Interest and the Corporation Tax

R. P. Marsh

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

Part of the Accounting Commons, and the Taxation Commons

Recommended Citation

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.
Interest and the Corporation Tax.

R. P. Marsh, C.P.A., of Savannah, Ga., under date of November 10, published a circular comment on the Corporation Tax, from which we make the following extracts:

I think that a majority of the managers of corporations have supposed that the tax was to be assessed on net profits, instead of upon cash receipts and disbursements; therefore it will be with considerable surprise to many managers, unless they are informed differently, when the discovery is made upon making returns upon the official blanks (which I understand have not yet been issued), that in some instances the net earnings received will be greatly in excess of net profits.

To explain how this can be I ask you to consider the possible operations of many cotton mills this year. Owing to the high prices of raw cotton, most mills will probably not have as large a stock of raw material or manufactured goods on hand on December 31 next, as was brought over from 1908, on January 1. Consequently the income received this year will include the proceeds of cotton, and cotton manufactures, bought or produced last year. If the value of the merchandise stock on January 1 was $200,000.00, and will be only $20,000.00 on December 31 next, the net income of the corporation, in the meaning of the law, will be swelled by $180,000.00, which certainly is not profit, and the cost of which cannot be included with expenses, not having been paid out during the year.

The reverse will be true, in some instances, and doubtless many corporations will not be assessed anything during the year 1909, although earning substantial dividends, because their stocks of merchandise or material have been increased during the year. The law requires returns for gross income received during the year from all sources, with allowances for ordinary and necessary expenses actually paid out during the year. No provision is made for income received from sales of stock on hand at commencement of year, or for "expenses actually paid out" for merchandise remaining unsold on December 31. Indeed, to ascertain such figures would be almost impossible in many, if not in most businesses, except by the customary methods of inventories, which however is clearly not permitted by the law.

It will not do to conclude that the excess taxation from this cause in one year will be equalized in the next. There can usually be no such equalization because there is no provision for deduction from succeeding years of "net income received" of this year's excess of "expenses actually paid out." The results this year may be net profits $50,000.00; but "net income" (?) minus $100,000.00, because of $150,000.00 increase of stock on hand. Consequently in following years net income received will be $150,000.00 greater upon realization of the same, and on this increased income the corporation would have to pay $1,500.00 against the saving effected this year of $500.00, viz., 1% on its net profits of $50,000.00 not paid.

The British Income Tax, which is general and not restricted to corporations, is based upon profits, and has stood the test of many years;
The Journal of Accountancy.

indeed, it appears that our law is the only one in any English-speaking country that attempts to levy an income tax upon the difference between cash receipts and disbursements.

There is another feature of the law that I think deserves consideration and amendment. It is the provision limiting the amount of interest which may be included with expenses, to interest upon an amount equal to the paid in capital stock of the corporation.

I believe it should be generally admitted that some such provision was necessary to prevent the disappearance of profit or income as interest, but its practical working will, it seems to me, in many instances work a hardship on our section of the country. The cotton and naval store business, both factorage and export, are very largely conducted on borrowed money. A cotton exporting corporation, aided by banks, might have several times its capital invested in cotton, and not being allowed, as necessary expenses, interest on more than its capital, might, instead of 1 per cent., be actually paying out double or even treble that rate. The injustice would be aggravated in respect to factorage houses, if such are required to include with their income interest charged to their customers and are not allowed to include with expenses (except for interest on amount of capital), the interest paid in order to maintain advances to their producer customers. I think such mercantile corporations should be allowed to include all interest actually incurred on money actually borrowed, or at least should be allowed to offset income received for interest by expense incurred for interest, in addition to the allowance for interest on the amount of capital.

Accountants have been engaged for some months in investigating the books of the City of Baltimore, and their voluminous report has been recently issued. The main recommendations of the report have relation to the proper organization of the Controller's office, suggesting that its duties should not include the handling of any cash, but should be confined to the control by totals of the accounts of the various department, and an audit of the details thereof by the staff of the Controller's office. They also recommend an annual audit of the accounts of the city by public accountants, and the introduction of a new system of accounting, to include correct records of all property owned, and the keeping of an income and expense account in place of the old-fashioned system of receipts and disbursements. Their recommendations are all in accord with sound accounting practice, and their audit for the city should make for economical and honest administration.