

COMMISSION
OF THE
EUROPEAN COMMUNITIES

Directorate-General
"Financial Institutions
and Fiscal Matters"

November 1974

Directorate Fiscal Matters

XV/B/1

R E P O R T

on

Taxation Measures against the Influence of Inflation

in

the nine member-countries of
the European Communities, Brazil
and the United States of America

prepared for

The Commission of the European Communities

by

The International Bureau of Fiscal Documentation

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GERMAN FEDERAL REPUBLIC

1. Introduction

Compared with other important western industrialized states the G.F.R. is almost the only state, which has not taken any fiscal measures to rectify the influence of inflation on taxation.

Despite the amounts of basis-exemption and maximum amounts of deductible items will be increased, and the existing progressive rate structure will be amended as of January 1, 1975 within the framework of what had been expected to be an extensive reform of individual income tax, neither are any periodical measures, whether automatic or otherwise, provided in order to allow for inflation.

2. Survey of existing measures

The following measures do, however, take inflation into consideration. These relate to the computation of profits in respect of both individuals and legal entities, and will not be changed nor extended under the abovementioned Income Tax Reform.

- All gains from sales or other disposal of business property are immediately taxed as business income.
However, deferral of tax on certain capital gains is possible in two cases:
 - (1) Where involuntarily realized capital gains result from an act beyond the taxpayer's control, immediate tax may be deferred under certain rules if replacement assets are acquired within statutory periods (35, Individual Income Tax Directives, see photocopy),
 - (2) Where voluntary conversions of qualifying fixed assets result in capital gains, tax may be deferred if replacement assets

are acquired within a certain period following the sale date. This deferral of certain voluntary capital gains was an extension by the 1964 Tax Amendment Law of the deferral already granted for involuntary conversions. The basic requirements are as follows (EStG art. 6b and 6c EStG, Individual Income Tax Law, see photocopies):

(a) Qualifying assets

Capital gains arising from sale or disposal of stocks or shares of corporate entities, real estate, buildings, ships, depreciable movable assets with useful lives of at least 25 years, and certain agricultural and forestry enterprises fixed assets. A six year holding period prior to sale applies to all but the last-mentioned assets and, since the introduction of the Tax Conversion Law (~~see para 395~~), certain transfers of minority shareholdings.

(b) Qualifying replacement assets

Qualifying replacement assets include the following:

- all depreciable movable assets;
- real estate, to the extent that the capital gain arose on the sale of real estate;
- buildings, to the extent that the capital gain arose on the sale of real estate, buildings on investments in corporate entities;
- investments in corporate entities, to the extent that the capital gain arose on the sale of a similar investment and the Federal or State ministry concerned certify the new investment is deserving of governmental support.

If the new investment is not made in the year in which the original asset was sold, a tax-free reserve may be created. Within two years (four years for buildings and ships whose construction has begun within two years) of the end of the year the reserve was created, new assets must be acquired and the

reserve offset against the cost. Future depreciation of the replacement asset is based on acquisition cost less the amount of untaxed capital gain, as with involuntary conversions.

- A tax-free reserve for extraordinary price increases may be set aside when the replacement cost of fungible goods which are part of inventory has been increased by more than 10 per cent in the course of a financial year. The reserve must be added back to taxable income not later than the sixth year following the end of the taxable year in which the reserve was created.
(EStG art. 51(1) 2.b and EStDV - Individual Income Tax Ordinance art. 74, see photocopies).
- An amount of 20 per cent may, under certain circumstances be deducted from the cost of acquisition or open market price, whichever is the lower, of certain goods of foreign origin, which are subject to wide price fluctuations on world markets.
(EStG art. 51(1) 2.m and EStDV art. 80, see photocopies).

It should be mentioned that the Lifo method, which may be applied under commercial law, may not be used for tax purposes, unless it is the actual practice of the taxpayer.

3. Pending proposals (subsequently rejected)

The Federal Council has sent to the Federal Government an initiative draft of a Tax Amendment Law 1974 which contains important proposals to combat inflationary influences on taxation, namely:

- a) The Federal Government must give every year a survey of the movement of prices and their influence on taxation of income, and must make proposals for adjustment of the income tax rate and of certain exempt amounts;
- b) The Federal Government will be authorized to make an ordinance, subject to approval by the Federal Council, on the formation of

reserves to hedge against inflation, thus making it possible for an enterprise to replace used business assets without being affected by inflation (see photocopy of the text of the proposal for such a reserve).

The Federal Government has, however, rejected these proposals.

4. Recent court decision

On May 14, 1974 the Federal Tax Court decided in two cases (BStBl - Official Tax Gazette - II, 1974, pp. 572 and 582) that the taxation of interest received in 1969 and 1971 was in accordance with the Constitution.

The appellants had requested that inflation should be taken into account in taxing interest income.

In both cases, the Court decided that a rectification of the taxation of this income under inflationary conditions could only be given by the legislature.

However, it is not clear whether the Court would have decided in this way if the rate of inflation had exceeded the rate of interest on long-term savings-bank deposits.

FRANCE

1. Tax rates

a. Individual income tax

French individual income tax rates have been regularly adjusted in the years 1970-74. These adjustments more or less reflect the reduced purchasing power of the national currency.

However, the measures in recent years taken by the French Government in connection with inflation are twofold, i.e. some rate reductions are intended to compensate for the reduction in purchasing power of the French franc caused by inflation whereas rate increases were introduced to combat inflation. The first measures tend to keep the purchasing power of the French taxpayers stable whereas the latter, reduce their purchasing power. These measures, which are, in essence, conflicting, were sometimes taken in one and the same year. This report, however, will only discuss the first kind of measures.

Under French individual income tax law the incomes of husband, wife and minor children are aggregated and are taxed under the so-called "family-quotient" system. Aggregate family income is split into parts, e.g. a single person is deemed to receive one part, a married taxpayer two parts and taxpayers having children $\frac{1}{2}$ part per child. In order to compute the income tax due, the taxpayer's income is divided by the number of parts. The tax table applicable on one part is then applied on the resulting amount. The tax amount thus computed is subsequently multiplied by the number of parts. In other words, under French individual income tax law there are neither special family deductions nor separate tax tables reflecting the family status of the taxpayer.

Note that recently the above family quotient system has been criticized because it would grant a greater advantage to taxpayers in the high income brackets.

When the tax tables for 1969 and 1970 income (see Chart) are compared it is found that not only the tax rates were reduced but that also the tax brackets were broadened.

The Official Explanation to the "Projet de Loi de Finances pour 1971" (which fixes the individual income tax rates on 1970 income) states that the rate reduction is connected with the reduction of the 5% credit (from 5% to 3%) available to salaried persons (and also some other categories) under article 198 of the Code général des impôts (hereinafter cited as CGI). Therefore, this rate reduction is not connected with any compensation for inflation.

However, the income brackets were broadened by approximately 5% with a view to the reduced purchasing power of the French franc. The Official Explanation reads:

"Ces aménagements (i.e. the rate reductions) sont complétés par un relèvement des tranches du barème.

Afin d'éviter que l'augmentation nominale des revenus de 1969 à 1970 n'entraîne une aggravation de la progressivité de l'impôt, les limites supérieures des tranches sont majorées en moyenne de 5%".

(Document No. 1376 of the Assemblée Nationale)

The tax reductions for lower tax assessments were in 1970 maintained. In this respect the Official Explanation states:

"Par ailleurs les réductions dégressives de 15% à 2% appliquées en 1970 aux cotisations n'excédant pas 5,000 F. sont maintenues en vigueur sans qu'un texte spécial soit à cet égard nécessaire. Le Gouvernement a l'intention de poursuivre cet effort d'allègement au cours des prochaines années, tant pour tenir compte des phénomènes des prix (emphasis added) que pour améliorer la situation des titulaires de revenus salariaux modestes"

In other words the rate reductions were -- at least partially -- maintained in order to meet inflation.

In 1971 neither the tax rates nor the reductions and increases of the tax assessments were changed. The income tax brackets, however, were further broadened by approximately 5% as a compensation for inflation.

The Official Explanation reads:

"En application des orientations permanentes de la politique fiscale définies l'an dernier par le Gouvernement, il est proposé de relever les limites supérieures des tranches du barème afin de limiter la croissance de l'impôt sur le revenu. Le relèvement est de 5% en moyenne. Cette mesure bénéficie à l'ensemble des contribuables".

(Document No. 1993 of the Assemblée Nationale).

In 1972 the income tax rates were reduced by three percentage points. This rate reduction was connected with the abolition of the 3% credit available to a number of categories of individual taxpayers under article 198 CGI (see above). This rate reduction is, therefore, not connected with any compensation for inflation.

The abolition of the rate increase for higher tax assessments was not further explained in the official documents. The broadening of the income tax brackets, however, (more than 6% for the three lower income tax brackets and 2.7% for the highest brackets) was possibly to a certain extent, as a compensation for inflation.

The Official Explanation reads:

"Afin de mettre en harmonie l'évolution de l'impôt avec l'augmentation réelle des revenus, il est proposé de relever les limites des tranches du barème d'imposition."

Cette mesure, qui concerne l'ensemble des contribuables, bénéficie principalement aux personnes les moins favorisées. En effet, le relèvement, qui est de 2,7% pour les revenus les plus importants, excède 6% pour les trois premières branches".

(Document No. 2583 of the Assemblée Nationale)

The income tax table for 1973 was thoroughly amended. In the first place the income tax brackets were uniformly broadened by 6.5%. The Official Explanation to the Finance Bill 1974 (Projet de Loi de Finances pour 1974, document No. 646 of the Assemblée Nationale) states that simultaneously all exemptions and rate reductions would be abolished in order to simplify the computation of individual income tax which had become extremely complex over the years. No mention was made of any intention of the Government to compensate -- wholly or partially -- for inflation, although it may be presumed that this has also been taken into account.

It is noted that a new 5% bracket was introduced, which was intended to give a more equitable result for persons in the lower income brackets. For 1974 income a tax table has been proposed whose rates are graduated by 5 percentage points instead of by 10 percentage points as was formerly the case. This new tax table means a general reduction of income tax whose cost to the national economy has been estimated to amount to 4,300 million French francs.

The Official Explanation to the Finance Bill 1975 (Projet de Loi de Finances pour 1975, document no. 1180 of the Assemblée Nationale) reads:

"Le barème proposé comporte, par rapport à celui voté l'an dernier, deux innovations:

- une détente de 12%,*
- et en application de l'article 16 de la loi de finances pour 1974, un échelonnement de 5 points des taux applicables aux différents tranches".*

No mention is made of any compensation for inflation, but it may again be assumed that this was one of the reasons for the amendment of the income tax table.

By virtue of article 5-2^obis of the CGI persons who receive mainly a salary or pension are exempt from individual income tax if their income does not exceed 10,000 Frfrs, other persons are exempt if their income does not exceed 8,000 Frfrs. The Finance Bill 1975 proposes to increase these amounts to 11,400 Frfrs and 10,000 Frfrs respectively. No mention was made, however, of a compensation for inflation, although it seems likely that this was one of the reasons to increase these amounts.

./.. A chart showing the income tax rates for the years 1969 through 1974 is enclosed.

b. Corporate income tax

The corporate income tax rate (50%) has not been changed in the last year. Since it is imposed at a flat rate there is no reason for an adjustment for inflation.

II. Business income

There do not exist any general provisions in French income tax law which are meant to counteract inflation. Some provisions, for instance, with respect to the taxation of long term capital gains, may give the taxpayer to a certain extent a relief. However, we have not been able to find any official statement that this was the Government's intention when introducing these provisions.

a. Long term capital gains

Long term capital gains are: (i) gains on the sale or other transfer of non-depreciable fixed assets (e.g. land) which have been held for two years or more and (ii) gains on the sale or other transfer of depreciable fixed assets which have been held for two years or more, with the exception of that part of the gain which reflects the difference between the book value of the asset and its original acquisition cost (i.e. the so-called recaptured depreciation) is excluded and is taxed as ordinary income).
CGI. arts. 39 duodecies - 39 sexdecies.

Long term capital gains and long term capital losses must be netted each year and if the balance is a gain it may be used to absorb losses from previous years (ordinary losses carried over from the 5 previous years, long term capital losses of the previous 10 years, ordinary tax losses of the same year and deferred depreciation of previous years). Any balance is subject to income tax at a reduced rate of 15%. For individual taxpayers this tax relief is unconditional. Corporate taxpayers must credit the long term capital gain (less the tax paid) to a special reserve. CGI, art. 209 quater. If, the reserve is used for distribution to shareholders it is added back to taxable income. (In that case, the 15% tax paid may be credited against the 50% corporate income tax due. No additional corporate income tax is due where the corporate taxpayer uses the reserve to absorb ordinary losses or long term capital losses of the following 10 years, for incorporation in its capital or for liquidation distributions.

b. Reserve for inventory price increase (provision pour hausse des prix)

By virtue of article 39-1-5^o CGI enterprises are permitted to deduct (temporarily) from taxable income a fraction of the profits which are invested in the reconstitution of inventory in case of

substantial price increase. For this purpose a tax exempt reserve for inventory price increases may be set up in any year in which, on an item by item basis, the unit price has increased by more than 10% since the opening inventory of that year or of that of the preceding year. Only the increase in excess of 10% may be placed in the reserve. The reserve must be added back to taxable income of the year running at the end of six calendar years following the year in which it has been created. However, in those cases where the inventory turnover period is normally longer than 3 years addition to taxable income may be effected after a period which has twice the length of the turnover period.

