrate. On October 7, at 2:30 P.M., a violent explosion, caused by a time bomb hidden in the corner of the Post Office, destroyed the end of that building and tore an enormous hole in the street. There was considerable loss of life, chiefly civilians. In all 30 people were killed, 84 were severely injured (hospitalized), and 25 were slightly injured. I was in my office across the street when the explosion occurred. I went to the scene at once and helped give first aid to the wounded. Many were women and children. In the Via Partenope a time bomb in the street exploded on October 3rd, at about dusk. Fortunately nobody was hurt though a few minutes before a group of workmen had passed over the spot. On October 11th, at 8:55 A.M., a time bomb set in the Italian Artillery Barracks, occupied by our 307th and 36th Engineers, exploded. Some 24 of our men were killed and 47 wounded. This cannot be justified as an act against our armed forces, for it was only by chance that we were using the barracks for soldiers. It had been previously used by Italian families. Every effort has been made to locate unexploded bombs and with much success. A time bomb and about 1500 pounds of TNT were removed from the basement of the Park Hotel on October 2nd, before explosion occurred. On October 16th, an unexploded time bomb and 1600 pounds of TNT were removed from the building housing a part of the 82nd Airborne Division. Ordnance officers estimated that the bomb had about 3 days and 17 hours more to run, on the timing device, before explosion.

9. Opening of Prisons: Before their departure, the Germans released all prisoners in the jails and prisons of Naples, of which there are about a dozen, one of them the largest in Italy. While we have been able to re-arrest many of the criminals, this act of the Germans has been productive of danger and loss of morale to the civil population.

- 4 -

10. Demolition of Flour Mills: Naples, like most Italian cities, grinds its wheat a little at a time, rather than converting a whole crop to flour at once. Thus flour mills are an essential feature of the city's economic and welfare system. All of the large mills were wrecked by the Germans.

11. Destruction of the University of Naples and of its Famous Libraries: The University of Naples is one of the oldest and most famous in existence. The library of the Royal Society of Naples, one of the great learned societies of the world, was housed therein. It was put to the torch on 12 September, a little more than a fortnight before we took the city. We are collecting affidavits of the Rector and many faculty members and students. They agree that at about 3:00 P.M., a party of some 600 Germans entered the University and announced that they were about to burn it, in retaliation for the fighting of Neapolitans, including students, against their troops. Cans of gasoline were brought in and the walls, furniture and books covered with it, and the fire was started. The firemen arrived soon thereafter but the officer in charge refused to allow them to enter. Two Carabinieri (military police) who tried to stop the destruction were taken to the front entrance and shot. Many of the nearby houses were robbed, not only those of professors but of others. Several witnesses agree that the notorious Col. Scholl, Commander of German troops garrisoned in Naples, arrived in person when the work was finished and read a proclamation in German and Italian announcing that the university had been wrecked as a punishment to Naples. When I first visited the ruined buildings the ashes of the Library of the Royal Society were still warm and the pool of blood on the front steps, where the shooting of the Carabinieri was reported to have occurred, was still evident.

12. Robbing of Hospitals: Directors of the several hospitals of Naples agree that the Germans before departure, carried off all of the hospital equipment and supplies that they could find. Some of these institutions had practically no medicines or dressings when we arrived. Even establishments of the Italian Red Cross were not spared.

OFFENSES AGAINST INDIVIDUALS

In a report of this kind, prepared on a few hours notice, it is not possible to give a detailed account of offenses against individuals. That must wait until our final report on German misdeeds in Naples is completed. The following incidents are taken at random from a mass of documentary evidence thus far gathered.

- 5 -

There is general agreement that Germans collectively and individually robbed shops, homes and even people in the streets. This varied all the way from ordinary highwayman's technique to burglary. Many individuals, not excepting those in high position, were carried off as hostages. Among such hostages were the Bishop of Cava dei Terreni and the Abbot of Badia at Corpo di Cava. Many people were beaten to make them disclose the whereabouts of supposed valuables. Women as well as men were subjected to such treatment. There were many murders, some of a sadistic nature, with mutilation of dead bodies, particularly those of women. One deposition says that the eye witness saw a man buried in a grave he had been forced to dig himself, being bayoneted before being thrown in. Often the populace were told to help themselves after the Germans had begun looting. Many of the more intelligent witnesses state that the killing of Italian civilians was not merely acts of individual German soldiers, but often in response to direct orders of their officers, all as a part of a campaign to terrorize the people. "Booby traps" were placed not only in places where they might be set off by our troops, but where children and other civilians would find them. Many such people have been mutilated or killed. There was much wanton destruction of property, frequently associated with physical harm to people. Furniture not desired was smashed or burned, live-stock killed, supplies of food destroyed or fouled so that it could not be used. Particularly cruel were the measures against those Italians between 18 and 35 who failed to respond to the German proclamation of September 22nd, requiring them to report for forced labor with the German Army.

