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FEDERAL REGISTER

VOLUME 8 NUMBER 218

Washington, Wednesday, November 3, 1943

The President

EXECUTIVE ORDER 9393

POSSESSION AND OPERATION OF COAL MINES

WHEREAS widespread stoppages have occurred in the coal industry and strikes are threatened which will obstruct the effective prosecution of the war by curtailing vitally needed production in the coal mines directly affecting the countless war industries and transportation systems dependent upon such mines; and

WHEREAS it has become necessary for the effective prosecution of the war that the coal mines in which stoppages or strikes have occurred, or are threatened, be taken over by the Government of the United States in order to protect the interests of the nation at war and the rights of workers to continue at work:

NOW, THEREFORE, by virtue of the authority vested in me by the Constitution and laws of the United States particularly the War Labor Disputes Act, (Public Law 89, 78th Congress), as President of the United States and Commander-in-Chief of the Army and Navy, it is hereby ordered as follows:

The Secretary of the Interior is authorized and directed to take immediate possession, so far as may be necessary or desirable, of any and all mines producing coal in which a strike or stoppage has occurred or is threatened, together with any and all real and personal property, franchises, rights, facilities, funds, and other assets used in connection with the operation of such mines, and to operate or arrange for the operation of such mines in such manner as he deems necessary for the successful prosecution of the war, and to do all things necessary for or incidental to the production, sale and distribution of coal.

In carrying out this order, the Secretary of the Interior shall act through or with the aid of such public or private instrumentalities or persons as he may designate. He shall permit the management to continue its managerial functions to the maximum degree possible consistent with the aims of this order.

The Secretary of the Interior shall make employment available and provide protection to all employees resuming work at such mines and to all persons seeking employment so far as they may be needed; and upon the request of the Secretary of the Interior, the Secretary of War shall take such action, if any, as he may deem necessary or desirable to provide protection to all such persons and mines.

The Secretary of the Interior is authorized and directed to maintain customary working conditions in the mines and customary procedure for the adjustment of workers' grievances. He shall recognize the right of the workers to continue their membership in any labor organization, to bargain collectively through representatives of their own choosing, and to engage in concerted activities for the purpose of collective bargaining or other mutual aid or protection, provided that such concerted activities do not interfere with the operations of the mines.

The Secretary of the Interior is further authorized and directed to offer to the duly constituted representatives of the workers' own choosing a contract or contracts governing the terms and conditions of employment for the period of the operation of the mines by the Government, in accordance with the opinion of the National War Labor Board in the matter of Illinois Coal Operators Association and United Mine Workers of America of October 26, 1943, and with such further directives as may be given by the War Labor Board. When any such contract has been agreed upon, the Secretary of the Interior shall apply under section 5 of the War Labor Disputes Act to the National War Labor Board for the approval of such contract and such changes in the terms and conditions of employment as may be authorized therein.

Possession and operation of any mine or mines hereunder shall be terminated by the Secretary of the Interior as soon as he determines that possession and operation hereunder are no longer required for the furtherance of the war program, but in no event more than sixty

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FEDERAL REGISTER

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days after the restoration of the productive efficiency thereof prevailing prior to the taking possession thereof.

Nothing in this order shall be construed to repeal or amend Executive Order No. 9370 dated August 16, 1943,[1] authorizing the Economic Stabilization Director to take certain action in connection with the enforcement of directives of the National War Labor Board.

FRANKLIN D ROOSEVELT

THE WHITE HOUSE,
November 1, 1943.

[F. R. Doc. 43-17719; Filed, November 2, 1943; 11:51 a. m.]

Regulations

TITLE 6—AGRICULTURAL CREDIT

Chapter II—War Food Administration (Commodity Credit)

[Apple Program, Form 1]

PART 242—APPLE FREIGHT EQUALIZATION PROGRAM

CERTAIN SHIPMENTS OF APPLES FROM WASHINGTON, OREGON, AND WESTERN IDAHO

In order to encourage and maintain equitable distribution of apples to all consuming areas and to return to the growers in Washington, Oregon and Western Idaho, a price equivalent to that obtained by producers of apples in other producing districts on a basis consistent with the maintenance of price ceilings with respect to such apples, Commodity Credit Corporation (herein called "Commodity"), a corporate agency of the War Food Administration of the United States, pursuant to announcement heretofore made, hereby offers to make freight equalization payments to eligible shippers of eligible apples shipped from Washington, Oregon, and Western Idaho (Zone VI as defined herein), for the benefit of whosoever shall pay the transportation charges thereon, in the manner and subject to the terms and conditions specified in this offer.

Sec.
242.1 Eligible shippers.
242.2 Eligible apples.
242.3 Rates of payment.
242.4 Prerequisites to payment.
242.5 Payment.
242.6 Books and records.
242.7 Term of offer.
242.8 Termination.
242.9 Right to declare applications for payment invalid.
242.10 Instructions and interpretations.
242.11 Definitions.
242.12 Delegation.
242.13 Correspondence.

AUTHORITY: §§ 242.1 to 242.13, inclusive, issued under sec. 7, 49 Stat. 4, as amended by 50 Stat. 5, 53 Stat. 510, 55 Stat. 498, and Pub. Law 151, 78th Cong.

§ 242.1 *Eligible shippers.* Payments under this offer shall be available, upon compliance with the terms and conditions specified herein, to shippers of eligible apples (such shippers being herein called "eligible shippers").

§ 242.2 *Eligible apples.* The term "eligible apples", as used herein, means and includes all apples grown in Zone VI and shipped, during the term of this offer, from a point or points in Zone VI to a point or points in Zone I or Zone II (each such shipment of eligible apples being herein called an "eligible shipment"), except: (1) Lady apples and all varieties of crab apples; (2) apples heretofore or hereafter released pursuant to Food Distribution Order No. 69 (8 F.R. 10477); and (3) apples restricted from shipment under Food Distribution Order No. 83 (8 F.R. 13379).

§ 242.3 *Rates of payment.* The rate of the payment hereunder per wrapped box, or per hundredweight of bulk or loosepacked or non-standard wrapped boxed apples, as the case may be, included in any Eligible Shipment shall be determined in accordance with the following schedule upon the basis of the lowest applicable freight rate per hundredweight from the point of shipment in Zone VI to such point or points of destination in Zone I or Zone II as defined herein, respectively:

TO ZONE I

Lowest applicable freight rate per cwt.	$1.05	$1.15	$1.20	$1.25
Equalization payment per standard wrapped box	.39	.44	.465	.49
Equalization payment per cwt.	.78	.88	.93	.98

TO ZONE II

Lowest applicable freight rate per cwt.	$1.00	$1.05	$1.15	$1.20	$1.25	$1.35
Equalization payment per standard wrapped box	.195	.22	.27	.295	.32	.37
Equalization payment per cwt.	.39	.44	.54	.59	.64	.74

§ 242.4 *Prerequisites to payment.* Payments hereunder shall be made only to eligible shippers who (a) file applications for payment, in such form as may be prescribed by Commodity, with Commodity prior to September 30, 1944, and (b) supply, with and in respect of each such application for payment, the originals or properly certified copies of each of the following substantiating documents, in form and substance satisfactory to Commodity: (1) bill of lading; (2) shipping invoice; (3) standard confirmation of sale; (4) purchaser's certificate; (5) inspection certificate, inso-

[1] 8 F.R. 11463.

far as required under Food Distribution Order No. 83; and (6) paid freight bill (except to the extent that the submission of any of such documents shall be waived by Commodity).

§ 242.5 *Payment.* Commodity shall, as soon as practicable after receipt of each such application for payment, make payment thereon (if found to be in conformity with this offer) to the appropriate eligible shipper, in trust, for payment over immediately to whosoever shall have paid the shipping charges, on the eligible shipment or eligible shipments covered by such application for payment. The making of any such payment shall not constitute final acceptance of the validity or amount of the claim represented by the application for payment.

In the event of a subsequent finding that any such claim is invalid, defective or incorrectly computed or, if the eligible shipper does not comply with the terms of this offer in respect of paying such proceeds over to whosoever shall have paid the transportation charges on any eligible shipment involved, Commodity shall have the right to require restitution of any such payment or any part thereof, such right being in addition to any and all other rights of Commodity in the premises. In the event an Eligible Shipper shall, in respect of any shipment upon which application for payment is filed hereunder, violate any of the terms and conditions of this offer, such eligible shipper may, at the election of Commodity, be barred from making any application for payment hereunder in respect of any shipment made subsequent to the giving of notice by Commodity of such election by Commodity. Payment will be made to the person shown in the corresponding application for payment to be the eligible shipper. Payments due or to become due hereunder shall not be assignable without the written approval of Commodity.

§ 242.6 *Books and records.* All eligible shippers shall maintain complete and accurate books, records, and accounts with respect to all eligible shipments made by them and of the disposition of the proceeds of payment received by them from Commodity hereunder. All such books, records, and accounts shall be carefully preserved for a period of not less than two (2) years and shall be available for inspection by Commodity or its designated agents or representatives at any reasonable time.

§ 242.7 *Term of offer.* This offer shall apply to all eligible shipments by eligible shippers arriving at destination in Zone I and Zone II on or after October 17, 1943, and up to and including July 31, 1944 (unless this offer is terminated earlier pursuant to § 242.8 hereof).

§ 242.8 *Termination.* Commodity reserves the right to modify or terminate this offer at any time upon three (3) days' public notice. The issuance by Commodity of a press release shall constitute sufficient public notice for this purpose. Such modification or termination pursuant to this section shall not affect Commodity's obligations hereunder with respect to eligible shipments by eligible shippers made prior to the effective date of such modification or termination. This offer shall, at the election of Commodity, terminate immediately in the event of and upon the effective date of the termination or any modification of Maximum Price Regulation No. 426, Amendment 9.

§ 242.9 *Right to declare applications for payment invalid.* Commodity shall have the right to declare invalid, in whole or in part, any application for payment hereunder in the event such application for payment is not in conformity with this offer.

§ 242.10 *Instructions and interpretations.* Commodity shall have the right to supplement or clarify any provision or provisions of this offer or alter any procedure prescribed herein at any time by the issuance of instructions or interpretations in connection therewith.

§ 242.11 *Definitions.* For the purpose of this offer:

(a) The term "Western Idaho" means the Counties of Valley, Boise, Elmore, Idaho and Owyhee, in the State of Idaho, and all counties lying to the West and North thereof in said State;

(b) The term "Zone VI" means and includes Western Idaho and the States of Washington and Oregon;

(c) The term "shipper" means any person who ships apples, except as a carrier of apples owned by other persons;

(d) The term "box" means: (1) a standard western box of the following dimensions (inside measurements): 10½" x 11½" x 18"; or (2) a container of equivalent content; or (3) two standard western half boxes of the following dimensions (inside measurements) each: 5¼" x 11½" x 18";

(e) The term "Zone I" means and includes Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, New York, New Jersey, Pennsylvania, Ohio, Indiana, Illinois, District of Columbia, Delaware, Maryland, Virginia, West Virginia, North Carolina, South Carolina, Kentucky, all counties in Michigan east of Lake Michigan, the following counties in Wisconsin: Washington, Columbia, Vernon, Sauk, Dodge, and Ozaukes and all counties in Wisconsin south of said counties, the following counties in Missouri: Clark, Lewis and Marion, the following counties in Georgia: Effingham and Chatham, and the following counties in Tennessee: Scott, Morgan, Roane, Loudon, and Monroe and all counties in Tennessee east of said counties;

(f) The term "Zone II" means and includes Minnesota, Iowa, Florida, Alabama, Mississippi, Arkansas, those counties in Michigan, Wisconsin, Missouri, Georgia and Tennessee not included in Zone I, the following counties in Nebraska: Dakota, Thurston, Burt, Washington, Sarpy, and Douglas, the county of Wayandotte in Kansas, and the following parishes in Louisiana: Pointe Coupee, St. Martin, and Iberia and all parishes in Louisiana east of said parishes;

(g) The term "Maximum Price Regulation No. 426, Amendment 9", means Maximum Price Regulation No. 426, Amendment 9, in the form issued by the Office of Price Administration on October 5, 1943.

§ 242.12 *Delegation.* Any act, approval, direction or determination provided in the Offer to be made by Commodity may be delegated by Commodity to any agent, representative, or agency to act in its place and stead or for its account.

§ 242.13 *Correspondence.* All correspondence, applications for payment, substantiating documents, and notices required or permitted to be sent or made to or filed with Commodity pursuant to this Offer shall, unless and until Commodity shall otherwise prescribe, be sent or made to or filed with Fruit and Vegetable Branch, Food Distribution Administration, 210 Mayer Building, Portland, Oregon.

COMMODITY CREDIT CORPORATION,
[SEAL] By J. B. HUTSON, *President.*
Attest:
NORINE J. FAUBLE,
Assistant Secretary.
OCTOBER 22, 1943.

[F. R. Doc. 43-17702; Filed, November 1, 1943; 5:27 p. m.]

[Apple Program, Form 1, Int. 1]

PART 242—APPLE FREIGHT EQUALIZATION PROGRAM

INTERPRETATION OF TERM "ELIGIBLE APPLES"

In response to inquiries received by Commodity Credit Corporation (herein called "Commodity"), and to render explicit that which was implicit in the offer of Commodity Credit Corporation to make freight equalization payments in respect of certain shipments of apples from Washington, Oregon, and Western Idaho (herein called the "offer"), issued October 22, 1943, Commodity hereby issues the following interpretation with respect to such offer:

The term "eligible apples" as used in the offer shall mean and include only those apples as defined in § 242.2 of the offer, which are shipped for domestic civilian consumption other than for conversion into an alcoholic product for sale, and shall not include: (1) apples owned by, or shipped to or for utilization by, the United States Government or any department, agency, corporation, or bureau thereof; or (2) any other apples except as indicated above.

Persons acting in reliance upon the offer shall do so in accordance with and subject to this interpretation.

(Sec. 7, 49 Stat. 4, as amended by 50 Stat. 5, 53 Stat. 510, 55 Stat. 498, and Pub. Law 151, 78th Cong.)

Issued November 1, 1943.

COMMODITY CREDIT CORPORATION,
[SEAL] By J. B. HUTSON, *President.*
Attest:
ZELMA DAVIS.
Assistant Secretary.

[F. R. Doc. 43-17705; Filed, November 1, 1943; 5:27 p. m.]

TITLE 7—AGRICULTURE

Chapter XI—War Food Administration (Distribution Orders)

[FDO 45, Amdt. 2]

PART 1491—BEANS

RESTRICTIONS ON DELIVERIES OF BEANS

Food Distribution Order 45, as amended (8 F.R. 9106), issued by the Acting War Food Administrator on the first day of July 1943, is amended to read, as follows:

§ 1491.1 *Beans required to be set aside*—(a) *Definitions.* (1) "Beans" means dry threshed beans of the following classes, as defined in the United States Standards for Beans, as revised, effective September 1, 1941: Pea beans; Great Northern beans; Small White beans; Flat Small White beans; Light Red Kidney beans; Dark Red Kidney beans; Pink beans; Western Red Kidney beans; Cranberry beans; Small Red beans; Pinto beans; and Baby Lima beans.

(2) "Authorized purchaser" means any person who holds an existing contract to sell or deliver to a governmental agency products prepared, in whole or in part, from beans.

(3) "Country shipper" means any person whose total deliveries of beans, exclusive of his deliveries thereof to another country shipper, during any month of the calendar year 1943, has exceeded or exceeds 20,000 pounds, and who (i) owns beans, in whole or in part, which he has caused to be screened, sorted, handpicked, polished, or otherwise cleaned for delivery in the dry, uncooked state, whether for his own account or the joint account of himself and another; or (ii) purchases for his own account or the joint account of himself and another, beans, from a grower who caused such beans to be screened, sorted, handpicked, polished, or otherwise cleaned for delivery in the dry, uncooked state. Any person who once qualifies as a country shipper within this definition shall thereafter be deemed to be a country shipper and subject to the terms and conditions of this order, regardless of the volume of his deliveries in succeeding months.

(4) "Delivery" means the physical transfer of beans from a country shipper to a buyer. The transfer of beans by a country shipper to a carrier, truck, railroad car, or other vehicle for transportation to the buyer, regardless of the ownership or control of the carrier or vehicle being used for such transportation, shall constitute a delivery.

(5) "Person" means any individual, partnership, association, business trust, corporation, or any organized group of persons, whether incorporated or not.

(6) "Director" means the Director of Food Distribution, War Food Administration.

(7) "Governmental agency" means (i) the Armed Services of the United States (however, for the purposes of this order United States Army post exchanges, United States Navy ships' service departments, United States Marine Corps post exchanges, and similar organizations shall not be deemed a part of the Armed Services of the United States); (ii) the Food Distribution Administration, War Food Administration (including, but not restricted to, the Federal Surplus Commodities Corporation); (iii) any person who, pursuant to a Food Distribution Regulation, is entitled to purchase food subject to this order; and (iv) any other instrumentality or agency designated by the War Food Administration.

(8) "Armed Services of the United States" means the Army, Navy, Marine Corps, and Coast Guard of the United States.

(b) *Restrictions on country shippers.* (1) Each country shipper shall, during each calendar month, set aside and thereafter hold for delivery to governmental agencies or authorized purchasers a quantity of beans equal to at least 100% of his total deliveries thereof during such calendar month, exclusive of deliveries to governmental agencies, authorized purchasers in accordance with the provisions of this order, and other country shippers, of all beans of the classes listed in paragraph (a) (1) hereof.

(2) The beans set aside pursuant to the provisions hereof shall be of U. S. No. 2 grade or better, as specified in the United States Standards for Beans.

(3) The beans set aside pursuant to the provisions hereof may be offered for sale by country shippers at no more than the maximum prices established by the Office of Price Administration to governmental agencies, in response to announcements or notices issued by such agencies to the effect that offers for beans will be received on specified dates, or to authorized purchasers.

(4) The beans set aside pursuant to the provisions hereof may be sold to any governmental agency or authorized purchaser: *Provided, however,* That no beans set aside pursuant to this order shall be sold to any authorized purchaser unless such purchaser shall furnish a certificate in conformity with the provisions of paragraph (b) (5) hereof.

(5) Each authorized purchaser who purchases beans which have been set aside pursuant to the provisions of this order for use in the fulfillment of an existing contract with a governmental agency shall furnish to the country shipper from whom he buys such beans a certificate, signed by an authorized official, in substantially the form attached hereto as Exhibit A, which shall constitute a certification to the War Food Administrator that such authorized purchaser is familiar with the terms of this order (as originally issued or subsequently amended), and that the purchase of beans which have been set aside under this order has been authorized by this order, as amended, and that he will use the beans purchased in the fulfillment of existing contracts with governmental agencies. No country shipper shall, however, be entitled to rely on any such certificate if he knows or has reasonable cause to believe it to be false.

(6) The restrictions hereof shall be observed without regard to the rights of creditors, prior contracts, existing contracts, payments made, or deliveries of beans made prior to the effective date hereof. This order shall not, however, be construed as reducing the amount of beans which any person is required to set aside or deliver or to have set aside and held for delivery to governmental agencies under the provisions of this order prior to the effective date of this amendment or any existing contract made with a governmental agency, but any quantity of beans delivered after the effective date of this order to any governmental agency or authorized purchaser, except beans required to be set aside pursuant to the provisions of this order prior to the effective date of this amendment for delivery to governmental agencies, shall be allowed as a credit to such person in determining the quantity of beans required to be set aside and held for delivery to governmental agencies pursuant to the provisions hereof.

(7) Nothing herein shall be construed as applying to beans sold and delivered exclusively for seed purposes in compliance with State and Federal seed laws.

(c) *Prior restrictions modified.* Beans in quantities less than a carlot (80,000 pounds) required to be set aside pursuant to the provisions of this order prior to July 1, 1943, may be sold and delivered to a country shipper if such country shipper certifies to the seller (and such certification shall be deemed to be a representation to an agency of the United States) that he will set aside and hold such beans, or a quantity of beans equivalent thereto, for delivery to a governmental agency in addition to the quantity of beans he is otherwise required to set aside under this order, as amended. Beans set aside prior to July 1, 1943, in quantities in excess of a carlot (80,000 pounds) may be sold and delivered in accordance with the provisions of paragraphs (b) (3), (4), and (5) of this order, as amended.

(d) *Records and reports.* (1) Every country shipper shall keep all certificates furnished under paragraph (b) (5) of this order, and shall maintain such records for at least two years (or for such other periods of time as the Director may designate), and shall execute and file such reports upon such forms and submit such information as the Director may from time to time request or direct, and within such times as he may prescribe.

(2) The Director shall be entitled to obtain such information from, and require such reports and the keeping of such records by, any person, as may be necessary or appropriate, in his discretion, to the enforcement or administration of the provision of this order.

(3) The record-keeping requirements of this order have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942. Subsequent record-keeping or reporting requirements will be subject to the approval of the Bureau of the Budget pursuant to the Federal Reports Act of 1942.

(e) *Audits and inspections.* The Director shall be entitled to make such audit or inspection of the books, records, and other writings, premises, or stocks of beans of any person, and to make such investigations as may be necessary or appropriate, in his discretion, to the enforcement or administration of the provisions of this order.

(f) *Petition for relief from hardship.* Any person affected by this order who considers that compliance herewith would work an exceptional and unrea-

sonable hardship on him, may file a petition for relief in writing with the Director, addressed as follows: Director of Food Distribution, War Food Administration, Washington 25, D. C., Ref. FDO 45. Such petition shall set forth all pertinent facts and the nature of the relief sought. The Order Administrator of this order shall then act upon the petition. In the event that the petitioner is dissatisfied with the action taken by the Order Administrator, he may request a review of such action by the Director whose decision with respect to the relief sought shall be final.

(g) *Violations.* The War Food Administrator may, by suspension order, prohibit any person who violates any provision of this order from receiving, making any deliveries of, or using beans, or any other material subject to priority or allocation control by the War Food Administrator, and may recommend that any such person be prohibited from receiving, making any deliveries of, or using materials subject to the priority or allocation control of other governmental agencies. In addition, any person who wilfully violates any provision of this order is guilty of a crime and may be prosecuted under any and all applicable laws. Further, civil action may be instituted to enforce any liability or duty created by, or to enjoin any violation of, any provision of this order.

(h) *Authority to release beans.* The Director is hereby authorized, notwithstanding any of the provisions hereof, to release by general order or by written notices, any or all of the beans set aside by any country shipper pursuant to the provisions of this order.

(i) *Communications.* All reports required to be filed hereunder and all communications concerning this order shall, unless instructions to the contrary are issued by the Director, or otherwise provided herein, be addressed to the Director of Food Distribution, War Food Administration, Washington 25, D. C., Ref. FDO 45.

(j) *Delegation of authority.* The administration of this order and the powers vested in the War Food Administrator, insofar as such powers relate to the administration of this order, are hereby delegated to the Director, and may be redelegated by him to any employee of the United States Department of Agriculture.

(k) *Release of set aside peas and split-peas.* Peas and split-peas, set aside pursuant to the provisions of Food Distribution Order 45, as amended, are hereby released and may be disposed of without regard to the restrictions of this order in effect prior to the effective date of this amendment.

(l) *Territorial extent.* This order shall apply only to operations conducted within any of the forty-eight States of the United States or the District of Columbia.

(m) *Effective date.* This amendment shall become effective on the 1st day of November 1943, at 12:01 a. m., e. w. t. However, with respect to violations of Food Distribution Order 45, as amended, or rights accrued or liabilities incurred thereunder, prior to said date said Food Distribution Order 45, as amended, shall be deemed in full force and effect for the purpose of sustaining any proper suit, action, or other proceeding with respect to any such violation, right, or liability.

(E.O. 9280, 7 F.R. 10179; E.O. 9322, 8 F.R. 3807; E.O. 9334, 8 F.R. 5423)

Issued this 1st day of November 1943.

ASHLEY SELLERS,
Assistant War Food Administrator.

EXHIBIT A—AUTHORIZED PURCHASER'S CERTIFICATE

Certificate required by paragraph (b) (7) of Food Distribution Order No. 45, as amended. One copy of this certificate is to be delivered to each country shipper from whom the authorized purchaser acquires set aside beans and one copy is to be retained by the authorized purchaser. A certificate shall be given for each specific purchase of set aside beans.

Commodity and class	Date
Grade	Purchaser's name
Quantity	Purchaser's address
	Name of Government agency and contract number

In accordance with paragraph (b) (5) of Food Distribution Order No. 45 to assure an adequate supply and efficient distribution of beans to meet war and essential civilian needs, the undersigned hereby certifies, and this shall constitute a certification to the War Food Administrator, that the undersigned purchaser is familiar with the terms of Food Distribution Order No. 45 (as originally issued or subsequently amended) and that the purchase of beans described above from _____ _____,
Name of seller Address of seller
is authorized under the terms and provisions of Food Distribution Order No. 45, and that the purchaser will use the beans purchased in fulfillment of the contracts with the governmental agency specified herein.

_____
Legal name of authorized purchaser
By _____
Title of person executing certificate

Section 35a of the United States Criminal Code (18 U. S. C. 80) makes it a criminal offense to make a false statement or representation to any Department or agency of the United States as to any matter within its jurisdiction.

[F. R. Doc. 43-17685; Filed, November 1, 1943; 4:53 p. m.]

[FDO 7-1, Amdt. 2]

PART 1430—SUGAR

RAW SUGAR ALLOTMENTS

Pursuant to the authority vested in me by Food Distribution Order 7, as amended (8 F.R. 10605), issued by the War Food Administrator on July 28, 1943, Director Food Distribution Order 7-1, as amended (8 F.R. 10606), is hereby amended to read as follows:

§ 1430.6 *Allotments of raw sugar.* (a) No refiner or his agent shall purchase, import, or accept delivery of raw sugar in excess of the allotment hereby established for the period from January 1, 1942, to September 30, 1944, for him in the amount set forth below opposite his name. All such raw sugar which a regner has purchased, imported, or accepted delivery of, between January 1, 1942, and the effective date of this order shall be charged against such allotment.

	Short tons (raw value)
American Sugar Refining Co	2,825,936
J. Aron & Co	136,112
California & Hawaiian Sugar Refining Corp	1,544,172
Charms Company	29
Chase Candy Company	6,767
Colonial Sugars Company	375,697
Godchaux Sugars, Inc	597,292
Henderson Sugar Refinery	227,532
Imperial Sugar Company	407,175
Inland Sugar Company	17,829
Liquid Sugars, Inc	34,717
W. J. McCahan Sugar Refining and Molasses Company	486,774
National Sugar Refining Co	2,333,831
Pepsi-Cola Company	62,629
Realty Operators, Inc	63,970
Refined Syrups & Sugars, Inc	337,934
Revere Sugar Refinery	483,887
Savannah Sugar Refining Corp	513,184
South Coast Corporation	162,204
Sterling Sugars, Inc	92,570
Sucrest Corp. and Affiliates	329,022
South Coast Corporation	162,204
Tea Garden Products Company	2,201
Western Sugar Refinery	484,831

(b) This amendment shall become effective on November 4, 1943, at 12:01 a. m., e. w. t. However, with respect to violations of Director Food Distribution Order 7-1, as amended, or rights accrued or liabilities incurred thereunder, prior to said date, said Director Food Distribution Order 7-1, as amended, shall be deemed in full force and effect for the purpose of sustaining any proper suit, action, or other proceeding with respect to any such violation, right, or liability.

(FDO 7, as amended, 8 F.R. 10605; E.O. 9280, 7 F.R. 10179; E.O. 9322, 8 F.R. 3807; E.O. 9334, 8 F.R. 5423)

Issued this 2d day of November 1943.

C. W. KITCHEN,
Acting Director of Food Distribution.

[F. R. Doc. 43-17718; Filed, November 2, 1943; 11:20 a. m.]

TITLE 9—ANIMALS AND ANIMAL PRODUCTS

Chapter II—War Food Administration (Packers and Stockyards)

PART 204—POSTED STOCKYARDS AND LIVE POULTRY MARKETS

PINE BLUFF STOCKYARDS, ARK.

It has been ascertained that the Pine Bluff Stockyards, Pine Bluff, Arkansas, posted on July 15, 1936, as coming within the jurisdiction of the Packers and Stockyards Act, 1921, as amended, no longer comes within the definition of a stockyard under the Act. Therefore, notice of such fact is given to the owner of such stockyard and to the public, and the name of the stockyard is deleted from the list of posted stockyards in the Code of Federal Regulations, Title 9, § 204.1.

(7 U.S.C. 1940 ed. 181 et seq.; E.O. 9280, 7 F.R. 10179, E.O. 9322, 8 F.R. 3807; E.O. 9334, 8 F.R. 5423)

Done at Washington, D. C., this 1st day of November 1943.

THOMAS J. FLAVIN,
Assistant to the War Food Administrator.

[F. R. Doc. 43-17682; Filed, November 1, 1943; 4:12 p. m.]

TITLE 26—INTERNAL REVENUE

Chapter I—Bureau of Internal Revenue

Subchapter A—Income and Excess-Profits Taxes

[Regulations 111]

PART 29—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1941

Explanation of Regulations—Scope. The main body of these regulations deals with the income taxes imposed by chapter 1 (sections 1 to 476, inclusive) and subchapter A of chapter 2 (sections 500 to 511, inclusive) of the Internal Revenue Code, and with sections 3797 (definitions) and 3801 (mitigation of effect of limitation and other provisions) thereof. The regulations are applicable only with respect to taxable years beginning after December 31, 1941.

Arrangement and numbering. Each section, subsection, or paragraph of the Internal Revenue Code set forth in the regulations is followed by the section or sections (if any) of the regulations interpreting it. Sections of the Code may readily be distinguished from sections of the regulations, since each of the latter appears in larger type and bears a number commencing with 29 and a decimal point.

Each section of the regulations has been given a key number corresponding to the number of the section, subsection, or paragraph of the Internal Revenue Code which the regulations section interprets. Inasmuch as the regulations constitute Part 29 of Title 26 of the Code of Federal Regulations, each key number is preceded by the number 29 and a decimal point. The key number is followed by a dash (–) and the identifying number of the regulations section. By use of these key numbers one can readily ascertain how a given section, subsection, or paragraph of the Internal Revenue Code has been interpreted by the Bureau. Thus, one desiring to learn what interpretation has been placed on section 23 (d) of the Code should turn to § 29.23 (d)–1 of the regulations. In some cases several regulations sections are necessary in the interpretation of different phases of one section, subsection, or paragraph of the Code. For example, section 23 (m) of the Code, dealing with "Depletion," requires many regulations sections. Each of them, however, is designated by the key § 29.23 (m), for example, § 29.23 (m)–1, § 29.23 (m)–2, etc.

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AUTHORITY: §§ 29.1-1 to 29.3801 (e)-1 issued under sections 62 and 3791 of the Internal Revenue Code (53 Stat. 32, 467; 26 U.S.C., 62, 3791).

SUBPART A—INTRODUCTORY PROVISIONS

Pertinent Enacting Provisions of the Internal Revenue Code

AN ACT

To consolidate and codify the internal revenue laws of the United States.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the laws of the United States hereinafter codified and set forth as a part of this act under the heading "Internal Revenue Title" are hereby enacted into law.

SEC. 2. CITATION. This act and the internal revenue title incorporated herein shall be known as the Internal Revenue Code and may be cited as "I. R. C.".

* * * * *

SEC. 6. ARRANGEMENT, CLASSIFICATION, AND CROSS REFERENCES. The arrangement and classification of the several provisions of the Internal Revenue Title have been made for the purpose of a more convenient and orderly arrangement of the same, and, therefore, no inference, implication or presumption of legislative construction shall be drawn or made by reason of the location or grouping of any particular section or provision or portion thereof, nor shall any outline, analysis, cross reference, or descriptive matter relating to the contents of said Title be given any legal effect.

* * * * *

SEC. 1. APPLICATION OF CHAPTER.

The provisions of this chapter shall apply only to taxable years beginning after December 31, 1938. Income, war-profits, and excess-profits taxes for taxable years beginning prior to January 1, 1939, shall not be affected by the provisions of this chapter, but shall remain subject to the applicable provisions of the Revenue Act of 1938 and prior revenue acts, except as such provisions are modified by legislation enacted subsequent to the Revenue Act of 1938.

§ 29.1-1 *Scope and applicability of regulations.* These regulations deal with the taxes upon net income imposed by Chapter 1 of the Internal Revenue Code, including the tax imposed by section 102 upon the net income of certain corpora-

tions, and with the surtax imposed by subchapter A of chapter 2 (sections 500 to 511, inclusive) upon the undistributed subchapter A net income of personal holding companies.

These regulations are applicable only with respect to taxable years beginning after December 31, 1941.

Each section, subsection, or paragraph of the Internal Revenue Code set forth in these regulations shall be considered as a part of the respective regulations section to which it corresponds.

SEC. 2. CROSS REFERENCES.

The cross references in this chapter to other portions of the chapter, where the word "see" is used, are made only for convenience, and shall be given no legal effect.

SEC. 3. CLASSIFICATION OF PROVISIONS [as amended by sec. 172 (b), Rev. Act 1942.]

The provisions of this chapter are herein classified and designated as—

Subchapter A—Introductory provisions,

Subchapter B—General provisions, divided into parts and sections.

Subchapter C—Supplemental provisions divided into Supplements and sections,

Subchapter D—Victory tax on individuals, divided into parts and sections.

§ 29.3–1 *Division of regulations.* These regulations, which constitute Part 29 of Title 26 of the 1943 Supplement to the Code of Federal Regulations, are divided into six subparts. Subpart A relates to introductory provisions. Subpart B relates to general provisions. Subpart C relates to supplemental provisions. Subpart D relates to victory tax on individuals. Subpart E relates to surtax on personal holding companies. Subpart F relates to definitions. Subpart G relates to mitigation of effect of limitation and other provisions in income tax cases.

SEC. 4. SPECIAL CLASSES OF TAXPAYERS [as amended by sec. 102 (c), Rev. Act 1941; sec. 170 (b), Rev. Act 1942].

The application of the General Provisions and of Supplements A to D, inclusive, to each of the following special classes of taxpayers, shall be subject to the exceptions and additional provisions found in the Supplement applicable to such class, as follows:

(a) Estates and trusts and the beneficiaries thereof—Supplement E.

(b) Members of partnerships—Supplement F.

(c) Insurance companies—Supplement G.

(d) Nonresident alien individuals—Supplement H.

(e) Foreign corporations—Supplement I.

(f) Individual citizens of any possession of the United States who are not otherwise citizens of the United States and who are not residents of the United States—Supplement J.

(g) Individual citizens of the United States or domestic corporations, satisfying the conditions of section 251 by reason of deriving a large portion of their gross income from sources within a possession of the United States—Supplement J.

(h) China Trade Act corporations—Supplement K.

(i) Foreign personal holding companies and their shareholders—Supplement P.

(j) Regulated investment companies—Supplement Q.

(k) Shareholders of Personal Service Corporations—Supplement S.

(l) Individuals with gross income from certain sources of $3,000 or less—Supplement T.

§ 29.4–1. *Application of regulations to special classes of taxpayers.* With respect to certain classes of taxpayers, the application of the provisions of Subpart B of these regulations is subject to certain exceptions and additional provisions, which appear in Subpart C, as follows:

Estates and trusts—sections 161 to 172, inclusive.

Partnerships—sections 181 to 190, inclusive.

Insurance companies—sections 201 to 207, inclusive.

Nonresident alien individuals—sections 211 to 219, inclusive.

Foreign corporations—sections 231 to 237, inclusive.

Income from sources in possessions of the United States—sections 251 and 252.

China Trade Act corporations—sections 261 to 265, inclusive.

Foreign personal holding companies—sections 331 to 340, inclusive.

Regulated investment companies—sections 361 and 362.

Shareholders of personal service corporations—sections 391 to 396, inclusive.

Individuals with gross income from certain sources of $3,000 or less—sections 400 to 404, inclusive.

SUBPART B—GENERAL PROVISIONS

RATES OF TAX

SEC. 11. NORMAL TAX ON INDIVIDUALS [as amended by sec. 102 (b) (1), Rev. Act 1941; sec. 102, Rev. Act 1942].

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax of 6 per centum of the amount of the net income in excess of the credits against net income provided in section 25. (For alternative tax, if gross income from certain sources is $3,000 or less, see section 400).

§ 29.11–1 *Income tax on individuals.* Chapter 1 of the Internal Revenue Code imposes an income tax on individuals, including a normal tax (section 11), a surtax (section 12), and a victory tax (section 450). For optional tax in the case of taxpayers with gross income from certain sources of $3,000 or less, see section 400. The normal tax on individuals is at the rate of 6 percent and is upon net income, which is determined by subtracting the allowable deductions from the gross income. (See generally sections 21 to 24, inclusive.) In certain cases credits are allowed against the net income before computing the tax (section 25) and in other cases against the amount of the tax (sections 31, 32, and 131). In general, the tax is payable upon the basis of returns rendered by persons liable thereto (sections 51, 53 142, and 217), except that in some instances it is to be paid at the source of the income. Exceptions and additional provisions applicable to certain special classes of taxpayer are listed in section 4.

See Supplement P (sections 331 to 340, inclusive) as to shareholders of foreign personal holding companies. See section 117 as to the treatment of capital gains and capital losses.

§ 29.11–2 *Citizens or residents of the United States liable to tax.* In general, citizens of the United States, wherever resident, are liable to the tax, and it makes no difference that they may own no assets within the United States and may receive no income from sources within the United States. Every resident alien individual is liable to the tax even though his income is wholly from sources outside the United States. As to nonresident alien individuals, see sections 211 to 219, inclusive.