The following two examples which were taken from LAMY FISCAL 1974 at 134, illustrate the application of the above provisions:

Example 1

Assume that an enterprise's accounting year coincides with the calendar year. At the end of its accounting year 1973 it has 500 units of product A in stock. The unit price of this product was 20 Frfrs in 1971, 24 Frfrs in 1972 and 26 Frfrs in 1973.

The amount which in 1973 may be placed in the reserve for inventory price increases is: $500 (26 - (20 \times 1.1)) = 2,000$ Frfrs.

In this example it was assumed that the enterprise did not create a reserve for inventory price increases in 1972. If the enterprise had created such a reserve and if it is assumed that it had at the end of its accounting year 1972, 1,250 units of product A in stock, the amount which could be placed in the reserve for inventory price increases would have been: $1,250 (24 - (20 \times 1.1)) = 2,500$ Frfrs.

In such a case there would not have been a possibility for the enterprise to place any amount in the reserve in 1973, since the reserve of 1972 must be set off against the 1973 reserve (Annexe III to the CGI, article 10 nonies). On the other hand, there is no

obligation for the enterprise to add the difference between 2,500 Frfrs and 2,000 Frfrs back to 1973 taxable income.

Example 2

Assume that the same enterprise has at the end of 1973 500 units of product B of which the unit prices were 20 Frfrs on January 1, 1972, 18 Frfrs on December 31, 1972 and 23 Frfrs on December 31, 1973.

The amount which in 1973 may be placed in the reserve for inventory price increases is: $500 (23 - (18 \times 1.1)) = 1,600$ Frfrs.

In this case the unit price of December 31, 1972 may be taken, which is lower than the unit price on January 1, 1972, i.e. on the date on which the preceding accounting year was opened.

./.. The text of some of the major sections of the CGI (concerning long-term capital gains and the reserve for inventory price increases) are enclosed.

C H A R T 1

1969 income tax brackets (Fr.frs)	1969 rates %	1970 income tax brackets (Fr.frs)	1970 rates %
0 - 2,700	5	0 - 2,900	3
2,700 - 4,800	15	2,900 - 5,100	13
4,800 - 8,100	20	5,100 - 8,500	18
8,100 - 12,000	25	8,500 - 12,600	23
12,000 - 19,100	35	12,600 - 20,050	33
19,100 - 38,200	45	20,050 - 40,100	43
38,200 - 76,400	55	40,100 - 80,200	53
over 76,400	65	over 80,200	63

In 1969 the tax assessments were reduced or increased in the following manner:

In 1970 the tax assessments were reduced or increased in the following manner:

Amount of tax (Fr.frs)	Reduction %
less than 1,000	15
1,001 - 1,500	12
1,501 - 2,000	10
2,001 - 2,500	8
2,501 - 3,000	6
3,001 - 3,500	4
3,501 - 5,000	2
5,001 - 7,000	0

Amount of tax (Fr.frs)	Reduction %
less than 1,000	15
1,001 - 1,500	12
1,501 - 2,000	10
2,001 - 2,500	8
2,501 - 3,000	6
3,001 - 3,500	4
3,501 - 5,000	2
5,001 - 10,000	0

	<u>Increase</u>
7,001 - 8,000	2
8,001 - 9,000	3
9,001 - 10,000	4
10,001 - 10,500	5
10,501 - 12,000	6
12,001 - 14,000	7
over 14,000	7.5

	<u>Increase</u>
10,001 - 15,000	1
15,001 - 20,000	2
over 20,000	3

C H A R T 2

1971 income tax brackets (Fr.frs)	1971 rates %	1972 income tax brackets (Fr.frs)	1972 rates %
0 - 3,100	3	0 - 3,300	0
3,100 - 5,400	13	3,300 - 5,750	10
5,400 - 8,950	18	5,750 - 9,500	15
8,950 - 13,250	23	9,500 - 14,050	20
13,250 - 21,050	33	14,050 - 22,000	30
21,050 - 42,100	43	22,000 - 43,500	40
42,100 - 84,200	53	43,500 - 86,500	50
over 84,200	63	over 86,500	60

In 1971 the tax assessments were reduced or increased in the following manner:

In 1972 the tax assessments were reduced in the following manner. The rate increases were abolished.

Amount of tax (Fr.frs)	Reduction %	Amount of tax (Fr.frs)	Reduction %
less than 1,000	15	less than 1,000	15
1,001 - 1,500	12	1,001 - 1,500	12
1,501 - 2,000	10	1,501 - 2,000	10
2,001 - 2,500	8	2,001 - 2,500	8
2,501 - 3,000	6	2,501 - 3,000	6
3,001 - 3,500	4	3,001 - 3,500	4
3,501 - 5,000	2	3,501 - 5,000	2
5,001 - 10,000	0	5,001 - 10,000	0
	<u>Increase</u>		
10,001 - 15,000	1		
15,001 - 20,000	2		
over 20,000	3		

C H A R T 3

<u>1973 income tax brackets (Fr.frs)</u>	<u>1973 rates %</u>	<u>1974 income tax brackets (Fr.frs) (proposed)</u>	<u>1974 rates % proposed</u>
0 - 4,950	0	0 - 5,550	0
4,950 - 5,200	5	5,550 - 5,825	5
5,200 - 6,250	10	5,825 - 7,000	10
6,250 - 9,900	15	7,000 - 11,100	15
9,900 - 14,900	20	11,100 - 15,050	20
14,900 - 22,000	30	15,050 - 19,000	25
22,000 - 46,325	40	19,000 - 22,950	30
46,325 - 92,125	50	22,950 - 26,475	35
over 92,125	60	26,475 - 45,825	40
		45,825 - 64,900	45
		64,900 - 84,000	50
		84,000 - 103,150	55
		over 103,150	60

BELGIUM

I. Inflation and the taxation of individual taxpayers

The Belgian Income Tax Code (wetboek van de inkomstenbelastingen/ Code des impôts sur les revenus, hereinafter referred to as WIB/CIR) distinguishes between income from real property, income from movable property, income from "professional activities" (including business income, salaries and pensions) and income from miscellaneous sources.¹⁾ For purposes of taxation these different kinds of income are computed separately to determine their respective net amounts. Once completed the abovementioned amounts are added to determine the tax rate applicable on the total net income of the individual.

With respect to inflation and the effects thereof, it has been the government's policy not to adjust income tax rates. The reason given for this policy were budgetary consequences.²⁾

Any measures taken by the government to compensate for inflation, therefore, have been with respect to exemptions and deductions. However, these measures (which mainly concern taxpayers from the low and middle income brackets) are not part of a fixed and general rule laid down in the Income Tax Code, but rather have been taken on a per year basis.

The measures will be discussed together with the pertinent income types.

A. Inflation correctives with respect to the income from movable property

In determining net income from movable property (e.g. bonds and shares) the taxpayer has recently been accorded increased or new deductions and exemptions, with a view to partially compensate for the inflationary repercussions.

These changes were introduced by the law of July 25, 1974, published in the Belgisch Staatsblad/Moniteur Belge of July 26, 1974.³⁾

(1) Exempt interest from bank books

Pursuant to art. 19(7) of the WIB/CIR, as amended by art. 1(1) of the Law of July 25, 1974, the first 15,000 Bfrs. will be exempted in 1975. This is an increase of 5,000 Bfrs. as compared with the previous year.

Since 1969, the amount of this exemption has been increased regularly as shown in the following table:

69 - 70	71 - 72	73 - 74	75
5,000	7,500	10,000	15,000

(2) Exempt income from capital invested in cooperatives, accredited by the National Council for Cooperatives

To protect this income from inflation, the exempt amount determined by art. 19(8) WIB/CIR was raised from 1,000 Bfrs. to 1,500 by art. 1(2) of the Law of July 25, 1974.

A survey of the consecutive increases of this exemption since 1969 is as follows:

69 - 70	71 - 72	73 - 74	75
500	750	1,000	1,500

(3) Exempt income from other savings schemes with a fixed interest rate

Art. 2 of the law of July 25, 1974 provided for the insertion of article 19 bis in the WIB/CIR. By virtue of this new article the first

10,000 Bfrs. of the total income from savings accounts with a fixed interest rate, other than those discussed under (1), and/or from bonds or similar securities will be deductible from the net movable income subject to tax.

However, the full deduction of 10,000 Bfrs. will only be accorded in so far as the taxpayer's total taxable net income does not exceed 350,000 Bfrs. after this deduction. If it does exceed 350,000 Bfrs. the deduction will be reduced by the difference between the actual total taxable ^{net} income and 350,000 Bfrs.

(4) No exemptions for savings schemes subject to risks

During the parliamentary discussion of the above mentioned law, the Minister of Finance maintained, that no exemption could be accorded because:

"1^o les actionnaires sont moins exposés à une diminution de la valeur de leurs revenus (dividendes) et de leur capital que les épargnants qui bénéficient de revenus fixes;

2^o la nouvelle immunité de 10,000 francs proposée dans le projet est uniquement accordée aux petits épargnants (dont l'ensemble des revenus n'excède pas 350,000 francs). Ce n'est que très rarement que les petits épargnants investissent en obligations, ils préfèrent au contraire les investissements dans des formes d'épargne à revenu fixe;

3^o le crédit d'impôt accordé aux actionnaires a été augmenté par la loi du 25 juin 1973; cette mesure constitue un avantage non négligeable pour l'épargne à risques." 4)

(5) Effectiveness of the changes introduced by the law of July 25, 1974

The Commission of Finance stated in its parliamentary report that :

"Il a été affirmé en commission que le projet ne réussira pas à promouvoir l'épargne et à juguler l'inflation. Le relèvement de l'immunité est insuffisant pour neutraliser l'érosion monétaire; il en résultera une aggravation de la désaffection vis-à-vis des formes d'épargne classiques.

L'épargne disponible se concentrera davantage sur les investissements immobiliers, ce qui compromettra la politique anti-inflationniste. Au cours de cet échange d'idées, la suggestion a été faite d'indexer l'épargne. Cette mesure se justifierait non seulement pour des raisons d'équité, mais pourrait également constituer un volet très important d'une véritable politique anti-inflationniste."

B. Inflation Correctives with respect to the income derived from "professional activities".

1. General aspects

The income from "professional activities" benefits to a certain extent from preferential treatment because these activities are, for most people, their major source of income.

Thus, the WIB/CIR provides a lump sum deduction for expenses for all salaried taxpayers or those who exercise a liberal profession, in the event that they cannot prove or do not wish to deduct their real expenses.

Furthermore the taxpayer is accorded an unconditional lump-sum deduction from his total net professional income (that is, after deduction of his obligatory social security contributions and professional expenses).

However, it must be noted that the amount of both abovementioned deductions also depends on the size of the income from professional activities.

To mitigate the inflationary repercussions, both deductions have regularly been increased for taxpayers of the lower and middle income brackets.

In the Memorie van Toelichting/Exposé des Motifs of the Law of December 28, 1973 we therefore find the following statement⁶⁾.

Le présent projet de loi tend à aménager, dans une mesure compatible avec les impératifs budgétaires, les modalités de détermination de l'assiette et de calcul de l'impôt des personnes physiques des exercices d'imposition 1974 et 1975 (revenus des années 1973 et 1974) en vue d'effacer ou d'atténuer forfaitairement l'incidence de la progressivité de cet impôt sur la quotité monétaire des petits et moyens revenus professionnels, qu'il s'agisse de rémunérations, de bénéfices ou de profits.

L'aménagement proposé - et dont les modalités techniques quels décrites ci-après - aura pour effet:

1° d'effacer intégralement mais forfaitairement l'incidence de la progressivité de l'impôt sur la quotité monétaire des revenus professionnels nets (revenus bruts diminués des dépenses ou charges professionnelles, réelles ou forfaitaires) dont le montant total n'excèdera pas 150,000 F. pour chacune des années 1973 et 1974;

2° d'atténuer forfaitairement - et d'une manière dégressive - la même incidence sur la quotité monétaire des revenus professionnels dont le montant total pour les mêmes années sera compris entre 150,000 et 350,000 F. exclusivement.

Cet aménagement sera réalisé par la combinaison des mesures suivantes:

1° "indemnité" des trois premiers mois de l'année 1974 par l'article 51 du Code des impôts sur les revenus en matière de dépenses ou charges professionnelles (autres que les dépenses liées à l'habitat personnel) déductibles des revenus des travailleurs salariés et des profits de professions libérales, charges, offices ou occupations lucratives;

2° relèvement substantiel de l'abattement forfaitaire sur les revenus professionnels nets (autres que les pensions) dont le montant total n'atteint pas 350,000 F.;

3° léger relèvement, pour les contribuables ayant au moins quatre personnes à charge, du minimum imposable et de la limite au-delà de laquelle les réductions d'impôt pour charges de familles cessent d'être accordées.

