

12-1962

Tax Forum

Rosemary Hoban

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Recommended Citation

Hoban, Rosemary (1962) "Tax Forum," *Woman C.P.A.*: Vol. 25 : Iss. 1 , Article 7.

Available at: <https://egrove.olemiss.edu/wcpa/vol25/iss1/7>

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The Tax Forum

Rosemary Hoban, C.P.A.

REVENUE ACT OF 1962:

Many individuals may have a rather rude awakening when they discover the extent to which the recently enacted Revenue Act of 1962 affects their income returns. In addition to the many provisions dealing with income from foreign sources, mutual savings institutions, mutual insurance companies, and lobbying expenses, which provisions may not affect very many taxpayers, there are several that may affect a good many of us, our clients, our employers, or our customers. While several of the provisions are not effective until years beginning after December 31, 1962, some are effective for years ending after December 31, 1961, and it behooves us to be prepared and, in some instances, prepare procedures for reporting requirements, etc. Some of the highlights of the Revenue Act of 1962 are mentioned below.

The reporting of interest, dividends, and patronage refunds by payors will be required in all cases where the aggregate of such payments exceeds \$10.00 or more per person. The returns must show the name and address of the payee and the amount paid. An annual statement must be furnished to each payee showing the name and address of the payor and the amount paid. There are severe penalties for noncompliance.

A credit against the tax is allowed equal to 7 per cent of the basis of specified kinds of depreciable property acquired after December 31, 1961. In the case of assets having depreciable lives of less than eight years, the credit will be reduced proportionately. This credit is available against taxes for years ending during and after 1962 and one form (Form 3468 for individuals, trusts, etc.) for computing the credit has already been issued.

Somewhat as a corollary to the investment credit and the new depreciation guidelines is the change in the tax on disposition of certain types of depreciable property. While in the past the net gain from the sale of such assets has generally been taxed as long-term capital gain, such gain on the sale of certain business assets (excluding real property and livestock) will be taxed as ordinary income to the extent of depreciation allowed or allowable since December 31, 1961. There are several special rules as well as specific exceptions to these provisions and I would recommend anyone faced with a situation involving the sale of this type of property to check the rules carefully.

The sections of the Revenue Code of 1962 which may affect more individuals than any other are those pertaining to deduction of entertainment expenses, travel expense, and gifts. For taxable years ending after December 31, 1962, but only for periods after that date, Code Section 274 may operate to disallow deduction of entertainment expenses unless specific requirements are met. In the future, it will be the general rule that a deduction for entertainment expenses will be allowed only to the extent that it can be shown that it is "directly related" to the active conduct of the taxpayer's trade or business or that the expense directly preceded or was followed by a bona fide business discussion.

Generally, any entertainment which is part of substantial and bona fide business discussions, where the conduct of business is the principal activity during the time spent together by the taxpayer and the persons entertained will be deductible. Such instances might include the entertainment of a group of business associates and their wives after conducting substantial negotiations with the group, or, in the event of a convention, should a taxpayer entertain associates or prospective customers and their wives between or after the business meetings of such a convention.

The deduction of expense of any entertainment facility will be disallowed unless the facility was used primarily (over 50%) for the furtherance of the taxpayer's business and directly related to the active conduct of such trade or business. Such entertainment facility could include such property as a yacht, hunting lodge, and/or fishing camp. Club dues or fees paid to any social, athletic, or sporting club or organization are treated as entertainment facility expenses.

Under certain conditions travel expenses may be disallowed, based on the proportionate amount of time spent on business and personal affairs. The deduction for business gifts, with certain exceptions, has been limited to \$25.00 to any one individual.

It will also be required under Section 274 that such expense be substantiated by adequate records or corroborating evidence. Such evidence should cover the following items: (a) the amount of the expense; (b) the time and place of entertainment or travel, or the date and description of the gift; (c) the business purpose; (d) the business relationship to the taxpayer of persons entertained or re-

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Comments and Idea Exchange

Marion E. Davis

OWNERSHIP—GOING OUT OF FASHION?

Today, the emphasis is toward hiring or renting products and services. Free and clear ownership of a product seems to be a vanishing symbol of America.

Manufacturers stand in line to lease machinery. It is rather commonplace to rent cars or trucks. As individuals, we run to the hardware store to lease floor sanders, power mowers, electric saws, grass rollers, etc. If you stop and think about it, you are leasing your telephone.

What has brought on this trend, and is it good or bad?

Production in this country keeps steadily climbing higher, requiring constant absorption in the consumer market to keep money flowing. If not absorbed, inventories build up. Leasing has become an obvious way of helping to avoid this kind of economic situation. Then, too, many manufacturers feel, in the absence of greater allowance for accelerated depreciation in our tax laws, that they must turn to leasing as a substitute to avoid machine obsolescence.

Advantages: Leasing conserves working capital. No problems with disposal of old machines. There are tax advantages. Maintenance is eased. Operations can be made more flexible.

Disadvantages: Cost—leasing is not a low cost method of financing. An increase in fixed obligations. Failure to build equity. Tax disadvantages.

In any event, leasing has become big business. Nationally, leasing of machinery alone has topped the \$1 billion per year mark. People close to it expect this to increase tenfold in the next four or five years.

QUOTE FROM GEORGE O. MAY

In the long run, the willingness of an accountant to do what he conceives to be his duty to the unknown investor, even if by so doing he alienates a client and suffers a present loss of business, brings a rich reward both in self-respect and in a professional reputation which, in turn, brings a pecuniary benefit.

* * * * *

The man who graduates today and stops learning tomorrow is uneducated the day after.

—Newton D. Baker

CHECKS SORTED AUTOMATICALLY

Automatic processing of checks is spreading rapidly among the nation's commercial banks, the Federal Reserve System reports.

The American Bankers Association has developed a uniform system under which characters are printed on the bottoms of checks that can be "read" by electronic devices. The machines post the checks automatically to customers' accounts.

The Federal Reserve says that its current semi-annual survey shows that 68.3% of checks cleared through the 12 System banks carry the magnetic ink identification symbols, up from 54.6% six months ago and 36.1% a year ago. The Reserve handles nearly 13 million checks a day.

—Wall Street Journal

POINTS TO PONDER FROM PREVIOUS ISSUES

The stock brokerage business is a fast moving business, dealing with two highly negotiable instruments—money and securities. The temptation toward defalcation is greater than in most businesses.

—October, 1962

It is agreed that accounting has a double function. In the first place, it must make possible the determination of net profit by matching revenues and expenditures. In the second place, it must measure the growth of the net worth or the losses suffered during any particular period and show the net profits available for distribution, thus furnishing a basis for judging the profitability of the business.

—August, 1962

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ceiving the gifts. A diary plus receipted bills will probably suffice as evidence.

The Commissioner has indicated that the Service is endeavoring to issue promptly Regulations covering Section 274. It will be necessary to study such Regulations before the full impact of Section 274 is known but taxpayers would do well to get in the habit of accumulating sufficient evidence to substantiate their deductions.

The above has only covered the bare bones of a small portion of the Revenue Act of 1962. Perhaps by the time this publication reaches you sufficient rules, regulations, and comments will have been issued to answer some of your questions and solve a few of your problems raised by the Act. But we may have more on the same subject in the next issue.