

4-1921

Book Reviews

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Recommended Citation

Lawton, W. H. (1921) "Book Reviews," *Journal of Accountancy*. Vol. 31: Iss. 4, Article 10.

Available at: <https://egrove.olemiss.edu/jofa/vol31/iss4/10>

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Book Reviews

FEDERAL INCOME-TAX PROCEDURE, 1921, by ROBERT H. MONTGOMERY. The Ronald Press Co., New York. 1205 pp.

When the reviewer ventured to suggest some years ago in the course of review of Montgomery's *Income-tax Procedure, 1916*, that the prospective flood of treasury decisions might warrant a two-volume edition of this work in the near future he little foresaw this day when the matter has expanded to a 1200-page manual on income-tax procedure—to say nothing of the second volume covering the excess-profits tax. And now Col. Montgomery grimly hints in his preface that proposed enactment of a general-sales tax without preliminary consultation by congress with public accountants (which is unlikely) will result in “a tremendous aggregate of professional work,” a statement which makes one tremble at the prospective size of the next edition of *Income-tax Procedure*. There are those who hold that the income tax is the ideal method of raising public revenue because it is the fairest and simplest way to extract money from the taxpayer. Fairest it may be, but simplest? Could any method be devised (always excepting the marvelous excess-profits tax, of course) that would have more far-reaching ramifications and bring up more puzzling complications? Let Col. Montgomery's twelve hundred pages of law, decisions and comments answer.

Those who have been obliged to keep posted on the income-tax laws from the beginning will undoubtedly echo the author's statement (page 15) that “the 1918 law is simpler and more equitable than its predecessors,” but it is doubtful if the thousands who were caught in the net of lowered exemptions will agree. In his own experience the reviewer has been amazed at the inability of otherwise shrewd business men to understand the purport of apparently plain questions on the returns. Some of this may be due to thick-headedness, to be sure; but it must be admitted that often the highly technical language of the return is partly to blame. For instance, the first instruction on the small form has misled many to believe that no return was necessary because the average small retailer or wage earner takes net income to mean what he has left of his total receipts after paying all his expenses, including personal, for the year. Even Col. Montgomery fails to make the point clear in his definition of net income (page 27) when he uses the broad term “less deductions for expenses” without the important qualification “incurred in business or trade.” Surely it would be an easy matter to state on the return in parentheses “i. e., total income less business expenses.” To be sure this is not a comprehensive description of what the law regards as deductible expense, but it would be close enough to put the unwary on notice.

As a matter of course the author follows the order and classification of items of income and expense used in the statute, which is not the order followed on the returns. Familiarity with the law and the form enables the experienced accountant to turn to the pages he may require, but we should like to see the manual follow the order of the return. It would be

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more serviceable to the neophyte or the ordinary business man. At all events, an additional contents-page indicating the pages covering each schedule of the return would prove a time saver.

It is a happy suggestion (page 87) that corporation returns should be prepared on forms $8\frac{1}{2}$ x 11 inches in size and it might well be extended to partnership and individual forms. Typewriters are widely used these days and with the advent of the portable machines now being put on the market by several manufacturers their use promises to become well-nigh universal.

The instructions as to making returns under oath (page 89) prompts the reviewer to ask a question which has been on his mind for some time: Why should the government require returns to be attested at all? Beyond adding to the income of thousands of notaries public no particular good seems to arise from it. The income-tax bureau itself certainly disregards it whenever it calls upon a taxpayer to substantiate his return with additional information. It would seem as if signing with a competent witness would be sufficient to establish judicially the fact of signature. In the early days of withholding and monthly returns, when it really seemed as if every communication of any kind with the government had to be sworn, the writer had a voluminous and testy correspondence with a patient but helpless collector on this subject, in the course of which he showed that the withholding, payment and returning of a tax of \$1.75 cost the corporation he served \$5.20 in notarial fees. Things have improved since then, but there is still a bit of the old red-tape about the present regulation which requires a trading concern to have the inventory attested as well as the return. Considering that the signer of a return swears to the accuracy of everything in it, including the inventory in schedule A, this seems superfluous, to say the least.

