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CHAPTER 13

Sources of Divergences between Book Profit and Statutory Net Income

THE DATA FOR THE ANALYSIS OF SOURCES OF DIVERGENCE between book profit and statutory net income were taken mainly from Sample I. Sample II data are used to supplement Sample I in discussing depreciation and depletion and bad debt expenses. Initially it was hoped to make much more extensive use of Sample II but, as explained in Chapter 10, the data were found to be inadequate for this purpose.

The various sources of divergence were grouped into 15 classes, the first five of which affect primarily the amount of gross income reported, the next eight the amount of deductions claimed, and the last two cover special items (Table 24).

Inasmuch as the findings of this chapter are summarized in Chapter 9, Section C2, it seems superfluous to repeat them. The reader who is interested only in the broad findings is invited to turn to the summary.

Most of the qualifications on the book profit-statutory net income comparison apply also to the component items affecting net income. For instance, whatever errors are in the Treasury book profit figure will be reflected in erroneous statements with respect to some components of net income. As some components presumably will be affected more than others, the relative importance of the various sources of divergence between book profit and statutory net income will be altered in some degree. However, since the errors in the Treasury book

TABLE 24

Differences in Tax and Book Accounting, Sample I Corporations, 1936
Ratios Expressed as Percentages of Individual Sources of Divergence to Aggregate Divergence

INDUSTRIAL GROUP	No. of corp.	Dividends rec.	Capital gains or losses	Int. rec.	Inventories	Misc. income items	Depreciable & depletable assets	Intangible assets	Bad debt exp.	Int. paid	Taxes paid	Rents & royalties paid	Nonallowable reserves	Misc. deductions	Scope of accounting unit	Reorganizations, mergers, dissolutions	Total
Mining & quarrying	58	.0	3.7	1.1	.2	22.4	54.9	10.5	.4	.2	1.2	1.0	3.6	.9	.0	.0	100.0
Manufacturing																	
Food & kindred products	17	.1	7.9	1.1	.0	.1	52.2	.3	2.1	.0	6.5	7.6	7.5	14.6	.0	.0	100.0
Tobacco products	6	.0	3.0	27.3	.0	.0	8.1	.0	8.4	.4	3.4	.0	11.7	37.7	.0	.0	100.0
Liquors & beverages	29	.0	2.8	1.9	1.0	.4	32.7	1.2	9.3	.2	6.2	.0	10.8	33.4	.0	.0	100.0
Textiles, clothing, & apparel	19	21.0	8.2	.6	1.4	.7	32.8	.6	6.3	.1	2.9	.0	14.0	11.3	.0	.0	100.0
Paper, printing, & publishing	13	.0	1.2	1.4	.1	12.0	67.2	.1	1.9	.2	1.8	.0	2.7	11.4	.0	.0	100.0
Chemicals & allied products	10	.0	1.3	.2	.0	.0	22.4	.0	1.9	.4	.9	.0	1.0	1.6	2.1	68.1	100.0
Stone, clay & glass	19	1.5	8.6	3.6	4.4	.4	18.1	5.4	9.3	2.0	5.6	.2	39.2	1.5	.0	.0	100.0
Iron, steel, & nonferrous metals	22	.8	24.7	.9	8.6	1.1	37.2	1.0	3.8	3.0	5.4	.0	9.2	4.1	.0	.0	100.0
Indust., agr., & other mach. & tool mfr.	81	2.4	8.0	3.4	6.1	4.6	21.3	6.4	6.6	3.5	4.0	.2	17.8	14.5	.8	.2	100.0
Autos, aircraft, & shipbuilding	45	.0	6.8	4.3	5.1	9.9	18.9	13.4	5.6	2.7	3.5	.0	4.0	18.5	7.3	.0	100.0
Miscellaneous	25	7.8	1.3	7.2	8.8	.0	15.9	31.0	3.7	.1	1.8	.1	18.1	4.3	.0	.0	100.0
Finance	53	1.2	48.6	1.2	.0	8.4	1.6	.1	1.6	4.8	9.5	.0	13.8	9.1	.1	.0	100.0
Trade	52	.6	.1	1.4	.3	24.7	3.8	8.0	10.1	2.3	2.0	.2	12.1	30.4	2.0	1.9	100.0
Miscellaneous companies	16	.0	.1	4.6	.7	24.8	13.3	3.8	4.4	24.3	1.9	.0	6.0	16.1	.0	.0	100.0
Service	11	.0	2.5	3.8	.0	.6	5.7	30.4	8.6	.1	2.8	.0	10.4	35.1	.0	.0	100.0
Public utilities	29	.0	1.6	.4	.1	.7	34.0	.7	1.5	52.0	1.1	.0	2.7	4.6	.6	.0	100.0

profit figure appear to be relatively minor, the alterations are likely to be small.

Through auditing adjustments, especially during the years covered, the relationships of some components might be shifted significantly. For instance, as discussed in detail in Section E, substantial amounts of depreciation were disallowed by the Treasury during 1935-40. Comparisons of audited tax returns with book charges would therefore show tax depreciation charges to be somewhat smaller than those shown by the unaudited data. No information is available concerning the nature or size of auditing adjustments with respect to other components of income.

A Class 1: Dividends Received

As statutory net income is defined before the credit for dividends received is deducted, divergences reported in Class 1 exclude those due to this credit. There are few other sources of divergence.

With two or three isolated exceptions, divergences resulting from dividends received items are both few and small (Table 25). One divergence of over $100,000 tends to cause book profit to exceed statutory net income: a leather manufacturing company reported "dividends deductible under Section 23 (p) of the Revenue Act of 1934" (see below). Two divergences of more than $100,000 tend to cause statutory net income to exceed book profit: a clothing manufacturer reported "dividends from X Corporation" (name omitted to conceal identity) of more than $400,000. Since the names of the companies paying and receiving the dividends are closely similar, they are probably affiliated in some manner. A machine tool manufacturer reported "dividends received from subsidiaries" of more than $140,000.

In general, divergences in Class 1 cannot easily be divided into subclasses. Nevertheless, several examples are interesting. The following tended to cause book profit to exceed statutory net income: (a) Dividends in liquidation may have been

TABLE 25

Differences in Tax and Book Accounting, Basic Data, Sample I Corporations, 1936

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	Negative*	ANALYSIS Y RATIO (%) Positive*	Negative*	NUMBER OF DIVERGENCES Positive*	Negative*
			DIVIDENDS RECEIVED			
Mining & quarrying	00	00	.00	.00	0	0
Manufacturing						
Food & kindred products	780	00	.11	.00	1	0
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	00	00	.00	.00	0	0
Textiles, clothing, & apparel	1,809	423,517	.09	20.94	1	2
Paper, printing, & publishing	300	00	.02	.00	1	0
Chemicals & allied products	290	00	.03	.00	1	0
Stone, clay & glass	00	25,246	.00	1.48	0	1
Iron, steel, & nonferrous metals	15,066	3,150	.64	.13	3	1
Indust., agr., & other mach. & tool mfr.	867	143,344	.01	2.35	4	1
Autos, aircraft, & shipbuilding	00	00	.00	.00	0	0
Miscellaneous	115,506	00	7.79	.00	3	0
Finance	86,273	27,048	.92	.29	7	4
Trade	63,296	00	.58	.00	6	0
Miscellaneous companies	00	00	.00	.00	0	0
Service	00	00	.00	.00	0	0
Public utilities	00	00	.00	.00	0	0

		CAPITAL GAINS OR LOSSES				
Mining & quarrying	255,051	33,221	3.27	.43	5	6
Manufacturing						
Food & kindred products	50,011	4,299	7.28	.62	2	3
Tobacco products	10,890	00	2.99	.00	2	0
Liquors & beverages	11,894	13,598	1.28	1.47	1	4
Textiles, clothing, & apparel	120,298	46,490	5.95	2.30	10	3
Paper, printing, & publishing	2,798	13,199	.21	.98	4	1
Chemicals & allied products	00	12,839	.00	1.26	0	1
Stone, clay & glass	12,483	134,702	.73	7.90	2	4
Iron, steel, & nonferrous metals	179,778	397,631	7.69	17.00	7	6
Indust., agr., & other mach. & tool mfr.	7,737	480,538	.13	7.87	7	15
Autos, aircraft, & shipbuilding	16,134	61,857	1.40	5.37	5	11
Miscellaneous	2,383	17,330	.16	1.17	3	5
Finance	2,498,048	2,083,193	26.52	22.11	10	15
Trade	11,811	1,936	.12	.02	4	3
Miscellaneous companies	1,120	78	.11	.01	1	1
Service	9,784	00	2.47	.00	1	0
Public utilities	546,576	16,287	1.59	.05	1	1

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	AMOUNT OF DIVERGENCE ($) Negative*	ANALYSIS Y RATIO (%) Positive*	ANALYSIS Y RATIO (%) Negative*	NUMBER OF DIVERGENCES Positive*	NUMBER OF DIVERGENCES Negative*
		TOTAL INTEREST RECEIVED				
Mining & quarrying	85,067	00	1.09	.00	11	0
Manufacturing						
Food & kindred products	7,707	00	1.12	.00	2	0
Tobacco products	99,551	00	27.33	.00	1	0
Liquors & beverages	17,203	00	1.86	.00	3	0
Textiles, clothing, & apparel	12,407	41	.61	.00	5	1
Paper, printing, & publishing	19,498	00	1.45	.00	6	0
Chemicals & allied products	2,536	00	.25	.00	1	0
Stone, clay & glass	62,147	00	3.64	.00	8	0
Iron, steel, & nonferrous metals	22,083	00	.94	.00	5	0
Indust., agr., & other mach. & tool mfr.	205,423	5,160	3.37	.08	27	3
Autos, aircraft, & shipbuilding	49,711	31	4.32	.00	6	1
Miscellaneous	106,207	485	7.16	.03	7	1
Finance	106,648	7,046	1.13	.07	6	2
Trade	155,522	00	1.42	.00	21	0
Miscellaneous companies	47,541	00	4.58	.00	3	0
Service	15,121	00	3.82	.00	6	0
Public utilities	64,625	75,779	.19	.22	15	3

	INTEREST RECEIVED FROM TAX-EXEMPT SECURITIES					
Mining & quarrying	85,067	00	1.09	.00	11	0
Manufacturing						
Food & kindred products	7,707	00	1.12	.00	2	0
Tobacco products	95,551	00	27.33	.00	1	0
Liquors & beverages	17,203	00	1.86	.00	3	0
Textiles, clothing, & apparel	9,822	41	.48	.00	4	1
Paper, printing, & publishing	18,450	00	1.37	.00	5	0
Chemicals & allied products	2,536	00	.25	.00	1	0
Stone, clay & glass	62,147	00	3.64	.00	8	0
Iron, steel, & nonferrous metals	22,083	00	.94	.00	5	0
Indust., agr., & other mach. & tool mfr.	205,423	00	3.37	.00	27	0
Autos, aircraft, & shipbuilding	49,711	31	4.32	.00	6	1
Miscellaneous	106,207	00	7.16	.00	7	0
Finance	106,648	00	1.13	.00	6	0
Trade	104,276	00	.95	.00	20	0
Miscellaneous companies	47,541	00	4.58	.00	3	0
Service	15,121	00	3.82	.00	6	0
Public utilities	24,121	00	.07	.00	13	0

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	Negative*	ANALYSIS Y RATIO (%) Positive*	Negative*	NUMBER OF DIVERGENCES Positive*	Negative*
		OTHER INTEREST RECEIVED				
Mining & quarrying	00	00	.00	.00	0	0
Manufacturing						
Food & kindred products	00	00	.00	.00	0	0
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	00	00	.00	.00	0	0
Textiles, clothing, & apparel	2,585	00	.13	.00	1	0
Paper, printing, & publishing	1,048	00	.08	.00	1	0
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	00	00	.00	.00	0	0
Iron, steel, & nonferrous metals	00	00	.00	.00	0	0
Indust., agr., & other mach. & tool mfr.	00	5,160	.00	.08	0	3
Autos, aircraft, & shipbuilding	00	00	.00	.00	0	0
Miscellaneous	00	485	.00	.03	0	1
Finance	00	7,046	.00	.07	0	2
Trade	51,246	00	.47	.00	1	0
Miscellaneous companies	00	00	.00	.00	0	0
Service	00	00	.00	.00	0	0
Public utilities	40,504	75,779	.12	.22	2	3

			INVENTORIES			
Mining & quarrying	12,912	00	.17	.00	1	0
Manufacturing						
Food & kindred products	00	00	.00	.00	0	0
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	00	9,210	.00	.99	0	1
Textiles, clothing, & apparel	28,377	00	1.40	.00	2	0
Paper, printing, & publishing	00	748	.00	.06	0	1
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	7,292	67,357	.43	3.95	1	2
Iron, steel, & nonferrous metals	107,427	93,595	4.59	4.00	2	1
Indust., agr., & other mach. & tool mfr.	350,972	22,364	5.75	.37	5	3
Autos, aircraft, & shipbuilding	58,851	00	5.11	.00	3	0
Miscellaneous	130,079	00	8.77	.00	1	0
Finance	00	00	.00	.00	0	0
Trade	00	33,000	.00	.30	0	2
Miscellaneous companies	7,079	00	.68	.00	2	0
Service	00	00	.00	.00	0	0
Public utilities	15,071	14,975	.04	.04	2	5

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	Negative*	ANALYSIS Y RATIO (%) Positive*	Negative*	NUMBER OF DIVERGENCES Positive*	Negative*
		MISCELLANEOUS INCOME ITEMS				
Mining & quarrying	1,745,930	00	22.41	.00	8	0
Manufacturing						
Food & kindred products	445	00	.06	.00	1	0
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	00	3,467	.00	.37	0	1
Textiles, clothing, & apparel	14,300	541	.71	.03	1	1
Paper, printing, & publishing	160,487	00	11.97	.00	1	0
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	7,268	00	.43	.00	3	0
Iron, steel, & nonferrous metals	404	24,660	.02	1.05	1	1
Indust., agr., & other mach. & tool mfr.	270,372	11,798	4.43	.19	13	2
Autos, aircraft, & shipbuilding	36,363	77,968	3.16	6.77	1	3
Miscellaneous	00	00	.00	.00	0	0
Finance	789,752	701	8.39	.01	2	2
Trade	2,647,718	44,902	24.26	.41	12	2
Miscellaneous companies	4,286	253,200	.41	24.38	2	4
Service	2,208	00	.56	.00	1	0
Public utilities	209,254	34,017	.61	.10	8	3

	DEPRECIABLE AND DEPLETABLE ASSETS					
Mining & quarrying	4,035,007	241,744	51.78	3.10	24	6
Manufacturing						
Food & kindred products	280,615	78,389	40.83	11.41	7	3
Tobacco products	00	29,583	.00	8.12	0	1
Liquors & beverages	5,887	297,228	.64	32.10	3	16
Textiles, clothing, & apparel	436,042	227,158	21.55	11.23	10	6
Paper, printing, & publishing	611,313	288,688	45.61	21.55	5	3
Chemicals & allied products	220,934	6,500	21.76	.65	2	1
Stone, clay & glass	86,587	222,971	5.08	13.06	4	8
Iron, steel, & nonferrous metals	585,815	284,973	25.06	12.19	13	15
Indust., agr., & other mach. & tool mfr.	636,638	665,452	10.41	10.90	23	27
Autos, aircraft, & shipbuilding	141,939	75,548	12.33	6.56	8	13
Miscellaneous	201,172	33,957	13.58	2.30	7	6
Finance	106,077	40,976	1.13	.44	8	8
Trade	232,511	182,946	2.13	1.68	14	11
Miscellaneous companies	137,933	00	13.30	.00	5	0
Service	00	22,513	.00	5.69	0	5
Public utilities	11,321,253	399,016	32.89	1.16	29	6

