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Editorial

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EDITORIAL

The Broken Promise

When the first income-tax law was passed by the congress of the United States there was a general impression, which in many cases amounted to a positive affirmation, that whatever might happen the returns of taxpayers would be regarded as confidential. One of the earliest objections to the whole scheme of a direct tax upon income was the likelihood, or perhaps one should say the possibility, that affairs of purely personal interest might become public property. This fear was set at rest by the distinct understanding of both the legislative and administrative ends of the government that there should be no breach of confidence. So we have gone along for several years paying our taxes with the best grace possible and have felt little doubt that the exposition of personal affairs would always remain a matter between the taxpayer and the department charged with the duty of collection. It is practically certain that had there not been positive assurance of secrecy in regard to tax returns the sixteenth amendment of the constitution would never have been approved and income-tax legislation would never have passed either house of congress. It was only because the public was explicitly guaranteed against publicity that it was possible to bring about our present system of direct federal taxation. Now, however, the 1924 law ignores all earlier promises and anyone who will may see the return of any taxpayer. The whole thing appears utterly objectionable from every standpoint except that of the idly inquisitive.

The Foolishness of It

And then it must be remembered that the amount of income tax paid by any individual taxpayer is really no indication whatever of a taxpayer's income. Perhaps if returns were based upon a series of years and an annual average derived therefrom there might be some approximation of an accurate reflection of the financial position of a taxpayer. But this is not the case.

The man who pays a tax of $10,000 this year may have paid $100,000 last year and may pay another $100,000 next year and yet all the time be in receipt of practically the same income. The deduction of capital losses is so useful a feature of the law that taxpayers who understand its application are frequently able to reduce the amount of taxable income by losses which have really accrued over a period of years but are charged against the receipts of one year. The wise and cautious taxpayer who has capital gains is able to avail himself of the 12½% rate of taxation on such gains. Consequently although there may have been gains accumulating for years which are returned in one year the actual amount of tax paid on that account may not have a very substantial effect upon the total tax. Furthermore, so long as the federal laws may not levy a tax upon certain classes of securities, notably those of states or sub-divisions of states, it is quite the ordinary practice for persons of wealth whose normal and surtaxes would bring the rate of return from investment to a low percentage to invest the larger portion of their capital in tax-exempt securities. The revenues received from these securities, of course, do not appear in the tax return. The exemption of certain securities from taxation and the positive requirement for the taxation of all earned income above a small minimum have been the subject of a great deal of discussion in the press and also in congress. The secretary of the treasury, with the wisdom for which he is so well known, has endeavored to bring about something like a fair adjustment of the taxes on different classes of income. But congress will have none of it and anything which looks like a relief, even if it be no relief, from the burden of taxation on larger incomes, is immediately cast out by the legislators on Capitol hill. It really makes no great difference to many members of congress whether a law actually taxes heavily the larger incomes or not. The great point is that the law shall be so expressed as to induce the constituent back home to believe that congress is against the rich and in favor of the poor.

Effects of Taxation

The British Committee on National Debt and Taxation recently requested several prominent accountants to submit a statement containing their opinion of the effects of taxation. The opinion was prepared by Sir Arthur Lowes Dickinson, a member of the council of the Institute of Chartered Accountants in England and Wales, Sir John Mann, a member of the council of the Glasgow Institute of Chartered Accountants and Actuaries and representing the joint committee of councils of the chartered accountants of Scotland, and George Stanhope Pitt, president of the Society of Incorporated Accountants and Auditors. These accounts represented organizations having a total membership of 12,442. The report which was presented is largely confidential and it is not permissible to publish more than a summary. The matter, however, is of great importance and much of it will have a bearing upon questions likely to come before the next session of congress or before the new congress which will assemble in 1925. The effects of taxation are largely similar in the United States and in Great Britain, and indeed in all civilized countries. The accountants were asked to express their opinions upon the effects of existing taxation and apparently suggestions for alterations were not sought. Under the heading "general effects of taxation upon trade and industry" the accountants referred to the theory that taxation should not be a charge upon trade and should not have effect upon prices, but they go on to say:

"In actual practice, however, high taxation has had a considerable influence in further raising the prices of commodities. There has been a scramble for higher wages, salaries and prices, in which only those with fixed incomes have been unable to take part, and in which old standards have disappeared; as a general rise of prices due to other causes has deprived the consumer of basic standards to which he had become accustomed over a long period of years. In a few years general prices have increased up to a maximum of nearly three times those prevailing for many years before the war and have fallen again to about twice that level. Under these conditions trade and industry have been apt to consider taxation as part of their costs of production; and have tried with some success to recoup themselves by raising prices, not only to the extent of the taxation, but so as to include a profit on the taxation. This tendency is, however, limited by the ability of the consumer to pay the prices and by the effect of competition in keeping prices down.