§ 29.11–3 *Who is a citizen.* Every person born or naturalized in the United States, and subject to its jurisdiction, is a citizen. When any naturalized citizen has left the United States and resided for two years in the foreign country from which he came, or for five years in any other foreign country, it is presumed that he has ceased to be an American citizen. This presumption does not apply, however, to residence abroad while the United States is at war, nor does it apply in the case of individuals born in the United States subject to its jurisdiction. However, even though an individual born in the United States, subject to its jurisdiction, of either citizen or alien parents, resided in a foreign country for a number of years, he would still be a citizen of the United States, unless he had become naturalized in, or taken an oath of allegiance to, the foreign country of residence or some other foreign state. A foreigner who has filed his declaration of intention of becoming a citizen of the United States but who has not yet received his final citizenship papers is an alien. See §§ 29.211–2 to 29.211–5, inclusive, for distinction between a resident alien individual and a nonresident alien individual.

SEC. 12. SURTAX ON INDIVIDUALS [as amended by sec. 2, Rev. Act 1940; secs. 101, 102 (b) (2), Rev. Act 1941; secs. 103, 150 (j), Rev. Act 1942].

(a) *Definition of "surtax net income".* As used in this section the term "surtax net income" means the amount of the net income in excess of the credits against net income provided in section 25 (b).

(b) *Rates of surtax.* There shall be levied, collected, and paid for each taxable year upon the surtax net income of every individual the surtax shown in the following table:

If the surtax net income is:	*The surtax shall be:*
Not over $2,000	13% of the surtax net income.
Over $2,000 but not over $4,000	$260, plus 16% of excess over $2,000.
Over $4,000 but not over $6,000	$580, plus 20% of excess over $4,000.
Over $6,000 but not over $8,000	$980, plus 24% of excess over $6,000.
Over $8,000 but not over $10,000	$1,460, plus 28% of excess over $8,000.
Over $10,000 but not over $12,000	$2,020, plus 32% of excess over $10,000.
Over $12,000 but not over $14,000	$2,660, plus 36% of excess over $12,000.
Over $14,000 but not over $16,000	$3,380, plus 40% of excess over $14,000.
Over $16,000 but not over $18,000	$4,180, plus 43% of excess over $16,000.
Over $18,000 but not over $20,000	$5,040, plus 46% of excess over $18,000.
Over $20,000 but not over $22,000	$5,960, plus 49% of excess over $20,000.
Over $22,000 but not over $26,000	$6,940, plus 52% of excess over $22,000.
Over $26,000 but not over $32,000	$9,020, plus 55% of excess over $26,000.
Over $32,000 but not over $38,000	$12,320, plus 58% of excess over $32,000.
Over $38,000 but not over $44,000	$15,800, plus 61% of excess over $38,000.
Over $44,000 but not over $50,000	$19,460, plus 63% of excess over $44,000.

If the surtax net income is:	*The surtax shall be:*
Over $50,000 but not over $60,000	$23,240, plus 66% of excess over $50,000.
Over $60,000 but not over $70,000	$29,840, plus 69% of excess over $60,000.
Over $70,000 but not over $80,000	$36,740, plus 72% of excess over $70,000.
Over $80,000 but not over $90,000	$43,940, plus 75% of excess over $80,000.
Over $90,000 but not over $100,000	$51,440, plus 77% of excess over $90,000.
Over $100,000 but not over $150,000	$59,140, plus 79% of excess over $100,000.
Over $150,000 but not over $200,000	$98,640, plus 81% of excess over $150,000.
Over $200,000	$139,140, plus 82% of excess over $200,000.

(c) *Tax in case of capital gains or losses.* For rate and computation of alternative tax in lieu of normal tax and surtax in the case of a capital gain or loss from the sale or exchange of capital assets held for more than 6 months, see section 117 (c).

(d) *Sale of oil or gas properties.* For limitation of surtax attributable to the sale of oil or gas properties, see section 105.

(e) *Tax on personal holding companies.* For surtax on personal holding companies, see section 500.

(f) *Avoidance of surtaxes by incorporation.* For surtax on corporations which accumulate surplus to avoid surtax on shareholders, see section 102.

(g) For alternative tax if gross income from certain sources is $3,000 or less, see section 400.

§ 29.12–1 *Surtax.* In addition to the normal tax imposed by section 11 a surtax is imposed at the rates specified in section 12 upon the surtax net income of every individual, resident or nonresident, except nonresident alien individuals subject to the tax imposed by section 211 (a). The surtax net income is the amount of the net income in excess of the personal exemption and credit for dependents. (See generally §§ 29.25–1 to 29.25–7, inclusive.) For surtax on corporations improperly accumulating surplus, see section 102. As to surtax on personal holding companies, see sections 500 to 511, inclusive.

§ 29.12–2 *Computation of surtax.* The following table shows the surtax due for taxable years beginning after December 31, 1941, upon certain specified amounts of surtax net income. In each instance the first figure of the surtax net income in the surtax net-income column is to be excluded and the second figure included. The percentage given opposite applies to the excess of income over the first figure in the surtax net-income column. The last column gives the total surtax on a surtax net income equal to the second figure in the surtax net-income column.

SURTAX TABLE

Surtax net income	Percent	Total surtax
$0 to $2,000	13	$260
$2,000 to $4,000	16	580
$4,000 to $6,000	20	980
$6,000 to $8,000	24	1,460
$8,000 to $10,000	28	2,020
$10,000 to $12,000	32	2,660
$12,000 to $14,000	36	3,380
$14,000 to $16,000	40	4,180
$16,000 to $18,000	43	5,040
$18,000 to $20,000	46	5,960
$20,000 to $22,000	49	6,940
$22,000 to $26,000	52	9,020
$26,000 to $32,000	55	12,320
$32,000 to $38,000	58	15,800
$38,000 to $44,000	61	19,460
$44,000 to $50,000	63	23,240
$50,000 to $60,000	66	29,840
$60,000 to $70,000	69	36,740
$70,000 to $80,000	72	43,940
$80,000 to $90,000	75	51,440
$90,000 to $100,000	77	59,140
$100,00 to $150,000	79	98,640
$150,000 to $200,000	81	139,140
$200,000 up	82	----------

The surtax for any amount of surtax net income not stated in round figures in the table is computed by adding to the surtax for the largest amount stated which is less than the surtax net income, the surtax upon the excess over that amount at the rate indicated in the table. Accordingly, the surtax upon a surtax net income of $63,128 would be $31,998.32, computed as follows:

Surtax on $60,000 from table	$29,840.00
Surtax on $3,128 at 69 percent	2,158.32
Total	31,998.32

SEC. 13. TAX ON CORPORATIONS IN GENERAL [as amended by sec. 201, Rev. Act 1939; sec. 3 (a), Rev. Act 1940; sec. 101 (a), 2d Rev. Act 1940; sec. 103 (a), Rev. Act 1941; sec. 105 (a), Rev. Act 1942].

(a) *Definitions.* For the purposes of this chapter—

(1) *Adjusted net income.* The term "adjusted net income" means the net income minus the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(2) *Normal-tax net income.* The term "normal-tax net income" means the adjusted net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e) and minus the credit for dividends received provided in section 26 (b).

(b) *Imposition of tax.* There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation the normal-tax net income of which is more than $25,000 (except a corporation subject to the tax imposed by section 14, section 231 (a), Supplement G, or Supplement Q) whichever of the following taxes is the lesser:

(1) *General rule.* A tax of 24 per centum of the normal-tax net income; or

(2) *Alternative tax (corporations with normal-tax net income over $25,000 but not over $50,000).* A tax of $4,250, plus 31 per centum of the amount of the normal-tax net income in excess of $25,000.

(c) *Exempt corporations.* For corporations exempt from taxation under this chapter, see section 101.

(d) *Tax on personal holding companies.* For surtax on personal holding companies, see section 500.

(e) *Improper accumulation of surplus.* For surtax on corporations which accumulate surplus to avoid surtax on shareholders, see section 102.

§ 29.13–1 *Tax on corporations in general.* Section 13 imposes an income tax on corporations in general the normal-tax net income of which is more than $25,000. Every such corporation is liable to the tax imposed by such section, except (a) corporations expressly exempt from taxation under chapter 1 (see section 101); (b) corporations subject to tax under section 14, being (1) corporations having normal-tax net incomes of not more than $25,000 and not coming within the provisions of subsection (c), (d), or (e) of such section 14, and (2) foreign corporations engaged in trade or business within the United States; (c) foreign corporations not engaged in trade or business within the United States (see section 231 (a)); (d) insurance companies (see Supplement G (sections 201 to 207, inclusive)); and (e) regulated investment companies (see Supplement Q (sections 361 and 362)).

It makes no difference that a domestic corporation subject to any tax imposed by section 13 may derive no income from sources within the United States. The tax imposed by section 13 is computed upon the "normal-tax net income," that is, the adjusted net income minus the credit provided in section 26 (e) for income subject to the excess profits tax imposed by subchapter E of chapter 2 and minus the credit for dividends received provided in section 26 (b), relating to dividends received from a domestic corporation which is subject to taxation under chapter 1 (85 percent of dividends received, but not in excess of 85 percent of the adjusted net income reduced by the credit provided in section 26 (e) for income subject to the excess profits tax imposed by subchapter E of chapter 2). The "adjusted net income" of a corporation is the net income as defined in section 21 minus the credit provided in section 26 (a), relating to interest on certain obligations of the United States and its instrumentalities.

The tax imposed by section 13 is payable upon the basis of returns rendered by the corporations liable thereto, except that in some cases a tax is to be paid at the source of the income (see also sections 47, 52, 53, 144, and 235). For what the term "corporation" includes and for the difference between domestic and foreign corporations, see section 3797 (a). For surtax on corporations generally, see § 29.15–1. For surtax on personal holding companies, see sections 500 to 511, inclusive. For surtax on corporations improperly accumulating surplus, see section 102. For treatment of capital gains and losses, see section 117.

The manner of computing the tax imposed by section 13 depends upon the amount of the corporation's normal-tax net income. If the normal-tax net income is more than $50,000, the tax is 24 percent of the normal-tax net income. If the normal-tax net income is more than $25,000 and not more than $50,000, the tax is $4,250 plus 31 percent of the amount in excess of $25,000.

This section may be illustrated by the following examples:

Example (1). The A Corporation, a domestic corporation, which is not a bank affiliate referred to in section 26 (d), has for the calendar year 1942 a net income of $130,000, including interest on United States obligations (allowable as a credit under section 26 (a)) in the amount of $10,000 and dividends received (allowable as a credit under section 26 (b)) in the amount of $10,000. It also is entitled to a credit (allowable under section 26 (e)) for income subject to the excess profits tax imposed by subchapter E of chapter 2, in the amount of $20,000. The corporation's tax under section 13 for the calendar year 1942 is $21,960, computed as follows:

Net income	$130,000
Less credit for interest on United States obligations	10,000
Adjusted net income	120,000

Less credit for dividends received (85 percent of $10,000)	$8,500
	111,500
Less credit for income subject to excess profits tax	20,000
Normal-tax net income	91,500
Tax under section 13 (b) (1) (24 percent of $91,500)	21,960

Example (2). Assuming that the A Corporation's normal-tax net income for 1942 is $41,500, instead of $91,500, its tax under section 13 for such year would be computed under section 13 (b) (2) and is $9,365, that is, $4,250 plus $5,115 (31 percent of $16,500, the excess of $41,500 over $25,000).

SEC. 14. TAX ON SPECIAL CLASSES OF CORPORATIONS [as amended by sec. 201, Rev. Act 1939; sec. 3 (b), Rev. Act 1940; sec. 101 (b), 2d Rev. Act 1940; sec. 103 (b) (c), Rev. Act 1941; secs. 160 (b), 170 (b), Rev. Act 1942].

(a) *Imposition of tax.* There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of the following corporations (in lieu of the tax imposed by section 13) the tax hereinafter in this section specified.

(b) *Corporations with normal-tax net incomes of not more than $25,000.* If the normal-tax net income of the corporation is not more than $25,000, and if the corporation does not come within one of the classes specified in subsection (c), (d), or (e) of this section, the tax shall be as follows:

Upon normal-tax net incomes not in excess of $5,000, 15 per centum.

$750 upon normal-tax net incomes of $5,000, and upon normal-tax net incomes in excess of $5,000 and not in excess of $20,000, 17 per centum in addition of such excess.

$3,300 upon normal-tax net incomes of $20,000, and upon normal-tax net incomes in excess of $20,000, 19 per centum in addition of such excess.

(c) *Foreign corporations.* (1) In the case of a foreign corporation engaged in trade or business within the United States, the tax shall be an amount equal to 24 per centum of the normal-tax net income, regardless of the amount thereof.

(2) In the case of a foreign corporation not engaged in trade or business within the United States, the tax shall be as provided in section 231 (a).

(d) *Insurance companies.* In the case of insurance companies, the tax shall be as provided in Supplement G.

(e) *Regulated investment company.* In the case of a corporation subject to the tax imposed by Supplement Q (relating to regulated investment companies), the tax shall be as provided in such supplement.

(f) *Exempt corporations.* For corporations exempt from taxation under this chapter, see section 101.

(g) *Tax on personal holding companies.* For surtax on personal holding companies, see section 500.

(h) *Improper accumulation of surplus.* For surtax on corporations which accumulate surplus to avoid surtax on shareholders, see section 102.

§ 29.14–1 *Tax on special corporations.* Section 14 and this section are applicable with respect to taxable years beginning after December 31, 1941. See section 117 as to the treatment of capital gains and capital loses.

Section 14 imposes an income tax upon (1) corporations having normal-tax net incomes of not more than $25,000, and (2) foreign corporations engaged in trade or business within the United States. The tax imposed by section 14 is in lieu of the tax imposed by section 13. The tax is imposed upon the "normal-tax net income," for the definition of which see section 13 and § 29.13–1. Corporations expressly exempt from taxation under chapter 1 (see section 101) are not subject to the tax under section 14.

As in the case of corporations subject to the tax under section 13, it makes no difference that a domestic corporation subject to the tax imposed by section 14 may derive no income from sources within the United States. So, also, the tax is payable upon the basis of returns rendered by the corporations liable thereto, except that in some cases a tax is to be paid at the source of the income (see also sections 47, 52, 53, 144, and 235). For what the term "corporation" includes and for the difference between domestic and foreign corporations, see section 3797 (a). For surtax on corporations generally, see section 15 and § 29.15–1. For surtax on personal holding companies, see sections 500 to 511, inclusive. For surtax on corporations improperly accumulating surplus, see section 102.

Section 14 (b) imposes a tax at graduated rates on corporations which do not have normal-tax net incomes of more than $25,000 and which do not come within one of the classes specified in subsection (c) (foreign corporations), (d) (insurance companies), or (e) (regulated investment companies) of section 14. The tax is the same whether or not the corporation distributes any dividends during the taxable year.

The following table shows the income tax imposed by section 14 (b) upon certain specified amounts of normal-tax net income. In each instance the first figure of the normal-tax net income in the normal-tax net-income column is to be excluded and the second figure included. The percentage given opposite applies to the excess of income over the first figure in the normal-tax net-income column. The last column gives the total tax on a normal-tax net income equal to the second figure in the normal-tax net-income column.

TABLE OF CORPORATION INCOME TAX UNDER SECTION 14 (B)

Normal-tax net income	Percent	Total tax
$0 to $5,000	15	$750
$5,000 to $20,000	17	3,300
$20,000 to $25,000	19	4,250

The tax under section 14 (b) for any amount of normal-tax net income not shown in the table is computed by adding to the tax for the largest amount shown which is less than the normal-tax net income, the tax upon the excess over that amount at the rate indicated in the table.

The following example illustrates the computation of the tax imposed by section 14 (b):

Example. The A Corporation, a domestic corporation, has for the calendar year 1942 a net income of $28,000, including interest on United States obligations (allowable as a credit under section 26 (a)) in the amount of $9,000, and dividends received (allowable as a credit under section 26 (b)) in the amount of $5,000. It is also entitled to a credit (allowable under section 26 (e)) for income subject to the excess profits tax imposed by subchapter E of chapter 2, in the amount of $3,050. This tax upon the corporation under section 14 (b) is $1,889, computed as follows:

Net income	$28,000
Less credit for interest on United States obligations	9,000
Adjusted net income	19,000
Less credit for dividends received (85 percent of $5,000)	4,250
	14,750
Less credit for income subject to excess-profits tax	3,050
Normal-tax net income	11,700
Tax on $5,000 at 15 percent	750
Tax on $6,700 at 17 percent	1,139
Total tax	1,889

Section 14 (c) provides for a tax on foreign corporations engaged in trade or business within the United States equal to 24 percent of the normal-tax net income, regardless of the amount thereof. In the case of foreign corporations not engaged in trade or business within the United States, the tax is as provided in section 231 (a). In the case of insurance companies, the tax is as provided in Supplement G (sections 201 to 207, inclusive). In the case of regulated investment companies, the tax is as provided in Supplement Q (sections 361 and 362).

SEC. 15. SURTAX ON CORPORATIONS [as added by sec. 201, Rev. Act 1940, and amended by sec. 101 (d), 2d Rev. Act 1940; sec. 104 (a), Rev. Act 1941; sec. 105 (b), Rev. Act 1942].[1]

(a) *Corporation surtax net income.* For the purposes of this chapter, the term "corporation surtax net income" means the net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e) and minus the credit for dividends received provided in section 26 (b) (computed by limiting such credit to 85 per centum of the net income reduced by the credit for income subject to the tax imposed by Subchapter E of Chapter 2 in lieu of 85 per centum of the adjusted net income so reduced), and minus, in the case of a public utility, the credit for dividends paid on its preferred stock provided in section 26 (h). For the purposes of this subsection dividends received on the preferred stock of a public utility shall be disregarded in computing the credit for dividends received provided in section 26 (b).

(b) *Imposition of tax.* There shall be levied, collected, and paid for each taxable year upon the corporation surtax net income of every corporation (except a Western Hemisphere Trade Corporation as defined in section 109, and except a corporation subject to the tax imposed by section 231 (a), Supplement G, or Supplement Q), a surtax as follows:

(1) *Surtax net incomes not over $25,000.* Upon corporation surtax net incomes not over $25,000, 10 per centum of the amount thereof.

(2) *Surtax net incomes over $25,000 but not over $50,000.* Upon corporation surtax net incomes over $25,000, but not over $50,000, $2,500, plus 22 per centum of the amount of the corporation surtax net income over $25,000.

[1] The original section 15 of the Internal Revenue Code was eliminated by section 201 of the Revenue Act of 1939, which amended sections 13, 14, and 15 by enacting new sections 13 and 14 imposing taxes on the income of corporations for taxable years beginning after December 31, 1939.

(3) *Surtax net incomes over $50,000.* Upon corporation surtax net incomes over $50,000, 16 per centum of the corporation surtax net income.

§ 29.15–1 *Surtax on corporations.* Section 15 imposes a surtax upon the corporation surtax net income of every corporation, except (1) Western Hemisphere trade corporations (see section 109), (2) foreign corporations taxable under section 231 (a), (3) insurance companies (see Supplement G (sections 201 to 207, inclusive)), or (4) regulated investment companies (see Supplement Q (sections 361 and 362)).

The "corporation surtax net income" of a corporation is its net income minus (1) the credit provided in section 26 (e) for income subject to the excess-profits tax imposed by subchapter E of chapter 2, (2) the credit provided in section 26 (b) for dividends received, and (3) in the case of a public utility, the credit provided in section 26 (h) for dividends paid on its preferred stock. For the purposes of determining the corporation surtax net income, dividends received on the preferred stock of a public utility must be disregarded in computing the credit provided in section 26 (b) for dividends received. Also, for such purposes, such credit is limited to 85 percent of the corporation's net income (reduced by the credit provided in section 26 (e) for income subject to the excess profits tax imposed by subchapter E of chapter 2), rather than to 85 percent of the adjusted net income so reduced. The credit provided in section 26 (a) for interest received on obligations of the United States or its instrumentalities is not allowable in computing corporation surtax net income.

The rates of corporation surtax are as follows:

(1) Upon corporation surtax net incomes of $25,000 or less, 10 percent of the amount thereof.

(2) Upon corporation surtax net incomes over $25,000 but not over $50,000, $2,500, plus 22 percent of the amount of such income in excess of $25,000.

(3) Upon corporation surtax net incomes of more than $50,000, 16 percent of the entire amount thereof.

The computation of the surtax on corporations may be illustrated by the following example:

Example. The A Corporation, a domestic corporation which is not a public utility, has for the calendar year 1942 a net income of $86,000. The net income includes dividends received from a corporation which is not a public utility, in the amount of $9,000, and dividends received from the preferred stock of a public utility, in the amount of $3,000. It also includes income subject to the excess profits tax imposed by subchapter E of chapter 2, in the amount of $37,000. The A Corporation's surtax for the calendar year 1942 is $6,097, computed as follows:

Net income	$86,000
Less credit for income subject to excess profits tax	37,000
	49,000
Less credit for dividends received (85 percent of $9,000)	7,650
Corporation surtax net income	41,350
Tax ($2,500 plus 22 percent of $16,350, the excess of $41,350 over $25,000)	6,097

COMPUTATION OF NET INCOME

SEC. 21. NET INCOME [as amended by sec. 210 (a), Rev. Act 1939].

(a) *Definition.* "Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

(b) *Cross references.* For definition of "adjusted net income" and "normal-tax net income" see section 13.

§ 29.21–1 *Meaning of net income.* The tax imposed by chapter 1 is upon income. Neither income exempted by statute or fundamental law, nor expenses incurred in connection therewith, other than interest, enter into the computation of net income as defined by section 21. (See section 24 (a) (5).) In the computation of the tax various classes of income must be considered:

(a) Income (in the broad sense), meaning all wealth which flows in to the taxpayer other than as a mere return of capital. It includes the forms of income specifically described as gains and profits, including gains derived from the sale or other disposition of capital assets. Cash receipts alone do not always accurately reflect income, for the Internal Revenue Code recognizes as income-determining factors other items, among which are inventories, accounts receivable, property exhaustion, and accounts payable for expenses incurred. (See sections 22, 23, 24, and 117.)

(b) Gross income, meaning income (in the broad sense) less income which is by statutory provision or otherwise exempt from the tax imposed by chapter 1. (See section 22.)

(c) Net income, meaning gross income less statutory deductions. The statutory deductions are in general, though not exclusively, expenditures, other than capital expenditures, connected with the production of income. (See sections 23 and 24.)

(d) Net income less credits. (See sections 25, 26, 27, and 28.)

The normal taxes and surtaxes imposed on individuals and on corporations are computed upon net income less certain credits. Although taxable net income is a statutory conception, it follows, subject to certain modifications as to exemptions and as to deductions for partial losses in some cases, the lines of commercial usage. Subject to these modifications statutory net income is commercial net income. This appears from the fact that ordinarily it is to be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer. (See section 41.)

The net income of corporations is determined in general in the same manner as the net income of individuals, but the deductions allowed corporations are not precisely the same as those allowed individuals. (See sections 23, 24, 102, 118, 121, 122, 203, 204, 207, 208, 232, 336, and sections 500 to 511, inclusive.)

SEC. 22. GROSS INCOME [as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942; sec. 7 (a), Current Tax Payment Act 1943].

(a) *General definition.* "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly. In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income.

§ 29.22 (a)–1 *What included in gross income.* Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. Profits of citizens, residents, or domestic corporations derived from sales in foreign commerce must be included in their gross income; but special provisions are made for nonresident aliens and foreign corporations by sections 211 to 237, inclusive, and, in certain cases, by section 251, for citizens and domestic corporations deriving income from sources within possessions of the United States. Income may be in the form of cash or of property.

If property is transferred by a corporation to a shareholder, or by an employer to an employee, for an amount substantially less than its fair market value, regardless of whether the transfer is in the guise of a sale or exchange, such shareholder or employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value to the extent that such difference is in the nature of (1) compensation for services rendered or to be rendered or (2) a distribution of earnings or profits taxable as a dividend, as the case may be. In computing the gain or loss from the subsequent sale of such property its basis shall be the amount paid for the property, increased by the amount of such difference included in gross income. This paragraph does not apply, however, to the issuance by a corporation to its shareholders of the right to subscribe to its stock, as to which see § 29.22 (a)–8.

The fact that a dividend is declared shortly after the sale of corporate stock and the sale price is influenced by the expectation of the payment of a dividend, does not make such dividend when paid taxable to the vendor as a dividend. The amount advanced by the vendee to

the vendor in contemplation of the next dividend payment is an investment of capital and may not be claimed as a deduction from gross income. As to the amount of income tax paid for a bondholder by the obligor pursuant to a so-called tax-free covenant, see section 143 (a) (3). As to the determination of gain or loss from the sale or other disposition of property, see sections 111 to 113, inclusive. As to amounts received as loans from the Commodity Credit Corporation, see section 123. As to income upon a recovery in respect of war losses, see section 127 (c).

As to insurance companies and foreign corporations, see sections 202, 204, 206, 207, and 231.

§ 29.22 (a)–2 *Compensation for personal services.* Commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, pay of persons in the military or naval forces of the United States, retired pay of Federal and other officers, and pensions or retiring allowances paid by the United States (unless expressly exempt) or by private persons are income to the recipients; as are also marriage fees, baptismal offerings, sums paid for saying masses for the dead, and other contributions received by a clergyman, evangelist, or religious worker for services rendered. However, so-called pensions awarded by one to whom no services have been rendered are mere gifts or gratuities and are not taxable. The salaries of Federal officers and employees are subject to tax. Amounts deducted and withheld pursuant to the Civil Service Retirement Act of May 29, 1930, 46 Stat. 468, 475, as amended (5 U.S.C., ch. 14), from the basic salary, pay, or compensation of the employees in the civil service of the United States are includible in gross income for the year in which deducted and withheld. As used in this section the term "Federal officers and employees" includes all judges of courts of the United States irrespective of when they took office. Compensation received for services rendered as an officer or employee (including a member of a legislative body and a judge or officer of a court) of a State or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, is to be included in gross income, regardless of the nature of the office or employment.

The value of services need not be included in gross income when rendered directly and gratuitously to an organization described in section 23 (o). Where, however, pursuant to an agreement or understanding services are rendered to a person for the benefit of an organization described in section 23 (o) and an amount for such services is paid to such organization by the person to whom the services are rendered, the amount so paid constitutes income to the person performing the services even though at the time of the agreement or understanding the person making the payment acknowledges his liability to make payment to such organization. The second sentence of this paragraph shall not apply where such an agreement or understanding has been entered into prior to May 14, 1942 (the date of the approval of Treasury Decision 5151).

§ 29.22 (a)–3 *Compensation paid other than in cash.* If services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income. If the services were rendered at a stipulated price, in the absence of evidence to the contrary such price will be presumed to be the fair value of the compensation received. If a corporation transfers to its employees its own stock as compensation for services rendered by the employee, the amount of such compensation to be included in the gross income of the employee is the fair market value of the stock at the time of the transfer. If a person receives as compensation for services rendered a salary and in addition thereto living quarters or meals, the value to such person of the quarters and meals so furnished constitutes income subject to tax. If, however, living quarters or meals are furnished to employees for the convenience of the employer, the value thereof need not be computed and added to the compensation otherwise received by the employees. The value of quarters furnished to the commissioned officers, chief warrant officers, warrant officers, and enlisted personnel of the Army, Navy, Coast Guard, Coast and Geodetic Survey, and Public Health Service, or amounts received by them as commutation of quarters, are to be excluded from gross income. (See also section 22 (b) (6).) Premiums paid by an employer on policies of group life insurance covering the lives of his employees, the beneficiaries of which are designated by the employees, are not income to the employees. (See § 29.24–3.)

§ 29.22 (a)–4 *Compensation paid in notes.* Notes or other evidences of indebtedness received in payment for services constitute income to the amount of their fair market value. A taxpayer receiving as compensation a note regarded as good for its face value at maturity, but not bearing interest, shall treat as income as of the time of receipt the fair discounted value of the note at such time. Thus, if it appears that such a note is or could be discounted on a 6 percent basis, the recipient shall include such note in his gross income to the amount of its face value less discount computed at the prevailing rate for such transactions. If the payments due on a note so accounted for are met as they become due, there should be included as income in respect of each such payment so much thereof as represents recovery for the discount originally deducted.

§ 29.22 (a)–5 *Gross income from business.* In the case of a manufacturing, merchandising, or mining business, "gross income" means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. In determining the gross income subtractions should not be made for depreciation, depletion, selling expenses, or losses, or for items not ordinarily used in computing the cost of goods sold. But see § 29.23 (m)–1 (f).

§ 29.22 (a)–6 *State contracts.* The profit from a contract with a State or political subdivision thereof must be included in gross income. If warrants are issued by a city, town, or other political subdivision of a State, and are accepted by the contractor in payment for public work done, the fair market value of such warrants should be returned as income. If for any reason the contractor upon conversion of the warrants into cash does not receive and cannot recover the full value of the warrants so returned, he may deduct from gross income for the year in which the warrants are converted into cash any loss sustained, and if he realizes more than the value of the warrants so returned he should include the excess in his gross income for the year in which realized.

§ 29.22 (a)–7 *Gross income of farmers.* A farmer reporting on the basis of receipts and disbursements (in which no inventory to determine profits is used) shall include in his gross income for the taxable year (1) the amount of cash or the value of merchandise or other property received during the taxable year from the sale of live stock and produce which were raised during the taxable year or prior years, (2) the profits from the sale of any live stock or other items which were purchased, and (3) gross income from all other sources. The profit from the sale of live stock or other items which were purchased after February 28, 1913, is to be ascertained by deducting the cost from the sales price in the year in which the sale occurs, except that in the case of the sale of animals purchased as draft or work animals or solely for breeding or dairy purposes and not for resale, the profit shall be the amount of any excess of the sales price over the amount representing the difference between the cost and the depreciation theretofore allowed (but not less than the amount allowable) in respect of such property as a deduction in computing net income.

In the case of a farmer reporting on the accrual basis (in which an inventory is used to determine profits), his gross profits are ascertained by adding to the inventory value of live stock and products on hand at the end of the year the amount received from the sale of live stock and products, and miscellaneous receipts for hire of teams, machinery, and the like, during the year, and deducting from this sum the inventory value of live stock and products on hand at the beginning of the year and the cost of live stock and products purchased during the year. In such cases all live stock raised or purchased for sale shall be included in the inventory at their proper valuation determined in accordance with the method authorized and adopted for the purpose. Also live stock acquired, for draft, breeding, or dairy purposes and not for sale, may be included in the inventory, instead of being treated as capital assets subject to depreciation, provided such practice is followed consistently by the

taxpayer. In case of the sale of any live stock included in an inventory their cost must not be taken as an additional deduction in the return of income, as such deduction will be reflected in the inventory. (See § 29.22 (c)–6.)

In every case of the sale of machinery, farm equipment, or other capital assets purchased after February 28, 1913 (which are not to be included in an inventory if one is used to determine profits) any excess over the cost thereof less the amount of depreciation theretofore allowed (but not less than the amount allowable) in respect of such property as a deduction in computing net income, shall be included as gross income. If farm produce is exchanged for merchandise, groceries, or the like, the market value of the article received in exchange is to be included in gross income. Rents received in crop shares shall be returned as of the year in which the crop shares are reduced to money or the equivalent of money. Proceeds of insurance, such as hail and fire insurance on growing crops, should be included in gross income to the amount received in cash or its equivalent for the crop injured or destroyed. If a farmer is engaged in producing crops which take more than a year from the time of planting to the time of gathering and disposing, the income therefrom may, with the consent of the Commissioner (see § 29.41–2), be computed upon the crop basis; but in any such cases the entire cost of producing the crop must be taken as a deduction for the year in which the gross income from the crop is realized.

As herein used the term "farm" embraces the farm in the ordinarily accepted sense, and includes stock, dairy, poultry, fruit, and truck farms; also plantations, ranches, and all land used for farming operations. All individuals, partnerships, or corporations that cultivate, operate, or manage farms for gain or profit, either as owners or tenants, are designated as farmers. A person cultivating or operating a farm for recreation or pleasure, the result of which is a continual loss from year to year, is not regarded as a farmer.

Form 1040F should be filled in and attached to his income tax return by every farmer who either keeps no records or only records of cash receipts and disbursements; its use is optional with other farmers. (See further §§ 29.23 (a)–11, 29.23 (e)–5, and 29.23 (l)–10.)

§ 29.22 (a)–8 *Sale of stock and rights.* If shares of stock in a corporation are sold from lots purchased at different dates or at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchases of such stock. In the determination of the earliest purchases of stock the rules prescribed in paragraphs (1), (2), (3), (4), and (5) of section 117 (h) (relating to the period for which property has been held) shall be applied. The excess of the amount realized on the sale over the cost or other basis of the stock will constitute gain. With respect to the basis for determining gain or loss from the sale or other disposition of stock acquired as a stock dividend or the stock with respect to which the stock dividend was acquired, see §§ 29.113 (a) (19)–1 and 29.113 (a) (19)–2. If common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities, but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost.

Although the issuance by a corporation to its shareholders of rights to subscribe to its stock may not under section 115(f) give rise to taxible income, gain may be derived or loss sustained by the shareholder from the sale of such rights. In the case of stock in respect of which were acquired stock subscription rights which did not constitute income to the shareholders within the meaning of the sixteenth amendment to the Constitution, and in the case of such rights, the following rules are to be applied:

(a) If the shareholder does not exercise, but sells, his rights to subscribe, the cost or other basis, properly adjusted, of the stock in respect of which the rights are acquired shall be apportioned between the rights and the stock in proportion to the respective values thereof at the time the rights are issued, and the basis for determining gain or loss from the sale of a right on one hand or a share of stock on the other will be the quotient of the cost or other basis, properly adjusted, assigned to the rights or the stock, divided, as the case may be, by the number of rights acquired or by the number of shares held.

Example. A taxpayer in 1937 purchased 500 shares of common stock at $125 a share, and in 1942, by reason of the ownership of such stock, acquired 500 rights entitling him to subscribe to 100 additional shares of such stock at $100 a share. Upon the issuance of the rights each of the shares of stock in respect of which the rights were acquired had a fair market value of $120, and the rights had a fair market value of $3 each. Instead of subscribing to the additional shares, he sold the rights at $4 each. The profit is computed as follows:

500 (shares) × $125 = $62,500, cost of old stock (stock in respect of which the rights were acquired)

500 (shares) × $120 = $60,000, market value of old stock

500 (rights) × $3 = $1,500, market value of rights

$\frac{60,000}{61,500}$ of $62,500 = $60,975.61, cost of old stock apportioned to such stock

$\frac{1,500}{61,500}$ of $62,500 = $1,524.39, cost of old stock apportioned to rights

$2,000 (proceeds of sale of rights) less $1,524.39 (cost of old stock apportioned to rights) = $475.61, profit.

For the purpose of determining the gain or loss from the subsequent sale of the stock in respect of which the rights were acquired, the adjusted cost of each share is $121.95—that is, $60,975.61 ÷ 500.

(b) If the shareholder exercises his rights to subscribe, the basis for determining gain or loss from a subsequent sale of a share of the stock in respect of which the rights were acquired shall be determined as in paragraph (a). The basis for determining gain or loss from a subsequent sale of a share of the stock obtained through exercising the rights shall be determined by dividing the part of the cost or other basis, properly adjusted, of the old shares assigned to the rights, plus the subscription price of the new shares, by the number of new shares acquired

Example. A taxpayer in 1939 purchased 500 shares of common stock at $125 a share, and in 1942, by reason of the ownership of such stock, acquired 500 rights entitling him to subscribe to 100 additional shares of such stock at $100 a share. Upon the issuance of the rights each of the shares of stock in respect of which the rights were acquired had a fair market value of $120, and the rights had a fair market value of $3 each. The taxpayer exercised his rights to subscribe to the additional shares and later sold one of such shares for $140. The profit is computed as follows:

$1,524.39 (cost of old stock apportioned to rights pursuant to the computation in the example under paragraph (a)) + $10,000 (subscription price of additional shares) = $11,524.39, basis for determining gain or loss from sale of additional shares.

$11,524.39 ÷ 100 = $115.24, basis for determining gain or loss from sale of each share of additional stock.

$140 (proceeds of sale of share of additional stock) less $115.24 = $24.76, profit.

The basis for determining the gain or loss from subsequent sale of the stock in respect of which the rights were acquired is $60,975.61 ÷ 500, or $121.95 a share.

(c) If the stock in respect of which the rights are acquired was purchased at different times or at different prices and the identity of the lots cannot be determined, or if the stock in respect of which the rights are acquired was purchased at different times or at different prices and the stock rights acquired in respect of such stock cannot be identified as having been acquired in respect of any particular lot of such stock, the basis for determining the gain or loss from the sale or other disposition of the old shares, or the rights in cases in which the rights are sold, or from the sale or other disposition of the old or new shares in cases in which the rights are exercised, shall be ascertained in accordance with the principles laid down in § 29.113 (a) (12)–1.

As to deductions for losses from sales or exchanges of stocks or bonds, including losses from sales or exchanges of rights to subscribe to stock, see § 29.23 (e)–1.

§ 29.22 (a)–9 *Sale of patents and copyrights.* A taxpayer disposing of patents or copyrights by sale should determine the gain or loss arising therefrom by computing the difference between the selling price and the cost or other basis, with proper adjustment for depreciation, as provided in §§ 29.111–1, 29.113 (a) (14)–1, and 29.113 (b) (1)–1 to 29.113 (b) (3)–2, inclusive.

§ 29.22 (a)–10 *Sale of good will.* Gain or loss from a sale of good will results only when the business, or a part of it, to which the good will attaches is sold, in which case the gain or loss will be determined by comparing the sale price with the cost or other basis of the assets, including good will. (See §§ 29.111–1, 29.113 (a) (14)–1 and 29.113 (b) (1)–1 to 29.113 (b) (3)–2, inclusive.) If specific payment was not made for good will, there can be no deductible loss with respect thereto, but gain may be realized from the sale of good will built up through expenditures which have been currently deducted. It is immaterial that good will may never have been carried on the books as an asset, but the burden of proof is on the taxpayer to establish the cost or other basis of the good will sold.

