Denver Law Review

Volume 16 | Issue 9 Article 2

July 2021

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Recommended Citation
John G. Larson, Why December 31st? - A Suggestion for Closing the Business Year, 16 Dicta 285 (1939).

WHY DECEMBER 31ST?

A Suggestion for Closing the Business Year

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IT IS recognized that the calendar is a device for measuring time rather than determining time. The effect of the seasons on all of our activities is not due to the space occupied on the calendar by these particular seasons. Yet many businesses accept the calendar period from January 1st to December 31st as their accounting year. A large majority of Colorado corporations measure the results of their operations over the calendar year period. A classification of 295 businesses incorporated in Colorado in 1938 (where the names, as recorded in the office of the Secretary of State, indicate the nature of the business) shows that some 77% probably would find a year other than the calendar year best suited to them. But only about 10% of the active corporations in Colorado report income for tax purposes on the basis of a year which does not end on December 31st. On the assumption that the corporations organized in 1938 are representative of all Colorado corporations, something like 67% of those companies are using the calendar year, whereas some other fiscal year would be preferable.

Once a closing date has been adopted it is inconvenient to make a change. For that reason, it is important that those who are instrumental in the organization of businesses should use their influence to specify in the by-laws the accounting period which truly concurs with the year's activities. This is called by its proponents "the natural business year." Most concerns are seen to have an annual cycle of operations. A large portion of the year's activities is carried on during a part of the year, while at other times there is less activity. The natural year is a twelve-months period embracing a complete cycle of the operations of the business. The closing date should precede the beginning of the activities of the new season but should follow the past season sufficiently to permit the maximum conversion of inventories and receivables into cash. The occasional concurrence of this period with the calendar year is purely coincidental. Any other year than the natural year will combine the results of operations for parts of two different cycles or natural business years. Data collected under the operating conditions of one such year will be combined with those collected under another. This combination will not accurately reflect the results obtained during either natural business year.

From the preponderance of businesses using the calendar year as a basis for closing their books and reporting income, it might seem that some requirement of law or expediency made this necessary. The custom was given added impetus by the Federal Revenue Act of 1909 which levied an excise tax on corporations and associations, and required them to report on a calendar year basis. Many which had previously been using a different year switched to the calendar year for convenience in complying with this law. A number of these voiced objections to the calendar year requirement. This was corrected in the income tax law passed in 1913. It provided that a taxpayer might report income on a yearly basis other than the calendar year, provided that the books were kept on that other basis. The Colorado income tax law of 1937 is patterned after the Federal Revenue Act of 1936 and contains a similar provision. One possible inconvenience to a corporation using a fiscal year lies in the annual report required to be filed with the Secretary of State of Colorado. This report must be filed by March 15th of each year and must contain a financial statement as of some date not more than seventy-five days prior to March 15th. If the closing date does not fall within this seventy-five day period the statement as of the close of the natural year cannot be used. Many corporations prepare, or can prepare without great difficulty, a balance sheet as of a date other than the annual closing date. The possibility that the inconvenience of preparing a statement at an interim date for this report may deter some companies from adopting their natural business year, indicates that a change in the statute should be considered.

Although for 1913 and subsequent years a business could report income for income tax purposes on the basis of its fiscal year, there were still some inconveniences and disadvantages in using other than a calendar year. Since these are still sometimes referred to as reasons for following the calendar year, it should be noticed that they have now been removed from the income tax laws. Until 1934, new revenue acts always became effective January 1st. If the taxpayer's taxable period fell partially in each of two years for which different laws were effective, he was compelled to apportion his income between the two periods and compute the tax on each portion under the rates of the applicable Revenue Act. The 1934 and subsequent Revenue Acts, however, have provided that they should become effective for each taxpayer, with his first taxable period beginning after the previous December 31st. Thus, a taxpayer is liable for income taxes under the previous Revenue Act until he has a taxable period which begins January 1st or later in the year in which the new law is enacted.

Not only has the inconvenience been removed, to one using a taxable year not ending on December 31st, of computing the amount of tax under two sets of rates, but a distinct benefit may be derived. This is true of taxpayers whose taxable year begins after the enactment of the new law and prior to December 31st of the enactment year. The Revenue Act of 1936 was approved June 22nd; that of 1938 on May 28th. The provisions apply to taxable years beginning after December 31st of the previous year. All transactions of businesses whose taxable years begin before the enactment date are taxed under the new law before its provisions are known. Those taxpayers whose first year taxable under the new law does not begin until some time after the enactment date, have an opportunity to study the changes before they are liable for taxes thereunder. Since the period for which they are liable under the old law has not elapsed, they can take steps toward minimizing taxes by carrying out contemplated transactions under the provisions of either, whichever are the more favorable.