Pour déterminer la surtaxe qui, à défaut d'aménagement quelconque, serait contenue dans l'impôt des exercices d'imposition 1974 et 1975, il a été tenu compte des taux annuels d'inflation prévisibles à l'heure actuelle, c'est-à-dire d'un taux d'inflation de:

- 7% pour l'année 1973 par rapport à l'année 1972 (1972 = 100; 1973 = 107);
- 6,25% pour l'année 1974 par rapport à l'année 1973 (1973 = 100; 1974 = 106,25), ce qui donne cumulativement 13,6875% pour l'année 1974 par rapport à l'année 1972.

(a) Increase of the lump sum deduction for business expenses

Art. 51 of the WIB/CIR as amended by arts. 4 and 5 of the Law of December 28, 1973 provides for the deductibility of lump sum business expenses. Taxpayers who are eligible for this deduction are those who receive a salary of one kind or another and those who exercise a liberal profession.

The deduction is effected on the gross professional income minus the social security contributions.

As stated above, this deduction was last amended by the Law of December 28, 1973. The changes then introduced affected taxpayers in the lower and middle income brackets. These changes were justified as follows:

"Ces modifications sont nécessaires pour éviter, notamment que:

1° les contribuables dont les dépenses ou charges professionnelles (autres que les cotisations sociales personnelles) sont fixées forfaitairement soient défavorisés par rapport à ceux qui déduisent le montant réel de leurs dépenses ou charges professionnelles (lesquelles suivent normalement l'évolution du coût de la vie au même rythme que les revenus bruts qu'elles grèvent);

2° des travailleurs salariés dont les dépenses ou charges professionnelles sont fixées forfaitairement en chiffres absolus soient défavorisés par rapport aux travailleurs de la même catégorie dont les dépenses ou charges professionnelles forfaitaires sont fixées en pourcentage et évoluent au même rythme que leurs rémunérations brutes imposables.

Cette nécessité résulte de la structure même du forfait de dépenses ou charges professionnelles, qui est dégressif et qui comporte de ce fait des zones de revenus pour lesquelles il est fixé en chiffres absolus.

Bien sûr, pour traiter tous les contribuables intéressés de la même manière, il faudrait indexer toutes les limites et tous les minimums absolus du forfait actuel, c'est-à-dire, en clair, indexer également le forfait déductible des revenus bruts imposables excédant 300,000 F.

Mais, pas plus que les Gouvernements précédents, le Gouvernement actuel ne voit la possibilité, dans la conjoncture budgétaire

du moment, de procéder à une indexation complète du forfait de dépenses ou charges professionnelles, dont il conviendrait d'ailleurs de réformer fondamentalement la structure en vue de pallier les inconvénients évoqués ci-avant.⁷⁾

The increases in the lump sum deductions since 1966 are shown in the table below.

1966 - 1970

<u>Montant brut des rémunérations</u> <u>- sociale bijdragen</u>	<u>Charges professionnelles forfaitaires</u>
de 0 à 37,500 F	7,500 F (1)
de 37,501 à 92,500 F	20 p.c.
de 92,501 à 123,333 F	18,500 F
de 123,334 à 300,000 F	15 p.c.
de 300,001 à 450,000 F	45,000 F
de 450,001 à 600,000 F	10 p.c.
de 600,001 F et plus	60,000 F

1971 (1970 income)

<u>Montant brut des rémunérations</u>	<u>Charges professionnelles forfaitaires</u>
de 0 à 50,000 F	10,000 F (1)
de 50,001 à 107,500 F	20 p.c.
de 107,501 à 126,473 F	21,500 F
de 126,474 à 150,000 F	17 p.c.
de 150,001 à 159,378 F	25,500 F
de 159,379 à 200,000 F	16 p.c.
de 200,001 à 213,336 F	32,000 F
de 213,337 à 300,000 F	15 p.c.
de 300,001 à 450,000 F	45,000
de 450,001 à 600,000 F	10 p.c.
de 600,001 F et plus	60,000 F

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1972 and 1973 (1971 and 1972 income)

	Montant brut des rémunérations	Charges professionnelles forfaitaires
de	0 à 50,000 F	10,000 F (1)
de	50,001 à 107,500 F	20 p.c.
de	107,501 à 126,473 F	21,500 F
de	126,474 à 150,000 F	17 p.c.
de	150,001 à 159,378 F	25,500 F
de	159,379 à 200,000 F	16 p.c.
de	200,001 à 213,336 F	32,000 F
de	213,337 à 300,000 F	15 p.c.
de	300,001 à 450,000 F	45,000 F
de	450,001 à 600,000 F	10 p.c.
de	600,001 F et plus	60,000 F

1974 (1973 income)

	Y	≤	50,000 F	10,000 F
50,001	<	Y	≤ 115,000	20 pct.
115,001	<	Y	≤ 135,294	23,000 F
135,295	<	Y	≤ 160,000	17 pct.
160,001	<	Y	≤ 170,000	27,200 F
170,001	<	Y	≤ 214,000	16 pct.
214,001	<	Y	≤ 228,200	34,240 F
228,201	<	Y	≤ 300,000	15 pct.
300,000	<	Y	≤ 450,000	45,000 F
450,000	<	Y	≤ 600,000	10 pct.
	Y	>	600,000	60,000 F

1975
 (income earned in 1974 and subsequent years)

		Y	≤	50,000 F	10,000 F
50,001	<	Y	≤	122,500	20 pct.
122,501	<	Y	≤	144,118	24,500 F
144,119	<	Y	≤	170,000	17 pct.
170,001	<	Y	≤	180,626	28,900 F
180,627	<	Y	≤	227,000	16 pct.
227,001	<	Y	≤	242,100	36,320 F
242,101	<	Y	≤	300,000	15 pct.
300,000	<	Y	≤	450,000	45,000 F
450,000	<	Y	≤	600,000	10 pct.
		Y	>	600,000	60,000 F

(b) Increase of the lump sum deductions from the total net income from professional activities

Pursuant to art. 54(4) of the WIB/CIR, as amended by the Law of December 28, 1973, a lump sum deduction is accorded to all taxpayers on their total net professional income. Hereto, lower and middle income bracket taxpayers will be the sole beneficiaries of the measure mitigating inflation.

Below, is a review of the adaptations during the last few years showing the effect of the latest measures taken by the government

				64-70	71	
		Y	≤	150,000	5% (minimum 5,000)	10,000
150,000	<	Y	<	310,000	5% (maximum 10,000)	"
310,000	≤	Y	<	350,000	10,000	"
		Y	>	350,000	10,000	"

72	73	74
14,000	15,000	20,000
14,000 - 2,5% x (Y-150,000)	15,000 - 2,5%	20,000 - 2,5%
10,000	15,000 - 2,5%	20,000 - 2,5%
10,000	10,000	10,000
		75
		24,000
		24,000 - 7%
		24,000 - 7%
		10,000

2. Inflation correctives and capital gains

Pursuant to art. 21 of the WIB/CIR, all capital gains realised in the course of an industrial, commercial or agricultural exploitation are deemed to be income from professional activities and will consequently be subject to tax. Art. 30 of the WIB/CIR contains a similar provision for capital gains realised in the exercise of a liberal profession.

However, art. 93(1)(2) provides that the abovementioned capital gains will be subject to a reduced 15% tax rate, subject to the condition that the assets upon which the capital gains were realised had been used for at least 5 years in the profession on exploitation.

Also art. 34(1)(3) provides that no tax will be levied on the "monetary part" of the capital gains realised on immovables, equipment, participations and other securities invested for at least 5 years in the abovementioned exploitations or professions.

The "monetary part" of the capital gains realised is calculated by multiplying the acquisition price with the coefficients provided for in art. 119 WIB/CIR, less the depreciation and capital losses which were already fiscally deducted.⁸⁾

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The above coefficient varies in accordance with the year in which the asset was acquired (etc.) as follows:

Années	Coefficients applicables
1918 et antérieurs	16,33
1919	11,49
1920	6,15
1921	6,30
1922	6,43
1923	4,37
1924	3,89
1925	4,02
1926	2,72
1927 à 1934 incluse	2,35
1935	1,86
1936 à 1943 incluse	1,70
1944 à 1948 incluse	1,14
1949	1,10
1950 et suivants	1,-

An example will illustrate this:

In 1925 a company purchases premises for Bfrs. 250,000.
In 1967 the company sells the premises for Bfrs. 1,000,000.
In 1967 those premises were booked at Bfrs. 50,000 so that an amount of Bfrs. 200,000 was depreciated between 1925 and 1967.
The taxable base of the realized capital gain is computed as follows:

- the purchase price multiplied by the coefficient 4,02	Bfrs. 1,005,000
- depreciation	<u>Bfrs. 200,000</u>
	Bfrs. 805,000
- selling price	Bfrs. 1,000,000
- taxable base (1,000,000 - 805,000 =)	Bfrs. 195,000

However, the above coefficients, even though they do in a certain measure compensate for inflation were inspired by the consecutive devaluations of the Belgian Franc, and not by the inflation as such.

Furthermore it must be noted that this exemption does not apply to the realized capital gains on immovables which are in the possession of a taxpayer whose business activity consists in the purchasing or building and in the selling or hiring of immovables. If those immovables were acquired in view of selling them, or if those immovables were not continually used for the taxpayer's business activities, the related capital gains are treated as ordinary profits and subject to taxation for their full amount. However, with respect to non-built immovables, the purchase price may yearly be increased by 5% from the sixth year of possession with a ceiling of 50%.⁹⁾ Whether this yearly increase of 5% of the purchase price was strictly an inflation corrective measure cannot clearly be made out. However, the report by the reporter of the Parliamentary Commission for Finance does seem to so indicate.

"Door verschillende leden van uw commissie werden bezwaren ingebracht tegen de door de regering voorgestelde regeling.

Onder meer werd er op gewezen dat er een vrij lange tijdspanne verloopt tussen de aankoop van gronden en de verkoop van uitgeruste percelen en dat die uitrusting dikwijls opgelegd is door de overheid.

De gelijkstelling met koopwaar en de daaruit voortvloeiende gevolgen zijn derhalve - werd er beweerd - onverantwoord voor wat betreft de gronden die

door de immobiliënvennootschappen bouwrijp worden gemaakt met het oog op de verkoop (als bouwgrond).

Hierop werd door de regering geantwoord dat er ook in andere takken van de handel of de nijverheid een grote tijdsparre kan verlopen tussen de aankoop van grondstoffen of koopwaar en de realisatie ervan: men denke bijvoorbeeld aan de scheepstimmerwerven en de metaalbedrijven.

De regering meende dat het in het wetsvoorstel vastgelegd basis-principe moest worden behouden en dat, moest men de ongebouwde onroerende goederen gewoonweg aan de regeling onttrekken, deze regeling helemaal ontzema¹ zou worden vermits de activiteit van de vastgoedhandelaars hoofdzakelijk op dergelijke goederen slaat.

Zij verklaarde zich evenwel bereid haar tekst te amenderen om in zekere mate de gevolgen te temperen welke voor de vastgoedhandelaars zouden kunnen voortvloeien uit de overgang, zonder enige transitie, van de afzonderlijke belasting tegen een verlaagd tarief naar het stelsel van de belasting tegen het tarief van het gemeen recht voor de ongebouwde onroerende goederen die voortaan als koopwaar zullen worden aangemerkt.

Volgens het regeringsamendement dat eenparig door de commissie werd aangenomen zal, op het bedrag van de meerwaarden die door vastgoedhandelaars verwezenlijkt worden op ongebouwde onroerende goederen die, op het ogenblik van hun vervreemding, sedert meer dan vijf jaar in hun bezit waren, een vermindering worden toegepast gelijk aan 5 pct. van de beleggings- of aankoopwaarde van het vervreemde goed voor ieder jaar boven het vijfde dat de belastingplichtige dit goed in zijn bezit heeft gehad, met een maximum van 20 pct. van die beleggings- of aankoopwaarde.¹⁰⁾

Finally art. 35 of the WIB/CIR provides that the realized capital gains owing to damages, expropriations or similar events which are related to tangible and intangible assets, other than raw material products or merchandise are exempted.

This exemption applies in so far as the amount of the indemnification is reinvested in business assets, other than raw materials, products or merchandise, within three years following the taxable period in which the indemnification was received.

But reinvestment is not required with respect to the capital gains on assets used in an agricultural enterprise, or on non-built immovables of a taxpayer whose business activities consist in the purchasing or building and the selling or hiring of immovables.

3. Valuation of inventory

Although the general rules discussed under "2. Inflation correctives and capital gains" also apply in principle to the inventory and the valuation thereof, this separate paragraph will go in to greater detail with respect to the latter.

First it must be noted that there is no special provision in Belgian tax law with respect to the valuation of inventory assets.

The tax administration requires inventory assets to be valued at their cost price. If lower, inventory valuation may also be based on the replacement cost.

The cost price is the price actually paid by the company for the purchase or the production of the relevant asset.

The replacement cost is the cost price of the stock at the termination of the financial year.

But valuation methods as the base stock system and the LIFO inventory system are not permitted. The Compiled Administrative Rulings (Kommentaar op het Wetboek der Inkomsten Belastingen/Commentaire sur le Code des Impôts sur les Revenus) state under no's 44/345-347 and 44/349:

44/345 - Bien que ce mode d'évaluation des stocks présente des avantages au point de vue économique - il permet, en effet, en cas de fluctuations fréquentes des prix, de maintenir une plus grande stabilité dans les résultats des différents exercices comptables - il ne peut, pour les raisons suivantes, être admis au point de vue fiscal.