§ 29.22 (a)–11 *Sale of real property in lots.* If a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold as such, the cost or other basis shall be equitably apportioned to the several lots or parcels and made a matter of record on the books of the taxpayer, to the end that any gain derived from the sale of any such lots or parcels which constitutes taxable income may be returned as income for the year in which the sale is made. This rule contemplates that there will be gain or loss on every lot or parcel sold, and not that the capital in the entire tract may be recovered before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction, and gain or loss computed accordingly.

§ 29.22 (a)–12 *Annuities and insurance policies.* Annuities paid by religious, charitable, and educational corporations under an annuity contract are, in general, subject to tax to the same extent as annuities from other sources paid under similar contracts. (See section 22 (b) (2) and § 29.22 (b) (2)–2.) An annuity charged upon devised land is taxable to the donee-annuitant to the extent it becomes payable out of the rents or other income of the land, whether or not it is a charge upon the income of the land. (See section 22 (b) (3) and § 29.22 (b) (3)–1. As to certain cases in which an annuity charged upon devised land is taxable in full to a spouse upon divorce or legal separation, see section 22 (k). In such case the devisee is not required to return as gross income the amount of rent or other income paid to the annuitant, and he is not entitled to deduct from his gross income any sums paid to the annuitant. Amounts received as a return of premiums paid under life insurance, endowment, or annuity contracts, and the so-called "dividend" of a mutual insurance company which may be credited against the current premium, are not subject to tax.

§ 29.22 (a)–13 *Cancellation of indebtedness*—(a) *In general.* The cancellation of indebtedness, in whole or in part, may result in the realization of income. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income in the amount of the debt is realized by the debtor as compensation for his services. A taxpayer realizes income by the payment or purchase of his obligations at less than their face value. (See § 29.22 (a)–17.) In general, if a shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation to the extent of the principal of the debt.

For exclusion from gross income of income attributable to discharge of indebtedness of certain corporations, see § 29.22 (b) (9)–1. For exclusion from gross income attributable to discharge of indebtedness of railroad corporations in certain judicial proceedings, see § 29.22 (b) (10)–1.

(b) *Proceedings under Bankruptcy Act.* Income is not realized by a taxpayer by virtue of the discharge, under section 14 of the Bankruptcy Act, as amended, of his indebtedness as the result of an adjudication in bankruptcy, or by virtue of an agreement among his creditors not consummated under any provision of the Bankruptcy Act, as amended, if immediately thereafter the taxpayer's liabilities exceed the value of his assets. Furthermore, income is not realized in any case by a taxpayer in the case of a cancellation or reduction of his indebtedness under:

(1) A plan of corporate reorganization confirmed under either section 77B or Chapter X of the Bankruptcy Act, as amended;

(2) A composition agreement confirmed under either section 12 or 74 of the Bankruptcy Act, as amended;

(3) An "arrangement" or a "real property arrangement" confirmed under Chapter XI or XII, respectively, of the Bankruptcy Act, as amended; or

(4) A "wage earner's plan" confirmed under Chapter XIII of the Bankruptcy Act, as amended.

If, however, such plan of corporate reorganization or agreement of composition referred to in (1) to (4) above had for one of its principal purposes the avoidance of income tax, the cancellation or reduction of indebtedness, under such plan or agreement confirmed under section 12, 74, or 77B or under Chapter X, XI, XII, or XIII of the Bankruptcy Act, as amended, may result in the realization of income.

For adjustment of basis of certain property in the case of cancellation or reduction of indebtedness required by the Bankruptcy Act, as amended, see §§ 29.113 (b) (1)–2 and 29.113 (b) (1)–3.

§ 29.22 (a)–14 *Creation of sinking fund by corporation.* If a corporation, in order solely to secure the payment of its bonds or other indebtedness, places property in trust or sets aside certain amounts in a sinking fund under the control of a trustee who may be authorized to invest and reinvest such sums from time to time, the property or fund thus set aside by the corporation and held by the trustee is an asset of the corporation, and any gain arising therefrom is income of the corporation and shall be included as such in its gross income.

§ 29.22 (a)–15 *Acquisition or disposition by a corporation of its own capital stock.* Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stocks as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code.

§ 29.22 (a)–16 *Contributions to corporation by shareholders.* If a corporation requires additional funds for conducting its business and obtains such needed money through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special capital account, such amounts will not be considered income, although there is no increase in the outstanding shares of stock of the corporation. The payments under such circumstances are in the nature of voluntary assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company. (See §§ 29.22 (a)–13 and 29.24–2.)

§ 29.22 (a)–17 *Sale and purchase by corporation of its bonds.* (a) (1) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (2) If the corporation purchases any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (3) If, however, the corporation purchases any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

(b) (1) If, subsequent to February 28, 1913, bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. (2) If the corporation purchases any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount

of premium already returned as income (or over the face value plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. (3) If, however, the corporation purchases any of such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the issuing price, minus any amount of premium already returned as income (or of the face value plus any amount of premium not yet returned as income), over the purchase price is gain or income for the taxable year.

(c) (1) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (2) If the corporation purchases any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. (3) If, however, the corporation purchases any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the issuing price, plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted), over the purchase price is gain or income for the taxable year.

(d) (1) If bonds were issued by a corporation prior to March 1, 1913, at a premium, the net amount of such premium was gain or income for the year in which the bonds were issued and should not be prorated or amortized over the life of the bonds. (2) If the corporation purchases any of such bonds at a price in excess of the face value of the bonds, the excess of the purchase price over the face value is a deductible expense for the taxable year. (3) if, however, the corporation purchases any of such bonds at a price less than the face value, the excess of the face value over the purchase price is gain or income for the taxable year.

For exclusion from gross income of income attributable to discharge of indebtedness of certain corporations, see § 29.22 (b) (9)–1. For exclusion from gross income of income attributable to discharge of indebtedness of railroad corporations in certain judicial proceedings, see § 29.22 (b) (10)–1.

§ 29.22 (a)–18 *Sale of capital assets by corporation.* If property is acquired and later sold for an amount in excess of the cost or other basis, the gain on the sale is income. If, then, a corporation sells its capital assets in whole or in part, it shall include in its gross income for the year in which the sale was made the gain from such sale, computed as provided in sections 111 to 113, inclusive. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the selling price.

§ 29.22 (a)–19 *Income to lessor corporation from leased property.* If a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee directly to the shareholders and bondholders of the lessor. The fact that a corporation has conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not relieve it from liability to the tax. While the payments made by the lessee directly to the bondholders or shareholders of the lessor are rentals as to both the lessee and lessor (rentals paid in one case and rentals received in the other), to the bondholders and the shareholders such amounts are interest and dividend payments received as from the lessor and as such shall be accounted for in their returns.

§ 29.22 (a)–20 *Gross income of corporation in liquidation.* When a corporation is dissolved, its affairs are usually wound up by a receiver or trustees in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. (See sections 274 and 298.) Any sales of property by them are to be treated as if made by the corporation for the purpose of ascertaining the gain or loss. No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their acquisition. But see section 44 (d) and § 29.44–5. (See further § 29.52–2.)

[SEC. 22. GROSS INCOME—as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942; sec. 7 (a), Current Tax Payment Act 1943.]

(b) *Exclusions from gross income.* The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

§ 29.22 (b)–1 *Exemptions; exclusions from gross income.* Certain items of income specified in section 22 (b) are exempt from tax and may be excluded from gross income. These items, however, are exempt only to the extent and in the amount specified. No other items are exempt from gross income except (1) those items of income which are, under the Constitution, not taxable by the Federal Government; (2) those items of income which are exempt from tax on income under the provisions of any Act of Congress still in effect; and (3) the income exempted under the provisions of section 116. Since the tax is imposed on net income, the exemption referred to above is not to be confused with the deductions allowed by section 23 and other provisions of the Internal Revenue Code to be made from gross income in computing net income. As to other items not to be included in gross income, see sections 22 (k), 112, 119, 127 (c), and 171 and Supplements G, H, I, and J (sections 201 to 252, inclusive). Section 607 (f) of the Merchant Marine Act of 1936, as amended by section 28 of the Act of June 23, 1938 (52 Stat. 961), and changed to section 607 (h), reads as follows:

(h) The earnings of any contractor receiving an operating-differential subsidy under authority of this Act, which are deposited in the contractor's reserve funds as provided in this section, except earnings withdrawn from the special reserve funds and paid into the contractor's general funds or distributed as dividends or bonuses as provided in paragraph 4 of subsection (c) of this section, shall be exempt from all Federal taxes. Earnings withdrawn from such special reserve fund shall be taxable as if earned during the year of withdrawal from such fund.

[SEC. 22. GROSS INCOME—as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942; sec. 7 (a), Current Tax Payment Act 1943.]

[(b) *Exclusions from gross income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:]

(1) *Life insurance.* Amounts received under a life insurance contract paid by reason of the death of the insured, whether in a single sum or otherwise (but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income);

§ 29.22 (b) (1)–1 *Life insurance; amounts paid by reason of the death of the insured.* The proceeds of life insurance policies, paid by reason of the death of an insured to his estate or to a beneficiary (individual, partnership, or corporation), directly or in trust, are excluded from the gross income of the beneficiary, except in the case of certain transferees as provided in § 29.22 (b) (2)–3 and in the case of a spouse to whom such payments are income under section 22 (k). If, however, such proceeds are held by the insurer under an agreement to pay interest thereon, the interest payments must be included in gross income. In the case of a beneficiary to whom payments are made in installments pursuant to an option exercised by such beneficiary, the amount exempted is the amount payable immediately after the death of the insured had such beneficiary not elected to exercise an option to receive the proceeds of the policy or any part thereof at a later date or dates. In any mode of settlement pursuant to an agreement of the insurer with a beneficiary the portion of each distribution which is to be included in gross income shall be determined as follows:

(a) *Proceeds held by the insurer.* If the proceeds are held by the insurer under an agreement with a beneficiary to distribute either the increment to such proceeds currently, or the proceeds and increment in equal installments until

both are exhausted, there shall be included in gross income, the increment so paid to the beneficiary, or so credited to the fund in each year by the insurer.

(b) *Proceeds payable in installments for a fixed number of years.* If, pursuant to such an agreement, the proceeds are payable in installments for a fixed number of years, the amount that would have been payable by the insurance company immediately upon the death of the insured (if payment at a later date had not been provided for) is to be divided by the total number of installments payable over the fixed number of years for which payment is to be made, and the quotient represents the portion of each installment to be excluded from gross income. The amount of each installment in excess of such excluded portion is to be included in gross income. For example, if, at the insured's death, $1,000 would have been payable in a single installment, but 10 equal annual payments are made in lieu thereof, the portion of the installment received during any taxable year to be excluded from gross income is $100 ($1,000 divided by 10). Any amount received as an installment in excess of $100 is to be included in gross income.

If the proceeds are payable in installments to a spouse who was divorced or legally separated from the insured under a court decree, such proceeds are to be excluded from the income of such spouse to the extent provided in the preceding paragraph only if not required to be included in her gross income under section 22 (k), relating to alimony income. Thus, if under the terms of a divorce decree, an insurance policy upon the life of the husband is to be purchased by him to provide a principal sum of $10,000 payable upon his death in 10 annual installments, with interest, to his divorced wife, the full amount of such installments received by the wife, including the interest, is to be included in her income. See further section 22 (b) (2), section 22 (k), § 29.22 (b) (2)–4, and § 29.22 (k)–1.

(c) *Proceeds payable in installments during the life of the beneficiary.* If, pursuant to such an agreement, the proceeds are payable in installments during the life of the beneficiary the amount of each installment that is to be included in gross income will be determined as in paragraph (b) of this section, except that the number of years to be used in the specified computation will be determined by the life expectancy of the beneficiary, as calculated by the table of mortality used by the particular insurance company in determining the amount of the annuity.

(d) *Proceeds payable for a fixed number of years and for continued life.* If, pursuant to such an agreement, the proceeds are payable in installments for a fixed number of years and for continued life, the amount of each installment that is to be included in gross income will be determined either as provided in paragraph (b) of this section if the fixed number of years for which payment is to be made exceeds the life expectancy of the beneficiary, as calculated by the table of mortality used by the particular insurance company in determining the amount of the annuity; or, as provided in paragraph (c) of this section if such life expectancy exceeds the specified fixed period.

If a mode of settlement pursuant to such an agreement has been in effect prior to the first taxable year which begins after December 31, 1933 (or after December 31, 1935, in the case of a mode of settlement described in paragraph (d) of this section), the entire amount received and excluded from gross income in such prior years shall be deducted from the proceeds payable upon the death of the insured; the remainder shall be divided by the number of installments unpaid at the beginning of such taxable year (whether over the remaining portion of the fixed period or over the life expectancy as of that date, depending on the mode of settlement adopted); and that quotient shall be the excludible portion of each installment. As soon as the aggregate of the amounts received and excluded from gross income under the methods of computation provided for in this section equals the amount of the proceeds payable upon the death of the insured, the entire amount received thereafter in each taxable year must be included in gross income.

[SEC. 22. GROSS INCOME—as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942; sec. 7 (a), Current Tax Payment Act 1943.]

[(b) *Exclusions from gross income.* The following items shall not be included in gross income and shall be exempt from taxation under this chapter:]

(2) *Annuities, etc*—(A) *In general.* Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts and other than amounts received as annuities) under a life insurance or endowment contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income under this chapter or prior income tax laws in respect of such annuity equals the aggregate premiums or consideration paid for such annuity. In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) or this paragraph. The preceding sentence shall not apply in the case of such a transfer if such contract or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferor. This subparagraph and paragraph (1) shall not apply with respect to so much of a payment under a life insurance, endowment, or annuity contract, or any interest therein, as, under section 22 (k), is includible in gross income;

(B) *Employees' annuities.* If an annuity contract is purchased by an employer for an employee under a plan with respect to which the employer's contribution is deductible under section 23 (p) (1) (B), or if an annuity contract is purchased for an employee by an employer exempt under section 101 (6), the employee shall include in his income the amounts received under such contract for the year received except that if the employee paid any of the consideration for the annuity, the annuity shall be included in his income as provided in subparagraph (A) of this paragraph, the consideration for such annuity being considered the amount contributed by the employee. In all other cases, if the employee's rights under the contract are nonforfeitable except for failure to pay future premiums, the amount contributed by the employer for such annuity contract on or after such rights become nonforfeitable shall be included in the income of the employee in the year in which the amount is contributed, which amount together with any amounts contributed by the employee shall constitute the consideration paid for the annuity contract in determining the amount of the annuity required to be included in the income of the employee under subparagraph (A) of this paragraph.

§ 29.22 (b) (2)–1 *Life insurance; endowment contracts; amounts paid other than by reason of the death of the insured.* Amounts received under a life insurance or endowment policy (other than amounts paid by reason of the death of the insured, interest payments on such amounts, amounts received as annuities, and amounts of periodic payments included in gross income under section 22 (k)) are not taxable until the aggregate of the amounts so received (when added to the amounts received before the taxable year under such policy) exceeds the aggregate premiums or consideration paid, whether or not paid during the taxable year.

§ 29.22 (b) (2)–2 *Annuities.* Amounts received as an annuity under an annuity or endowment contract include amounts received in periodical installments, whether annually, semiannually, quarterly, monthly, or otherwise, and whether for a fixed period, such as a term of years, or for an indefinite period, such as for life, or for life and a guaranteed fixed period, and which installments are payable or may be payable over a period longer than one year. Such portion of each installment payment of an annuity (where the whole payment is not required to be included in income under section 22 (k)) shall be included in gross income as is not in excess of 3 percent of the aggregate premiums or consideration paid for such annuity, whether or not paid during the taxable year, divided by 12 and multiplied by the number of months in respect of which the installment is paid. As soon as the aggregate of the amounts received and excluded from gross income equals the aggregate premiums or consideration paid for such annuity, the entire amount received thereafter in each taxable year must be included in gross income. Annuities paid to retired

employees pursuant to the Civil Service Retirement Act of May 29, 1930, 46 Stat. 468, 475, as amended (5 U. S. C., 1940 ed., ch. 14), are subject to section 22 (b) (2), the aggregate premiums or consideration paid for such annuities being the total of the amounts previously withheld from the compensation of the employees.

The provisions of this section may be illustrated by the following examples:

Example (1). A bought in 1939, for $50,000 consideration, a life annuity, payable in annual installments of $5,000. For the calendar year 1942 he would be required to include in gross income $1,500 of the $5,000 received during that year (3 percent of $50,000), $3,500 being exempt. If A should live long enough to receive as exempt $50,000, then all amounts he receives thereafter under the annuity contract would be included in gross income.

Example (2). A bought an annuity on October 1, 1942, paying $100,000 as consideration therefor. The annuity amounts to $7,824 a year, payable in semiannual installments of $3,912, and on December 1, 1942, A received $1,304, the first payment under the contract being for a 2-month period. A shall include in his gross income for the calendar year 1942 the sum of $500, being 3 percent of $100,000 (the consideration paid) divided by 12 and multiplied by 2 (the number of months in respect of which the installment was paid).

Example (3). A bought an increasing annuity on August 1, 1942, paying $40,000 as consideration therefor. The annuity amounts to $1,000 a year for the first year, $2,000 a year for the second year, and $3,000 a year thereafter, payable in quarterly installments. A received the first quarterly installment on November 1, 1942, amounting to $250. A shall include in his gross income for the calendar year 1942 the sum of $250, being such portion of the installment as is not in excess of 3 percent of $40,000 (the consideration paid) divided by 12 and multiplied by 3 (the number of months in respect of which the installment was paid).

§ 29.22 (b) (2)–3 *Transfers of life insurance, endowment, or annuity contracts.* In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, to which section 22 (b) (1) or (2) (A) applies, only the actual value of the consideration given for such transfer and the amount of the premiums and other sums subsequently paid by the transferee shall be excluded from gross income, in lieu of the amounts provided in § 29.22 (b) (1)–1, 29.22 (b) (2)–1, or 29.22 (b) (2)–2, to be excluded with respect to payments under such life insurance, endowment, or annuity contract. In the event of such a transfer (other than to the insured), the rule stated in the preceding sentence transforms the exemption applicable under section 22 (b) (1) or (2) (A) from that determined as in the case of the insured or person to whom the policy was originally issued to an exemption determined as in the case of a transferee for a valuable consideration. The exemption applicable in the case of a transferee without valuable consideration or a donee beneficiary is determined in accordance with the rule applicable in the case of its last transferor or last owner of the policy. For the purpose of determining gross income in the case of a transfer of a life insurance, endowment, or annuity contract or any interest therein, if such contract or interest therein has a basis for determining gain or loss in the hands of the transferee determined, in whole or in part, by reference to such basis of such contract or interest therein in the hands of the transferor, the rule stated in the first sentence of this section shall not apply as to such transfer, and the rule applicable under section 22 (b) (1) or (2) (A) to a transferee without valuable consideration (as stated in the preceding sentence) shall apply as if the transfer from such transferor to such transferee were without valuable consideration. Thus, where a corporation acquires a life insurance policy from a predecessor corporation in a tax-free reorganization, if the proceeds received under the policy by reason of the death of the insured would be exempt from taxation in the hands of the transferor, such proceeds received by reason of the death of the insured will be exempt from taxation in the hands of the transferee, because the basis is determined with reference to the basis in the hands of the transferor.

The following examples illustrate the application of the provisions of this section:

Example (1). The A. Corporation procures, for a single premium of $500, an insurance policy in the face amount of $1,000 upon the life of X, one of its officers, naming the A Corporation as beneficiary. If X dies during the time the policy is held by the corporation, the proceeds of the policy paid by reason of the death of X will be tax-free to the corporation. If the A Corporation transfers the policy to the B Corporation for a valuable consideration (for example, $600 in cash, and not pursuant to a tax-free exchange or reorganization), the proceeds paid to the B Corporation by reason of the death of X would be taxable to the extent of $400 ($1,000 minus $600). Similarly, if, before the death of X, the B Corporation had transferred the policy to the C Corporation in a tax-free reorganization, the proceeds in the hands of the C Corporation would be taxable to the extent of $400, since $600, the consideration paid by Corporation B for the transfer, would be exempt.

Example (2). In 1922, Y took out an annual premium 20-year endowment policy having a maturity value of $20,000. After payment of premiums totaling $5,500, Y assigned the policy to the M Corporation for a consideration of $4,000. If the M Corporation held the policy and paid the premiums thereon, the $20,000 received upon maturity of the policy (while A is still alive) would be includible in the income of the M Corporation, except to the extent of the $4,000 consideration paid by it and the premiums which it paid after the transfer. If, prior to the maturity of the policy, the M Corporation transferred its assets, including the policy, to the N Corporation in a tax-free exchange for the stock of the N Corporation and the N Corporation held the policy until maturity (1942), paying all premiums due thereon after such transfer, the $20,000 received by the N Corporation would be includible in its gross income, except to the extent of the $4,000 consideration paid by the M Corporation for the transfer of the policy from Y and the aggregate premiums paid by the M and N Corporations upon the policy.

§ 29.22 (b) (2)–4 *Annuity, etc., payments in discharge of alimony obligation.* The full amount of any periodic payment received under a life insurance, endowment, or annuity contract by a spouse or former spouse is required to be included in her gross income if certain conditions specified in section 22 (k) exist. See § 29.22 (k)–1. Paragraphs 1 and 2 (A) of section 22 (b) do not apply (except the last sentence of section 22 (b) (2) (A)) with respect to so much of a payment as under section 22 (k) is includible in gross income. For example, upon the divorce of a husband and wife, the decree may require the husband to provide the wife with an annuity of $2,000 for her life. The wife, being desirous of a greater assured income, may pay with the husband to an insurance company a consideration which, when added to the amount paid by the husband, purchases an annuity paying $3,000. For each taxable year, $2,000 is to be included in her income under section 22 (k) and such portion of $1,000 is to be included in her income as is required under § 29.22 (b) (2)–2 on the basis of the consideration paid by her to the company.

§29.22 (b) (2)–5 *Employees' annuities.* If an employer purchases an annuity contract on behalf of an employee, including a retired or former employee, under a plan with respect to which his contribution is deductible under section 23 (p) (1) (B) (see § 29.23 (p)–9), the employee is not required to include such amount in his income in the taxable year during which such contribution is made. The amount received or made available to such employee under such annuity contract shall be included in gross income of the employee in the taxable year in which received or made available, except that if the employee contributed any of the consideration for the annuity, the annuity shall be included in his income as provided in § 29.22 (b) (2)–2, the consideration for the annuity being considered the amount contributed by the employee. If an employer purchases an annuity contract which is not under a plan with respect to which his contribution is deductible under section 23 (p) (1) (B), the amount of such contribution shall be included in the income of the employee in the taxable year during which such contribution is made, if the employee's rights under the annuity contracts are nonfortfeitable, except for failure to pay future premiums, at the time the contribution is made. In such case, the total amount of such contributions required to be included in the income of the employee together with any amounts contributed by him will constitute the consideration paid for the annuity contract in determining the amount of the annuity required to be included in the income of the employee under section 22 (b)–(2) (A). If the employee's rights under the annuity contract in such a case were forfeitable at the time the employer's contribution was made for the annuity contract, even though they become nonforfeitable later, the amount of such contribution is not required to be included in the income of the employee, but any amount received or made available to the employee under the annuity contract shall be includible in the gross income of the employee in the taxable year in which received or made available,

except that if the employee contributed any of the consideration for the annuity, the annuity shall be included in his income to the extent provided in § 29.22 (b)(2)–2. The fact that an employee may not live a sufficient length of time to enjoy any benefits under the annuity contract, or that no payments will be made under any circumstances to his estate or other beneficiary, will not make the annuity contract forfeitable.

If upon the death of a retired employee, the widow or other beneficiary of such retired employee is paid, in accordance with the terms of the annuity contract relating to the deceased employee, an annuity or other death benefit, the amounts received or made available to her shall be included in her income to the extent that they would have been included in the income of the deceased employee had he lived and received such payments. See also section 126 (a). As to taxation of life insurance benefits in connection with annuity contracts, see § 29.165–6.

If the employer is an organization which is exempt under section 101 (6), the employee is not required to include in his income the amount paid by the employer for an annuity contract, regardless of whether the annuity plan satisfies the requirements of section 165 (a) (3), (4), (5), and (6) and whether the employees' rights are nonforfeitable.

As to taxation of annuities purchased by a trustee under a pension or profit-sharing trust, see §§ 29.165–6 and 29.165–7.

As to the effective date of the amendments made by section 162 (c) of the Revenue Act of 1942, relating to employees' annuities and the effect of such amendments on both old and new annuity plans, see section 162 (d) of the Revenue Act of 1942 (set forth immediately preceding §§ 29.23 (p)–1) and 29.165–5.

[SEC. 22. GROSS INCOME—as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942; sec. 7 (a), Current Tax Payment Act 1943.]

[(b) *Exclusions from gross income.* The following items shall not be included in gross income and shall be exempt from taxation under this chapter:]

(3) *Gifts, bequests, devises, and inheritances.* The value of property acquired by gift, bequest, devise, or inheritance. There shall not be excluded from gross income under this paragraph, the income from such property, or, in case the gift, bequest, devise, or inheritance is of income from property, the amount of such income. For the purposes of this paragraph, if, under the terms of the gift, bequest, devise, or inheritance, payment, crediting, or distribution thereof is to be made at intervals, to the extent that it is paid or credited or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property;

SEC. 111. INCOME RECEIVED FROM ESTATES, ETC., UNDER GIFTS, BEQUESTS, ETC. (Revenue Act of 1942.)

* * * * *

(e) *Taxable years to which amendments applicable.* The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1941; except that in the case of income paid, credited or to be distributed or amounts paid, credited or to be distributed by an estate or trust the amendments made by this section shall be applicable only with respect to such income and such amounts paid, credited or to be distributed on or after the beginning of the first taxable year of the estate or trust, as the case may be, beginning after December 31, 1941.

§ 29.22 (b) (3)–1 *Gifts and bequests.* Property received as a gift, or received under a will or under statutes of descent and distribution, is not includible in gross income, although the income from such property is includible in gross income. If the gift, bequest, devise, or inheritance is of income from property, it is not to be excluded from gross income. An amount of principal paid under a marriage settlement is a gift. As to alimony or an allowance paid upon divorce or legal separation, see § 29.22 (k)–1.

Section 22 (b) (3) provides a special rule for the treatment of gifts, bequests, devises, or inheritances which by their terms are to be paid, credited, or to be distributed at intervals. To the extent any such gift, bequest, devise, or inheritance is paid, credited, or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property. Section 22 (b) (3) is designed to provide the same treatment for amounts of income from property, which income is paid, credited, or to be distributed under a gift or bequest, whether the gift or bequest is in terms of a right to payments at intervals (regardless of income) or is in terms of a right to income. To the extent the amounts in either case are paid, credited, or to be distributed at intervals out of income they are not to be excluded under section 22 (b) (3) from the taxpayer's gross income. As to the extent such amounts are paid, credited, or to be distributed out of income from property in cases in which the payment, crediting, or distribution thereof is to be made by an estate or trust, see section 162 and the regulations thereunder.

The operation of the last sentence of section 22 (b) (3) may be illustrated by the following example:

Example. A, by his will, gave his wife an annuity of $50,000 to be paid in advance in quarterly payments. By another clause of his will, A bequeathed the residue of his property in trust with directions to the trustees to collect the income from the property and to pay the annuity of $50,000 out of such income (after payment of expenses), or out of corpus to the extent such income is insufficient. Under the provisions of section 22 (b) (3), the $50,000 will be included in the wife's income each year and, under the provisions of section 162(b), will be deducted from the income of the trust to the extent of the income of the trust for its taxable year which is considered under section 162 (d) to be distributed in satisfaction of the annuity.

The last sentence of section 22 (b) (3), however, applies only to such amounts as are to be paid or credited at intervals. Thus, a bequest of money or property (other than income) intended to be paid in a lump sum or at one time is not to be included in the legatee's gross income, even though the executor may for reasons of convenience or necessity arrange to pay such amount in installments or pay it out of funds traceable as the income of property. However, payments at intervals do not need to be at regular intervals to come within the rule stated in the last sentence of section 22 (b) (3). Thus, in case of a direction in a testamentary trust to pay $5,000 a year to John for his life but to pay the $5,000 a year to Mary instead of John for any year in which Mary becomes 18, graduates from college, or marries, the $5,000 a year is income to John and Mary, respectively, in the years in which each is to receive it, to the extent it is paid or credited in such years out of income from the trust property.

Section 22 (b) (3) is not intended to tax a donee upon the same income which is taxed to the grantor of a trust or assignor of earnings or other income under section 22 (a), section 166, or section 167.

[SEC. 22. GROSS INCOME—as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939, secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942; sec. 7 (a), Current Tax Payment Act 1943.]

[(b) *Exclusions from gross income.* The following items shall not be included in gross income and shall be exempt from taxation under this chapter:]

(4) *Tax-free interest.* Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (B) obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States; or (C) the obligations of the United States or its possessions. Every person owning any of the obligations enumerated in clause (A), (B), or (C) shall, in the return required by this chapter, submit a statement showing the number and amount of such obligations owned by him and the income received therefrom, in such form and with such information as the Commissioner may require. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit to the extent they represent deposits made before March 1, 1941) and in the case of obligations of a corporation organized under Act of Congress, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt from the taxes imposed by this chapter;

PUBLIC DEBT ACT OF 1941 (APPROVED FEBRUARY 19, 1941)

* * * * *

SEC. 4. (a) Interest upon, and gain from the sale or other disposition of, obligations issued on or after the effective date of this Act by the United States or any agency or instrumentality thereof shall not have any exemption, as such, and loss from the sale or other disposition of such obligations shall not have any special treatment, as such, under Federal tax Acts now or hereafter enacted; except that any such obligations which the United States Maritime Commission or the Federal Housing Administration has, prior to the effective date of this Act, contracted to issue at a future date, shall when issued bear such tax-exemption privileges as were, at the time of such contract, provided in the law authorizing their issuance. For the purposes of this subsection a Territory, a possession of the United States,

and the District of Columbia, and any political subdivision thereof, and any agency or instrumentality of any one or more of the foregoing, shall not be considered as an agency or instrumentality of the United States.

(b) The provisions of this section shall, with respect to such obligations, be considered as amendatory of and supplementary to the respective Acts or parts of Acts authorizing the issuance of such obligations, as amended and supplemented.

SEC. 5. This Act, except sections 2 (b) and (c), shall become effective on the first day of the month following the date of its enactment.

PUBLIC DEBT ACT OF 1942 (APPROVED MARCH 28, 1942)

* * * * *

SEC. 6. Section 4 of the Public Debt Act of 1941 (Public Numbered 7, Seventy-seventh Congress, first session), is hereby amended to read as follows:

SEC. 4. (a) Interest upon obligations, and dividends, earnings, or other income from shares, certificates, stock, or other evidences of ownership, and gain from the sale or other disposition of such obligations and evidences of ownership issued on or after the effective date of the Public Debt Act of 1942 [March 28, 1942] by the United States or any agency or instrumentality thereof shall not have any exemption, as such, and loss from the sale or other disposition of such obligations or evidences of ownership shall not have any special treatment, as such, under Federal tax Acts now or hereafter enacted; except that any such obligations which the United States Maritime Commission or the Federal Housing Administration had, prior to March 1, 1941, contracted to issue at a future date, shall, when issued bear such tax-exemption privileges as were, at the time of such contract, provided in the law authorizing their issuance. For the purposes of this subsection a Territory, a possession of the United States, and the District of Columbia, and any political subdivision thereof, and any agency or instrumentality of any one or more of the foregoing, shall not be considered as an agency or instrumentality of the United States.

(b) The provisions of this section shall, with respect to such obligations and evidences of ownership, be considered as amendatory of and supplementary to the respective Acts or parts of Acts authorizing the issuance of such obligations and evidences of ownership, as amended and supplemented.

(c) Nothing contained herein shall be construed to amend or repeal sections 114 and 115 of the Revenue Act of 1941.

§ 29.22 (b) (4)–1 *Interest upon State obligations.* Interest upon the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia is exempt from the income tax. Obligations issued by or on behalf of the State or Territory or a duly organized political subdivision acting by constituted authorities empowered to issue such obligations are the obligations of a State or Territory or a political subdivision thereof. Special tax bills issued for special benefits to property, if such tax bills are legally collectible only from owners of the property benefited, are not the obligations of a State, Territory, or political subdivision. The term "political subdivision," within the meaning of the exception, denotes any division of the State or Territory which is a municipal corporation, or to which has been delegated the right to exercise part of the sovereign power of the State or Territory. As thus defined, a political subdivision of a State or Territory may or may not, for the purpose of exemption, include special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts and divisions of a State or Territory.

§ 29.22 (b) (4)–2 *Dividends from shares and stock of Federal agencies or instrumentalities*—(a) *Issued prior to March 28, 1942.* Section 26 of the Federal Farm Loan Act of July 17, 1916 (39 Stat. 380, 12 U.S.C., 931), provides that Federal land banks and national farm-loan associations, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from taxation, except taxes upon real estate. Section 7 of the Federal Reserve Act of December 23, 1913 (38 Stat. 258, 12 U.S.C., 531), provides that Federal reserve banks, including the capital stock and surplus therein and the income derived therefrom, shall be exempt from taxation, except taxes upon real estate. Section 5 (h) of the Home Owners' Loan Act of 1933 (48 Stat. 133, 12 U.S.C., 1464 (h)) provides that shares of Federal savings and loan associations shall, both as to their value and the income therefrom, be exempt from all taxation (except surtaxes, estate, inheritance, and gift taxes) imposed by the United States. Under the above-mentioned provisions, income consisting of dividends on stock of Federal land banks, national farm-loan associations, and Federal reserve banks is not, in the case of stock issued prior to March 28, 1942, subject to the income tax; and income consisting of dividends on share accounts of Federal savings and loan associations is not, in the case of shares issued prior to March 28, 1942, subject to the normal tax on income. For taxability of such income in the case of such stock or shares issued on or after March 28, 1942, see section 6 of the Public Debt Act of 1942 and paragraph (b) of this section. For the time at which a stock or share is issued within the meaning of this section, see paragraph (b) of this section.

Regardless of the exemption from income tax of dividends paid on the stock of Federal reserve banks, dividends paid by member banks are treated like dividends of ordinary corporations.

Dividends on the stock of the central bank for cooperatives, the production credit corporations, production credit associations, and banks for cooperatives, organized under the provisions of the Farm Credit Act of 1933, constitute income to the recipients, subject to both the normal tax and surtax (see section 63 of the Farm Credit Act of 1933 (48 Stat. 267, 12 U.S.C., 1138c)).

(b) *Issued on or after March 28, 1942.* By virtue of the provisions of section 6 of the Public Debt Act of 1942, the tax exemption provisions set forth in paragraph (a) of this section with respect to income consisting of dividends on stock of the Federal land banks, national farm-loan associations, and Federal reserve banks, or on share accounts of Federal savings and loan associations, are not applicable in the case of dividends on such stock or shares issued on or after March 28, 1942.

For the purposes of this section, a stock or share is deemed to be issued at the time and to the extent that payment therefor is made to the agency or instrumentality. The date of issuance of the certificate or other evidence of ownership of such stock or share is not determinative if payment is made at an earlier or later date. Where old stock is retired in exchange for new stock of a different character or preference, the new stock shall be deemed to have been issued at the time of the exchange rather than when the old stock was paid for. This paragraph may be illustrated by the following examples:

Example (1). A, the owner of an investment share account, consisting of 10 shares, in a Federal savings and loan association, has a single certificate issued prior to March 28, 1942, evidencing such ownership. In order that A may dispose of half of such shares, the association at his request issues, after March 27, 1942, two 5-share certificates in substitution for the 10-share certificate. The shares evidenced by the two new certificates are deemed to have been issued prior to March 28, 1942, the shares having been paid for prior to such date.

Example (2). The X Bank, a member of a Federal reserve bank, owns 50 shares of Federal reserve bank stock, evidenced by a single stock certificate issued prior to March 28, 1942. On December 31, 1942, the X Bank reduces the amount of its capital stock, as a result of which it is required to reduce the amount of its Federal reserve bank stock to 40 shares. It surrenders the 50-share certificate to the Federal reserve bank and receives a new 40-share certificate. The 40 shares evidenced by such certificate are deemed to have been issued prior to March 28, 1942. On December 31, 1943, the X Bank increases the amount of its capital stock, as a result of which it is required to purchase 10 additional shares of the Federal reserve bank stock. The Federal reserve bank issues a 10-share certificate evidencing ownership of the new shares. Of the 50 shares then owned by the X Bank, 40 were issued prior to March 28, 1942, and 10 were issued after March 27, 1942.

Example (3). A, the owner of a savings share account, in the amount of $100, in a Federal savings and loan association, has a passbook containing a certificate issued prior to March 28, 1942, evidencing such ownership. Subsequent to March 27, 1942, A deposits $10,000 in the account. With respect to the $10,000 deposit, the share is deemed to have been issued after March 27, 1942.

§ 29.22 (b) (4)–3 *Interest upon notes secured by mortgages executed to Federal agencies or instrumentalities.* Section 26 of the Federal Farm Loan Act of July 17, 1916 (39 Stat. 380, 12 U. S. C., 931), and section 210 of such Act, as added by section 2 of the Act of March 4, 1923 (42 Stat. 1450, 12 U. S. C., 1111), provide that first mortgages executed to Federal land banks, joint-stock land banks, or Federal intermediate credit banks, and the income derived therefrom, shall be exempt from taxation. Accordingly, income consisting of interest on promissory notes held by such banks and secured by such first

mortgages is not subject to the income tax.