"The effect of high taxation upon the profits of trade and industry is considerable. In regard to existing business it causes:

(1) reduced available profits, and, or
(2) increased prices

"In the former case it directly reduces either or both the amount available for extension of business and the amount distributed to shareholders and partners, thus in the majority of cases reducing the savings of the individual taxpayer.

"In the latter case it either:—

(a) forces a corresponding reduction in consumption, i. e., a less demand for commodities, and so ultimately reduces production (and profits) and increases unemployment; or
(b) reduces the savings of the individual consumer available for investment in business enterprises.

"So far as the profits of an industry are distributed the income tax paid is passed on by deduction to the owner or holder of the investment. If dividends are paid free of tax this is equally true, except that, without changing the nominal rate, a higher real rate may be distributed than would otherwise be the case.

"The balance of profits not distributed has borne its share of tax, and the amount retained in the business is reduced thereby.

"In effect therefore the accumulation of reserves in the business may be reduced in two ways:

(1) by increased dividends being paid to shareholders to make up for the high rates of taxation;
(2) by the high taxation paid on the profits not distributed.

Taxation and National Debt

The next subject of consideration is the "effect of taxation on capital available for industry." This is followed by the effect of taxation on savings, on enterprise, on foreign investments, on foreign investors, on exports, the general effect of death duties and then by a discussion of the relation of taxation to repayment of the national debt. Under this caption the accountants say:

"The rate of repayment of debt (both funded and floating) should be regulated by the excess of production over consumption, that is, by the net savings of the nation. But allowances must be made for accumulation of capital (a) to provide for growth of population; (b) to replace capital lost in the war; (c) to provide for new undertakings; and (d) to permit improvements in the standard of living."

And again:

"Repayment of debt should be steady and continuous in bad times and good, so as to maintain national credit and tend to bring about a steady reduction of interest rates; without disturbing the stability upon which the progress of industry and well-being depends. Slow repayment of debt retards the recovery of national credit; but quick repayment may deprive industry of necessary capital and slacken individual effort. Statistics before the committee will doubtless afford a guide for suggesting what is a reasonable rate of reduction."

Conclusion of the Matter

The report then proceeds to consideration of the effect of government expenditures upon taxation and their effect upon customs and excise duties on trade and industry. The conclusion of the report contains the following comment upon the effects of taxation generally:

"The effect of high taxation is to reduce annual savings, to restrict enterprise, to drive both domestic and foreign capital out of the country, to raise domestic prices, to reduce consumption and to discourage thrift.

"It is a sound principle that taxation should be limited to such a proportion of the national savings as will permit the accumulation of absolutely necessary supplies of additional capital, as well as a steady reduction of the national debt.

"To attain this object not only must the people practise thrift so as to increase savings and to repair war waste; but also the government should exercise the strictest economy in every direction; make every endeavor to use anticipated surplus for the purpose of reducing taxation; and avoid or postpone all expenditure, even upon desirable objects, that is not absolutely necessary.

"It is equally necessary that every effort should be put forward by all classes to increase production, and government policy should be directed to this end. To what extent government action should regulate or leave unaffected trade-union policy, which limits individual output, is not a matter within our compass; though that policy is of far-reaching consequence as regards cost of production and ability to compete with imported articles and also in the foreign markets of the world.

"The loss of capital during the war and the lower production per head, due to many causes and, in part, to the effects of the war, must tend to reduce the standard of living; and attempts to increase or even maintain that standard cannot succeed without greatly increased effort. High taxation of annual savings does not promote these increased efforts, and the heavy taxation of large incomes has a specially deterrent effect on new enterprises.

"Any attempt to tax past savings or to increase the national debt for objects which the nation cannot afford to carry out from its annual savings can only aggravate the situation and prevent that recovery which is essential to the restoration of pre-war prosperity. The success of such attempts must mean a transfer to the government of a part of the capital of trade and industry and lead to further loss and expense if, as is believed, the efficiency of government ownership and management must be less than that of private enterprise.

"Taxation on a scale which must seriously hamper trade and industry is inevitable as a result of the war. Its ill effects may be increased or mitigated according to the manner in which the proceeds are employed and the way in which the burden is distributed. To minimize the effects of war, reductions in personal expenditure, a high scale of individual effort and production, and increased savings resulting in additional capital are necessary. Economy on the part of government and a scale of taxation which does not reduce the incentive to private savings are, it is submitted, two essentials which would be most effective in reducing to a minimum the sacrifices needed to make good the ravages of war."

