1954

America's new tax law [pattern speech]

American Institute of Accountants

AMERICA'S NEW TAX LAW

(This is an outline for use in developing your original speech. A pattern speech follows, which you can use if you prefer, either as is or modified for your audience.)

A. Introduction, appropriate to the occasion.

B. Significance of the Internal Revenue Code of 1954.

1. First general revision of code in entire history of federal income tax.

2. Multitude of changes affecting individuals and businesses.

C. Changes affecting individuals, whether or not in business.

1. Deadline extended one month for individual returns.

2. Child care deduction for working wives, widows, etc.

3. Children under 19 or in school can earn over $600 without forfeiting parents' right to exemptions for them.

4. Medical expenses deductible in excess of 3% instead of 5%; top limit can go as high as $10,000; drugs and medicines deductible in excess of 1% of adjusted gross income.

5. Dividend income: $50 exclusion plus credit for 4% of remainder.

6. Retirement income, annuities, deduction for charitable contributions, estimated returns.

D. Changes affecting business men and corporations.

1. More flexible rules for depreciation.

2. Research and development costs immediately deductible.

3. Tax accounting harmonized with generally accepted accounting principles.

4. Option for proprietorships and partnerships to be taxed as corporations.

5. Payment of estimated tax by corporations with $100,000 tax liability.

6. Two-year carry-back of losses.

7. Earnings of $60,000 may be accumulated without danger of penalty.

E. Conclusion

1. Better tax administration; first CPA as Commissioner.

2. Law is major achievement; CPAs helped write it.

3. Taxpayers should get help from IRS and qualified advisers.

NOTE: This speech has been prepared for delivery by certified public accountants before civic, business and professional groups, such as Chambers of Commerce, Rotary Clubs, business women's clubs, etc. It gives a general description of the new tax law and may be presented as written, or adapted for any particular audience or occasion.

AMERICA'S NEW TAX LAW

Mr. Chairman, etc. -

Did you wonder for a while last spring whether Congress ever would really pass the new tax law? Many of us had our doubts, for it was a monumental task and there was always the danger that in the rush for adjournment this complicated bill might get thrown over the side.

Well, the Internal Revenue Code of 1954 was passed. It is the first general revision of the code during the entire history of the Federal income tax. The old law had been patched up and altered many times but this is its first complete overhaul.

The law consists of 929 pages and contains many changes affecting large and small taxpayers.

How will the new law affect *your* income tax? There are far too many changes for me to make any attempt to mention them all. I'd like to talk about a few, however, which I think will be of special interest to you.

First, let us consider some of the changes which affect individual taxpayers, whether they are in business or not.

All of us, except possibly comedians, will be glad about the change of the date for filing individual income tax returns. The comedians will have to throw away a lot of old gags about the Ides of March. The deadline for the average taxpayer is now April 15. An extra month for filing individual returns is also granted to taxpayers who close their fiscal years on dates other than December 31.

I am sure you have also heard of the deduction for baby sitters, but you will be disappointed if you have been taking it at face value. The deduction is only for actual expenses up to $600 for the care of dependents while a widow, widower, divorced person, or wife is gainfully employed. These expenses must be for the care of a child under 12 years of age or of another dependent who is mentally or physically incapable of caring for himself. A husband and wife claiming this deduction, must reduce the $600 by the amount that their adjusted gross income exceeds $4,500. In other words, the husband and wife get no deduction for this purpose if their adjusted gross income is $5,100 or more. This child care deduction helps people who need it because of special circumstances, but it has nothing to do with the expenses of a sitter when husband and wife go out for a night's entertainment.

Before the new law was passed, parents could not deduct an exemption for a child who earned more than $600. Now they are permitted to keep the exemption even if the child earns over $600, provided he is either under 19 years of age or is a student.

Medical deductions, too, are easier to get under the new law. It used to be that medical and dental expenses were only deductible to the extent they exceeded 5% of your adjusted gross income. In other words on a $10,000 income you could only deduct medical expenses after the first $500. Now on the same income you could deduct such expenses after the first $300. The 5% rule has been changed to 3%. The top limit on medical deductions has also been raised so that it can now go as high as $10,000 for a married couple or head of household with four exemptions.

You'll have to watch out for two new limitations on medical deductions, however, as you can only deduct drugs and medicines to the extent they exceed 1% of your adjusted gross income. And in the case of travel which is prescribed for health, only the transportation expenses, not the ordinary living expenses are deductible.

If you are a stockholder you will be interested in the dividend credit. This was put into the bill to offset the double taxation of dividends. The point is that any profits made by a corporation are subject, first of all, to a tax of as much as 52% on corporation income. Then upon distribution of these profits in the form of dividends, you and other stockholders have to pay a further tax on these dividends as personal income.

This double taxation, in the most extreme case, could reduce $100 of corporate profit to $4.32 in the pocket of the stockholder. First, the corporation tax at maximum rate would take away $52, leaving $48 to be distributed as a dividend. If this $48 dividend were subject to the maximum rate of personal income tax, which is 91%, this would take away another $43.68, leaving $4.32 in the taxpayer's pocket from the original $100. Just to carry this a step further, let us assume that $1,000 was invested to produce that $100 of profit. A little arithmetic will show us that the $4.32 represents a return of less than half of one per cent on the investment, in spite of a 10% profit before taxes.

This situation could have been improved either by giving some form of relief to the corporation paying dividends or to the stockholder receiving them. The latter was finally done on a compromise basis, after a bitter struggle in both House and Senate. Here is how the new law handles this problem.