Also, by this provision the incidence of higher tax rates is delayed for a taxpayer using a taxable year not ending December 31st. Adversely, relief from taxes offered by new provisions does not come so soon. The 1936 and subsequent Revenue Acts contain a provision removing a possible disadvantage to corporations desiring to change from a calendar to a fiscal year. Previously, a taxpayer wishing to make this change was required to place the income for the short period between the close of the old and the beginning of the new fiscal year on an annual basis. This was likely to result in a greater amount of taxes if a larger percentage of the income were earned during this interim period. The new provision in Section 47(c) provides that income of corporations for short periods, due to a change in the accounting period, shall not be placed on an annual basis.

The use of a natural year was of great benefit to corporations with respect to the undistributed profits tax provisions of the Revenue Act of 1936. Income could be more accurately estimated in advance of the closing date so that the tax could be minimized by payment of the necessary dividends. In addition, the financial condition being more liquid at this time, the dividends could more likely be paid without borrowing for the purpose. While the importance of paying dividends to minimize income taxes is much less under the Revenue Act of 1938, the advantage still lies with the corporation using its natural year.

With the increasing complexity of tax laws and the growing tax burden, accurate annual determination of income for tax purposes becomes more important. In several of the paragraphs that follow, reference is made to the effect of a properly-selected accounting period on the accurate calculation of income. It is not that the total income over a number of years will be different, but that income will be more correctly attributed to the period in which earned. Mistakes in the attribution of income to periods would be minimized and consequent overpayments of income taxes for some years, and in total, would be avoided.

Additional advantages to be derived through the use of a natural business year are numerous. The procedure of closing the books and measuring the results of operations for the year is simplified. Neither will the interference of these activities with the regular routine of the business be as great. Employees' time will not be required when they should be occupied in regular activities. The annual audit can be conducted with the minimum of inconvenience to the office force.

The inventory, being smaller, is more easily and accurately taken at the close of a natural period. Employees' time is not so occupied by regular duties and they can devote more care to taking the inventory. Neither is the employment of additional help for this job so likely to be required.

Receivables due from customers are usually at the low point and it is easier to determine the proper reserve for losses on uncollectible accounts. The correctness of the determination of operating results and income for any period is affected by the accuracy of this reserve. Any means which will obtain a truer valuation of the receivables will enhance the accuracy and value of the annual statements.

The close of the natural year is the best time for a comparison of the year's operating results with previous years, and for future planning. Data for comparison will be homogeneous, based on the flow of transactions for completed and uniform periods of activity. Executives will be somewhat relieved of other duties and can give more attention to studying the results of operations, comparing them with those for prior periods and forming policies for the future.

At the close of the natural period the statements of the company will show it in its best financial position. Greater liquidity will have been obtained because of the reduction in the inventory and the collection of receivables. Cash thus obtained will have been used to pay off liabilities. Concerns using a calendar year which is not their natural year often claim that statements as of December 31st do not fairly present their financial position. Consequently, they often reduce inventories, avoid commitments and otherwise attempt to improve their ratio of current assets to current liabilities. The loss resulting from this curtailing of operations, when they should be in full swing, is evident. If the concern were using a year adopted to its cycle of operations, it would appear at its best, without the use of artificial and expensive means.

The responsibility for the proper selection of a business year rests with the management. The adoption of accounting periods ending at times other than December 31st is of interest also to bankers, credit men and certified public accountants. They are all concerned with the statements presenting most accurately the financial condition and operating results. In addition, with the present large majority of corporations closing on December 31st, the accountants particularly find themselves deluged with work during a few months of the year and comparatively idle during the remainder. During these few months they must work under a great deal of pressure and they find it necessary to make temporary additions to the staff. Thus, they often cannot devote time to giving helpful advice and suggestions to the degree which would be possible at another time. The management which is interested in obtaining the greatest value from the services of these agencies would do well to consider this along with other advantages in selecting a natural business year.

The annual cycle of operations in certain lines of business and the period which constitutes their natural business year are apparent from a cursory examination. For others, an analysis of the effect of the seasons on operations and conditions existing during the year, will indicate what it is. In this connection the fluctuations throughout the year in sales volume, inventories, receivables and current liabilities should be considered. The practice of others in the industry will serve as a guide, although circumstances peculiar to the company in question may indicate a different date. In cooperation with the research department of Dun & Bradstreet, the Natural Business Year Council makes studies of industries to determine their most logical closing dates and publishes its findings in order to affect a more widespread adoption of the natural business year. A list of closing dates suggested by the Natural Business Year Council follows. Dates suggested as the result of studies, other than those of the Council, are in parentheses and those marked (*) are confirmed by other such studies.