A question interesting to public accountants is touched upon by the author in his remark (page 125) "it should be noted that the plenary power of examination" (by treasury officers) "extends also to persons other than the taxpayer who have knowledge of his income." What becomes of the professional secrecy of the public accountant in such case? The author is silent on this point. As far as the reviewer can ascertain, it seems to be the general opinion in the profession that the public accountant cannot plead privilege, as a lawyer can, if he is called upon to answer the questions of a treasury agent. This might give rise to a curious anomaly. A taxpayer is sometimes obliged to consult his lawyer as well as a public accountant in preparing his return. In case of later investigation the lawyer could plead privilege and refuse to answer, in which he would be upheld by the courts, whereas the accountant, who may have acted upon the advice of the lawyer, would be compelled to answer. It is obvious that if this is good law and practice there can be no confidential relationship between accountant and client in income-tax matters. This problem is serious enough to warrant the attention of the American Institute.

The inequity of requiring the recipient of tax-free bond interest to return the 2 per cent. paid by the corporation is discussed by the author with his usual clarity. As he points out, the corporation in effect pays the

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8 per cent. normal tax for the stockholder but the latter is not obliged to include this tax as additional income. The reviewer would go further and say that the taxing of bond interest to the recipient while exempting the receiver of dividends is also inequitable. Following the judicial fashion of the day of looking through the form to the substance, it is common knowledge and common sense that interest on bonds is as much a part of profits as dividends. This is not orthodox, but it is true. Interest paid on current loans may be a legitimate business expense, but interest paid on bonds which are a part of the permanent capitalization of a corporation is not an expense but a guaranteed, limited share of the profits. It would be better and more equitable practice if the corporation income tax were levied on net earnings *before* interest. Then the bond holder would be placed in the same position as the stock holder and relieved from the normal tax on bond interest. There would then be no question of covenant tax-free interest to worry and obfuscate the recipient of the interest, for the tax on the net earnings of the corporation would not be a tax on the bond interest *per se*. This change would necessitate still another definition of net income as applied to corporations, but congress has become quite skilful in definitions of late years. The increased taxes from corporations would take the place of the excess profits tax in great measure. If reports from Washington are reliable there is to be an increase in corporation taxes anyhow, and this method would have the advantage of doing away with the present cumbersome and irritating method of collecting and returning tax-free interest.

Col. Montgomery handles the subject of reasonable salaries, bonuses and Christmas gifts in a vigorous and common-sense way that one wishes would clear the rather foggy atmosphere in the tax bureau. There is a slight error in stating that the case of the *U. S. v. Phila. Knitting Mills* was brought under the 1917 act. It was under the 1909 excise-tax law, but nevertheless, and notwithstanding the letter of Special Assistant United States Attorney Walnut contending that the decision of the United States district court did not apply to the income-tax laws, the principle laid down by the court is broad enough to cover them all. The gist of the decision is that while congress undoubtedly had the power to limit the amount of reasonable salaries or compensation as deductible expense it did not exercise such power; therefore no such power of deciding on the amount of reasonable compensation to be allowed was delegated to the commissioner. Subject to affirmation by the higher courts this practically nullifies this clause in the 1909 and all subsequent acts. At present the test of deductibility is, in the author's words, "whether or not they are legal and are in fact payments purely for services." The reviewer, however, cannot follow Col. Montgomery in his further doubt that "congress may delegate this power" (of limiting the amount of deductions for salaries) "to the commissioner." He goes on to say: "If this discretion may be delegated to him, why could not congress go a little further and say that corporations and individuals shall pay a tax on a net income which shall be determined by the commissioner of internal revenue?" What else has congress done in

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sec. 1317 where it is provided that the commissioner "may, from his own knowledge * * * make a return * * *"? It is a penalty clause to catch slackers, to be sure; but the power to fix the amount of net income is certainly delegated to the commissioner.

On page 655 the author refers the reader to the second volume of his manual for a form of reconciliation statement important to any taxpayer who keeps books. This will not trouble the public accountant who will naturally have both volumes, but is it not rather an imposition on the individual or partnership to be obliged to buy the second volume which deals with a subject confined to corporations? The form should have been given in this first volume as well.

W. H. LAWTON.