It is to be hoped that this extremely important statement will soon be released for complete publication. The extracts which we have quoted will indicate the value of the report and also indirectly emphasize the increasingly important influence of the profession in national affairs. The participation of accountants in the affairs of the United States and of Great Britain and its dependencies is spreading with a rapidity which is eminently gratifying but often overlooked. The effect upon national finance must be beneficent.

A Tax on Thought

A correspondent who has been much disturbed because of the provision of the income-tax law of 1924 imposing a tax on donors of gifts inter vivos says a great many things which are of no particular importance. It is difficult to understand whether he is in favor of or opposed to the gift tax, but there is one brilliant saying which should be preserved. He says:

"Without saying anything pro or con about this gift tax—for it is still all too new—we all must grant it is a big step in some direction. Some day in this country they will place a tax on thinking and a lot of our best citizens are going to be surprised to discover that they will not even have to file a return."

Single Partnerships

The first rule of conduct of the American Institute of Accountants reads as follows:

> A firm or partnership, all the individual members of which are members of the Institute (or in part members and in part associates, provided all the members of the firm are either members or associates), may describe itself as "Members of the American Institute of Accountants," but a firm or partnership, all the individual members of which are not members of the Institute (or in part members and in part associates), or an individual practising under a style denoting a partnership when in fact there be no partner or partners or a corporation or an individual or individuals practising under a style denoting a corporate organization shall not use the designation "Members (or Associates) of the American Institute of Accountants."

There seemed to be a certain amount of misunderstanding of this rule when it was first adopted, but it is being enforced and members are abstaining from describing themselves as what they are not. The question, however, frequently arises as to the use of the designation "certified public accountant," more especially in the case of a firm. For example, may Brown and Jones describe themselves as certified public accountants when only Brown is certified? Or may John Smith & Co., a concern of which John Smith, C. P. A., is the only partner, be described as certified public accountants? In both cases the answer must be No, if the one who answers is imbued with the right ideals. It is misleading to describe a firm as certified public accountants unless all the members of it are certified, and it is equally misleading to designate a firm in the plural when in fact it is singular. There may be some unknown reason why the words "and company" are considered to have greater weight than the mere name of the practitioner, but there certainly can be no excuse for describing one person as two or more certified public accountants. It seems that the best way in which to handle the matter in the case of John Smith & Co. is to place at one side of the letterhead—of course in these days there would not be any other form of advertisement—the name of the head of the firm with the initials C. P. A. appended. This plan is being adopted by many accounting firms whatever may be the number of partners.

Regional Meeting at Toledo

An important regional meeting of the Institute is to be held at Toledo on December 6th and the committee on arrangements has requested that particular attention be drawn to the meeting. All who are interested in accounting are urged to attend. Members of the Institute, of course, are expected to be on hand if they are anywhere in the vicinity, but it may be well to emphasize the general nature of the meeting. Regional meetings are not restricted to those who are members of the organization. The purpose of a regional meeting is to afford an opportunity for informal discussion of matters interesting to the profession and to enable accountants to meet and know each other. Toledo is a central point for a large industrial area and there are great numbers of accountants in cities which can be reached in a night's ride. The meeting will take place at the Lasalle and Koch auditorium beginning at 10 o'clock in the morning.

"The Accountant's" Jubilee

Accountants everywhere in the English-speaking world are more or less familiar with the weekly magazine *The Accountant* published by Gee & Co. of London. It is the best known of weekly accounting publications and its influence has been widespread. Even here in America where there are many different ideas in regard to the practice of accountancy *The Accountant* has many subscribers and its opinions are widely read. Now *The Accountant* has completed its fiftieth year of publication and the issue of October 11th is described as a jubilee number. THE JOURNAL OF ACCOUNTANCY congratulates its British contemporary upon its accomplishments and upon its venerable age and wishes for it an indefinitely extended term of life and an increasing measure of success.

