

War Loan Bonds and Income Tax Prospects

Since the First of July the Quotations on War Bonds in Montreal and Toronto Have Materially Improved

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The financial community has been somewhat depressed over the unfavorable market action of the second and third war loans during May and June. The quotations for the first loan, due 1925, have held firmly around the issue price, 97½; but the two succeeding loans went below the issue price immediately after the third war loan was floated, and subsequently both dropped below the net cost to subscribers. It was, of course, the feature of convertibility that kept the first loan steady while the others were weakening. The bonds due 1925 are convertible at 97½ into any subsequent loan which the Dominion Government may put out during the war. How much of the first loan remains unconverted is not publicly known. A considerable number of the bonds were turned in as part payment for the second loan, and a further amount came forward on the occasion of the third flotation. On both of these occasions those holders of the "convertibles," who turned in their bonds sensibly lengthened the term during which they could collect the abnormally high interest rate on the Dominion bonds; and in one case at least a slightly higher net yield on the investment was obtained.

The low quotations in May and June created an impression that perhaps the financial system of the Dominion had been slightly overstrained with the effort of placing the \$150,000,000 loan; and they made it appear that some difficulty might be experienced in floating another large domestic loan if the attempt was made at too early a date. It was thought that it might be necessary for the Government to wait a little while until the investing classes accumulated fresh funds, and also the net yield to investors might be further increased. If the net interest rate on a fourth domestic loan were placed above 5½ per cent, the bonds having a currency of fifteen or twenty years, the advantages derived from conversion of the 1925 loan would be greater than in the case of either of the preceding loans; and probably a large proportion of the outstanding bonds of the first loan would be turned in—perhaps it would be virtually cleaned up. Although the war has lately had something of an aspect of deadlock, there are several underlying factors of great importance which might at any time start a landslide of Allied victories. The re-awakening of the Russian armies, the arrival of the Americans in France, the final overthrow of Constantine of Greece; all are full of promise for decisive successes early in 1918 if not before. And very soon after our next domestic loan is floated the war situation might be such as to point unmistakably to an early breakdown of the enemy's resistance—in which case there would probably be a tendency, on the part of our own and other Allied Governments, to shade or lower the interest rate on war loans.

MATERIAL IMPROVEMENT.

Since the first of July the quotations on war bonds in Montreal and Toronto, have materially improved—the accepted explanation being that reinvestment of July interest and dividends has helped the market. It may also be the case that the various large subscribers who took up more of the third loan than they intended to carry, have nearly completed their liquidating sales. The suggestion has also been made that recent intimations of the Finance Minister to the effect that a Dominion income tax is imminent, have served to stimulate the purchase of tax-exempt bonds by the well-to-do. It is well known that the tax exemption clause of the Liberty Loan of the United States helped the flotation greatly. The very rich families applied for large amounts of the bonds, notwithstanding that they bear but 3½ per cent interest. So far we have nothing definite from Ottawa as to the rates of taxation that will be applied here, but it is probably safe to assume that the tax will be at a low rate on small incomes, with a sharply rising scale for the large ones. As the yield on our war bonds is practically 5½ per cent, while municipal and industrial bonds yield from 5½ to 6½ per cent, it is easy to see that the imposition of an income tax will drive a considerable amount of capital into the war loans.

Take the case of a wealthy Canadian whose income is to be taxed at the rate of 10 per cent. He has say \$10,000 to invest. By putting it into a good steady stock or purchasing a Western city bond, he

could get 5 per cent on his money, or \$600 per year; but the 10 per cent tax would absorb \$60, leaving \$540 net. On the other hand, a purchase of Dominion war bonds on the 5½ per cent basis would yield \$550 free from Federal income tax. The very large incomes in the United States are taxed around 33 per cent; but as Canada has no class of multi-millionaires to compare with the wealthiest Americans, it is perhaps not to be expected that our tax will rise to that level. That is to say none of our incomes would be large enough to qualify for taxation at this rate according to the American tax schedule. It is possible that our government might impose a tax that would take 15 per cent of income or perhaps 20 per cent in the cases of a few of our richest citizens. In the event of their tax being greater than 10 per cent they, of course, would find a greater gain through buying tax exempt bonds than shown in the above illustration.

Although the general public is unreservedly in favor of piling very heavy taxes on citizens having large incomes, it is possible that awkward consequences would follow any wholesale diversion of capital from industrial and other securities into tax exempt Government bonds. If taxed reasonably or moderately on what they make, the rich will always be ready to put their money into promising ventures of one kind or another, and their activity in this respect counts importantly in developing their country and in bettering the economic condition of the people; but

if the tax on what they make is excessive or unreasonably oppressive, they will show a marked tendency in many cases to confine themselves to tax-exempt investments and avoid the risks connected with new development work. So, if the taxation rate is extreme, the progress of the country is checked and in all probability the Government does not collect as much in the form of income tax as it would be able to collect if the rate applying to large incomes were fixed at a lower level.