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	AMOUNT OF DIVERGENCE ($) Negative*	ANALYSIS Y RATIO (%) Positive*	ANALYSIS Y RATIO (%) Negative*	NUMBER OF DIVERGENCES Positive*	NUMBER OF DIVERGENCES Negative*
			DEPRECIATION			
Mining & quarrying	71,662	28,599	.92	.37	3	2
Manufacturing						
Food & kindred products	101,843	13,796	14.82	2.01	5	1
Tobacco products	00	29,583	.00	8.12	0	1
Liquors & beverages	5,887	252,004	.64	27.22	3	13
Textiles, clothing, & apparel	116,921	174,876	5.77	8.64	5	3
Paper, printing, & publishing	600,393	288,688	44.80	21.55	3	3
Chemicals & allied products	2,990	6,500	.29	.65	1	1
Stone, clay & glass	86,587	182,972	5.08	10.71	4	4
Iron, steel, & nonferrous metals	426,763	231,762	18.26	9.91	8	11
Indust., agr., & other mach. & tool mfr.	579,431	514,644	9.47	8.43	19	20
Autos, aircraft, & shipbuilding	141,939	70,239	12.33	6.10	8	11
Miscellaneous	166,440	13,411	11.24	.91	6	3
Finance	73,415	6,002	.78	.06	3	1
Trade	232,511	166,946	2.13	1.53	14	10
Miscellaneous companies	72,684	00	7.00	.00	3	0
Service	00	20,486	.00	5.18	0	4
Public utilities	7,588,535	12,483	22.05	.04	23	1

			DEPLETION			
Mining & quarrying	3,860,059	201,850	49.53	2.58	19	4
Manufacturing						
Food & kindred products	00	00	.00	.00	0	0
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	00	00	.00	.00	0	0
Textiles, clothing, & apparel	00	6,578	.00	.33	0	1
Paper, printing, & publishing	6,089	00	.45	.00	1	0
Chemicals & allied products	217,944	00	21.47	.00	1	0
Stone, clay & glass	00	33,186	.00	1.95	0	2
Iron, steel, & nonferrous metals	00	38,365	.00	1.64	0	1
Indust., agr., & other mach. & tool mfr.	17,647	798	.29	.01	1	1
Autos, aircraft, & shipbuilding	00	00	.00	.00	0	0
Miscellaneous	00	4,009	.00	.27	0	1
Finance	208	00	.00	.00	1	0
Trade	00	00	.00	.00	0	0
Miscellaneous companies	65,249	00	6.30	.00	2	0
Service	00	00	.00	.00	0	0
Public utilities	13,996	6,495	.04	.02	2	1

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	Negative*	ANALYSIS Y RATIO (%) Positive*	Negative*	NUMBER OF DIVERGENCES Positive*	Negative*
	ITEMS ALTERNATIVELY REGARDED AS CAPITAL EXPENDITURES OR CURRENT EXPENSES					
Mining & quarrying	00	8,286	.00	.11	1	0
Manufacturing						
Food & kindred products	00	00	.00	.00	0	0
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	00	00	.00	.00	0	0
Textiles, clothing, & apparel	00	45,126	.00	2.23	0	1
Paper, printing, & publishing	00	00	.00	.00	0	0
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	00	00	.00	.00	0	0
Iron, steel, & nonferrous metals	00	5,767	.00	.25	0	1
Indust., agr., & other mach. & tool mfr.	5,292	147,440	.09	2.42	1	4
Autos, aircraft, & shipbuilding	00	00	.00	.00	0	0
Miscellaneous	34,732	5,914	2.34	.40	1	1
Finance	20,673	34,974	.22	.38	3	7
Trade	00	00	.00	.00	0	0
Miscellaneous companies	00	00	.00	.00	0	0
Service	00	00	.00	.00	0	0
Public utilities	901,134	1,660	2.62	.00	2	1

	LOSSES ON ABANDONMENT OF FIXED ASSETS					
Mining & quarrying	103,286	3,009	1.33	.04	1	0
Manufacturing						
Food & kindred products	178,772	64,593	26.01	9.40	2	2
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	00	45,224	.00	4.88	0	3
Textiles, clothing, & apparel	319,121	578	15.78	.03	5	1
Paper, printing, & publishing	4,831	00	.36	.00	1	0
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	00	6,813	.00	.40	0	2
Iron, steel, & nonferrous metals	159,052	9,079	6.80	.39	5	2
Indust., agr., & other mach. & tool mfr.	34,268	2,570	.56	.04	2	2
Autos, aircraft, & shipbuilding	00	5,309	.00	.46	0	2
Miscellaneous	00	10,623	.00	.72	0	1
Finance	11,781	00	.13	.00	1	0
Trade	00	16,000	.00	.15	0	1
Miscellaneous companies	00	00	.00	.00	0	0
Service	00	2,027	.00	.51	0	1
Public utilities	2,817,588	378,378	8.18	1.10	2	3

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	Negative*	ANALYSIS Y RATIO (%) Positive*	Negative*	NUMBER OF DIVERGENCES Positive*	Negative*
			INTANGIBLE ASSETS			
Mining & quarrying	770,596	49,184	9.89	.63	7	2
Manufacturing						
Food & kindred products	1,292	581	.19	.08	1	1
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	5,330	6,097	.58	.66	1	2
Textiles, clothing, & apparel	00	11,918	.00	.59	0	1
Paper, printing, & publishing	00	1,085	.00	.08	0	1
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	00	91,560	.00	5.37	0	4
Iron, steel, & nonferrous metals	14,793	8,809	.63	.38	3	2
Indust., agr., & other mach. & tool mfr.	259,493	133,587	4.25	2.19	19	16
Autos, aircraft, & shipbuilding	107,308	46,829	9.32	4.07	12	11
Miscellaneous	429,499	30,715	28.97	2.07	3	5
Finance	8,164	747	.09	.01	1	1
Trade	864,386	13,094	7.92	.12	8	3
Miscellaneous companies	230	39,081	.02	3.76	1	2
Service	00	120,190	.00	30.38	0	1
Public utilities	211,753	22,853	.62	.07	7	3

	ORGANIZATION AND REORGANIZATION EXPENSES					
Mining & quarrying	00	00	.00	.00	0	0
Manufacturing						
Food & kindred products	1,292	00	.19	.00	1	0
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	00	5,797	.00	.63	0	1
Textiles, clothing, & apparel	00	11,918	.00	.59	0	1
Paper, printing, & publishing	00	1,085	.00	.08	0	1
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	00	77,807	.00	4.56	0	2
Iron, steel, & nonferrous metals	00	00	.00	.00	0	0
Indust., agr., & other mach. & tool mfr.	00	26,257	.00	.43	0	2
Autos, aircraft, & shipbuilding	00	13,009	.00	1.13	0	5
Miscellaneous	00	00	.00	.00	0	0
Finance	00	00	.00	.00	0	0
Trade	1,017	4,737	.01	.04	1	2
Miscellaneous companies	00	39,081	.00	3.76	0	2
Service	00	120,190	.00	30.38	0	1
Public utilities	00	7,000	.00	.02	0	1

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	AMOUNT OF DIVERGENCE ($) Negative*	ANALYSIS Y RATIO (%) Positive*	ANALYSIS Y RATIO (%) Negative*	NUMBER OF DIVERGENCES Positive*	NUMBER OF DIVERGENCES Negative*
			PATENT EXPENSES			
Mining & quarrying	00	00	.00	.00	0	0
Manufacturing						
Food & kindred products	00	581	.00	.08	0	1
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	5,330	00	.58	.00	1	0
Textiles, clothing, & apparel	00	00	.00	.00	0	0
Paper, printing, & publishing	00	00	.00	.00	0	0
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	00	787	.00	.05	0	1
Iron, steel, & nonferrous metals	229	7,097	.01	.31	1	1
Indust., agr., & other mach. & tool mfr.	196,849	93,764	3.22	1.54	17	11
Autos, aircraft, & shipbuilding	41,139	12,849	3.57	1.12	10	3
Miscellaneous	707	645	.05	.04	1	2
Finance	00	00	.00	.00	0	0
Trade	00	00	.00	.00	0	0
Miscellaneous companies	230	00	.02	.00	1	0
Service	00	00	.00	.00	0	0
Public utilities	117	00	.00	.00	1	0

		OTHER INTANGIBLE ASSETS				
Mining & quarrying	770,596	49,184	9.89	.63	7	2
Manufacturing						
Food & kindred products	00	00	.00	.00	0	0
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	00	300	.00	.03	0	1
Textiles, clothing, & apparel	00	00	.00	.00	0	0
Paper, printing, & publishing	00	00	.00	.00	0	0
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	00	12,966	.00	.76	0	1
Iron, steel, & nonferrous metals	14,564	1,712	.62	.07	2	1
Indust., agr., & other mach. & tool mfr.	62,644	13,566	1.03	.22	2	3
Autos, aircraft, & shipbuilding	66,169	20,971	5.75	1.82	2	3
Miscellaneous	428,792	30,070	28.92	2.03	2	3
Finance	8,164	747	.09	.01	1	1
Trade	863,369	8,357	7.91	.08	7	1
Miscellaneous companies	00	00	.00	.00	0	0
Service	00	00	.00	.00	0	0
Public utilities	211,636	15,853	.62	.05	6	2

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	AMOUNT OF DIVERGENCE ($) Negative*	ANALYSIS Y RATIO (%) Positive*	ANALYSIS Y RATIO (%) Negative*	NUMBER OF DIVERGENCES Positive*	NUMBER OF DIVERGENCES Negative*
			BAD DEBT EXPENSES			
Mining & quarrying	9,770	00	.13	.24	1	3
Manufacturing						
Food & kindred products	13,982	500	2.03	.07	5	1
Tobacco products	00	30,611	.00	8.40	0	1
Liquors & beverages	48,750	37,724	5.26	4.07	3	7
Textiles, clothing, & apparel	4,221	123,353	.21	6.10	3	4
Paper, printing, & publishing	2,749	22,387	.21	1.67	4	4
Chemicals & allied products	236	19,057	.02	1.88	1	1
Stone, clay & glass	62,857	96,603	3.68	5.66	5	5
Iron, steel, & nonferrous metals	44,633	45,042	1.91	1.93	8	4
Indust., agr., & other mach. & tool mfr.	155,267	247,583	2.54	4.06	15	21
Autos, aircraft, & shipbuilding	51,878	12,967	4.51	1.13	9	7
Miscellaneous	10,799	43,573	.73	2.94	4	8
Finance	131,032	14,601	1.39	.16	3	2
Trade	230,533	875,063	2.11	8.02	13	9
Miscellaneous companies	43,758	1,736	4.21	.17	2	1
Service	33,805	00	8.55	.00	1	0
Public utilities	240	524,414	.00	1.52	2	13

		TOTAL INTEREST PAID				
Mining & quarrying	15,304	00	.20	.00	4	0
Manufacturing						
Food & kindred products	68	00	.01	.00	2	0
Tobacco products	298	984	.08	.27	1	1
Liquors & beverages	1,975	00	.21	.00	3	0
Textiles, clothing, & apparel	190	2,528	.01	.12	1	1
Paper, printing, & publishing	2,850	95	.21	.01	2	1
Chemicals & allied products	00	4,577	.00	.45	0	1
Stone, clay & glass	35,019	00	2.05	.00	1	0
Iron, steel, & nonferrous metals	54,787	16,495	2.34	.71	2	3
Indust., agr., & other mach. & tool mfr.	197,004	18,703	3.23	.31	8	5
Autos, aircraft, & shipbuilding	26,316	4,489	2.29	.39	5	5
Miscellaneous	1,125	00	.08	.00	3	0
Finance	45,739	403,699	.49	4.29	4	2
Trade	243,006	3,601	2.23	.03	9	2
Miscellaneous companies	252,356	00	24.30	.00	3	0
Service	00	538	.00	.14	0	1
Public utilities	17,036,146	868,284	49.50	2.52	30	12

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	Negative*	ANALYSIS Y RATIO (%) Positive*	Negative*	NUMBER OF DIVERGENCES Positive*	Negative*
		FUNDED DEBT EXPENSES				
Mining & quarrying	12,464	00	.16	.00	2	0
Manufacturing						
Food & kindred products	00	00	.00	.00	0	0
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	70	00	.01	.00	1	0
Textiles, clothing, & apparel	00	00	.00	.00	0	0
Paper, printing, & publishing	2,850	00	.21	.00	2	0
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	35,019	00	2.05	.00	1	0
Iron, steel, & nonferrous metals	54,357	16,495	2.32	.71	1	3
Indust., agr., & other mach. & tool mfr.	110,933	2,505	1.82	.04	4	1
Autos, aircraft, & shipbuilding	7,243	00	.63	.00	2	0
Miscellaneous	195	00	.01	.00	1	0
Finance	45,723	403,699	.49	4.29	3	2
Trade	17,950	489	.16	.00	4	1
Miscellaneous companies	252,066	00	24.27	.00	2	0
Service	00	00	.00	.00	0	0
Public utilities	15,621,348	856,890	45.39	2.49	14	7

	INTEREST ON PRIOR YEAR FEDERAL INCOME TAXES					
Mining & quarrying	00	00	.00	.00	0	0
Manufacturing						
Food & kindred products	68	00	.01	.00	2	0
Tobacco products	298	00	.08	.00	1	0
Liquors & beverages	1,905	00	.20	.00	2	0
Textiles, clothing, & apparel	190	2,528	.01	.12	1	1
Paper, printing, & publishing	00	00	.00	.00	0	0
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	00	00	.00	.00	0	0
Indust., agr., & other mach. & tool mfr.	00	00	.00	.00	0	0
Iron, steel, & nonferrous metals	34,629	00	.57	.00	2	0
Autos, aircraft, & shipbuilding	5,573	00	.48	.00	2	0
Miscellaneous	930	00	.07	.00	2	0
Finance	16	00	.00	.00	1	0
Trade	2,679	00	.02	.00	4	0
Miscellaneous companies	00	00	.00	.00	0	0
Service	00	00	.00	.00	0	0
Public utilities	3,843	6,531	.01	.02	2	2

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	Negative*	ANALYSIS Y RATIO (%) Positive*	Negative*	NUMBER OF DIVERGENCES Positive*	Negative*
	INTEREST ON INDEBTEDNESS INCURRED TO PURCHASE TAX-EXEMPT SECURITIES					
Mining & quarrying	00	00	.00	.00	0	0
Manufacturing						
Food & kindred products	00	00	.00	.00	0	0
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	00	00	.00	.00	0	0
Textiles, clothing, & apparel	00	00	.00	.00	0	0
Paper, printing, & publishing	00	00	.00	.00	0	0
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	00	00	.00	.00	0	0
Iron, steel, & nonferrous metals	00	00	.00	.00	0	0
Indust., agr., & other mach. & tool mfr.	00	11,945	.00	.20	0	2
Autos, aircraft, & shipbuilding	00	2,260	.00	.20	0	2
Miscellaneous	00	00	.00	.00	0	0
Finance	00	00	.00	.00	0	0
Trade	00	00	.00	.00	0	0
Miscellaneous companies	00	00	.00	.00	0	0
Service	00	00	.00	.00	0	0
Public utilities	00	00	.00	.00	0	0