§ 29.22 (b) (4)–4 *Interest upon United States obligations*—(a) *Issued prior to March 1, 1941.* Although interest upon the obligations of the United States and its possessions and upon obligations of a corporation organized under Act of Congress, if such corporation is an instrumenality of the United States, is generally exempt from tax, in the case of obligations issued by the United States after September 1, 1917, which include Treasury certificates of indebtedness, Treasury bonds, and Treasury notes, and in the case of obligations of a corporation organized under Act of Congress, the interest is exempt from tax only if and to the extent provided in the Acts authorizing the issue thereof, as amended and supplemented.

Every person owning any of the obligations enumerated in clause (A), (B), or (C) of section 22 (b) (4) shall submit in his income tax return a statement showing the number and amount of such obligations owned and the income received therefrom. For the purpose of such statement, in the case of Treasury bills issued after June 17, 1930, (1) the "amount of such obligations" is their par (maturity) value and (2) the "income received therefrom" is the net excess of the amount realized during the taxable year from the sale or other disposition of the bills over the cost or other basis thereof, a separate computation of discount being unnecessary.

The interest on Treasury certificates of indebtedness is entirely exempt from Federal income taxes. Interest upon Treasury notes is exempt only to the extent provided in the terms of the issue. Interest (discount at which issued) on Treasury bills and any gain from the sale or other disposition of such bills are also entirely exempt from Federal income taxes. With respect to the nondeductibility of losses from the sale or other disposition of such bills, see § 29.23 (e)–1.

The interest on Treasury bonds is exempt from Federal income taxes except surtaxes imposed upon the income or profits of individuals, partnerships, associations, or corporations.

Treasury bonds are entitled to a limited exemption from surtaxes imposed by the United States. Interest on an aggregate of not exceeding $5,000 principal amount of these obligations is exempt from the surtaxes imposed by the Internal Revenue Code. Interest in excess of the interest on an aggregate of not exceeding $5,000 principal amount of such obligations is subject to surtax and must be included in gross income.

Section 26 of the Federal Farm Loan Act of July 17, 1916 (39 Stat. 380, 12 U. S. C., 931), and section 210 of such Act, as added by section 2 of the Act of March 4, 1923 (42 Stat. 1459, 12 U. S. C., 1111), provided that farm-loan bonds issued by Federal land banks and joint-stock land banks and debentures issued by Federal intermediate credit banks, with the income therefrom, shall be exempt from taxation. Accordingly, interest from such farm-loan bonds or debentures is not subject to the income tax.

Interest credited to postal savings accounts upon moneys deposited prior to March 1, 1941, in postal savings banks is wholly exempt from income tax.

(b) *Issued on or after March 1, 1941.* By virtue of the provisions of sections 4 and 5 of the Public Debt Act of 1941 (55 Stat. 9), the exemption prescribed in paragraph (a) of this section is limited to such bonds, debentures, notes, or certificates of indebtedness as have been issued prior to March 1, 1941. Under such provisions of the Public Debt Act of 1941, interest upon obligations issued on or after March 1, 1941, by the United States, or any agency or instrumentality thereof, shall not have any exemption, as such, from Federal tax now or hereafter imposed except in respect of any such obligations which the United States Maritime Commission or the Federal Housing Administration has, prior to March 1, 1941, contracted to issue at a future date. The interest on such obligations so contracted to be issued shall bear such tax-exemption privileges as were at the time of such contract provided in the law authorizing their issuance. For the purposes hereof, under section 4 (a) of the Public Debt Act of 1941, a Territory, a possession of the United States, and the District of Columbia and any political subdivisions thereof, and any agency or instrumentality of any one or more of the foregoing, shall not be considered as an agency or instrumentality of the United States.

In the case of obligations issued as the result of a refunding operation, as, for example, where a corporation exchanges bonds for previously issued bonds, the refunding obligations are deemed, for the purposes of this section, to have been issued at the time of the exchange rather than at the time the original bonds were issued.

§ 29.22 (b) (4)–5 *Treasury bond exemption in the case of trusts or partnerships.* (a) When the income of a trust is taxable to beneficiaries, as in the case of a trust the income of which is to be distributed to the beneficiaries currently, each beneficiary is entitled to exemption as if he owned directly a proportionate part of the Treasury bonds held in trust. When, on the other hand, income is taxable to the trustee, as in the case of a trust the income of which is accumulated for the benefit of unborn or unascertained persons, the trust, as the owner of the bonds held in trust, is entitled to the exemption on account of such ownership.

(b) As the income of a partnership is taxable to the individual partners, each partner is entitled to exemption as if he owned directly a proportionate part of the bonds held by the partnership.

§ 29.22 (b) (4)–6 *Interest upon United States obligations in the case of nonresident aliens and foreign corporations, not engaged in business in the United States.* By virtue of section 4 of the Victory Liberty Loan Act of March 3, 1919 (40 Stat. 1311), amending section 3 of the Fourth Liberty Bond Act of July 9, 1918 (40 Stat. 845), the interest received on and after March 3, 1919, on bonds, notes, and certificates of indebtedness of the United States while beneficially owned by a nonresident alien individual, or a foreign corporation, partnership, or association, if such individual, corporation, partnership, or association is not engaged in business in the United States, is exempt from income taxes. Such exemption applies only to such bonds, notes, or certificates as have been issued prior to March 1, 1941. Interest derived by a nonresident alien individual, or by a foreign corporation, partnership, or association on such bonds, notes, or certificates issued on or after March 1, 1941, is subject to tax as in the case of taxpayers generally as provided in § 29.22 (b) (4)–4 (b).

[SEC. 22. GROSS INCOME—as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 213 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a), (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942; sec. 7 (a), Current Tax Payment Act 1943.]

[(b) *Exclusions from gross income.* The following items shall not be included in gross income and shall be exempt from taxation under this chapter:]

(5) *Compensation for injuries or sickness.* Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 23 (x) in any prior taxable year, amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness, and amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country;

(6) *Ministers.* The rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation;

(7) *Income exempt under treaty.* Income of any kind, to the extent required by any treaty obligation of the United States;

(8) *Miscellaneous items.* The following items, to the extent provided in section 116:

Earned income from sources without the United States;

Salaries of certain Territorial employees;

The income of foreign governments;

Income of States, municipalities, and other political subdivisions;

Receipts of shipowners' mutual protection and indemnity associations;

Dividends from China Trade Act corporations;

Compensation of employees of foreign governments.

(9) *Income from discharge of indebtedness.* In the case of a corporation, the amount of any income of the taxpayer attributable to the discharge, within the taxable year, of any indebtedness of the taxpayer or for which the taxpayer is liable evidenced by a security (as hereinafter in this paragraph defined) if the taxpayer makes and files at the time of filing the return, in such manner as the Commissioner, with the approval of the Secretary, by regulations prescribes, its consent to the regulations prescribed under section 113 (b) (3) then in effect. In such case the amount of any income of the taxpayer attributable to any unamortized premium (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be included in gross income and the amount of

the deduction attributable to any unamortized discount (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be allowed as a deduction. As used in this paragraph the term "security" means any bond, debenture, note, or certificate, or other evidence of indebtedness, issued by any corporation. This paragraph shall not apply to any discharge occurring before the date of enactment of the Revenue Act of 1939, or in a taxable year beginning after December 31, 1945.

§ 29.22 (b) (9)–1 *Income from discharge of indebtedness.* Section 22 (b) (9) provides, with respect to taxable years beginning after December 31, 1941, and before January 1, 1946, a method whereby a corporation may elect to have excluded from its gross income the amount of income attributable to a discharge, within the taxable year, of its indebtedness or of indebtedness for which it is liable as, for example, in the case of a debt arising from an assumption of liability of another corporation. To be entitled to the benefits of the provisions of section 22 (b) (9) for such years a corporation must file with its return for the taxable year a consent to the provisions of the regulations, in effect at the time of the filing of the return, prescribed under section 113 (b) (3) (see §§ 29.113 (b) (3)–1 and 29.113 (b) (3)–2, relating to adjustment of basis).

As used in this section "indebtedness" means indebtedness evidenced by a security, that is, by a bond, debenture, note, or certificate, or other evidence of indebtedness issued by either the taxpayer corporation or any other corporation regardless of when issued.

Discharges of indebtedness (including discharges occurring in a proceeding under Chapter XV of the Bankruptcy Act of 1898, as amended, if such proceeding was initiated by petition filed on or after October 16, 1942, and on or before November 1, 1945) occurring in a taxable year beginning after December 31, 1941, and prior to January 1, 1946, are governed by the provisions of section 22 (b) (9).

If as a result of the discharge of indebtedness there remains unamortized premium or unamortized discount, the amount of the income attributable to such premium is to be excluded from gross income and the amount of the deduction attributable to such discount shall be disallowed as a deduction. The unamortized premium and unamortized discount, as the case may be, is in each instance to be computed as of the first day of the taxable year in which the discharge of indebtedness occurred.

Section 22 (b) (9) and this section are inapplicable in the case of any discharge occurring in any proceeding under section 77B of the Bankruptcy Act of 1898, as amended, under Chapter X or XI of such Act, or under Chapter XV of such Act if the proceeding under such chapter was initiated by a petition filed on or before July 31, 1940 (see paragraphs 3 to 16, inclusive, of the Appendix to these regulations), and with respect to any discharge of indebtedness to which section 22 (b) (10) applies.

§ 29.22 (b) (9)–2 *Making and filing of consent.* A consent to have the basis of its property adjusted in accordance with the provisions of the regulations, in effect at the time of filing of the return, prescribed under section 113 (b) (3) (see §§ 29.113 (b) (3)–1 and 29.113 (b) (3)–2) shall be made by or on behalf of the taxpayer corporation in duplicate on Form 982, in accordance with these regulations and the instructions on the form or issued therewith. The original and duplicate shall be filed with the return.

[SEC. 22. GROSS INCOME—as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942; sec. 7 (a), Current Tax Payment Act 1943.]

[(b) *Exclusions from gross income.* The following items shall not be included in gross income and shall be exempt from taxation under this chapter:]

(10) *Income from discharge of indebtedness of a railroad corporation.* The amount of any income attributable to the discharge, within the taxable year, of any indebtedness of a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended, to the extent that such income is deemed to have been realized by reason of a modification in or cancellation in whole or in part of such indebtedness pursuant to an order of a court in a receivership proceeding or in a proceeding under section 77 of the National Bankruptcy Act, as amended. In such case the amount of any income of the taxpayer attributable to any unamortized premium (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be included in gross income and the amount of the deduction attributable to any unamortized discount (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be allowed as a deduction. Paragraph (9) shall not apply with respect to any discharge of indebtedness to which this paragraph applies. This paragraph shall not apply to any discharge occurring in a taxable year beginning after December 31, 1945.

§ 29.22 (b) (10)–1 *Income from discharge of indebtedness of railroad corporations.* Under section 22 (b) (10) the amount of any income attributable to the discharge within the taxable year, of any indebtedness of a railroad corporation as a result of an order of a court in a receivership proceeding, or in a railroad reorganization proceeding under section 77 of the Bankruptcy Act of 1898, as amended, is, for taxable years beginning before January 1, 1946, excluded from the gross income of the railroad corporation. The section is applicable only in a case where income accrues to a taxpayer from the modification or cancellation of the corporate indebtedness (whether in whole or in part) pursuant to a court order.

The railroad corporations to which this section and section 22 (b) (10) apply are those defined in section 77m of the Bankruptcy Act of 1898, as amended, namely, any common carrier by railroad engaged in the transportation of persons or property in interstate commerce, except a street, a suburban, or interurban electric railway which is not operated as a part of a general railroad system of transportation or which does not derive more than 50 percent of its operating revenues from the transportation of freight in standard steam railroad freight equipment.

As used in section 22 (b) (10) and this section the term "indebtedness" means an obligation, absolute and not contingent, to pay on demand or within a given time, in cash or another medium, a fixed amount.

If, as a result of the discharge of indebtedness, there remains unamortized premium or unamortized discount, the amount of the income attributable to such premium is to be excluded from gross income and the amount of the deduction attributable to such discount shall be disallowed as a deduction. The unamortized premium and unamortized discount, as the case may be, is in each instance to be computed as of the first day of the taxable year in which the discharge of indebtedness occurred.

The provisions of section 22 (b) (10) and this section are applicable to taxable years beginning before January 1, 1946.

[SEC. 22. GROSS INCOME—as amended by sec. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942; Sec. 7 (a), Current Tax Payment Act 1943.]

[(b) *Exclusion from gross income.* The following items shall not be included in gross income and shall be exempt from taxation under this chapter:]

(11) *Improvements by lessee on lessor's property.* Income, other than rent, derived by a lessor of real property upon the termination of a lease, representing the value of such property attributable to buildings erected or other improvements made by the lessee.

§ 29.22 (b) (11)–1 *Exclusion from gross income of lessor of real property of value of improvements erected by lessee.* Income derived by a lessor of real property upon the termination, through forfeiture or otherwise, of the lease of such property and attributable to buildings erected or other improvements made by the lessee upon the leased property is excluded from gross income. However, where the facts disclose that such buildings or improvements represent in whole or in part a liquidation in kind of lease rentals, the exclusion from gross income shall not apply to the extent that such buildings or improvements represent such liquidation. The exclusion applies only with respect to the income realized by the lessor upon the termination of the lease and has no application to income, if any, in the form of rent, which may be derived by a lessor during the period of the lease and attributable to buildings erected or other improvements made by the lessee. It has no application to income which may be realized by the lessor upon the termination of the lease but not attributable to the value of such buildings or improvements. Neither does it apply to income derived by the lessor subsequent to the termination of the lease incident to the

ownership of such buildings or improvements.

The provisions of this section may be illustrated by the following example:

Example. The A Corporation leased in 1935 for a period of 50 years unimproved real property to the B Corporation under a lease providing that the B Corporation erect on the leased premises an office building costing $500,000, in addition to paying the A Corporation a lease rental of $10,000 per annum beginning on the date of completion of the improvements, the sum of $100,000 being placed in escrow for the payment of the rental. The building was completed on January 1, 1937. The lease provided that all improvements made by the lessee on the leased property would become the absolute property of the A Corporation on the termination of the lease by forfeiture or otherwise and that the lessor would become entitled on such termination to the remainder of the sum, if any, remaining in the escrow fund. The B Corporation forfeited its lease on January 1, 1942, when the improvements had a value of $100,000. Under the provisions of section 22 (b) (11), the $100,000 is excluded from gross income. The amount of $50,000 representing the remainder in the escrow fund is forfeited to the A Corporation and is included in the gross income of that taxpayer. If, in this example, the lease covered a period of only 25 years and the building upon completion had an estimated value of $75,000 as of the end of the lease term and in accordance with an option granted by the regulations the A Corporation included in gross income the sum of $3,000 for each taxable year from 1937 to 1941, both years inclusive, then there shall be excluded from gross income for the taxable year 1942 and subsequent taxable years any such amounts otherwise includible in gross income for such years and attributable to the building erected by the B Corporation, notwithstanding the exercise of such option. As to the basis of the property in the hands of the A Corporation, see § 29.113 (c)–1.

[SEC. 22. GROSS INCOME—as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942; sec. 7 (a), Current Tax Payment Act 1943.]

[(b) *Exclusions from gross income.* The following items shall not be included in gross income and shall be exempt from taxation under this chapter:]

(12) *Recovery of bad debts, prior taxes, and delinquency amounts.* Income attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the amount of the recovery exclusion with respect to such debt, tax, or amount. For the purposes of this paragraph:

(A) *Definition of bad debt.* The term "bad debt" means a debt on account of worthlessness or partial worthlessness of which a deduction was allowed for a prior taxable year.

(B) *Definition of prior tax.* The term "prior tax" means a tax on account of which a deduction or credit was allowed for a prior taxable year.

(C) *Definition of delinquency amount.* The term "delinquency amount" means an amount paid or accrued on account of which a deduction or credit was allowed for a prior taxable year and which is attributable to failure to file return with respect to a tax, or pay a tax, within the time required by the law under which the tax is imposed, or to failure to file return with respect to a tax or pay a tax.

(D) *Definition of recovery exclusion.* The term "recovery exclusion", with respect to a bad debt, prior tax, or delinquency amount, means the amount, determined in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, of the deductions or credits allowed, on account of such bad debt, prior tax, or delinquency amount, which did not result in a reduction of the taxpayer's tax under this chapter (not including the tax under section 102) or corresponding provisions of prior revenue laws, reduced by the amount excludible in previous taxable years with respect to such debt, tax, or amount under this paragraph.

(E) *Special rules in case of section 102 tax and personal holding company tax.*—In the application of subparagraphs (A), (B), (C), and (D) in determining the tax under section 102 or Subchapter A of Chapter 2, a recovery exclusion allowed for the purposes of Chapter 1 shall be allowed for the purpose of such section or subchapter whether or not the bad debt, prior tax, or delinquency amount resulted in a reduction of the section 102 tax or Subchapter A tax for the prior taxable year; and in the case of a bad debt, prior tax, or delinquency amount not allowable as a deduction or credit for the prior taxable year under Chapter 1 (except section 102) but allowable for the same taxable year under such section or subchapter a recovery exclusion shall be allowable for the purposes of such section or subchapter if such bad debt, prior tax, or delinquency amount did not result in a reduction of the tax under such section 102 or such Subchapter A. As used in this subparagraph references to Chapter 1, section 102, and Subchapter A in the case of taxable years not subject to the Internal Revenue Code, shall be held to be made to corresponding provisions of prior revenue Acts.

§ 29.22 (b) (12)–1 *Recovery of bad debts, prior taxes and delinquency amounts*—(a) *In general.* Section 22 (b) (12) provides that incomes attributable to the recovery during any taxable year of bad debts, prior taxes, and delinquency amounts shall be excluded from gross income to the extent of the "recovery exclusion" with respect to such items. In substance, the recovery exclusion is an amount equal to the portion of such items which, when deducted or credited for a prior taxable year, did not result in a reduction of any tax of the taxpayer under chapter 1 of the Internal Revenue Code (other than a tax under section 102) or under corresponding provisions of prior revenue laws.

(1) *Section 22 (b) (12) items.* Bad debts, prior taxes, and delinquency amounts are defined in section 22 (b) (12) (A), (B), and (C), respectively. A typical example of a delinquency amount described in that section is interest upon delinquent taxes. The bad debts, prior taxes, and delinquency amounts referred to in that section, called "section 22 (b) (12) items" in this section, are only those for which a deduction or credit was allowed for a prior taxable year. Thus, if a bad debt was previously charged against a reserve by a taxpayer on the reserve method of treating bad debts, it was not deducted, and it is therefore not considered a section 22 (b) (12) item.

(2) *Definition of "recovery."* Recoveries result from the receipt of amounts in respect of the previously deducted or credited items described in section 22 (b) (12), such as from the collection or sale of a bad debt, refund or credit of taxes paid, or cancellation of taxes accrued. Care should be taken in the case of bad debts which were treated as only partially worthless in prior years to distinguish between the item described in section 22 (b) (12), that is, the part of such debt which was deducted, and the part not previously deducted, which is not a section 22 (b) (12) item and is considered the first part collected. The collection of the part not deducted is not considered a "recovery." Furthermore, the term "recovery" does not include the gain resulting from the receipt of an amount on account of a section 22 (b) (12) item which, together with previous such receipts, exceeds the deduction or credit previously allowed for such item. For instance, a $100 corporate bond purchased for $40 and later deducted as worthless is subsequently collected to the extent of $50. The $10 gain (excess of $50 collection over $40 cost) is not a recovery of a section 22 (b) (12) item. Such gain is in no case excluded from gross income under section 22 (b) (12), regardless of whether the $40 recovery is or is not excluded.

(3) *Treatment of debt deducted in more than one year by reason of partial worthlessness.* In the case of a bad debt deducted in part for two or more prior years, each such deduction of a part of the debt is considered a separate section 22 (b) (12) item. A recovery with respect to such debt is considered first a recovery of those items (or portions thereof), resulting from such debt, for which there are recovery exclusions. If there are recovery exclusions for two or more items resulting from the same bad debt, such items are considered recovered in the order of the taxable years for which they were deducted, beginning with the latest. The recovery exclusion for any such item is determined by considering the recovery exclusion with respect to the prior year for which such item was deducted as being first used to offset all other applicable recoveries in the year in which the bad debt is recovered.

(4) *Special provisions as to worthless bonds, etc., which are treated as capital losses.* For taxable years beginning after December 31, 1937, bad debts on account of certain worthless securities and, for taxable years beginning after December 31, 1942, certain nonbusiness bad debts are treated as losses from the sale or exchange of capital assets. See section 23 (k) of the Internal Revenue Code, and section 23 (k) of the Revenue Act of 1938. The amount of the deductions allowed for any year under section 117 (d) on account of such losses for such year is considered to be section 22 (b) (12) items. Any part of such losses which, under section 117 (d), is a deduction for a subsequent year through the capital loss carry-over (any later receipt of an amount with respect to such deducted loss is a recovery) is considered a section 22 (b) (12) item for the year in which such loss was sustained. Bad debts are considered the last capital losses deducted under section 117 (d) or carried over under section 117 (e).

(b) *Computation of recovery exclusion*—(1) *Amount of recovery exclusion allowable for year of recovery.* For the

year of any recovery, the section 22 (b) (12) items which were deducted or credited for one prior year are considered as a group and the recovery thereon is considered separately from recoveries of any items which were deducted or credited for other years. This recovery is excluded from gross income to the extent of the recovery exclusion with respect to this group of items as (i) determined for the original year for which such items were deducted or credited (see (2), below, of this paragraph) and (ii) reduced by the recoveries in intervening years on account of all section 22 (b) (12) items for such original year. A taxpayer claiming a recovery exclusion shall submit, at the time the exclusion is claimed, the computation of the recovery exclusion claimed for the original year for which the items were deducted or credited, and computations showing the amount recovered in intervening years on account of the section 22 (b) (12) items deducted or credited for the original year.

(2) *Determination of recovery exclusion for original year for which items were deducted or credited.* The recovery exclusion for the taxable year for which section (b) (12) items were deducted or section 22 (b) (12) items were deducted or credited (that is, the "original taxable amount of such deductions and credits which could be disallowed without causing an increase in any tax of the taxpayer imposed under chapter 1 of the Internal Revenue Code (such as the normal tax, surtax, and victory tax), other than the tax imposed on corporations by section 102 for the improper accumulation of surplus, or in any tax imposed under corresponding provisions of prior revenue laws. For this purpose, consideration must be given to the effect of net operating loss carry-overs and carry-backs or capital loss carry-overs.

The preceding paragraph shall be applied by determining the recovery exclusion as the aggregate amount of the section 22 (b) (12) items for the original year for which such items were deducted or credited reduced by whichever of the following amounts is the greatest:

(i) The difference between (*a*) the income subject to normal tax (net income reduced by credits allowable for normal tax purposes) for such original year and (*b*) the income subject to normal tax computed without regard to the section 22 (b) (12) items for such original year.

(ii) The difference between (*a*) the surtax net income for such original year and (*b*) the surtax net income computed without regard to the section 22 (b) (12) items for such original year.

(iii) For taxable years beginning on or after January 1, 1943, in the case of taxpayers other than corporations, the difference between (*a*) the income subject to victory tax (the victory tax net income reduced by the specific exemption) for such original year and (*b*) the income subject to victory tax computed without regard to the section 22 (b) (12) items for such original year.

(iv) In the case of a taxpayer subject to any income tax in lieu of normal tax or surtax or both (except the alternative tax on capital gains imposed by section 117 (c), which is disregarded), the difference between (*a*) the income subject to such tax for such original year and (*b*) the income subject to such tax computed without regard to the section 22 (b) (12) items for such original year.

(Neither the amount determined under (*a*) nor the amount under (*b*) of (i), (ii), (iii), or (iv) above shall in any case be considered less than zero.) For this determination of the recovery exclusion, the aggregate of the section 22 (b) (12) items must be further decreased by the portion thereof which caused a reduction in tax in preceding or succeeding taxable years through any net operating loss carry-overs or carry-backs or capital loss carry-overs affected by such items. This decrease is the aggregate of the largest amount determined for each of such preceding and succeeding years under (i), (ii), (iii), and (iv) above, the computation of each carry-over or carry-back to the preceding or succeeding year being made under subdivision (*a*) of (i), (ii), (iii), and (iv) with regard to the section 22 (b) (12) items for the original year, and such computation being made under subdivision (*b*) without regard to such items. For the purposes of the preceding sentence, the computations under both subdivisions (*a*) and (*b*) shall be made without regard to any section 22 (b) (12) items for such preceding or succeeding year and the carry-overs and carry-backs to such year shall be determined without regard to any section 22 (b) (12) items for years subsequent to the original year.

Example. A single individual, who has no dependents, has for 1942 $2,800 gross income, $2,000 business expenses, and a deduction of $900 for bad debts and of $700 for property taxes. His income and deductions for 1941 are set out below. His recovery exclusion on account of the section 22 (b) (12) items for 1942 (the debts and taxes) is $500, determined as follows:

The $1,600 aggregate of the section 22 (b) (12) items is reduced by the $300 difference between the surtax net income for 1942 computed with and without regard to such aggregate, since this difference is greater than such difference between the incomes subject to normal tax, ascertained as follows:

	With deduction of section 22 (b) (12) items	Without deduction of section 22 (b) (12) items
Gross income	$2,800	$2,800
Less: Business expenses	2,000	2,000
Remainder	800	800
Less: Bad debts and taxes	1,600	
Net income or (loss)	(800)	800
Personal exemption	500	500
Surtax net income	0	300
Earned income credit	0	80
Net income subject to normal tax	0	220
Difference between surtax net incomes ($300–$0)		300
Difference between incomes subject to normal tax ($220–$0)		220

The taxpayer had no items which would cause section 122 (d) adjustments for 1942 or 1941. For 1941 he had $6,000 gross income, and his only deduction was a net operating loss deduction of $800 based on his loss for 1942. There would be no net operating loss deduction for 1941 if the carry-back to 1941 was computed without regard to the section 22 (b) (12) items for 1942. Accordingly, $800 of such items for 1942 resulted, by way of carry-back to 1941, in a reduction of tax for 1941, since net income subject to normal tax and surtax net income for 1941 were reduced to the extent of the carry-back (computed in the manner set forth in the preceding paragraph). The $1,600 aggregate of the section 22 (b) (12) items for 1942 is further reduced by the $800 which caused a reduction in tax through the carry-back. Therefore, the recovery exclusion for the items for 1942 is $500, that is, the $1,600 aggregate of such items reduced by the $300 and by the $800.

In 1946 the taxpayer recovers $400 of the property taxes. All of this recovery is excluded from income by reason of the recovery exclusion of $500 determined for the original year 1942. In 1947 he recovers all of the bad debt of $900, of which $100 is excluded from gross income. That is, the recovery exclusion of $500 determined for the original year 1942 is reduced by the $400 recovery in 1946 on account of the section 22 (b) (12) items deducted for such original year.

(c) *Provisions as to taxes imposed by section 102 and subchapter A of chapter 2.* Section 22 (b) (12) (E) provides special rules for determining the recovery exclusion in the case of the tax imposed on corporations by section 102 for the improper accumulation of surplus and the tax imposed on personal holding companies by subchapter A of chapter 2 of the Internal Revenue Code. Such taxpayers have, for the purposes of such taxes, the recovery exclusion described in the preceding paragraphs of this section. This recovery exclusion is used for the purposes of the taxes imposed by section 102 and subchapter A of chapter 2 regardless of what particular effect the section 22 (b) (12) items had on such taxes, that is, regardless of whether the section 22 (b) (12) items did or did not cause a reduction of such taxes. Furthermore, a recovery exclusion is granted for certain other items which are described in section 22 (b) (12) (E). The recovery exclusion on account of such other items shall be determined under the principles set forth in this section with respect to section 22 (b) (12) items.

[SEC. 22. GROSS INCOME—as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942, sec. 7 (a), Current Tax Payment Act 1943]

[(b) *Exclusions from gross income.* The following items shall not be included in gross income and shall be exempt from taxation under this chapter:]

(13) *Additional allowance for military and naval personnel.* In the case of compensation received during any taxable year and before the termination of the present war as proclaimed by the President, by a member of the military or naval forces of the United States for active service in such forces during such war, or by a citizen or resident of the United States who is a member of the military or naval forces of any of the other United Nations for active service in such forces during such war, so much of such compensation as does not exceed $1,500. [NOTE: Under sec. 7 (b), Current Tax Payment Act 1943, this provision is applicable with respect to taxable years beginning after December 31, 1942. The corresponding provision applicable with respect to taxable years beginning after December 31, 1941, and before January 1, 1943, is as follows: "(13) *Additional allowance*

for military and naval personnel. So much of the amount received before the termination of the present war as proclaimed by the President, by personnel below the grade of commissioned officer in the military or naval forces of the United States as salary or compensation in any form from the United States for active service in such forces during such war, as does not exceed $250 in the case of a single person and $300 in the case of a married person or head of a family. The determination, for the purposes of this paragraph, of the taxpayer's status in the armed forces and his family status shall be made as of the end of the taxable year."]

§ 29.22 (b) (13)-1 *Compensation of military and naval forces*—(a) *Taxable years beginning after December 31, 1942.* For any taxable year beginning after December 31, 1942, in addition to other exemptions and credits otherwise applicable, there may be excluded from gross income in the case of:

(1) A member of the military or naval forces of the United States or

(2) A citizen or a resident of the United States who is a member of the military or naval forces of any of the other United Nations

so much of the compensation for active service in such forces during the present war as does not exceed the sum of $1,500. Such exclusion is applicable without distinction as to the rank or as to the marital status of the recipient of such compensation but is applicable only to such compensation received prior to the termination of the present war to be fixed by proclamation of the President. If the husband and wife both meet such requirements, then each is entitled to exclude such amount from gross income. For the purposes of this section the military and naval forces of the United States include (but are not necessarily limited to) the Army, the Navy, the Marine Corps, the Coast Guard, the Army Nurse Corps, Female, the Navy Nurse Corps, Female, the Women's Army Auxiliary Corps or the Women's Army Corps, the Women's Reserve branch of the Naval Reserve, the Marine Corps Women's Reserve, and the Coast Guard Reserve, including the Coast Guard Women's Reserve. For the purposes of this subsection the term "member of the military or naval forces of any of the other United Nations" shall mean any individual whose duties in the service of any of the United Nations other than the United States correspond to those of any member of the military or naval forces of the United States as defined in this section.

A person is in active service if he is actually serving in such forces, not necessarily in the field or in the theater of war. Personnel in the inactive reserve or on retirement are not in active service. Periods during which a person is absent from duty on account of sickness, wounds, leave, internment by the enemy, or other lawful cause are periods of active service.

This exemption does not apply to salary or compensation received by such person subsequent to discharge or release from active service even though payment may have been made as compensation for services rendered while in active service.

(b) *Taxable years beginning in 1942.* For any taxable year beginning after December 31, 1941, and prior to January 1, 1943, a person below the grade of commissioned officer in active service in the military or naval forces of the United States during the present war may exclude from gross income salary or compensation received in any form from the United States for such service, in an amount not in excess of $250 if single or $300 if married or the head of a family. If the husband and wife both meet such requirements, then each is entitled to the $300 exclusion. The exemption under this paragraph does not apply to compensation received before January 1, 1942, or after the close of the taxable year of the taxpayer beginning before January 1, 1943.

As to what constitutes the military and naval forces of the United States for the purposes of this paragraph, see paragraph (a) of this section. For the purposes of this paragraph, personnel serving with the Army Specialist Corps are not within the scope of the exemption. As to what constitutes active service for the purposes of this paragraph, see paragraph (a) of this section.

This exemption does not apply to salary or compensation received by such person subsequent to discharge or release from active service even though payment may have been made as compensation for services rendered while in active service.

For the purposes of this paragraph, whether a person is in active service in the military or naval forces of the United States and whether such person is single, married, or the head of a family is determined by such person's status on the last day of the taxable year.

[SEC. 22. GROSS INCOME—as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942; sec. 7 (a), Current Tax Payment Act 1943.]

(c) *Inventories.* Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

§ 29.22 (c)-1 *Need of inventories.* In order to reflect the net income correctly, inventories at the beginning and end of each taxable year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. The inventory should include all finished or partly finished goods and, in the case of raw materials and supplies, only those which have been acquired for sale or which will physically become a part of merchandise intended for sale, in which class fall containers, such as kegs, bottles, and cases, whether returnable or not, if title thereto will pass to the purchaser of the product to be sold therein. Merchandise should be included in the inventory only if title thereto is vested in the taxpayer. Accordingly, the seller should include in his inventory goods under contract for sale but not yet seggregated and applied to the contract and goods out upon consignment, but should exclude from inventory goods sold (including containers), title to which has passed to the purchaser. A purchaser should include in inventory merchandise purchased (including containers), title to which has passed to him, although such merchandise is in transit or for other reasons has not been reduced to physical possession, but should not include goods ordered for future delivery, transfer of title to which has not yet been effected. (But see § 29.22 (d)-1.)

§ 29.22 (c)-2 *Valuation of inventories.* Section 22 (c) provides two tests to which each inventory must conform:

(a) It must conform as nearly as may be to the best accounting practice in the trade or business, and

(b) It must clearly reflect the income.

It follows, therefore, that inventory rules cannot be uniform but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order clearly to reflect income, the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation so long as the method or basis used is substantially in accord with these regulations. An inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a general rule, be regarded as clearly reflecting his income.

The bases of valuation most commonly used by business concerns and which meet the requirements of section 22 (c) are (a) cost and (b) cost or market, whichever is lower. (For inventories by dealers in securities, see § 29.22 (c)-5.) Any goods in an inventory which are unsalable at normal prices or unusable in the normal way because of damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange, should be valued at bona fide selling prices less direct cost of disposition, whether basis (a) or (b) is used, or if such goods consist of raw materials or partly finished goods held for use or consumption, they shall be valued upon a reasonable basis, taking into consideration the usability and the condition of the goods, but in no case shall such value be less than the scrap value. Bona fide selling price means actual offering of goods during a period ending not later than 30 days after inventory date. The burden of proof will rest upon the taxpayer to show that such exceptional goods as are valued upon such selling basis come within the classifications indicated above, and he shall maintain such records of the disposition of the goods as will enable a verification of the inventory to be made.

In respect of normal goods, whichever basis is adopted must be applied with reasonable consistency to the entire inventory except as to those goods inventoried under the elective method authorized by section 22 (d). Taxpayers were given an option to adopt the basis of either (a) cost or (b) cost or market, whichever is lower, for their 1920 inventories. The basis properly adopted for that year or any subsequent year is controlling, and a change can now be made only after permission is secured from the Commissioner. Application for permission to change the basis of valuing inventories shall be made in writing and filed with the Commissioner as provided in § 29.41–2. Goods taken in the inventory which have been so intermingled that they cannot be identified with specific invoices will be deemed to be the goods most recently purchased or produced, and the cost thereof will be the actual cost of the goods purchased or produced during the period in which the quantity of goods in the inventory has been acquired. But see section 22 (d) as to inventories under elective method. Where the taxpayer maintains book inventories in accordance with a sound accounting system in which the respective inventory accounts are charged with the actual cost of the goods purchased or produced and credited with the value of goods used, transferred, or sold, calculated upon the basis of the actual cost of the goods acquired during the taxable year (including the inventory at the beginning of the year), the net value as shown by such inventory accounts will be deemed to be the cost of the goods on hand. The balances shown by such book inventories should be verified by physical inventories at reasonable intervals and adjusted to conform therewith.

Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. The inventories of taxpayers on whatever basis taken will be subject to investigation by the Commissioner, and the taxpayer must satisfy the Commissioner of the correctness of the prices adopted.

The following methods, among others, are sometimes used in taking or valuing inventories, but are not in accord with these regulations, viz:

(1) Deducting from the inventory a reserve for price changes, or an estimated depreciation in the value thereof.

(2) Taking work in process, or other parts of the inventory, at a nominal price or at less than its proper value.

(3) Omitting portions of the stock on hand.

(4) Using a constant price or nominal value for so-called normal quantity of materials or goods in stock.

(5) Including stock in transit, shipped either to or from the taxpayer, the title to which is not vested in the taxpayer.

§ 29.22 (c)–3 *Inventories at cost.* Cost means:

(a) In the case of merchandise on hand at the beginning of the taxable year, the inventory price of such goods.

(b) In the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

(c) In the case of merchandise produced by the taxpayer since the beginning of the taxable year, (1) the cost of raw materials and supplies entering into or consumed in connection with the product, (2) expenditures for direct labor, (3) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital, whether by way of interest or profit.

(d) In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry. Among such cases are (1) farmers and raisers of live stock (see § 29.22 (c)–6), (2) miners and manufacturers who by a single process or uniform series of processes derive a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike (see § 29.22 (c)–7), and (3) retail merchants who use what is known as the "retail method" in ascertaining approximate cost (see § 29.22 (c)–8).

§ 29.22 (c)–4 *Inventories at cost or market, whichever is lower.* Under ordinary circumstances and for normal goods in an inventory, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which usually purchased by the taxpayer, and is applicable in the cases:

(a) Of goods purchased and on hand, and

(b) Of basic elements of cost (materials, labor, and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts (i. e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, under which the taxpayer is protected against actual loss, which goods must be inventoried at cost.

Where no open market exists or where quotations are nominal, due to stagnant market conditions, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific purchases or sales by the taxpayer or others in reasonable volume and made in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where the taxpayer in the regular course of business has offered for sale such merchandise at prices lower than the current price as above defined, the inventory may be valued at such prices less direct cost of disposition, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market.

Where the inventory is valued upon the basis of cost or market, whichever is lower, the market value of each article on hand at the inventory date shall be compared with the cost of the article, and the lower of such values shall be taken as the inventory value of the article.

§ 29.22 (c)–5 *Inventories by dealers in securities.* A dealer in securities who in his books of account regularly inventories unsold securities on hand either:

(a) At cost,

(b) At cost or market, whichever is lower, or

(c) At market value,

may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another method be authorized by the Commissioner pursuant to a written application therefor filed with the Commissioner as provided in § 29.41–2. A dealer in securities in whose books of account separate computations of the gain or loss from the sale of the various lots of securities sold are made on the basis of the cost of each lot shall be regarded, for the purposes of this section, as regularly inventorying his securities at cost. For the purpose of this rule, a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation, irrespective of whether such buying or selling constitutes the carrying on of a trade or business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.