The Ideal Bank Auditor

Careful students of the pronouncements of bankers may occasionally have run across expressions of opinion in regard to what the public accountant should be and do. It is not altogether outside the range of possibility that some bankers have been slightly overfond of preaching to accountants. Of course, all this is a thing of the past and the banker and accountant are working together harmoniously and it is only in the very remote parts of the country that a banker could be found who would venture to adopt the didactic tone when addressing a group of accountants. At least we hope that this is so. Now the accountant is beginning to arise from his place at the speakers' table and inform the banker of some important things. In due time the sentiments of both the banking and accounting professions will have found an average and there will be fair understanding. Unfortunately, however, there are some employees of banks who have not always worked harmoniously with public accountants who have been engaged in bank audit. There have been accountants who have expressed the opinion that the ideal bank auditor, meaning by that the internal auditor of the bank, had not yet been born. Edward E. Gore, speaking at a recent meeting in Illinois described the ideal bank auditor, who, he says, should be a rare combination:

> "He should be, first of all, a thorough-going accountant with an intimate knowledge of banking, extending from the opening of an account to the payment of a loan, through all the departments that are concerned with banking transactions. He should be tactful to the end that he may discharge his duties without irritation of those with whom he comes in contact. He should be able to impress upon all with whom he has dealings that he is working for the bank and that his own personality is submerged in the service that he renders. He will have opportunity to use to the full extent knowledge of securities and their values, of loans and their collectibility, of customers' balance-sheets and the stories that they tell. He should have inventive capacity in order that he may discover and apply new methods for the economical handling of the business of his bank. He should so conduct his work as to make it thoroughly understood by every other member of the bank's organization that he is there for the purpose of protecting the integrity of the bank's transactions and guarding it against the losses which would indicate carelessness on the part of its recording employees and carelessness also on the part of those entrusted with the handling, lending and investment of its funds. These qualifications would indicate that the bank auditor may well be a man of wide experience and thorough education in banking as well as one who is utterly familiar with accounts and their significance. The bank auditor may well be one of the most important functionaries of the bank. He should be the repository of knowledge of his bank's affairs to which those entitled thereto may have recourse for all information that is desired concerning such affairs. If a bank auditor, equipped with the experience, knowledge and personal fitness which has been indicated as necessary, is given the freedom of action and independence of thought which is his due he can do more to insure the fidelity of the bank's employees and the safety of its funds than any of its other officers or employees."

Commissions Again

From time to time it seems to be necessary to draw attention to the question of accountants' commissions although we do not believe that the number of accountants who would accept commissions can be very large. That there must be some, however, who are so lost to a sense of propriety is indicated by the efforts which continue to be made by stationery houses and other commercial organizations. If every accountant would immediately repudiate the whole principle of commission we should probably have an end of it. It might be a good plan for the accountants of the country to enter into an agreement to refrain from patronizing any commercial house which offers a commission to accountants. Perhaps this would be in contravention of the Sherman act, but we commend it to the consideration of all accountants who think aright. At the present moment there is before us a circular letter headed "Special Accountants Commission $33\frac{1}{3}$ per cent." It is an interesting letter and we should like to publish it in full, but we rest content with the following extracts. It is one of the most pernicious exhibitions of indecency which we have seen for some time. It will be noted that this letter is addressed to gentlemen:

> "Gentlemen: We have secured the exclusive agency, for the entire line of the . . . company.
>
> "The . . . line of loose-leaf ledgers, binders, columnar sheets and ring books comprises one of the largest assortments and highest grade goods manufactured.
>
> "Believing you are in a position to use a considerable quantity of these goods when installing systems for your clients we have arranged to allow public accountants a special discount of $33\frac{1}{3}\%$ from the regular retail price of these goods. Please remember this is a *confidential discount to accountants* and in no instance to be quoted to the customers, otherwise we reserve the right to immediately cancel your discount.
>
> "You may select the goods personally or bring your client to our store, goods will be delivered and billed to your customer and check mailed covering your commission.
>
> "By this arrangement your client pays no more than the regular retail price of the merchandise, which is less than elsewhere. We offer accountants this discount to secure their business and compensate them for placing their orders with us.
>
> "We carry in stock for immediate delivery the largest line of blank books and loose leaf devices in . . . . . Call and inspect our line, it will prove mutually advantageous."

Casting out "Expert"

A reader writes:

> "The appellation 'expert accountant' appears to me incorrect as applied to one who is a professional public accountant and I doubt if any member of the Institute would so style himself. Even the courts are drawn into the use of the term presumably thoughtlessly and on account of its common usage as shown in your editorial on page 282 of October JOURNAL, where you quote from a case in the supreme court of Montana. It seems to me that its use should be omitted entirely in the pages of THE JOURNAL and if quoted be shown in italic or preferably inverted commas. This is just passed along to you as a suggestion and needs no reply."

We have an abhorrence of quotation marks and no great affection for italic type, but everyone will agree that the word "expert" should suffer some kind of punishment. It is becoming so sadly over-worked and misused that the time is not far distant when the one who is accused of being an expert will have ground for action. And when the word "tax" is prefixed, any method of defense will be justified.