		OTHER INTEREST PAID				
Mining & quarrying	2,840	00	.04	.00	2	0
Manufacturing						
Food & kindred products	00	00	.00	.00	0	0
Tobacco products	00	984	.00	.27	0	1
Liquors & beverages	00	00	.00	.00	0	0
Textiles, clothing, & apparel	00	00	.00	.00	0	0
Paper, printing, & publishing	00	95	.00	.01	0	1
Chemicals & allied products	00	4,577	.00	.45	0	1
Stone, clay & glass	00	00	.00	.00	0	0
Iron, steel, & nonferrous metals	430	00	.02	.00	1	0
Indust., agr., & other mach. & tool mfr.	51,442	4,253	.84	.07	2	2
Autos, aircraft, & shipbuilding	13,500	2,229	1.18	.19	1	3
Miscellaneous	00	00	.00	.00	0	0
Finance	00	00	.00	.00	0	0
Trade	222,377	3,112	2.05	.03	1	1
Miscellaneous companies	290	00	.03	.00	1	0
Service	00	538	.00	.14	0	1
Public utilities	1,410,955	4,863	4.10	.01	14	3

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	AMOUNT OF DIVERGENCE ($) Negative*	ANALYSIS Y RATIO (%) Positive*	ANALYSIS Y RATIO (%) Negative*	NUMBER OF DIVERGENCES Positive*	NUMBER OF DIVERGENCES Negative*
	TAXES PAID (EXCL. FEDERAL INCOME AND UNDISTRIBUTED PROFITS TAXES)					
Mining & quarrying	13,879	76,261	.18	.98	5	12
Manufacturing						
Food & kindred products	33,718	11,093	4.91	1.61	3	7
Tobacco products	9,775	2,680	2.68	.74	2	1
Liquors & beverages	47,869	9,844	5.17	1.06	7	8
Textiles, clothing, & apparel	43,773	14,932	2.16	.74	9	6
Paper, printing, & publishing	21,727	3,000	1.62	.22	8	1
Chemicals & allied products	2,467	6,407	.24	.63	3	3
Stone, clay & glass	31,362	64,781	1.84	3.80	5	7
Iron, steel, & nonferrous metals	99,723	26,471	4.26	1.13	6	9
Indust., agr., & other mach. & tool mfr.	146,511	100,774	2.40	1.65	33	24
Autos, aircraft, & shipbuilding	35,341	4,908	3.07	.43	19	6
Miscellaneous	3,254	23,200	.22	1.57	5	7
Finance	102,578	794,492	1.09	8.44	13	20
Trade	119,319	97,199	1.10	.89	17	15
Miscellaneous companies	4,303	15,467	.41	1.49	2	6
Service	9,912	1,349	2.51	.34	3	6
Public utilities	304,089	69,500	.88	.20	12	14

		RENTS AND ROYALTIES PAID				
Mining & quarrying	72,232	2,774	.93	.04	1	2
Manufacturing						
Food & kindred products	00	52,040	.00	7.57	0	2
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	00	00	.00	.00	0	0
Textiles, clothing, & apparel	00	00	.00	.00	0	0
Paper, printing, & publishing	00	00	.00	.00	0	0
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	3,741	00	.22	.00	1	0
Iron, steel, & nonferrous metals	00	00	.00	.00	0	0
Indust., agr., & other mach. & tool mfr.	9,730	00	.16	.00	1	0
Autos, aircraft, & shipbuilding	00	00	.00	.00	0	0
Miscellaneous	00	1,033	.00	.07	0	1
Finance	00	4,874	.00	.05	0	1
Trade	2,037	21,463	.02	.20	2	1
Miscellaneous companies	00	00	.00	.00	0	0
Service	00	00	.00	.00	0	0
Public utilities	550	00	.00	.00	1	0

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	AMOUNT OF DIVERGENCE ($) Negative*	ANALYSIS Y RATIO (%) Positive*	ANALYSIS Y RATIO (%) Negative*	NUMBER OF DIVERGENCES Positive*	NUMBER OF DIVERGENCES Negative*
			TOTAL NONALLOWABLE RESERVES			
Mining & quarrying	42,878	239,825	.55	3.06	2	5
Manufacturing						
Food & kindred products	39,657	11,926	5.77	1.74	2	3
Tobacco products	21,676	20,950	5.95	5.75	3	4
Liquors & beverages	43,933	56,504	4.74	6.10	5	6
Textiles, clothing, & apparel	100,523	182,383	4.97	9.02	4	10
Paper, printing, & publishing	18,805	17,618	1.40	1.31	2	4
Chemicals & allied products	00	10,000	.00	.98	0	1
Stone, clay & glass	276,157	391,625	16.19	22.96	9	10
Iron, steel, & nonferrous metals	157,281	58,945	6.73	2.52	11	6
Indust., agr., & other mach. & tool mfr.	534,042	552,090	8.75	9.04	25	38
Autos, aircraft, & shipbuilding	26,429	19,506	2.30	1.69	6	4
Miscellaneous	207,400	61,284	13.99	4.13	3	5
Finance	1,280,019	19,817	13.59	.21	7	5
Trade	533,526	799,111	4.89	7.25	24	26
Miscellaneous companies	54,774	7,800	5.27	.75	4	1
Service	1,825	39,340	.46	9.95	1	1
Public utilities	509,853	410,837	1.48	1.19	16	20

	NONALLOWABLE RESERVES FOR INSURANCE AND COMPENSATION					
Mining & quarrying	40,698	58,453	·52	·75	1	4
Manufacturing						
Food & kindred products	00	1,729	.00	.25	0	1
Tobacco products	00	6,565	.00	1.80	0	1
Liquors & beverages	611	3,718	.07	.40	1	2
Textiles, clothing, & apparel	00	00	.00	.00	0	0
Paper, printing, & publishing	00	17,413	.00	1.30	0	2
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	121,169	9,582	7.10	·56	4	2
Iron, steel, & nonferrous metals	29,612	12,809	1.27	·55	3	2
Indust., agr., & other mach. & tool mfr.	86,925	27,133	1.42	·44	4	6
Autos, aircraft, & shipbuilding	2,755	3,617	.24	·31	2	1
Miscellaneous	00	00	.00	.00	0	0
Finance	17,893	2,049	.19	.02	2	1
Trade	48,303	37,389	·44	·34	6	10
Miscellaneous companies	31,439	00	3.02	.00	1	0
Service	1,825	00	.46	.00	1	0
Public utilities	89,688	198,318	.26	·58	5	11

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	AMOUNT OF DIVERGENCE ($) Negative*	ANALYSIS Y RATIO (%) Positive*	ANALYSIS Y RATIO (%) Negative*	NUMBER OF DIVERGENCES Positive*	NUMBER OF DIVERGENCES Negative*
	NONALLOWABLE RESERVES FOR REPAIRS AND REPLACEMENTS					
Mining & quarrying	00	00	.00	.00	0	0
Manufacturing						
Food & kindred products	00	00	.00	.00	0	0
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	3,155	14,635	.34	1.58	1	3
Textiles, clothing, & apparel	41,820	00	2.07	.00	1	0
Paper, printing, & publishing	00	00	.00	.00	0	0
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	00	00	.00	.00	0	0
Iron, steel, & nonferrous metals	11,951	1,684	.51	.07	1	1
Indust., agr., & other mach. & tool mfr.	29,862	21,011	.49	.34	2	3
Autos, aircraft, & shipbuilding	2,636	00	.23	.00	1	0
Miscellaneous	00	00	.00	.00	0	0
Finance	00	00	.00	.00	0	0
Trade	129,135	1,845	1.18	.02	2	2
Miscellaneous companies	14,032	00	1.35	.00	2	0
Service	00	00	.00	.00	0	0
Public utilities	36,642	25,391	.11	.07	2	2

	NONALLOWABLE RESERVES FOR INVESTMENT AND EXCHANGE FLUCTUATIONS					
Mining & quarrying	00	00	.00	.00	0	0
Manufacturing						
Food & kindred products	2,400	00	.35	.00	1	0
Tobacco products	00	13,021	.00	3.58	0	1
Liquors & beverages	00	00	.00	.00	0	0
Textiles, clothing, & apparel	00	29,039	.00	1.44	0	2
Paper, printing, & publishing	1,912	148	.14	.01	1	1
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	00	372,928	.00	21.87	0	4
Iron, steel, & nonferrous metals	36,160	00	1.55	.00	4	0
Indust., agr., & other mach. & tool mfr.	119,638	27,850	1.96	.46	4	7
Autos, aircraft, & shipbuilding	21,038	00	1.83	.00	3	0
Miscellaneous	46,117	20,399	3.11	1.38	1	1
Finance	802,089	61	8.52	.00	2	1
Trade	129,208	48,571	1.18	.44	5	4
Miscellaneous companies	00	7,800	.00	.75	0	1
Service	00	00	.00	.00	0	0
Public utilities	988	89	.00	.00	1	1

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	AMOUNT OF DIVERGENCE ($) Negative*	ANALYSIS Y RATIO (%) Positive*	ANALYSIS Y RATIO (%) Negative*	NUMBER OF DIVERGENCES Positive*	NUMBER OF DIVERGENCES Negative*
	NONALLOWABLE RESERVES FOR SALES EXPENSES					
Mining & quarrying	00	00	.00	.00	0	0
Manufacturing						
Food & kindred products	00	6,710	.00	.98	0	2
Tobacco products	5,560	1,364	1.53	.37	2	2
Liquors & beverages	00	00	.00	.00	0	0
Textiles, clothing, & apparel	747	153,094	.04	7.57	1	7
Paper, printing, & publishing	16,893	57	1.26	.00	1	1
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	14,927	00	.87	.00	2	0
Iron, steel, & nonferrous metals	3,905	2,743	.17	.12	1	1
Indust., agr., & other mach. & tool mfr.	49,461	267,425	.81	4.38	9	10
Autos, aircraft, & shipbuilding	00	1,525	.00	.13	0	1
Miscellaneous	1,283	37,394	.09	2.51	1	2
Finance	00	6,879	.00	.07	0	1
Trade	8,240	51,874	.08	.48	4	4
Miscellaneous companies	9,303	00	.90	.00	1	0
Service	00	00	.00	.00	0	0
Public utilities	19,590	49,694	.06	.14	1	3

		OTHER NONALLOWABLE RESERVES (INCL. CONTINGENCY RESERVES)			
Mining & quarrying	2,180	181,372	.03	2.31	1	1
Manufacturing						
Food & kindred products	37,257	3,487	5.42	.51	1	0
Tobacco products	16,116	00	4.42	.00	1	0
Liquors & beverages	40,167	38,151	4.33	4.12	3	1
Textiles, clothing, & apparel	57,956	250	2.86	.01	2	1
Paper, printing, & publishing	00	00	.00	.00	0	0
Chemicals & allied products	00	10,000	.00	.98	0	1
Stone, clay & glass	140,061	9,115	8.22	.53	3	4
Iron, steel, & nonferrous metals	75,653	41,709	3.23	1.78	2	2
Indust., agr., & other mach. & tool mfr.	248,156	208,671	4.07	3.42	6	12
Autos, aircraft, & shipbuilding	00	14,364	.00	1.25	0	2
Miscellaneous	160,000	3,491	10.79	.24	1	2
Finance	460,037	10,828	4.88	.12	3	2
Trade	218,640	651,432	2.01	5.97	7	6
Miscellaneous companies	00	00	.00	.00	0	0
Service	00	39,340	.00	9.95	0	1
Public utilities	362,945	137,345	1.05	.40	7	3

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	AMOUNT OF DIVERGENCE ($) Negative*	ANALYSIS Y RATIO (%) Positive*	ANALYSIS Y RATIO (%) Negative*	NUMBER OF DIVERGENCES Positive*	NUMBER OF DIVERGENCES Negative*
			TOTAL MISCELLANEOUS DEDUCTIONS			
Mining & quarrying	1,417	69,748	.02	.90	2	11
Manufacturing						
Food & kindred products	74,185	26,037	10.80	3.79	4	12
Tobacco products	132,874	4,375	36.49	1.20	1	3
Liquors & beverages	262,616	47,029	28.36	5.08	7	16
Textiles, clothing, & apparel	176,724	51,241	8.74	2.53	3	13
Paper, printing, & publishing	102,282	50,856	7.63	3.79	1	11
Chemicals & allied products	00	16,479	.00	1.62	0	6
Stone, clay & glass	59	25,801	.00	1.51	1	13
Iron, steel, & nonferrous metals	77,471	18,795	3.31	.80	5	9
Indust., agr., & other mach. & tool mfr.	387,350	498,500	6.35	8.17	11	50
Autos, aircraft, & shipbuilding	59,099	153,756	5.13	13.36	7	34
Miscellaneous	37,526	25,852	2.53	1.74	4	13
Finance	849,721	4,107	9.02	.04	7	7
Trade	3,131,607	186,476	28.67	1.70	10	42
Miscellaneous companies	143,634	23,950	13.83	2.31	4	8
Service	18,996	119,994	4.80	30.33	2	6
Public utilities	1,053,113	521,522	3.06	1.52	13	24

	NONALLOWABLE DONATIONS AND CONTRIBUTIONS					
Mining & quarrying	00	52,088	.00	.69	0	6
Manufacturing						
Food & kindred products	00	5,791	.00	.84	0	5
Tobacco products	00	330	.00	.09	0	1
Liquors & beverages	00	11,868	.00	1.28	0	7
Textiles, clothing, & apparel	605	3,277	.03	.16	1	4
Paper, printing, & publishing	00	2,776	.00	.21	0	4
Chemicals & allied products	00	00	.00	.00	0	0
Stone, clay & glass	00	9,818	.00	.58	0	7
Iron, steel, & nonferrous metals	00	7,788	.00	.33	0	5
Indust., agr., & other mach. & tool mfr.	00	6,814	.00	.11	0	17
Autos, aircraft, & shipbuilding	750	2,661	.07	.23	1	7
Miscellaneous	00	1,178	.00	.08	0	5
Finance	00	934	.00	.01	0	3
Trade	00	60,162	.00	.55	0	12
Miscellaneous companies	00	3,264	.00	.31	0	2
Service	246	256	.06	.06	1	1
Public utilities	1,657	77,236	.01	.22	1	12

TABLE 25 (cont.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($) Positive*	AMOUNT OF DIVERGENCE ($) Negative*	ANALYSIS Y RATIO (%) Positive*	ANALYSIS Y RATIO (%) Negative*	NUMBER OF DIVERGENCES Positive*	NUMBER OF DIVERGENCES Negative*
	INSURANCE PREMIUMS ON OFFICERS' LIVES WHEN THE TAXPAYER IS A BENEFICIARY					
Mining & quarrying	1,338	10,864	.02	.16	1	3
Manufacturing						
Food & kindred products	330	13,832	.05	2.02	1	5
Tobacco products	00	3,100	.00	.85	0	1
Liquors & beverages	147,415	29,900	15.92	3.23	1	7
Textiles, clothing, & apparel	00	18,034	.00	.89	0	8
Paper, printing, & publishing	00	47,279	.00	3.52	0	5
Chemicals & allied products	00	4,097	.00	.40	0	3
Stone, clay & glass	00	6,874	.00	.40	0	3
Iron, steel, & nonferrous metals	3,793	11,007	.16	.47	1	4
Indust., agr., & other mach. & tool mfr.	9,991	80,943	.16	1.33	4	27
Autos, aircraft, & shipbuilding	976	107,768	.08	9.37	2	24
Miscellaneous	952	16,061	.06	1.08	1	7
Finance	5,587	3,000	.06	.03	1	2
Trade	9,395	82,847	.09	.76	3	24
Miscellaneous companies	00	7,698	.00	.74	0	4
Service	00	9,146	.00	2.31	0	3
Public utilities	00	00	.00	.00	0	0

			OTHER MISCELLANEOUS DEDUCTIONS			
Mining & quarrying	79	4,041	.00	.05	1	2
Manufacturing						
Food & kindred products	73,855	6,414	10.75	.93	3	2
Tobacco products	132,874	945	36.49	.26	1	1
Liquors & beverages	115,201	5,261	12.44	.57	6	2
Textiles, clothing, & apparel	176,119	29,930	8.71	1.48	2	1
Paper, printing, & publishing	102,282	801	7.63	.06	1	2
Chemicals & allied products	00	12,382	.00	1.22	0	3
Stone, clay & glass	59	9,109	.00	.53	1	3
Iron, steel, & nonferrous metals	73,678	00	3.15	.00	4	0
Indust., agr., & other mach. & tool mfr.	377,359	410,743	6.19	6.73	7	6
Autos, aircraft, & shipbuilding	57,373	43,327	4.98	3.76	4	3
Miscellaneous	36,574	8,613	2.47	.58	3	1
Finance	844,134	173	8.96	.00	6	2
Trade	3,122,212	43,467	28.58	.39	7	6
Miscellaneous companies	143,634	12,988	13.83	1.26	4	2
Service	18,750	110,592	4.74	27.96	1	2
Public utilities	1,051,456	444,286	3.05	1.30	12	12

TABLE 25 (concl.)

