Journal of Accountancy

Volume 39 | Issue 5 Article 6

5-1925

Income-tax Department

Stephen G. Rusk

Follow this and additional works at: https://egrove.olemiss.edu/jofa

Part of the Accounting Commons, and the Taxation Commons

Recommended Citation
Rusk, Stephen G. (1925) "Income-tax Department," *Journal of Accountancy*: Vol. 39 : Iss. 5 , Article 6.
Available at: https://egrove.olemiss.edu/jofa/vol39/iss5/6

This Article is brought to you for free and open access by the Archival Digital Accounting Collection at eGrove. It has been accepted for inclusion in Journal of Accountancy by an authorized editor of eGrove. For more information, please contact egrove@olemiss.edu.

Income-tax Department

EDITED BY STEPHEN G. RUSK

The United States board of tax appeals ruled in a case (B. T. A. decision 281, docket 802) that where a portion of an employee's salary had been credited to his account on the books of his employer the amount credited was not taxable income to the employee unless it was available to him. A reading of the entire decision reveals that because of the financial condition of the employer the employee's salary was not available.

In another case (B. T. A. decision 298, docket 553) the board held that a dividend declared in 1917, and credited to the stockholders' accounts in that year, although it was to be paid when and as directed by the officers or directors, was to be regarded as a distribution in the year in which the dividend was declared. It appears that the corporation's financial condition was such that the dividends could have been paid in 1917. Upon a casual reading of the two foregoing decisions it would appear that there was some conflict in the two decisions but a more careful reading reveals that in one case the salary though credited to the employee was not available for his uses because of the financial position of the employer, and in the other it is presumed the dividends credited to stockholders' accounts in the books were available to them because the earnings in the year in which the dividend was declared were sufficient to make them available. It does not appear in the record of this case, however, that the earnings of 1917 had become sufficiently liquid to render a distribution possible. As the record shows that the corporation had sustained losses in the two next preceding years to 1917, it would appear a probability that the earnings of 1917 could not have been transformed in such a manner that year as to render the dividends credited to the stockholders in 1917 available for their uses in that year.

The question as to whether or not compensation of employees of a municipally owned utility for services they render to it is taxable income seems to be unsettled. The conflict in two court decisions as to this question was pointed out in these columns in last month's issue. Another court decision has been made which seems to complicate the solution of this question, and it is probable that the final adjudication will not be had until a court of last resort has passed upon it. In the case of *Seattle et al.* v. *Poe, Collector et al,* tried in U. S. district court, D. Washington, N. D., it was held that "proceedings for the collection of income taxes on compensation of employees of a municipally owned street-railway system will not be enjoined." The court points out that "to attempt to tax a state highway, with its bridges and ferries, which are absolutely essential to the freedom and liberty of its citizens, is a vastly different thing in its principle from the taxation of the income of individual employees of a municipal street-car system, operated as a business upon the state's highways."

SUMMARY OF RECENT RULINGS

Where a partnership has become bankrupt, the government's claim for taxes assessed against the individual members of the partnership is not to be paid prior to the payment of partnership creditors. (U. S. supreme court decision in *U. S.* v. *Kaufman; U. S.* v. *Coxe.*)

A lessee of a mine holding a lease upon a royalty basis and sub-leasing to another upon a royalty basis is entitled to a depletion deduction under the act of 1916. (U. S. supreme court decision in case of *Lynch* v. *Alworth-Stephens Co.*)

A taxpayer, owner in fee of land, who leased the same for the purpose of exploration for oil and gas, is not entitled to deduct an amount as cost to him of the leasehold estate. (B. T. A. decision 265, docket 720.)

A balance remaining in capital account representing the cost of an exclusive business privilege may be deducted from gross income as a loss in the year in which the privilege is terminated. (B. T. A. decision 269, docket 747.)

A corporation which acquired patents from a stockholder and agreed to pay a sum each year based upon the profits therefrom, and at the same time increased its capital stock without any reference to the patents is not entitled to include any amount in its invested capital representing the estimated value of the patents. (B. T. A. decision 274, docket 346.)

A taxpayer who consistently charged to expense over a period of years the cost of molds and patterns is not entitled to amend his books of account and charge the cost to capital account and deduct depreciation thereon. (B. T. A. decision 274, docket 346.)

Salary credited to employee on the books of a corporation is not taxable unless it is available for the use of the employee.

Acceptance by an employee of non-par-value shares of stock of a corporation, that has no market value, in consideration for settlement for unpaid salary and for advances to corporation does not result in taxable income to employee. (B. T. A. decision 281, docket 802.)

A resolution of the board of directors of a corporation directing that a surplus fund be placed to the credit of the stockholders "to be paid to the stockholders when and as directed by the officers or directors" constitutes a dividend at the time the resolution was passed.

