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CORRESPONDENCE

Gain or Loss on Foreign Exchange

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: In the July issue of THE JOURNAL OF ACCOUNTANCY [Accounting Questions, page 74], a question was raised about the treatment of gains resulting from a drop of foreign-exchange rates between the time a purchase contract is made and the time of payment. The three answers presented in THE JOURNAL differ, and may leave the reader with the impression that such gains in any given case may either be treated as deductions from the cost of goods purchased, or as additions to income. Closer analysis will show, however, that in any given case only one treatment constitutes a correct presentation of the facts.

The statement of profit and loss attempts to match income with related expenditures, and to show separately such gains or losses as are not directly related to other items of income or expense. The question whether the gain from a reduction in foreign-exchange rates between the time of purchase and the time of payment belongs in costs of goods sold or in other income therefore depends on the relationship which the gain bears to the income from the sale of the merchandise. If the merchandise is sold before the change in the exchange rates occurs, the gain is unrelated to the income from the sale, and ought to be shown among other income. If the sale follows the fall of the price of the foreign currency, both buyer and seller will presumably take the new situation into account in establishing the selling price. The exchange profit will not be unrelated to the proceeds from the sale of the merchandise, and therefore ought to be treated as a reduction of the cost of the merchandise.

Difficulties will arise if not a sudden devaluation but a protracted decline of exchange rates occurred, and if the merchandise was not sold in a single lot but was sold or used gradually. It may become necessary in such cases to apply the method of presentation

which comes nearest to the truth, and to explain the matter through footnotes. The aim should be to show as gross profit from sales as accurately as possible the profit from the trading or manufacturing operations of the business undistorted by unrelated gains or losses.

Yours truly,

HAROLD S. BENJAMIN

New York, N. Y.

Accountancy Profession and the War

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: With reference to the article by Mary E. Murphy entitled "The British Accountancy Profession and the War," which appeared in the July issue of THE JOURNAL, we submit the following:

Accountants, qualified, of twenty-five years, and audit assistants, with ten years' experience in practising accountant's office, are reserved; that is, they are not called upon for military service if they come within the above categories at the date of registration under the military-service act.

But, of course, many, very many, who would have been reserved now were under liability to service through being members of the Territorial Army, etc. Many also enlisted before the age was reduced to twenty-five.

It is a common thing, for example, to find offices which *no longer* have the services of 25 per cent to 75 per cent of their pre-war *male* staff. Those remaining are grossly overworked and are putting in voluntary work in connection with air-raid precautions, home defence, etc.

Every junior staff has been replaced by young people, but offices are very very short of semiskilled staff of two to four years' experience; the result is that senior staff are carrying an increasing burden.

Yours truly,

DALGLIESH & MURRAY

Edinburgh, Scotland

"On the Nature of the Gain on Treasury Stock"

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: On reading the article by D. Paul Musselman, "On the Nature of the Gain on Treasury Stock," in the August JOURNAL, my first reaction was to attempt an article in reply. Later I concluded that it hardly deserved such a formal reply. A Board of Tax Appeals phrase which the author quotes, about the "exploration of the metaphysical concepts of accounting" seems an unfortunately apt description of much of his material.

And when one looks up two of his principal citations, one finds that neither of them supports his thesis, because they were decided on other points. In the Woods Machine Co. case, a majority of the Board of Tax Appeals originally found no tax. However, it is instructive to note a sentence in Arundell's dissent, joined in by five other members. Arundell clearly saw the true issue, and said: "The real question for decision is whether petitioner realized income as the result of the infringement of its patents and not whether gain or loss may arise out of transactions in capital stock as the case is treated in the majority opinion." The Circuit Court of Appeals very properly reversed the Board, so that it apparently saw the point too, although the opinion does not express it thus forthrightly. Obviously, it was proper to tax income arising from an award for damages. There was no interdependence between the income and the method or time of settling the resulting claim.

The other case, which is not mentioned by name, but from the opening salvo of which (35 BTA 965. 1937) the writer quotes approvingly near the beginning of his article, turns out to be the famous Reynolds Tobacco Company treasury-stock case. Mr. Musselman would apparently have his readers believe that this was one of those cases in which the "prevailing rule of no profit . . . has been blasted . . . out of the law in no uncertain terms," as he expresses it. Actually,

however, the Board's fuse was stamped out by the Circuit Court of Appeals, (97 F. 2d 302) in June, 1938, and water poured on by the Supreme Court in January, 1939 (306 U. S. 110). Why there was no mention in the article of these reversals in favor of the taxpayer is something of a mystery. But no matter, for this case, although the decisions said there was no tax, holds no comfort for either the gain or the no-gain camp. The issue on which the case was resolved was whether or not the Commissioner could promulgate over a period of years one regulation stating that there was no tax on dealings in treasury stock, in the light of which the taxpayer acted in 1929, and in a subsequent year, while the tax liability was still open, change that regulation to allow the possibility of tax, and then tax the earlier year's transactions under the revised regulation. The proposition of whether there was in fact gain or no gain from dealings in treasury stock was left wandering about the no-man's land of "On the one hand . . . On the other hand . . . There is room for debate" (Circuit Court of Appeals).

Now for a little constructive rebuttal:

Whatever one may believe about the net credit resulting from the purchase and later resale by a corporation of its own stock (and I state unhesitatingly that I believe it to be a capital credit), he will certainly characterize as novel, to say the least, Mr. Musselman's proposition that gain can result from the mere purchase of treasury stock. Any purchase of anything whatever can be no more than an expression of a *hope* for gain. If in Mr. Musselman's M Corporation the other four stockholders had bought A's stock individually at the same price which they caused the corporation to pay, their equities in the company would have increased as much as when the corporation bought the stock, but not even Mr. Musselman would contend that they had realized any gain, taxable or otherwise, unless and until they sold the stock for more than it cost them.— Or would he?

Yours truly,

R. W. SNYDER

Indianapolis, Ind.