Journal of Accountancy

Volume 44 | Issue 1 Article 5

7-1927

Income-tax Department

Stephen G. Rusk

Income-tax Department

EDITED BY STEPHEN G. RUSK

During the past eight years many corporations and partnerships changed their annual accounting period from their natural or fiscal year basis to that of the calendar year. Their act was caused, in most instances, by a desire to make it easier to prepare federal-income and profits-tax returns. It is a fact that making a corporation or partnership-tax return for a calendar year presented less difficulty at the times when new revenue enactments were passed than did the making of a return on the fiscal year basis. To facilitate this task, these concerns, irrespective of any other considerations, obtained permission from the commissioner to change their accounting period so that it would end December 31st.

Looking backward, it would appear that in a great many instances this hasty decision was not wise, for many of them find the December 31st closing comes at a time when business is going at top speed, inventories are high, cash and accounts receivable are low, and liabilities are heavy. Everything is pending. The results of the business of the natural year are so intermingled with the possible results of the future business that the management is deprived of the great advantage of looking over the past year; taking cognizance of the weaknesses shown; gauging the causes, and planning the future course.

To each of us it would be a boon if at some time when one's affairs had quieted down temporarily, one could retire to some quiet place and "take stock" of one's self, look back upon the immediate past to learn in what direction one is trending; count the results of one's endeavors, and then, in the light of that information, look to the future. It is difficult to make these calculations at a time when one is absorbed by watching the instruments as one's enterprise is plunging along at full speed. It is not easy to keep out thoughts of the proper steering of the machine when it is humming along in traffic. What is true of the individual is true of the corporation or partnership, and for them to adopt an accounting year not in conformity with the natural year of their particular business is not in the interests of advanced thought or business planning.

Every revenue law enacted since 1916 has had provisions enabling those whose accounting period did not end with the calendar year to make their returns on a fiscal year basis. The government itself closes its books June 30th of each year. It does not operate its affairs upon a calendar year basis. The budget committee meets some time in June and carefully plans the future in the light of the past.

American business men have the well deserved reputation of being alive, alert, ready to adopt new ideas, new means, whenever they find them meritorious. They are not hampered by precedent or tradition. When, however, business changed its accounting period from the natural to a calendar year, because of the federal income-tax laws, it simply adopted the easiest way, not the right way, and the federal tax laws should not bear the responsibility.

There was genuine merit in the good old custom of taking stock at an annual period when the business for seasonal reasons slowed up, and it is believed that this custom will be resumed in the future.

SUMMARY OF RECENT RULINGS

A petition to the board of tax appeals for redetermination of a deficiency filed within the statutory period may not be denied because not accompanied by the $10 filing fee imposed by the board under section 904, act of 1926. (United States circuit court of appeals, third circuit, *John H. Weaver* v. *Commissioner.*)

The transfer, pursuant to an irrevocable anti-nuptial agreement, of property to a trustee, to pay the income thereof to his intended wife for life or remarriage, with power of appointment by will in certain events, and the surrender by the wife of her inchoate rights of dower, was held to be a "bona fide sale for a fair consideration or money's worth," within the meaning of section 402 (c) act of 1918, the sum so held constituting no part of the gross estate of the husband upon his death. (United States circuit court of appeals, third circuit, *McCaughn, collector,* v. *Charles Carver, executor.*)

Income from a trust payable to minor beneficiaries, which under the provisions of the trust, was to be spent annually for their benefit in such amounts as the trustees should determine, and the balance to be invested and accumulated for their benefit annually, was held taxable to the beneficiaries, and not to the trust estate as an entity. (United States circuit court of appeals, eighth circuit, *Willcutts, collector,* v. *John G. Ordway, et al.*)

The tax upon income accumulated under a trust provision of a will, which trust, by court order was later declared void and the fund and its accumulation found to be the property of the heirs, should be assessed upon the individual shares of the beneficiaries and not upon the estate in gross, under acts of 1916, and 1917. (United States circuit court of Appeals, third circuit, *McCaughn, collector,* v. *Girard Trust Company, trustee.*)

The statute of limitations may not be pleaded in a suit for refund of taxes, if the claim for refund, upon which the suit is based, did not submit the issue to the commissioner. (United States district court of Louisiana, New Orleans division, *Dryfoos Dry Goods Company,* v. *D. A. Lines, collector.*)

Salary increases of more than 386% to three officers of a close corporation, for the years 1916, 1917 and 1918, were held properly reduced by the commissioner as not constituting an ordinary and necessary expense, under the 1916 act, nor as within the meaning of "reasonable salary" contemplated by the 1918 act. (United States court of claims, *Seinsheimer Paper Company* v. *United States.*)

A liability, representing the difference between a public service rate charged and a stipulated contract rate paid, accrued in a lump sum for 1919, pending a decision in a test case to determine the validity of the increased public service rate, to which suit the taxpayer was not a party, was held a deductible expense under section 214 (a) of the 1918 act, to a taxpayer making returns of an accrual basis. (United States court of claims, *Pittsburg Hotels Company* v. *United States.*)

A court has not the authority to compute taxes under section 327 and 328, of the 1918 act, except, perhaps, when reviewing a computation thereunder by the commissioner, and a demurrer will be sustained to a petition under these sections for recovery of taxes assessed under section 301 of the act. (United States court of claims, *Williamsport Wire Company* v. *United States.*)

Gains from illicit traffic in liquor were taxable under the 1921 act.

Privilege against incrimination in fifth amendment is not a defense to an indictment charging failure to file return, and does not authorize a refusal to state the amount of income, though the taxpayer's income was made in crime. (United States supreme court, *United States of America* v. *Manley S. Sullivan.*)

The amount of contracts issued during 1917 to purchasers of loan notes, to pay bonuses upon such notes during their life, accrued and set upon the books of a corporation as a liability and charged to expense, is an expense "incurred and properly attributable" to the income of such year, and . . . is deductible as an expense, although not "accrued" in such year in the sense of becoming then due and payable. (United States supreme court, *American National Company, receiver,* v. *United States.*)

A return is an essential preliminary to the assessment of income tax under section 3176 of the revised statutes as amended by the acts of 1916 and 1918,

authorizing the collector or his deputy, or, under the 1918 act, the commissioner to make a return where the taxpayer had made no return or a false return, and a telegram from an internal revenue agent in charge of recommending immediate assessment of income tax, is not such return as is required, nor a substitute therefor. (United States district court, S. D. Georgia, *United States* v. *William H. Haar, et al.*)

A taxpayer is not estopped in proceeding in equity from asserting the invalidity of a tax assessed in the absence of a return because he had obtained an abatement of the original assessment without disclosing his contention that the assessment was void. (United States district court, S. D. Georgia, *United States* v. *William H. Haar, et al.*)

A member of a partnership was held to be taxable upon his distributive share of the partnership net income for 1919 as shown on the partnership books and in the partnership return, which was signed by the president of the partnership, even though in excess of the amount to which he was entitled under the partnership agreement. (United States court of claims, *Isidor Hellman* v. *United States.*)

Section 402 (c) act of 1918, in so far as it requires the inclusion in gross estate of the value of property transferred by a decedent prior to its passage, merely because intended to take effect in possession or enjoyment at or after his death is so arbitrary and capricious as to be confiscatory and to offend the fifth amendment. (United States supreme court, *Nichols, collector*, v. *Coolidge & Loring, executors.*)