STATE TAXATION, OTHER THAN NEW YORK

Conducted by:

THE COMMITTEE ON STATE TAXATION—OTHER THAN NEW YORK
HERBERT SITVER, CPA, Chairman

NEW JERSEY—APPELLATE COURT SUSTAINS USE OF SOUND ACCOUNTING PRINCIPLES FOR CORPORATION FRANCHISE TAX

In a very important and well-reasoned opinion, the New Jersey Superior Court, Appellate Division, recently reversed the Division of Tax Appeals and unanimously held that the transfer by the Director, Division of Taxation, of a liability, "reserve for deferred income taxes," to net worth was not in accordance with sound accounting principles within the intended meaning of the New Jersey corporation franchise tax statute. (American Can Company v. Director, Division of Taxation, March 1, 1965.)

The American Can Company had, at the direction of its independent auditors, set up on its books a liability reserve for deferred income taxes which reflected the use of an accelerated method of depreciation for federal income tax purposes and the use of straight-line depreciation for financial accounting purposes. (See a discussion of the ruling of the Division of Tax Appeals in this column in November, 1964.) The uncontradicted expert accounting testimony supported the taxpayer's position as being consistent with generally accepted accounting practices and was pursuant to the standards of the AICPA and the regulations of the SEC. See Accounting Research Bulletin No. 44 (Revised) of AICPA (July, 1958) and Supplementary Letter of April, 1959; and SEC Accounting Series Release No. 85 (February, 1960.)

Although the Corporation Business Tax Act (1945) in N.J.S.A. 54:10A-4(d) permits the Director to redetermine a corporation's net worth in order to reflect the fair value of the assets carried on its books, the statute requires that he must do so "in accordance with sound accounting principles." Thus, in R. H. Macy & Co., Inc. v. Director, Division of Taxation, 77 N.J. Super. 155 (App. Div. 1962), affirmed 41 N.J. 3 (1963) (discussed in this column in March, 1964), the court held that the Director may re-evaluate the taxpayer's inventory by using Fifo rather than Lifo on the justification that Fifo produced inventory costs more nearly approximating the assessing date than did Lifo. The court concluded that, by using Fifo, the Director was able to arrive at a more realistic determination of net worth. However, the Director was permitted to make this change only because the use of *either* the Fifo method or the Lifo method was consistent with sound accounting principles. Likewise in the Macy case, the court upheld the Director's right to revise downward the taxpayer's book reserve for bad debts since the amount determined by the Director was not arbitrary and was found to be consistent with sound accounting principles.

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Thus, the rule of the Macy case is that adherence by the taxpayer to sound accounting principles does not necessarily prevent the net worth reflected thereby from being redetermined by the Director. However, the statute plainly requires that any redetermination of net worth by the Director must of itself be consistent with "sound accounting principles" in the sense that the accounting profession would understand that term, viz: "generally accepted accounting principles."

In the American Can case, the Director contended that he had the statutory right to eliminate the entire deferred tax reserve from the liability section of the balance sheet and incorporate it into surplus, even though it is clearly proscribed by generally accepted accounting principles. The Superior Court properly concluded that the Director lacked such authority.

It is anticipated that the Director will petition the New Jersey Supreme Court for an appeal of this decision.

It is suggested that taxpayers, who paid a tax based on net worth which included a reserve for deferred income taxes, should consider filing a claim for refund since the statute of limitations with respect to refunds expires within two years after payment of the tax.

NEW JERSEY—CHANGE IN FILING DATE OF PERSONAL PROPERTY RETURN

Effective for the year 1965 and thereafter, the New Jersey tangible personal property tax returns (Form PT-1) are to be filed with the local assessor by July 1 instead of May 1. The bill was signed on April 12, 1965, and provides for a permanent change in the filing date to July 1.

BURNED OUT OF BUSINESS

The credit histories of 100 businesses that suffered fire losses revealed that following the fires:

43% did not resume business or were out of business within six months.

14% suffered a reduction of 30% to 67% in their credit ratings.

17% no longer furnished financial statements as in the past.

26% were unaffected as to their credit ratings.

Further inquiry spelled out the exact reasons why the fire losses were so disastrous to many of the companies. While a few of the companies suffered from under-insurance, the greatest cause was shown to be the destruction of records. The inability to produce substantiating records prevented the full collection of fire insurance proceeds. Also, in the absence of records, unjust claims as to accounts payable could not be resisted, and in many instances receivables were uncollectible. As the result of the loss of cost, purchasing, inventory, sales or other vital records, the resumption of operations was seriously impeded or made impossible. Source: Safe Manufacturers National Association, Inc.

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