INDUSTRIAL GROUP	AMOUNT OF DIVERGENCE ($)		ANALYSIS Y RATIO (%)		NUMBER OF DIVERGENCES	
	Positive*	Negative*	Positive*	Negative*	Positive*	Negative*
	SCOPE OF ACCOUNTING UNIT					
Mining & quarrying	00	00	.00	.00	0	0
Manufacturing						
Food & kindred products	00	00	.00	.00	0	0
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	00	00	.00	.00	0	0
Textiles, clothing, & apparel	00	00	.00	.00	0	0
Paper, printing, & publishing	00	00	.00	.00	0	0
Chemicals & allied products	21,596	00	2.13	.00	1	0
Stone, clay & glass	00	395	.00	.02	0	1
Iron, steel, & nonferrous metals	00	918	.00	.04	0	1
Indust., agr., & other mach. & tool mfr.	12,030	37,464	.20	.61	2	3
Autos, aircraft, & shipbuilding	83,562	383	7.26	.03	2	1
Miscellaneous	00	00	.00	.00	0	0
Finance	6,000	6,000	.06	.06	1	1
Trade	3,682	219,485	.03	2.01	1	2
Miscellaneous companies	00	00	.00	.00	0	0
Service	00	00	.00	.00	0	0
Public utilities	00	187,984	.00	.55	0	1

	REORGANIZATIONS, MERGERS, AND DISSOLUTIONS					
Mining & quarrying	00	00	.00	.00	0	0
Manufacturing						
Food & kindred products	00	00	.00	.00	0	0
Tobacco products	00	00	.00	.00	0	0
Liquors & beverages	00	00	.00	.00	0	0
Textiles, clothing, & apparel	00	00	.00	.00	0	0
Paper, printing, & publishing	00	00	.00	.00	0	0
Chemicals & allied products	691,619	00	68.10	.00	1	0
Stone, clay & glass	00	00	.00	.00	0	0
Iron, steel, & nonferrous metals	00	00	.00	.00	0	0
Indust., agr., & other mach. & tool mfr.	13,751	00	.23	.00	2	0
Autos, aircraft, & shipbuilding	00	00	.00	.00	0	0
Miscellaneous	00	00	.00	.00	0	0
Finance	00	00	.00	.00	0	0
Trade	206,614	00	1.89	.00	2	0
Miscellaneous companies	00	55	.00	.01	0	1
Service	00	00	.00	.00	0	0
Public utilities	00	00	.00	.00	0	0

treated as income items for book purposes but as a return of capital for tax purposes. (b) For the corporations deducting dividends under the Revenue Act of 1934, Section 23 (p), statutory net income is not defined as it is above.[1] (c) Two companies reported treasury stock dividends. (d) Nontaxable stock dividends were presumably regarded as increasing book profit.

Examples tending to have the opposite effect, namely, to cause statutory net income to exceed book profit, follow: (a) Dividends received from subsidiaries were apparently included in statutory net income but not in book profit. (b) Dividends from domestic companies were reported as "credited to surplus" on the books of one company but were included in statutory net income. In another and possibly more typical case, dividends received were credited to an asset account (probably an investment account) instead of to income or surplus. (c) Dividends in arrears were reported as "capitalized" by one company for book purposes, but presumably were taxable in the year received. The exact nature of this transaction is not clear, since dividends received are not ordinarily capitalized in the strict accounting sense of the term. Possibly cumulative preferred dividends were treated as accrued income in preceding years even though they had not been received. In this event, the current year book credit for income from dividends received would include only dividends accrued during the current year. But, according to the tax regulations, all dividends, both those accruing in the current year and in preceding years, would be regarded as current year income. If, on the other hand, the dividends were not accrued in preceding years, they may have been credited to surplus instead of to income for book purposes, since they may have been regarded as actu-

1 Why these companies reported their 1936 incomes under the 1934 Act is not known. Perhaps fiscal year complications are involved. Section 23 (p), providing that the amount received as dividends from a domestic corporation subject to taxation under the 1934 Act may be deducted from gross income in determining statutory net income, was replaced by a partial dividend credit in the Revenue Act of 1936.

ally representing preceding years', rather than current, income. (d) One company reported taxable stock dividends which were not entered on its books as income.

B Class 2: Capital Gains and Losses

Different amounts of capital gains and losses may be reported for tax and book purposes for a wide variety of reasons. No attempt will be made to explain or to classify these reasons systematically. An explanation would obviously entail a discussion of the intricate problems of reorganization procedure, basis determination, and depreciation and depletion accounting, and the considerations involved in deciding whether to treat an item as an income or surplus charge for book purposes. These issues are discussed in detail in Part One.

Unfortunately, the data on capital gains and losses are not consistently reported in sufficient detail to warrant subdivision. The unsegregated data are presented in Table 25. Approximately 30 percent of the companies in Sample I report different treatments of capital gains and losses for book and tax purposes. Except for two industrial groups—iron and steel and nonferrous metals companies, and finance companies—the Analysis Y ratio lies with surprising consistency, in view of the size of the sample, in the 0-8 percent range. In general, deviations in Class 2 seem considerably smaller than might have been expected. The high ratio for the iron and steel and nonferrous metals group is attributable to the unusually large deviations reported by two companies. Consequently, it probably may be regarded as a statistical accident rather than as an indication that Class 2 divergences are especially large in this particular group. On the other hand, the high ratio for the finance group—accounting for nearly half of aggregate divergences in this group—is entirely in accord with expectations. While individual divergences vary from negligible amounts to nearly $1,000,000, there is a liberal sprinkling of large divergences, including at least a half dozen of more than $100,000. Even though from the evidence of Sample I, capital gains and

losses may seem not to be a major source of divergence except among financial enterprises, Class 2 is important because an extremely large divergence may appear at any time in any industrial group.

Moreover, the importance of divergences in Class 2 may conceivably be seriously underestimated because items that properly belong in it were put in other classes. In some degree the line between "losses on the abandonment of fixed assets" (Subclass 6d) and "nonallowable reserves for investment and exchange fluctuations" (Subclass 12c) on the one hand, and Class 2 on the other, was difficult to draw. In general, items representing merely unrealized adjustments of book values were put in Subclass 12c, while Class 2 consists of realized gains and losses. Moreover, certain Class 2 items may be concealed in the unspecified portions of the two miscellaneous classes, 5 and 13, or in Subclass 12e, "other nonallowable reserves". Indeed, the general principle may be laid down that divergences in all narrowly defined classes, as distinct from the 'miscellaneous' classes, are likely to be understated because of the difficulty of identifying some items not described in detail on tax returns. Nevertheless, these possible sources of understatement probably do not drastically distort the impression Class 2 gives.

Despite the lack of detail, a case by case perusal of Class 2 divergences reveals certain pervasive causes. At least 20 companies reported divergences due to different bases for tax and book purposes. For example, a textile company reported a higher tax than book net residual value of fixed assets disposed of during the year. A metal company reported a loss on securities sold which had been written down on its books to nominal values in prior years. This write-down was, of course, not recognized for tax purposes. Divergences of this general nature may reflect merely a difference in the particular accounting periods to which income is assigned for the two purposes.

At least ten companies reported taxable capital gains or deductible losses that had been credited or charged to surplus on

their books. As the above discussion indicates, such divergences are permanent; they will never be offset.

At least a dozen companies—probably considerably more—reported net capital losses in excess of $2,000 for book purposes. Statutory deductions for net capital losses, however, were limited to $2,000 in 1936. Divergences thus caused will not be offset in subsequent years. The great majority of the remaining 100 cases are not described in sufficient detail to warrant classification; doubtless many fall into the subclasses already described.

C Class 3: Interest Received

Under the definition of statutory net income used in *Statistics of Income* for 1936 and here, deviations due to different treatments of interest-received items are moderately common but small. The definition of statutory net income must, however, be kept carefully in mind (see Ch. 10, Sec. D).

Interest received from tax-exempt securities, Subclass 3a, constitutes the chief source of divergence in Class 3 (Table 25). Consequently, most Class 3 divergences tend to cause book profit to exceed statutory net income. But the quantitative importance of the class as a whole is small. The Analysis Y ratio exceeds 5 percent for only two industrial groups, and for most groups it is less than 2 percent. The high ratios for the tobacco group, very poorly represented in Sample I, and for the miscellaneous manufacturing group, reflect single divergences; hence, they are not statistically significant. In no industrial group is the Subclass 3b ratio, which summarizes 'other interest received' divergences, higher than one-half of 1 percent.

Except for the two cases in Subclass 3a tending to cause statutory net income to exceed book profit, both for "negative interest on United Treasury Notes", illustrations are superfluous. Illustrations of Subclass 3b divergences are interest received applicable to prior years; interest earnings credited to reserve for contingencies; differences between interest accrued and received; and net interest received on settlement of prior

year income taxes. Some will be canceled by offsetting items in subsequent years, while others represent permanent differences in the amount of income reported for tax and business purposes.

D Class 4: Inventory Accounting

Until 1938 and 1939 at least, tax requirements for the valuation of inventories were rather rigid, barring for tax purposes the industrial practices of many firms. Most of these industrial practices are designed to minimize the effect of changes in prices upon profits. The base stock, inventory reserve, and last-in first-out methods all have this effect. In 1936 none of these methods was allowed for tax purposes.

Divergences may arise from other less basic causes than different methods of valuing inventories. For instance, obsolescence reserves may be set up for book purposes before the Treasury is willing to recognize that a portion of the inventory has become obsolete.

Deviations due to different treatments of inventories are smaller than might have been expected. Only 34 companies —less than 7 percent of the sample—reported Class 4 divergences. Moreover, few are large. The ratio for the miscellaneous manufacturing group is an exception: one company reported $130,000 for a charge to a reserve for its inventory adjustment account. The machinery and other metal products group reported 8 divergences; in this group a single large divergence accounts for two-thirds of the Analysis Y ratio, which is slightly over 6 percent.

As in the case of capital gains and losses, the data do not justify rigid conclusions concerning the importance of divergences due to differences in the treatment of inventory. Items that properly belong in Class 4 may be concealed in the miscellaneous classes. Moreover, the possibility that large deviations may appear at any time renders prediction on the basis of a small sample especially dangerous. A substantial portion of the divergences arose because an 'inventory reserve' account,

not permitted for tax purposes, was used for book purposes. When credits to an inventory reserve account set up from income exceed charges against the account, book profit will tend to be less than statutory net income. Similarly, when charges exceed credits, book profit will tend to exceed statutory net income. Several examples of both cases are included in the sample.

Inventory reserve accounts may apply to the entire inventory and be set up to mitigate the effects of fluctuations in prices; or they may apply to specific portions of the inventory and be set up to absorb losses from obsolescence. Often the purpose of the reserve account is not specified. Once or twice the reserve was specifically designated as set up to mitigate the effects of fluctuations in prices. More frequently it was referred to as a "reserve for defective goods" or a "merchandise obsolescence reserve". Most of the illustrations involving inventory reserve accounts merely state that the deviation resulted from a net charge or credit to the account. Such cases presumably would not create permanent differences in the two income concepts. A "loss on obsolete inventory charged to surplus on books", on the contrary, will not be offset in subsequent years. Other divergences not obviously related to a reserve account include a provision for "the valuation of acquired inventory to production costs"; unrealized profits on intercompany inventories; and an item representing the difference between the lower of cost or market, presumably the tax value, and the book value of inventories.

E Class 5: Miscellaneous Income Items

One of the most difficult tasks encountered in the analysis of Sample I was the proper treatment of divergences too few or small or too ambiguously described to warrant inclusion in sharply defined classes. Such items were thrown into two 'all other' classes—'miscellaneous income items' (Class 5) and 'miscellaneous deduction items' (Class 13). Although items allocated to the miscellaneous classes are not always clearly

described, an attempt was made to place in Class 5 items that affect the amount of gross income reported. Items representing deductions from gross income were placed in Class 13.

The items in Class 5 vary widely in nature. Nevertheless, certain well defined causes of divergence are included. One is sufficiently important to constitute a major cause of divergence in one industrial group. About three-fourths of the 73 deviations assigned to Class 5 tend to cause book profit to exceed statutory net income. In 11 of the 17 industrial groups the Analysis Y ratio is smaller than 5 percent. In 5 of the remaining 6 groups no systematic cause of divergence is responsible for the substantial Class 5 deviations. A single item of over $1,600,000, "oil revenue from property leased from State of X" (name of state concealed), accounts for almost the entire divergence in the mining group. Most of the divergence in the paper, printing, and publishing group is caused by one company which transferred a reserve for unrealized profits to current earnings on its books. An item entitled "excess book over actual profit" accounts for most of the deviation in the finance group.

The deviations in these classes are interesting, but they do not represent frequently recurring causes of divergence. In the trade group, on the other hand, the use of an installment basis of computing sales for one purpose but not for the other accounts for over half of the total number of divergences and for over 90 percent of the total amount of divergence.

The nature of Class 5 items has already been indicated, but a few more illustrations may be of interest. Thirteen divergences are due to different treatments of deposits in closed banks. Such divergences may cause a variation in either direction. Book profit tends to exceed statutory net income in one case when a recovery was made from a closed bank. The deposits in the closed banks had been written off on the books in preceding years, but this deduction was not allowed for tax purposes. In a second case the situation was reversed: the deduction had been taken for tax but not for book purposes in

preceding years. Thus in the year of recovery an income credit was recorded only for tax purposes.

Examples such as "1925 income item" and "income taxed in prior year by Revenue Agent" represent divergences arising from the limited period covered by the data. Both of these examples tend to make book profit larger than statutory net income in 1936, apparently because the company was more cautious than the tax authorities in recognizing the realization of income. In several cases adjustments or deferments of rental and royalty incomes created divergences. Dividends and discounts on treasury stock likewise caused several divergences. In the public utility group a half dozen companies reported "contributions from others credited to income" on their books; in these instances, these contributions did not constitute taxable income. Only a few of the remaining cases are so incompletely described that they may actually belong in other classes.

