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COMPLEXITIES IN THE COLLECTION OF THE INCOME TAXES HAVE BEEN MADE CLEAR

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IT has been estimated that the income tax law will directly affect more than half a million citizens and aliens. Probably millions will be indirectly affected in one way or another by the provisions of the law for payment of the tax "at the source." In addition to those directly and indirectly affected, there are many who will be concerned to know whether or not they come within the provisions of the new law. In the light of more than twenty years' experience in handling tax questions from the legal standpoint, I have sought to set down the questions which would naturally come to the mind of the inquiring citizen and to set down briefly and in simple language the answers to such questions.

Preliminary Questions.

Q.—When was this law passed? A.—Oct. 3, 1913, and went into effect at once. It forms section 2 of the tariff bill.

Q.—Does it affect any income I received before the law was passed? A.—Yes; it taxes income from March 1, 1913.

Q.—Why did the law fix March 1, 1913, as the date from which income was to be taxed? A.—Because the United States supreme court had held some years ago that the government had no constitutional power to pass such a law, and it was therefore necessary to adopt a constitutional amendment giving the government power to tax incomes. This constitutional amendment went into effect the last part of February, 1913, and congress therefore taxed incomes from the very earliest date.

Q.—Has the government the power to pass a law in October, 1913, taxing income which I received before that date? A.—It has been claimed that this provision of the income tax law is unconstitutional, because income received from March to October, 1913, had become part of capital at the time the income tax law was passed. It is unquestioned that the federal government has no power to tax a man's capital directly. Whether this provision of the law is unconstitutional is extremely doubtful.

Q.—Have I the right to refrain from paying the tax on income received before the law passed until the courts have determined whether this tax was valid? A.—No; you must pay the tax next June, and you cannot await any court's decision.

Q.—Does that mean if this provision is invalid I will lose what I paid to the government? A.—No. You should pay that portion of the tax which relates to your income before October, 1913, under protest. If this feature of the law is held to be invalid the government will then repay to you this part of the tax. The government has always been very fair in refunding taxes paid under any law found to be invalid.

Individuals Subject to the Tax.

Q.—What persons are subject to the tax? A.—Every citizen of the United States, whether residing at home or abroad, and every alien residing in the United States are taxable upon their entire net income minus specific exemptions. Every nonresident alien is taxable upon his net income derived from property in the United States or from carrying on any business or profession in the United States.

Q.—Who pays the tax? A.—The tax will be collected either directly from the taxpayer or through the employer, agent, trustee or other person having control of his income. The latter method is termed "collection at the source."

Corporations Subject to the Tax.

Q.—What corporations are subject to the tax? A.—Every corporation, joint stock company or association and every insurance company organized in the United States is subject to a tax of 1 per cent upon its net income, and every foreign corporation is subject to a tax upon its net income from business transacted or capital invested within the United States.

Q.—Are any concerns exempt? A.—Yes. Agricultural organizations, mutual savings banks, fraternal beneficiary societies, building loan associations, cemetery companies and religious, charitable, scientific and educational corporations, business leagues, boards of trade and civic organizations are not subject to the tax. They are clearly defined in the law, so that other corporations may not use these exceptions as a loophole.

Tax Returns.

Q.—What individuals are required to make tax returns? A.—Every person of lawful age subject to the tax having a net income of $3,000 or over for the taxable year. In addition, all guardians, trustees, executors, administrators, agents, receivers and conservators must make a tax return for the person for whom they act.

Q.—Suppose there are two or more guardians, trustees, executors, etc., must each make a return? A.—No; a return made by any one is sufficient.

Q.—Are there any individuals who need not make a tax return? A.—Persons having net incomes not exceeding $3,000, persons for whom the return is made by an employer or by a guardian, trustee, executor, etc., and who have no other income, and persons whose income is derived solely from dividends on stock in corporations which pay tax and whose net income does not exceed $20,000.

Q.—Does a copartnership have to file a return? A.—No; only if required by the commissioner or collector; each partner must make an individual return.

Q.—What corporations must make returns? A.—All corporations subject to the tax.

Q.—When must the return be filed? A.—Individuals and corporations must file the return on or before March 1.

Q.—For what period is the tax levied? A.—For the calendar year, except in 1913, when it is levied from March 1, 1913, only.

Q.—Suppose a corporation has a fiscal year which does not correspond with the calendar year; must it make its return for the calendar or for its fiscal year? A.—The tax is levied and the return must be filed for the calendar year, but the corporation may designate and use the last day of any month as the day for closing its fiscal year, provided it gives thirty days' notice to the district collector. The tax is then levied for the fiscal year, and the return must be filed within sixty days after the close of the fiscal year and the tax paid within 120 days after the close of the fiscal year.

Q.—Where must the return be filed? A.—An individual must file the return where he resides or has his principal place of business; a corporation or a nonresident must file where the principal place of business is located, and the trustee, guardian, executor, etc., must file the return where he resides or where the instrument under which he acts is recorded.

Q.—What must the return contain? A.—The gross income and certain deductions and allowances which will be explained shortly.