§ 29.22 (c)–6 *Inventories of livestock raisers and other farmers.* Farmers may change the basis of their returns from that of receipts and disbursements to that of an inventory basis provided adjustments are made in accordance with one of the two methods outlined in (a) and (b) below. It is optional with the taxpayer which method is used, but, having elected one method, the option so ex-

ercised will be binding upon the taxpayer for the year for which the option is exercised and for subsequent years unless another method be authorized by the Commissioner.

(a) Opening and closing inventories shall be used for the year in which the change is made. There should be included in the opening inventory all farm products (including livestock) purchased or raised which were on hand at the date of the inventory, and there must be submitted with the return, for the current taxable year an adjustment sheet for the preceding taxable year based on the inventory method, upon the amount of which adjustment the tax shall be assessed and paid (if any be due) at the rate of tax in effect for that year. Ordinarily an adjustment sheet for the preceding year will be sufficient, but if, in the opinion of the Commissioner, such adjustment is not sufficient clearly to reflect income, adjustments for earlier years may be accepted or required. If it is impossible to render complete inventories for the preceding year or years, the Commissioner will accept estimates which, in his opinion, substantially reflect the income on the inventory basis for such preceding year or years; but inventories must not include real estate, buildings, permanent improvements, or any other assets subject to depreciation.

(b) No adjustment sheets will be required, but the net income for the taxable year in which the change is made must be computed without deducting from the sum of the closing inventory and the sales and other receipts, the inventory of livestock, crops, and products at the beginning of the year: *Provided, however:*

(1) That if any livestock, grain, or other property on hand at the beginning of the taxable year had been purchased and the cost thereof not charged to expense, only the difference between the cost and the selling price should be reported as income for the year in which sold;

(2) But if the cost of such property had been charged to expense for a previous year, the entire amount received must be reported as income for the year in which sold.

Because of the difficulty of ascertaining actual cost of livestock and other farm products, farmers who render their returns upon an inventory basis may value their inventories according to the "farm-price method," which provides for the valuation of inventories at market price less direct cost of disposition. If the use of the "farm-price method" of valuing inventories for any taxable year involves a change in method of valuing inventories from that employed in prior years, permission for such change shall first be secured from the Commissioner as provided in § 29.41–2. In such case the opening inventory for the taxable year in which the change is made should be brought in at the same value as the closing inventory for the preceding taxable year. If such valuation of the opening inventory for the taxable year in which the change is made results in an abnormally large income for that year, there may be submitted with the return for such taxable year an adjustment statement for the preceding year. This statement shall be based on the "farm-price method" of valuing inventories, upon the amount of which adjustments the tax, if any be due, shall be assessed and paid at the rate of tax in effect for such preceding year. If an adjustment for the preceding year is not, in the opinion of the Commissioner, sufficient clearly to reflect income, adjustment sheets for prior years may be accepted or required.

If returns have been made in which the taxable net income has been computed upon incomplete inventories, the abnormality should be corrected by submitting with the return for the current taxable year a statement for the preceding year. In this statement such adjustments shall be made as are necessary to bring the closing inventory for the preceding year into agreement with the opening complete inventory for the current taxable year. If necessary clearly to reflect income, similar adjustments may be made as at the beginning of the preceding year or years, and the tax, if any be due, shall be assessed and paid at the rate of tax in effect for such year or years.

§ 29.22 (c)–7 *Inventories of miners and manufacturers.* A taxpayer engaged in mining or manufacturing who by a single process or uniform series of processes derives a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike, and who in conformity to a recognized trade practice allocates an amount of cost to each kind, size, or grade of product, which in the aggregate will absorb the total cost of production, may, with the consent of the Commissioner, use such allocated cost as a basis for pricing inventories, provided such allocation bears a reasonable relation to the respective selling values of the different kinds, sizes, or grades of product. See section 22(d) as to inventories under elective method.

§ 29.22 (c)–8 *Inventories of retail merchants.* Retail merchants who employ what is known as the "retail method" of pricing inventories may make their returns upon that basis, provided (1) that the use of such method is designated upon the return, (2) that accurate accounts are kept, and (3) that such method is consistently adhered to unless a change is authorized by the Commissioner as provided in § 29.41–2. Under this method the total of the retail selling prices of the goods on hand at the end of the year in each department or of each class of goods is reduced to approximate cost by deducting therefrom an amount which bears the same ratio to such total as:

(a) The total of the retail selling prices of the goods included in the opening inventory plus the retail selling prices of the goods purchased during the year, with proper adjustment to such selling prices for all mark-ups and mark-downs, less

(b) The cost of the goods included in the opening inventory plus the cost of the goods purchased during the year,

bears to (a).

This amount should represent as accurately as may be the amounts added to the cost price of the goods to cover selling and other expenses of doing business and for the margin of profit.

A taxpayer maintaining more than one department in his store or dealing in classes of goods carrying different percentages of gross profit should not use a percentage of profit based upon an average of his entire business, but should compute and use in valuing his inventory the proper percentages for the respective departments or classes of goods.

A taxpayer who previously has determined inventories in accordance with the foregoing, except that, to obtain a basis of approximate cost or market, whichever is lower, the practice has been followed, consistently and uniformly, of adjusting the retail selling prices of the goods included in the opening inventory and purchased during the year for mark-ups but not for mark-downs, may continue such practice subject to the conditions herein prescribed. The adjustments must be bona fide and consistent and uniform. Where mark-downs are not included in the adjustments, mark-ups made to cancel or correct mark-downs shall not be included; and the mark-ups included must be reduced by the mark-downs made to cancel or correct such mark-ups.

In no event shall mark-downs not based on actual reduction of retail sales prices, such as mark-downs based on depreciation and obsolescence, be recognized in determining the retail selling prices of the goods on hand at the end of the year.

A taxpayer who previously has determined inventories without following the practice of eliminating mark-downs in making adjustments to retail selling prices, may adopt such practice, provided permission to do so is obtained in accordance with, and subject to the terms provided by, § 29.41–2. A taxpayer filing a first return of income may adopt such practice subject to approval by the Commissioner upon examination of the return.

[SEC. 22. GROSS INCOME—as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942; sec. 7 (a), Current Tax Payment Act 1943.]

(d) (1) A taxpayer may use the following method (whether or not such method has been prescribed under subsection (c)) in inventorying goods specified in the application required under paragraph (2):

(A) Inventory them at cost;

(B) Treat those remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof, and second, those acquired in the taxable year; and

(C) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time and determine their cost by the average cost method.

(2) The method described in paragraph (1) may be used—

(A) Only in inventorying goods (required under subsection (c) to be inventoried) specified in an application to use such method filed at such time and in such manner as the Commissioner may prescribe; and

(B) Only if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer has used no procedure other than that specified in subparagraphs (B) and (C) of paragraph (1) in inventorying such goods to ascertain the income, profit, or loss of the first taxable year for which the method described in paragraph (1) is to be used, for the purpose of a report, or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or to beneficiaries, or (ii) for credit purposes.

(3) The change to, and the use of, such method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

(4) In determining income for the taxable year preceding the taxable year for which such method is first used, the closing inventory of such preceding year of the goods specified in such application shall be at cost.

(5) If a taxpayer, having complied with paragraph (2), uses the method described in paragraph (1) for any taxable year, then such method shall be used in all subsequent taxable years unless—

(A) With the approval of the Commissioner a change to a different method is authorized; or

(B) The Commissioner determines that the taxpayer has used for any such subsequent taxable year some procedure other than that specified in subparagraph (B) of paragraph (1) in inventorying the goods specified in the application to ascertain the income, profit, or loss of such subsequent taxable year for the purpose of a report or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or beneficiaries, or (ii) for credit purposes; and requires a change to a method different from that prescribed in paragraph (1) beginning with such subsequent taxable year or any taxable year thereafter.

In either of the above cases, the change to, and the use of, the different method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

(6) *Involuntary liquidation and replacement of inventory*—(A) *Adjustment of net income and resulting tax.* If, for any taxable year beginning after December 31, 1941, and prior to the termination of the present war as proclaimed by the President, the closing inventory of a taxpayer inventorying goods under the method provided in this subsection reflects a decrease from the opening inventory of such goods for such year, and if, at the time of the filing of the taxpayer's income tax return for such year, the taxpayer elects to have the provisions of this paragraph apply and so notifies the Commissioner, and if, at the time of such election, it is established to the satisfaction of the Commissioner, in accordance with such regulations as the Commissioner may prescribe with the approval of the Secretary, that such decrease is attributable to the involuntary liquidation of such inventory as defined in subparagraph (B), and if the closing inventory of a subsequent taxable year, ending not more than three years after the termination of the present war as proclaimed by the President, reflects a replacement, in whole or in part, of the goods so previously liquidated, the net income of the taxpayer otherwise determined for the year of such involuntary liquidation shall be adjusted as follows:

(i) Increased by an amount equal to the excess, if any, of the aggregate cost of such goods reflected in the opening inventory of the year of involuntary liquidation over the aggregate replacement cost; or

(ii) Decreased by an amount equal to the excess, if any, of the aggregate replacement cost of such goods over the aggregate cost thereof reflected in the opening inventory of the year of the involuntary liquidation.

The taxes imposed by this chapter and by Subchapter E of Chapter 2 for the year of such liquidation and for all taxable years intervening between such year and the year of replacement shall be redetermined, giving effect to such adjustments. Any increase in such taxes resulting from such adjustments shall be assessed and collected as a deficiency but without interest, and any overpayment so resulting shall be credited or refunded to the taxpayer without interest.

(B) *Definition of involuntary liquidation.* The term "involuntary liquidation," as used in this paragraph, means the sale or other disposition of goods inventoried under the method described in this subsection, either voluntary or involuntary, coupled with a failure on the part of the taxpayer to purchase, manufacture, or otherwise produce and have on hand at the close of the taxable year in which such sale or other disposition occurred such goods as would, if on hand at the close of such taxable year, be subject to the application of the provisions of this subsection, if such failure on the part of the taxpayer is due, directly and exclusively, (i) to enemy capture or control of sources of limited foreign supply; (ii) to shipping or other transportation shortages; (iii) to material shortages resulting from priorities or allocations; (iv) to labor shortages; or (v) to other prevailing war conditions beyond the control of the taxpayer.

(C) *Replacements.* If, in the case of any taxpayer subject to the provisions of subparagraph (A), the closing inventory of the taxpayer for a taxable year, subsequent to the year of involuntary liquidation but prior to the complete replacement of the goods so liquidated, reflects an increase over the opening inventory of such goods for the taxable year, the goods reflecting such increase shall be considered, in the order of their acquisition, as having been acquired in replacement of the goods most recently liquidated (whether or not in a year of involuntary liquidation) and not previously replaced, and if the liquidation was an involuntary liquidation shall be included in the inventory of the taxpayer for the year of replacement at the inventory cost basis of the goods replaced.

(D) *Election irrevocable.* An election by the taxpayer to have the provisions of this paragraph apply, once made, shall be irrevocable and shall be binding for the year of the involuntary liquidation and for all determinations for subsequent taxable years insofar as they are related to the year of liquidation or replacement.

(E) *Adjustment in certain cases.* If the adjustments specified in subparagraph (A) are, with respect to any taxable year, prevented, on the date of the filing of the income tax return of the taxpayer for the year of the replacement, or within three years from such date, by any provision or rule of law (other than this subparagraph and other than section 3761, relating to compromises), such adjustments shall nevertheless be made if, in respect of the taxable year for which the adjustment is sought, a notice of deficiency is mailed or a claim for refund is filed, as the case may be, within three years after the date of the filing of the income tax return for the year of replacement. If, at the time of the mailing of such notice of deficiency or the filing of such claim for refund, the adjustment is so prevented, then the amount of the adjustment authorized by this paragraph shall be limited to the increase or decrease of the tax imposed by this chapter and Subchapter E of Chapter 2 previously determined for such taxable year which results solely from the effect of subparagraph (A), and such amount shall be assessed and collected, or credited or refunded, in the same manner as if it were a deficiency or an overpayment, as the case may be, for such taxable year and as if, on the date of the filing of the income tax return for the year of the replacement, three years remain before the expiration of the periods of limitation upon assessment or the filing of claim for refund for the taxable year. The tax previously determined shall be ascertained in accordance with section 734 (d). The amount to be assessed and collected under this paragraph in the same manner as if it were a deficiency or to be credited or refunded in the same manner as if it were an overpayment shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of subparagraph (A). Such amount, if paid, shall not be recovered by a claim or suit for refund, or suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of subparagraph (A).

§ 29.22 (d)–1 *Inventories under elective method.* Any taxpayer permitted or required to take inventories pursuant to the provisions of section 22 (c), and pursuant to the provisions of §§ 29.22 (c)–1 to 29.22 (c)–8, inclusive, may elect with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by section 22 (d). Under this elective inventory method, the taxpayer is permitted to treat those goods remaining on hand at the close of the taxable year as being:

First, those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof, and

Second, those acquired during the taxable year.

This elective inventory method is not dependent upon the character of the business in which the taxpayer is engaged, or upon the identity or want of identity through commingling of any of the goods on hand, and may be adopted by the taxpayer as of the close of any taxable year.

If the elective inventory method is used by a taxpayer who regularly and consistently, in a manner similar to hedging on a futures market, matches purchases with sales, then firm purchases and sales contracts (i. e., those not legally subject to cancellation by either party) entered into at fixed prices on or before the date of the inventory may be included in purchases or sales, as the case may be, for the purpose of determining the cost of goods sold and the resulting profit or loss, provided that this practice is regularly and consistently adhered to by the tax-

payer and that, in the opinion of the Commissioner, income is clearly reflected thereby.

§ 29.22 (d)–2 *Requirements incident to adoption and use of elective method.* The adoption and use of the elective inventory method is, by section 22 (d) and regulations thereunder, made subject to the following requirements:

(a) The taxpayer shall file an application to use such method specifying with particularity the goods to which it is to be applied;

(b) The inventory shall be taken at cost regardless of market values;

(c) Goods of the specified type included in the opening inventory of the taxable year for which the method is first used shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand. The actual cost of the aggregate shall be determined pursuant to the inventory method employed by the taxpayer under the regulations applicable to the preceding taxable year with the exception that restoration shall be made with respect to any write-down to market values resulting from the pricing of former inventories;

(d) Goods of the specified type on hand as of the close of the taxable year in excess of what were on hand as of the beginning of the taxable year shall be included in the closing inventory, regardless of identification with specific invoices, at costs determined as follows:

(1) By reference to the actual cost of the goods most recently purchased or produced;

(2) By reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition;

(3) By application of an average unit cost equal to the aggregate cost of all of the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced, the goods reflected in such inventory increase being considered for the purposes of section 22 (d) as having been acquired all at the same time; or

(4) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

Whichever of the several methods of valuing the inventory increase is adopted by the taxpayer and approved by the Commissioner shall be consistently adhered to in all subsequent taxable years so long as the elective inventory method is used by the taxpayer;

Example (1). Suppose that the taxpayer adopts the elective inventory method for the taxable year 1942 with an opening inventory of 10 units at 10 cents per unit, that it makes 1942 purchases of 10 units as follows:

January	1	@	11=11
April	2	@	12=24
July	3	@	13=39
October	4	@	14=56
Totals:	10		130

and that it has a 1942 closing inventory of 15 units. This closing inventory, depending upon the taxpayer's method of valuing inventory increases, will be computed as follows:

(a) Most recent purchases—

	10	@ 10	=100
	4	@ 14 (October)	= 56
	1	@ 13 (July)	= 13
Totals:	15		169

or

(b) In order of acquisition—

	10	@ 10	=100
	1	@ 11 (January)	= 11
	2	@ 12 (April)	= 24
	2	@ 13 (July)	= 26
Totals:	15		161

or

(c) At an annual average—

	10	@ 10	=100
	5	@ 13 (130/10)	= 65
Totals:	15		165

Example (2). Suppose, in addition to the facts stated in example (1), that there is a 1943 closing inventory of 13 units. This closing inventory, being determined wholly by reference to the opening inventory, and being taken in the order of acquisition, and depending upon the taxpayer's method of valuing its inventory increase for the preceding taxable year, will be computed as follows:

(a) In case the increase was taken as most recent purchases—

	10	@ 10 (from 1941)	=100
	1	@ 13 (July, 1942)	= 13
	2	@ 14 (October, 1942)	= 28
Totals:	13		141

or

(b) In case the increase was taken in order of acquisition—

	10	@ 10 (from 1941)	=100
	1	@ 11 (January, 1942)	= 11
	2	@ 12 (April, 1942)	= 24
Totals:	13		135

or

(c) In case increase was taken on basis of an average—

	10	@ 10 (from 1941)	=100
	3	@ 13 (from 1942)	= 39
Totals:	13		139

(e) The taxpayer shall establish to the satisfaction of the Commissioner that the taxpayer, in ascertaining income, profit, or loss for the taxable year for which the elective inventory method is first used or for any subsequent taxable year, for credit purposes or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, has not used any inventory method other than that referred to in § 29.22 (d)–1 or at variance with the requirement referred to in paragraph (c) of this section, the taxpayer's use of market value in lieu of cost or his issuance of reports or credit statements covering a period of operations less than the whole of the taxable year not being considered at variance with this requirement;

(f) Goods of the specified type on hand as of the close of the taxable year preceding the taxable year for which this inventory method is first used shall be included in the taxpayer's closing inventory for such preceding taxable year at cost determined in the manner prescribed in paragraph (c) of this section;

(g) The elective inventory method, once adopted by the taxpayer with the approval of the Commissioner, shall be adhered to in all subsequent taxable years unless:

(1) A change to a different method is approved by the Commissioner; or

(2) The Commissioner determines that the taxpayer, in ascertaining income, profit, or loss for the whole of any taxaxle year subsequent to his adoption of the elective inventory method, for credit purposes or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, has used any inventory method at variance with that referred to in § 29.22 (d)–1 and requires of the taxpayer a change to a different method for such subsequent taxable year or any taxable year thereafter; and

(h) The records and accounts employed by the taxpayer in keeping his books shall be maintained in conformity with the inventory method referred to in § 29.22 (d)–1; and such supplemental and detailed inventory records shall be maintained as will enable the Commissioner readily to verify the taxpayer's inventory computations as well as his compliance with these several requirements.

§ 29.22 (d)–3 *Time and manner of making election.* The elective inventory method may be adopted and used only if the taxpayer files with his return for the taxable year as of the close of which the method is first to be used (or, if such return is filed prior to March 10, 1943, the ninetieth day after the approval of Treasury Decision 5199, then at any time prior to such date), in triplicate on Form 970, and pursuant to the instructions printed thereon and to the requirements of this section, a statement of his election to use such inventory method. Such statement shall be accompanied by an analysis of all inventories of the taxpayer as of the beginning and as of the end of the taxable year for which the elective method is proposed first to be used, and also as of the beginning of the preceding taxable year. In the case of a manufacturer, this analysis shall show in detail the manner in which costs are computed with respect to raw materials, goods in process, and finished goods, segregating the products (whether in process or finished goods) into natural groups on the basis of either (1) similarity in factory processes through which they pass, or (2) similarity of raw materials used, or (3) similarity in style, shape, or use of finished products. Each group of products shall be clearly described.

The taxpayer shall submit for the consideration of the Commissioner in connection with the taxpayer's adoption or use of the elective inventory method such other detailed information with respect to his business or accounting system as may be at any time requested by the Commissioner.

As a condition to the taxpayer's use of the elective inventory method, the Commissioner may require that the method be used with respect to goods other than those specified in the tax-

payer's statement of election if, in the opinion of the Commissioner, the use of such method with respect to such other goods is essential to a clear reflection of income.

Whether or not the taxpayer's application for the adoption and use of the elective inventory method should be approved, and whether or not such method, once adopted, may be continued, and the propriety of all computations incidental to the use of such method will be determined by the Commissioner in connection with the examination of the taxpayer's returns.

§ 29.22 (d)–4 *Adjustments to be made by taxpayer.* A taxpayer may not change to the elective method of taking inventories unless, at the time he files his application for the adoption of such method, he agrees to such adjustments incident to the change to or from such method, or incident to the use of such method, in the inventories of prior taxable years or otherwise, as the Commissioner upon the examination of the taxpayer's returns may deem necessary in order that the true income of the taxpayer will be clearly reflected for the years involved.

§ 29.22 (d)–5 *Revocation of election.* An election made to adopt and use the elective inventory method is irrevocable, and the method once adopted shall be used in all subsequent taxable years, unless the use of another method be required by the Commissioner, or authorized by him pursuant to a written appliation therefor filed with him as provided in § 29.41–2.

§ 29.22 (d)–6 *Change from elective inventory method.* If the taxpayer is granted permission by the Commissioner to discontinue the use of the elective method of taking inventories, and thereafter to pursue some other method, or if the taxpayer is required by the Commissioner to discontinue the use of the elective method by reason of the taxpayer's failure to conform to the requirements detailed in § 29.22 (d)–2, the inventory of the specified goods for the first taxable year affected by the change and for each taxable year thereafter shall be taken:

(a) In conformity with the method used by the taxpayer under section 22 (c) in inventorying goods not included in his elective inventory computations; or

(b) If the elective inventory method was used by the taxpayer with respect to all of his goods subject to inventory, then in conformity with the inventory method used by the taxpayer prior to his adoption of the elective inventory method; or

(c) If the taxpayer had not used inventories prior to his adoption of the elective inventory method and had no goods currently subject to inventory by a method other than the elective method, then in conformity with such inventory method as may be selected by the taxpayer and approved by the Commissioner as resulting in a clear reflection of income; or

(d) In any event, in conformity with any inventory method to which the taxpayer may change pursuant to application approved by the Commissioner.

§ 19.22 (d)–7 *Involuntary liquidation and replacement.* If prevailing war conditions beyond the control of the taxpayer should render it impossible during the period of the war for a taxpayer using the elective inventory method to have on hand at the close of the taxable year a stock of merchandise in kind and description like that included in the opening inventory for the year, or in a quantity equal to that of the opening inventory, the resulting inventory decrease for the year will be regarded, at the election of the taxpayer, as reflecting an involuntary liquidation subject to replacement. If the taxpayer notifies the Commissioner at the time of filing his income tax return for the year of the liquidation that he intends to effect a replacement of the liquidated stock, in whole or in part, and that he desires to have applied in his case the involuntary liquidation and replacement provisions of section 22 (d) (6), and if he establishes to the satisfaction of the Commissioner the involuntary character of the liquidation to which his stock has been subjected, effect shall be given, when replacement has been made, to an adjustment of net income for the year of liquidation to the extent of the difference between the replacement costs incurred and the original inventory cost of the base stock inventory liquidated. If the replacement costs exceed such inventory costs, the net income of the taxpayer otherwise computed shall be reduced by an amount equal to such excess. If the replacement costs are less than the inventory costs, net income otherwise computed shall be increased to the extent of such difference. Any deficiency in the income or excess profits tax of the taxpayer, or any overpayment of such taxes, attributable to such adjustment shall be assessed and collected by the Commissioner or credited or refunded to the taxpayer without interest.

The statutory provisions affording recognition to the involuntary character of inventory decreases which become apparent in war years and authorizing for tax purposes a replacement of the items of merchandise so liquidated are limited in their application to liquidations occurring in taxable years beginning prior to the termination of the present war as proclaimed by the President, and to inventory replacements effected in taxable years ending not more than three years after the termination of the war so proclaimed.

A failure on the part of the taxpayer to have on hand in his closing inventory for the taxable year merchandise of the kind, description, and quantity of that reflected in his opening inventory will be considered as an involuntary liquidation only if it is established to the satisfaction of the Commissioner that such failure is due wholly to his inability to purchase, manufacture, or otherwise produce and procure delivery of such merchandise during the taxable year of liquidation by reason of prevailing war conditions, such as (i) enemy capture or control of sources of limited foreign supply; (ii) shipping or other transportation shortages; (iii) material shortages resulting from priorities or allocations; (iv) labor shortages; and (v) similar war conditions beyond the control of the taxpayer. A voluntary shift by the taxpayer, in the exercise of business judgment, to merchandise of a different character, description, or use, or to merchandise processed out of a substantially different kind of raw materials while raw materials of the type originally used are still available will not be considered as an involuntary liquidation notwithstanding the fact that such a shift in merchandise stocked was prompted by a shifting market demand attributable to war conditions. The term "involuntary liquidation" presupposes a physical inability to maintain a normal inventory as distinguished from a financial or business disinclination on the part of the taxpayer to do so.

If the taxpayer would have the involuntary liquidation and replacement provisions applicable with respect to any inventory decreases suffered during war years, he must so elect at the time of filing his income tax return for the year reflecting the decrease. In making such election, the taxpayer shall attach to his return and make a part thereof a statement setting forth the following matters: (1) the wish of the taxpayer to invoke the involuntary liquidation and replacement provisions; (2) a detailed list or other identifying description of the items of merchandise claimed to have been subjected to involuntary liquidation and the extent to which replacement is intended; (3) the circumstances relied upon as rendering the taxpayer unable to maintain throughout the taxable year a normal inventory of the items involved; (4) detailed proof of such circumstances to the extent that they may not be the subject matter of common knowledge; and (5) a full description of what efforts were made on the part of the taxpayer to effect replacement during the taxable year and the result of such efforts.

The election of the taxpayer to treat an involuntary decrease of inventory as subject to the replacement adjustments is to be exercised separately for each taxable year reflecting such a decrease, and the election, once exercised with respect to a given year, shall be irrevocable with respect to the particular decrease involved and its prospective replacement, and shall be binding for the year of liquidation, the year of replacement, and all intervening and subsequent years to the extent that such intervening and subsequent years are affected by the adjustments authorized. The ultimate replacement and the resulting adjustment for the year of liquidation may have consequences, among others, in the earnings and profits of intervening years and the inventory accounts of subsequent years. Adjustments are to be made for the intervening and subsequent years consistent with the adjustments made for the year of liquidation. De-

tailed records shall be maintained such as will enable the Commissioner, in his examination of the taxpayer's returns for the year of replacement, readily to verify the extent of the inventory decrease claimed to be involuntary in character and the facts upon which such claim is based, all subsequent inventory increases and decreases, and all other facts material to the replacement adjustment authorized.

Notwithstanding the ultimate purchase price or the cost of production ultimately incurred by the taxpayer in effecting replacement of a stock involuntarily liquidated, the merchandise reflecting the replacement shall be included in the closing inventory for the year of replacement, and in that of subsequent taxable years, at the inventory cost figure of the merchandise replaced.

The goods reflected in any inventory increase in a year subsequent to a year of involuntary liquidation, to the extent that they constitute items of the kind and description liquidated in prior years, whether or not in a year of involuntary liquidation, shall be deemed, in the order of their acquisition, as having been acquired by the taxpayer in replacement of like goods most recently liquidated and not previously replaced. To the extent that the items of increase are allocated to items liquidated voluntarily, no adjustment will be required or permitted. Such replacement merchandise will be carried in the inventory at its actual cost of acquisition. To the extent that replacements are allocated to items involuntarily liquidated, however, the provisions of this section shall apply, both with respect to adjustments for the year of liquidation and other taxable years affected and with respect to inventory computations for the year of replacement and all subsequent taxable years.

In some cases it may appear at the time of the filing of the income tax return for the year of replacement, or at the time of the Commissioner's examination of such return, that an adjustment with respect to the income or excess profits taxes for the year of the involuntary liquidation, or for some intervening taxable years, is prevented by the running of the statute of limitations, by the execution of a closing agreement, by virtue of a court decision which has become final, or by reason of some other provision or rule of law other than section 3761 relating to compromises and other than the inventory replacement provisions. The adjustments provided for in connection with the involuntary liquidation and replacement of inventory shall nevertheless be made, but only if, within a period of three years after the date of the filing of the income tax return for the year of replacement, a notice of deficiency is mailed or a claim for refund is filed. No credit or refund will be allowed under such circumstances, whether within or without such 3-year period, in the absence of a claim for refund duly filed; nor will a resulting deficiency be assessed or collected under section 272 (d) relating to waivers of restrictions. The issuance of the statutory notice of deficiency or the filing of a claim for refund are statutory conditions upon which depend the provisions of subparagraph (E) of the liquidation and replacement enactment. The adjustment authorized by subparagraph (E) is limited further to the tax attributable solely to the replacement adjustments. The amount of the adjustment shall be computed by reference to the amount of the tax previously determined, and without regard to factors affecting the taxable year involved to which no effect was given in such prior determination. The tax previously determined shall be ascertained in accordance with the principles stated in section 734 (d) and those sections of the regulations prescribed thereunder. Any deficiency paid or any overpayment credited or refunded under these circumstances shall not be subject to recovery on a claim for refund or a suit for the recovery of an erroneous refund in any case in which such claim or suit is based upon factors other than those giving rise to the adjustments made.

[SEC. 22. GROSS INCOME—as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act. 1942; sec. 7 (a), Current Tax Payment Act 1943.]

(e) *Distributions by corporations.* Distributions by corporations shall be taxable to the shareholders as provided in section 115.

(f) *Determination of gain or loss.* In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

(g) *Gross income from sources within and without United States.* For computation of gross income from sources within and without the United States, see section 119.

(h) *Foreign personal holding companies.* For provisions relating to gross income of foreign personal holding companies and of their shareholders, see section 334.

(i) *Consent dividends.* For inclusion in gross income of amounts specified in shareholders' consents, see section 28.

(j) *Income from mortgages made or obligations issued by joint stock land banks.* For taxable status of income derived from mortgages made or obligations issued by joint stock land banks, see section 3799.

(k) *Alimony, etc., income.* In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, periodic payments (whether or not made at regular intervals) received subsequent to such decree in discharge of, or attributable to property transferred (in trust or otherwise) in discharge of a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includible in the gross income of such wife, and such amounts received as are attributable to property so transferred shall not be includible in the gross income of such husband. This subsection shall not apply to that part of any such periodic payment which the terms of the decree or written instrument fix, in terms of an amount of money or a portion of the payment, as a sum which is payable for the support of minor children of such husband. In case any such periodic payment is less than the amount specified in the decree or written instrument, for the purpose of applying the preceding sentence, such payment, to the extent of such sum payable for such support, shall be considered a payment for such support. Installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property, specified in the decree or instrument shall not be considered periodic payments for the purposes of this subsection; except that an installment payment shall be considered a periodic payment for the purposes of this subsection if such principal sum, by the terms of the decree or instrument, may be or is to be paid within a period ending more than 10 years from the date of such decree or instrument, but only to the extent that such installment payment for the taxable year of the wife (or if more than one such installment payment for such taxable year is received during such taxable year, the aggregate of such installment payments) does not exceed 10 per centum of such principal sum. For the purposes of the preceding sentence, the portion of a payment of the principal sum which is allocable to a period after the taxable year of the wife in which it is received shall be considered an installment payment for the taxable year in which it is received. (In cases where such periodic payments are attributable to property of an estate or property held in trust, see section 171 (b).) [NOTE: Under section 120 (g) of the Revenue Act of 1942 this provision is applicable only with respect to taxable years beginning after December 31, 1941; except that if the first taxable year beginning after December 31, 1941, of the husband does not begin on the same day as the first taxable year beginning after December 31, 1941, of the wife, this provision shall first become applicable in the case of the husband on the first day of the wife's first taxable year beginning after December 31, 1941, regardless of the taxable year of the husband in which such day falls.]

§ 29.22 (k)-1 *Alimony and separate maintenance payments; income to former wife*—(a) *In general.* Section 22 (k) provides rules for treatment in certain cases of payments in the nature of or in lieu of alimony or an allowance for support as between spouses who are divorced or legally separated under a court order or decree. For convenience, the payee spouse will hereafter in this section of the regulations be referred to as the "wife" and the spouse from whom she is divorced or legally separated as the "husband." See section 3797 (a) (17).

In general, section 22 (k) requires the inclusion in the gross income of the wife of periodic payments (whether or not made at regular intervals) received by her after the decree of divorce or of separate maintenance. Such periodic payments may be received from either of the two following sources:

(1) In discharge of a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by the husband, or

(2) Attributable to property transferred (in trust or otherwise) in discharge of a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by the husband.

The obligation of the husband must be imposed upon him or assumed by him (or made specific) under either of the following:

(1) A court order or decree divorcing or legally separating the husband and wife, or

(2) A written instrument incident to such divorce or legal separation.

The periodic payments received by the wife attributable to property so transferred and includible in her income are not to be included in the gross income of the husband. See also § 29.171–1 in cases where such periodic payments are attributable to property held in trust.

The purpose and effect of section 22 (k) may be illustrated, in general, by the following examples, in which it is assumed that the husband and wife make their income tax returns on the calendar year basis:

Example 1. W sues H for divorce in 1942. The court awards W temporary alimony of $25 a week pending the final decree. On September 1, 1942, the court grants W a divorce and awards her $200 a month permanent alimony. No part of the $25 a week temporary alimony received prior to the decree is includible in W's income under section 22 (k), but the $200 a month received during the balance of 1942 by W is includible in her income for 1942. Under section 23 (u), H is entitled to deduct such $200 payments from his income.

Example 2. W files suit for divorce from H. In consideration of W's promise to relinquish all marital rights and not to make public H's financial affairs, H makes a legally binding promise in writing to W to pay to her $200 a month if a final decree of divorce is granted without any provision for alimony. Accordingly, W does not request alimony and no provision for alimony is made under a final decree of divorce entered prior to 1942. During 1942, H pays W $200 a month, pursuant to the promise. The $2,400 thus received by W is includible in her gross income under the provisions of section 22 (k). Under section 23 (u), H is entitled to a deduction of $2,400 from his gross income.

Example (3). H and W enter into an antenuptial agreement, under which, in consideration of W's relinquishment of all marital rights (including dower) in H's property, and, in order to provide for W's support and household expenses, H promises to pay W $200 a month for her life. Ten years after their marriage, W sues H for divorce but does not ask for or obtain alimony because of the provision already made for her support in the antenuptial agreement. Likewise, the divorce decree is silent as to such agreement and H's obligation to support W. Section 22 (k) does not apply to such a case. If, however, the decree were modified so as to refer to the antenuptial agreement, or if, at the time of the divorce, reference had been made to the antenuptial agreement in the court's decree or in a written instrument incident to the divorce, section 22 (k) would require the inclusion of the payments received by W after the decree in her income for taxable years beginning after December 31, 1941. (As to including such payments in the wife's income, if made by a trust created under the antenuptial agreement, regardless of whether referred to in the decree or a later instrument, see § 29.171–1.)

Section 22 (k) applies only where the legal obligation being discharged arises out of the family or marital relationship in recognition of the general obligation to support, which is made specific by the instrument or decree. Thus, section 22 (k) does not apply to that part of any periodic payment which is attributable to the repayment by the husband of, for example, a bona fide loan previously made to him by the wife, the satisfaction of which is specified in the divorce decree as a part of the general settlement between the husband and wife.

Periodic payments are includible in the wife's income under section 22 (k) only for the taxable year in which received by her. As to such amounts, the wife is to be treated as if she makes her income tax returns on the cash receipts and disbursements basis, regardless of whether she normally makes such returns on the accrual basis. However, if the periodic payments described in section 22 (k) are to be made by an estate or trust, such periodic payments are to be included in the wife's taxable year in which they are includible according to the rules as to income of estates and trusts provided in sections 162, 164, and 171(b), whether or not such payments are made out of the income of such estates or trusts.

(b) *Alimony income attributable to property.* The full amount of periodic payments received under the circumstances described in section 22 (k) is required to be included in the gross income of the recipient whether such amounts are derived, in whole or in part, from income received or accrued by the source to which such payments are attributable. Thus, it matters not that such payments are attributable to property in trust, to life insurance, endowment, or annuity contracts, or to any other interest in property, or are paid directly or indirectly by the obligor husband from his income or capital. For example, if in order to meet an alimony obligation of $500 a month, the husband purchases or assigns for the benefit of his former wife a commercial annuity contract paying such amount, the full $500 a month received by the wife is includible in her income, and no part of such amount is includible in the husband's income or deductible by him. See section 22 (b) (2) (A) and § 29.22 (b) (2)–4. Likewise, if property is transferred by the husband, subject to an annual charge of $5,000, payable to his former wife in discharge of his alimony obligation under the divorce decree, the $5,000 received annually is, under section 22 (k), includible in the wife's income, regardless of whether such amount is paid out of income or principal of the property.

The same rule applies to perodic payments attributable to property in trust. The full amount of periodic payments to which section 22 (k) applies is includible in the wife's income, regardless of whether such payments are made out of trust income. This rule applies even though under the law applicable to taxable years beginning before January 1, 1942, only the income of a trust for the benefit of the divorced wife was taxable to her. Such periodic payments are to be included in the wife's income under section 22 (k) and are to be excluded from the husband's income, even though the income of the trust would otherwise be includible in his income under section 22 (a), section 166, section 167, or any other section of the Code or these regulations. As to periodic payments received by a former wife attributable to property in trust in cases to which section 22 (k) does not apply because the husband's obligation is not specified in the decree or an instrument incident thereto, see section 171 (a) and § 29.171–1.

