Woman C.P.A.

Volume 6 | Issue 5 Article 4

8-1944

Tax News

Alberta R. Crary

Tax News

ALBERTA R. CRARY, *Whittier, California*

The Individual Income Tax Act of 1944 received presidential approval on May 29, 1944. The provisions of this bill may make it necessary to revise tax estimates in September or before the final filing date of January 15, 1945.

CORRECTION: In the June issue of *The Woman C.P.A.*, Adjusted Gross Income in Tax-News was defined as gross income minus certain eight deductions. Number 7—Charitable deductions and Number 8—Medical and dental deductions were included in that list in error. The Tax Editor asks your pardon. Following is the definition of "Adjusted Gross Income" as defined in the bill as passed.

"Adjusted Gross Income" is defined as gross income minus the following deductions:

(1) Trade and Business Deductions — expenses incurred in the operation of a business or practice of a trade or profession, but not if tax payer incurs such expense as an employee.

(2) Expenses of Travel and Lodging connected with Employment—expense of travel, meals and lodging while away from home if in connection with the performance of services as an employee.

(3) Reimbursed Expenses in Connection with Employment—this applies to expenses incurred by the taxpayer for which he receives reimbursement from his employer either as a stated allowance or payment for expense actually incurred when these deductions are taken, monies received from the employer for traveling expense must be included in gross income.

(4) Deductions Attributable to Rents and Royalties—interest, repairs, taxes, depreciation, rental commissions, and other expenses incurred in connection with rental property.

(5) Certain Deductions of Life Tenants and Income Beneficiaries of Property—depreciation and depletion deduction are allowed to life tenant of property or to an income beneficiary of property held in trust.

(6) Losses from Sales or Exchange of Property—Capital losses or losses from sales of property other than capital assets are deductible in arriving at adjusted gross income.

All of the deductions from gross income to arrive at "adjusted gross income" under the above six divisions are limited to deductions allowed under Section 23 of the Internal Revenue Code. However, Section 8 of the new law contains certain limitations on deductions allowed under Section 23. It will be well to look at each of these deductions carefully. Some of the standard deductions used under prior laws may not be allowable under the new law.

(1) Trade and Business Deductions—

"The deductions allowed by Section 23 which are attributable to a trade or business carried on by the taxpayer, if such trade or business does not consist of the performance of services by the taxpayer as an employee."

On the 1943 return and those of former years, item one, page one of Form 1040 asks for wages, and salaries less deductible expense. Deductible expenses there meant, state unemployment insurance contributions, union dues, tools, professional licenses and dues, special clothing needed in performing services, traveling expense. Under the 1944 Act only traveling expense in the above list may be deducted if the taxpayer is an employee, to arrive at adjusted gross income. It is assumed that if the taxpayer is an employee, these other deductions may be deducted to arrive at net income, if the optional standard deduction is not used. It is to be hoped that when the regulations covering the new law are issued, that a clear ruling on this point may be included.

To have a clearer idea of the meaning of "adjusted gross income" under the new law, let us look at Form 1040 for the year 1943, taking each item from numbers one to ten, and see if we can find the differences to be considered under the 1944 Act.

FORM 1040:

Item 1—*Salary, Wages and Compensation for Prsonal Services less Deductible expense.*

If the taxpayer is an employee, these deductible expenses are limited to those incurred for travel, meals, and lodging while away from home, or for those for which he is reimbursed directly by a separate payment by his employer. The report of the Senate Finance Committee includes this explanatory statement: "Thus, for example, an employee who incurs expenses for his employer for which he is reimbursed or for which he receives a per diem remuneration, would include in his gross income the amount of the per diem or reimbursement, but would be entitled to deduct the amounts paid out by him for expense." From this, it is necessary to include all amounts received from the employer for traveling expenses. Every employee who incurs traveling expense should keep a detailed account of these to prove his deductions. Expenses that may be included in this deduction are: Airplane, train, bus, or boat fares; auto expense and depreciation; baggage and porter charges; meals and lodging; telephone and telegraph costs; and sample room charges.

Items 2 and 3—*Dividends and Interest on corporation bonds, bank deposits, notes, etc.*

The gross amount of income from these sources must be included in full. Expenses incurred in collecting this type of income will not be allowed in arriving at adjusted gross income. The 1942 Act allowed the deduction of all expenses incurred in the production of income. It seems now that these deductions will no longer be deductible unless connected with a trade or business or property producing rents and royalties.

Item 4—*Interest on Government obligations, etc.* (a) and (b) from Schedule A.

Item 4 (a) under prior laws was not subject to the normal tax rate of 6%. It is now taxable at the new surtax rates which included the old normal tax.

Item 5—*Annuities.*

Includes all subject to usual limitations.

Item 6—(a) *Net gain or loss from sale or exchange of capital assets.*

(b) *Net gains or loss from sale or exchange of property other than capital assets.*

This includes all exchanges of all capital assets—bonds, stocks, non-business, bad debts, etc., and capital loss carry-over.

Item 7—*Rents and Royalties.*

The amount of this item to be included is the gross amount received less expenses incurred in the operation of the property from which income is received. The list of deductible expenses include: depletion, depreciation of buildings and equipment, patents or copyrights, leasehold improvements, losses, casualty, fire or damage suits, repairs and decorating, interest on mortgage, insurance—fire and liability, taxes—real estate, payroll taxes on necessary employees, and other operating and maintenance expense.