Q.—Must the return be sworn to? A.—Yes. In case of a corporation the oath or affirmation is made by an officer.

Gross Income.

Q.—What does gross income mean under the income tax law? A.—Gross income is defined in the statute as gains, profits and income derived from salaries, wages or compensation for personal service or from professions, vocations, businesses, trade, commerce or sales or dealings in real or personal property growing out of the ownership or use of or interest in real or personal property, also interest, rent, dividends, securities, or the transaction of any lawful business, or gains, profits and income from any source whatever.

Q.—Does gross income include property acquired by gift or by will? A.—No, but it includes the income from such property.

Q.—Will proceeds of life insurance policies paid upon death or paid upon the maturity of a term or upon surrender of a policy be included as income? A.—No.

Rates of Taxation.

Q.—What is the rate of taxation? A.—The normal rate is 1 per cent of the net income, and this applies to corporations as well as to individuals. In the case of individuals having a net income exceeding $20,000 the law provides for an additional tax.

Q.—What is the rate of the additional tax against incomes of individuals? A.—One per cent on amount by which income exceeds $20,000 but does not exceed $50,000; 2 per cent on amount by which income exceeds $50,000 but does not exceed $75,000; 3 per cent on amount by which income exceeds $75,000 but does not exceed $100,000; 4 per cent on amount by which income exceeds $100,000 but does not exceed $250,000; 5 per cent on amount by which income exceeds $250,000 but does not exceed $500,000; 6 per cent on amount by which income exceeds $500,000.

Q.—Are corporations ever liable for the additional tax? A.—Never.

Q.—In calculating net income for the additional tax, are the same deductions made as in calculating net income for the normal tax of 1 per cent? A.—Yes, with the exception that in calculating net income for the additional tax neither dividends nor amount of income on which tax is withheld at the source will be deducted.

Exemptions and Deductions.

Q.—Is there any exemption allowed to a taxable person? A.—Yes, $3,000; and if the person is married and his wife lives with him the exemption is $1,000 more, making $4,000 in all. The same provision is made if the person making the return is a married woman whose husband lives with her.

Q.—Can husband and wife each deduct the additional $1,000? A.—No. Only one deduction of $4,000 shall be made from the aggregate income of husband and wife when living together.

Q.—Can guardians, trustees, executors, etc., deduct the exemption of $3,000 for the benefit of the person for whom they act? A.—Yes.

Q.—What deductions can be made by an individual for expenses, etc.? A.—1. Necessary expenses actually paid in carrying on business. 2. All interest paid on indebtedness. 3. All national, state, county, school and municipal taxes. 4. All losses actually sustained in trade or arising from fire, storms or shipwreck and not compensated by insurance or otherwise. 5. Debts due and found worthless and charged off. 6. Reasonable allowance for wear and tear. 7. Dividends received from corporations which pay income tax. 8. Amount of income on which tax is paid or withheld at the source, provided such income does not exceed $3,000 or is irregular as to time and amount. 9. Interest on obligations of the United States, a state or a political subdivision of a state. 10. Salaries of the present president of the United States, present judges of the federal courts and the compensation of all officers, employees of a state or a political subdivision of a state, provided the same is not paid by the United States government. 11. The exemption of $3,000 or $4,000 for couples living together. As above explained, these deductions are allowed in calculating net income for the normal tax. For the additional tax items 7 and 8 are not allowed.

Q.—Can personal, living or family expenses be deducted? A.—No.

Q.—Is an assessment for local benefits deemed a tax and deductible as such? A.—No. The statute expressly provides that such assessments shall not be deducted.

Q.—Can any deduction be allowed for cost of new buildings, improvements or betterments made to increase the value of any property? A.—No.

Q.—What is meant by the necessary expenses paid in carrying on business? A.—Clerk hire, rent, lighting, heating, stationery, delivery charges, etc.

Q.—Suppose I have allowed state or local taxes to accumulate for several years; can I deduct the payment of accumulated taxes, or can I only deduct the taxes which fell due within the year for which I made an income tax return? A.—You can deduct all the tax payments, whether they were accumulated or not.

Q.—What deductions are allowed to corporations? A.—1. The ordinary and necessary expenses incurred in maintaining and operating the business and properties of the company, including rentals. 2. All losses actually sustained and not compensated by insurance or otherwise, including reasonable allowance for depreciation. 3. Interest paid on bonded and other indebtedness to an amount of such indebtedness not exceeding one-half the interest bearing indebtedness and its outstanding capital stock. 4. All taxes, national or state or imposed by a foreign government.

Q.—Is a corporation entitled to an exemption of $3,000 or $4,000 like an individual? A.—No. There are no exemptions in the case of corporations; they are allowed to deduct the expenses, losses, interest and taxes as already explained.

Q.—Individuals may deduct dividends; can a corporation deduct dividends received from other corporations? A.—No, while this appears to result in a double taxation, a tax of 1 per cent having been paid upon the dividends by the corporation from which they were received, congress intended to tax dividends received by one corporation from another.