A dividend declared by a corporation in 1917, prior to August 6th of that year, out of March 1, 1913, surplus is not taxable to its stockholders as income. (B. T. A. decision 298, docket 553.)

Where the taxpayer's sole witness admits that a portion of his testimony was false, the board may regard all of his testimony as having no weight in establishing error on the part of the commissioner in determining a deficiency. (B. T. A. decision 314, docket 1213.)

Where the corporate stock is so closely held that it can not be valued upon the basis of sales in the open market, its value will be determined upon the basis of assets and earnings. (B. T. A. decision 320, docket 1337.)

TREASURY RULINGS

(T. D. 3682; March 9, 1925)

Income tax—Revenue act of 1918—Decision of court

1. Income—Dividends—Allocation.

Section 201 (e) of the revenue act of 1918, providing that "any distribution made during the first 60 days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable year," applies to the returns of corporations and not to the returns of individuals.

2. Same—Rate of Taxation.

Taxable dividends received by individuals during the first 60 days of the year 1918 are taxed at the rates prescribed by the revenue act of 1918. (Art. 1542 of Regs. 45 sustained.)

The following decision of the United States court of claims in the case of *Thomas M. Adams* v. *The United States* is published for the information of internal revenue officers and others concerned.

Court of Claims of the United States

Thomas M. Adams v. *The United States*

(Decided February 9, 1925)

Downey, judge, delivered the opinion of the court:

The plaintiff made an income tax return for the year 1918 in which he segregated dividends to the amount of $83,647, received during the first 60 days of 1918, from $51,097 of dividends received during that year, but subsequent to the first 60 days, and computed his income tax on the basis of the application to the first-named amount of the rates provided by law for the year 1917. The commissioner of internal revenue, holding that the entire income from dividends received during 1918 was subject to the prescribed rates for that year, levied an additional tax to the amount of $28,245.10, which plaintiff paid under protest and seeks to recover here, having first duly presented to the commissioner a claim for refund.

Plaintiff's reliance is upon paragraph (e) of section 201 of the revenue act of February 24, 1919 (40 Stat., 1057, at 1060), which, in part, is as follows:

"(e) Any distribution made during the first 60 days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable year; . . ."

And the contention is that the surtax on the dividends received by the plaintiff during the first 60 days of 1918 should have been taxed at the 1917 rate. The question is purely one of statutory construction without complications otherwise arising.

Section 201, subhead "dividends," appears, like the preceding section, under the head "general provisions," and, while section 200 bears the subhead "definitions," it is apparent that section 201 is also definitive in character and does not attempt to deal with applicable rates.

We are mindful of the established rules cited by counsel as to the construction of taxing statutes and if there were no room for the application of paragraph (e) otherwise than to the matter of applicable individual rates they would perhaps be of some force in determining construction, but that condition certainly does not prevail.

There is abundant application for the paragraph in question under the various provisions of the revenue act having to do with the returns by corporations of their fiscal affairs, so evident that a review seems wholly unnecessary, to which it may be added that the language of the paragraph applies itself naturally to the fiscal affairs of the corporation paying the dividends and not to the individual receiving them. The provision must certainly mean that "any distribution," referring necessarily to a distribution made by the corporation as dividends, within the first 60 days of any taxable year, shall be deemed, so far as the corporation is concerned, to have been made from the earnings or accumulated profits of a preceding year, and we find no room for its application to the individual income tax return of the recipient of those dividends. Extended discussion seems unnecessary.

We conclude that the plaintiff is not entitled to recover and have accordingly ordered that his petition be dismissed.

(T. D. 3677, February 27, 1925)

Income tax—Revenue act of 1921—Decision of supreme court

1. Income Tax—Income From Exports—Constitutionality.

An income tax levied upon net income from the business of exporting goods from the United States and selling such goods in foreign countries is not a tax laid on articles exported from any state in violation of article I, section 9, clause 5, of the constitution of the United States.

2. Same—Revenue Act of 1921—Constitutionality.

An income tax levied under the revenue act of 1921 upon net income from the business of exporting goods from the United States and selling them in foreign countries, even though the act be construed as exempting from such

tax the income of foreign corporations from like sources, does not deprive the taxpayer of his property without due process of law in violation of the fifth amendment to the constitution of the United States; nor does such a tax violate the rule of uniformity.

The appended decision of the Supreme Court of the United States in the case of *National Paper & Type Co.* v. *Frank K. Bowers, Collector,* is published for the information of internal-revenue officers and others concerned.

SUPREME COURT OF THE UNITED STATES. No. 320—OCTOBER TERM, 1924

National Paper & Type Co., plaintiff in error v. *Frank K. Bowers, Collector of Internal Revenue for the Second District of New York,*

In error to the District Court of the United States for the Southern District of New York.

(December 15, 1924)

Mr. Justice McKenna delivered the opinion of the court.

