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Book Reviews

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THE UNDISTRIBUTED-PROFITS TAX, by ALFRED G. BUEHLER. *McGraw-Hill Book Company*, New York. 281 pages. 1936.

Expressly avoiding the mazes of accounting and legal complexity involved, the author proposes "to describe the features of the new tax law, to state some of the economic and fiscal problems of the undistributed-profits tax, and to appraise it tentatively as a member of the Federal tax system."

Far from being "the tax of theoretical perfection claimed by its proponents," the revenue act of 1936 stands condemned at Dr. Buehler's hands on several grounds. He emphasizes particularly its pernicious effects upon smaller corporations. It fails to equalize the taxation of partnerships and corporations. As an economic stabilizer, it is worse than futile—it will not only not encourage wholesome and discourage unwholesome saving, it will probably "exert a tendency to increase rather than to lessen business fluctuations." But as a revenue measure, Dr. Buehler thinks it has some justification. While opinions may differ on this point, one may cordially agree with his statement that:

"The government's huge spending and borrowing program cannot go on unabated without grave social as well as fiscal consequences . . . the tremendous Federal outlays of recent years are laying now, and will in the future lay, onerous tax charges on business and individuals" (p. 267).

Some other points in the book invite more detailed comment. Discussing the precedents in which the proponents of the legislation sought to find support, Dr. Buehler observes that the Civil War income tax hardly offers a parallel because of "the great differences in attendant circumstances." It would seem that as much might be said of the late Dr. T. S. Adams's earlier views on the question, which are considered at some length, and were also advanced by the Treasury in behalf of the measure. While this is not the place to vindicate Dr. Adams, it is surprising to find in a volume dedicated to his memory no discussion of his trenchant denunciation of undistributed-profits taxation before the National Tax Association in 1923,* a reading of which could scarcely lead one to believe that he would have supported the recent legislation.

The administration, it is alleged on page 24, derived inspiration also from "the English method of taxing undistributed profits." If that is so, the authorities in Washington were as mistaken as Dr. Buehler is confused in his interpretation of English practice. The following passage appears on page 52:

"The surtax of the income tax is imposed on the shareholders of companies in those instances where it is clear that reasonable distributions of earnings have not been made. A surtax is also levied on personal holding companies if they fail to distribute more than 20 per cent. of their net income to shareholders."

The fact is that there is no *general* provision in English law penalizing the accumulation of profits or surplus. Dr. Buehler has mistakenly meta-

* See his presidential address, "Evolution vs. revolution in Federal tax reform," *Proceedings of the National Tax Association (1923)*.

morphosed a provision for special cases (cases analogous to personal holding companies in this country) into a requirement applicable to all English companies, although the authority upon which he relies (Magill, Parker and King, *A Summary of the British Tax System*, p. 25) is perfectly clear upon even casual reading:

> "The section [of the finance act] applies to any company which is under the control of not more than five persons and which is not a subsidiary company or a company in which the public is substantially interested."

And, although to describe the English corporation income tax as "essentially a tax on undistributed profits" (page 53) is not strictly speaking incorrect, such a characterization, without explanation beyond merely pointing out that the tax is a revenue and not a punitive measure, may mislead readers unacquainted with English practice. An English company serves in effect as an instrument for collecting taxes from its shareholders. It pays tax on its entire net income and then deducts the equivalent of a tax when distributing dividends to shareholders. It is thus in substance relieved of tax on profits which are distributed (either in the current or in later years) to shareholders; it bears a tax on profits not ultimately distributed to shareholders, and in that sense on "undistributed profits."

The book will not be helpful in correcting current misconceptions of the general policy and practice of English companies as to reservation and reinvestment of earnings. On page 129, the author remarks: "The reinvestment of corporate earnings has been very common in the United States and other countries. It is indicative of conservative financial planning." But, on page 81 we encounter, in answer to a question as to whether such practice is peculiar to the United States, the statement "that English and European corporations distribute practically all of their earnings to their stockholders, and that capital for expansion is raised chiefly by the sale of securities." Reference to Graham & Dodd's *Security Analysis* (p. 331), upon which this is based, turns up the following: "The typical English, French, or German company pays out practically all the earnings of each year, *except those carried to reserves!*" (my italics).* The term "reserves" refers, of course, only to those reserves which are in effect equivalent to "earned surplus" in American usage.