Q.—Does the present income tax law take the place of the corporation income tax law of 1909? A.—Yes, but for the months of January and February, 1913, the old corporation income tax law remains in force. The present income tax law goes into effect from March 1, 1913.

Collection at Source.

Q.—What is meant by the collection of this tax "at the source?" A.—The law provides that all persons, firms and corporations paying interest, rent, salaries, annuities or other fixed or determinable annual or periodical gains, profits and income of any other person exceeding $3,000 per year shall withhold 1 per cent and pay it to the government as the normal tax upon that portion of the income of the person who was entitled to receive the rent, salary, income, annuity, etc.

Q.—If the annual rent on my home or place of business is $2,500 and I know that the landlord has other income which would make him taxable, shall I deduct 1 per cent from my rent? A.—No; you can only make the deduction provided the rent you ~~pay~~ exceeds $3,000 per year, and this same principle applies to all payments of rent, salary, interest, annuities, etc., with the sole exception of interest on corporate bonds.

Q.—If the interest on corporate bonds amounts to less than $3,000, must the 1 per cent be deducted at the source? A.—Yes; the law provides that where the income is interest on corporate bonds the tax must be deducted at the source, irrespective of the amount of the interest payment.

Q.—If rent or salary payable by me amounts to $3,000 or less I understand I withhold no tax, but if it amounts to more than $3,000, do I withhold the tax on the excess or on the whole amount? A.—You withhold the tax on the whole amount. For example, if rent or salary due from you amounts to $3,000 or less you deduct nothing, but if it amounts to $3,500 you must deduct $35—namely, 1 per cent of the entire $3,500.

Q.—Can the person entitled to rent, salary, interest, annuity, etc., claim an exemption? A.—Yes; by filing a notice with you he can claim and obtain an exemption of $3,000 (or $4,000 if married and with a wife living with him); in that case you should only deduct the 1 per cent from the excess over the exemption. For example, if a landlord or employee is entitled to $5,000 a year and files with you an exemption as a married man amounting to $4,000 you would only deduct $10—namely, 1 per cent on the excess of $1,000.

Q.—How about the collection of coupons on corporate bonds? A.—The interest is to be deducted by the corporation. The owner of the coupon must then file a certificate of ownership with the bank or other concern which receives the coupon for collection, otherwise that bank would have to deduct the tax and attach its own certificate, giving the name of the owner. The owner has a right to claim exemption up to $3,000 if single or $4,000 if married. The forms of certificates of ownership and of exemptions have been prescribed and may be obtained from the collector.

Q.—In deducting the tax from rent, salary and interest, shall I deduct from each payment or wait until $3,000 has been paid? A.—Under the regulations you need not withhold the tax until such time as the rent, salary or interest shall have reached an aggregate in excess of $3,000. The tax subsequently is to be deducted from the full amount or from $3,000 or $4,000 less if notice of exemption has been filed.

Q.—What tax shall be deducted in 1913? A.—For the year 1913 everything is on a five-sixths basis, because the law will have been in effect for ten months. All calculations of exemptions, deductions, income, etc., for 1913 shall be taken at five-sixths of the whole annual amount in each case.

Q.—Suppose the landlord or employee entitled to receive more than $3,000 a year has business expenses, losses, etc., which bring his net income below $3,000 in all; can he, by filing a statement of such business expenses, losses, etc., obtain a full payment from me without deduction? A.—No. You must still deduct 1 per cent. He will be entitled to obtain the benefit of such deduction by application to the collector.

Q.—What do I do with the amounts I deduct from payments of salary, interest, rent, annuity, etc.? A.—You hold them and make separate returns for such deduction at the same time you make your own return. You pay the amount of the deductions to the collector between June 1 and June 30. Individuals and corporations will be notified of the amount upon which they are liable on or before June 1.

Publicity of Returns.

Q.—Are the returns made by an individual or corporation open to the inspection of the public? A.—All returns, whether by individuals or corporations, are public records, but they may be inspected only upon the order of the president under rules and regulations to be prescribed by the secretary of the treasury and approved by the president.

Q.—Can income tax returns be inspected by the tax officers of any state, city or county? A.—No, except as they may be inspected by any citizen, as explained in my answer to the previous question. The only exception is that officers of any state which imposes a general income tax may have access to the returns.

Penalties.

Q.—What is the penalty for neglect or refusal to make a return on time? A.—Five per cent of the amount of the tax is added and 1 per cent per month from the time it became due, and a fine may be imposed of not less than $20 or more than $1,000 in the case of an individual or not more than $10,000 in the case of a corporation.

Q.—What is the penalty for making a false or fraudulent return? A.—A fine not exceeding $2,000, imprisonment for one year, or both, in the case of an individual or officer of a corporation and a fine not exceeding $10,000 in the case of a corporation.

Q.—Is there any penalty if a landlord or employee or other person from whom a tax must be deducted at the source files a false statement respecting the $3,000 exemption or $4,000 for a married couple? A.—Yes; a fine of $300.

Q.—Can a man's or company's books and accounts be examined by the collector? A.—The United States courts can compel attendance, production of books and testimony in cases where persons are summoned by the collector.