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The Corporation Tax Return

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Every domestic and every resident foreign corporation not specifically exempted, whether or not having any net income, must file a return. The term "corporation" is defined by the Code to include associations, joint stock companies, and insurance companies. Receivers, trustees in dissolution, trustees in bankruptcy, and assignees operating the property or business of corporations must make returns of income for such corporations.

Corporation returns may be prepared on the cash basis or the accrual basis. In most instances corporation books of account are kept on the accrual basis and must report all income accrued, even though it has not actually been received and all expenses incurred although not paid. If the return is made on the cash basis, it is necessary to report all income received or constructively received and all expenses actually paid.

Corporation returns should be sworn to by the president, vice-president, or other principal officer, and by the treasurer, assistant treasurer, or chief accounting officer. It is of considerable importance that a return be properly verified, otherwise the period of limitation does not start running against the government when the purported return is filed. In instances where returns are not filed, the statute of limitations does not run against the government; therefore, it is important that corporations should file returns even though there is no tax.

In the event of a dissolution of a corporation by proper procedure, the statute of limitations can be reduced to a period of 18 months instead of 3 years as at present.

Section 102 of the Internal Revenue Code imposes a surtax on corporations for improperly accumulating surplus. The tax imposed by this section is 27½% of the amount of the undistributed net income not in excess of $100,000, plus 38½% of the undistributed net income in excess of $100,000.

Information returns should be filed with respect to compensation payments to unmarried citizens or residents of $750.00 or more, or $1,500 or more to a married citizen or resident. Dividend payments of $100 or more should be included.

Inventories. Very careful consideration should be given to the item of inventories with respect to the preparation of a return, as in-

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ventories are the primary factor in determining the gross profit. This applies to the inventory at the beginning of the period as well as the inventory at the end of the period. There are two primary methods to be used as the basis to value an inventory: (a) at cost, or (b) cost or market, whichever is lower. After the basis of valuing the inventories is adopted, it can not be changed until permission is obtained from the Commissioner of Internal Revenue.

The Revenue Act of 1938 provided that the inventories of tanners, and producers and processors of certain nonferrous metals under certain conditions could be valued on the term "last in first out." The present act removes the limitation as to the type of business. This term has been referred to as "Lifo." The advantages claimed for the "Lifo" inventory basis are:

1. Profits and losses determined on this basis more accurately reflect operating results.

2. Income taxes are more fairly determined on this basis, and generally will be lower.

3. Probably more important than the previous two is the claim that by requiring the matching of the sales price against the most recent purchase it should result in increased profits over a complete cycle. When cost prices are rising book profits will be shown as being lower and when cost prices are falling they will be shown as being higher. On the way up, it is believed that the tendency will be not to lose capital by basing sales prices on costs, when it is known that the inevitable price recession is ultimately coming and, on the way down, it is believed that the Lifo basis should enable the retailer sooner to give the consumer the benefit of lower retail prices based on replacement cost, thereby stimulating sales when sales are most needed.

Depletion. Section 23 (m) and Section 114 (b) of the Internal Revenue Code make provisions for a basis of depletion. The procedure under the two sections is materially different. Careful consideration should be given to the basis adopted as after an election is once made, the taxpayer cannot select the other method, and in certain instances one of the methods or bases is much more advantageous than the other.

Contributions. Corporations may deduct contributions or gifts actually paid within the taxable year to or for the use of a corporation, trust, or community chest fund or foundation created or organized under certain conditions and where owned and operated for specified purposes and where no part of the net earnings of which inure to the benefit of any private stockholder or individual and no part of the activities of which is for lobbying purposes or for the promotion or defeat of legislation or for campaign funds. The amount paid shall not exceed 5% of the corporate net income as computed without the benefit of this deduction. Such deduction shall be allowed only for the taxable year in which the contributions or gifts are actually paid, regardless of when pledged and regardless of the method of accounting employed by the corporation in keeping its books and records.

Bad Debts. Bad debts may be treated in either of two ways: (1) by deduction from income in respect of a debt ascertained to be worthless in whole or in part, or (2) by deduction from income a reasonable amount to a reserve for bad debts. A taxpayer filing a first return of income may select as to either of the two methods. After making an election it must be followed in returns for subsequent years unless permission is granted by the Commissioner to change to the other method.

Other Deductions. Losses incurred in transactions which were neither connected with the business nor entered into for profit are not deductible.

