

Tax Audit Reveals Evasion Is Rife

By Philip Stoddard Brown

THE COST of those "great social events of Washington's winter season" that get reported in the society pages of this newspaper are, I should guess, tax deductible in most cases—or, paid for by governments out of tax revenue.



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Certainly in these days of steeply-progressive income taxes, few people can afford to spend \$5000, or even \$1000, of after-tax income for a single party.

But it piques my curiosity how some private hosts and hostesses justify such expenses as "ordinary and necessary and directly related" to their business or professional duties.

What a difficult task Internal Revenue has to determine the motives and circumstances of entertainment. Should 60 rather than 70 per cent of the expenses of a dinner party four years ago be allowed as a deduction? Was business or pleasure the main purpose of a trip to New York or Paris?

Maze of Deductions

The whole domain of tax deductions has become a weird maze. The taxpayer can't even be expected to produce receipts for contributions at church services, for taxi fares and gratuities, or for every meal, telephone call, business magazine and postage stamp. How then can Internal Revenue decide, within wide limits, whether stated deductions were actual expenses? And even where receipts exist, are they valid and do they represent a business, rather than personal, expenditure?

Well, you can't run a tax-collecting outfit by simply accepting the word of each taxpayer. Yet, in many cases, you have to do just this. You can't probe behind every figure.

Taxable income might be defined, I suppose, as income that is taxed. Often it is just a plausible figure. Sometimes, it is a compromise suggested by the Internal Revenue examiner. The arithmetic must be accurate and the books should be in order, but there's lots of scope for doubt, argument and estimation in the original entries for expenses, depreciation and receipts. Was that \$5.27 for a "business luncheon" on April 16, 1956 with Joe Bloke, a lawyer and old friend really "to discuss tax problems" or just social?

To be sure, there can be no question about many receipts and expenditures. But, where expenses equal, say, 90 per cent of receipts, taxable income can be cut in half by neglecting to count 3 per cent of income and inflating expenses by slightly over 2 per cent. Tax liability is reduced by more than 50 per cent.

The amount of understatement of taxable income in the returns of business and professional people may surprise many salaried people whose returns are fairly straightforward.

\$2.7 Billion More

Recently, the results of a very special audit by Internal Revenue of 36,000 representative returns for 1949 were published. The audit indicated that a similar examination of 6.7 million business and professional returns for that year would have increased net profits by 20 per cent and yielded \$2.7 billion additional revenue.

Some indicated changes in net profit from that reported are as follows:

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Per Cent
Increase

Manufacturing, total	17.5
Lumber and wood products, except furniture	39.4
Printing and publishing	13.5
Transportation, communication and utilities	25.9
Trade, total	26.4
Department stores, gen'l. mdse. and dry goods	36.5
Package liquor stores	37.4
Eating and drinking places	32.0
Automobile dealers	25.6
Lumber, bldg. supplies and coal	11.5
Services, total	11.2
Hotels	36.7
Barber and beauty shops	8.9
Auto repair and garages	21.4
Amusement services	87.1
Professional and social services, total	7.1
Accountants	2.9
Physicians	7.0
Dentists	8.1
Legal services	4.3
Finance, insurance and real estate	10.9
Insurance agents	7.1
Real estate	21.0
Construction, total	18.5
Agriculture and related industries, total	23.1

If the average firm engaged in "amusement services" understates its taxable income by 46 per cent, its perturbing to speculate how much understatement individual firms must get away with. Actually, evasion is greater even than the above figures indicate.

The understatement of profit indicated by this audit is only what fairly experienced examiners might uncover. As Marius Farioletti, who prepared an excellent paper on this remarkable audit, makes clear: additional errors would have been found if more time had been allowed for examination and if the examiners had been even more experienced. Also, it is likely that there are "errors" that even the most experienced examiners would not uncover.

Consultants Swell GNP

The income tax has become so complicated—as well as messy—that more and more small proprietors and professional people retain tax accountants. Last week, a friend told me that he pays \$1500 a year to his tax consultant. "My business isn't very big, but there are a lot of tax angles. It's a case of either my attending to my business, or reading all those reports of a tax advisory service that I used to subscribe to, but not both."

Well, the hiring of tax consultants—like the hiring of anybody else—increases GNP (gross national product). So the more the better! GNP hasn't been rising so fast of late, despite all that "research and development" going on in Detroit to achieve "a shatteringly new look" for the 1961 and 1962 model cars.

One returning vacationer is reassuring. He tells me that Florida can be counted on to boost GNP this year. One of many projects is the building of a mile-long sandy beach along the coral reef of Key West, by trucking sand from somewhere way off. So maybe we can keep ahead of the Russians, after all—provided they don't step up their hiring of accountants even faster and don't haul around even more sand.