F Class 6: Depreciable and Depletable Assets

1 *Sample I Data*

Class 6 and the seven classes that follow constitute deductions from gross income. Class 6 is one of the largest sources of divergence, both quantitatively and numerically; for analysis it was divided into four subclasses.

Subclass 6a is composed of divergences that arise from differing depreciation allowances for book and tax purposes. Any one of many causes may bring about different depreciation charges, but they arise mainly from different bases on which depreciation is allowed and different rates at which assets are depreciated.

Differing depletion allowances are grouped in Subclass 6b. Two causes probably explain the largest items in this subclass. The percentage-of-gross-income and discovery-value methods of computing depletion deductions, allowable in certain cases for tax purposes, are exceedingly generous to the taxpayer. Companies that use these methods for tax purposes usually

take considerably smaller depletion deductions on their books, if, indeed, they take any book deductions at all. Thus tax depletion deductions exceed book depletion deductions both because of the generosity of the former and the absence of the latter.

The cost of depreciable assets may be either charged directly to current expenses or be set up as an asset subject to depreciation in subsequent years; divergences due to the adoption of one of these methods for book purposes and the other for tax purposes were put in Subclass 6c. Subclass 6c divergences are uniformly small. The largest number of items is reported by the finance group. Possibly financial companies regard their wasting physical assets as of such minor importance that they write them off as current expenses for book purposes. The most common source of divergence is reported in the reconciliation schedule as "furniture and fixtures, additions or betterments treated as expenses on books less depreciation on furniture and fixtures". In subsequent years the tax charge would continue to appear as a depreciation deduction, but no offsetting book deduction would be shown. Other items, such as tools and dies, have been treated similarly. The procedure was reversed in the case of repairs, which were charged off immediately for tax purposes but deferred for book purposes. Possibly such repairs should not be placed in Subclass 6c.

Subclass 6d comprises divergences arising from the 'retirement of fixed assets'. Two obvious reasons probably account for most of these divergences. First, the practice of some companies of charging losses on such retirements to surplus on their books, especially if the losses are unexpected, will usually create a divergence tending to cause book profit to exceed statutory net income. Secondly, different bases for tax and book purposes will give rise to different charges at the time of retirement.

As expected, Subclass 6d divergences are not frequent but they are often large. Only 39 companies—less than 8 percent of the sample—reported such divergences. In 12 industrial

groups the Analysis Y ratio is lower than 2 percent. On the other hand, 3 groups reported ratios ranging—because of large isolated divergences—from over 9 to nearly 36 percent.

Most items in Subclass 6d are described simply as "loss on assets scrapped", "retirement losses", or by some similar phrase without any detailed explanation of the nature of the divergences arising from these losses. For a few items, more detail was given. For example, one company reported a "loss on abandonment of furniture and fixtures in discontinued departments charged to capital surplus". Another reported that a portion of the losses experienced on the abandonment of buildings was deferred on its books but written off for tax purposes. In contrast to these two instances the book deduction of one company exceeded its tax deduction at the time machinery and equipment were scrapped, since the appraised book value of these assets exceeded their cost value and was charged to current income.

These subclasses are by no means unrelated. Different depreciation policies may be responsible for divergences upon the retirement of partly depreciated assets. A decision to treat an item as a current expense on one set of accounts and as a capital asset on the other will create divergences in basis and in depreciation charges, in both current and subsequent accounting periods.

Table 25 reveals the great importance of divergences in depreciable and depletable assets. Two hundred ninety-seven divergences are reported by the 505 corporations comprising Sample I. Some companies reported divergences in more than one subclass. The total number of Class 6 divergences was calculated by adding the number of divergences in each subclass rather than by determining the number of companies reporting divergences.

Analysis Y ratios vary widely from one industrial group to another, but in general they are high with sufficient consistency to warrant the conclusion that different treatments of depreciable and depletable assets are the largest single source

of differences between book profit and statutory net income. Moreover, the dispersion among industrial groups appears to reflect actual differences in the importance of depreciable and depletable assets in different industrial groups; at any rate, it accords with expectations. For instance, depreciation is of relatively minor importance in the finance, service, and trade industries. Precisely these groups reported the smallest ratios for Class 6 divergences.

With the exception of the mining group and of one or two other groups where accidental causes probably predominate, divergences in depreciation charges constitute the dominant reason for Class 6 deviations. In the mining group depletion differences are the major cause of divergence. They comprise substantially the entire Class 6 divergence and over half of all divergences in the mining group. A few depletion divergences are scattered among other industrial groups, but they are of no general importance.

Data on tax returns are not sufficiently detailed to permit allocation into finer subclasses, but enough detail is presented on some returns to provide interesting illustrations. The following instances are typical of divergences arising from different treatments of depreciation tending to cause book profit to exceed statutory net income. Tax deductions for depreciation were claimed in 1936 when the book deductions had been taken earlier. Some of these cases undoubtedly represent current year depreciation divergences resulting from prior year Subclass 6d divergences. In other instances book depreciation was computed on a lower basis than the tax basis. Thus, at the same rates of depreciation the tax charge would exceed the book charge. One company reported a larger tax deduction for depreciation on a cost basis than on the revalued basis for book purposes. Another reported higher depreciation and amortization based on cost than on appraised values. Occasionally, a tax deduction was allowed when no book deduction was taken in either the current year or prior years. For example, depreciation was charged to surplus on the books of one com-

pany. In other cases book depreciation was charged to obsolescence reserves, and, therefore, would not constitute an income deduction in the current year; moreover, if this reserve had been created from a surplus account, it would at no time have constituted an income deduction. A public utility company reported excess allowable depreciation over renewals and replacements taken as book deductions. Doubtless other examples are concealed in the many unexplained divergences reported merely as depreciation divergences.

The divergences tending to cause statutory net income to exceed book profit are considerably less varied in nature. The most common source is 'depreciation on appreciation'; that is, the book basis of the assets was written up higher than the tax basis, and the revaluation results in larger book deductions for depreciation in subsequent years. Sometimes such a divergence may reflect purely a book revaluation of assets. At other times it undoubtedly reflects a difference in basis due to a reorganization or other transfer of assets from one corporation to another. For instance, one company reported a difference in the depreciation taken on the appraised book value of assets as compared with the tax depreciation based on the cost to its predecessor. Other examples include depreciation accrued on the books but not deducted on the tax return; depreciation applicable to prior years taken on the books but not allowed for tax purposes; depreciation for taxable year on fire loss replacement not allowed for tax purposes; and many unexplained items such as "book depreciation in excess of federal" and "excessive depreciation".

Few depletion divergences are described in much detail; frequently no information is given beyond the brief comment "divergent depletion charges". Several companies reported "excess depletion allowed for tax purposes". Occasionally, depletion computed by the percentage method for tax purposes is mentioned as exceeding book depletion. At least one company reported "depletion not recorded on books". The few cases in which book depletion charges exceeded the tax charges

include such items as "depletion not on return", "depletion not deductible", and "depletion not claimed". It should be emphasized once again that Sample I does not include oil and gas producing companies. Hence the important deviations in this industry resulting from different treatments of deductions for depletion and of intangible drilling costs are not reflected in the sample.

2 *Sample II Data*

The above measures of the relative importance of different treatments of depreciable and depletable assets in terms of aggregate divergences between book profit and statutory net income are now supplemented by Analysis X ratios computed from Sample II data (Tables 26 and 27).[2]

From Table 26 the following tendencies may be noticed as points worthy of further investigation.[3] Tax depreciation charges for public utilities are apparently consistently larger than the corresponding book charges. The opposite relationship seems to hold, although to a much smaller degree, for the foods, beverages, and tobacco manufacturing group. On the whole, with the exception of the public utility group, the average differences between book and tax depreciation, by industrial groups, are remarkably small. This conclusion becomes more impressive when the relatively small size of the sample is considered. The averages, however, conceal a wide dispersion of individual companies. Book deductions are perhaps slightly larger in 1936 and 1937, relative to tax deductions, than in 1934 and 1935, but the evidence is inconclusive.

In connection with the comparison of book and tax deductions for depreciation it is important to recall that the tax

[2] The Analysis X ratio is computed for Sample II because aggregate depreciation and depletion charges are available; data with respect to the aggregate causes of divergence between book profit and statutory net income, as used in the Analysis Y ratio, are not available. For Sample I the situation was the reverse.

[3] Throughout this section and Section 8 the qualifications made in Chapter 10, Section C1, because of the imperfect comparability of the data should be kept in mind.

TABLE 26

Ratio of Divergences between Tax and Book Deductions to their Arithmetic Mean, Sample II Corporations, 1934–1937
(percentages)

	1934	1935	1936	1937
	DEPRECIATION			
Manufacturing				
Foods, beverages, & tobacco	7.7	9.9	9.6	7.7
Metals	−8.1	0.3	−1.0	2.6
Miscellaneous	6.8	5.6	−0.7	3.9
Trade	−5.7	−5.3	1.7	−0.5
Public utilities	−15.3	−29.0	−19.7	−27.4
Miscellaneous companies	−10.6	−3.0	6.2	4.3
	DEPRECIATION AND DEPLETION			
Mining	−64.0	−59.0	−56.9	−61.2
Manufacturing				
Foods, beverages, & tobacco	7.7	9.9	9.6	7.7
Metals	−8.3	0.2	−3.0	1.7
Miscellaneous	4.2	4.8	−1.7	2.6
Trade	−5.7	−5.3	1.7	−0.5
Public utilities	−4.2*	−29.0	−19.7	−27.4
Miscellaneous companies	−7.4	−1.3	−2.9	−1.9
	BAD DEBT EXPENSE			
Mining	−94.1	−96.7	−59.3	−59.4
Manufacturing				
Foods, beverages, & tobacco	5.8	−4.3	5.3	−3.1
Metals	−18.9	−26.4	−6.8	−28.4
Miscellaneous	−30.5	−12.8	5.2	14.3
Trade	−22.2	4.4	−13.0	−4.7
Public utilities	23.8	49.2	42.4	7.0
Miscellaneous companies	−138.0	−74.9	−53.7	−47.5

* This ratio is abnormally large (algebraically) because one large company reported substantial book depreciation and depletion charges in 1934 but no tax depreciation and depletion charges whatsoever. This probably represents an error in reporting rather than a significant difference. The ratio under 'Depreciation' above, −15.3, is undoubtedly more representative of the sample.

data are taken from unaudited tax returns. Under Congressional pressure the Treasury inaugurated in 1934 a campaign to increase tax revenues by disallowing unduly large claims by taxpayers for depreciation deductions (Ch. 3, Sec. A3). The annual reports of the Commissioner of Internal Revenue indicate that during the five years ending June 30, 1940, approximately $1 billion, or an annual average of $200 million, of claims for depreciation were disallowed by the Treasury. The

TABLE 27: Tax and Book Deductions, Sample II Corporations, 1934–1937
(dollar figures in millions)

		MANUFACTURING						
	MINING	Total	Food, bev. & tobacco	Metals	Misc.	TRADE	PUB. UT.	MISC. CO.
1934				DEPRECIATION				
No. of corp.		206	43	101	62	39	37	39
Tax ded.		36.76	5.73	21.13	9.89	4.79	42.96	3.70
Book ded.		36.27	6.19	19.50	10.58	4.52	36.84	3.33
1935								
No. of corp.		285	60	133	92	53	51	52
Tax ded.		55.04	6.85	34.08	14.11	6.95	72.86	6.19
Book ded.		52.65	7.57	34.17	14.92	6.59	54.38	6.01
1936								
No. of corp.		352	75	169	108	63	58	74
Tax ded.		56.05	8.25	30.80	17.00	8.56	78.56	6.06
Book ded.		56.47	9.08	30.50	16.88	8.70	64.46	6.45
1937								
No. of corp.		371	72	185	114	66	63	70
Tax ded.		66.90	8.64	37.72	20.54	9.03	95.16	7.99
Book ded.		69.39	9.34	38.70	21.35	8.98	72.20	8.34
1934		DEPRECIATION AND DEPLETION						
No. of corp.	27	211	43	104	64	39	38	36
Tax ded.	11.54	39.87	5.73	22.42	11.72	4.79	42.96*	3.70
Book ded.	5.95	39.03	6.19	20.63	12.21	4.52	41.21*	3.44
1935								
No. of corp.	30	288	60	135	93	53	51	46
Tax ded.	12.94	55.72	6.85	34.22	14.65	6.95	72.86	6.02
Book ded.	7.05	57.22	7.57	34.29	15.36	6.59	54.38	5.94
1936								
No. of corp.	50	360	75	173	112	63	58	57
Tax ded.	16.90	66.07	8.25	37.55	20.27	8.56	78.56	6.03
Book ded.	9.42	65.43	9.08	36.43	19.92	8.70	64.46	5.85
1937								
No. of corp.	48	378	72	188	118	66	63	61
Tax ded.	20.52	70.54	8.64	39.00	22.90	9.03	95.16	6.47
Book ded.	10.90	72.53	9.34	39.68	23.52	8.98	72.20	6.35
1934				BAD DEBT EXPENSE				
No. of corp.	28	210	44	102	64	37	38	36
Tax ded.	.11	4.68	.57	2.90	1.20	1.23	2.90	3.43
Book ded.	.04	3.89	.61	2.40	.88	.98	2.28	.63
1935								
No. of corp.	30	289	60	137	92	52	51	46
Tax ded.	.13	5.53	.87	3.09	1.58	1.84	1.90	.70
Book ded.	.04	4.59	.83	2.37	1.39	1.92	3.15	.32
1936								
No. of corp.	50	361	74	175	112	62	58	55
Tax ded.	.07	4.96	1.04	2.31	1.61	2.19	1.53	.79
Book ded.	.04	4.95	1.10	2.16	1.70	1.92	2.35	.46
1937								
No. of corp.	48	378	72	188	118	65	63	60
Tax ded.	.11	5.24	.96	2.83	1.45	2.57	2.20	1.01
Book ded.	.06	4.72	.93	2.12	1.67	2.45	2.36	.62

* The tax depreciation and depletion deduction for the public utilities group in 1934 exceeds the book deduction by only a small amount because one large company took substantial deductions on its books but did not claim any deduction on its tax return. The depreciation data for the public utilities group in 1934 are undoubtedly more representative of the sample.

amounts disallowed were approximately 6 percent of total annual deductions for depreciation claimed by corporate taxpayers.

In interpreting these auditing adjustments several points should be noted. First, the $1 billion figure is for total disallowances of depreciation claims; some part—though presumably a small part—is for disallowances of deductions for depreciation claimed by unincorporated enterprises. Secondly, there is no way of distributing these amounts to the tax years to which they apply. Thirdly, it seems reasonable to believe that the amounts disallowed in 1935-40 were abnormally large because of the special pressure applied to the Bureau of Internal Revenue by Congress.[4]

The important difference between the 'Depreciation' and 'Depreciation and Depletion' sections of Table 26 lies, of course, in the mining group, where tax charges for depletion far exceed book charges. In the first section mining corporations were included among 'miscellaneous companies' since only a few mining companies reported no or negligible charges for depletion. Moreover, the mining companies reporting no depletion charges for book or tax purposes may be assumed to be atypical. The favorable tax treatment accorded depletion companies is a matter of general knowledge; the extent of the advantage is illustrated by the ratios of the second section.

Table 28 expresses the sum of the deductions for depreciation and depletion taken by the Sample II corporations in 1937 as a percentage of the deductions for depreciation and depletion taken by all corporations in the comparable industrial groups of *Statistics of Income* for 1937, thereby indicating the coverage of the sample.

