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Raby: The Income Tax and Business Decision

Francis J. Larkin

BOOK REVIEW

The Income Tax and Business Decisions. By William L. Raby: Prentice Hall, 1964, $10.60, pp. x 438.

Of all the forms of our national polity, our system of federal taxation is undoubtedly among the most complicated. Any attempt to derive an internally consistent meaning from the disparate Codal provisions, rendered even more heterogeneous by the vagaries of the preferential tax treatment accorded certain sectors of the population, challenges to the fullest the capacity for creative synthesis.[1] The challenge is conspicuously demanding on those who would seek to produce a vehicle for first introducing students to the world of federal taxation while, at the same time, according due emphasis to an exposition of the related accounting and financial concepts which necessarily impinge on the process of making business decisions. Accordingly, to judge the success of such an effort, a reviewer should not, perhaps, focus exclusively on the author's mechanical devotion to detail, or his pervasiveness in the assembly of data and materials—significant as these factors most assuredly are. Rather, the standard should be whether the arrangement of the materials best conduces towards a meaningful exposition of the taxation system in the environmental context of its business and financial climate, not just as an arid set of rules, but as a process which demands the greatest flexibility, imagination, and continuous adjustment both on the parts of citizens and of their business and tax planners. Judged by this latter criterion, Mr. Raby, an associate professor of accounting at Ohio University and a practicing C.P.A., has produced an admirable effort.

While the book has apparently been designed for use in undergraduate college programs of business administration, it is also useful for practicing lawyers who do not specialize in tax laws, for accountants who work in the tax field and, in general, for the great and growing mass of people who in their business or profession, need more than a casual knowledge of the radiating potencies of the Internal Revenue Code. The book may even be profitable for law students to read either as a supplement to, or in conjunction with, a case book[2] because, as will be suggested below,

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1 . . . I can only say that the tax laws must always be quite messy as long as they represent an uneasy compromise among contending groups and interests with different purposes and values.

Eisenstein, A Discussion of the Ideologies of Taxation, 18 Tax L. Rev. 1, 21 (1962).

2 For an indication that the use of this type of book in such a capacity would not be totally outside the mainstream of current academic legal thinking, we submit the following:

> We may then fairly be asked: Why a supplemental text? Is not any attempt at simplification akin to heresy, something like giving students shotguns with which to shoot sitting ducks—even drugging the ducks beforehand? For justification we plead the intricacy of the subject, the shortness of life and a possible mellowing—some would say softening—of our judgment. Many of us may now be prepared to believe that the diligent student who has ground his way through the cases in perplexity and wonder, perhaps has earned the right to

the book's format and approach furnish an illuminating connecting thread—in a decision-making orientation—from one typical tax problem to another.

The plan of the book is in conspicuous contrast with the traditional format of popular tax or accounting texts. Textbooks and materials—particularly those prepared for undergraduate tax or accounting courses—are frequently suffused with what might be termed the mechanical aspects of bookkeeping. The result is that students frequently receive the impression that, at bottom, the accounting process and the intertwined question of taxation consist of a set of formal rules, allowing no area for the exercise of judgment or discretion. Raby, on the other hand, has proceeded on the premise that "the learning of isolated facts is a relatively wasteful approach to the mastery of the subject," (Preface iii) and that pedagogical success in this area—as in all others—derives from viewing the particular principle under scrutiny as part of a larger cohesive framework, from which it can be severed only at the price of mutilation or confusion. Despite the built-in limitations of the subject matter, to which we have alluded above, Raby has happily succeeded in his objective. This result is truly a fortunate one, for neither accountants nor tax lawyers can practice effectively unless they rise from a preoccupation with details to that level where a comprehensive survey is possible, where meaningful relationships may be properly seen, and, where, to the extent such is possible, things assume their true proportions.

The compelling feature of the book is the manner in which Raby demonstrates the role that questions of taxation play in business problems and the decision-making process. These considerations apart, the author has produced an excellent analysis of the generic problem of contemporary industrial decision-making in furtherance of corporate objectives.[3]

It is, of course, obvious that the accomplishment of any intelligent action assumes an initial design and its corresponding fulfillment. Since, usually, it falls not to the lot of man either to plan with perfect foresight or to act with unerring judgment, the accomplishment of a particular design almost invariably produces situations which compel a choice between competing alternatives. Raby is aware that this is an inescapable reality, and he supplies excellent examples of the *modus operandi* of the vast majority of business and investment decisions, *i.e.*, a choice between alternative courses

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> know something of the perplexity and wonder of those who have gone before him—and what they have made of it all. As for the less than diligent student—neither this nor any other text will buoy him if he has not learned from the cases how to swim in the current.