The case, displayed by the amended complaint, omitting verbal circumlocutions, is as follows: Plaintiff (plaintiff in error here) is and was at all of the times mentioned a corporation organized and existing under the laws of New Jersey. It is engaged in New York in the business of exporting, which is defined to be the purchase of personal property within the United States and the sale thereof without the United States, and has under the revenue act of 1921 been required to pay an income tax on its net income, part of which is derived from such foreign business.

At the same time and times there were foreign corporations engaged in like business of buying personal property within the United States and exporting and selling it without the United States. Under sections 217 and 233 of the revenue act of 1921 these corporations were wholly exempted from payment of the tax on the net income or profits accruing or derived from such business.

On the 15th of March, 1922, the defendant (defendant in error here), being collector of internal revenue, and acting as such, in pursuance of sections 230 and 205 of the revenue act of 1921, demanded of plaintiff the sum of $4,203.91, as due and payable from the plaintiff as one-fourth part of its income tax for the fiscal year ending March 31, 1921—that is, for the months of January, February and March, 1921—and threatened to enforce payment of that sum together with penalties and interest thereon provided for by the laws of congress.

Plaintiff, on the 15th of March, 1922, solely to prevent distraint and sale of its property, and protesting that no tax was due, and that defendant was without authority to exact or collect the same or any part thereof, paid the tax.

On or about the 6th of December, 1922, plaintiff, in accordance with law, made a claim in writing to the commissioner of internal revenue and demanded the repayment of the tax on the ground that it was illegally assessed, that more than six months had expired since the filing of the claim for refund as provided for by section 1318 of the revenue act, and that no part of the claim had been remitted or repaid to plaintiff, or to anyone, for its account. This action was then brought against the collector.

Judgment was prayed for $3,999.08, the amount of the tax.

Motion was made by the district attorney to dismiss the amended complaint on the ground that it did not state facts sufficient to constitute a cause of action.

The motion was granted on the authority of and upon the reasoning of *National Paper & Type Co.* v. *Edwards, Collector of Internal Revenue* (292 Fed., 633). Judgment was formally entered dismissing the complaint upon the merits.

To review this action and judgment, this writ of error is directed. The difference in treatment of domestic and foreign corporations in respect to business of sales in foreign countries, it is contended, is a "hostile discrimination and confiscation of property."

To sustain the charge, plaintiff asserts that its business and that of foreign corporations is done under exactly the same circumstances and conditions and that the discrimination hence resulting offends the "due process of law" provision of the fifth amendment. Cases are cited, and the deduction from them is declared to be that "our whole system of law is predicated on the general fundamental principle of equality of application of the law." (*Truax* v. *Corrigan*, 257 U. S. 312.)

Here the discrimination, if such it can be called, is in favor of foreign corporations in respect to taxation of earnings from business done in foreign countries. Clearly as to such business congress may adopt a policy calculated to serve the best interests of this country in dealing with citizens or subjects of another country, and may properly say that as to earnings from such business, the foreign subjects or citizens shall be left to the taxation of their own government or to that having jurisdiction of the sales. Even if we were to concede, as we can not, that the fifth amendment in enjoining due process of law requires as part thereof equality of taxation, it certainly could not be held to apply to a subject matter not within this country.

Regarding the purchase of articles of personal property within the United States and the mere fact of exportation therefrom, domestic and foreign corporations may be pronounced alike—may seem to be in the same relation to taxing legislation. But there is something else to consider, and its effect. There may be benefit in the inviting of foreign corporations into the United States—benefit in their investments and activities; and, as counsel for the government points out, the domestic corporation gets the power of the United States to protect its interests and redress its wrongs in whatever part of the world its business may take it. And as the government further points out, the foreign corporation must look to the country of its origin for protection against injury and redress of losses occurring in that and other foreign countries, and not to the United States. The government, therefore, contends, and rightly contends, that domestic corporations are required to pay a tax on their incomes from all sources while foreign corporations are taxed only on their income from sources within the United States because, to repeat, only that income is earned under the protection of American laws.

And we understand a further contention to be that the discrimination is the fact that makes the tax on plaintiff a direct burden on and impediment to its business of exporting, "in violation of paragraph 5 of section 9 of article I of the constitution of the United States, which provides that 'no tax or duty shall be laid on articles exported from any state.'" The alleged discrimination is said in some way to emphasize and increase the violation of that paragraph of the constitution.

So far as the invocation of paragraph 5 depends upon discrimination, what we have said disposes of it; if it be independent of discrimination and based upon the fact of a tax upon exports, it is completely answered and disposed of adversely by *Peck & Co.* v. *Lowe* (247 U. S. 165), and needs no further comment.

The difference in the legislation, we think, is constitutional and justified by the considerations which we have submitted. The judgment is affirmed.