Section 22 (k) does not apply to that part of any periodic payment attributable to that portion of any interest in property transferred in discharge of the husband's obligation under the decree or instrument incident thereto, which interest originally belonged to the wife. It will apply, however, if she received such interest from her husband in contemplation of or as an incident to the divorce or separation without adequate and full consideration in money or money's worth, other than the release of the husband or his property from marital obligations. An example of the first rule is a case where the husband and wife transfers securities, which were owned by them jointly, in trust to pay an annuity to the wife. In this case, the full amount of that part of the annuity received by the wife in discharge of the husband's obligation under the decree, or instrument incident thereto, is taxable to her under section 22 (k), while that portion of the annuity attributable to the wife's interest in the securities so transferred is taxable to her only to the extent it is out of trust income, as provided in section 162. If, however, the husband's transfer of an interest in his property to his wife, preliminary to a transfer of such property in discharge of his obligation, is made in an attempt to avoid the application of section 22 (k) to part of such payments received by his wife, such transfers will be considered as a part of the same transfer by the husband of his property in discharge of his obligation. In such a case, section 22 (k) will be applied to the full amount received by the wife. As to periodic payments received under a joint purchase of a commercial annuity contract, see § 29.22 (b) (2)–4.

(c) *Alimony installment payments.* In general, installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property specified in the decree of divorce or legal separation, or in an instrument incident thereto, are not considered "periodic payments" and therefore are not to be included under section 22 (k) in the wife's income. An exception to this general rule is provided, however, in cases where such principal sum, by the terms of the decree or such instrument, may be or is to be paid within a period ending more than 10 years from the date of such decree or instrument. In such cases, the installment payment is considered a periodic payment for the purposes of section 22 (k) but only to the extent that the installment payment, or sum of the installment payments, received during the wife's taxable year does not exceed 10 percent of the principal sum. This 10 percent limitation applies to installment payments made in advance but does not apply to delinquent installment payments for a prior taxable year of the wife made during her taxable year.

The rule as to installment payments may be illustrated by the following examples:

Example (1). Under the terms of a divorce decree, H is to pay W a gross sum of $100,000 in four annual installments. No part of the $100,000 is includible in W's income under section 22 (k) nor deductible by H.

Example (2). A divorce decree in 1940 provides that H is to pay W $20,000 each year for the next 5 years, beginning with the date of the decree and then $5,000 each year for the next 10 years. Assuming the wife makes her returns on the calendar year basis, each payment received in 1942, 1943, and 1944 is a periodic payment under section 22 (k), but only to the extent of 10 percent of the principal sum of $150,000. Thus for such taxable years, only $15,000 of the $20,000 received is includible under section 22 (k) in the wife's income and is deductible by the husband under section 23 (u). For the years 1945–1954, inclusive, the full $5,000 received each year by the wife is includible in her income and is deductible from the husband's income.

Example (3). Under the terms of a separation agreement incident to divorce granted in December 1941, H agrees to pay W $500 on the 1st day of each month, beginning with the month after the decree, for 12 years. W makes her income tax returns on the calendar year basis while H makes his returns on the basis of the fiscal year ending June 30. H makes the promised payments in 1942 and, in addition, on December 31, 1942, pays W $1,500 as an advance payment of installments for the next three months. In the calendar year 1943, H makes no payments at all because of financial straits. On January 1, 1944, H inherits $15,000, which he immediately pays to W in satisfaction of not only his back alimony installments for the last 9 months of 1943 but also his alimony installments for the next 21 months. The results as to H and W are as follows:

As to W: In the calendar year 1942, W received $7,500. Since 10 percent of $72,000 (the principal sum) is $7,200, only $7,200 of the $7,500 so received is includible in her income for 1942. For 1943, nothing is includible in her income under section 22 (k). In 1944, W received $15,000. Of this amount $4,500 is in payment of back installments and, therefore, is includible without limitation in her income for 1944. Of the balance of $10,500, only $7,200 is includible in her income for 1944.

As to H: For the taxable year ended June 30, 1942, H paid $6,000, of which only $3,000 is deductible by H since only that much of the $6,000 was paid in the wife's first taxable year beginning after December 31, 1941. In the taxable year ended June 30, 1943, H paid W $4,500, which, not being in excess of 10 percent of the principal sum, is deductible for such year. In his taxable year ended June 30, 1944, H paid $15,000, of which $11,700 (the sum of $4,500 and $7,200) is deductible.

(d) *Payments for support of minor children.* Section 22 (k) does not apply to that part of any periodic payment which, by the terms of the decree or the written instrument under section 22 (k), is specifically designated as a sum payable for the support of minor children of the husband. The statute prescribes the treatment in cases where an amount or portion is so fixed but the amount of any periodic payment is less than the amount of the periodic payment specified to be made. In such cases, to the extent of the amount which would be payable for the support of such children out of the originally specified periodic payment, such periodic payment is considered a payment for such support. For example, if the husband is by terms of the decree required to pay $200 a month to his divorced wife, $100 of which is designated by the decree to be for the support of their minor children, and the husband pays only $150 to his wife, $100 is nevertheless considered to be a payment by the husband for the support of the children. If, however, the periodic payments are received by the wife for the support and maintenance of herself and of minor children of the husband without such specific designation of the portion for the support of such children, then the whole of such amounts is includible in the income of the wife as provided in section 22 (k). Except in cases of a designated amount or portion for the support of the husband's minor children, periodic payments described in section 22 (k) received by the wife for herself and any other person or persons are includible in whole in the wife's income, whether or not, the amount or portion for such other person or persons is designated. As to treatment of such amounts with respect to credit for dependents and head of family exemption, see sections 25 (b) (2) (A) and 401 (a) (2) and §§ 29.25–4 and 29.25–6.

[SEC. 22. GROSS INCOME—as amended by secs. 1, 3, Public Salary Tax Act 1939; secs. 215 (a), 219 (a), Rev. Act 1939; secs. 110 (a), 111 (a), 112 (a), 113, 114 (a) (b), 115 (a), 116 (a), 117, 118 (a) (b), 119, 120 (a) (d), 127 (d), 134 (c), 162 (c), Rev. Act 1942; sec. 7 (a), Current Tax Payment Act 1943.]

(1) *Income of decedents.* For inclusion in gross income of certain amounts which constituted gross income in respect of a decedent, see section 126.

SEC. 23. DEDUCTIONS FROM GROSS INCOME [as amended by secs. 211 (a), 224, Rev. Act. 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942].

In computing net income there shall be allowed as deductions:

(a) *Expenses*—(1) *Trade or business expenses*—(A) *In general.* All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(B) *Corporate charitable contributions.* No deduction shall be allowable under subparagraph (A) to a corporation for any contribution or gift which would be allowable as a deduction under subsection (q) were it not for the 5 per centum limitation therein contained and for the requirement therein that payment must be made within the taxable year.

(C) *Expenditures for advertising and good will.* If a corporation has, for the purpose of computing its excess profits credit under Chapter 2E, claimed the benefits of the election provided in section 733, no deduction shall be allowable under subparagraph (A) to such corporation for expenditures for advertising or the promotion of good will which, under the rules and regulations prescribed under section 733 (a), may be regarded as capital investments.

(2) *Non-trade or non-business expenses.* In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

§ 29.23 (a)–1 *Business expenses.* Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23 (b) to 23 (z), inclusive, and the regulations thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provision thereof. As to charitable contributions by corporations not deductible under section 23 (a), see § 29.23 (a)–13. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See § 29.22 (a)–5.) Among the items included in business expenses are management expenses, commissions (but see § 29.24–2), labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see § 29.23 (a)–2.), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. Penalty payments with respect to Federal taxes, whether on account of negligence, delinquency, or fraud, are not deductible from gross income. The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business. As to items not deductible under any provision of section 23, see section 24.

§ 29.23 (a)–2 *Traveling expenses.* Traveling expenses, as ordinarily understood, include railroad fares and meals and lodgings. If the trip is undertaken for other than business purposes, the railroad fares are personal expenses and the meals and lodging are living expenses. If the trip is solely on business, the reasonable and necessary traveling expenses, including railroad fares, meals, and lodging, are business expenses.

(a) If, then, an individual, whose business requires him to travel, receives a salary as full compensation for his services, without reimbursement for traveling expenses, or is employed on a commission basis with no expense allowance, his traveling expenses, including the entire amount expended for meals and lodging, are deductible from gross income.

(b) If an individual receives a salary and is also paid his actual traveling expenses, he shall include in gross income the amount so repaid and may deduct such expenses.

(c) If an individual receives a salary and also an allowance for meals and lodging, as, for example, a per diem allowance in lieu of subsistence, the amount of the allowance should be in-

cluded in gross income and the cost of such meals and lodging may be deducted therefrom.

A payment for the use of a sample room at a hotel for the display of goods is a business expense. Only such expenses as are reasonable and necessary in the conduct of the business and directly attributable to it may be deducted. A taxpayer claiming the benefit of the deductions referred to herein must attach to his return a statement showing (1) the nature of the business in which engaged; (2) the number of days away from home during the taxable year on account of business; (3) the total amount of expenses incident to meals and lodging while absent from home on business during the taxable year; and (4) the total amount of other expenses incident to travel and claimed as a deduction.

Claim for the deductions referred to herein must be substantiated, when required by the Commissioner, by evidence showing in detail the amount and nature of the expenses incurred.

Commuters' fares are not considered as business expenses and are not deductible.

§ 29.23 (a)–3 *Cost of materials.* Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only to the amount that they are actually consumed and used in operation during the year for which the return is made, provided that the cost of such materials and supplies has not been deducted in determining the net income for any previous year. If a taxpayer carries incidental materials or supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, it will be permissible for the taxpayer to include in his expenses and deduct from gross income the total cost of such supplies and materials as were purchased during the year for which the return is made, provided the net income is clearly reflected by this method.

§ 29.23 (a)–4 *Repairs.* The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as expense, provided the plant or property account is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, should be charged against the depreciation reserve if such account is kept. (See §§ 29.23 (l)–1 to 29.23 (l)–10, inclusive.)

§ 29.23 (a)–5 *Professional expenses.* A professional man may claim as deductions the cost of supplies used by him in the practice of his profession, expenses paid in the operation and repair of an automobile used in making professional calls, dues to professional societies and subscriptions to professional journals, the rent paid for office rooms, the cost of the fuel, light, water, telephone, etc., used in such offices, and the hire of office assistants. Amounts currently expended for books, furniture, and professional instruments and equipment, the useful life of which is short, may be deducted.

§ 29.23 (a)–6 *Compensation for personal services.* Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:

(a) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. (1) An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stock holdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. (2) An ostensible salary may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such a case it may be found that the salaries of the former partners are not merely for services, but in part constitute payment for the transfer of their business.

(b) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(c) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

§ 29.23 (a)–7 *Treatment of excessive compensation.* The income tax liability of the recipient in respect of an amount ostensibly paid to him as compensation, but not allowed to be deducted as such by the payor, will depend upon the circumstances of each case. Thus, in the case of excessive payments by corporations, if such payments correspond or bear a close relationship to stock holdings, and are found to be a distribution of earnings or profits, the excessive payments will be treated as a dividend. If such payments constitute payment for property, they should be treated by the payor as a capital expenditure and by the recipient as part of the purchase price. In the absence of evidence to justify other treatment, excessive payments for salaries or other compensation for personal services will be included in gross income of the recipient and subjected to both normal tax and surtax.

§ 29.23 (a)–8 *Bonuses to employees.* Bonuses to employees will constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for the services actually rendered by the employees, provided such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered. It is immaterial whether such bonuses are paid in cash or in kind or partly in cash and partly in kind. Donations made to employees and others, which do not have in them the element of compensation or are in excess of reasonable compensation for services, are not deductible from gross income.

§ 29.23 (a)–9 *Pensions; compensation for injuries.* Amounts paid by a taxpayer for pensions to retired employees or to their families or others dependent upon them, or on account of injuries received by employees, and lump-sum amounts paid or accrued as compensation for injuries, are proper deductions as ordinary and necessary expenses. Such deductions are limited to the amount not compensated for by insurance or otherwise. When the amount of the salary of an officer or employee is paid for a limited period after his death to his widow or heirs, in recognition of the services rendered by the individual, such payments may be deducted. As to deductions for payments to employees' pension trusts, see section 23 (p).

§ 29.23 (a)–10 *Rentals.* If a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter. The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment of capital, an annual deduc-

tion may be made from gross income of an amount equal to the total cost of such improvements divided by the number of years remaining of the term of lease, and such deduction shall be in lieu of a deduction for depreciation. If the remainder of the term of lease is greater than the probable life of the buildings erected, or of the improvements made, this deduction shall take the form of an allowance for depreciation.

In cases in which the lease contains an unexercised option of renewal, the matter of spreading such depreciation or amortization over the term of the original lease, together with the renewal period or periods, depends upon the facts in the particular case. As a general rule, unless the lease has been renewed or the facts show with reasonable certainty that the lease will be renewed, the cost or other basis of the lease or the cost of improvements shall be spread only over the number of years the lease has to run, without taking into account any right of renewal. However, if the taxpayer for any taxable year ending prior to December 31, 1939, has been allowed such depreciation or amortization on the basis of spreading the cost or other basis of such lease or improvements over the number of years the lease has to run, including any exercised or unexercised renewal period or periods, and such taxable year has been closed on that basis and the tax for that year cannot be redetermined, then the taxpayer may for subsequent taxable years take deductions on such basis if within 90 days after the approval of Part 24 of this chapter (approved December 6, 1939) or within such later period as may be specified by the Commissioner, he files Form 969, in duplicate, with the Commissioner of Internal Revenue, Washington, D. C., attention of the Income Tax Unit, Records Division, signifying his election to have deductions in respect of such items determined upon such basis, and expressly waives his right to claim or receive the benefits of any reduction in his tax liability which would result from the allowance of deductions for such items on the basis of only the number of years the lease has to run, without taking into account any right of renewal, or on any basis other than that set forth in his election. If, in any case, the life of the improvements is less than the number of years the lease has to run, including the renewal period if properly to be considered, the deduction for depreciation with respect to such improvements shall be spread only over such life.

§ 29.23 (a)–11 *Expenses of farmers.* A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in the carrying on of the business of farming. The cost of ordinary tools of short life or small cost, such as hand tools, including shovels, rakes, etc., may be deducted. The cost of feeding and raising live stock may be treated as an expense deduction, in so far as such cost represents actual outlay, but not including the value of farm produce grown upon the farm or the labor of the taxpayer. Where a farmer is engaged in producing crops which take more than a year from the time of planting to the process of gathering and disposal, expenses deducted may, with the consent of the Commissioner (see § 29.41–2), be determined upon the crop basis, and such deductions must be taken in the year in which the gross income from the crop has been realized. The cost of farm machinery, equipment, and farm buildings represents a capital investment and is not an allowable deduction as an item of expense. Amounts expended in the development of farms, orchards, and ranches prior to the time when the productive state is reached may be regarded as investments of capital. Amounts expended in purchasing work, breeding, or dairy animals are regarded as investments of capital, and may be depreciated unless such animals are included in an inventory in accordance with § 29.22 (a)–7. The purchase price of an automobile, even when wholly used in carrying on farming operations, is not deductible, but is regarded as an investment of capital. The cost of gasoline, repairs, and upkeep of an automobile if used wholly in the business of farming is deductible as an expense; if used partly for business purposes and partly for the pleasure or convenience of the taxpayer or his family, such cost may be apportioned according to the extent of the use for purposes of business and pleasure or convenience, and only the proportion of such cost justly attributable to business purposes is deductible as a necessary expense. If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from the sale of products may be ignored in rendering a return of income, and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions. (See also §§ 29.22 (a)–7, 29.23 (e)–5, and 29.23 (l)–10.)

§ 29.23 (a)–12 *Depositors' guaranty fund.* Banking corporations which pursuant to the laws of the States in which they are doing business are required to set apart, keep, and maintain in their banks the amount levied and assessed against them by the State authorities as a "Depositors' guaranty fund," may deduct from their gross income the amount so set apart each year to this fund; *Provided*, That such fund, when set aside and carried to the credit of the State banking board or duly authorized State officer, ceases to be an asset of the bank and may be withdrawn in whole or in part upon demand by such board or State officer to meet the needs of these officers in reimbursing depositors in insolvent banks; *And provided further*, That no portion of the amount thus set aside and credited is returnable under the laws of the State to the assets of the banking corporation. If, however, such amount is simply set up on the books of the bank as a reserve to meet a contingent liability and remains an asset of the bank, it will not be deductible except as it is actually paid out as required by law and upon demand of the proper State officers.

§ 29.23 (a)–13 *Corporate contributions.* No deduction is allowable under section 23 (a) for a contribution or gift by a corporation if any part thereof is deductible under section 23 (q). Thus, for example, if a corporation makes a contribution of $5,000, only $4,000 of which is deductible under section 23 (q) (whether because of the 5 percent limitation or requirement of actual payment, or both), no deduction is allowable under section 23 (a) for the remaining $1,000.

The limitations provided in section 23 (a) (1) and this section apply only to payments which are in fact contributions or gifts to organizations described in section 23 (q). For example, payments by a street railway corporation to a local hospital (which is a charitable organization within the meaning of section 23 (q)) in consideration of a binding obligation on the part of the hospital to provide hospital services and facilities for the corporation's employees are not contributions or gifts within the meaning of section 23 (q) and may be deductible under section 23 (a) if the requirements of that section are otherwise satisfied. Donations to organizations other than those described in section 23 (q) which bear a direct relationship to the corporation's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. For example, a street railway corporation may donate a sum of money to an organization (of a class not referred to in section 23 (q)) intending to hold a convention in the city in which it operates, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars.

§ 29.23 (a)–14 *Expenditures for advertising or promotion of good will.* A corporation which has, for the purpose of computing its excess profits credit, elected under section 733 to charge to capital account expenditures for advertising or the promotion of good will which may be regarded as capital investments and which were deducted for taxable years beginning after December 31, 1935, and prior to January 1, 1940, may not deduct similar expenditures for the taxable year. Such a taxpayer has the burden of proving that expenditures for advertising or the promotion of good will which it seeks to deduct for such later taxable years may not be regarded as capital investments under the provisions of the regulations prescribed under section 733. For rules for determining what expenditures for advertising or the promotion of good will may be regarded as capital investments, and for information required to be submitted with respect to such expenditures, see § 30.733–2 of this chapter.

§ 29.23 (a)–15 *Nontrade or nonbusiness expenses*—(a) *In general.* Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23 (a) (2) only upon the condition that:

(1) It has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) It is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23 (a) (2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includible in income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter incurred in connection therewith are deductible. Similarly, ordinary and necessary expenses incurred in the management, conservation or maintenance of a building devoted to rental purposes are deductible notwithstanding that there is actully no income therefrom in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. Expenses incurred in managing, conserving, or maintaining property held for investment may be deductible under this provision even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on transactions, which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23 (a) (2), must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24. Section 24 (a) (5) disallows any amount otherwise allowable as a deduction (whether under section 23 (a) (2) or otherwise) which is allocable to one or more clases of tax-exempt income, other than interest, and has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts otherwise allowable under that section which are allocable to tax-exempt interest. Thus, any amount allocable to the production or collection of one or more classes of income which is not includible in gross income or to the management, conservation, or maintenance of property held for the production of such income is not deductible under section 23 (a) (2). Nor does section 23 (a) (2) allow any expenses which are disallowed by any of the provisions of chapter 1.

Capital expenditures, and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. The question whether or not a transaction is carried on primarily for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income, rather than primarily as a sport, hobby, or recreation, is not to be determined solely from the intention of the taxpayer but rather from all the circumstances of the case, including the record of prior gain or loss of the taxpayer in the activity, the relation between the type of activity and the principal occupation of the taxpayer, and the uses to which the property or what it produces is put by the taxpayer.

Among expenditures not allowable under section 23 (a) (2) are the following: Commuters' expenses; expenses of taking special courses or training; expenses for improving personal appearance; the cost of rental of a safe-deposit box for storing jewelry and other personal effects; and expenses such as expenses in seeking employment or in placing oneself in a position to begin rendering personal services for compensation, campaign expenses of a candidate for public office, bar examination fees and other expenses incurred in securing admission to the bar, and corresponding fees and expenses incurred by physicians, dentists, accountants, and other taxpayers for securing the right to practice their respective professions.

Fees for services of investment counsel, custodian fees, clerical help, office rent, and similar expenses paid or incurred by a taxpayer in connection with investments held by him are deductible under section 23 (a) (2) only if (1) they are paid or incurred by the taxpayer for the production or collection of income, or for the management, conservation, or maintenance of investments held by him for the production of income; and (2) they are ordinary and necessary under all the circumstances, having regard to the type of investment and to the relation of the taxpayer to such investment.

Ordinary and necessary expenses in connection with the management, conservation, or maintenance of property used as a residence by the taxpayer or acquired by him for such use are not deductible, even though the taxpayer makes efforts to sell the property at a profit or to convert it to income-producing purposes, and even though the property is not occupied by the taxpayer as a residence, unless prior to the time that such expenses are incurred the property has been rented or otherwise appropriated to income-producing purposes by some affirmative act and has not been reconverted.

Expenditures incurred by an administrator or executor in securing the processes and orders of the court having jurisdiction over the probate of the estate, or in collecting the assets of the estate (other than income which, if and when realized, must be reported by the estate for income tax purposes), or in adjusting claims against the decedent, or in distributing the remaining assets to the beneficiaries, or in conserving the assets for ultimate distribution to the parties entitled thereto, are not deductible under this section. Ordinary and necessary expenses, however, which are paid or incurred during the taxable year by an administrator or executor for the production or collection of income which, if and when realized, must be reported by the estate for income tax purposes, such as fees for collecting rents on property in the estate of the decedent, or for collecting interest or dividends on securities in that estate, or which are paid or incurred during the taxable year for the management, conservation, or maintenance of property in the estate of the decedent held for the production of income, the income from which, if and when realized, must be reported by the estate for income tax purposes, such as expenditures for insurance or repairs, or expenditures of a similar nature, are deductible under this section at the option of the taxpayer notwithstanding that deductions therefor are allowable under section 812 (b) in computing the gross estate subject to the estate tax, provided the requisite statement and waiver are filed. (See section 162 (e).)

The ordinary expenditures of administration incurred in a receivership or bankruptcy proceeding are not deductible. Such expenditures include expenditures incurred in the performance of the ordinary duties of a receiver or trustee in bankruptcy, as, for example, fees paid to the attorney for the petitioning creditors, fees paid to the appraisers, and disbursements which are made in connection with the proceeding and which look toward the collection of the assets and their preservation pending ultimate distribution to the parties entitled thereto.

Reasonable amounts paid or incurred by a trustee on account of trustees' fees and other expenses which are ordinary and necessary in connection with the production or collection of trust income or with the management, conservation,

or maintenance of trust property held for the production of income are deductible, notwithstanding that the trust is not engaged in a trade or business.

Reasonable amounts paid or incurred for the services of a guardian or committee for a ward or minor, and other expenses of guardians and committees which are ordinary and necessary, in connection with the production or collection of income inuring to the ward or minor, or in connection with the management, conservation, or maintenance of property, held for the production of income, belonging to the ward or minor, are deductible.

It is immaterial whether the expenses of fiduciaries are paid from the corpus of the estate or from income. Expenses derive their character not from the fund from which they are paid, but from the purposes for which they are incurred.

Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenditures incurred in protecting or asserting one's rights to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible expenses. Expenditures incurred for the purpose of preparing tax returns (except to the extent such returns relate to taxes on property held for the production of income), for the purpose of recovering taxes (other than recoveries required to be included in income), or for the purpose of resisting a proposed additional assessment of taxes (other than taxes on property held for the production of income) are not deductible expenses under this section, except that part thereof which the taxpayer clearly shows to be properly allocable to the recovery of interest required to be included in income.

The deduction of an item otherwise allowable under section 23 (a) (2) will not be disallowed simply because the taxpayer also had an election under chapter 1 to treat it as a capital expenditure, rather than to deduct it as an expense. (See section 24 (a) (7).) Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in chapter 1, no deduction is allowable under this section; and this is true regardless of whether any basis adjustment is allowed under section 113.

(c) The provisions of section 23 (a) (2) are not intended in any way to disallow expenses which would otherwise be allowable under section 23 (a) (1) or the regulations applicable thereto, or under any other section of the Internal Revenue Code or the regulations applicable thereto. Double deductions are not permitted. Amounts deducted under one provision of the Code cannot again be deducted under any other provision thereof.

§ 29.23 (a)–16 *Wage and salary payments in contravention of wage and salary limitations not deductible*—(a) *General.* In any case in which a wage or salary payment, for which a deduction would otherwise be allowable, is determined by the National War Labor Board, by the Secretary of Agriculture, or by the Commissioner to have been made in contravention of the Act of October 2, 1942 (Public Law 729, 77th Congress), entitled "An Act to amend the Emergency Price Control Act of 1942, to aid in preventing inflation, and for other purposes," as amended by the Public Debt Act of 1943 (Public Law 34, 78th Congress), or of the regulations, orders, or rulings promulgated thereunder, the entire amount of such payment shall be disallowed as a deduction. Such a payment will not be allowed for this purpose notwithstanding that the same payment is also disallowed (1) for the purpose of determining costs or expenses of an employer for the purpose of some other law or regulation, either heretofore or hereafter promulgated, including the Emergency Price Control Act of 1942, or any maximum price regulation thereof; or (2) for the purpose of determining costs or expenses under any contract made by or on behalf of the United States.

(b) *Amount of illegal wage or salary payment not deductible*—(1) *Unauthorized wage or salary increases.* In the case of a wage or salary increased in contravention of the Act, or of the regulations, rulings, or orders referred to under paragraph (a) of this section, the amount which is not to be allowed as a deduction under this section is the amount of the wage or salary actually paid or accrued by the employer at the increased rate and not merely an amount representing the increase in such wage or salary. Thus, if, for example, on November 1, 1942, a weekly salary rate of $100 or a wage rate of $2 an hour is unjustifiably increased for the remainder of 1942 to $150 or $3, respectively, then the amounts not deductible under this section are the total weekly amounts of $150 or the total hourly amounts of $3, as the case may be. Also, if, for example, on February 1, 1943, a weekly salary rate of $100 or a wage rate of $2 an hour is increased without prior required approval to $150 or $3, respectively, but is restored on June 1, 1943, after formal disapproval, to $100 or $2, respectively, then the amounts not deductible under this section are the total weekly amounts of $150 or the total hourly amounts of $3, as the case may be, paid from February 1, 1943, to June 1, 1943, inclusive.

(2) *Unauthorized wage or salary decreases.* In the case of a wage or salary decrease in contravention of the Act, or of the regulations, rulings, or orders referred to under paragraph (a) of this section, the amount which will not be allowed as a deduction under this section is the amount of the wage or salary actually paid or accrued by the employer at the reduced rate. Thus, if, for example, on November 1, 1942, a weekly salary rate of $100 or a wage rate of $2 an hour has been unjustifiably reduced for the remainder of the calendar year 1942 to $90 or $1.80, respectively, the amounts not deductible under this section are the total weekly amounts of $90 or the total hourly amounts of $1.80, as the case may be.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(b) *Interest.* All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this chapter.

§ 29.23 (b)–1 *Interest.* Interest paid or accrued within the year on indebtedness may be deducted from gross income, except that interest on indebtedness incurred or continued to purchase or carry obligations, such as municipal bonds, Panama Canal loan 3 percent bonds, or (in case of a taxpayer not an original subscriber) obligations of the United States issued after September 24, 1917, the interest upon which is wholly exempt from tax, is not deductible. Interest paid or accrued within the year on indebtedness incurred or continued to purchase or carry (a) obligations of the United States issued after September 24, 1917, the interest upon which is not wholly exempt from the taxes imposed by chapter 1, or (b) (in the case of an original subscriber) obligations of the United States issued after September 24, 1917, the interest upon which is wholly exempt from the taxes imposed by chapter 1, is deductible in accordance with the general rule.

Interest paid by the taxpayer on a mortgage upon real estate of which he is the legal or equitable owner, even though the taxpayer is not directly liable upon the bond or note secured by such mortgage, may be deducted as interest on his indebtedness. Payments of Maryland or Pennsylvania ground rents are deductible as interest if the ground rent is redeemable, but are treated as rent if the ground rent is irredeemable and in such case are deductible only to the extent they constitute a proper business expense.

Interest calculated for cost-keeping or other purposes on account of capital or surplus invested in the business which does not represent a charge arising under an interest-bearing obligation, is not an allowable deduction from gross income. Interest paid by a corporation on scrip dividends is an allowable deduction. So-called interest on preferred stock, which is in reality a dividend thereon, cannot be deducted in computing net income. (See, however, section 121 and § 29.22 (a)–17.) In the case of banks and loan or trust companies, interest paid within the year on deposits such as interest paid on moneys received for in-

vestment and secured by interest-bearing certificates of indebtedness issued by such bank or loan or trust company may be deducted from gross income. As to other amounts of interest not deductible under section 23 (b), see section 24 (c).

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(c) *Taxes generally*—(1) *Allowance in general.* Taxes paid or accrued within the taxable year, except—

(A) Federal income taxes;

(B) war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, section 702 of the Revenue Act of 1934, or Subchapter E of Chapter 2, or by any such provisions as amended or supplemented;

(C) income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States, if the taxpayer chooses to take to any extent the benefits of section 131;

(D) estate, inheritance, legacy, succession, and gift taxes; and

(E) taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges.

(2) *Excess-profits tax under chapter 2E—Special rules.* [Paragraph (2) repealed by sec. 105 (c) (2), Rev. Act 1942.]

(3) *Retail sales tax.* In the case of a tax imposed by any State, Territory, District, or possession of the United States, or any political subdivision thereof, upon persons engaged in selling tangible personal property at retail, which is measured by the gross sales price or the gross receipts from the sale or which is a stated sum per unit of such property sold, or upon persons engaged in furnishing services at retail, which is measured by the gross receipts for furnishing such services, if the amount of such tax is separately stated, then to the extent that the amount so stated is paid by the purchaser (otherwise than in connection with the purchaser's trade or business) to such person such amount shall be allowed as a deduction in computing the net income of such purchaser as if such amount constituted a tax imposed upon and paid by such purchaser.

§ 29.23 (c)–1 *Taxes*—(a) *In general.* Subject to the exceptions stated in this section and §§ 29.23 (c)–2 and 29.23 (c)–3, taxes imposed by the United States, any State or Territory, or political subdivision of either, possessions of the United States, or foreign countries, are deductible from gross income for the year in which paid or accrued (see section 43). Estate, inheritance, legacy, succession, and gift taxes and Federal income taxes are not deductible from gross income. The Federal war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, section 702 of the Revenue Act of 1934, and subchapter E of chapter 2 are not deductible from gross income. Income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States are deductible from gross income in cases where the taxpayer does not choose to take to any extent for the taxable year the benefits of section 131 (relating to credit for taxes of foreign countries or possessions of the United States). (See the last sentence of section 131 (a).) See generally §§ 29.131–1 to 29.131–8, inclusive, as to tax credits. Postage is not a tax. Amounts paid to States or Territories under secured debts laws in order to render securities tax exempt are deductible. Automobile license fees are ordinary taxes. In general taxes are deductible only by the person upon whom they are imposed. As to tax paid at the source on interest from tax-free covenant bonds, see section 143 (a) (3).

(b) *State and local sales taxes.* Amounts representing sales taxes paid by a purchaser of services or tangible personal property are deductible by such purchaser as taxes, provided they are not paid in connection with his trade or business. The fact that, under the law imposing it, the incidence of the sales tax does not fall on the purchaser is immaterial. The requirement of section 23 (c) (3) that the amount of the tax must be separately stated will be deemed complied with where it clearly appears that the tax was added to the sales price and collected or charged as a separate item. It is not necessary, for the purposes of this section, that the purchaser be furnished with a sales slip, bill, invoice, or other statement on which the tax is separately stated. Where the law imposing the sales tax for which the taxpayer seeks a deduction contains a prohibition against the seller absorbing the tax, or a provision requiring a posted notice stating that the tax will be added to the quoted price, or a requirement that the tax be separately shown in advertisements or separately stated on all bills and invoices, it is presumed that the amount of the sales tax was separately stated at the time paid by the purchaser.

As used in this section the term "sales tax" means a tax imposed by any State, Territory, District, or possession of the United States, or any political subdivision thereof upon persons engaged in selling tangible personal property at retail, which is measured by the gross sales price or the gross receipts from the sale, or which is a stated sum per unit of such property sold. The term also includes a tax imposed by such authorities upon persons engaged in furnishing services at retail, which is measured by the gross receipts for furnishing such services.

§ 29.23 (c)–2 *Federal duties and excise taxes.* Import or tariff duties paid to the proper customs officers, and business, license, privilege, excise, and stamp taxes paid to internal revenue collectors, are deductible as taxes imposed by the authority of the United States, provided they are not added to and made a part of the expenses of the business or the cost of articles of merchandise with respect to which they are paid, in which case they cannot be separately deducted. (See § 29.23 (a)–1.)

§ 29.23 (c)–3 *Taxes for local benefits.* So-called taxes, more properly assessments, paid for local benefits, such as street, sidewalk, and other like improvements, imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied, do not constitute an allowable deduction from gross income. A tax is considered assessed against local benefits when the property subject to the tax is limited to property benefited. Special assessments are not deductible, even though an incidental benefit may inure to the public welfare. The real property taxes deductible are those levied for the general public welfare by the proper taxing authorities at a like rate against all property in the territory over which such authorities have jurisdiction. Assessments under the statutes of California relating to irrigation and of Iowa relating to drainage, and under certain statutes of Tennessee relating to levees, are limited to property benefited, and if the assessments are so limited, the amounts paid thereunder are not deductible as taxes. The above statements are subject to the exception that in so far as assessments against local benefits are made for the purpose of maintenance or repair or for the purpose of meeting interest charges with respect to such benefits, they are deductible. In such cases the burden is on the taxpayer to show the allocation of the amounts assessed to the different purposes. If the allocation cannot be made, none of the amounts so paid is deductible.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs, 301, 506 (b), 2d Rev. Act. 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(d) *Taxes of shareholders paid by corporation.* The deduction for taxes allowed by subsection (c) shall be allowed to a corporation in the case of taxes imposed upon a shareholder of the corporation upon his interest as shareholder which are paid by the corporation without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes.

§ 29.23 (d)–1 *Tax on bank or other stock.* Banks or other corporations paying taxes assessed against their shareholders on account of their ownership of the shares of stock issued by such corporations without reimbusement from such shareholders may deduct the amount of taxes so paid. The Internal Revenue Code specifically provides, however, that in such cases the shareholders may not deduct the amount of the taxes. The amount so paid should not be included in the income of the shareholder.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126

(a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(e) *Losses by individuals.* In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

§ 29.23 (e)–1 *Losses by individuals.* Losses sustained by individual citizens or residents of the United States and not compensated for by insurance or otherwise are fully deductible if (a) incurred in the taxpayer's trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck, or other casualty, or theft, and a deduction therefor has not prior to the filing of the return been claimed for estate tax purposes in the estate tax return, or (d) if not prohibited or limited by any of the following sections of the Internal Revenue Code: Sections 23 (g) and 117, relating to capital losses; section 23 (h), relating to wagering losses; section 24 (b), relating to losses from sales or exchanges of property between persons designated therein; section 112, relating to recognition of gain or loss upon sales or exchanges of property; section 118, relating to losses on wash sales of stock or securities; section 251, relating to income from sources within possessions of the United States; and section 252, relating to citizens of possessions of the United States. See section 213 as to limitation upon losses sustained by nonresident aliens.

In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. Full consideration must be given to any salvage value and to any insurance or other compensation received in determining the amount of losses actually sustained. See section 113 (b). For special provisions with respect to war losses, see section 127.

A loss occasioned by damage to an automobile maintained for pleasure, where such damage results from the faulty driving of the taxpayer or other person operating the automobile, but is not due to the willful act or negligence of the taxpayer, is a deductible loss in the computation of net income. If damage to a taxpayer's automobile results from the faulty driving of the operator of an automobile with which the automobile of the taxpayer collides, the loss occasioned to the taxpayer by such damage is likewise deductible.

No loss is realized by the transfer of property by gift or by death. But see section 44 (d).

A loss on the sale of residential property purchased or constructed by the taxpayer for use as his personal residence and so used by him up to the time of the sale is not deductible. If, however, property so purchased or constructed is prior to its sale rented or otherwise appropriated to income-producing purposes and is used for such purposes up to the time of its sale, a loss from the sale of the property, computed as provided in section 111, is, subject to the limitations provided in section 117, an allowable deduction in an amount not to exceed the excess of the value of the property at the time it was appropriated to income-producing purposes (with proper adjustment for depreciation) over the amount realized from the sale.

Example (1). Residential property was purchased by a taxpayer in 1932 for use as his personal residence at a cost of $25,000, of which $15,000 was allocable to the building. The property was so used by the taxpayer until January 1, 1939. From that date to January 1, 1942, when the property was sold, it was rented by the taxpayer. The fair market value of the property at the time it was rented on January 1, 1939, was $22,000, of which $12,000 was allocable to the building. The building had an estimated life of 20 years on January 1, 1939. The property was sold on January 1, 1942, for $16,000. The loss from the sale allowable as a deduction, except as limited by section 117, is $4,200, computed as follows:

Cost of property in 1932	$25,000
Less depreciation allowed (not less than amount allowable) in respect of the building (depreciation for 8 years at 5 percent based on $12,000, value of building when converted to business use)	1,800
	23,200
Selling price of property	16,000
Loss computed as provided in section 111	7,200
Value of property at time it was rented on January 1, 1939	22,000
Less proper adjustment for depreciation	1,800
	20,200
Selling price of property	16,000
Portion of $7,200 loss which is deductible except as limited by section 117	4,200

Example (2). If, under the circumstances set forth in example (1), the property had been purchased at a cost of $20,000, of which $10,000 was allocable to the building, but otherwise the facts assumed are the same, the deductible loss, except as limited by section 117, is $2,500, computed as follows:

Cost of property in 1932	$20,000
Less depreciation allowed (not less than amount allowable) in respect of the building (depreciation for 8 years at 5 percent based on $10,000, cost of building)	1,500
	18,500
Selling price of property	16,000
Loss computed as provided in section 111	2,500
Deductible loss, except as limited by section 117	2,500

Losses from the sale or other disposition of Treasury bills issued after June 17, 1930, and before March 1, 1941, are not deductible.