Conformément aux principes énoncés ci-dessus, les marchandises en magasins à la date du bilan doivent être inventoriées, soit au prix d'acquisition ou de revient, soit à leur valeur effective de réalisation.

44/346 - Par ailleurs, les plus-values réalisées sur la vente de marchandises constituent de véritables bénéfices d'exploitation dont il y a lieu de tenir compte en vue de la détermination des revenus imposables. Les marchandises étant l'objet d'un renouvellement constant, les plus-values d'inventaire interviennent naturellement dans la fixation des profits imposables. Ainsi, lorsqu'un objet inventorié à 100 F est vendu 150 F, l'opération se traduit par un bénéfice brut de 50 F alors même qu'il faille déboursier 150 F ou plus pour se reprocurer le même objet.

44/347 - Pour déterminer le bénéfice imposable, il faut donc déduire du prix de vente, non pas le prix de renouvellement (150 F dans l'exemple ci-dessus), mais le prix de revient pour lequel l'objet vendu était repris à l'inventaire (100 F).

Le nouvel objet acheté pour 150 F par exemple, et remplaçant dans les stocks celui qui a été vendu, devra en principe être inventorié en fin d'exercice comptable s'il se trouve encore dans le stock à ce moment, au prix d'achat réel de 150 F et non pas au prix (100 F) auquel avait été acheté celui qu'il remplace (of Cass., 12.6.1944, S.A. "Moulins de l'Escaut", Pas. 1944, I, 382)

44/349 - Admettre la théorie du "stock-outil" reviendrait d'ailleurs à accorder un variable privilege attendu que la plus-value inflationniste réalisée sur les marchandises vendues provenant des stocks ne serait jamais taxée - sauf bien entendu en cas de liquidation - ce qui serait contraire au principe de l'annualité.

C. Inflation Correctives with respect to an Individual's Total Net Income

Pursuant to art. 79 of the WIB/CIR the total net income of an individual is tax exempted when it does not exceed certain limits. Furthermore art. 81 of the WIB/CIR provides tax deductions for the individuals with dependents.

To complete the inflation corrective measures, the law of December 28, 1973 provided that and the limits for tax exempted minimum income and the maximum income tax deductions for dependents would be raised for those taxpayers with four or more dependents because¹¹⁾

"Pour ces contribuables - qui ressentent d'ailleurs les effets de la hausse du coût de la vie d'autant plus durement qu'ils n'ont de personnes à charge - la mesure générale faisant l'objet des articles 6 à 8¹²⁾ du présent projet de loi peut, en effet, dans certains cas, s'avérer insuffisante pour que l'incidence de la progressivité de l'impôt sur la quotité monétaire des revenus professionnels soit:

- effacée intégralement jusqu'à 150,000 F de revenus professionnels nets;
- atténuée dans une mesure suffisante entre 150,000 F et 350,000 F de revenus professionnels, nets, comparativement à ce qui sera fait au profit des contribuables ayant moins de quatre personnes à charge.

Pour redresser cette situation, il convient de relever légèrement:

- (a) - d'une part, le minimum imposable dans le chef des contribuables dont il est question ci-avant (mesure visant essentiellement les contribuables ayant 4 ou 5 personnes à charge et moins de 150,000 F de revenus professionnels nets);

Increase of the tax exempted minimum income

<i>number of dependents</i>	<i>69-73 tax exempted minima</i>	<i>74 id.</i>	<i>Increase</i>
0	35,000	35,000	0
1	40,000	40,000	0
2	45,000	45,000	0
3	50,000	50,000	0
4	74,000	75,000	1,000
5	113,000	115,000	2,000
6	152,000	155,000	3,000
7	191,000	195,000	4,000
8	230,000	235,000	5,000
9	269,000	275,000	6,000
10	308,000	315,000	7,000

(b) Dependent relatives allowances

- d'autre part, la limite au-delà de laquelle les réductions d'impôt cessent d'être accordées (mesure visant essentiellement les contribuables ayant au moins 4 personnes à charge et moins de 350,000 F de revenus professionnels nets).

These allowances are deducted as a percentage from the tax amount (a disabled child may be considered as 2 children):

<i>Number of dependents</i>	<i>Survey of the deduction for dependents</i>		
	<i>72-73</i>	<i>74</i>	<i>increase</i>
4	21,255	21,435	180
5	40,150	40,850	700
6	63,070	64,540	1,470

7	89,910	92,430	2,520
8	109,825	113,575	3,750
9	120,325	124,825	4,500
10	130,825	136,075	5,250

The *Memorie van Toelichting/Exposé des Motifs* then concludes:

Bien sûr, le relèvement de cette limite profitera également aux contribuables dont les revenus professionnels excèdent, même largement, 350,000 F, mais cela est une des conséquences du régime actuellement en vigueur en matière d'aménagement familial de l'impôt, qu'il n'est pas possible d'éviter, dans le cadre du présent projet de loi, sans entrer dans la voie de complications inextricables.

II. Inflation and the taxation of Corporations

No specific inflation corrective measures have been taken with respect to corporations. The inflation corrective measures taken for the benefit of the individual taxpayer with respect to income from movable property are inapplicable to corporations¹⁵⁾.

With respect to the capital gains, only the inflation corrective provided by arts 34 and 119 is applicable. (see I, 2). It must furthermore be noted that pursuant to art. 130 of the WIB/CIR, a reduced rate of 21% is applicable to capital gains realized on assets which had been invested in the company for more than five years, in contrast to the 15% rate of which those capital gains would be subject in the case of an individual taxpayer. (id).

Finally, art. 105 of the WIB/CIR provides that the realized capital gains owing to damages, expropriations or similar events which relate to tangible and intangible assets other than raw materials,

products or merchandise are only exempted to the extent that they are (and remain) included in one or more separate accounts on the liabilities' side, and that they are not used for the creation or the increasing of the legal reserve, nor for any kind of reward or bonus. If those conditions are no longer fulfilled during a taxable period, the capital gains are considered profits of that taxable period.

(see art. 35 WIB/CIR and I, 2 in fine).

III. APPENDIX

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Latest inflation corrective measures and proposals with respect to the taxation of the individual taxpayer.

The previous government had committed itself during the parliamentary discussion of the future law of December 28, 1973, to introduce new inflation corrective measures and proposals if the inflation rate should prove to exceed the estimated 6,25% for the year of 1974.¹⁶⁾

The actual government with the same Minister of Finance implemented this commitment. After the first few months, when it was obvious that the inflation rate would soar far higher than previously estimated, the Minister of Finance decreed¹⁷⁾ that prior to the exact determination of the actual rate of inflation, the withholding tax on the salaries of the taxpayers from the lower and middle income brackets would be reduced. This reduction of the withholding tax is calculated on a lump sum basis and is effective with respect to the salaries earned as of July 1, 1974.

Echelons de rémunérations brutes imposables (montant brut diminué des cotisations sociales)	Montant de la réduction		
	par mois	par quinzaine	par semaine
	F	F	F
par mois : 20,000 F et moins...	100	-	-
par quinzaine: 9,600 F et moins...	-	50	-
par semaine : 4,800 F et moins...	-	-	25
par mois : de 20,001 à 25,000 F	75	-	-
par quinzaine: de 9,601 à 12,000 F	-	40	-
par semaine : de 4,801 à 6,000 F	-	-	20
par mois : de 25,001 à 30,000 F	50	-	-
par quinzaine: de 12,001 à 14,400 F	-	25	-
par semaine : de 6,001 à 7,200 F	-	-	12
30,001 F par mois, 14,401 F par quinzaine ou 7,201 F par semaine et plus	néant	néant	néant

However on October 24, 1974 the government introduced a bill¹⁸⁾ to parliament with the promised new inflation correctives, now calculated on a basis of an inflation rate of 12,5%.

This means that the inflation correctives made by the law of December 28, 1973 will have to be increased with approximately 6,25% for the fiscal year 1975.

The proposed changes are laid down in the following charts:

- i. Lump sum deduction for business expenses

actual deductions (fiscal year - 75)

		Y	≤	50,000 F	10,000 F
50,001	<	Y	≤	122,500	20 pct.
122,501	<	Y	≤	144,118	24,500 F
144,119	<	Y	≤	170,000	17 pct.
170,001	<	Y	≤	180,626	28,900 F
180,627	<	Y	≤	227,000	16 pct.
227,001	<	Y	≤	242,100	36,320 F
242,101	<	Y	≤	300,000	15 pct.
300,000	<	Y	≤	450,000	45,000 F
450,000	<	Y	≤	600,000	10 pct.
		Y	>	600,000	60,000 F

proposed increases (-57)

		Y	≤	50,000	10,000
50,001	<	Y	≤	130,000	20%
130,001	<	Y	≤	144,118	26,000
144,119	<	Y	≤	180,000	17%
180,001	<	Y	≤	180,626	30,600
180,627	<	Y	≤	240,000	16%
240,001	<	Y	≤	242,100	38,400
242,101	<	Y	≤	300,000	15%
300,000	<	Y	≤	450,000	45,000
450,000	<	Y	≤	600,000	10%
		Y	>	600,000	60,000

ii. Lump sum deduction from the total net income

Actual deductions (fiscal year '75)

		Y ≤ 150,000	24,000
150,000	<	Y < 310,000	24,000 - 7%
310,000	<	Y < 350,000	24,000 - 7%
		Y ≥ 350,000	10,000

proposed increases ('75)

		Y ≤ 170,000	29,000
170,000	<	Y < 310,000	29,000 - 7%
310,000	<	Y < 360,000	29,000 - 7%
		Y ≥ 360,000	10,000

iii. Proposed increase of the tax exempted minimum income

number of dependents	actual exemption	proposed exemption	increase
0	35,000	35,000	0
1	40,000	40,000	0
2	45,000	45,000	0
3	50,000	50,000	0
4	75,000	76,000	1,000
5	115,000	117,000	2,000
6	155,000	158,000	3,000
7	195,000	199,000	4,000

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8	235,000	240,000	5,000
9	275,000	281,000	6,000
10	315,000	322,000	7,000

iv. Proposed increase for the deduction for dependents

The deduction may now be credited against the tax due on the first 280,000 Bfrs., increased with 32,000 Bfrs. for every dependent after the third.

FOOTNOTES

1. Art. 6 WIB/CIR.
2. The Minister of Finance stated during the parliamentary discussions prior to the adoption of the law of December 28, 1973 that the complete indexation of the tax rates would entail a loss of revenue between nine and ten thousand million Bfrs. Verslag van de Kommissie van Begroting/Rapport de la Commission du Budget, Kamer van Volksvertegenwoordigers/Chambre des Représentants, Doc. 694, no. 8, p. 19. Nevertheless the government did commit itself during those parliamentary discussions to increase the inflation corrective measures in 1974, should the inflation exceed the estimated 6,25%. As a result of that commitment it has now introduced new proposals. Memorie van Toelichting/Exposé des Motifs of the bill containing the budgetary proposals for 1974-1975. Chambre des Représ./Kamer - Volksvert. (74-75). Doc. 277, no. 1, p. 9.
3. 1. Le présent projet de loi, que le Gouvernement a l'honneur de soumettre à vos délibérations, tend:
1° à encourager l'épargne et à remédier dans une certaine mesure, par le biais de la fiscalité directe, à la dépréciation des épargnes à revenu fixe constituées surtout par les petits épargnants;
Kamer van Volksvertegenwoordigers/Chambre des Représ. (BZ/S.F.74) Memorie van Toelichting/Exposé des Motifs, Doc. 109, no. 1, p.1.
4. Verslag v.d. Kommissie voor Financiën/Rapport de la Commission des Finances. Doc. 109, no. 3, p.7.
5. Id.
6. Kamer v. Volksvertegenwoordigers/Chambre des Représ. (73-74) Memorie v. Toelichting/Exposé des Motifs. Doc. 694, no. 1, p.9 and 10.
7. Id. p. 11.
8. WIB/CIR, art. 34, 2.
9. WIB/CIR, art, 36 bis.
10. Parl. Handelingen/Annales Parl. Kamer v. Volksvertegenwoordigers/Chambre des Représentants, vergadering 9-5-'73, blz. 1676. The 20% mentioned in fine was eventually increased to 50%, before the amendment was accepted.
11. Kamer v. Volksvertegenwoordigers/Chambre des Représentants (73-74). Memorie van Toelichting/Exposé des Motifs, Doc. 694, no. 1, p.4.

12. i.e., the increased lump-sum deduction from the individuals total net income.
13. Id.
14. Id.
15. WIB/CIR, art. 100 and 109 in conjunction.
16. See under no. 2.
17. See Belgisch Staatsblad/Moniteur Belge, June 21, 1974.
18. Wetsontwerp/Projet de Loi - Memorie v. Toelichting/Exposé des Motifs, Kamer v. Volksvertegenwoordigers/Chambre des Représentants (74-75). Doc. 277, no. 1

NETHERLANDS

Fiscal measures to correct the influence of inflation

1. Introduction

The Netherlands has taken a small number of tax measures to correct the influence of inflation.