THE EXCESS PROFITS TAX

Subject to certain limitations, every corporation having an excess profits net income of more than $5,000 must make a return on Form 1121 United States Corporation Income and Excess Profits Tax Return.

Although a corporation's books of account may show a loss, nevertheless it may be subject to filing an excess profits tax return and required to pay a tax. This, of course, can only be determined after giving effect to the adjustments required by the return. The theory of the excess profits tax is to tax the corporate profits which result as an outgrowth of the normal operations of the business.

This return provides two methods for computing excess profits tax net income. If one method is not disclaimed, Schedules I, II, A and B must be completed. One method is based on income subject to the adjustment covering the taxable year beginning after December 31, 1935, and before January 1, 1940. The other method is based on the invested capital subject to adjustment. This return has caused considerable discussion, and it has been proposed that the income method of computation be eliminated and all corporations subject to this tax be compelled to use the invested capital method only.

It is estimated that the changes in the Revenue Act of 1941 as compared with the Revenue Acts of 1940 will produce additional revenue to the amount of three and one-half billion dollars. The estimated total revenue is thirteen and one-half billion dollars, of which nine billions is expected to be obtained from income taxes.

Generally speaking, there are four types of taxes applicable to the income of corporations, namely:

1. Surtax (Section 15 I.R.C.)
2. Normal tax (Sections 13 and 14 I.R.C.)
3. Declared value excess-profits tax (Section 600 I.R.C.)
4. Excess profits tax (Section 710 I.R.C.)

Surtax. The 1941 act eliminates the separate 10% defense tax. As a general plan the defense tax has been integrated into formerly existing types of taxes. The corporation surtax is an entirely new tax in the 1941 act. This new tax was developed on the theory that it was a means of reaching income from the large volume of partially tax exempt federal securities held by corporations. Some authorities view this tax as a means of increasing the normal tax rates applicable to corporations. This, in my judgment, is not entirely correct, as it reaches the income of certain corporations which were not taxed under the normal tax. It is a further increase in taxes for some corporations, but a first federal income tax for others. The base for the computation of this tax is "corporate surtax net income, which is defined as the net income minus the credit for dividends received, computed by limiting such credit to 85% of the net income in lieu of 85% on the adjusted net income. Interest on partially tax exempt securities is included in the corporation's surtax net income."

The rates of this new tax are 6% on the first $25,000 of the corporation surtax net income and 7% on the remainder.

As an example of the surtax, assume a corporation has:

Taxable interest on U. S. obligations	$ 20,000
Dividends from domestic corporation	100,000
Total Income	$120,000
Less Deductions	35,000
Net Income	$ 85,000
Less: dividends received (85% of the net income of $85,000)	72,250
Corporation surtax net income	$ 12,750
Surtax at 6%	$ 765

You will observe here that 85% of dividends from domestic corporations would have amounted to $85,000; however, the 85% on dividends received from taxable domestic corporations is limited to 85% of the net income, which in this instance is 85% of $85,000 or $72,250.

Normal Income Tax. Corporations with a normal tax net income compute the tax in the following manner: Start with the net income. Subtract the credit for interest on obligations of the United States and its instrumentalities, and you obtain the result of the adjusted net income. From this subtract credit on dividends received (85% of dividends received from taxable domestic corporations, or 85% of adjusted net income, whichever is less).

The result is the normal tax net income subject to tax at the following block rates:

Up to $5,000	15%
From $5,000 to $20,000	17%
From $20,000 to $25,000	19%
From $25,000 to $38,461.54	37%

In other words, on incomes between $25,000 and $38,461.54 the tax is $4,250.00 on the first $25,000 plus 37% above $25,000 up to $38,461.54. Corporations having a net income of $38,461.54 or less should calculate their tax on the above block rates, but after reaching the figure of $38,461.54, the above block rates are equal to 24% of the entire normal tax net income. In the case of corporations with a normal tax net income of more than $38,461.54 the tax is 24% of the entire normal tax net income.

Using the same example as was used above with reference to the corporation surtax, i.e. taxable income United States obligations $20,000, dividends from domestic corporation $100,000, total income $120,000, less $35,000 deductions, less $20,000 taxable interest on United States obligations, or an adjusted net income of $65,000, assuming of course there was no declared value excess profits tax or no excess profits tax to be deducted, the 85% credit for dividends received from a domestic corporation would be based on the adjusted net income of $65,000, which would amount to $55,250, and not on the amount of $100.000, because of the limitation of 85% of the adjusted normal tax net income. Deducting the $55,250 from the $65,000 would leave a normal tax net income of $9,750 to be calculated at 15% for the first $5,000 and 17% on the remainder of $4,750, or a normal tax of $1,557.50.