Item 8—*Net Profit or loss from business or profession from Schedule C (2).*

This is gross income from business minus the deductions allowed in prior years. Though the tax services and commentaries have gone to great lengths in discussing this, item (1) under Section 22 (n) dealing with adjusted gross income headed "Trade or Business Deductions," it does not appear that the man in business for himself, or working at his trade or profession on his own will follow any different procedure on the 1944 return, to arrive at net income or loss from business or profession, than he has in the past. If he uses Schedule C (2) or like schedule provided or submits a separate schedule showing the operations of the business, the results will be the same as in past years. In the event of a net operating loss carryover, this deduction is to be computed in arrived at net profit or loss for the year.

Item 9—*Income or loss from partnerships, fiduciary income and other.*

This item would be the amount shown on the partnership or fiduciary return as earned by the taxpayer. Beneficiaries under a trust may or may not be entitled to a deduction for depreciation or depletion on property, held in trust. If income is distributed to the beneficiary disregarding the depreciation, deduction is allowable to the beneficiary. If the terms of the trust instrument specify that the trustee make distributions of income from net income after this deduction, the deduction will be taken by the trustee. A question arises here, if whether or not a member of a partnership who, separately owns an automobile, machinery, or fixtures used in the partnership business, is entitled to deduct depreciation of these assets from partnership income to arrive at adjusted gross income. Regulations may clear this and other questionable deductions.

Item 10—On the new return should be total "*Adjusted Gross Income.*"

It is necessary for taxpayers to arrive at the amount of adjusted gross income to determine whether or not to use the optional form and take the optional standard deduction. If the adjusted gross income of one spouse in case of joint return, is less than $500, the normal tax exemption on the return is limited to $500 for one spouse and the amount of adjusted gross income of the other spouse. As an example, if the husband's adjusted gross income were $4000, and the wife's adjusted gross income is only $400, the normal tax exemption on

Please turn to Page Eleven

rubber, oil, textiles, and foods were the basic raw materials discussed; their relation to the war effort and comparisons of the allied and axis resources were brought out. Potential man-power, plants and equipment, and consumers' goods were touched on in the course of the lively discussion. These play important roles on the homefront in that they constitute the back-bone of the war-time set-up.

The relation of inflation in wages to former wages was discussed both from a national economic point of view and from a personal point of view. A few historical points were mentioned, such as the lagging of skilled labor wages in Germany after World War I. The fact that Germany was crushed after the last war and that the United States was victorious is significant here. Historical patterns are important for anticipating the future, but all the circumstances of any given pattern must be taken into consideration. An opinion was expressed that present real wages are relatively the same, if not somewhat less than in a period of relative non-inflation.

Inflation and social welfare was the last topic of the evening. From reliable sources, it was stated that through inflation, gifts to charitable institutions become fewer in the long run. However, the students did not quite agree and brought up a case where a local church recently paid off a $125,000 mortgage with donations. Here income tax deductions probably had a great deal to do with it. Several community churches were mentioned in this connection.

Editor's Note: Peggy Kalpakian is a junior at the University of Southern California where she is majoring in Finance and Business Administration. She is vice-president of Xi of Phi Chi Theta and a member of Ephebian, an honorary civic betterment society, membership in which is given to the upper 2½% of high school graduating class. She is also a part-time employee of The Security-First National Bank of Los Angeles in the Escrow Department and office assistant in the office of the Dean of the College of Commerce, U.S.C.

Thanks, Peggy, and best wishes for a world of success. Certainly, the career of one so promising will be followed with keen interest.

Coast-to-Coast—Continued from Page Five

want to stay there permanently if post-war jobs are available for them. It is highly necessary that some sort of blueprint for the future be prepared so that the population shall have an opportunity in private enterprise, thus avoiding a critical unemployment situation in the reconversion of industry from war to peace. It has been estimated that we should have at least 20% more jobs available after the war than we had available in 1940 and this is one of the important problems now confronting the Committee for Economic Development.

Miss Haines's appointment to this important committee is pleasing recognition of her ability.

New AWSCPA Members

AWSCPA welcomes as a new member *Miss Viola Becklin* of Brookfield, Illinois. Miss Becklin, who obtained her C.P.A. certificate in May of 1943, is employed by H. E. Snyder & Company, Certified Public Accountants, in Chicago. She holds a B.A. degree from the University of Chicago and has had accounting training at both the University of Chicago and at Loyola University.

Tax News—Continued from Page Nine

their return would be only $900. Husbands and wives living in community property states, filing joint return will be entitled to $500 each if the adjusted gross community income is in excess of $1000. The limitation on medical expenses is computed on medical expenses in excess of 5% of adjusted gross income. The limitations on charitable contributions is based upon 15% of adjusted gross income.

The amount of charitable deductions and medical deductions may be a determining factor in deciding whether or not to elect to take the optional standard deduction or compute the deductions in the usual manner.

Every taxpayer has the right to elect the standard deduction. If adjusted gross income is less than $5000, the deduction is 10% of adjusted gross income. If adjusted gross income is in excess of $5000, the standard deduction is limited to $500. If the taxpayer's income is less than $5000, and he elects to use the standard deduction, then he pays the alternative tax, using the table on the optional tax forms. The decision to use the standard deduction in any year cannot be revoked for that year. A taxpayer might find that he should have saved by using his normal deductions, but cannot change his decision for that year. So extreme care should be used in arriving at correct adjusted gross income, and an accurate computation of ordinary deductions for net income, should be made before electing to use the standard deduction.