In addition to the measures taken with the explicit intention to correct the influence of inflation there are a number of rules already existing in tax laws which also have an effect of correcting the influence of inflation. The measures taken explicitly are primarily intended to correct the tax rates and the already existing rules have their primary effect in the field of the computation of business profits.

2. The measures with the avowed object of correcting the influence of inflation.

2.1. Section 54 of the Income Tax Law 1964

By section 54¹⁾ of the Income Tax Act of 1964 the Minister is required to change the amounts mentioned in sections 5²⁾, 44e³⁾, 44⁴⁾ f and 53⁵⁾.

The amount mentioned in section 5 concerns the allocation of a part of the profits of an individual's business to his wife, if she works for a certain number of hours in her husband's business. For that amount the wife is a taxable person herself.

The amounts of sections 44e and 44f concern the increase and decrease of the provision for a pension for taxable persons carrying on a business.

Section 53 rules: a) The income-brackets and the percentages of income tax regarding each bracket. b) The personal allowances depending on marital status. c) Child allowances. d) A special allowance for individuals above the age of 65 years and e) A special allowance for individuals, who because of mental or physical illness earn less than 55 percent of what a comparable healthy person does.

The mechanism of the change of the amounts mentioned above is as follows: at the beginning of each year, hereinafter called the correction date, the amounts are to be multiplied by a correction factor. This correction factor is the ratio of the average of the price index of the family consumption of the total Netherlands population during the period between the 18th and 7th month preceding the correction date and the average of the same index during the period between the 30th and 19th month preceding the correction date.

From this ratio is eliminated the influence of costprice increasing taxes and costprice decreasing subsidies granted by public authorities. Sub-paragraph 3 of section 54 allows the Minister of Finance to limit the actual correction to 80 percent of the correction factor.

2.2. Legal grounds and working of the measure of section 54.

The fact that the Dutch income tax rates are graduated is justified among other reasons by the principle of financial strength. The substance of this principle is that individuals with more financial strength than other individuals can carry a comparatively higher tax burden.

An increase of nominal income caused by a compensation for the increase of costs of living results in an increase of the tax burden, although the real disposable income does not increase. This increase of tax burden was considered unacceptable.

The automatic correction was adopted in 1971 and effective for the first time in 1972.

For the years 1972, 1973 and 1975, the correction factor was limited to 80 percent. In 1974 the factor was limited to zero percent by a special law. The influence of the correction according to section 54 on the budget of 1975 is a lower yield of Dfl. 1,200,000,000,-

2.3. Section 46 of the Income Tax Act 1964

By law of December 19, 1973 another automatic correction was introduced concerning the so-called extraordinary medical expenses of section 46⁶⁾. Medical expenses are deemed to be extraordinary if and as far as they exceed a certain amount.

The non-deductible amounts are: by an income of less than Dfl. 52,000,- 12 percent of the income with a maximum of Dfl. 2,750,- and by an income of Dfl. 52,000,- or more Dfl. 3,400,- is non-deductible.

The excess of real medical expenses minus the non-deductible amount must always be multiplied by a factor of $1\frac{1}{4}$; or by a factor of $1\frac{1}{2}$ if the taxable person has had extraordinary medical expenses in the previous year or he has an allowance for more than four children; or by a factor of $1\frac{3}{4}$ if the taxable person has had extraordinary medical expenses in the two previous years. An example may clarify this. "A" had an income of Dfl. 40,000,-; medical expenses Dfl. 3,000,- in this year and also the two previous years.

Deductible: $(\text{Dfl. } 3,000,- - \text{Dfl. } 2,750,-) \times 1.75 = \text{Dfl. } 437,50.$

In order to explain the automatic correction we shall define: the above mentioned 12 percent: as the percentage; the amount of Dfl. 2,750 as the lower threshold amount; the amount of Dfl. 3,400,-: as the higher threshold amount; the income of Dfl. 52,000,-: as the income amount. Further more a brief explanation about the Sick Fund Act must be given for a better understanding of these income tax provisions.

In the Netherlands employees are obliged to be insured for costs of sickness if they earn less than the so-called wage ceiling. This wage ceiling and the premium percentage are revised each year. The automatic correction of section 46 is as follows: the percentage will be $1\frac{1}{2}$ times the premium percentage of the Sick Fund (say x percent); the lower threshold amount will be the same percentage of the wage ceiling; the higher threshold amount will be $1\frac{1}{2}$ times the lower threshold amount and the income amount will be $2\frac{1}{2}$ times the wage ceiling under the Sick Fund Act. The annual increases in the wage ceiling for the compulsory Sick Fund insurance are generally intended to keep an equal proportion of the working population within the Sick Fund. This implies that not only wage increases due to inflation, but also wage increases which reflect an increase in the standard of living are taken into account.

3. Existing rules on computation of the profit which mitigate the influence of inflation.

In reviewing the rules below it is necessary to realise that the Netherlands tax system does not have a special capital gains tax; so business profit and capital gains made by the alienation of assets are taxed at the normal rates.

3.1. Valuation of inventory

The usual valuation methods of inventory are:

1. LIFO
2. FIFO
3. The ^{initial} stock system, with or without replacement reserve.

The most attractive method to mitigate the influence of inflation is the initial stock system.

The initial stock system of inventory valuation has been approved by the Supreme Court as "sound business practice" provided the taxpayer's inventory consists of similar goods or is divided into categories of similar goods. The basic characteristics of this system are:

(1) without replacement reserve:

The initial, or base stock is the minimum stock necessary to enable the enterprise to function. It is valued at the lowest cost price registered since the company adopted this system.

(2) with replacement reserve:

The initial stock is the normal inventory at the start of the accounting period during which the system was introduced. It is valued at cost value or at market value, whichever is higher on that date. It may be adjusted upward or downward at the beginning of a new accounting period if a major change in the volume of inventory occurs, i.e., due to business expansion. The replacement reserve is a tax-free amount equal to the number of inventory assets by which the actual inventory is short of the theoretical "initial stock" figure multiplied by the actual replacement or market cost of these items.

If the actual inventory exceeds the initial stock figure in either situation, the excess must be valued at cost or market value, whichever is lower.

3.2. Valuation of participations

The shares of stock in another company constituting a participation (in general 5% or more of the share capital) are to be valued at costprice. The capital gains realized by alienation of the participation are exempt from tax. (section 13 Corporate Income Tax Law 1969. Wet op de Vennootschapsbelasting 1969).

3.3. Replacement reserves

If a tangible capital asset has been lost, damaged or otherwise alienated (voluntary sales are also included) and the amount of indemnification or the consideration received exceeds the adjusted depreciable basis, then the excess may be placed in a tax free reserve if and as long as it is intended that the capital asset is to be repaired or replaced. However, unless special circumstances exist, the asset must be replaced or repaired within a maximum of 4 years.

- ./.
- Photocopies of the major provisions of the income tax act, as discussed above are enclosed.

LUXEMBOURG

Fiscal measures to correct the influence of inflation

1. Introduction

The Luxembourg Government has introduced in the Income Tax Law (Loi du 4 décembre 1967 concernant l'impôt sur le revenu) a section with the express purpose to correct the influence of inflation on the income tax burden.

Other provisions already existed in Luxembourg tax laws, which also have some aspects related to the correction of the influence of inflation.

2. The measure with the avowed object of correcting the influence of inflation.

2.1. The principle of correction was laid down in Section 125 of the Income Tax Law of 1967.

If in the first 6 months of a year, the average of the weighted indexes of the cost of living compared with the same average in the first 6 months of the preceding year shows a change of at least 5 percent, then the income tax rates for the next year will be fixed in proportion to that change.

The change must be at least 5 percent of the average of the first 6 months of the preceding year and not, for instance, an increase of 5 percentage points.

If in any year the change meets the above condition, the Government shall propose the grand duc to correct the tax rates accordingly. This change of the rates has to be included in the annual Budget Law. The reduction of the tax burden is in practice effected through an adjustment of the income brackets.

Although section 125 provides that the proposal to change the tax rates should be accompanied by an estimate of the loss in state revenue caused by the adjustment of rates, no such data were shown in the budget law of 1974. Also, as other changes in income tax rates were introduced over the years, the effect of the inflation adjustment cannot be isolated from the total change in income tax rates in any given year.

2.2. In the past few years there was an occasional adjustment of some deductions, for instance, the deduction for extraordinary expenses and lump sum deductions with respect to certain costs of acquiring the income. These adjustments, however, were only of minor importance.

The lump sum deduction with respect to extraordinary expenses amounted to Lux.frs. 4,800 for 1966 and 1967, Lux.frs. 6,000 for 1968 through 1971 and Lux.frs. 9,000 for 1972 through 1974.

Also the child allowance was adjusted. The method of granting child allowances is as follows:

If the taxable income is less than Lux.frs. 415,200, the income has to be divided by a certain figure depending on the number of children. Afterwards the amount of tax corresponding to the result of this division of the taxable income has to be multiplied by the same figure. For the year 1974 these figures are:

2.6 for one child;	7.0 for five;
3.4 for two ;	8.6 for six ;
4.4 for three ;	10.4 for seven;
5.6 for four ;	12.4 for eight children.

With a taxable income exceeding Lux.frs. 415.200, but not exceeding Lux.frs. 766.800, the income has to be divided by two.

The amount of tax corresponding to this taxable amount has to be multiplied by two. From this amount of tax may be deducted

Lux.frs.	8,654.-	and 1%	of the taxable income	for one child.
"	16,036.-	and 2%	" " " "	" " two children.
"	22,200.-	and 3%	" " " "	" " three children.
"	27,360.-	and 4%	" " " "	" " four children.
"	31,680.-	and 5%	" " " "	" " five children.
"	35,553.-	and 6%	" " " "	" " six children.

The deduction for six children may be raised by Lux.frs. 3,696.- for each additional child over six.

With a taxable income exceeding Lux.frs. 766,800.- the deduction is only a certain amount for each child.

Due to this complicated system, we restrict ourselves to showing the increases of the various amounts for the higher incomes:

	Deduction:
1966/67 Income over Lux.frs. 734,400.	
for one child	Lux.frs. 13,073
" two children	" 26,196
" three "	" 38,556
" four "	" 49,997
" five "	" 61,440
" six "	" 73,464
" each additional child	" 11,460
1968/69 Income over Lux.frs. 600,000.	
for one child	" 12,725
" two children	" 24,440
" three "	" 35,252
" four "	" 45,173
" five "	" 54,480
" six "	" 63,461
" each additional child	" 8,751

1970/71	Income over Lux.frs. 632,400		Deduction:
	for one child		Lux.frs. 13,452
"	two children		" 25,840
"	three "		" 37,238
"	four "		" 47,707
"	five "		" 57,636
"	six "		" 67,125
"	each additional child		" 9,540
1972	By income over Lux.frs. 690,000		" 14,640
	for one child		" 28,092
"	two children		" 40,567
"	three "		" 52,046
"	four "		" 62,784
"	five "		" 73,164
"	six "		" 10,108
"	each additional child		
<u>1973</u>	By income over Lux.frs. 720,000		<u>1974</u> : 766,800
	for one child	Lux.frs. 15,278	Lux.frs. 16,322
"	two children	" 29,347	" 31,372
"	three "	" 42,336	" 45,204
"	four "	" 54,259	" 58,032
"	five "	" 65,448	" 70,020
"	six "	" 76,248	" 81,561
"	each additional child	" 10,526	" 11,364

3. Existing rules on the computation of business profits which mitigate the influence of inflation.

3.1. Valuation of inventory

The rules for the valuation of inventory (stock-in-trade) are very severe.

The main rule is that inventory has to be valued at the lower of acquisition cost or fair market value. The LIFO and FIFO systems are allowed if the business situation justifies such system.

3.2. Valuation of participation.

A substantial participation of 25 percent or more must be valued at the acquisition cost or lower going concern value. The difference in value is deductible from business income. The capital gain realized by alienation is normally taxable at the normal rate. However, if the Minister of Finance considers the alienation and a reinvestment into a stock participation in the interest of the Luxembourg economy, the capital gain may be put in a replacement reserve.

3.3. Replacement reserve.

The capital gain realized when an asset is destroyed, expropriated or sold in order to avoid expropriation, may be used to depreciate the new asset acquired to replace the former, or may be put into a reserve in cases where such new asset is not bought in the same financial year.

Such new asset must be acquired at the latest at the end of the second year after the alienation of the asset. If this replacement has not taken place within this period the reserve will be added back to taxable business income.

The new asset must be economically and technically similar to the replaced asset. If not, the reserve will be added back to income.

A similar procedure to that described above is employed when an asset is damaged or destroyed and the insurance payment received exceeds the book value of the asset.

When a building or other non-depreciable asset is voluntarily sold, the gain produced on alienation may be put in a reserve or deducted from the acquisition price of the replacing asset under the following conditions:

- (i) the alienated asset must be part of a permanent establishment in Luxembourg;
- (ii) the alienated asset must have been an asset of the permanent establishment for at least five years.

If reinvestment does not take place in the year of alienation, a reserve may be formed under the following conditions:

- (i) the company must have the intention of reinvesting the proceeds received at alienation;
- (ii) reinvestment must be completed by the end of the second financial year following the year of alienation.