Trade or Industry	*Closing Date, Last Day of:*
Advertising, outdoor	March
Advertising agencies	July (December)
Agricultural implements—mfr.	September (June or October)
Air transportation companies	April
Airports	April
Automobiles—retail	November (October)
Automotive accessories—wholesale	January
Awnings and sunshades—mfr.	August
Bakeries	June
Barber shop and beauty parlor supplies—mfr.	September
Beverages, non-alcoholic—mfr.	September (*)
Books—publishing	June (January or December)
Book stores	June (*)
Breweries	September
Bricks—mfr.	March (*)
Brokers	November
Brooms and brushes—mfr.	June
Building contractors	February (December to April)
Candy—mfr.	April
Candy—wholesale	July
Canning	March to May (February to May)
Canvas goods—mfr.	November
Cemeteries	March
Charitable institutions	May or November
Clay and stone products—mfr.	October (December)
Cleaning and dyeing establishments	November
Clothing, men's—retail	January
Coal—mining	March (*) or April
Coal—retail	May
Coal—wholesale	April
Colleges	June (*)
Containers, paper—mfr.	April
Contractors, general	February
Crockery and glassware—mfr.	January
Dairy and produce companies	February or March (*)
Department stores	January (*)
Drugs—retail	September
Drugs—wholesale	June
Dry goods—wholesale	November
Electrical appliances—retail	June
Feed—mfr.	May or June
Filling stations	September
Florists—retail	September (June)
Flour milling	May or June (*)
Foundries and machine shops	January (December)

Trade or Industry	*Closing Date, Last Day of:*
Fruit and vegetable brokers	June
Furniture—mfr.	November (June)
Furniture—retail	June
Garages	September
Gasoline, refining	October
General merchandise—retail	January
Gift shops	May
Glass—mfr.	June (December)
Grain dealers	June
Grain, mills and elevators	May or June
Groceries—retail	June
Groceries—wholesale	June (*)
Hardware—retail	(December)
Hatcheries, chicken	June
Hats—mfr.	October
Heating and plumbing contractors	(December)
Hospitals	(December)
Hotels, residential	June (July)
Hotels, resort	Last month of season (*)
Ice, artificial—mfr.	October
Ice cream—mfr.	(December)
Jewelers—mfr. and silversmiths	November or March (January or February)
Jewelry and silverware—retail	January (*)
Laundries	June
Leather goods—retail	January
Lime—production	November
Lumber products—mfr.	October
Lumber—retail	(November)
Mail order houses	January (December)
Mattresses—mfr.	July
Meat, packing	October (*)
Millinery—retail	June
Motion picture exhibitors	(June to August)
Musical instruments—retail	June
Newspapers	August
Office buildings	May
Office supplies—retail	May
Oil production	June (December)
Oil well drilling contractors	July (*)
Paints and varnishes—mfr.	November (December)
Paper—wholesale	June
Paving contractors	March
Photographers	April
Plumbers materials—wholesale	February

Trade or Industry	*Closing Date, Last Day of:*
Pottery—mfr.	June (*)
Poultry farms	September
Public utilities	(December)
Radio—wholesale	January
Radio—retail	March
Railroads, street and interurban	June
Ready-to-wear, ladies'—retail	January
Real estate—agencies	September
Real estate holding companies	September
Restaurants	June
Roofing and waterproof paper—mfr.	June
Rubber goods—mfr.	October (June)
Rubber tires—mfr.	October (November)
Schools, private	June or August
Seeds—wholesale and retail	June
Sheet metal—mfr.	March
Stationery—retail	June
Steel and iron products—mfr.	June
Sugar, beet—mfr.	March (*) (February)
Theatre building ownership	June
Warehouses, cold storage	March

The frequencies of the selections of months as closing dates, including alternative dates, are as follows:

	Frequencies	*% to Total*
January	13	9.2
February	7	4.9
March	12	8.5
April	8	5.6
May	10	7.0
June	36	25.4
July	5	3.5
August	4	2.8
September	11	7.7
October	10	7.0
November	12	8.5
December	14	9.9
	142	100.0

From this it appears that if the suggested dates were universally adopted, the use of the calendar year as a business year would be only an average occurrence. While it is not expected that such acceptance of the natural business year will be achieved, attention should be given to its advantages and its more widespread use encouraged.