One of the leading American dailies points out that while a rich man in the United States holding a large block of securities yielding say 5 per cent, will be required to pay 25 per cent or more of the interest income in the form of income tax, a small investor, with income less than \$2,000 per year, might buy from this rich man a portion of these same securities and enjoy the full 5 per cent interest without any deduction for income tax. Suppose, for the sake of argument, that the rich man disposes of the whole of his security holdings to small investors whose incomes are not large enough to subject them to the Federal tax, and puts the money into tax exempt Government bonds. The result is that neither he nor the purchasers of those securities would pay any income tax. Thus the purpose of the Government is to a certain extent defeated. Small investors not subject to income tax and investors whose rate of taxation is low can buy these securities from the rich and they will pay no tax or only a small one.

There is another point that should be remembered when the Dominion income tax schedules are being fixed. An income tax applied to moderate incomes, will in numerous cases induce the taxpayers to cut out unnecessary expenses as a means of offsetting the tax, and in that way it may further promote economical habits. But an excessive tax levied on the rich does not as a rule cause them to economize or cut out unnecessary spendings. The tax reduces the amount of income which they have available for reinvestment, and thus wipes out what would otherwise become new capital.

Third Crop Report for 1917

The third crop report issued by the Manitoba Free Press is, taken as a whole, fairly optimistic. Conditions are not so bad but what they might be worse. A summary of the report follows:

Speaking broadly, the entire West has had rain. Manitoba has had the least and reports the need of more, in many cases "badly." The whole west, however, is badly in need of warm, moist weather to force growth. Straw is generally short. Comparatively a very small proportion of the crop has reached the shot blade, and indeed nearly the entire crop is admitted to be from 10 days to 2 weeks later than last year. The frost damage, on the whole, since last report, has been light. Coarse grains are much more backward than usual, and are generally in an unsatisfactory condition, with a few honorable exceptions; hay crop light and short and generally considered to be past the stage of any very substantial improvement.

During June, 1916, conditions on the whole were good, and on the 26th the Free Press report stated that there was abundance of moisture; no damage from frost, cutworms, gophers or weeds and that all that was needed was hot, dry weather with occasional showers and light winds. Everyone knows what happened. We got the heat but not the winds.

In June, 1915, on the contrary, the Free Press diary shows that there were frosts on the 5th, 6th, 7th, 9th, 10th, 11th and 12th of June. Then on the 15th came a frost running to 12 to 14 degrees at some points. That was the June which ushered in the finest crop the west has ever seen.

MANITOBA.

Of the 94 points queried in Manitoba, 81 were heard from, with the following results:

Seventeen points report no wheat as yet in shot blade; five report from 50 to 70%, and the remainder report "a little"; "5%" and so on. 36 points report no damage from frost since June 5, date of last report; the remainder report frost damage from slight to serious.

All points but one report some rain; 14 points only light rains; 23 points report rain still "very badly needed"; 26 points want more rain and 26 points declare they have sufficient. Only 8 points report crop as far advanced as at the same date last year; the remainder report crop from 5 to 21 days late, with an average of 14 to 15 days. A few points report serious damage from drifting of light land, but on the whole, loss from this evil will be comparatively light, though a serious matter to individual farmers. Loss from cutworms is also light.

Condition of coarse grains is far from satisfactory.

The replies run about as follows: "late," "uneven," "only fair," "backward," "very poor," "only 50% germinated," while only 10 report conditions good, and only 2 report excellent.

Many reports indicate hay crop as very light.

ALBERTA.

In Alberta 28 points were queried and 21 heard from. Here conditions are better. Little has advanced to the stage of the shot blade, but on the other hand there has been practically no frost damage. Every point has had sufficient rain; crop is quite as late as in Manitoba, but there has been no damage from wind drifting the soil, only very slight damage from cutworms, while, with the exception of two points condition of coarse grains is "good" to "excellent."

SASKATCHEWAN.

In this province 105 points were queried and 90 replies received. These showed that 45 points have no wheat in shot blade and only very small areas advanced to that stage in the other 45 points. Fourteen points reported severe frost damage since last report and in a few cases the flax totally destroyed. The damaging frost was on the nights of the 21st and 22nd of June. Every point heard from had had rain, many reporting "plenty." While a good many points said they still wanted more, 67 points stated that no more rain was needed for the present.

The Saskatchewan crop on the whole is slightly later than the other provinces. Fewer points reported it as advanced as last year, while quite a number reported it 21 days late. The loss from soil drifting on the whole has been light, and except as to gardens, cutworms have not wrought serious havoc. Reports on coarse grains are very mixed, but on the whole indicate a rather backward crop with hope of recovery now that rains have come. General condition of crop rather below average.

SUMMARY:

Altogether 202 points have been heard from, spread well over the three provinces and the indications are, that while the crop is late and short, it looks quite as well as it did at the same period in 1915, when so much needless apprehension was felt for the ultimate outcome. The present crop has a good root, it has now got a fair supply of moisture and even in the two or three days since rain came the improvement has been marked and the history of 1915 may be repeated. The one great difference between the two years is, that 1915 crop went in mainly on summer-fallow, while 1917 crop may almost be said to have gone in mainly on stubble.