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Editorial

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Editor

EDITORIAL

Income Tax Inequities

Since the enactment of the first of the present series of income-tax laws in this country it has repeatedly been alleged in defence of the laws and their administration that we must not expect perfection at once, and that in the light of experience sharp edges would be worn off and rough places made plain.

It is now approximately six years since the enactment of a federal income-tax law in 1913, and it must be admitted that there has been a gratifying indication of a desire to improve both the form of the laws and the method of administering them. This is not to admit, however, that we have approached within hailing distance of perfection. Indeed, we are so far from it that few of us ever expect to realize our hopes.

There are one or two obvious injustices in the present system of laws which could be corrected without a great amount of amendment. If some of them were removed it would be greatly to the relief of the far too heavily burdened taxpayer.

It is well enough to pay heavy taxes during a time of war or in a period of reconstruction. We all expect to continue to pay taxes of an abnormally high character for some years to come, but we may justly feel that the government and congress should do everything in their power to place taxation upon as nearly fair a basis as can be discovered.

One of the glaring injustices of the present laws is the general classification of all increment as income. There are various sorts of increases in one's assets which may not be income in the true sense of the word.

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For example, capital profits under the present laws are regarded in the same category as income from business or investment. This is not as it should be.

As an illustration, let us assume that A purchased in 1912 a piece of property for \$10,000. In 1919 he received an offer of \$50,000 for the property. Under the law, as it stands, A, if he sold the property, would be required to return \$40,000 as income of the year 1919, when as a matter of fact the increment in value had been accruing from the date of purchase to the date of sale. In other words, A would be compelled to pay surtax at the highest rate ever called for in this country upon an increase in assets, only a portion of which had accrued during the period when such high taxes were in force.

Another illustration may be found in the case of the shareholders in corporations whose stocks are listed on public exchanges or otherwise the subject of sale. In 1912 stock in the Blank Steel Company may have been quoted at \$40 a share. In 1919 it would be quite reasonable to expect such a company's shares to be selling in the neighborhood of \$150. The shareholder might be anxious to sell his shares, but if he did so he would be obliged to return \$110 a share as income of the year 1919, when in reality the advance in value had been in progress since the beginning of the war and had kept pace with the growth of demand for steel products.

We believe that accountants everywhere will agree that such profits as those mentioned in the foregoing illustrations should not be classified as income in the strict sense of the word—that is to say, income for the year of return. Perhaps the treasury would be ready to recommend an amendment of the law separating increases of capital value from ordinary income if the matter were properly presented to the department. With the experience which officers of the bureau of internal revenue have had it must be apparent to them that there is need for a revision of the laws so as to permit the bureau to differentiate between what might be called income of the year and capital profits.

Among earlier rulings of the department there were decisions which permitted profits of the kind mentioned to be prorated over the years from purchase to sale, but latterly there has been a

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complete departure from this principle and all increment is regarded as pure income.

One of the most apparent and undesirable effects of the law in this particular was the recent bull market on stock exchanges throughout the country. It is generally admitted that while there has been justification for a considerable advance in quotations for stock of industrial companies, the advance has been out of proportion to the increase in intrinsic value of the shares. It is also recognized that one of the most potent factors in the advance has been the scarcity of stock. People who own shares of stock in the great industrials find themselves unwilling to take the profits which appear on paper because if they do so they will be compelled to pay surtax on an increase in value not entirely accruing during the year of return. The result is that enormous quantities of stock are held up by owners who would be glad to sell if they could do so without being compelled to part with practically all the profit. It may not be too much to say that if there had been some fair and easily computed tax on capital profits the number of shares available for investment would have been greatly increased and market prices would not have risen to a point at which many economists feel they are unsound.

It may not be stretching the point too far to attribute to the same cause part of the enormous increase in real estate values and the consequent increases in rentals. Persons who hold real estate upon which there is a paper profit of considerable magnitude cannot sell and realize any profit at all without adding enough to the already enhanced value to cover payment of income tax. To put it in another way, property values are now quoted at prices which will cover income tax up to the highest rate.

There have been various suggestions as to the manner in which taxation could be arranged to meet the necessities of the case. It has been proposed that there should be a pro-rated tax based upon the normal and surtaxes of each succeeding year and computed on the income returns of each individual or corporation concerned. This might be perfectly fair but it would probably require an entire college of actuaries to work out the computation, and when the result was reached no one would know whether it was right or wrong.

It seems to us that a fairer and more easily enforced law would be one which would separate annual profit from profit accruing over a series of years and providing that in the latter case a special rate, either low or high, as might be necessary, should apply, with the understanding, of course, that it should not be higher than an average of the taxes during the years from 1913 onward.

In the case of stocks the increment in price depends largely on the surplus. When a sale is made it would be fairer to impose a surtax based on the rates in force in the years when the surplus accrued. This would be in line with the 1917 law which so taxed dividends.

This is a matter which is of the utmost importance to all taxpayers, and therefore to accountants, and we bring it to the attention of our readers in the hope that some definite suggestions may be made which will appeal to the authorities in Washington.

Filing Tax Returns

It appears from recent rulings of the treasury department that there will be no general extension for the filing of income-tax returns except in the case of "absence or sickness." In such cases the rule which applied this year, namely, the payment of 25 per cent. of the estimated tax and presentation of a guess at the amount of taxable income on March 15th, will be followed, and the complete return may be filed within thirty days thereafter.

The experience of this year is likely to be duplicated in 1920. There may not be quite so much confusion in the compilation of returns nor such protracted delays in the issuance of forms, but the whole transaction is extremely complicated and there is no possibility whatever that all corporations in the country will be able to make their returns within the two and a half months provided by the law.

Last year extensions were not granted until the eleventh hour. Surely the treasury department could give attention to the matter now and thereby assist taxpayers to make their returns with proper care and without undue haste. The result would be to the benefit of the government, as well as to that of the taxpayer.

There is a further complication which will increase year by year. When the laws were first enacted taxpayers were inclined

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to call upon lawyers, bankers and all sorts and conditions of men to make out their tax returns for them. It gradually became apparent, however, that the professional men most capable of handling the matter intelligently were the accountants, and the burden of tax preparation has been accumulating rapidly upon them. This year the amount of work was almost overwhelming, and in 1920 there is every reason to expect a further increase in the demand for accountants' services.

The profession is rendering a splendid service to the government and to the taxpayer, and it is only right to expect that the department charged with the administration of the law will cooperate to the utmost extent with the men upon whose shoulders chiefly falls the duty of tax return preparation.

The best solution of the difficulty is for the department to adopt last year's plans and accept tentative returns accompanied by twenty-five per cent. of the estimated amount shown. No detailed computation should be required. Thus the treasury will get its full twenty-five per cent. on time and six per cent. interest on the amounts by which income may be underestimated.