The analyses of the reports of English public companies, published regularly by *The Economist*, show that from 1924 to 1929 (inclusive) "balances carried forward"—that is, carried annually to reserves—averaged more than 20 per cent. of profits after interest. In 1936, some £60,000,000, or 26 per cent., was so reserved by the companies tabulated. The following comment of Henry Clay in his *The Post War Unemployment Problem* (1929) is also pertinent (p. 138): "The chief source and means of expansion, then [before the war] as now, was the profits of existing businesses placed to reserve or otherwise reinvested." As *The Economist* observed a few months ago: "In view of the part which retained profits have played in the financing of industrial expansion during the recovery

* Incidentally, Dr. Buehler's reference (on p. 81) to the *Minutes of Evidence* of the Royal Commission on Income Tax of 1919 does not correctly give the source of his statement that during the war boom, companies set aside on the average at least 30 per cent. of their profits for reserves.

years since 1931, both British directors and British investors may at least be grateful that there is no counterpart, in this country, of the Rooseveltian system of taxing company reserves."

In sum, the volume under review does not display either that personal grasp of the problem or the gift of judicious and accurate citation from the works of others which might have made it authoritative.

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THEORY AND MECHANICS OF ACCOUNTING, 1937 Edition; by LEO A. SCHMIDT, *Prentice-Hall, Inc.*, New York. 475 pages.

Every teacher of accounting develops a twofold philosophy. First, he organizes his material according to some plan which will result in the most satisfactory presentation. Second, he develops certain theories relative to accounting technique. The first aspect of the subject is primarily pedagogical in nature. The second aspect relates principally to procedure and may be assumed to reflect the teacher's interpretation of the developments which are taking place in the professional field.

Even in the case of elementary texts on accounting the recognition of a philosophy of accounts is undoubtedly desirable. Accounting is a science but it is not an abstract body of theory. It is concerned with cost and value in their practical aspects, and even the beginner in the study of accounting soon learns that the element of judgment is a feature which cannot be overlooked. The chapters of an elementary text cannot be mere unrelated discussions of isolated topics. On the contrary they must be correlated steps in the development of a highly unified theory. An author of a beginning text fails in one of his primary objects if he fails to make clear the fact that the principles of debit and credit are merely one aspect of this theory.

Professor Schmidt, in 1929, published his *Mechanics of Accounting*. The revision of this book now appears under the title *Theory and Mechanics of Accounting*. This change in title indicates the author's appreciation of the fact that theory underlies all accounting procedure, even that which is looked upon as elementary in character. This reviewer is not primarily concerned with the mere details found in this book. These are the same, essentially, in all satisfactory texts. Instead he is concerned with the order of development of the subject and the methodology which underlies the presentation of details.

Perhaps the most striking feature of the book is the rapidity with which the author advances into phases of the subject which are frequently deferred to later portions of elementary text books or even to more advanced courses. It is true that the balance-sheet method of approach is emphasized, but the question may be raised whether or not the development of the elementary principles has not to some extent been clouded by the introduction of illustrative material which might have been deferred to later portions of the book. Technically, no criticism can be made of the procedure followed; but, pedagogically, it appears that the student is compelled to build the foundation of his accounting knowledge in a relatively short period of time. Practically the entire basic theory of accounting procedure is developed in the first 115 pages of the book. Then, attention is given to such matters as technical problems of valuation and the more specific problems of partnership and corporation accounting, as well as management.

The book adheres to orthodox accounting principles. Its unique feature is the manner of presentation rather than the subject matter itself. Herein one finds evidence of the author's individuality. Certain phrases are given as they might have been expressed by the author while lecturing to his class, seeking for a colorful means of driving home important aspects of the subject.

The division of the book which deals with valuation problems represents, perhaps, the author's most important contribution and at the same time the most notable diversion from the outlines followed in standard accounting texts. This diversion is not unwelcome to the experienced accountant although question may be raised as to the appropriateness of so extended a discussion of complicated problems in a portion of the text which the student is expected to master after about four months of study. No doubt the success with which such a subject can be handled must depend upon the ability and skill of the teacher. It is true that the success achieved with any text depends largely on the instructor's qualifications, but this is a text in which his aptitude must, to a considerable extent, determine the degree of success to be achieved.

The book is divided into six parts. The first part deals with the fundamentals of accounting. The second part deals with the development of technique. The third part is given over to the discussion of valuation problems. Part four relates to partnership problems. Corporation problems receive attention in part five. The book closes with part six which relates to the management uses of accounting.

From a typographical point of view the book is excellent. The division of material is clearly indicated. The paragraphing is such that the reader finds it comparatively easy to note the changes in the subject matter as he proceeds. The index is sufficiently detailed to enable one to refer to any topic in which he may be interested.

The book, notwithstanding some matters on which accounts might be expected to differ, is a constructive piece of work. Moreover, there is presented material which, properly mastered, will lay a satisfactory foundation for further study of the science of accounting.

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