The law does not contain any qualifications with regard to the replacing assets, other than the requirement that there should be a reinvestment.

If the proceeds received are not fully used for reinvestment purposes then the capital gain will be included in taxable income.

./. A photocopy of section 125 of the income tax law, concerning the adjustment of the income tax rates is enclosed.

ITALY

Italy has recently reformed its entire tax system. As of January 1, 1974, a new, synthetical, system of direct taxation replaces the former schedular system.

Individual income tax

The new individual income tax system does not provide for an automatic adaptation of the (progressive) individual income tax table in case of inflation. It is still too soon to predict whether Italy will revise regularly its tax rates or increase its personal allowances upon the decrease in value of the lire.

Under the former system the tax tables remained the same for years, while personal allowances were not often and certainly not regularly revised.

It is hardly possible to compare the tax burden on the individual taxpayer under the new and under the old system, because the two systems are entirely different. Certainly the overall tax rates would indicate that the income is subject to a lower tax under the new system; but, one of the main purposes of the tax reform was a more simple tax system, so that tax evasion becomes more difficult. It is, therefore, possible that the actual tax burden will become heavier.

There is no indication in the parliamentary discussions or in the official commentaries and explanations to the new tax reform that the problem of inflation has had anything to do with the reform of the individual or the corporate income tax.

During 1974, however, the steep rise in prices for most essential goods, and labor unrest have caused the Government to increase the earned income allowance for persons with an income not exceeding 4 million lire, from 36,000 lire to 72,000 lire.

For 1975, these persons receive an additional child deduction of 4,000 lire per child (Decree Law 259 of July 6, 1974, confirmed by law 384 of August 17, 1974).

Taxation of business income

In determining taxable business income, there are few provisions which may mitigate the consequences of inflation: Depreciation based on the replacement value is not allowed. However, gains realized on business assets are not taxed, provided they are placed in a special reserve and are used within the two next tax years for the acquisition of depreciable business assets (Art. 54(5) of Decree 597 of September 29, 1973).

No investment allowances are granted.

Inventory is valued at cost or market value, whichever is lower. The base stock method is not allowed, but Lifo method is permitted for fungible goods (Art. 62(3) of Decree 597 of September 29, 1973).

Corporate income tax

Under the Tax Reform the corporate tax rate for 1974 and subsequent years was 25%; together with the local income tax, the total amount of tax could not surpass 40%. This was well below the tax under the old system, where total taxes could exceed 50% of taxable income. However, because of the grave economic situation of Italy and the need of the Government of additional income, the 25% rate has been increased to 35% (Law no. 384, of August 17, 1974). As a result, the total tax on corporations is nearly the same as in 1973 and preceding years.

Capital gains

Capital gains on the transfer of immovable property located in Italy are subject to a special capital gains tax (Imposta comunale sull'incremento di valore degli immobili).

In case the immovable property was a business asset, the gain is subject to income tax too, and the capital gains tax is deductible as an expense. (Immovable property companies pay this capital gain tax also on the increase in value of their immovable property, after each ten-year period of ownership).

This tax contains a provision that is intended to account for the decrease in value of the lire, at least to a certain extent. The net gain realized (sales price less initial price plus expenses for improvement) may be reduced by 4% of the initial value for each year of ownership before the disposal (Decree 643 of October 26, 1972).

- ./. Photocopies of the major provisions regarding the replacement of business assets, and the computation of capital gains with respect to immovable property are enclosed.

DENMARK

1. Introduction

Denmark is one of the very few countries where the income tax laws provide for automatic adjustments in the rates of national income tax for individual taxpayers as well as in the amount of the personal deduction.

Another example of such adjustment is to be found in the tax on so-called "special income" where capital gains realized on the sale of immovable property are computed on the basis of an adjusted purchase price. This system is not applied to other kinds of capital gains and the adjustment of the amount of the capital gain on immovable property is linked with a much higher rate than that applicable to other capital gains and other types of "special income".

These two examples of adjustments are discussed below. In addition, a survey of some favorable provisions in computing business income is given which may counter some ill effects of inflation on the business community.

2. Individual income tax provisions

As of the year 1970, drastic changes were made in the Danish income tax legislation.

Under the old system, the rates of tax were high, the highest bracket being taxed at a rate of more than 100%, but the tax paid in any year was deductible in computing taxable income, so that the effective rate was much lower. Under this old system only moderate changes were made in the rates of tax over the years.

Under the present income tax rates act ("Udskrivningslov") of June 18, 1969, effective January 1, 1970, the rates were changed considerably and the deductibility of taxes paid was terminated.

Moreover, provisions were included to change the various rate brackets and the personal allowance annually, in accordance with the general rise in prices.

The basic rates were fixed as follows:

on the first Kr. 17,000	:	18%
on the next Kr. 13,000	:	30%
on the next Kr. 40,000	:	40%
on the remainder	:	45%

This tax is computed on taxable income as reduced by a personal allowance of which the basic amount is Kr. 5,000 for single taxpayers and Kr. 10,000 for married couples.

Both the income brackets (the amounts of Kr. 17,000, 13,000 and 40,000 mentioned above) and the personal deduction of Kr. 5,000 are reviewed annually.

For the year 1970 through 1972 para. 4 of the law provided that the above amounts should be regulated on the basis of the price index for the month of January preceding the year in question, in such a way that the various amounts should be increased (or decreased) by 3% for each full 4% change in the price index as compared with the price index for January 1969.

For the years 1973 and 1974 the adjustments are based on a price index with the price level in January 1971 taken as 100. The adjustments are based on the price index for the month of January of the year preceding the tax year. The amounts are increased (or decreased) by 3 1/3% for each full 3 points change in the price index in comparison with a price index at 90.

As a result of the above provisions, the various amounts for the years 1970 through 1974 were as follows (in Kronor)

	1970	1971	1972	1973	1974
personal allowances:	5,000	5,100	5,400	5,800	6,100
	10,000	10,200	10,800	11,600	12,200
first bracket	17,000	17,500	18,500	19,800	20,900
second bracket	13,000	13,300	14,100	15,100	16,000
third bracket	40,000	41,200	43,600	46,600	49,300
percentage change as compared with basic amounts	-	3%	9%	16 2/3%	23 1/3%

Under an act of October 2, 1974, amending the income tax rates act of June 18, 1969 the system has again been changed considerably, as of the year of income 1975.

The basic rates of tax are reduced, and are now as follows:

- on the first Kr. 50,000 : 16%
- on the next Kr. 40,000 : 32%
- on the excess : 44%

The personal allowance is increased to Kr. 9,000 but this allowance is no longer deductible in computing taxable income; under the new system, an amount equal to the aggregate of national income tax at the lowest (16%) rate, social security premiums, and local income tax and church tax at the rate applying in the taxpayer's municipality of residence, imposed on the amount of the personal allowance is deducted from the income tax assessment. Through this system all taxpayers, irrespective of their income, receive an equal amount of tax reduction by way of the personal allowance (except to the extent of the differences in local income tax rates), so that the higher income taxpayers no longer get a greater benefit in money terms than the lower income taxpayers.

In addition, the adjustment formula has been changed, also as of the year of income 1975. Henceforth, the amounts of the personal allowance and the tax brackets are adjusted on the basis of the Bureau of Statistics' index for the hourly wages of industrial workers, taking the average hourly wage during 1972 as 100. The adjustment is equal to 2.1% for each 3% change in the wage index for the month of March preceding the year of income as compared with an index figure of 141.9.

./.. The text of the relevant para. 4 of the income tax rates act (Udskrivningslov) for the years 1970 through 1972; 1973 and 1974; and 1975 onwards is enclosed.

The income tax reduction for 1975, estimated to cost Kr. 7,000,000,000 per annum, will be offset by savings in budgetted expenditure of the State, inter alia, by reducing the tax free child benefits payable by the State, and by increasesⁱⁿ some indirect taxes.

Finally, it should be added that the basic rates of national income tax as outlined above, are not always levied in full. The government is entitled to impose tax at a certain percentage of the basic rate, subject to a maximum of 105% of such basic rates. In accordance with this authority, tax was imposed in 1970 at 95% of the basic rate, and in 1971 through 1974 at 91% of the basic rate. Thus, for the years 1971 through 1974, for instance, the actual rates of the national income tax amounted to 16.38%, 27.3%, 36.4% and 40.95%, in lieu of 18%, 30%, 40% and 45%. For 1975, tax will be imposed at 90% of the new basic rates.

The local income tax and church tax, mentioned briefly above, are imposed at a flat rate, varying from municipality to municipality. The rates are determined annually on the basis of the financial needs of the respective local authorities, and no adjustments against inflation are made, except that the personal allowance (which is adjusted annually) also applies for local income tax purposes.

The rates of local income tax and church tax tend to rise slightly over the years. In order to give some idea about the local income tax burden, it may be mentioned that the national average for 1974 is 19.4% and that the average is estimated to rise to 20.2% in 1975.

3. Tax on special income (immovable property)

As indicated in the introduction, the tax on special income contains special provisions taking account of the fall in value of money, in computing taxable capital gains on the sale of immovable property.

These special rules do not apply to the extent that depreciation allowances have been taken in previous years (most kinds of buildings used for business purposes), nor if the property is purchased with a view to speculation or in the course of a trade or business which includes the buying and selling of such property. In these cases the full gain is taxed at ordinary individual or corporate income tax rates. With respect to depreciated buildings the special rules do apply to the excess of sales price over the original cost price, i.e., to that part of the gain which exceeds depreciation allowances taken.

There are also special exemptions for owner-occupied dwelling houses which are not to be discussed here.

The special provisions to subject these capital gains on immovable property to the tax on special income were introduced for sales made on or after July 10, 1960 of property acquired after December 31, 1948.

During the initial years the taxable gain was computed as the difference between actual sales price and adjusted purchase price, the adjustment being made by increasing actual purchase price (as well as the cost of improvements) by a certain percentage reflecting the change in the value of money.

These percentages were originally fixed as follows:

<u>year of purchase or improvement:</u>	<u>percentage increase of cost:</u>
1949	128%
1950	120%
1951	112%
1952	104%
1953	96%
1954	88%
1955	80%
1956	72%
1957	64%
1958	56%
1959	48%
1960 and subsequent years	40%

The regularity of this table (an 8% difference annually) implies that the adjustments made do not exactly reflect the effects of inflation actually attributable to any year, but rather an estimated average.

The gain so computed was further reduced by a Kr. 5,000 exemption annually. Tax was imposed on total "special income" at a rate of 30% for individuals and at the normal corporate income tax rate for companies.

After the initial period which lasted until December 31, 1964, the above system was changed many times, mainly for tax-political reasons. On the one hand, some measure of adjustment for inflation was maintained, though through a different system, but the resulting (reduced) gain was increased considerably, at first by 50%, and later by higher percentage, also varying with the type of property involved, with the object of imposing a very heavy effective tax

rate on adjusted profits. Also, property acquired prior to January 1, 1949 was made subject to tax, if such property was sold on or after January 1, 1965.

As it is virtually impossible to set out in detail all amendments made since January 1, 1965, we will restrict ourselves to a survey of the existing situation, up to an act of February 6, 1974, amending the act on special income tax ("lov om særlig indkomstskat m.v.").

The gain is, in principle, computed as the difference between consideration received at the disposal of the property and the adjusted cost of acquisition. If the property is acquired on or after January 1, 1966, the cost of acquisition and the outlay on improvements (the latter only to the extent that they exceed Kr. 1000 in any year) is increased by a fixed addition of 30% of cost, plus a varying addition of 6% for the year of acquisition or improvement and each subsequent year of ownership, up to but excluding the year of disposal.

If the property was acquired in whole or in part, prior to January 1, 1966, the above rules are also followed, but the annual addition of 6% is not available for years prior to 1966.

However, if the property was wholly acquired before January 1, 1966 the taxpayer may elect to compute the adjusted cost of acquisition on the basis of the valuation resulting from the 13th general valuation of immovable property in lieu of on the basis of actual cost of acquisition. ^{as} under the main rule, the value resulting from the said valuation is increased by a fixed addition of 30% plus 6% for the year 1966 and each subsequent full year of ownership.

The gain as computed under the above rules (being the difference between consideration received at disposal and adjusted cost of acquisition) is subsequently reduced by 5% of adjusted cost of acquisition, subject to a minimum of Kr. 5,000 and a maximum of Kr. 20,000 per annum.

The resulting net gain is finally increased by an amount equal to 30% of the net gain for individuals, and 80% of the net gain for companies. The final amount so arrived at is taxed at the normal "special income" tax rate of currently 50% (individuals), and at the normal corporate income tax rate of 37% (corporate taxpayers). Through the 30% or 80% addition to the net gain, the effective tax rate on these immovable property gains is approximately 65% for both individuals and companies.

Certain exemptions are granted with respect to owner-occupied dwelling houses and taxpayers engaged in a trade or business may create a replacement reserve in case of deemed disposals if an insurance indemnity is received on the property being damaged or destroyed. Normally replacement has to take place not later than the year following the year of damage but this time limit may be extended.