Ehrenzweig & Louisell, Jurisdiction In a Nutshell V, VI (1964).

[3] That the subject is one of continuous concern to corporate planners, see Granger, The Hierarchy of Objectives, 42 Harv. Bus. Rev. 63 (1963).

> Objectives, properly developed and applied, can tell us in what paths, new and old, our total undertakings should be moving. They can guide both the day-to-day activities and the personal development of individuals in an organization. If we in management can clarify the objectives of our undertakings by even a small amount, we can greatly increase the effectiveness and efficiency of our business.

Id. at 74.

of action. Here are outlined the conceptual framework of corporate objectives relevant to the decision-making process, of which the industrial manager must, or ought, to be aware: namely, the criteria for selecting fundamental and intermediate objectives, and the quest for alternative approaches to the desired goal, usually in the light of the tax ramifications of the competing alternatives. One cannot leave the book without a better and more logical awareness of the problems involved in formulating objectives and without a more precise and illuminating indication of the information required in order to determine the "best" solution. Moreover, one is struck with the thought that while the exact extent of conscious quantitative analysis which is utilized in the decision-making process is incapable of precise measurement, this book reveals—if ever there was a doubt—that the one factor which is accorded conspicuous deference on all occasions is the tax consequences of the various alternatives open to the manager and his advisors.

The likeness and diversity of accounting principles and concepts to the field of federal taxation is lucidly explored through a survey of modern financial concepts. We see that while the approach of the tax laws is fundamentally the "transactional" approach of the accountant, there are a host of significant differences between the concepts of income as viewed by the accountant and as viewed by the tax attorney.[4] Raby gives a penetrating analysis of the influence that depreciation and inventory treatment exert on investment decision through their effect on net income, as a continuing exposition of the interrelation between tax law and accounting concepts and their cumulatively residual impact on business decisions. Relative to depreciation, the persistent philosophic dispute between the appropriate cost figure—original or reproduction—is skillfully traced, with the author apparently favoring the latter.[5]

In the chapter entitled "Some Special Opportunities for the Investor," the author provides a good survey of commercial vehicles used in real estate transactions, together with the multitude of tax problems encountered therein. The tax implications involved in the acquisition, operation and depreciation of real estate are explored in detail, together with a discussion centering on the use of syndicates, real estate investment trusts, "sale and leasebacks" (with the Yankee Stadium illustratively utilized as the *locus in quo*), and other tax planning techniques in the real estate field. This chapter alone should serve as a concise introduction to the individual whose duties require him to be familiar with the myriad tax problems and pitfalls incident to most real estate transactions of any consequence.

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4 Indeed, a comprehensive portion of the book is occupied with those areas where commercial accounting and tax accounting fail to converge.

5 Here the competing values are "certainty" and "reality." While it is argued that original cost is not a "realistic" figure for depreciation purposes, particularly in a period of rising prices, it is determinate. On the other hand, current reproduction cost may be fairly speculative and future reproduction cost fanciful. In weighing the comparative values, the decreasing integrity of the original dollar must be measured against the real danger of financial statements losing all integrity by supplying an "estimate" of current values ostensibly more realistic in determining depreciation. Raby does not deal with this question.

Throughout the book, whatever the topic, Raby keeps in focus the perennial problem of the tax-motivated transaction. Ever fascinating and always elusive, the concepts of business purpose, form versus substance, sham or artifice, and other judicial responses to tax avoidance maneuverings are kept before the reader to inhibit those whose imagination is too zestful or fertile.

A book which attempts to canvass such a very great number of subjects will perforce show some unevenness in the quality of their treatment. Such is the case here. However, while many of the discussions are briefer than would be required for exhaustive study,[6] the corresponding value for the novice is that he may gain an orientation and a fair working understanding of the operative tax and accounting principles with greater ease than that allowed by the more voluminous source books. As noted above, the book has been formulated on the premise that once the fundamentals of the subject have been inculcated, and the scaffolding of the Revenue Code clearly drawn, amplification, elaboration, and technical minutiae are better understood and can be more readily appended.

FRANCIS J. LARKIN
The Assistant Dean
Boston College Law School

[6] Perhaps most surprisingly for a survey book of this type, the author does strive at all times to give the reader at least a nodding acquaintance with some of the more abstract philosophic questions which the present structure of the tax laws generate. For example, he discusses the ultimate incidence of the corporate income tax. The question of who ultimately bears the burden of the corporate income tax—the shareholder or the consumer as a short term cost—has long been debated by economists and businessmen. For a recent discussion of this issue, see Krzyzaniak & Musgrave, The Shifting of the Corporation Income Tax (1963).