

4-1939

Correspondence: Research Department; “Bonus Problems under the Revenue Act of 1938”

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Recommended Citation

Hosmer, W. A. and Reno, Edwin S. (1939) "Correspondence: Research Department; “Bonus Problems under the Revenue Act of 1938”," *Journal of Accountancy*. Vol. 67: Iss. 4, Article 7.

Available at: <https://egrove.olemiss.edu/jofa/vol67/iss4/7>

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CORRESPONDENCE

Research Department

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: The establishment of the Institute's department of research under the committee on accounting procedure was described in an editorial in *THE JOURNAL* for March, 1939. Initial steps are now being taken to carry forward the purposes of the Institute as indicated in the action of the council last September and in the more recent action of the executive committee. The department of research is now established with quarters of its own at the Institute building.

The first problem facing the committee was to determine its approach to the problem with which it has to deal. There is an obvious need for narrowing down the range of choices in accounting procedures which are exercised at the present time. It is also desirable to establish a more carefully selected and better integrated system of accounting principles or practices.

The present plan of the committee is to consider specific topics, first of all in relation to the existing state of practice, and to recommend, wherever possible, one or more alternative procedures as being definitely superior in its opinion to other procedures which have received a certain measure of recognition and, at the same time, to express itself adversely in regard to procedures which should in its opinion be regarded as unacceptable.

In considering each case, particularly where alternative methods seem to possess substantial merit, it will aim to consider the conflict of considerations which make such a situation possible and thus gradually to prepare the way for a further narrowing of choices.

The committee recognizes that the problems with which it is called upon to deal involve in some cases only a question of form; in other cases questions of substance are involved. It has tentatively selected some questions lying in each of these two fields for intensive consideration. Included in this group are the following:

1. The question of combining those statements which have to do with the determination of income—current and cumulative. This involves the question of integrating the income and surplus statements, and also statements relative to reserves which constitute segregation of surplus, including general contingency reserves.
2. The treatment of unamortized discount on indebtedness that is refunded.
3. The treatment of depreciation in cases where assets have been written up or written down.

The committee has established procedures which will enable it to secure and coordinate expressions of opinion from qualified persons in different groups including not only those engaged in the public practice of accountancy but those engaged in teaching or in private accounting work. It desires to secure information from the widest possible sources and particularly invites expressions of opinion and points of view from all members of the Institute. Any communications of this character should be addressed to the department at the Institute building and they will receive prompt acknowledgment and consideration. The committee regards the task which it has undertaken as one of great importance to the future of accountancy and, while it realizes the main burden of work must fall on the research staff and members of the committee, it appeals for the fullest cooperation on the part of all members and others interested in the continued progress of accounting.

W. A. HOSMER

Acting Director and Coördinator of Research

“Bonus Problems under the Revenue Act of 1938”

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: With reference to Mr. Tyson's article in the February, 1939, *JOURNAL*, it is perhaps timely to point out that interdependent tax and bonus problems, as a general proposition, can be more readily solved by use of the top-bracket correction method

Correspondence

than otherwise. While the revenue act of 1938 with its simplified rate structure permits of solutions of the type offered by Mr. Tyson, such a method is practically useless when confronted with a complicated rate structure such as is contained in the 1936 act, and at

best is cumbersome for problems involving excess-profits taxes under the present act.

The following solution of Mr. Tyson's first example is submitted. This general method has been used in Pennsylvania where we have had interdependent taxes since 1935:

	Bonus plus Social Security	Federal
	Rate = $.10 + .003$ = $.103$	
Net income subject to bonus, or tax.....	\$90,000.00	<u>\$100,000.00</u>
Federal tax, tentative, @ 19%.....		\$ 19,000.00
Less—Credits.....		<u>2,402.50</u>
Net federal tax, tentative.....	16,597.50	\$ 16,597.50
Balance.....	(A) <u><u>\$73,402.50</u></u>	

Divisor to obtain bonus plus social security:

$$\frac{1}{.103} = 9.708738$$

$$+ 1.$$

Less: Federal top-bracket rate — .19

$$10.518738 \text{ (D)}$$

$$\text{Bonus plus social security} = \frac{A}{D} = \qquad \qquad \qquad \$ 6,978.26$$

$$\text{Federal tax correction} = \$6,978.26 \times .19 = \qquad \qquad \qquad \underline{\underline{- 1,325.87}}$$

$$\text{Federal tax, corrected} \qquad \qquad \qquad \underline{\underline{\$ 15,271.63}}$$

$$\text{Bonus} = \$6,978.26 \times \frac{.10}{.103} = \qquad \qquad \qquad \underline{\underline{6,775.01}}$$

$$\text{Social security} = \$6,775.01 \times .03 = \qquad \qquad \qquad \underline{\underline{\$ 203.25}}$$

It might be added that, if the bonus (plus social-security tax) were not a deduction in computing itself, then the "+ 1" quantity would be omitted in computing the *divisor*.

Mention should also be made that, to facilitate the solution of problems of this type, there have been prepared and made available to the profession, through the Pennsylvania

Institute of Certified Public Accountants, tables of federal composite top-bracket rates for the various combinations of tax rates under the 1936 and 1938 acts.

Yours truly,

EDWIN S. RENO

Pittsburgh, Pa.