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Income-tax Department

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Income-tax Department

EDITED BY STEPHEN G. RUSK

Our attention has been arrested on numerous occasions of late by the interest that is being evinced by certain individuals and newspapers as to the administration by the treasury department of the provisions of section 220 of the revenue act of 1921.

This section, it will be remembered, imposes an additional tax of 25% upon income of corporations which permit the accumulation of gains and profits beyond the reasonable needs of their business in order to prevent the levying of the surtaxes upon their stockholders. It gives the stockholders the option of being taxed upon their proportion of the earnings though undistributed, in lieu of the specific additional tax above mentioned. Former revenue acts have had provisions of a similar nature but undoubtedly have been found unenforceable, at least we have heard of very little action toward the collection of these taxes.

It appears from the language of the section that a corporation will be subjected to this tax if there is evidence that it was formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders. Prima facie evidence of such purpose is the fact that it is a mere holding company, or that gains or profits are permitted to accumulate beyond the reasonable needs of the business.

One can foresee the difficulties the administrative officials will have in imposing this tax, and the elaborate statistics that will be prepared by the department in order to prove that the accumulated gains are beyond the reasonable needs of the business. When consideration is given to the power this section of the law places in the hands of the government and the extent to which it takes out of private control the management of the fiscal policies of corporations, it seems highly probable that upon a test being made it will be found impracticable if not unconstitutional.

In view of the general business conditions now being faced by corporate management, with the uncertainties of the future to face and the need of conserving its resources it will be difficult for the government to prove the unreasonableness of the amount of the accumulation in the majority of cases.

The treasury department is being urged to action upon this particular tax provision, and question is being raised as to stock dividends declared as if the declarations of stock dividends were made to forestall the imposition of this tax.

As to the avoidance of tax under this section by the declaration of a stock dividend, we are of the opinion that as a stock dividend has been held not to be a distribution of gains and profits, the declaration and payment of such a dividend will not prevent the imposition of the tax under this section. The fact that unreasonable accumulations of gains and profits have been capitalized by the issuance of stock certificates to represent them, obviously would not prevent the functioning of this section and those advancing this theory do not seem to have taken account of the language and intent of these provisions.

The Journal of Accountancy

Question has been raised as to the effective date of this section. Some maintain that it is November 23, 1921, the date of the signing of the revenue act. Some maintain that its effective date is January 1, 1921, the date the other taxing sections became effective. We believe there is some question as to which of these dates is the right one, though we have thought November 23, 1921, is the effective date.

Opinions of our readers are solicited upon the provisions of this section of the law.

(On account of extreme pressure on space in this issue we omit publication of any treasury rulings.)