Frequency distributions of the Analysis X ratio for depreciation and depletion charges of the Sample II corporations for

[4] Indeed, it is presumably only because of this pressure that published information is available for 1935-40 concerning the amounts of depreciation disallowed by the Treasury. Such data are not available for other disallowances or for depreciation deductions since 1940.

TABLE 28

Deductions Reported on Tax Returns by Sample II Corporations and in *Statistics of Income,* 1937 (dollar figures in millions)

		MANUFACTURING						
	MINING	Total	Food, bev. & tob.	Metals	Misc.	TRADE	PUB. UT.	MISC. CO.
			DEPRECIATION AND DEPLETION					
1 Amt. report. by Sample II corp.	20.52	70.54	8.64	39.00	22.90	9.03	95.16	6.47
2 Amt. report. in *Stat. of Income*	446.41	1,592.49	187.44	469.60	935.45	276.12	926.20	583.95*
3 % line 1 is of 2	4.6	4.4	4.6	8.3	2.4	3.3	10.3	1.1
			BAD DEBT EXPENSE					
4 Amt. report. by Sample II corp.	.11	5.24	.96	2.83	1.45	2.57	2.20	1.01
5 Amt. report. in *Stat. of Income*	10.79	185.65	27.11	53.81	104.73	183.44	28.95	342.56†
6 % line 4 is of 5	1.0	2.8	3.5	5.3	1.4	1.4	7.6	0.3

* Because of rounding, the manufacturing groups do not add precisely to the total manufacturing figure in *Statistics of Income.*

† Agriculture is excluded from the miscellaneous companies for purposes of comparability.

1937, classified by industrial groups, are presented in Chart 5.[5] If we omit, for the moment, the mining and public utility groups, the following generalizations may be made. There is a marked concentration of Analysis X ratios about a zero value. On the other hand, a small minority of corporations have large divergences; for instance, approximately 14 percent of all manufacturing corporations have ratios numerically greater than 50 percent.

For the food, beverage, and tobacco industries, taken as a unit, book depreciation and depletion charges systematically exceeded the tax charges; [6] the aggregate Analysis X ratio for

[5] Detailed worksheets were constructed for much finer industrial groups for each year 1934-37. The charts presented are typical of these worksheets. In Chart 5, and also Chart 6, the dotted area in the zero column represents companies that report equal amounts of depreciation and depletion (or in Chart 6 bad debt expenses) for tax and book purposes. The cross-hatched area represents companies that do not report such charges for either purpose.

[6] While the data presented in Chart 5 include both depreciation and depletion charges, for all industrial groups except mining depletion charges are negligible. Thus, no significant error will be introduced if the charts for the nonmining groups are interpreted simply as frequency distributions of depreciation charges.

this industrial group was 7.5-10 percent in each year 1934-37. The beverage group is almost entirely responsible for the tendency of book charges to exceed tax charges. The concentration to the right is marked in each year 1934-37. For example, in 1937, 28 percent of the beverage group has Analysis X ratios algebraically in excess of +50 percent, while fewer than 10 percent of the entire manufacturing group, exclusive of beverages, have ratios exceeding +50 percent.

Since 1933 beverages, including alcoholic liquors, have been a rapidly growing and presumably highly profitable industry. Most of the beverage companies in our sample have reported much larger charges for depreciation on their public statements than they have claimed for tax purposes. A possible explanation is that they may have deliberately attempted to minimize their apparent profitability. Such a policy might have been followed for several reasons. Companies could withhold a larger proportion of their true earnings without arousing protest from their stockholders. In addition they might safeguard themselves from public or political criticism as profiteers or from increased competition from new investment attracted to the industry by its unusual profitability.

The data do not demonstrate the validity of this hypothesis, but they do suggest that more extensive study of depreciation policies of companies classified by their rate of profitability might be illuminating. Unfortunately, the present sample is not adequate for such a study.

The mining and public utility groups have patterns strikingly different from the other groups: tax deductions typically exceed book deductions, often by large amounts. None of the 63 corporations in the public utility group, for instance, has a positive Analysis X ratio exceeding 4 percent. In certain fields of utility operations, the discrepancy between the amounts of depreciation and related expenses taken for the two purposes is attributable largely to retirement accounting.

The explanation for the marked tendency of tax deductions for depreciation and depletion to exceed book deductions in

CHART 5

Frequency Distribution of Analysis X Ratios for Depreciation and Depletion Charges Sample II Corporations, 1937

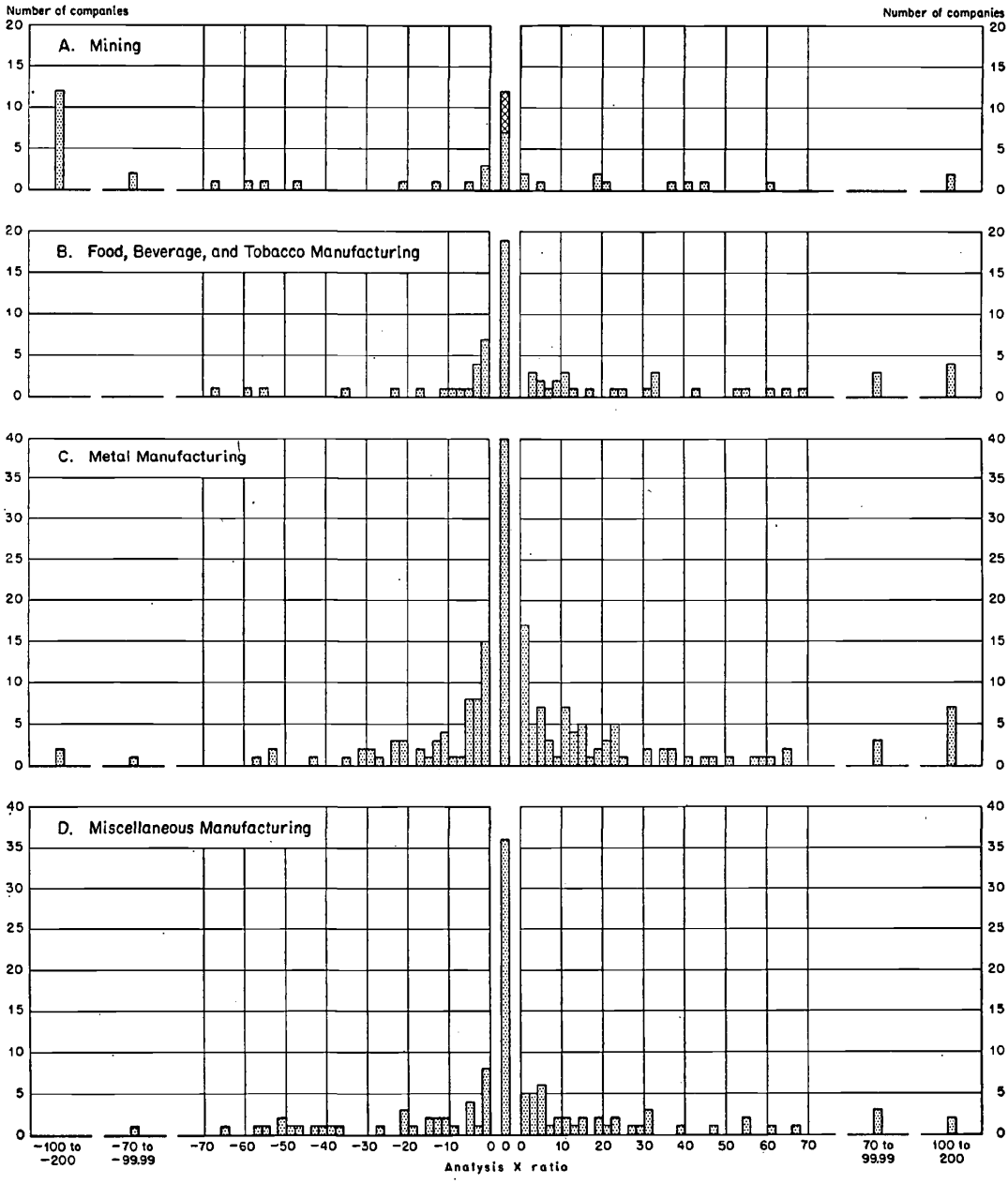
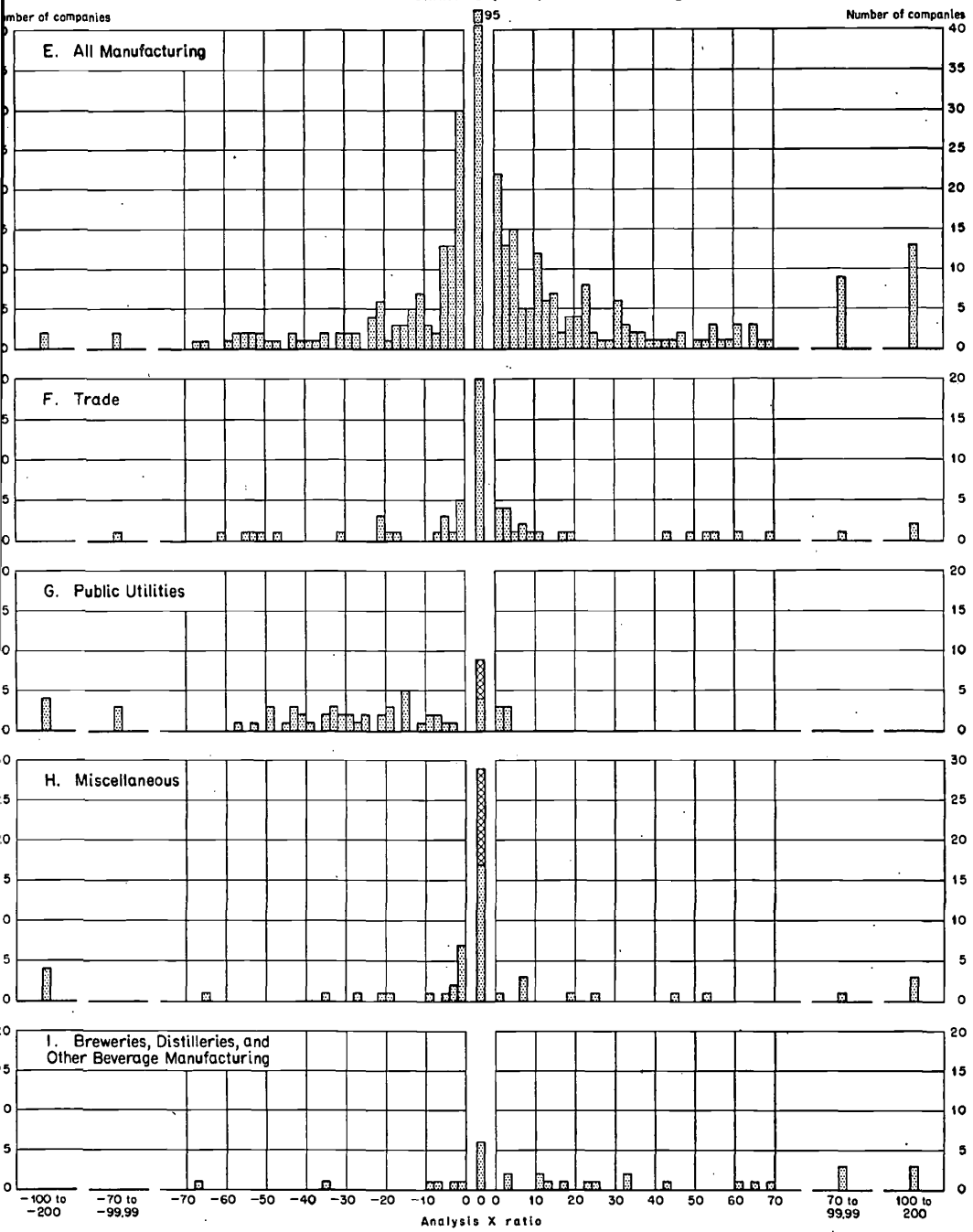


CHART 5 (concl.)



the mining group is simple: deductions were computed by the percentage-of-gross-income or discovery-value methods for tax purposes but not for book purposes.

G Class 7: Intangible Assets

The nature of Class 7 divergences varies with the particular intangible asset involved. Differences in the treatment of organization and reorganization expenditures, Subclass 7a, for example, systematically tend to cause statutory net income to exceed book profit. Such expenditures are never allowed as deductions for tax purposes. For book purposes, however, they are usually treated as current expenses or as assets subject to amortization.

Patent expenses constitute a second general source of Class 7 divergences. Some part of expenditures on patents are ordinarily regarded as assets subject to amortization for tax purposes, but the entire amounts are often charged off as current expenses for book purposes. Thus, in the year in which a new patent is purchased or developed, the book charge is likely to be larger than the tax charge. In subsequent years, however, when the patent is amortized for tax purposes, the tax charge will exceed the book charge. The cost of additional patents in later years may, of course, conceal this relationship.

Other sources of Class 7 divergences were grouped in Subclass 7c, which includes divergences resulting from different treatments of all intangible assets except patents and organization and reorganization expenses. Different treatments of development expenses are responsible for many deviations. For example, one company reports development expenses amortized for tax purposes but previously charged to surplus on its books. The different treatments of mining leases are not explained. A large source of divergence in the trade and public utility groups is the treatment of leaseholds. One company reports the "amortization of cost of leaseholds not charged off on books"; others report apparently similar items in less detail. Most cases mentioned tended to cause book profit

to exceed statutory net income. The most frequent source of divergence operating in the opposite direction is the treatment of the cost of issuing new securities or registering securities on stock exchanges. In a sense some of these divergences are closely similar to reorganization expenses.

A striking fact about the analysis of Classes 1-6 is that, except for isolated items and predictable variations, the relative importance of each is surprisingly consistent among industrial groups. Class 7 divergences, in contrast, vary greatly from group to group and are apparently not explained by special causes operating in specific industrial groups. Hence, an evaluation of their probable importance in a larger sample is difficult.

In 9 of the 17 industrial groups the Analysis Y ratio is lower than 2 percent. On the other hand, in 7 groups it exceeds 5 percent and in 4 groups 10 percent. Class 7 divergences are moderately common: 118 are reported by Sample I corporations.

None of the 3 subclasses dominates this class. Twenty companies reported different treatments of assets representing organization and reorganization expenditures. Eighteen of these conform to expectations, showing larger book than tax deductions; in two unexplained instances the tax exceeds the book deduction. Only twice do these divergences exceed $50,000. Fifty companies reported different treatments of patent expenses, but the differences are uniformly small; the highest Analysis Y ratio for Subclass 7b is smaller than 5 percent. Subclass c has about the same number of divergences as b, but they run to considerably larger amounts. In the mining group, for example, two items of over $300,000 are reported, one described as development costs capitalized and another as a statutory loss on leases written off. A miscellaneous manufacturing company reported over $400,000 for development expenses charged off on its books in 1935 but not claimed as a tax deduction until 1936. One retail trade company reported

a special statutory amortization of leasehold improvements of over $900,000, while only $80,000 was taken as book amortization.

H Class 8: Bad Debt Expenses

1 *Sample I Data*

Differences in bad debt accounting are frequent and occasionally of moderate size. Their nature is discussed in detail in Chapter 5 and need not be repeated here.

Over one-third of the companies in Sample I report bad debt divergences, but most are small (Table 25). The largest divergence occurs in the retail trade industry where one company reported nearly $700,000 for "addition to bad debts reserve". The Analysis Y ratio does not reach 11 percent in any industrial group. But it exceeds 5 percent in 8 groups and in 3 other groups it is between 3 and 5 percent.