First, let us go back to the high-bracket stockholder who had $4.32 left after taxes from his $100. Under the new law the corporation tax will still take $52, leaving a $48 dividend. This comes within the $50 of dividends now permitted to be excluded from taxable income. The taxpayer will keep the $48 instead of having only $4.32. Any dividends he might have in excess of $50 will be taxed, but he may deduct from his tax bill 4% of the amount of these dividends.

Let's see how this works for a married couple who have an income after deductions and exemptions of $50,000, including $20,000 from dividends on jointly owned stock. First they can exclude $100 of dividend income from their taxable income. Being in the 59% bracket, this couple will save $59 as a result of the exclusion. Then they can take a credit against their tax amounting to 4% of the remaining dividend income, saving them $796. Their total saving is $855. I emphasize that this is an outright saving, not just a deduction. This provision doesn't completely overcome the double taxation of dividends, but it certainly is a step in the right direction.

These are only a few of the provisions which affect individuals. The new law also contains provisions to allow credit for retirement income, to ease taxation of annuities, to raise the maximum deduction allowable for charitable contributions, to relieve some of the taxpayers of the necessity of filing estimated returns, and many others.

Turning now to the changes which affect business men and corporations we find that they are numerous and very significant. We can only skim over them lightly, with a warning that you had better get expert advice before making any plans based on these changes.

A very important change has to do with depreciation. You can now deduct greater depreciation during the first few years of the life of any new machinery or other capital assets. You can depreciate as much as 40% of the cost in the first quarter of its service life and as much as two-thirds of the cost in the first half of its life. One method specifically permitted by the new law is the declining balance method at double the regular rate. Also permitted is the sum-of-the-years' digits method.

These provisions for liberalized depreciation, together with other provisions which allow certain research and development costs to be taken as immediate deductions, should provide a considerable stimulus for modernization and expansion of American business.

A very important change, I think, is one that is woven all the way through the law. It has to do with the basic problem of making the tax accounting rules correspond with generally accepted accounting principles. Businesses must follow generally accepted accounting principles in making their reports to stockholders. Whenever the tax rules require something different they distort income, they make twice as much work and they add a large measure of confusion. A great many changes have been made throughout the law to permit greater consistency between tax accounting and generally accepted accounting principles.

There is another change which will be of benefit to some businesses. Certain proprietorships and partnerships now have the option of being taxed as if they were corporations. An option in the reverse direction, which was dropped from the law at the last moment, would have been even more helpful. It would have permitted certain closely held corporations the choice of being taxed as partnerships. With both of these options in effect, it would have been possible for many business men to decide whether to incorporate on the basis of various advantages and disadvantages of the corporate form apart from tax considerations.

Now that the option applies only in the direction of being taxed as a corporation its chief advantage is to partners or proprietors who are in tax brackets considerably higher than the 52% maximum rate for corporations. If they qualify for the option their current tax on any profit that stays in the business will be not more then 52%. Of course, it will probably be subject later to capital gains or estate taxes.

There are many other important revisions affecting businesses. There is a change in the schedule for payment of corporation income tax which requires a declaration of estimated tax by certain corporations. Each year for five years a larger proportion of tax will become due during the year in which it is earned. For the sake of simplicity, I'll take the case of a corporation which uses the calendar year -- although it is actually better for many corporations to adopt a fiscal year other than the calendar year. This calendar-year corporation will pay 5% of its 1955 tax in September, 1955, 5% in December, 1955, and 45% in March and again in June of 1956. Each year September and December payments will increase and March and June payments will decrease until there will be equal installments of 25% in September and December of 1959 and March and June of 1960. This new schedule of payments does not apply to corporations with less than $100,000 tax liability. They will pay their tax 50% in March and 50% in June of the year after the income is earned.

Under another provision of the new law business losses can be carried back two years instead of one, as well as being carried forward five years.

Corporations which were considering expansion often were handicapped by Section 102 of the old law. Under this section there was always the threat that profits retained in the business might be judged an unreasonable accumulation and subject to a special penalty tax. The burden of proof that the accumulation was not unreasonable was on the corporation. Now the burden of proof is on the government and, in any case, the penalty tax will not be imposed on any corporation whose accumulated earnings are less than $60,000.

I could go on telling you about many more of the provisions of the new law, but I think I have mentioned enough to make it clear that you are operating under a brand new Internal Revenue Code.

This new tax law has many provisions which will help to eliminate difficulties that have hampered tax administration in the past. Bringing tax rules in line with generally accepted accounting principles will be a great help in many ways. Incidentally much has already been done for better administration by the present Commissioner of Internal Revenue, T. Coleman Andrews. The members of my profession are naturally proud of him as the first certified public accountant to serve in that office.

The new tax law is not perfect, of course. Such a law never can be, and we will always have additional recommendations for improvement. It is, however, a major achievement. It represents many years work by many persons. Certified public accountants, through their state and national organizations, have helped to bring about this revision of the tax law. Business men, lawyers, labor unions, tax organizations and of course Treasury officials, Congressional committees and their staffs also have all contributed ideas to the new law.

Now I suppose you would like to know what all this means to you as you contemplate transactions which will affect your income tax and as you prepare to file your income tax returns. Well, the average taxpayer should be able to make out his return by following the instructions supplied by the Internal Revenue Service. The Director of Internal Revenue in each district has people on his staff who will answer questions and assist in the preparation of taxpayers' returns.

When you have complicated problems which you feel require some special help, I pass on the advice of the Internal Revenue Service: to make sure that your advisers in these matters are properly qualified.

As I indicated at the outset, the 929 page Internal Revenue Code is much too complicated for me to attempt to explain it in detail, but I hope that my remarks have been helpful in giving you an understanding of some of the major provisions of this monumental piece of legislation.

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