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Tax Forum

Doris L. Bosworth

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TAX FORUM

DORIS L. BOSWORTH, CPA, Editor
Peat, Marwick, Mitchell & Co.
New York, New York

BOOK REVIEW

Working With The Review Code—1967 Edited by Arthur J. Dixon, CPA and David Zack, CPA, American Institute of Certified Public Accountants, 1967, New York. Pages 278.

This annual presentation of material culled from the Journal of Accountancy's Tax Clinic for the years 1954 through 1967 is an excellent book for the practitioner. Actually it represents a review and editing of articles that have appeared in that publication for the past thirteen years, updated annually. The editors and contributing editors, all of whom are knowledgeable in the field, have selected pertinent and worthwhile articles for presentation in one volume. Of a necessity the subject matter represents current thinking in critical areas, and is essentially a condensation of the practical experience and research of many practitioners throughout the country.

The publication has two functions. It is a handy reference in the event of being confronted with a particular problem, and is also a practical guide in tax planning. To this end, the table of contents is by Code Section numbers, accompanied by a brief, but definitive, description of the material covered. There is also a subject index and table of cases cited. If your problem is related to a particular section of the Code, or even a case, and it has been discussed in a selected Tax Clinic article, it is only a matter of moments to locate an up-to-date appraisal of the matter. On the other hand, if you are looking for ideas in any particular areas, such as Estate Planning, material will be found that will form the nucleus of proper planning in a particular fact situation. An example of this function may be illustrated by the treatment of Section 303, wherein both the flexibility and pitfalls of that Section are reviewed. In the introduction, the editors express the hope that practitioners will find the book of value in answering tax questions that do not appear in the services, or at least provide a base for further exploration. The book lives up to these expectations, and is a recommended addition to any tax library. It is what its title implies—a tool for working with the Code, circa 1967.

MEDICAL REIMBURSEMENT PLANS

Section 105(b) of the Internal Revenue Code provides, with certain limitations, for reimbursement of employees' medical expenses under an employer's "plan" covering one or more employees. Such payments are deductible by the employer as ordinary and necessary business expenses under Section 162(a), without being taxable income to the employee. A formal, written plan is not a prerequisite of qualification under this section, but to obviate the necessity of proof of its existence, it is advisable to incorporate the essential elements in the minutes of a meeting of the Board of Directors, followed by written notification to covered employees. The plan may cover not only the medical expenses of the employee, but those of the spouse and dependents. It may include any or all expenses that would ordinarily qualify as medical expense deductions on the employee's return, such as drugs, dental work, doctors' bills, etc.

On the surface it would appear that section 105(b) is an excellent method of providing fringe benefits to stockholder-employees of a closely held corporation. A literal interpretation of the code and regulations would seem to permit the selection of a few stockholder-employees as recipients of these fringe benefits. Certain caveats have developed, however, in recent Tax Court decisions that indicate the Treasury Department is reviewing these plans from the standpoint of the nondiscriminatory provisions of qualified pension and profit-sharing plans, although the decisions have not employed that language. In Alan B. Larkin and Charna Larkin et al, 48 TC No. 59 the Court rejected the plan on the grounds that it was not a plan for the benefit of employees, and as to the stockholder beneficiaries the payments constituted dividends. The "plan" covered two officer-stockholders, their father, who was an officer but not a stockholder, and one nonstockholder employee. This last employee was not covered until several years after the plan went into effect, and his dependents were not included. The Court concluded that, because of the relatively minor benefits accruing to the one nonstockholder beneficiary, the plan was not for the benefit of employees.

In Sanders and Son, Inc. et al, TC Memo. 1967-146 the plan covered all full-time officers, but in the case under review such officers were also stockholders. In determining deductibility of the payments under Section 162(a) they were considered in conjunction with compensation; and, in the case of one of the covered employees, the total compensation, including medical reimbursement, was deemed excessive in consideration of services rendered.

Present case law should not discourage the use of medical reimbursement plans in closely held corporations. In view of the favorable tax treatment accorded both the corporation and covered employees, however, the adoption of any plan should encompass a sufficient number of nonstockholders, on an equivalent basis with shareholders, to enable the plan to be characterized as for the benefit of employees. In all cases the reimbursement, plus compensation, should not exceed what would be deemed to be reasonable compensation. To overcome the difficulty present in a year where illness in the family results in large medical expenses, the plan for reimbursement should place a ceiling on the amount payable by the corporation which, together with regular compensation, will not be deemed excessive.

ACCOUNTING AS A MEANS OF MEASURING PRODUCTIVITY

(continued from page 10)

the functional expenses to sales and are an automatic by-product of any income statement and capital productivity ratios) which relate the production (at cost) to the total funds employed, have proven quite practical. Allocation problems, however, are frequently encountered in determining capital or assets employed by function.

To increase the meaningfulness of capital productivity ratios when measuring productivity of subfunctions such as accounting, billing, purchasing, etc., the measurement base is best changed from the organizational output to units of output or services rendered by the specific function, such as equivalent work hours required for work to be done, units sold, or purchase orders processed.

To measure directly the productivity of individual employees carrying out specific functions, the use of work measurement techniques, as applied to production, have proven quite successful.

The most powerful tool, however, when attempting to measure productivity by functions, is a budget constructed on the basis of responsibility centers and compared regularly with actual performance data as supplied by responsibility accounting. If such comparisons are periodically presented in the form of current performance reports, management of the various levels is informed not only as to what happened by accounts, but also what happened according to functional responsibilities of individuals.

By measuring the variances between actual and budgeted performance, such functional performance reports disclose inefficiencies in productivity and pinpoint trouble areas. If actual operations in each functional responsibility center follow budgetary plans, presumably there are no troubles and operations can be allowed to continue unchanged.

If the performance reports disclose significant favorable or nonfavorable variances, the specific area of operations must be investigated to discover the underlying causes. In case of variances indicating declining productivity which will have an adverse effect upon profits, immediate remedial actions have to be taken once the causes are detected. In case of variances with favorable effect upon profits, management should discover the causes to promote continuation of the situation.

Conclusion

As demonstrated, the managerial segment of the accounting profession has developed during the past decades a number of valuable tools capable of measuring and improving productivity of a firm as a whole and its segments. Some of them are specifically designed to measure increases or decreases of productivity, others enhance, indirectly, efficiency in the performance of all operational functions and in the use of all input factors by attempts to maximize profits and to minimize costs.

They all qualify as other milestones in the present revolutionary reorientation process of our discipline, which is characterized by attempts to create tools not only capable of periodic reporting of the operating and financial condition, but also able to provide management of all levels with the information necessary for meaningful planning, decision making, and measurement of productivity in performance.

DP—Data Processing—also stands for Data Polution, "Contamination of information that contributes to erroneous management decisions." Definition supplied by Jean Paul Pittenger, manager, Peat, Marwick, Mitchell & Co., Cleveland.