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REVENUE ACT OF 1939

By ALBERT J. GOULD, of the Denver Bar

WHILE the Revenue Act of 1939 did not make many changes which are of immediate interest to lawyers, nevertheless, a survey of the more important changes would seem to be valuable to the members of the bar. It is not my purpose to analyze these changes in too much detail, but merely to give the high-lights, in order that attorneys may be advised and make the necessary complete investigation of the law, if and when these points arise in their practice.

1. *A Corporation Having an Unsound Financial Structure* is permitted to discharge an indebtedness for which it is liable and which is evidenced by securities in existence on June 1, 1939, at less than the face value thereof, without accounting for the difference between the face value and the purchase price as income. A security is defined as any bond, note, certificate, debenture or other evidence of indebtedness issued or assumed by the corporation. Specific provision is made whereby the corporation may establish its unsound financial condition for the above purposes.

2. *Declared Value of Capital Stock May Be Re-Declared by Increasing Same*, but not by decreasing same. In the capital stock tax returns to be filed in 1939 and 1940, a corporation may increase the declared value of its capital stock, thereby paying an additional tax at the rate of \$1 per thousand, but by so doing it may avoid an excess profits tax of 6% to 12% upon its net income in excess of 10% of its re-declared value of its capital stock. By the 1938 Act, a re-declaration was not permitted until July, 1941. The 1939 return may be filed on or before August 31, 1939, but the 1940 return must be filed in July, 1940.

3. *Net Operating Business Losses* of corporations, individuals, estates and trusts for taxable years, beginning after December 31, 1938, may be carried over to two subsequent years. This provision permits taxpayers to deduct net operating business losses from net income for the next succeeding year, and if there is any excess, it may be deducted from net income for the second succeeding year.

This provision is particularly important to taxpayers whose profits and losses fluctuate sharply and to new enterprises which may not be profitable in the first year of their organization. From the standpoint of individuals, business losses sustained in poor years will serve to reduce surtax rates to which an individual might be liable in profitable years.

An excess of losses over gains sustained by the disposition of capital assets may not be carried over, regardless of whether the capital gains and losses are long term or short term. The above benefits apply strictly to net operating business losses.

4. *Capital Losses of Corporations.* Capital losses on assets held for more than eighteen months may be deducted by corporations from ordinary net income, contrary to the former provision limiting such losses to \$2,000. The above provisions are applicable to taxable years beginning after December 31, 1939. Corporations having large potential capital losses should not sell said assets, if possible, until after the beginning of a taxable year beginning after December 31, 1939. Corporations whose fiscal years are not identical with the calendar year may have to suspend this action until late in 1939, but consideration should be given to the effect of this new provision.

It must be remembered, however, that the net loss carry-over permitted by the 1939 Act does not apply to net capital losses.

5. *"Last-In-First-Out" Inventory Option* granted by the 1939 Act for the calendar year 1939 and subsequent taxable years is of immediate importance to all taxpayers engaged in businesses involving substantial inventories, and tax attorneys and accountants at once should recommend to their clients having substantial inventories that they consider placing their regular accounting procedure completely upon a last-in-first-out basis.

The method is to treat the goods remaining on hand at the close of the taxable year, for the purposes of determining the cost of those sold during the year, as being, first, those included in the opening inventory of the taxable year in the order of acquisition of the goods so included; and second,

those acquired in the taxable year. When this method is used the inventory must be taken at cost.

The effect of the foregoing provision is to permit taxpayers to treat articles sold during the year as having been sold out of inventory acquired during the year (to the extent thereof) without regard to identity. In the event of a rising commodity market, the taxpayer's net profits, under this method, would be less than if inventoried articles on hand at the first of the year had been sold at a greater margin of profit. (For method of valuing inventory, see Article 22 (d-1) (Reg. 101) under the 1938 Act, which it is assumed will be followed in the new regulations to be issued under the 1939 Act.)

6. *Stock Dividends or Stock Rights.* For some time there has been confusion as to the basis in the hands of the taxpayer of non-taxable stock dividends or stock rights. The 1939 Act has removed this confusion by providing that the cost basis of the shares on which the dividend is declared shall be allocated between said shares and the dividend stock or rights, in computing gain or loss on a subsequent sale. This provision is retroactive to February 28, 1913, and taxpayers who have sold stock dividends and have reported their receipts as profit in full may file petition for refund, if not barred by the statute of limitations, which is three years from the date the return was filed, or two years from the date the tax was paid. Profit or loss from future sales of stock or rights heretofore received as non-taxable dividends will be determined by this section.

7. *Compensation for Services Over Five Years.* Attorneys will be interested in the provision in the 1939 Act which permits the taxpayer, upon receipt of compensation for personal services rendered over a period of five years or more, to pro-rate the same over said period, provided 95% or more of the compensation is paid upon completion of the service. Contingent fees in extended litigation often will come within this classification.

8. *New Corporation Tax Rates.* For taxable years beginning after December 31, 1939, net income of corporations will be taxed as follows:

For corporations earning in excess of \$25,000, a flat tax of 18%:

For corporations earning less than \$25,000, 12½% of the first \$5,000, 14% of the next \$15,000, 16% of the last \$5,000;

Corporations earning slightly over \$25,000 will pay, first, 18% of their normal tax net income, or, second, \$3,525, plus 32% of the amount of the normal tax net income in excess of \$25,000, whichever is less. The \$3,525 figure is the full tax for corporations earning \$25,000 under the above schedule.

9. *Individual Tax Rates.* No change.

10. *Stamp Tax.* The 1939 Act permits transfer of stock by an executor or administrator without stamp taxes, if the value of the shares is not greater than the amount of the tax that otherwise would be imposed.

AUGMENTING THE ANOMALOUSNESS OF THE ANOMALOUS INDORSER

By R. HICKMAN WALKER, *of the Denver Bar*

THIS relates to *Winton vs. Sullivan*, 104 Colo. 450, decided June 12, 1939. En Banc. No dissent. Mr. Justice Francis E. Bouck not participating. Opinion by Mr. Justice Bock.

The writer hereof would not have been bothered by *Winton vs. Sullivan* if it were not for the fact, intrinsically unimportant, that during a period of years he personally conducted annual excursions at a nearby university into the alien scenery of the Law Merchant. Among the curiosities rather closely examined on these explorations was the Anomalous Indorser. This was the accommodating person who, prior to the delivery of a negotiable instrument, wrote his name upon the back thereof for the purpose of lending credit to the maker or payee and without sustaining any other relation to the instrument. Before the adoption of N. I. L. (a symbol, perhaps, also of what is generally known about it) there was no uniformity in the views of the courts of the United States as to the nature of the contract of the anomalous indorser. Some courts held that his contract was that of an indorser; others that his contract was that of a maker (in the case of a note); and still others that his contract was to be established by parol