Declared Value Excess Profits Tax. As stated before, the defense tax has been eliminated and as a general plan integrated into the various taxes. Here we find an outstanding instance. Heretofore the tax rate was 6% on such portion of the net income of the taxable year as is in excess of 10% and not in excess of 15% of the capital stock declared value; whereas, under the new act the rate is 6.6%. Under the prior act the rate was 12%; whereas, under the present act it is 13.2%

of such portion of the net income for such income taxable year as is in excess of 15% of the declared value.

There is a definite relation between the return of capital stock tax for the year ended June 30 and the declared value excess-profits tax computation, as the cost for each one thousand dollars declared value on the return of capital stock tax is $1.25, which if it is not sufficient to eliminate the top rate of declared value excess-profits tax computation the tax cost to the corporation is $13.20. The corporation has, or should have, the information as to its profits for the first half of the taxable year at the time of filing the return of capital stock tax, if on a calendar year basis, and with past experience, unless unforeseen conditions arise, should be in a position to eliminate or materially reduce any tax which would fall in the top bracket of this particular tax.

Excess Profits Tax. After determining the adjusted excess profits net income, the amount is reduced by the sum of the following:

1. $5,000 specific exemption.
2. Excess profits credit.
3. Unused excess profits credit carry-over.

The rates applicable to this tax for the first $20,000 is 35%; the next $30,000, 40%; the next $50,000, 45%; the next $150,000, 50%; the next $250,000, 55%, and all over $500,000, 60%.

Under the prior law the normal income tax was deductible in determining the adjusted excess profits net income. Under the present act it is not deductible and the effect of disallowance of this deduction is to increase the amount of income subject to excess profits. Under the 1940 act the excess profits credit, when computed under the invested capital method, was on the basis of 8%; whereas, under the 1941 act the invested capital credit is reduced from 8% to 7% on the amount of invested capital in excess of $5,000,000. The credit for 1940 under this method, after applying the 1941 definition, may produce a smaller amount of unused credit carry-over.

Deductions of charitable contributions by corporations is limited to 5% of the net income computed without taking into account such contributions. Because of the change in the 1941 act, permitting deduction of the excess profits tax in computing the net income, the 5% limitation is less for normal income tax purposes than for excess profits tax purposes. For example, if net income before deduction of excess profits tax and charitable contributions is $100,000, and the excess profits tax amounted to $20,000, the allowance for contributions for income tax purposes is limited to $4,000, which is 5% of the net income of $80,000. For excess profits tax computation, however, the limitation is $5,000, which is 5% of the net income computed without deduction of the excess profits tax.

In preparing a corporation return, the four taxes should be computed in the following order: First prepare the declared value excess profits tax computation, then the excess profits tax computation, as the former tax is allowed as a deduction in computing the excess profits tax. Next prepare the surtax and normal tax schedules, as both the two excess profits taxes are allowable as deductions in computing the income subject to the normal tax and surtax.

Entirely too many taxpayers give very little, if any, serious thought to their tax problems until their blank tax return form is received through the mail. By that time it is usually too late to render advice that would be advantageous.

Examination for Federal Legal Positions Suspended Pending Congressional Action

The examination for federal legal positions, the written portion of which was scheduled to be held April 11, as reported in Bulletin 6, C.B.A.L., has been postponed indefinitely because of uncertainty surrounding the future status of the Board of Legal Examiners in the Civil Service Commission. The Board was established by executive order last April to administer a career service for lawyers in the federal service. The scheduled examination was designed as the first step in the creation of a register of eligible lawyers, from which appointments to the lower grades of the service were to have been made during the fiscal year beginning July 1.

The uncertain position of the Board of Legal Examiners arises from the action of the House of Representatives in denying an appropriation of approximately $100,000 requested by the Civil Service Commission to finance the work of the Board during the fiscal year 1943. The House has passed the Independent Offices Appropriation Bill without this item and with an amendment prohibiting the use by the Board of any other funds appropriated by the bill. The Commission has applied to the Senate committee for restoration of the appropriation but the final determination of the Congress has not yet been made.

Formal announcement by the Civil Service Commission of the examination as originally scheduled has been withheld pending clarification of the will of Congress with regard to the Board's work. If the ultimate congressional action is favorable to the program, the examination will be given at a later date. Announcement will be made in ample time to permit applicants to file.