The data are not sufficiently detailed to warrant a division of bad debts divergences into subclasses. Nevertheless, almost every kind of divergence mentioned in Chapter 5 could be illustrated. The broader scope of the tax classification is illustrated by one case where the tax deduction exceeds the book deduction by the amount of second mortgage notes ascertained to be uncollectible and therefore charged off. Other representative instances apparently not due to differences in scope include bad debts accrued in excess of the actual write off; reserve for bad debts in excess of the actual loss; and excess book provision for bad debts. Several companies reported different treatments of bad debt recoveries; one reads "recovery of bad debts previously disallowed". Presumably, this recovery was reported as book income, since the debt had previously been charged against income on the company's books, but not as taxable income.

2 *Sample II Data*

As in the analysis of depreciation and depletion deductions, Sample II may be used to supplement the information on bad

debt divergences revealed by Sample I. Conclusions based on the bad debt section of Table 26 must be even more tentative than those drawn from the depreciation section of Table 26, for the bad debt ratios are much more subject to distortion by single, large divergences.[7] With the exception of the public utility group, and to a lesser degree the foods and miscellaneous manufacturing groups, the tax deductions are consistently larger than the book deductions. Excluding public utilities, 19 of the remaining 24 ratios are negative. Thus, the expectation that bad debt deductions claimed for tax purposes exceed book deductions because of the more inclusive character of the tax concept is confirmed.

On the average, manufacturing companies show moderately small divergences. The ratios for the food, beverage, and tobacco group are within 6 percent of zero in all four years. In two years they are negative and in the other two years, positive. Likewise, the miscellaneous manufacturing group ratios are twice negative and twice positive. The ratios in this subgroup become progressively larger, algebraically, during the four years. Probably, however, this variation is not significant. Three large divergences account for the size of the negative ratio in 1934. Nevertheless, the ratio would be negative even if these three cases were eliminated. A single, large divergence is responsible for the size of the 1937 ratio also, but not for its algebraic sign, which is positive. The metals group, on the contrary, has a negative ratio in all four years; in three years the numerical ratio exceeds 18 percent. Though several substantial divergences are reported, their direction is such that they largely offset one another. On the whole, the elimination of the largest half-dozen individual divergences would bring the ratios closer to zero, but they would remain negative.

The ratios for the trade group are negative in three years and positive in the fourth. The large negative ratio in 1934 can be attributed to three companies which report much larger

[7] Throughout this section the qualifications mentioned in Chapter 10, Section C1, because of the imperfect comparability of the data should be kept in mind.

tax than book deductions. The mining group shows unusually large negative ratios in every year because several companies reported moderately large bad debt deductions for income tax purposes but no deductions for book purposes. No one company dominates the group.

Since financial companies are included in the miscellaneous group, it too shows large negative ratios in all four years in accordance with expectations. In 1935 and 1936 several large divergences are responsible for the size, but not the sign, of the ratios. One extremely large divergence accounts for the exceptionally large 1934 ratio.

In sharp contrast to all the other groups, public utilities have positive ratios in each year. In three years the ratios are large. While several substantial divergences account for the size of the ratios in the first three years, the ratios would be positive even if these cases were ignored. Why the public utility group is different is not clear. It may be simply a statistical accident, but that seems somewhat unlikely, since the ratio is consistent from year to year. Moreover, as Table 28 indicates, bad debt deductions by the public utility companies in the sample represent nearly 8 percent of the total bad debt deductions reported by all public utility corporations in *Statistics of Income* for 1937. Indeed, the sample contains approximately 1-8 percent of the bad debt deductions claimed by the entire corporate economy in 1937 in most of the broad industrial groups.

Chart 6, which shows frequency distributions of the Analysis X ratio for bad debt deductions by industrial groups, is identical technically with those in the book profit-statutory net income comparison. Data are for 1937 except for the 'miscellaneous corporations' group which presents the frequency distribution for 1936, a more typical year for this group. Preliminary charts were made for all four years and for narrower industrial classifications, but the charts here presented are adequate to represent the nature of the distribution of bad debt divergences.

I Class 9: Interest Paid

With one major exception, divergences due to the treatment of interest expenses are not large. But this exception, different treatments of funded debt expenses by public utility companies, ranks with depletion in the mining group and depreciation in the public utility group as among the most dramatic cases revealed in this study. Indeed, divergences in interest expenses, primarily in funded debt expenses, account for over half of the aggregate divergences reported by the 29 public utility companies in Sample I, aggregating nearly $18 million. Moreover, 90 percent tend to cause book profit to exceed statutory net income. Scattered instances of different treatments of funded debt expenses are reported in other industrial groups, but most lead to relatively small divergences. A holding company, however, reported $350,000 for a credit to a debenture retirement fund reserve, an unallowable book deduction, and a bridge company reported a tax deduction of $250,000 representing the cost of retiring bonds but did not take a book deduction. Because the miscellaneous group, in which the latter company is classified, is poorly represented in the sample the Analysis Y ratio reflecting this divergence is 24.3 percent. Of 51 Subclass 9a divergences 40 percent occur in the public utility group.

Funded debt expenses may be treated in a considerable variety of ways. Regulations 94, Article 22(a)-18, stipulated the treatment to be followed for tax purposes in accounting for the sale and purchase by a corporation of its bonds under the Revenue Act of 1936. Broadly speaking, income or expense from bonds issued after February 28, 1913 at a premium or discount is amortized over the life of the bonds. On the other hand, if a corporation purchases or redeems its bonds, income or loss on the transaction is taxable or deductible in the year of purchase. The amount is determined by the excess of the issuance price, adjusted for premiums or discounts already amortized, over the purchase price.

CHART 6

Frequency Distribution of Analysis X Ratios for Bad Debt Deductions Sample II Corporations, 1937

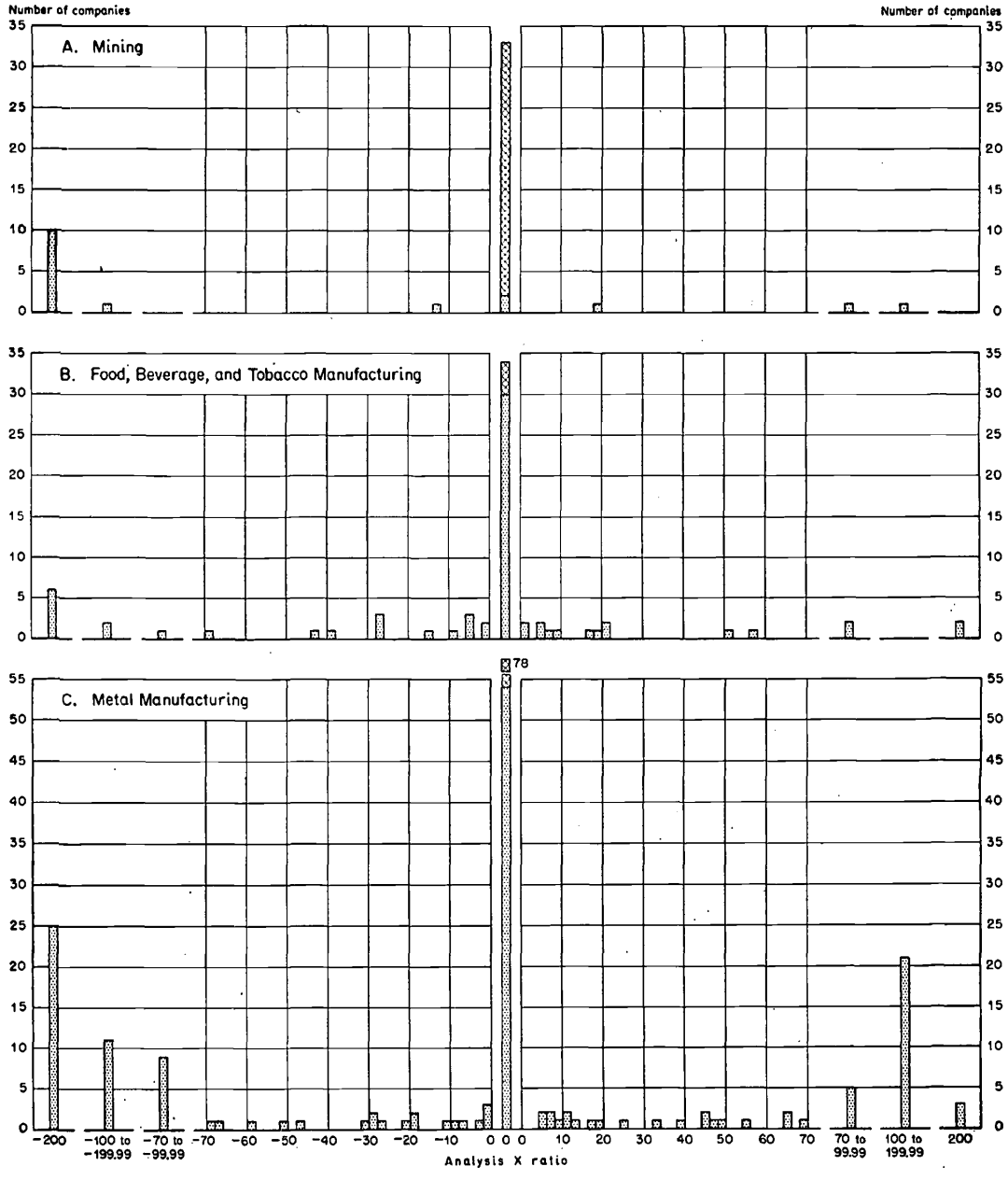
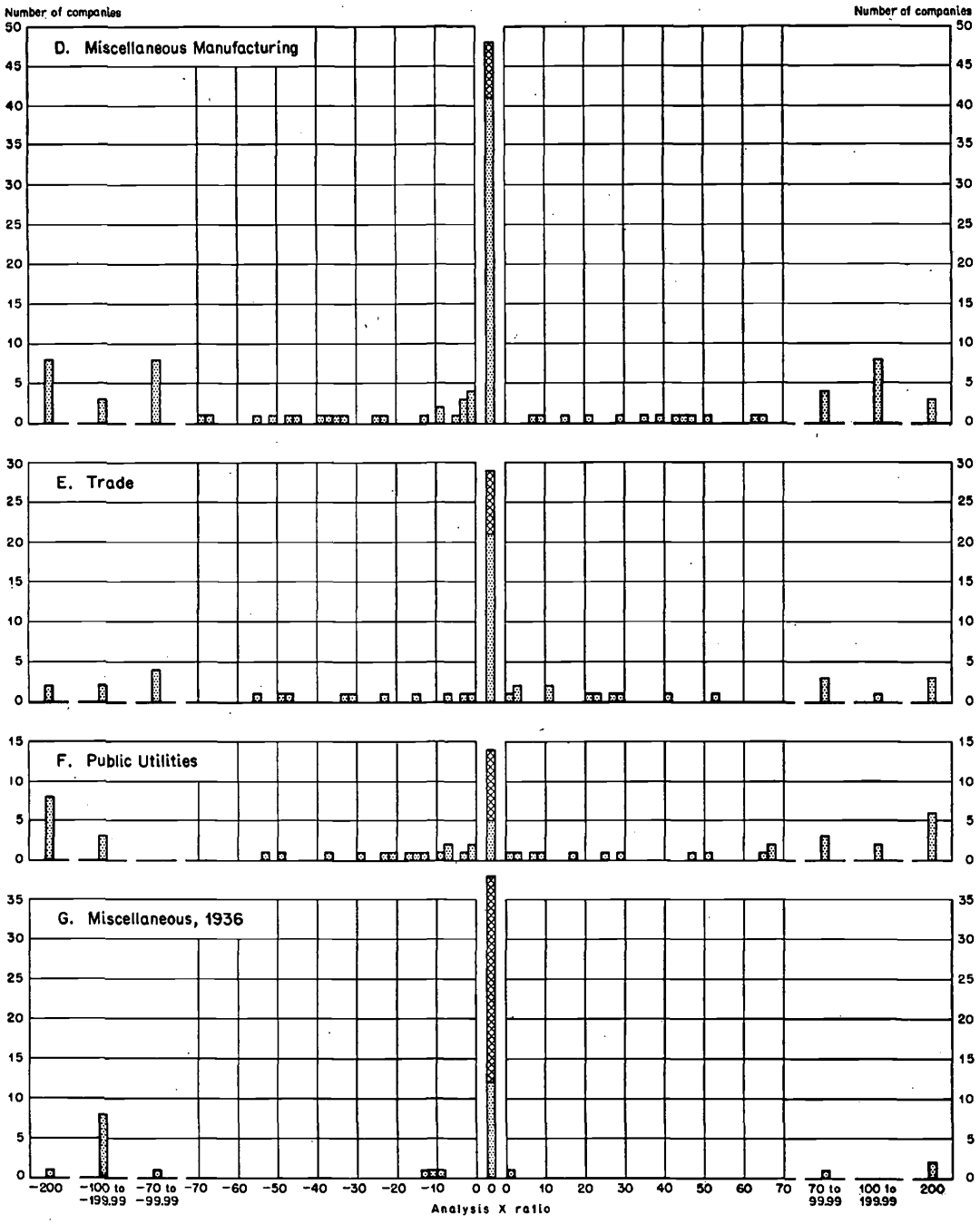


CHART 6 (concl.)



The tax regulations obviously prescribe only one of many ways in which these transactions may be recorded. A different rate of amortization may be used for book purposes. Indeed, the entire premium or discount may be credited or charged to income at the time of issuance. The book charge may be carried directly to surplus. A surplus credit or charge is especially likely if bonds are called for redemption when a large unamortized premium or discount remains outstanding.

Most of these treatments are represented, although often without complete details. Many divergences are reported with uninformative explanatory comments such as "amortization of bond discount on bonds charged to surplus". One company reported a larger tax than book deduction for "unamortized debt discount and expense and premium and redemption expense on bonds called for redemption in 1936". Possibly these expenses were charged to surplus on the books. In a similar case, however, such charges were reported as deferred on the books. Occasionally, the divergence consists only of year-to-year variations. For example, one company reported "discount on bonds purchased during 1936 not on books until 1937".

Subclass 9b divergences—interest paid or received on prior-year federal income taxes paid or refunded in the current year—are uniformly small; indeed, in no case does the Analysis Y ratio reach even 1 percent. When, as is often the case, payments or refunds of prior-year taxes are charged or credited to surplus rather than to income accounts, the interest is usually charged or credited to surplus. But the interest on such taxes, in contrast to the taxes themselves, constitutes an allowable tax deduction. Divergences arise, therefore, when such interest expenses or receipts are charged or credited to surplus for book purposes.[8] Twenty-one such cases, scattered through the various industrial groups, are reported. Eighteen represent in-

[8] Some of the items classified in both Subclasses 9a and b are gross income items. While the practice of regarding them as part of interest expenses is logically inconsistent, it afforded the most convenient basis of classification for our purposes.

terest payments that had been charged to surplus for book purposes.

The often referred to but unimportant provision that interest on indebtedness incurred to purchase tax exempt securities shall not be considered an allowable deduction gives rise to small divergences. They were put in Subclass 9c. Only four companies—less than 1 percent of the sample—report such divergences.