§ 29.23 (e)–2 *Voluntary removal of buildings.* Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements is deductible from gross income. When a taxpayer buys real estate upon which is located a building, which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and building plus the cost of removing the useless building.

§ 29.23 (e)–3 *Loss of useful value.* When, through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the basis (adjusted as provided in section 113 (b) and §§ 29.113 (a) (14)–1 and 29.113 (b) (1)–1 to 29.113 (b) (3)–2, inclusive) and the salvage value of the property. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost or change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be fully explained in the return of income. The limitations provided in section 117 with respect to the sale or exchange of capital assets have no application to losses due to the discarding of capital assets.

If the depreciable assets of a taxpayer consist of more than one item and depreciation, whether in respect of items or groups of items, is based upon the average lives of such assets, losses claimed on the normal retirement of such assets are not allowable, inasmuch as the use of an average rate contemplates a normal retirement of assets both before and after the average life has been reached and there is, therefore, no possibility of ascertaining any actual loss under such circumstances until all assets contained in

the group have been retired. In order to account properly for such retirement the entire cost or other basis of assets retired, adjusted for salvage, will be charged to the depreciation reserve account, which will enable the full cost or other basis of the property to be recovered.

In cases in which depreciable property is disposed of due to causes other than exhaustion, wear and tear, and normal obsolescence, such as casualty, obsolescence other than normal, or sale, a deduction for the difference between the basis of the property (adjusted as provided in section 113 (b) and §§ 29.113 (a) (14)–1, and 29.113 (b) (1)–1 to 29.113 (b) (3)–2, inclusive) and its salvage value and/or amount realized upon its disposition may be allowed subject to the limitations provided in the Internal Revenue Code upon deductions for losses, but only if it is clearly evident that such disposition was not contemplated in the rate of depreciation.

In the case of classified accounts, if it is the consistent practice of the taxpayer to base the rate of depreciation on the expected life of the longest lived asset contained in the account, or in the case of single item accounts if the rate of depreciation is based on the maximum expected life of the asset, a deduction for the basis of the asset (adjusted as provided in section 113 (b) and §§ 29.113 (a) (14)–1, and 29.113 (b) (1)–1 to 29.113 (b) (3)–2, inclusive) less its salvage value is allowable upon its retirement. (See §§ 29.23 (l)–1 to 29.23 (l)–10, inclusive.)

§ 29.23 (e)–(4) *Shrinkage in value of stocks.* A person possessing stock of a corporation cannot deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. If stock of a corporation becomes worthless, its cost or other basis as determined and adjusted under section 113 and §§ 29.113 (b) (1)–1 to 29.113 (b) (3)–2, inclusive, is deductible by the owner for the taxable year in which the stock became worthless, provided a satisfactory showing is made of its worthlessness. Federal or State authorities incident to the regulation of banks and certain other corporations may require that stock be charged off as worthless or written down to a nominal value. If, in any such case, the basis of the requirement is the worthlessness of the stock, such charging off or writing down will, for income tax purposes, be considered prima facie evidence of worthlessness; but if the charging off or writing down is due to market fluctuations, or if no reasonable attempt has been made to determine worthlessness, no deduction for income tax purposes of the amount so charged off or written down can be allowed. For dealers in securities, see § 29.22 (c)–5. For limitations on deductions for losses from sales or exchanges of capital assets generally, including stocks and bonds, see section 117.

§ 29.23 (e)–5 *Losses of farmers.* Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for favorable markets, no deduction on account of shrinkage in weight or physical value or by reason of deterioration in storage shall be allowed, except as such shrinkage may be reflected in an inventory if used to determine profits. The total loss by frost, storm, flood, or fire of a prospective crop is not a deductible loss in computing net income. A farmer engaged in raising and selling stock, such as cattle, sheep, horses, etc., is not entitled to claim as a loss the value of animals that perish from among those animals that were raised on the farm, except as such loss is reflected in an inventory if used. If livestock has been purchased after February 28, 1913, for any purpose, and afterwards dies from disease, exposure, or injury, or is killed by order of the authorities of a State or the United States, the actual purchase price of such livestock, less any depreciation allowable as a deduction in respect of such perished livestock, may be deducted as a loss if the loss is not compensated for by insurance or otherwise. The actual cost of other property (with proper adjustment for depreciation) which is destroyed by order of the authorities of a State or of the United States, may in like manner be claimed as a loss. If reimbursement is made by a State or the United States in whole or in part on account of stock killed or other property destroyed in respect of which a loss was claimed for a prior year, the amount received shall be reported as income for the year in which reimbursement is made. The cost of any feed, pasture, or care which has been deducted as an expense of operation shall not be included as part of the cost of the stock for the purpose of ascertaining the amount of a deductible loss. If gross income is ascertained by inventories, no deduction can be made for livestock or products lost during the year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of livestock or products on hand at the close of the year. If an individual owns and operates a farm, in addition to being engaged in another trade, business, or calling, and sustains a loss from such operation of the farm, then the amount of loss sustained may be deducted from gross income received from all sources, provided the farm is not operated for recreation or pleasure. As to losses claimed as deductions for estate tax purposes, see § 29.23 (e)–1. See also §§ 29.22 (a)–7, 29.23 (a)–11, and 29.23 (l)–10.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(f) *Losses by corporations.* In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

§ 29.23 (f)–1 *Losses by corporations.* Losses sustained by domestic corporations during the taxable year and not compensated for by insurance or otherwise are deductible in so far as not prohibited or limited by sections 23 (g), 23 (h), 24 (b), 112, 117, 118, and 251. The provisions of §§ 29.23 (e)–1 to 29.23 (e)–5, inclusive, and § 29.23 (i)–1 are in general applicable to corporations as well as individuals. See section 232 as to deductions by foreign corporations. For special provisions with respect to war losses, see section 127.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(g) *Capital losses*—(1) *Limitation.* Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

(2) *Securities becoming worthless.* If any securities (as defined in paragraph (3) of this subsection) become worthless during the taxable year and are capital assets, the loss resulting therefrom shall, for the purposes of this chapter, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

(3) *Definition of securities.* As used in this paragraph (2) of subsection [1] the term "securities" means (A) shares of stock in a corporation, and (B) rights to subscribe for or to receive such shares.

(4) *Stock in affiliated corporation.* For the purposes of paragraph (2) stock in a corporation affiliated with the taxpayer shall not be deemed a capital asset. For the purposes of this paragraph a corporation shall be deemed to be affiliated with the taxpayer only if:

(A) at least 95 per centum of each class of its stock is owned directly by the taxpayer; and

(B) more than 90 per centum of the aggregate of its gross incomes for all taxable years has been from sources other than royalties, rents, dividends, interest, annuities, or gains from sales or exchanges of stocks and securities; and

(C) the taxpayer is a domestic corporation.

§ 29.23 (g)–1 *Capital Losses.* Section 23 (g) provides in effect that deductions allowed to individuals under section 23 (e) and to corporations under section 23 (f) for losses sustained on the sale or exchange of a capital asset shall be limited in amount to the extent provided in section 117. Losses sustained by virtue of securities becoming worthless during the taxable year are, under section 23 (g), made subject to the limitations provided in section 117 with respect to sales or exchanges, provided the securities are "capital assets" as that term is defined in § 29.117 (a)–1. For purposes of computing the net income of any taxpayer, such losses are to be considered as being sustained from the sale or exchange of the securities on the last day of the taxable year, irrespective of when during the taxable year such securities actually became worthless. Section 23 (g) does not apply to securities which

[1] So in original. "As used in paragraph (2) of this subsection" evidently intended.

are deemed destroyed or seized under section 127, relating to war losses.

As used in section 23 (g) and this section the term "securities" means shares of stock in a domestic or foreign corporation and rights to subscribe for or to receive such shares.

The application of section 23 (g) may be illustrated as follows:

Example. A, an individual, who is not a dealer in corporate stocks or stock rights and whose taxable year is the calendar year, purchased 120 shares of stock in the X Corporation on February 1, 1941, for which he paid $3,000. In June 1942 the stock became worthless. A is entitled to a deduction of $1,500 in computing his net income for 1942. The deduction is computed as follows:

Purchase price	$3,000
Amount realized	None
Actual loss	$3,000
Period stock considered to have been held (February 1, 1941, to December 31, 1942)	23 months
Percentage of loss taken in account under section 117 (b)	50 percent
Long-term capital loss (50 percent of $3,000) (section 117 (a) (5))	$1,500

§ 29.23 (g)–2 *Loss on stock of affiliate.* If a taxpayer is a domestic corporation and is affiliated, within the definition in section 23 (g) (4), with another corporation, the stock in such affiliated corporation owned by the taxpayer is not considered to be a "capital asset" of the taxpayer for the purpose of determining the loss from the worthlessness of such stock within the provisions of section 23 (g) (2) and § 29.23 (g)–1. For the purposes of section 23 (g) (2), section 23 (g) (4), § 29.23 (g)–1, and this section a corporation shall be deemed to be affiliated with the taxpayer only if all the following factors are present:

(a) The taxpayer owns directly at least 95 percent of each class of the stock of such corporation,

(b) More than 90 percent of the aggregate of the gross incomes of such corporation for all the taxable years during which it has been in existence has been from sources other than royalties, rents, dividends, interest, annuities, or gains from sales or exchanges of stocks and securities, and

(c) The taxpayer is a domestic corporation.

Example. Corporation P, a domestic manufacturing corporation which makes its income tax returns on the calendar year basis, owns 100 percent of each class of the stock of Corporation S, and, in addition, 4 percent of the common stock (the only class of stock) of Corporation R which it acquired in 1936. Corporation S, a domestic manufacturing corporation which makes its income tax returns on the calendar year basis, owns 96 percent of the common stock of Corporation R which it acquired in 1934. It is established that the stock of Corporation R which has from its inception derived all its gross income from manufacturing operations, became worthless during 1942. Since Corporation P does not own directly at least 95 percent of the stock of Corporation R, and therefore for the purposes of section 23 (g) (4) and this section is not affiliated with Corporation R, the stock of such corporation is a capital asset. Any loss upon such stock, under section 23 (g) (2), will be considered to be a loss from the sale or exchange of a capital asset. Since such stock was held for more than six months, such loss shall be considered a long-term capital loss under section 117. (See also section 117 (d).) Since Corporation R is deemed to be affiliated with Corporation S for the purposes of section 23 (g) (4) and this section, the stock of Corporation R is not a "capital asset" in the hands of Corporation S for the purposes of section 23 (g) (2) and section 29.23 (g) 1. Consequently, in computing the net income of Corporation S for 1942, any loss upon such stock, under section 23 (f), will be deducted as an ordinary loss and will not be circumscribed by the provisions of section 23 (g) or section 117.

With respect to losses on bonds and similar securities, as defined in section 23 (k) (5), of a corporation affiliated with the taxpayer, as provided in such section, see § 29.23 (k)–4.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act. 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(h) *Wagering losses.* Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.

§ 29.23 (h)–1 *Wagering losses.* Deductions for losses from wagering transactions are allowed only to the extent of gains from such transactions. In the case of a husband and wife making a joint return, the combined losses of the spouses as a result of wagering transactions shall be allowed to the extent of the combined gains of the spouses from such transactions.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224 Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a), (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(i) *Basis for determining loss.* The basis for determining the amount of deduction for losses sustained, to be allowed under subsection (e) or (f), and for bad debts, to be allowed under subsection (k), shall be the adjusted basis provided in section 113 (b) for determining the loss from the sale or other disposition of property.

§ 29.23(i)–1 *Basis for determining loss.* The basis for determining the amount of the deduction for losses allowed to individuals under section 23 (e) and to corporations under section 23 (f), or of the amount of the deduction for bad debts allowed to both individuals and corporations under section 23 (k), is the same as is provided in section 113 for determining the loss from the sale or other disposition of property. Proper adjustment must be made in each case for any expenditure, receipt, loss, or other item properly chargeable to capital account, and for depreciation, obsolescence, amortization, or depletion. (See section 113 (b) and §§ 29.113 (b) (1)–1 to 29.113 (b) (3)–2, inclusive.)

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a), (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(j) *Loss on wash sales of stock or securities.* For disallowance of loss deduction in the case of sales of stock or securities where within thirty days before or after the date of the sale the taxpayer has acquired substantially identical property, see section 118.

(k) *Bad debts*—(1) *General rule.* Debts which become worthless within the taxable year; or (in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part which becomes worthless within the taxable year, as a deduction. This paragraph shall not apply in the case of a taxpayer, other than a bank, as defined in section 104, with respect to a debt evidenced by a security as defined in paragraph (3) of this subsection. This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection. [The last sentence of this paragraph is, under section 124 (d), Rev. Act, 1942, applicable only with respect to taxable years beginning after December 31, 1942.]

(2) *Securities becoming worthless.* If any securities (as defined in paragraph (3) of this subsection) become worthless within the taxable year and are capital assets, the loss resulting therefrom shall, in the case of a taxpayer other than a bank, as defined in section 104, for the purposes of this chapter, be considered as a loss from the sale or exchange on the last day of such taxable year, of capital assets.

(3) *Definition of securities.* As used in paragraphs (1), (2), and (4) of this subsection the term "securities" means bonds, debentures, notes, or certificates, or other evidences of indebtedness, issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form.

(4) *Non-business debts.* In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. The term "non-business debt" means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business. [This paragraph is, under sec. 124 (d), Rev. Act 1942, applicable only with respect to taxable years beginning after December 31, 1942.]

(5) *Securities of affiliated corporations.* Bonds, debentures, notes or certificates, or other evidences of indebtedness issued with interest coupons or in registered form by any corporation affiliated with the taxpayer shall not be deemed capital assets for the purposes of paragraph (2) and paragraph (1) shall apply with respect to such debt except that no such deduction shall be allowed under such paragraph with respect to any such debt which is recoverable only in part. For the purposes of this paragraph a corporation shall be deemed to be affiliated with the taxpayer only if:

(A) at least 95 per centum of each class of its stock is owned directly by the taxpayer; and

(B) more than 90 per centum of the aggregate of its gross incomes for all taxable years has been from sources other than royalties, rents, dividends, interest or annuities or gains from sales or exchanges of stock and securities; and

(C) the taxpayer is a domestic corporation.

§ 29.23 (k)–1 *Bad debts.* (a) Bad debts may be treated in either of two ways:

(1) By a deduction from income in respect of debts which become worthless in whole or in part, or

(2) By a deduction from income of an addition to a reserve for bad debts.

Taxpayers were given a similar option for 1921 to select either of the methods mentioned for treating such debts. (See article 151, Regulations 62.) While ascertainment of worthlessness and charge-off during the taxable year (which were prerequisite to deduction of a bad debt under the law at that time) are no longer required for the allowance of a debt which becomes worthless, the method used in the return for 1921 must be used in returns for all subsequent years unless permission is granted by the Commissioner to change to the other method. A taxpayer filing a first return of income may select either of the two methods subject to approval by the Commissioner upon examination of the return. If the method selected is approved, it must be followed in returns for subsequent years, except as permission may be granted by the Commissioner to change to another method. Application for permission to change the method of treating bad debts shall be made at least 30 days prior to the close of the taxable year for which the change is to be effective. (See also § 29.23 (k)–5.)

(b) If, from all the surrounding and attending circumstances, the Commissioner is satisfied that a debt is partially worthless, the amount which has become worthless during the taxable year shall be allowed as a deduction in computing net income. Before a taxpayer may deduct a debt in part, he must be able to demonstrate to the satisfaction of the Commissioner the amount thereof which is uncollectible and the part thereof which has become worthless during the taxable year. If a debt becomes wholly worthless during the taxable year, the amount thereof which has not been allowed as a deduction for any prior taxable year shall be allowed as a deduction for the taxable year. There should accompany the return a statement of facts substantiating any deduction claimed for bad debts. Any amount subsequently received on account of a bad debt or on account of a part of such debt previously allowed as a deduction for income tax purposes, must be included in gross income for the taxable year in which received, except to the extent excludible from gross income under the provisions of section 22 (b) (12). In determining whether a debt is worthless in whole or in part the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. Partial deductions will be allowed with respect to specific debts only.

Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. In bankruptcy cases a debt may become worthless before settlement in some instances, and in others only when a settlement in bankruptcy shall have been had. In either case the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, confirming the conclusion that the debt is worthless, will not authorize shifting the deductions to such later year. If a taxpayer computes his income upon the basis of valuing his notes or accounts receivable at their fair market value when received, which may be less than their face value, the amount deductible for bad debts in any case is limited to such original valuation.

(c) Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders of such supervisory officers charge off debts in whole or in part, such debts shall, to the extent charged off during the taxable year, be conclusively presumed, for income tax purposes, to have become worthless or worthless only in part during the taxable year, as the case may be. But no such debt shall be so conclusively presumed to be worthless or worthless only in part, as the case may be, if the amount so charged off is not claimed as a deduction by the taxpayer at the time of filing the return for the taxable year in which such charge-off takes place. If a taxpayer does not claim a deduction in its return for such a totally or partially worthless debt for the year in which such charge-off takes place, but claims such deduction for the taxable year in which the debt becomes worthless or partially worthless, as the case may be, then such charge-off will be deemed to have been involuntary and the deduction shall be allowed for the year in which the debt becomes worthless or partially worthless, as the case may be.

(d) The provisions of paragraphs (a) and (b) of this section apply to all taxpayers, except that (1) they do not apply in the case of a taxpayer, other than a corporation, with respect to a nonbusiness debt as defined in paragraph (4) of section 23 (k) of the Code; (2) no deduction on account of worthlessness shall be allowed with respect to any debt of the type enumerated in section 23 (k) (5) of the Code which is recoverable only in part; and (3) in the case of taxpayers other than banks as defined in section 104, the term "debts" as used in such subdivisions means obligations to pay fixed or determinable sums of money which are not evidenced by securities as defined in § 29.23 (k)–4.

§ 29.23 (k)–2 *Examples of bad debts.* Worthless debts arising from unpaid wages, salaries, rents, and similar items of taxable income will not be allowed as a deduction unless the income such items represent has been included in the return of income for the year for which the deduction as a bad debt is sought to be made or for a previous year. Only the difference between the amount received in distribution of the assets of a bankrupt and the amount of the claim may be deducted as a bad debt. The difference between the amount received by a creditor of a decedent in distribution of the assets of the decedent's estate and the amount of his claim may be considered a worthless debt. A purchaser of accounts receivable which become worthless is entitled to deduct them, the amount of deduction to be based upon the price he paid for them and not upon their face value.

§ 29.23 (k)–3 *Uncollectible deficiency upon sale of mortgaged or pledged property.* If mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt, and the portion of the indebtedness remaining unsatisfied after such sale is wholly or partially uncollectible, the mortgagee or pledgee may deduct such amount (to the extent that it constitutes capital or represents an item the income from which has been returned by him) as a bad debt for the taxable year in which it has become wholly or partially worthless. In addition, if the creditor buys in the mortgaged or pledged property, loss or gain is realized measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or bid price of the property to the extent that such obligations constitute capital or represent an item the income from which has been returned by him) and the fair market value of the property. The fair market value of the property shall be presumed to be the amount for which it is bid in by the taxpayer in the absence of clear and convincing proof to the contrary. If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

Accrued interest may be included as part of the deduction only if it has previously been returned as income.

§ 29.23 (k)–4 *Worthless bonds and similar obligations.* Except as otherwise provided in section 23 (k) (5), no deduction is allowable under section 23 (k) (1) to any taxpayer (other than a bank as defined in section 104) with respect to a debt evidenced by a security which has become worthless in whole or in part. If a security is a capital asset and becomes worthless during the taxable year, a deduction for the loss resulting therefrom is allowable under section 23 (k) (2) to a taxpayer other than a bank. Such a loss, however, is made subject to the limitations provided in section 117 with respect to sales or exchanges. For the purposes of computing the net income of any taxpayer, other than a bank as defined in section 104, such a loss is to be considered as being sustained from the sale or exchange of the security on the last day of the taxable year, irrespective of when during the taxable year such security actually became worthless. Except in the case of a bank as defined in section 104, no deduction is allowable

under section 23 (k) with respect to a debt evidenced by a security, as defined in section 23 (k) (3), which is recoverable only in part. Section 23 (k) (2) does not apply to securities which are deemed destroyed or seized under section 127, relating to war losses.

As used in section 23 (k) (2), the term "security" means a bond, debenture, note, or certificate, or other evidence of indebtedness to pay a fixed or determinable sum of money, which has been issued at any time by a domestic or foreign corporation (including that issued by any government or political subdivision thereof), either in registered form or accompanied by interest coupons.

A bond issued by an individual, if it has become worthless, may be treated as a bad debt. A bond (whether or not a security) of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders is regarded as having become worthless not later than the year of the foreclosure sale, and no deduction is allowable in computing a bondholder's income for a subsequent year.

A taxpayer (other than a dealer in bonds or other similar obligations) possessing debts evidenced by bonds or other similar obligations cannot deduct from gross income any amount merely on account of market fluctuation. If, however, due, for instance, to the financial condition of the debtor, or conditions other than market fluctuation, the taxpayer will recover upon maturity none or only a part of the debt evidenced by the bonds or other similar obligations (which bonds or other obligations are not securities as defined in this section) and he so demonstrates to the satisfaction of the Commissioner, he may deduct in computing the net income the uncollectible part of the debt evidenced by the bonds or other similar obligations. A bank as defined in section 104 may deduct such uncollectible part of the debt even though the evidence of the debt is a security as defined in this section.

The application of section 23 (k) to deductions for worthless bonds and similar obligations which are securities may be illustrated by the following examples:

Example (1). On February 1, 1941, A, an individual, who is not a dealer in corporate bonds, purchased bonds of the X Corporation bearing interest coupons payable semiannually, for which he paid $3,000. During the calendar year 1942 (his taxable year) the bonds became worthless. A is entitled to a deduction of $1,500 in computing his net income for 1942. The computation of the amount of the deduction is the same as the computation in the example under § 29.23 (g)–1.

Example (2). If the facts in example (1) are the same except that because of the financial condition of the X Corporation the debt evidenced by its bonds became recoverable only in part, no deduction is allowable to A under either section 23 (k) (1) or (2) with respect to the uncollectible part of such debt.

Under section 23 (k) (5), bonds, debentures, notes or certificates, or other evidences of indebtedness to pay a fixed or determinable sum of money, issued with interest coupons or in registered form by any corporation affiliated with the taxpayer, shall not be deemed capital assets of the taxpayer for the purposes of section 23 (k) (2) or as a debt (evidenced by a security) for the purposes of this section; and the provisions of section 23 (k) (1) and of paragraphs (a) and (b) of § 29.23 (k)–1 shall apply with respect to such debts except that no deduction shall be allowed to the taxpayer with respect to any such debt which is recoverable only in part. For the purposes of this section, a corporation is deemed to be affiliated with the taxpayer only if the taxpayer owns at least 95 percent of each class of the stock of such corporation, if more than 90 percent of the aggregate of the gross incomes of such corporation for all taxable years has been from sources other than royalties, rents, dividends, interest, or annuities, or gains from the sales or exchanges of stocks and securities and if the taxpayer is a domestic corporation.

§ 29.23 (k)–5. *Reserve for bad debts.* Taxpayers who have established the reserve method of treating bad debts and maintained proper reserve accounts for bad debts, or who, in accordance with § 29.23 (k)–1, adopt the reserve method of treating bad debts, may deduct from gross income a reasonable addition to a reserve for bad debts in lieu of a deduction for specific bad debt items.

What constitutes a reasonable addition to a reserve for bad debts must be determined in the light of the facts, and will vary as between classes of business and with conditions of business prosperity. It will depend primarily upon the total amount of debts outstanding as of the close of the taxable year, those arising currently as well as those arising in prior taxable years, and the total amount of the existing reserve. In case subsequent realizations upon outstanding debts prove to be more or less than estimated at the time of the creation of the existing reserve, the amount of the excess or inadequacy in the existing reserve should be reflected in the determination of the reasonable addition necessary in the taxable year. A taxpayer using the reserve method should make a statement in his return showing the volume of his charge sales (or other business transactions) for the year and the percentage of the reserve to such amount, the total amount of notes and accounts receivable at the beginning and close of the taxable year, and the amount of the debts which have become wholly or partially worthless and have been charged against the reserve account.

§ 29.23 (k)–6 *Non-business bad debts.* In the case of a taxpayer, other than a corporation, if a non-business bad debt becomes entirely worthless within a taxable year beginning after December 31, 1942, the loss resulting therefrom shall be treated as a loss from the sale or exchange of a capital asset held for not more than six months. Such a loss is subject to the limitations provided in section 117 with respect to gains and losses from the sale and exchange of capital assets. A loss with respect to such a debt will be treated as sustained only if and when the debt has become totally worthless, and no deduction shall be allowed for a non-business debt which is recoverable in part during the taxable year. Nor are the provisions of this section applicable in the case of a loss resulting from a security as defined in section 23 (k) (3). A non-business debt is a debt, other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business and other than a debt evidenced by a security as that term is defined in section 23 (k) (3). The question whether a debt is one the loss from the worthlessness of which is incurred in the taxpayer's trade or business is a question of fact in each particular case. The determination of this question is substantially the same as that which is made for the purpose of ascertaining whether a loss from the type of transaction covered by section 23 (e) is "incurred in trade or business" under paragraph (1) of that section.

The character of the debt for this purpose is not controlled by the circumstances attending its creation or its subsequent acquisition by the taxpayer or by the use to which the borrowed funds are put by the recipient, but is to be determined rather by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. If that relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt is not a non-business debt for the purposes of this amendment.

To illustrate: A, an individual engaged in the grocery business and who makes his income tax returns on the calendar year basis, extends credit on an open account to B in 1941.

(1) In 1942 A sells the business but retains the claim against B. The claim becomes worthless in A's hands in 1943. A's loss is controlled by the nonbusiness debt provisions. While the original consideration was advanced by A in his trade or business, the loss was not sustained as a proximate incident to the conduct of any trade or business in which he was engaged at the time the claim became worthless.

(2) In 1942 A sells the business to C but sells the claim against B to the taxpayer, D. The claim becomes worthless in D's hands in 1943, at a time when D is not engaged in a trade or business incident to the conduct of which a loss from the worthlessness of such a claim would be a proximate result. D's loss is controlled by the nonbusiness debt provisions, even though the original consideration was advanced by A in his trade or business.

(3) In 1942 A dies, leaving the business, including the accounts receivable, to his son, C, the taxpayer. The claim against B becomes worthless in C's hands. C's loss is not controlled by the nonbusiness debt provisions. While C did not advance any consideration for the claim or acquire it in carrying on his trade or business, the loss was sustained as a proximate incident to the conduct of the trade or business in which he was engaged at the time the debt became worthless.

(4) In 1942 A dies, leaving the business to his son, C, but the claim against B to his son, D, the taxpayer. The claim against B becomes worthless in D's hands in 1943, at a time when D is not engaged in a trade or business incident to the conduct of which a loss from the worthlessness of such a claim would be a proximate result. D's loss is controlled by the nonbusiness debt provisions, even though the original consideration was advanced by A in his trade or business.

(5) In 1942 A dies and while his executor, C, is carrying on the business, the claim against B becomes worthless. The loss sustained by A's estate is not controlled by the nonbusiness debt provisions. While C did not advance any consideration for the claim on behalf of the estate or acquire it in carrying on a trade or business in which the estate was engaged, the loss was sustained as a proximate incident to the conduct of the trade or business in which the estate was engaged at the time the debt became worthless.

(6) In 1942, A, in liquidating the business, attempts to collect B's claim but finds that it has become worthless. A's loss is not controlled by the non-business debt provisions, since a loss incurred in liquidating a trade or business is a proximate incident to the conduct thereof.

The provisions of this section with respect to non-business debts are applicable only to taxable years beginning after December 31, 1942.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(l) *Depreciation.* A reasonable allowance for the exhauston, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

§ 29.23 (l)–1 *Depreciation.* A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or treated under § 29.23 (a)–15 as held by the taxpayer for the production of income, may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis of the property determined in accordance with section 113. Due regard must also be given to expenditures for current upkeep. In the case of property held by one person for life with remainder to another person, the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property so that he will be entitled to the deduction during his life, and thereafter the deduction, if any, will be allowed to the remainderman. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustee and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee. For deduction with respect to the amortization of emergency facilities, in lieu of the deduction for depreciation, see sections 23 (t) and 124.

§ 29.23 (l)–2 *Depreciable property.* The necessity for a depreciation allowance arises from the fact that certain property used in the business, or treated under § 29.23 (a)–15 as held by the taxpayer for the production of income, gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the business. It does not apply to inventories or to stock in trade, or to land apart from the improvements or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provisions for this being made in the Internal Revenue Code. (See sections 23 (m) and 114.) Property kept in repair may, nevertheless, be the subject of a depreciation allowance. (See § 29.23 (a)–4.) The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business, or treated under § 29.23 (a)–15 as held by the taxpayer for the production of income. No such allowance may be made in respect of automobiles or other vehicles used solely for pleasure, a building used by the taxpayer solely as his residence, or in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be the subject of a depreciation allowance.

§ 29.23 (l)–3 *Depreciation of intangible property.* Intangibles, the use of which in the trade or business or in the production of income is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses, and franchises. Intangibles, the use of which in the business or trade or in the production of income is not so limited, will not usually be a proper subject of such an allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business or in the production of income for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner. No deduction for depreciation, including obsolescence, is allowable in respect of good will.

§ 29.23 (l)–4 *Capital sum recoverable through depreciation allowances.* The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. (See sections 113 (a) and 114.) To this amount should be added from time to time the cost of improvements, additions, and betterments, and from it should be deducted from time to time the amount of any definite loss or damage sustained by the property through casualty, as distinguished from the gradual exhaustion of its utility which is the basis of the depreciation allowance. (See section 113 (b).) In the case of the acquisition on or after March 1, 1913, of a combination of depreciable and nondepreciable property for a lump price, as, for example, buildings and land, the capital sum to be replaced is limited to an amount which bears the same proportion to the lump price as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time. In the case of property which has been the subject of deductions for amortization under sections 214 (a) (9) and 234 (a) (8) of the Revenue Acts of 1918 and 1921, depreciation deductions will be computed after the close of the amortization period upon the cost or other basis of such property after the amortization allowance has been deducted. No depreciation deduction will be allowed in the case of property which has been amortized to its scrap value and is no longer in use.

§ 29.23 (l)–5 *Method of computing depreciation allowance.* The capital sum to be recovered shall be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made. If the cost or other basis of the property has been recovered through depreciation or other allowances no further deduc-

tion for depreciation shall be allowed. The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such ratable amount as may reasonably be considered necessary to recover during the remaining useful life of the property the unrecovered cost or other basis. The burden of proof will rest upon the taxpayer to sustain the deduction claimed. Therefore, taxpayers must furnish full and complete information with respect to the cost or other basis of the assets in respect of which depreciation is claimed, their age, condition, and remaining useful life, the portion of their cost or other basis which has been recovered through depreciation allowances for prior taxable years, and such other information as the Commissioner may require in substantiation of the deduction claimed.

A taxpayer is not permitted under the law to take advantage in later years of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. This paragraph may be illustrated by the following example:

Example. An asset was purchased January 1, 1937, at a cost of $10,000. The useful life of the asset is 10 years. It has no salvage value. Depreciation was deducted and allowed for 1937 to 1941 as follows:

1937	$1,000.00
1938	----------
1939	2,000.00
1940	2,000.00
1941	----------
Total amount allowed	5,000.00

The correct amended reserve as of December 31, 1941, is computed as follows:

December 31—	
1937	$1,000.00
1938	1,000.00
1939	2,000.00
1940	2,000.00
1941	666.67
Reserve December 31, 1941	6,666.67

Depreciation for 1942 and subsequent taxable years is $666.67, computed as follows:

Cost	$10,000.00
Reserve as of December 31, 1941	6,666.67
Unrecovered cost	3,333.33
Depreciation allowable for 1942 and each subsequent taxable year (6⅔ percent of $10,000)	666.67

§ 29.23 (l)–6 *Obsolescence.* With respect to physical property the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a fuuture date prior to the end of its normal useful life, so that depreciation deductions alone are insufficient to return the cost or other basis at the end of its economic term of usefulness, a reasonable deduction for obsolescence, in addition to depreciation, may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. No deduction for obsolescence will be permitted merely because, in the opinion of a taxpayer, the property may become obsolete at some later date. This allowance will be confined to such portion of the property on which obsolescence is definitely shown to be sustained and cannot be held applicable to an entire property unless all portions thereof are affected by the conditions to which obsolescence is found to be due.

§ 29.23 (l)–7 *Depreciation of patent or copyright.* In computing a depreciation allowance in the case of a patent or copyright, the capital sum to be replaced is the cost or other basis of the patent or copyright. The allowance should be computed by an apportionment of the cost or other basis of the patent or copyright over the life of the patent or copyright since its grant, or since its acquisition by the taxpayer, or in the case of a copyright, since March 1, 1913, as the case may be. If the patent or copyright was acquired from the Government, its cost consists of the various Government fees, cost of drawings, experimental models, attorneys' fees, development or experimental expenses, etc., actually paid. Depreciation of a copyright can be taken on the basis of the fair market value as of March 1, 1913, only when affirmative and satisfactory evidence of such value is offered. Such evidence should whenever practicable be submitted with the return. If the patent becomes obsolete prior to its expiration, such proportion of the amount on which its depreciation may be based as the number of years of its remaining life bears to the whole number of years intervening between the basic date and the date when it legally expires may be deducted. The fact that depreciation has not been taken in prior years does not entitle the taxpayer to deduct in any taxable year a greater amount for depreciation than would otherwise be allowable.

§ 29.23 (l)–8 *Depreciation of drawings and models.* If a taxpayer has incurred expenditures in his business for designs, drawings, patterns, models, or work of an experimental nature calculated to result in improvement of his facilities or his product, and if the period of usefulness of any such asset may be estimated from experience with reasonable accuracy, it may be the subject of depreciation allowances spread over such estimated period of usefulness. The facts must be fully shown in the return or prior thereto to the satisfaction of the Commissioner. Except for such depreciation allowances no deduction shall be made by the taxpayer against any sum so set up as an asset except on the sale or other disposition of such asset at a loss or on proof of a total loss thereof.

§ 29.23 (l)–9 *Records of depreciable property.* In order that the verification of depreciation allowances claimed by the taxpayer may be facilitated, depreciation shall be recorded on the taxpayer's books, the amount measuring a reasonable allowance for depreciation either being deducted directly from the book value of the assets or preferably being credited to a depreciation reserve account, which should be reflected in the annual balance sheet. For the same reason the allowances shall be computed and recorded with express reference to specific items, units, or groups of property, each item or unit being considered separately or specifically included in a group with others to which the same factors apply. Also, the taxpayer's books shall show the basis of the depreciable property and any adjustments thereto, and, in cases where the basis of the property is other than cost, or value on March 1, 1913, or value at date of acquisition (as, for example, if the property was acquired by gift or transfer in trust after December 31, 1920), or through a reorganization or a tax-free exchange (see particularly section 113 (a), the books shall show the data used in ascertaining such basis and the adjustments thereto. If a taxpayer does not desire to have his regular books of account show all of the factors entering into the computation of depreciation allowances, such factors shall be recorded in permanent auxiliary records which shall be kept with and reconciled with the regular books of account.

§ 29.23 (l)–10 *Depreciation in case of farmers.* A reasonable allowance for depreciation may be claimed on farm buildings (other than a dwelling occupied by the owner), farm machinery, and other physical property. A reasonable allowance for depreciation may also be claimed on livestock acquired for work, breeding, or dairy purposes, unless they are included in an inventory used to determine profits in accordance with § 29.22 (a)–7. Such depreciation should be based on the cost or other basis and the estimated life of the livestock. If such livestock be included in an inventory no depreciation thereof will be allowed, as the corresponding reduction in their value will be reflected in the inventory. (See also §§ 29.23(a)–11 and 29.23(e)–5.)

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; Secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(m) *Depletion.* In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be ap-

portioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

For percentage depletion allowable under this subsection, see section 114 (b), (3) and (4).

(n) *Basis for depreciation and depletion.* The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

§ 29.23 (m)–1 *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.* Section 23 (m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

The adjusted basis of depreciable property is returnable through annual depreciation deductions. Depreciation and depletion deductions on the property of a corporation are allowed to the corporation and not to its shareholders. (But see § 29.115–6.) The principles governing the apportionment of depreciation in the case of property held by one person for life with remainder to another person and in the case of property held in trust are also applicable to depletion. (See § 29.23 (l)–1.)

When used in these sections (§§ 29.23 (m)–1 to 29.23 (m)–28, inclusive) covering depletion and depreciation:

(a) The "fair market value" of a property is that amount which would induce a willing seller to sell and a willing buyer to purchase.

(b) A "mineral property" is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface of the land only as is necessary for purposes of mineral extraction. The value of a mineral property is the combined value of its component parts.

(c) The term "mineral deposit" refers to minerals in place. The cost of a mineral deposit is that proportion of the total cost of the mineral property which the value of the deposit bears to the value of the property at the time of its purchase.

(d) "Minerals" include ores of the metals, coal, oil, gas, and such nonmetallic substances as abrasives, asbestos, asphaltum, barytes, borax, building stone, cement rock, clay, crushed stone, feldspar, fluorspar, fuller's earth, graphite, gravel, gypsum, limestone, magnesite, marl, mica, mineral pigments, peat, potash, precious stones, refractories, rock phosphate, salt, sand, silica, slate, soapstone, soda, sulphur, and talc.

(e) The term "mine" does not include oil and gas wells.