The overall picture emanating from the above provisions is to exempt most owner-occupied dwelling houses as well as small gains (through the Kr. 5,000 minimum of the 5% deduction granted in computing the net gain), but a fairly heavy tax burden of approximately 65% on major gains, subject to an adjustment of the cost of acquisition, which also depends on the length of the period of ownership, but apparently no attempt is made to reflect the varying rate of inflation over the years, with a view to the fixed deduction of 6% per annum. The above effective rate of 65% may well be further increased in future.

./.. The text of the major provisions of the law are enclosed.

4. Some aspects of the computation of business profits

a) depreciation

ordinary depreciation of machinery and equipment is calculated on a collective basis, i.e., on depreciated book value of all

existing assets at the beginning of the year plus acquisitions and less realisations during the year, except that assets purchased during the second half are only taken into account for half their cost for the year of acquisition.

The annual rate of depreciation may be chosen by the taxpayer, subject to a maximum of 30%.

Accelerated depreciation, available at 30% of purchases of machinery, equipment, new buildings and installations to the extent that total expenditure on such assets exceeds Kr. 700,000 during the year, is deducted from the cost price in computing the basis for ordinary depreciation.

This system of ordinary depreciation on a collective basis implies that a sale of machinery or equipment at a price exceeding depreciated book value does not give rise to taxable income; the proceeds of sale are deducted from the depreciable basis and merely reduce the scope for depreciation in the future. Only if the depreciable basis becomes negative, the balance has to be added to taxable income, unless replacement assets are purchased not later than at the end of the year following the year of sale.

The same system, as outlined above, also applies to ships which are also written off on a collective basis.

b) investment reserve

Up to 20% of a taxpayer's business income may be placed in a tax free reserve. However, this amount is reduced by the amount of any accelerated depreciation taken during the year. The amount of the allocation to the reserve must be deposited on a blocked bank account (only 50% need be deposited if the taxpayer keeps proper accounts in conformity with the relevant laws on bookkeeping).

Within 12 years the amount of the reserve must be used for the acquisition of new assets, and the amount of the reserve so used is deducted from cost of acquisition for purposes of accelerated and normal depreciation. If the reserve is not used in time, the amount of the reserve is added back to profits, increased by a penalty of 5% for each year the reserve has been existence.

Through this investment reserve, taxpayers can, in fact, deduct part of the cost of future purchases which implies a hedge against inflation with respect to the computation of profits in the years the reserve is created.

c) valuation of stock-in-trade

Stock-in-trade may be valued at the lower of cost or market value, less a deduction, at the taxpayer's option, of up to 30% of such value.

With respect to contracts to purchase stock-in-trade, to be delivered in the next year, a deduction in computing taxable income may be taken in computing taxable income for the years 1973 through 1975, which may not exceed the difference between the contracted price and 75%, 80% and 90%, respectively of the actual market value at the end of the years of income 1973, 1974 and 1975, respectively.

The 30% deduction for goods at hand, as well as the temporary deduction with respect to goods on order, create a safeguard against price fluctuations.

./. The major provisions regarding depreciation, the investment reserve and the valuation of stock are enclosed.

UNITED KINGDOM

1. Introduction

There are no provisions in United Kingdom tax law which provide for automatic adjustments in computing taxable income or capital gains, or in computing taxes payable, which might reflect changes in the value of money.

Some measures have been taken over the years to reduce the tax burden on individual taxpayers, and relief from capital gains tax is granted with respect to certain types of business assets which are replaced by similar assets. The various measures are outlined below.

2. Survey of some of the major personal allowances (deductions) for income tax and rates of income tax (and surtax) since the year of assessment 1968-69.

	68-69	69-70	70-71	71-72	72-73
personal allowance:					
single	£ 220	£ 255	£ 325	£ 325	£ 460
married	£ 340	£ 375	£ 465	£ 465	£ 600
child allowance:					
11 or under	£ 115	£ 115	£ 115	£ 155	£ 155
between 11 and 16	£ 140	£ 140	£ 140	£ 180	£ 180
over 16 receiving full time education	£ 165	£ 165	£ 165	£ 205	£ 205
earned income allowance:	2/9ths (max. £ 1550)	id.	id.	2/9ths (no max.)	2/9ths (no max.)
income tax rate:	41.25%	41.25%	41.25%	38.75%	38.75%

surtax rates: (unchanged during years 68-69 through 72-73)

on the first	£ 2,000	: nil
on the next	£ 500	: 10%
on the next	£ 500	: 12.5%
on the next	£ 1,000	: 17.5%
on the next	£ 1,000	: 22.5%
on the next	£ 1,000	: 27.5%
on the next	£ 2,000	: 32.5%
on the next	£ 2,000	: 37.5%
on the next	£ 2,000	: 42.5%
on the next	£ 3,000	: 47.5%
on the excess over	£ 15,000	: 50%

The various allowances applying for purposes of income tax also applied for the progressive surtax, subject to a reduction equal to the personal allowance for single taxpayers. With respect to "earned income" (being all income other than investment income, such as employment income and income from a business or profession) there was a special "earnings" allowance for surtax purposes granted in addition to the normal earned income allowance. This "earnings" allowance was equal to £ 2,000, or such smaller sum as would reduce the earned income (after deduction of the earned income allowance) to £ 2,000.

Example:

earned income	£ 4,000
earned income allowance: 2/9ths	<u>£ 889</u>
	£ 3,111
"earnings" allowance	<u>£ 1,111</u>
included in income for surtax	£ 2,000
	=====

It follows from the above figures that the only adjustments made are the increases in personal allowances and, to a lesser extent, child allowances, made at more or less regular intervals.

Although the main argument for these increases in allowances seemed to be a reduction of the total number of taxpayers, it is obvious that this argument in fact recognises that without adjustment the total number of taxpayers would increase due to rises of income which merely reflect the fall in the value of money. It is also noteworthy that for the year of assessment 1971-72 the standard rate of income tax was reduced but that, on the other hand, the personal allowances were not changed. Finally, it is, in fact, impossible to say whether the increases in allowances merely are an adjustment against the effects of inflation or also an effective tax reduction. An element of true tax reduction will certainly be present in the relatively big increase in allowances for the year 1972-73.

Several important changes were enacted as of the year of assessment 1973-74. The earned income allowances were abolished, but the basic rate of income tax was reduced accordingly, from 38.75% to 30%. Moreover the income tax and surtax were merged into one progressive income tax, with a basic rate (as stated) of 30% (increased to 33% for the year 1974-75) and higher rates between 40% and 75% (between 43% and 83% for 1974-75). The differentiation in tax burden between earned income and investment income is maintained under the new system by an investment income surcharge of 15%, imposed on that part of a taxpayer's investment income which exceeds £ 2,000 per annum. This implies a maximum marginal rate on investment income of 98% (83% + 15%). The personal and child allowances were also increased to reflect the abolition of the earned income allowance.

Although differences in effective tax burden under the old and the new system may occur for particular taxpayers, it is understood that the overall effect of the change should be neutral, and should not result in an effective tax increase.

The main allowances and the rates of tax for the two years of assessment 1973-74 and 1974-75 are as follows:

personal allowance:

- single : £ 595 (73-74) ; £ 625 (74-75)
- married : £ 775 (73-74) ; £ 865 (74-75)

- child allowances : £ 200, 235 or 265 according to age (1973-74)
£ 240, 275 or 305 according to age (1974-75)

rates of income tax

<u>1973-74</u>			<u>1974-75</u>		
first	£ 5,000	30%	first	£ 4,500	33%
next	£ 1,000	40%	next	£ 500	38%
next	£ 1,000	45%	next	£ 1,000	43%
next	£ 1,000	50%	next	£ 1,000	48%
next	£ 2,000	55%	next	£ 1,000	53%
next	£ 2,000	60%	next	£ 2,000	58%
next	£ 3,000	65%	next	£ 2,000	63%
next	£ 5,000	70%	next	£ 3,000	68%
remainder		75%	next	£ 5,000	73%
			remainder		83%

The increases in the various allowances in 1974-75, as compared with 1973-74 are intended not only as an adjustment for inflation, but also to offset the general tax increases as far as low income taxpayers are concerned. Thus, before announcing the increases in the rates of tax, the Chancellor of the Exchequer said in his Budget Speech:

Personal Allowances and Reliefs

First the good news. One of the worst consequences of inflation has been to force more and more of the worse-off into paying higher tax because their money incomes have increased although their real

earnings have risen very much less. To relieve those at the bottom of the scale I therefore propose to increase the main tax allowances and so to put up the threshold for income tax. The personal allowance for single people will go up by £ 30, and that for married couples by £ 90. I am proposing a substantially higher increase in the married allowance because this has in recent years been falling behind in comparison with the single allowance. I also propose to increase the income tax child allowance: this is the only way open to me of giving early help to the great majority of families, since it is not administratively possible to introduce family allowances, or some form of child credit, for the first child in the immediate future. The increase for child allowances will be \$ 40 at each of the three rates. The total cost of these changes in allowances will be £ 513 million in 1974-75 (£ 654 million in a full year). The number of taxpayers relieved from income tax in the coming year, as a result of these changes in tax allowances, will be 1½ million (including earning wives).

3. Adjustments in the computation of business profits

No adjustments can be made in the computation of business profits with respect to changes in the value of money. In particular, re-valuation of assets has no significance for tax purposes and replacement reserves cannot be created, except to a certain extent in the computation of capital gains.

However, depreciation allowances are very generous with respect to new and second-hand machinery and plant (equipment), including ships the expenditure for which is incurred after October 26, 1970. As of that date, there is a "first year allowance" which originally amounted to 60% of the expenditure (up to July 20, 1971), and 80% from July 20, 1971 until March 21, 1972 and is currently 100%, which implies that machinery and plant purchased can be written off completely in the year of purchase. The taxpayer may elect to take the

"first year allowance" only partially; in that case, depreciation in following years is given at a rate of 25% (declining balance method). Apart from the first year allowance, the annual depreciation allowances for plant and machinery are granted on a collective basis, i.e. on the book value of all qualifying assets at the beginning of the year, less sales during the year and plus the remaining book value (less first year allowance) of qualifying assets purchased in the previous year. This system implies that a sale at a price exceeding depreciated book value, does not give rise to a taxable profit at the time of sale, but merely diminishes the basis for "collective depreciation" in the same and subsequent years. It could be argued that this depreciation system performs the same function as a replacement reserve. There are no such favourable depreciation allowances for assets other than machinery and plant (equipment).

4. Capital gains taxation

There are no possibilities for revaluation of the cost of acquisition in computing taxable capital gains. To the contrary, with respect to so-called "wasting assets", i.e. assets with a predictable life of 50 years or less, the cost of acquisition has to be reduced by depreciation according to the predictable life of the asset, so that a capital gain may arise even if the asset is disposed of for a price which is less than the original cost of acquisition. However, with respect to tangible movable property which are "wasting assets" there is currently an exemption from capital gains tax, except in case of wasting assets used in a trade, profession or vocation, eligible for depreciation allowances. For the latter category, which will normally be subject to depreciation allowances as "plant and machinery" the sales price is subtracted from the "collective" depreciation base, as explained under para. 3, above, but only to the extent that the sales price does not exceed original cost of acquisition. A taxable capital gain arises to the extent that the sales price or other consideration received exceeds the original cost of acquisition.

With respect to certain classes of assets used for purposes of a trade, viz. land and buildings, ships, aircraft, hovercraft and goodwill, any capital gain arising on the disposal of such assets may not be taxable, but may instead be deducted from the purchase price of assets replacing the assets disposed of, provided the replacement takes place during a period beginning 12 months before the disposal of the first asset and ending three years after such disposal. If the taxpayer elects for this special treatment the cost of acquisition of the new asset is reduced, for capital gains tax purposes, by the amount of the gain realized on the disposal of the old asset, so that a bigger capital gain will arise if the new asset is disposed of in the future, unless again a replacement takes place. It should be recalled that this "replacement reserve" only applies to the extent that the sales price or other consideration received at the disposal of the assets in question exceeds the cost of acquisition. If depreciation allowances (termed "capital allowances" in the law) have been granted during the use of the assets, and the sales price or other consideration received exceeds depreciated book value, that part of the total gain representing former depreciation allowances is added to ordinary taxable income by way of a so-called "balancing charge". See, however, para. 3 for special rules regarding machinery and plant (equipment). Furthermore, no "balancing charge" is currently added to ordinary income if an industrial building is disposed of after more than 25 years since the year the building was first used after construction, i.e. after the cost of construction has been written off at the statutory rate of 4% per annum. It may be added here, that "industrial buildings" are the only buildings eligible for depreciation allowances in United Kingdom tax law, and that, for instance, office, shops, hotels, showrooms and similar buildings cannot be depreciated for tax purposes.

The main capital gains provisions regarding the replacement of business assets are laid down in Sec. 33 of the Finance Act 1965, as amended. A copy of the present text is added whereby words printed in italics have been removed by amendment, whereas words in square

brackets have been added, as indicated at the end of the section.

It may finally be noted that taxable capital gains are subject to tax at a special flat rate of 30% for both individuals and corporate taxpayers; undoubtedly, one of the reasons for the special low tax rate is a recognition of the fact that capital gains represent, at least partially, mere "paper" profits caused by the fall in value of money.