The other interest paid subclass, 9d, consists of several miscellaneous items of which the most important is interest charged to surplus or deferred until future accounting periods. Thirty-five divergences, amounting to $1.4 million, are reported, over half of them in the public utility group. In this group they are overshadowed by Subclass 9a divergences, and they are unimportant elsewhere. Subclass 9d offers a considerable variety of cases. At least 10 public utilities—more than one-third of the companies in the sample—reported interest on funds advanced for construction work as a tax deduction but not as a book deduction. One or two reported an item of this nature along with different amounts of funded debt expenses. Companies outside the public utility group also reported interest set up in an asset account for book purposes without explaining the nature of the assets. Other companies reported interest charged to surplus. Divergences reported as causing book deductions to exceed tax deductions include "interest credited to asset account" and "interest expense not applicable to 1936". Presumably the book deduction was taken in 1936 while the tax deduction was taken in another year.

J Class 10: Taxes Paid (Exclusive of Federal Income and Undistributed Profits Taxes)

Differences in taxes paid are by far the most frequent source of divergences between book profit and statutory net income. Three hundred and four companies—over 60 percent of the sample—reported different figures for taxes. Many report several items on their tax returns causing divergences. By a

strange coincidence, exactly half of the companies reporting divergences show larger book deductions while the other half show larger tax deductions.

Despite the great frequency of divergences in taxes paid, their average size is so small that, quantitatively, they are only moderately important (Table 25). In no case does the Analysis Y ratio exceed 10 percent. Five industrial groups, however, have ratios of 5-10 percent, and in only one group is the ratio less than 1 percent.

No attempt was made to compute an elaborate set of tables for Class 10. But a rough count of the divergences attributable to different taxes was made in order to indicate, even though crudely, the principal sources. Approximately 165 companies —one-third of the sample—report divergences in accounting for the federal capital stock tax. Most of these divergences reflect the fact that the tax was assessed for a period that ordinarily did not coincide with the accounting period used for book or tax purposes. For example, one company reported that a portion of the federal capital stock tax for the year ended June 30, 1936 was deferred on its books and charged as an expense for the calendar year 1936. But the entire amount of the tax through June 30, 1936 was deducted on the 1935 income tax return filed for the period ended December 31, 1935. Likewise, a portion of the tax assessed for the year ended June 30, 1937 was deferred to the calendar year 1937 for book purposes, although it was deducted in full on the tax return for the calendar year 1936. Other companies reported substantially similar treatments. Many merely reported divergences without explaining their causes.

About 85 companies reported different amounts of state taxes. The New York state franchise tax—and less commonly franchise taxes of other states—was reported with considerable frequency as a source of divergence. State income, excise, and capital stock taxes are well represented. To some extent the explanation is the same as that suggested as the principal cause of differences in federal capital stock taxes. In other cases an

unallowable reserve for payment of the tax in question was set up on the books, while for tax purposes the deduction was claimed as it accrued in the tax sense or was paid. In still other cases the accounting procedures were identical but different amounts were charged for the two purposes.

About 50 companies reported current year payments or refunds of prior year taxes as creating divergences. Probably more than two-thirds involved the federal income tax. Such payments or refunds may be charged or credited to either net income or surplus accounts on the company's books. When they are carried through the income account a divergence is created, since they do not constitute current year expenses or income for tax purposes.

About 40 companies, many in the public utility group, reported deducting federal income taxes on tax free covenant bonds for book but not for tax purposes. About 10 companies reported nondeductible special assessments against property for local improvements enhancing the value of the property. The treatment of various local taxes caused 20 divergences. Unemployment insurance taxes were charged to surplus or set up in asset accounts by a handful of companies. 'Organization taxes', such as document stamps, were charged to surplus in a dozen cases. Processing tax refunds and windfall taxes on 'unjust enrichments' received a smattering representation. Several divergences in the amount of foreign taxes reported were recorded. One company reported a reversal of a reserve for taxes on unrealized appreciation of securities held. Several companies reported different treatments of excess profits taxes. Finally, perhaps 50 divergences were reported without any explanatory detail.

K Class 11: Rents and Royalties

Statistically, divergences between rents and royalties are wholly unimportant, as Table 25 indicates. Of the 13 reported, all are small. Indeed, in only one industrial group does the Analysis Y ratio exceed 1 percent: an item of $50,000 in the

foods group, 'deferred rents', causes statutory net income to exceed book profit. Other examples operating in the same direction include overaccruals of rent expense and different treatments of royalties.

Divergences tending to cause book profit to exceed statutory net income include such items as rent paid to X (name withheld) Telephone Company for use of poles charged to surplus; royalty payments not deducted on books; minimum royalties on non-operating reserves; pro rata portion of lease revision; and amortization of cost of lease previously written off.[9]

L Class 12: Nonallowable Reserves

Except in isolated instances—such as the reserve for bad debts provision—the tax law does not permit a deduction for reserves against possible subsequent but unascertained expenses or losses. At one extreme are items analogous to the reserve for bad debts, representing necessary exclusions from gross income in order to obtain a proper accounting definition of income. Tax practice, however, ordinarily disallows their deduction; the practice with reference to reserves for bad debts is a statutory exception to the general rule. At the other extreme are purely precautionary reserves.

Business corporations have set up a wide variety of reserve accounts for book purposes. To facilitate tabulation, the numerous specific reserve accounts were divided into 5 subclasses: reserves for insurance and compensation, repairs and replacements, investment and exchange fluctuations, sales expenses, and for contingency and other unallowable items.

The importance of Class 12 divergences is manifest from Table 25. Indeed, nonallowable reserve accounts for book purposes are perhaps second only to differences in the treatment of depreciable and depletable assets as a cause of divergence. Moreover, Class 12 divergences include only items that

[9] When leases were reported in the mining group they were regarded as intangible assets on the theory that they probably resemble development expenditures. In all other groups, however, such divergences were included in Class 11.

cannot conveniently be allocated to other classes; for example, a divergence between a book reserve for taxes and statutory taxes paid or accrued would be assigned to Class 10. Class 12 has 273 divergences, divided rather evenly between the two directions.

Subclass 12a—unallowable reserves for insurance and compensation—constitutes a relatively frequent but not especially large source of divergence. Seventy-three companies report such divergences as reserves for workmen's compensation, pensions, employees' welfare, employees' injury, vacation payroll, plate glass insurance, and employee retirement. The Analysis Y ratio exceeds 2 percent in only two industrial groups.

Reserves for unallowable repairs and replacements are infrequent. Examples include reserves for dock repairs, painting, maintenance of general structures, extraordinary maintenance, and for relining furnaces. Only 23 cases, rather evenly divided between the two directions of divergence, are reported. The Analysis Y ratios are uniformly small.

Forty-five companies report different amounts of reserves for investment and exchange fluctuations; these too are almost equally divided between the two directions. While they are less frequent than those in Subclass 12a, they are considerably larger. Four industrial groups report Analysis Y ratios in excess of 3 percent. The line between Subclass 12c and divergences in capital gains and losses (Class 2) is rather fine. In general, items representing merely unrealized adjustments of book values were included in Subclass 12c, while Class 2 consists of realized gains and losses. This distinction is perhaps of doubtful validity, and Subclass 12c should be kept in mind when Class 2 is appraised. Examples of Subclass 12c include property valuation reserves, reduction in reserves for securities, appreciation of securities, provision for loss on investment, excess of charges over credits to exchange reserves, foreign exchange adjustment, and depreciation of sterling account.

Divergences due to unallowable reserves for sales expenses

number 56 but the Analysis Y ratio exceeds 3 percent in only two industrial groups. Examples of Subclass 12d are reserves for discounts, customer allowances, dealers' commission, and for advertising expenses, sales discount not charged to current earnings, prepaid foreign commissions, noncollectible accounts of agent, provision for returns and allowances, and unallowable increases in reserves for participation certificates.[10]

Subclass e—other nonallowable reserves—are by far the largest source of Class 12 divergences, reported by 75 companies. While the highest Analysis Y ratio is 11.0 percent, 10 industrial groups report ratios of over 4 percent. Thus, other nonallowable reserves are consistently of moderate importance although nowhere of dominant importance. As contingency reserves constitute the vast majority of cases, most of the divergences probably represent nonallowable precautionary reserves. Other scattered divergences include reserves for legal expenses, closed banks, and for farm lands. Subclass 12e, like Classes 5 and 13, may conceal items which, if described more explicitly, would significantly alter the reported ratios for other classes.

M Class 13: Miscellaneous Deductions

Three subclasses not considered sufficiently important to deserve separate listing were grouped as miscellaneous deductions. This decision was made although two of these subclasses are among the most common causes of divergence. Subclass 13a comprises unallowable donations and contributions. Divergences may result from either the character or the amount of corporate donations and contributions. In Subclass 13b are listed insurance premiums paid on the life of any officer or employee when the corporation is directly or indirectly a bene-

10 The last item is explained as follows: "When dealers take in merchandise in trade, we participate and accept participation certificates in partial settlement of outstanding accounts. On receipt of these participation certificates, we charge off to profit and loss a portion of their face and carry the balance as an asset. This anticipated loss is not claimed for federal income tax purposes until actually realized."

ficiary. Subclass 13c contains other miscellaneous deductions.

A glance at Table 25 suffices to indicate that a sizeable fraction of aggregate divergences is included in Class 13. Both Subclasses 13a and b show an overwhelming portion of cases that tend to cause statutory net income to exceed book profit. In 98 of 102 companies with unallowable donations and contributions, the divergence reported tends to cause statutory net income to exceed book profit. The surprising fact is not that 98 cases have this tendency, but that 4 have the opposite tendency. These 4 cases reflect the fact that the definition of the subclass was not applied rigidly. Accordingly, one case entitled "contributions to X University (name withheld) not charged off on books" was assigned to Subclass 13a even though it was not strictly an unallowable deduction. Quantitatively, this subclass is negligible. In all industrial groups the Analysis Y ratio is less than 2 percent and only one group reports a ratio as high as 1 percent.

The distribution of cases in Subclass 13b is very similar. Of 144 divergences, 129 tend to cause statutory net income to exceed book profit. The payment of an unallowable premium—if not offset by proceeds from the policy upon the death of the insured person—will cause divergences in this direction.

Divergences tending to cause book profit to exceed statutory net income occur for several reasons. A few companies report that the cash surrender value of life insurance policies which they hold has increased by a larger amount than the premium due on the insurance. In other cases dividends on a paid-up life insurance policy augmented book profit but not statutory net income. Proceeds from life insurance upon the death of the insured person were reported by only two companies. One, a receipt of $140,000 of nontaxable income, accounts for the single Analysis Y ratio higher than 10 percent. All other Subclass 13b ratios are small; indeed, in 14 of the 17 industrial groups they are less than 3 percent.

Subclass c accounts for the vast majority of Class 13 divergences. Indeed, in 8 industrial groups it accounts for over 10

percent of aggregate divergences. Divergences tending to cause book profit to exceed statutory net income are much larger than those operating in the reverse direction, and are divided rather evenly between the two directions. Because of the heterogeneous nature of Subclass 13c, important cases of divergence are discussed in considerable detail.

In the food group two items—expenses charged to surplus and loss on judgment—account for the greater part of the divergence. One tobacco company reported "radio and newspaper advertising deferred on books". Several companies producing beverages reported items such as discarded labels, losses on containers and on cartons in the hands of customers. All were presumably charged to surplus for book purposes.

Most of the divergence in the textiles group is accounted for by a single large item, $140,000, entitled "allowable deductions not taken on books". Unfortunately, a considerable number of divergences in Subclass 13c are described in this unsatisfactory manner. Consequently, some cases assigned to it may be misclassified. Other divergences in the textiles group are due to idle mill expenses and legal and professional services. Presumably they were charged to surplus or set up as deferred charges for book purposes. In the paper, publishing, and printing group the major source of divergence is entitled "deductible portion of items deferred on books".

The machinery and equipment manufacturers group reports such items as adjustment to cost of sales, law suits and stamps charged to surplus, breakage on boat shipments, and, surprisingly, "ordinary and necessary expenses capitalized". Not to treat ordinary and necessary expenses as a deduction from income is indeed peculiar! In the iron and steel and nonferrous metals group, both strike expenses and flood losses were deducted for statutory but not for book purposes.

Divergences in the finance group are very inadequately described. Four large items, amounting to nearly a million dollars, bear such ambiguous titles as "deductions debited to deferred charges on books", "not shown per books", "unex-

plained and miscellaneous deductions". In the trade group, on the other hand, an excellent degree of detail is given. One large item, $2.6 million for "amortization in settlement of landlord's claims", was taken as a statutory but not as a book deduction. One company described a statutory deduction of nearly $400,000 as "administrative expenses of trustee". No corresponding book deduction was taken.

Two interesting cases occur in the public utility group. In one, costs in connection with the establishment of a uniform accounting system were not taken as book deductions. Similarly, book profit tended to exceed statutory net income by $500,000 in another case because of different treatments of "amortization of 30/60 cycle change-over expenses in 1936"; details were not given.

All the illustrations cited so far tended to cause book profit to exceed statutory net income. Divergences operating in the reverse direction are generally not large, but are significant in two or three industrial groups. One company in the machinery and equipment manufacturers group, for example, reported a divergence amounting to nearly $400,000 for "adjustment of South American Branch income per tax schedule". An automobile parts and accessories company reported a substantial item for "advertising expense" without any details. In the services group two large divergences are for "prior year's expense" and "miscellaneous". Finally, several interesting cases appear in the public utilities group. One company reported a "credit to surplus on books from the sale of securities transferred to the company by trustees of the service annuity fund". Presumably the sale of these securities involved a realized capital gain. Perhaps this item should have been assigned to Class 2. Another item is reported merely as "indirect charges to construction in excess of 10 percent of general expense".

N Class 14: Divergences in Scope of Accounting Unit when Unconsolidated Returns are Submitted

In some cases, even when unconsolidated returns are submitted, transactions of subsidiary or affiliated companies are included on the books of the parent company.[11] Such transactions do not affect statutory net income. Seventeen such divergences are reported, of which two or three are of moderate size. Examples of Class 14 divergences include adjustment of subsidiary profit on sale of equipment, net income of subsidiary not consolidated, net profit from operation of X company for portion of taxable year prior to merger, reduction in reserve for affiliated company, reserve for inter-company profits, excess losses over profits of wholly owned subsidiaries, loss on stock of subsidiary, proportion of cost of investment in subsidiary company written off, and additional reserve for deficit of subsidiary company. Perhaps one or two of these really belong in Class 2. Most, however, clearly illustrate differences in the scope of the accounting unit adopted for book and tax purposes.

O Class 15: Differences due to Reorganizations, Mergers, and Dissolutions

To differentiate Class 15 divergences from Class 14 and Subclass 7a divergences is difficult, and probably not entirely successful. Class 15 is designed to include divergences due to current year reorganizations, mergers, and dissolutions of a far-reaching character. Accordingly, the amortization of prior year organization expenses and even of current year issues of new securities was relegated to Class 7, divergences in the treatment of intangible assets. Likewise, divergences resulting from

11 Corporations reporting on a consolidated basis for book purposes were deliberately excluded from Sample I. Consequently, no divergences are reported as due to the use of consolidated reports for book purposes and unconsolidated reports for tax purposes. Had the sample not been selected so as to avoid this problem such divergences might have assumed significant proportions.

profits or losses of subsidiary companies taken up on the books of the parent company were assigned to Class 14.

Class 15 contains only 6 divergences. Fortunately, for purposes of illustration, one represents a loss of nearly $700,000 upon the liquidation of a wholly owned subsidiary. It accounts for 68 percent of aggregate divergences in the rather poorly represented chemicals group. The other cases also represent divergences growing out of liquidation procedures. As these instances dramatically illustrate, Class 15 divergences are exceedingly rare, but they may be huge.