I wish that there were time to give you more details and to complete the report of the first two weeks of the work of the Allied Military Government of this great city. I should like to give you further particulars beyond what I could tell you in a few minutes last night. I think that I may say, however, that we have achieved our dual goal. First that of keeping the burdens of governing this war to ~~the~~ city from the shoulders of our military Commander, whose entire attention is needed for the leading of a great army. Secondly, we have been able to keep the city running in something like a normal fashion, despite the handicaps imposed by war and by the German studied policy of destruction.

May I wish you a safe journey home and once more thank you for your interest in what we are doing.

Respectfully yours,

(S) Edgar Erskine Hume

EDGAR ERSKINE HUME,
Colonel, General Staff Corps,
United States Army,
Chief of Military Government.

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BRITISH DEPARTMENT
TREASURY DEPARTMENT
OFFICE No. 362

COPY No. 12

Information received up to 10 A.M. 4th November, 1943.

1. NAVAL Home Waters 2nd/3rd. 1 E-boat probably sunk and 2 others damaged by H.M.S. Destroyer during enemy attack on a West bound Coastal Convoy off HASTINGS.

3rd/4th. 1 MTB sunk during engagement of E-boats and heavily escorted enemy convoy off DUTCH coast by our Coastal Forces.

Mediterranean 27th. One of H.M. Submarines probably sunk 3,000 ton ship in convoy off TOULON.

3rd. U.S. MTB's sank a 4,000 ton escorted tanker off ELBA. On 31st German raiding party about 70 strong destroyed telegraphic and radio office on CAJAJA Island (North-east of EASTIA).

Anti-Submarine 1st/2nd One of H.M. Sloop sank U-boat off OSMIA.

2. MILITARY Italy 8th Army. 3rd. In attack North of R. TRIGNO our troops captured the town and station of S. SOLVO (2 1/2 miles from Coastal) after determined resistance. Further South our positions across River were improved. Area West of TORELLA (9 miles Northwest of CAMPOBASSO) clear of enemy. Hill features were captured North and South of Main Road to ISERNIA.

5th Army. U.S. Forces reached within 3 miles of ISERNIA. In Coastal Area our positions West of TEANO (13 miles North-west of CAPUA) were improved.

Russia 3rd. Russian Advance in area between Dniaper and KARKINITSKIY Gulf reached BOLSHIE LOPANI and MIKHAILOVKA (20 miles South-east and 25 miles South of KHERSON) and KRASNOE (45 miles West of PEKROP).

Burma Active patrolling on both sides but no further Japanese progress towards FALAM (25 miles South of FORT WHITE). Chinese Forces are in contact with enemy 65 miles South South East of LEDO.

3. AIR OPERATIONS Western Front 3rd. 443 Fortresses (317) out of 448 despatched and 105 Liberators (B 24) out of 117 despatched attacked WILHELMSHAVEN dropping 1351 tons. Results unobserved in thick cloud. 207 escorted Marauders (P26) successfully dropped 265 tons on 3 airfields in Northern FRANCE and HOLLAND. Typhoons and Spitfires attacked other targets enemy casualties 47.21.25. Our 7 Fortresses, 2 Marauders and 4 Fighters missing.

3rd. 4th. Aircraft despatched - DUSSELDORF 589 (18 missing) COLOGNE 62, RHEINHAUSEN 13, DORMUND 2, Sea Mining 23, Leaflets 29, (1 missing), Intruders 31, Anti-shipping 8. Good concentration and fires reported at DUSSELDORF which was clear of cloud but some ground haze. 12 enemy aircraft operate over East Anglia. Some casualties, damage and fires caused mainly at IPSWICH and also at BRAMFORD where main electricity station was damaged, affecting power in WEST SUFFOLK.

Italy 1st/2nd. 11 Bostons (A20) bombed targets in battle area. About 30 enemy aircraft (1 destroyed) unsuccessfully attacked NAPLES Harbour.

2nd. 35 Allied medium and 36 light Bombers attacked railway targets in AQUILA Area. 24 Medium, 189 Light and 277 Fighter Bombers attacked targets in Battle Area.