IRELAND

1. Introduction

Irish tax laws do not contain provisions with respect to automatic adjustments of rates or allowances, or with respect to corrections in computing taxable profits, intended to reflect changes in the value of the currency.

As far as individual taxpayers are concerned, there have been some changes in tax rates and allowances in past years, as outlined below, but it can hardly be maintained that these changes were solely or even mainly intended to counter the effects of inflation.

One important aspect of the Irish tax system is that capital gains whether realised in the course of carrying on a business or not, are exempt from tax, subject to a limited number of exceptions.

The origin of this exemption, however, bears no relationship to inflation: it reflects the old British concept of distinguishing between profits of a capital nature and profits of an income nature, only the latter being subject to tax. This long-standing exemption of capital gains has been severely affected in the United Kingdom by the introduction of long-term capital gains taxation in 1965, but this example has not yet been followed by Ireland, although the present Government is contemplating the introduction of a capital gains tax in a not too distant future.

2. Survey of some major personal allowances (deductions) for income tax and surtax rates for individual taxpayers since the year of assessment 1968-69.

	68-69	69-70	70-71	71-72	72-73	73-74	74-75
personal allowance:							
single	£ 234	£ 249	£ 249	£ 249	£ 299	£ 299	£ 500
married	£ 394	£ 424	£ 424	£ 424	£ 494	£ 494	£ 800

child allowance:

11 years or under	£ 135	£ 135	£ 135	£ 135	£ 155	£ 155	£ 200
between 11 and 16							
years of age	£ 150	£ 150	£ 150	£ 150	£ 170	£ 170	£ 200

earned income allow-
 ance:

one-fourth (max. £ 500)	id.	id.	id.	id.	id.	id.	abolish
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income tax rate:	68-69	69-70	70-71	71-72	72-73	73-74	74-75
	35%	id.	id.	id.	id.	id.	see bel

	68-69	69-70	70-71	71-72	72-73	73-74	74-75
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surtax rates:

£ 2,500-£ 4,500	: 15%						
£ 4,500-£ 6,500	: 30%	id.	id.	id.	id.	id.	see bel
over £ 6,500	: 45%						

As of the year of assessment 1974-75 the income tax (imposed at a flat rate of 35%) and the progressive surtax have been merged into a single progressive income tax. At the same time, various personal allowances were increased and the "earned income allowances" for income tax (and surtax) were abolished. The new rates are as follows:

on the first	£ 1,550	: 26%
on the next	£ 2,800	: 35%
on the next	£ 2,000	: 50%
on the next	£ 2,000	: 65%
on the remainder		: 80%

The total tax burden under the new rates will on average be similar to the combined burden of income tax and surtax under the former system.

Especially with respect to "earned income" (including income from employments, trades and professions) the rate reductions and the increase in personal allowances are largely offset by the abolition of the "earned income allowances" (equal to one-fourth of "earned income" subject to a maximum of £ 500 annually for income tax purposes, and the first £ 2,000 of earned income per annum for surtax purposes). For investment income, however, the new rates will represent an effective tax reduction, particularly for individuals with a low or non-existing "earned income".

3. Treatment of capital gains

As indicated in the introduction capital gains realized by private individuals, as well as by individuals and companies engaged in a trade or business are exempt from tax in Ireland unless the sale is made in the normal course of business (e.g. sale of stock-in-trade) or the purchase and sale are deemed to be "an adventure in the nature of a trade". With respect to business assets there is one major exception to this rule: if an asset is sold or otherwise disposed of for a consideration which exceeds the depreciated book value, a "balancing charge" is added to taxable income to the extent that the gain does not exceed depreciation allowances taken in past years. In other words, the various depreciation allowances taken in the past are recouped at the time of disposal to the extent that the consideration received exceeds depreciated book value. Any excess of the consideration received over the original purchase price (in the case of industrial buildings: the cost of construction) remains tax exempt.

Conversely, a "balancing allowance" is granted if the consideration received at the disposal of the asset is less than depreciated book value.

In case of machinery and plant (equipment) the addition of a balancing charge to taxable income may, at the taxpayer's option, be avoided if the asset disposed of is replaced by another asset, in which case

the amount of the balancing charge is deducted from the cost of the replacing asset for purposes of depreciation allowances with respect to the latter. In effect, this provision on the replacing of machinery and plant is tantamount to a replacement reserve as known in other countries.

Special rules for replacement do not exist for industrial buildings.

For machinery and plant (equipment), the exemption for capital gains (consisting of the difference between consideration received at disposal and original cost of acquisition) and the special provisions regarding the replacement of assets, together with the rather generous depreciation allowances granted (e.g., free depreciation for new assets acquired on or after April 1, 1971) provide a considerable hedge against inflation. The same may be said with respect to the exemption of capital gains in case of all other business assets.

Again, it should be emphasized, however, that the exemption for capital gains stems from the old British concept of distinguishing between receipts of a capital nature versus receipts of an income nature and does not represent a deliberate tax measure to counteract the ill effects of inflation. Moreover, the present Government intends to introduce some kind of capital gains tax which may, or may not, take account of inflationary effects.

The provisions regarding the replacement of machinery and plant (equipment) are contained in section 273 of the Income Tax Act, 1967, which reads as follows:

(1) Where machinery or plant in the case of which any of the events mentioned in section 272 (1) has occurred is replaced by the owner thereof and a balancing charge falls to be made on him by reason of that event, or, but for the provisions of this subsection, would have fallen to be made on him by reason thereof, then, if by notice in writing to the inspector he so elects, the following provisions shall have effect:

(a) if the amount on which the charge would have been made is greater than the capital expenditure on providing the new machinery or plant -

- (i) the charge shall be made only on an amount equal to the difference,
- (ii) no initial allowance, no balancing allowance and no wear and tear allowance shall be made in respect of the new machinery or plant or the expenditure on the provision thereof, and
- (iii) in considering whether any, and if so what, balancing charge falls to be made in respect of the expenditure on the new machinery or plant, there shall be deemed to have been made in respect of that expenditure an initial allowance equal to the full amount of that expenditure;

(b) if the capital expenditure on providing the new machinery or plant is equal to or greater than the amount on which the charge would have been made -

- (i) the charge shall not be made,
- (ii) the amount of any initial allowance in respect of the said expenditure and the amount of any wear and tear allowance shall be calculated as if the expenditure had been reduced by the amount on which the charge would have been made, and
- (iii) in considering whether any, and if so what, balancing allowance or balancing charge falls to be made in respect of the new machinery or plant, there shall be deemed to have been granted in respect thereof an initial allowance equal to the amount on which the charge would have been made, in addition to any initial allowance actually granted in respect thereof.

(2) Where any such election is made as is mentioned in section 243, no balancing allowance shall be made in respect of the machinery or plant which is replaced.

BRAZIL

1. Introduction

The serious and continuous inflation in Brazil is not, as for most European countries and the U.S.A., a recent phenomenon, but exists already for some decades. Inflation was so high, sometimes as much as 80% a year, that the Brazilian Government was compelled to take far-reaching measures. First, the measures were taken at an ad hoc basis, for instance a revaluation of fixed business assets in 1944, 1951 and 1956. From 1958 to 1964, monetary restatements of the book value of fixed business assets could be voluntarily made every two years.

As of 1964 the legislation provided for a constant yearly and compulsory revaluation of business assets according to officially published monetary correction index coefficients.

2. Current situation

Recent legislation recognizes and takes into account a constant inflation and many laws affecting and regulating the economic life of Brazil contain measures designed to annul as far as possible the most unpleasant effects of inflation. Wages, salaries and rents are automatically increased and certain debt claims are revalued according to the rate of inflation. Private savings are, in this system, not discouraged because banks are allowed to accept fixed term deposits (in general of at least 6 months) and loans which are not subject to inflation; the amount of the deposit or debt is not revalued at maturity, but the loan carries two kinds of interest, normal compensation for capital supplied, which interest is included in the taxable income of the recipient and an interest which represents the monetary devaluation and is free from tax. However, the law limits the total of normal interest and monetary correction (in 1969: 30%).

The Government has issued regularly treasury bonds under the condition that upon redemption the nominal value of the bond will be revalued, so that also those bonds are not subject to inflation.

Moreover, individuals may deduct from income before tax 30% of their investments during a tax year in those treasury bonds (the deduction, together with certain other deductions, may not exceed 50% of income before tax).

Corporations may issue bonds with a monetary correction clause.

Corporations and business enterprises are, in general, not taxed on accounting profits which are merely caused by the inflation. Taxable business profits are determined on the basis of the profit and loss account and the balance sheet.

The following monetary corrections are applied:

Fixed business assets are revalued by applying official monetary correction index coefficients to them, which coefficients are annually published by the Ministry of Finance. The original cost price is revalued, as well as all depreciation allowances taken. The accounting profit resulting from this revaluation must be reduced by any accounting profit resulting from previous revaluations. The result must be placed on a special reserve and is not subject to tax. This reserve may not be distributed as dividend to shareholders, it may be retained as a reserve, but also it may be converted into share capital. Such a capital increase is not subject to tax on the corporation and also the shareholder, who receives the bonus shares upon capitalization, is not subject to income tax on the value received.

In 1966 the application of the monetary correction was extended to a company's working capital. There is no obligation to revalue the working capital, as in the case of fixed assets. Any accounting profit

resulting from the revaluation is free from tax and must be placed on a special reserve account. This reserve account may only be used for the expanding of the share capital. Up to 1973, the contribution to this reserve was limited to 20% of the annual profit of the corporation, but this restriction has been abolished.

For the individual taxpayer, the income tax table, the personal allowances and any other lump sum deductions are readjusted every year.

If a taxpayer is late with respect to the payment of his tax, he is not only subject to interest on the amount due and to fines, but also the amount of tax and fines he has to pay is revalued according to the latest monetary correction index coefficient.

A recent law provides that any withholding tax on, e.g., employment income, on dividends, etc., which is creditable against income tax, must be revalued according to the official coefficients, taking into account the month in which these taxes were withheld.

./.. Photocopies of the following documents are enclosed:

- I. Law no. 4,506 of November 30, 1964. This law made it compulsory for corporations to revalue yearly their fixed assets.
- II. Law no. 4,728 of July 14, 1965. Regulating e.g. the issuing of bonds subject to monetary correction. (articles 26 ff)-
- III. Law no. 4,357 of July 16, 1964. The issue of bonds by the Treasury subject to monetary corrections and extensive modifications in the income tax law, e.g. with respect to the revaluation of fixed business assets.
- IV. Example of official index coefficients for purposes of revaluing late payments of tax.
- V. Example of monetary correction index coefficients for purposes of revaluing the working capital of corporations.

International bureau of fiscal documentation
Internationaal belasting documentatie bureau
Bureau international de documentation fiscale
Internationales Steuerelementationsbüro

- VI. Example of monetary correction index coefficients for purposes of revaluing loans.
- VII. Example of monetary correction index coefficients for purposes of revaluing certain immovable property.

Literature

The Tax System of Brazil, Carl S. Shoup (Fundação Getúlio Vargas - Comissão de Reforma do Ministério da Fazenda) (1965)

Aspectos jurídicos de la incidencia de la inflación en el sistema tributario; el caso Brasileño - Rubens Gomes de Sousa - Cuadernos de Finanzas Publicas - Union Panamericana (1968)

Die Besteuerung von Tochterunternehmen in Brasilien nach deutschem und brasilianischem Recht, Eduard Metzger - No. 5 in the series "Private Auslandsinvestitionen in Lateinamerika - Institut für Iberoamerika-Kunde (1974).

U.S.A.

The U.S. Federal Tax legislation does not contain specific measures intended to offer relief to taxpayers for profits or gains caused by inflation nor measures directly intended to reduce inflation.

1. Individual income tax

The 1969 Tax Reform Act has increased the personal exemptions, the standard deductions and several other deductions. These measures were, however, not taken because of existing inflation, but the Government recommended the increases, and in general, the entire Tax Reform as a more equitable sharing of the tax burden.

In 1970 the individual tax table was revised, and the maximum rate was reduced from 77% to 70% (for earned income 50%). There was no connection made with inflation (inflation, being rather unimportant in those years).

2. Taxation of business income

There are no measures for the computation of business income, directly intended to mitigate the influence of inflation.

A 7% investment tax credit was reintroduced during 1971 to further investments. Originally it was even intended to limit the investment tax credit to the acquisition of assets manufactured in the United States. (Sec. 50, I.R.C.).

3. Corporate income tax

Since 1964 the rates of the corporate income tax have remained the same.

4. Capital gains

No relief is granted with respect to capital gains caused by inflation. On the contrary, the tax rate to be applied to capital gains has been increased in 1970 (for corporations from 25% to 30%; for individuals the maximum rate from 25% to 32.5%, spread over two years).

The manner in which the amount of capital gains must be computed has not changed substantially during the past years, and no deductions accounting for the decrease of the value of the dollar are allowed. It might be argued, however, that the reduced tax rate applying to capital gains reflects the fact that the gains represent, at least partially, a mere inflationary gain due to the decrease in value of the currency.

- ./.. A photocopy of the section of the Internal Revenue Code, according to which the personal exemption is increased over a number of years, is enclosed.