(f) "Gross income from the property," as used in section 114 (b) (3) and (4) and §§ 29.23 (m)–1 to 29.23 (m)–28, inclusive, means the amount for which the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine or well, but, if the product is transported or processed (other than by the processes excepted below) before sale, it means the representative market or field price (as of the date of sale) or crude mineral product of like kind and grade before such transportation or processing. If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation and the processes not listed below. The processes excepted are as follows:

(1) In the case of coal—cleaning, breaking, sizing, and loading at the mine for shipment;

(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading at the mine for shipment;

(3) In the case of iron ore, ball and sagger clay or rock asphalt, and ores which are customarily sold in the form of the crude mineral product—sorting or concentrating to bring to shipping grade, and loading at the mine for shipment; and

(4) In the case of lead, zinc, copper, gold, silver, or fluorspar ores and ores which are not customarily sold in the form of the crude mineral product—crushing, concentrating (by gravity or flotation), and other processes to the extent to which they do not beneficiate the product in greater degree (in relation to the crude mineral product on the one hand and the refined product on the other) than crushing and concentrating (by gravity or flotation).

In case any of the excepted processes are not applied in the immediate vicinity of the mining district in which the mine is located, costs incurred for transportation to the processing location and, if transported by taxpayer, the proportionate profits attributable to transportation should be subtracted from the sale price of the product to determine "gross income from the property."

In the case of oil and gas, if the crude mineral product is not sold on the property but is manufactured or converted into a refined product or is transported from the property prior to the sale, then the "gross income from the property" shall be assumed to be equivalent to the market or field price of the oil or gas before conversion or transportation.

In all cases there shall be excluded in determining the "gross income from the property" an amount equal to any rents or royalties which were paid or incurred by the taxpayer in respect of the property and are not otherwise excluded from the "gross income from the property." If royalties in the form of bonus payments have been paid in respect of the property in the taxable year or any prior years or if advanced royalties have been paid in respect of the property in any taxable year ending prior to December 31, 1939, the amount excluded from "gross income from the property" for the current taxable year on account of such payments shall be an amount equal to that part of such payments which is allocable to the product sold during the current taxable year. If advanced royalties have been paid in respect of the property in any taxable year ending on or after December 31, 1939, the amount excluded from "gross income from the property" for the current taxable year on account of such payments shall be an amount equal to the deduction for such taxable year taken on account of such payments pursuant to § 29.23 (m)–10 (e).

(g) "Net income of the taxpayer (computed without allowance for depletion) from the property," as used in section 114 (b) (2), (3), and (4) and §§ 29.23 (m)–1 to 29.23 (m)–28, inclusive, means the "gross income from the property" as defined in paragraph (f) of this section less the allowable deductions attributable to the mineral property upon which the depletion is claimed and the allowable deductions attributable to the processes listed in paragraph (f) in so far as they relate to the product of such property, including overhead and operating expenses, development costs properly charged to expense, depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. Deductions not directly attributable to particular properties or processes shall be fairly allocated. To illustrate: In cases where the taxpayer engages in activities in addition to mineral extraction and to the processes listed in paragraph (f), deductions for depreciation, taxes, general expenses, and overhead, which cannot be directly attributed to any specific activity, shall be fairly apportioned between (1) the mineral extraction and the processes listed in paragraph (f) and (2) the additional activities, taking into account the ratio which the operating expenses directly attributable to the mineral extraction and the processes listed in paragraph (f) bear to the operating expenses directly attributable to the additional

activities. If more than one mineral property is involved, the deductions apportioned to the mineral extraction and the processes listed in paragraph (f) shall, in turn, be fairly apportioned to the several properties, taking into account their relative production.

(h) "Crude mineral product," as used in paragraph (f) of this section, means the product in the form in which it emerges from the mine or well.

(i) "The property," as used in section 114 (b) (2), (3), and (4) and §§ 29.23 (m)–1 to 29.23 (m)–19, inclusive, means the interest owned by the taxpayer in any mineral property. The taxpayer's interest in each separate mineral property is a separate "property"; but, where two or more mineral properties are included in a single tract or parcel of land, the taxpayer's interest in such mineral properties may be considered to be a single "property," provided such treatment is consistently followed.

§ 29.23 (m)–2 *Computation of depletion of mines, oil and gas wells, and other natural deposits without reference to discovery value or percentage depletion.* The basis upon which depletion, other than discovery depletion or percentage depletion, is to be allowed in respect of any property is the basis provided in section 113 (a), adjusted as provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property. (See §§ 29.113 (a)–1 to 29.114–1, inclusive.) If the amount of the basis as adjusted applicable to the mineral deposit has been determined for the taxable year, the depletion for that year shall be computed by dividing that amount by the number of units of mineral remaining as of the taxable year, and by multiplying the depletion unit, so determined, by the number of units of mineral sold within the taxable year. In the selection of a unit of mineral for depletion, preference shall be given to the principal or customary unit or units paid for in the products sold, such as tons of ore, barrels of oil, or thousands of cubic feet of natural gas.

As used in this section the phrase "number of units sold within the taxable year," in the case of a taxpayer reporting income on the cash receipts and disbursements basis, includes units for which payments were received within the taxable year although produced or sold prior to the taxable year, and excludes units sold but not paid for in the taxable year. The phrase does not include units with respect to which depletion deductions were allowed or allowable prior to the taxable year.

"The number of units of mineral remaining as of the taxable year" is the number of units of mineral remaining at the end of the year to be recovered from the property (including units recovered but not sold) plus the "number of units sold within the taxable year" as defined in this section.

In determining the amount of the basis as adjusted applicable to the mineral deposit there shall be excluded (a) amounts representing the cost or value of the land for purposes other than mineral production, (b) the amount recoverable through depreciation and through deductions other than depletion, and (c) the residual value of other property at the end of operations, but there shall be included, in the case of oil and gas wells, those amounts of capitalized drilling and development costs which, as provided in § 29.23 (m)–16, are recoverable through depletion.

In the case of a natural gas well where the annual production is not metered and is not capable of being estimated with reasonable accuracy, the taxpayer may compute the depletion allowance (without reference to percentage depletion) in respect of such property for the taxable year by multiplying the adjusted basis of the property by a fraction, the numerator of which is equal to the decline in closed or rock pressure during the taxable year and the denominator of which is equal to the expected total decline in closed or rock pressure from the taxable year to the economic limit of production. Taxpayers computing depletion by this method must keep accurate records of periodical pressure determinations.

§ 29.23 (m)–3 *Computation of depletion of mines (other than metal, coal, fluorspar, ball and sagger clay, rock asphalt, or sulphur mines) on basis of discovery value.* The basis upon which depletion is to be computed in the case of mines (other than metal, coal, fluorspar, ball and sagger clay, rock asphalt, or sulphur mines) discovered by the taxpayer after February 28, 1913, is the fair market value of the property at the date of discovery or within 30 days thereafter, if such mines were not acquired as the result of purchase of a proven tract or lease, and if the fair market value of the property is materially disproportionate to cost. The value must be equitably apportioned between the owners of the economic interests therein. For the method of determining whether a discovery has been made, see § 29.23 (m)–14. For the method of determining the fair market value, see § 29.23 (m)–7.

With respect to any property for which discovery value is the taxpayer's basis for depletion, the depletion for any taxable year shall be computed by (1) adding to the discovery value of the mineral deposit in the property any subsequent allowable capital additions made by the taxpayer, (2) subtracting the aggregate of depletion deductions with respect to the property which would previously have been allowable to the taxpayer without the application of any net income limitation, (3) dividing the remainder by the number of units of mineral remaining as the taxable year, and (4) multiplying the depletion unit, thus determined, by the number of units of mineral sold within the taxable year.

The depletion allowance based on discovery value under this section shall not exceed 50 percent of the net income of the taxpayer (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion be less than it would be if computed without reference to discovery value. For definition of "net income of the taxpayer (computed without allowance for depletion) from the property," see § 29.23 (m)–1 (g).

This section does not apply to metal mines, coal mines, fluorspar mines, ball and sagger clay mines, rock asphalt mines, or sulphur mines or deposits, or to oil or gas wells.

As used in this section the phrase "number of units sold within the taxable year," in the case of a taxpayer reporting income on the cash receipts and disbursements basis, includes units for which payments were received within the taxable year although produced and sold prior to the taxable year, and excludes units sold but not paid for in the taxable year. The phrase does not include units with respect to which depletion deductions were allowed or allowable prior to the taxable year.

"The number of units of mineral remaining as of the taxable year" is the number of units of mineral remaining at the end of the year to be recovered from the property (including units recovered but not sold) plus the "number of units sold within the taxable year" as defined in this section.

§ 23.23 (m)–4 *Computation of depletion based on a percentage of income in case of oil and gas wells.* Under section 114 (b) (3), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ percent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 percent of the net income of the taxpayer (computed without allowance for depletion) from the property. (For definitions of "gross income from the property" and "net income of the taxpayer (computed without allowance for depletion) from the property," see § 29.23 (m)–1 (f) and (g).) In no case shall the deduction computed under this section be less than it would be if computed upon the cost or other basis of the property provided in section 113.

§ 29.23 (m)–5 *Computation of depletion based on percentage of income in case of coal mines, metal mines, fluorspar mines, ball and sagger clay mines, rock asphalt mines, and sulphur mines or deposits.* Under section 114 (b) (4) a taxpayer may deduct for depletion an amount equal to 5 percent of the gross income from the property during the taxable year in the case of coal mines, an amount equal to 15 percent of the gross income from the property during the taxable year in the case of metal, fluorspar, ball and sagger clay, or rock asphalt mines, and an amount equal to 23 percent of the gross income from the property during the taxable year in the case of sulphur mines or deposits, but such deduction shall not in any case exceed 50 percent of the net income of the taxpayer (computed without allowance for depletion) from the property. (For definitions of "gross income from the property" and "net income of the taxpayer (computed without allowance for depletion) from the property," see § 29.23 (m)–1 (f) and (g).) In no case shall the deduction computed under this

section be less than it would be if computed upon the cost or other basis of the property provided in section 113.

A taxpayer may compute the depletion allowance provided in this section, or in § 29.23 (m)–2, without regard to any election previously made in respect of computation of the allowances.

§ 29.23 (m)–6 *Determination of cost of deposits.* In any case in which a depletion or depreciation deduction is computed on the basis of the cost or price at which any interest in any mineral property was acquired, the taxpayer will be required to show that the cost or price at which such interest was bought was fixed for the purpose of a bona fide purchase and sale, by which the interest passed in fact as well as in form to an owner other than the vendor. No fictitious or inflated cost or price will be permitted to form the basis of any calculation of a depletion or depreciation deduction, and in determining whether the price or cost at which any purchase or sale was made represented the actual market value of the interest sold, due weight will be given to the relationship or connection existing between the person selling the interest and the buyer thereof.

§ 29.23 (m)–7 *Determination of fair market value of mineral properties, including oil and gas properties.* (a) If the fair market value of the property at a specified date is to be determined for the purpose of ascertaining the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the Commissioner, by the owner of the property in the light of the conditions and circumstances known at that date, regardless of later discoveries or developments in the property or subsequent improvements in methods of extraction and treatment of the mineral product. The value sought should be that established assuming a transfer between a willing seller and a willing buyer as of that particular date. The Commissioner will give due weight and consideration to any and all factors and evidence having a bearing on the market value, such as cost, actual sales and transfers of similar properties, market value of stock or shares, royalties and rentals, value fixed by the owner for purpose of the capital stock tax, valuation for local or State taxation, partnership accountings, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in probate court, and, in the absence of better evidence, disinterested appraisals by approved methods. Valuations by analytic appraisal methods, such as the present value method, are not entitled to great weight, (1) if the value of a mineral deposit can be determined upon the basis of cost or replacement value, (2) if the knowledge of the presence of the mineral has not greatly enhanced the value of the mineral property, (3) if the removal of the mineral does not materially reduce the value of the property from which it is taken, or (4) if the profits arising from the exploitation of the mineral deposit are wholly or in great part due to the manufacturing or marketing ability of the taxpayer or to extrinsic causes other than the possession of the mineral itself. If the fair market value must be ascertained as of a certain date, analytic appraisal methods will not be used if the fair market value can reasonably be determined by any other method.

(b) To determine the fair market value of a mineral property by the present value method, the essential factors must be determined for each deposit included in the property. The factors essential in the case of all mineral deposits are (1) the total expected profit, (2) the rate at which this profit will be obtained, and (3) the rate of interest commensurate with the risk for the particular deposit. In case of oil and gas properties the additional factors are (i) the total quantity of oil and gas in terms of the principal or customary unit (or units) paid for in the product marketed, (ii) the quantity of oil and gas expected to be recovered during each operating period, (iii) the average quality or grade of the oil and gas reserves, (iv) the allocation of the total expected profit to the several processes or operations necessary for the preparation of the oil and gas for market, (v) the probable operating life of the deposit in years, (vi) the development cost, and (vii) the operating cost. In order to estimate the total expected profit from the operation of mines it is necessary to determine the quantity, quality, and recoverable mineral content of the developed, probable, and prospective ore reserves in all cases. For mines with a prior operating record the "spread of profit" per unit of recoverable mineral, or the percentage of net profit to gross proceeds from mineral production is the other factor required in estimates of the total expected profit. For mines with no prior operating record the future sales price and future production cost per unit of mineral must be estimated in order to determine the "spread of profit" per unit of recoverable mineral.

(c) If the deposit has been sufficiently developed the valuation factors specified in paragraph (b) of this section may be determined from past operating experience. In the application of factors derived from past experience full allowance should be made for probable future variations in the rate of exhaustion, quality or grade of the mineral, percentage of recovery, cost of development, production, interest rate, and selling price of the product marketed during the expected operating life of the mineral deposit. Mineral deposits for which these factors may not be determined with reasonable accuracy from past operating experience may also, with the approval of the Commissioner, be valued by the present value method; but the factors must be deduced from concurrent evidence, such as the general type of the deposit, the characteristics of the district in which it occurs, the habit of the mineral deposits in the property itself, the intensity of mineralization, the oil-gas ratio, the rate at which additional mineral has been disclosed by exploitation, the stage of the operating life of the property, and any other evidence tending to establish a reasonable estimate of the required factors.

(d) Mineral deposits of different grades, locations, and probable dates of extraction in a mineral property should be valued separately. The mineral content of a deposit shall be determined in accordance with § 29.23 (m)–9. In estimating the average grade of the developed and prospective mineral, account should be taken of probable increases or decreases as indicated by the operating history. The rate of exhaustion of a mineral deposit should be determined with due regard to the limitations imposed by plant capacity, by the character of the deposit, by the ability to market the mineral product, by labor conditions, and by the operating program in force or reasonably to be expected for future operations. The operating life of a mineral deposit is that number of years necessary for the exhaustion of both the developed and prospective mineral content at the rate determined as above. The operating life of oil and gas wells is influenced by the natural decline in pressure and flow, and also by voluntary or enforced curtailment of production. The operating cost includes all current expense of producing, preparing, and marketing the mineral product sold (due consideration being given to taxes) exclusive of allowable capital additions, as defined in §§ 29.23 (m)–15 and 29.23 (m)–16, and deductions for depreciation and depletion, but including cost of repairs. For definitions of "development expenses" and "operating expenses" in the case of oil and gas wells, see § 29.23 (m)–16. This cost of repairs is not to be confused with the depreciation deduction by which the cost or value of plant and equipment is returned to the taxpayer free from tax. In general, no estimates of these factors will be approved by the Commissioner which are not supported by the operating experience of the property or which are derived from different and arbitrarily selected periods.

(e) The value of each mineral deposit is measured by the expected gross income (the number of units of mineral recoverable in marketable form multiplied by the estimated market price per unit) less the estimated operating cost, reduced to a present value as of the date as of which the valuation is made at the rate of interest commensurate with the risk for the operating life, and further reduced by the value at that date of the depreciable assets and of the capital additions, if any, necessary to realize the profits. The degree of risk is generally lowest in cases where the factors of valuation are fully supported by the operating record of the mineral property prior to the date as of which the valuation is made; relatively higher risks attach to appraisals upon any other basis.

(f) If, for the purpose of the equitable apportionment of depletion among the several owners of economic interests, the value of any mineral property must be ascertained as of any specific date for the determination of the basis for depletion, the values of the several interests therein may be determined separately, but, when determined as of the same date, shall together never exceed the

value at that date of the mineral property in fee simple.

§ 29.23 (m)–8 *Revaluation of mineral deposits not allowed.* No revaluation of a property whose value as of any specific date has been determined and approved will be made or allowed during the continuance of the ownership under which the value was so determined and approved, except in the case of a subsequent discovery of nonmetallic minerals, other than fluorspar, ball and sagger clay, rock asphalt, coal, sulphur, oil, or gas, as defined in § 29.23 (m)–14, or of misrepresentation or fraud or gross error as to any facts known on the date as of which the valuation was made. Revaluation on account of misrepresentation or fraud or such gross error will be made only with the written approval of the Commissioner. The value should, however, be corrected when a virtual change of ownership of part of the property results as the outcome of litigation. The value should be redistributed:

(a) If a revision of the number of remaining recoverable units of mineral in the property has been made in accordance with section 23 (m) and § 29.23 (m)–9, and

(b) In the case of the sale of a part of the property, between the part sold and the part retained.

§ 29.23 (m)–9 *Determination of mineral contents of mines and of oil or gas wells.* If it is necessary to estimate or determine with respect to any property as of any specific date the total recoverable units (tons, pounds, ounces, barrels, thousand of cubic feet, or other measure) of mineral products reasonably known, or on good evidence believed, to have existed in the ground as of that date, the estimate or detemination must be made according to the method current in the industry and in the light of the most accurate and reliable information obtainable. In the selection of a unit of estimate, preference shall be given to the principal unit (or units) paid for in the product marketed. The estimate of the recoverable units of the mineral products in the property for the purposes of valuation and depletion shall include as to both quantity and grade:

(a) The ores and minerals "in sight," "blocked out," "developed," or "assured," in the usual or conventional meaning of these terms with respect to the type of the deposit, and

(b) "Probable" or "prospective" ores and minerals (in the corresponding sense), that is, ores and minerals that are believed to exist on the basis of good evidence although not actually known to occur on the basis of existing development; but "probable" or "prospective" ores and minerals may be estimated (1) as to quantity, only in case they are extensions of known deposits or are new bodies or masses whose existence is indicated by geological or other evidence to a high degree of probability, and (2) as to grade, only as accords with the best indications available as to richness.

If the number of recoverable units of mineral in the property has been previously estimated for the prior year or years, and if there has been no known change in the facts upon which the prior estimate was based, the number of recoverable units of mineral in the property as of the taxable year will be the number remaining from the prior estimate, but in any case in which it is ascertained either by the taxpayer or the Commissioner as the result of operations or development work prior to the close of the taxable year that the remaining recoverable mineral units as of the taxable year are materially greater or less than the number remaining from the prior estimate, then the estimate of the remaining recoverable units shall be revised and the annual depletion allowance with respect to the property for the taxable year and for subsequent taxable years will be based upon the revised estimate unless a change in the facts requires another revision. Such revised estimate will not, however, affect the basis for depletion.

§ 29.23 (m)–10 *Depletion; adjustments of accounts based on bonus or advanced royalty.* (a) If a bonus in addition to royalties is received upon the grant of rights in mineral property, there shall be allowed to the payee as a depletion deduction in respect of the bonus an amount equal to that proportion of the basis for depletion as provided in section 114 (b) (1) or (2) which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the payee's basis for depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received. In the case of the payor any payment made for the acquisition of an economic interest in a mineral deposit or standing timber constitutes a capital investment in the property recoverable only through the depletion allowance.

(b) If the owner of operating rights in mineral property for a term of years is required to extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or to pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the premises, the payee shall treat an amount equal to that part of the basis for depletion allocable to the number of units so paid for in advance of extraction as an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by such payee shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

(c) If for any reason any grant of mineral rights expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the grantor shall adjust his capital account by restoring therto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which such expiration, termination, or abandonment occurs.

(d) In lieu of the treatment provided for in paragraphs (a) and (b) above, the owner of an economic interest in oil and gas wells may take as a depletion deduction in respect of any bonus or advanced royalty from the property for the taxable year 27½ percent of the amount thereof; and the owner of an economic interest in sulphur mines, metal mines, and coal mines may take as a depletion deduction in respect of any bonus or advanced royalty from the property for the taxable year 23 percent, 15 percent, and 5 percent, respectively, of the amount thereof; but the deduction shall not in any case exceed 50 percent of the net income of the taxpayer (computed without allowance for depletion) from the property. The owner of an economic interest in fluorspar, ball and sagger clay, or rock asphalt mines may take as a depletion deduction in respect of any bonus or advanced royalty from the property for the taxable year 15 percent of the amount thereof, but the deduction shall not in any case exceed 50 percent of the net income of the taxpayer (computed without allowance for depletion) from the property.

(e) If a lessee or other owner of operating rights in one or more mineral properties is required to pay royalties on a specified number of units of mineral annually, whether or not extracted within the year, and may apply any amounts paid on account of units not extracted within the year against the royalty on mineral thereafter extracted, he may at his option treat the advanced royalties so paid or accrued in either one of the following manners:

(1) As deductions from gross income for the year the advanced royalties are paid or accrue; or

(2) As deductions from gross income for the year the mineral product in respect of which the advanced royalties were paid is sold.

The option contained in this paragraph shall apply only to advanced royalties paid or accrued in taxable years ending on or after December 31, 1939. Every taxpayer must make an election as to the treatment of all such advanced royalties in his return for the first taxable year ending on or after December 31, 1939, in which such amounts are paid or accrue. A taxpayer will be considered to have made an election in accordance with the manner in which such items are treated in the return. A failure to deduct any such items for the year paid or accrued will constitute an election to have all such items treated in accordance with paragraph (e) (2) above. Any election made under this section is binding for all subsequent years and the taxpayer must treat all advanced royalties paid or accrued in such subsequent years in the same manner.

§ 29.23 (m)–11 *Depletion and depreciation accounts on books.* Every taxpayer claiming and making a deduction for depletion and depreciation of mineral property shall keep accurate ac-

counts in which shall be recorded the cost or other basis provided by section 113 (a), as the case may be, of the mineral deposit and of the plant and equipment, together with subsequent allowable capital additions to each account and all of the other adjustments required by section 113 (b).

If the plan or method of depletion and depreciation accounting adopted by the taxpayer has once been approved by the Commissioner, it cannot be changed by the taxpayer without the consent of the Commissioner. These accounts shall thereafter be credited annually with the amounts of the depletion and depreciation computed in accordance with §§ 29.23 (m)–2, 29.23 (m)–3, 29.23 (m)–4, or 29.23 (m)–5; or the amounts of the depletion and depreciation so computed shall be credited to depletion and depreciation reserve accounts, to the end that when the sum of the credits for depletion and depreciation equals the cost or other basis of the property, plus subsequent allowable capital additions, no further deductions for depletion and depreciation with respect to the property shall be allowed, except such depletion deductions as may thereafter be allowable under section 114 (b) (2), (3), or (4) and §§ 29.23 (m)–3, 29.23 (m)–4, or 29.23 (m)–5.

Every taxpayer to whom section 114 (b) (2) and § 29.23 (m)–3 are applicable shall keep similar accounts with respect to discovery value.

§ 29.23 (m)–12 *Statement to be attached to return when valuation, depletion, or depreciation of mineral property is claimed.* (a) Except as provided in § 29.23 (m)–13, there shall be attached to the return of every taxpayer asserting a value for any mineral property as of specific date or claiming a deduction for depletion or depreciation a statement setting forth with respect to each mineral property (including oil and gas property):

(1) The name, description, location, and identifying number, if any, of the property;

(2) The nature of the taxpayer's interest in the property, accompanied by a certified copy of the instrument or instruments by which it was acquired;

(3) The date of acquisition and, if under lease, the exact terms and date of expiration of the lease;

(4) The cost of the property, stating the amount paid to each vendor, with his name and address;

(5) The date as of which the property is valued, if a valuation is necessary to establish the basis as provided by section 113 (a);

(6) The value of the property on that date with a statement of the precise method by which it was determined;

(7) An allocation of the cost or value as between the mineral deposit and other assets such as plant, equipment, or the surface of the land for purposes other than mineral production;

(8) The estimated number of units of each kind of mineral at the end of the taxable year, and also at the date of acquisition, if acquired during the taxable year or at the date as of which any valuation is made, together with an explanation of the method used in the estimation, the name and address of the person making the estimate, and an average analysis which will indicate the quality of the mineral valued, including the grade or gravity in the case of oil;

(9) The number of units sold and the number of units for which payment was received during the year for which the return is made (in the case of newly developed oil and gas properties it is desirable that this information be furnished by month);

(10) The gross amount received from the sale of mineral;

(11) The amount of the depreciation for the taxable year and the amount of depletion for the taxable year computed without reference to percentage depletion or discovery value;

(12) The amounts of depletion and depreciation, stated, separately, which for each and every prior year (i) were allowed, (ii) were allowable, and (iii) would have been allowable without reference to percentage depletion or discovery value; and

(13) Any other data which will be helpful in determining the reasonableness of the valuation asserted or of the deduction claimed.

(b) To the return of every taxpayer claiming a deduction for depletion in respect of (1) property in which he owns a fractional interest only, or (2) a leasehold, or (3) property subject to lease, there shall also be attached a statement setting forth the fraction of the gross production to which the taxpayer is entitled, the name and address and the precise nature of the holding of each person interested in the property, and, in the case of a lessor, whether the lease involved was still in effect at the close of the taxable year, and, if not, when it was terminated and for what reason, and whether the lessor repossessed the property. Any taxpayer who is the assignor of a lease with respect to any property, or the holder of an interest purporting to be an overriding royalty interest, or of any interest other than that of a lessor or an operating lessee, and who claims depletion with respect to such property or interest, shall state the exact nature of the interest held and shall furnish a certified copy of the instrument or instruments by which it was acquired.

(c) In the case of oil and gas properties the statement attached to the return shall contain, in addition to the foregoing, the following information with respect to each property:

(1) The number of acres of producing oil or gas land and, if additional acreage is claimed to be proven, the amount of such acreage and the reasons for believing it to be proven;

(2) The number of wells producing at the beginning and end of the taxable year;

(3) The date of completion of wells finished during the taxable year;

(4) The date of abandonment of all wells abandoned during the taxable year;

(5) A property map showing the location of the property and of the producing and abandoned wells, dry holes, and proven oil and gas lands (the map should show depth, initial production, and date of completion of each well, to the extent that such data are available);

(6) The number of pay sands and average thickness of each pay sand or zone on the property;

(7) The average depth to the top of each of the different pay sands;

(8) Annual production of the tract or of the individual wells, if the latter information is available, from the beginning of its productivity to the end of the taxable year, the average number of wells producing during each year, and the initial daily production of each well (the extent to which oil or gas is used for fuel on the property should be stated with reasonable accuracy);

(9) All available data regarding change in operating conditions, such as unit operation, proration, flooding, use of air-gas lift, vacuum, shooting, etc., which have a direct effect on the production of the property; and

(10) Available geological information having a probable bearing on the oil and gas content; information with respect to edge water, water drive, bottom hole pressures, oil-gas ratio, porosity of reservoir rock, percentage of recovery, expected date of cessation of natural flow, decline in estimated potential, and characteristics similar to characteristics of other known fields.

(d) All of the foregoing information must be furnished under oath, should be summarized, and may be included in a single affidavit.

(e) Any of the information required by this section which has been previously filed by the taxpayer need not be filed again but the statement attached to the return must indicate clearly when and in what form the information was previously filed. When a taxpayer has filed adequate maps with the Commissioner he may be relieved of filing further maps of the same properties, provided all additional information necessary for keeping the maps up to date is filed each year. This includes records of dry holes, as well as producing wells, together with logs, depth and thickness of sands, location of new wells, etc.

§ 29.23 (m)–13 *Statement to be attached to return when depletion is claimed on percentage basis.* (a) There shall be atached to the return of every taxpayer who claims depletion of oil and gas wells under section 114 (b) (3) and § 29.23 (m)–4, or depletion of coal mines, metal mines, fluorspar mines, ball and sagger clay mines, rock asphalt mines, or sulphur mines or deposits under section 114 (b) (4) and § 29.23 (m)–5, a statement containing the following information with respect to every property for which percentage depletion is allowable:

(1) All data necessary for the determination of the "gross income from the property" as defined in § 29.23 (m)–1 (f), including the amounts paid to lessors as rents or royalties, the amounts paid to holders of other interests in the mineral property and the price per unit at which royalties were paid;

(2) All additional data necessary for the determination of the "net income of

the taxpayer (computed without allowance for depletion) from the property" as defined in § 29.23 (m)–1 (g); and

(3) The information required by paragraphs (a) (1), (a) (2), (a) (3), and (b) of § 29.23 (m)–12. The other information required by § 29.23 (m)–12 shall also be furnished if necessary in determining the gain or loss from the sale or other disposition of the property during the taxable year or if a valuation of the property is necessary for any purpose. The taxpayer may find it desirable to furnish such information in all cases.

(b) All of the foregoing information shall be furnished under oath, should be summarized, and may be included in a single affidavit.

§ 29.23 (m)–14 *Discovery of mines other than coal, metal, fluorspar, ball and sagger clay, rock asphalt, or sulphur mines.* (a) To entitle a taxpayer to a valuation of his property, for the purpose of depletion allowances, by reason of the discovery of a mine (other than a coal, metal, fluorspar, ball and sagger clay, rock asphalt, or sulphur mine) or minerals (other than oil or gas, coal, sulphur, metal, metallic ores, fluorspar, ball and sagger clay, or rock asphalt), it must appear that the mine or minerals were not acquired as the result of the purchase of a proven tract or lease; also, the discovery must be made by the taxpayer after February 28, 1913, and must result in the fair market value of the property becoming disproportionate to the cost. The fair market value of the property will be deemed to have become disproportionate to the cost when the newly discovered minerals are of such quantity and of such quality as to afford a reasonable expectation of return to the taxpayer of an amount materially in excess of the capital expended in making such discovery plus the cost of future development, equipment, and exploitation.

(b) A mine or minerals of a kind not excepted by this section may be said to be discovered when (1) there is found a natural deposit of mineral, or (2) there is disclosed by drilling or exploration, conducted above or below ground, a mineral deposit not previously known to exist and the existence of which was so improbable that such deposit had not and could not have been included in any previous valuation for the purpose of depletion, and which in either case exists in quantity and grades sufficient to justify commercial exploitation.

(c) In determining whether a discovery entitling the taxpayer to a valuation has been made, the Commissioner will take into account the peculiar conditions of each case; but no discovery, for the purposes of depletion, can be allowed as to minerals which constitute merely uninterrupted extensions of continuing commercial veins or deposits already known to exist, which have been or should have been included in "probable" or "prospective" mineral, or which were in any other way comprehended in a prior valuation, nor can a discovery, for purposes of depletion, be allowed as of a date subsequent to that when, in fact, discovery was evident, when delay by the taxpayer in making claim therefor has resulted or will result in excessive allowances for depletion.

(d) Discoveries include minerals in commercial quantities contained within a vein or deposit discovered in an existing mine or mining tract by the taxpayer after February 28, 1913, but such vein or deposit must not be merely the uninterrupted extension of a continuing commercial vein or deposit already known to exist, and the newly discovered minerals must be of sufficient value and quantity that they could be separately mined and marketed at a profit.

(e) The value of property claimed as the result of a discovery must be the fair market value, as defined in § 29.23 (m)–7, based on what is evident within 30 days after the commercially valuable character and extent of the discovered deposits of mineral have with reasonable certainty been established, determined, or proved.

§ 29.23 (m)–15 *Allowable capital additions in case of mines.* (a) All expenditures in excess of net receipts from minerals sold shall be charged to capital account recoverable through depletion while the mine is in the development stage. The mine will be considered to have passed from a development to a producing status when the major portion of the mineral production is obtained from workings other than those opened for the purpose of development, or when the principal activity of the mine becomes the production of developed ore rather than the development of additional ores for mining.

(b) Expenditures for plant and equipment and for replacements, not including expenditures for maintenance and for ordinary and necessary repairs, shall ordinarily be charged to capital account recoverable through depreciation. Expenditures for equipment (including its installation and housing) and for replacements thereof, which are necessary to maintain the normal output solely because of the recession of the working faces of the mine, and which (1) do not increase the value of the mine, or (2) do not decrease the cost of production of mineral units, or (3) do not represent an amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made, shall be deducted as ordinary and necessary business expenses.

§ 29.23 (m)–16 *Charges to capital and to expense in case of oil and gas wells*— (a) *Taxable years beginning prior to January 1, 1943* The provisions of this paragraph apply only to taxable years beginning prior to January 1, 1943.

(1) Items chargeable to capital or to expense at taxpayer's option:

(i) Option with respect to intangible drilling and development costs in general: All expenditures for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas, may, at the option of the taxpayer, be deducted from gross income as an expense or charged to capital account. Such expenditures have for convenience been termed intangible drilling and development costs. Examples of items to which this option applies are, all amounts paid for labor, fuel, repairs, hauling, and supplies, or any of them, which are used (*a*) in the drilling, shooting, and cleaning of wells; (*b*) in such clearing of ground, draining, road making, surveying, and geological work as are necessary in preparation for the drilling of wells; and (*c*) in the construction of such derricks, tanks, pipe lines, and other physical structures as are necessary for the drilling of wells and the preparation of wells for the production of oil or gas. In general, this option applies only to expenditures for those drilling and development items which in themselves do not have a salvage value. For the purpose of this option labor, fuel, repairs, hauling, supplies, etc., are not considered as having a salvage value, even though used in connection with the installation of physical property which has a salvage value. Drilling and development costs shall not be excepted from the option merely because they are incurred under a contract providing for the drilling of a well to an agreed depth, or depths, at an agreed price per foot or other unit of measurement.

(ii) Option with respect to cost of nonproductive wells: In addition to the foregoing option the cost of drilling nonproductive wells at the option of the taxpayer may be deducted from gross income for the year in which the taxpayer completes such a well or be charged to capital account returnable through depletion and depreciation as in the case of productive wells.

(iii) If deductions for depreciation or depletion have either on the books of the taxpayer or in his returns of net income been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or if capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return.

(2) Recovery of optional items, if capitalized:

(i) Items returnable through depletion: If in exercising these options, or either of them, the taxpayer charges such expenditures as fall within the options to capital account, the amounts so capitalized in so far as they are not represented by physical property, are returnable through depletion. For the purposes of this section the expenditures for clearing ground, draining, road making, surveying, geological work, excavation, grading, and the drilling, shooting, and cleaning of wells are considered not to be represented by physical property, and when charged to capital account are returnable through depletion.

(ii) Items returnable through depreciation: If in exercising these options, the taxpayer charges such expenditures as fall within the options to capital account, the amounts so capitalized, in so far as they are represented by physical property, are returnable through depreciation. Such expenditures are amounts paid for wages, fuel, repairs, hauling, supplies, etc., used in the installation of

casing and equipment and in the construction on the property of derricks and other physical structures.

(iii) In the case of capitalized intangible drilling and development costs incurred under a contract, such costs shall be allocated between the foregoing classes of items for the purposes of determining the depletion and depreciation allowances.

(3) Nonoptional items distinguished:

(i) Capital items: The option with respect to intangible drilling and development costs in general does not apply to expenditures by which the taxpayer acquires tangible property ordinarily considered as having a salvage value. Examples of such items are the costs of the actual materials in those structures which are constructed in the wells and on the property, and the cost of drilling tools, pipe, casing, tubing, tanks, engines, boilers, machines, etc. The options do not apply to any expenditure for wages, fuel, repairs, hauling, supplies, etc., in connection with equipment, facilities, or structures, not incident to or necessary for the drilling of wells, such as structures for storing or treating oil or gas. These are capital items and are returnable through depreciation.

(ii) Expense items: Expenditures which must be charged off as expense, regardless of the options provided by paragraph (a) of this section, are those for labor, fuel, repairs, hauling, supplies, etc., in connection with the operation of the wells and of other facilities on the property for the production of oil or gas. General overhead expense, taxes, and depreciation of drilling equipment, are not considered as capital items, even when incurred during the development of the property.

(4) Paragraph (a) of this section does not grant a new option or election. Any taxpayer who made an election or elections under article 223 of Regulations 69 or under article 243 of Regulations 74 or under article 236 of Regulations 77 or under article 23 (m)–16 of Regulations 86 or under article 23 (m)–16 of Regulations 94[1] or under article 23 (m)–16 of Regulations 101[1] or under article 23 (m)–16 of Regulations 103[1] is, by such election or elections, bound with respect to all optional expenditures whether made before January 1, 1942, or after December 31, 1941, in connection with oil and gas wells. Any taxpayer who has never made expenditures for drilling oil or gas wells prior to the first taxable year beginning after December 31, 1941, must make an election as to intangible drilling and development costs in general in the return for the first taxable year in which the taxpayer makes such expenditures, and a taxpayer who has never made expenditures for a nonproductive well prior to the first taxable year beginning after December 31, 1941, must make an election as to the cost of such wells in the return for the first taxable year in which the taxpayer completes such a well. Any election so made is binding for all subsequent years. A taxpayer is considered to have made an election in accordance with the manner in which the respective types of optional items are treated (i) in his return for the first taxable year ending after December 31, 1924, in which optional expenditures of the respective types are or were made, or (ii) in an amended return filed between June 18, 1927, and December 18, 1927, in accordance with Treasury Decision 4025. Any taxpayer who has made expenditures for optional drilling and development costs must attach to his return for the first taxable year beginning after December 31, 1941, and for each year thereafter a clear statement of his election under each of the options, together with a statement of the time at which, and the manner in which, such election was made.

(b) *Taxable years beginning after December 31, 1942.* The provisions of this paragraph apply only to taxable years beginning after December 31, 1942.

(1) Items chargeable to capital or to expense at taxpayer's option:

(i) Option with respect to intangible drilling and development costs incurred by an operator (one who holds a working or operating interest in any tract or parcel of land either as a fee owner or under a lease or any other form of contract granting working or operating rights) in the development of oil and gas properties: All expenditures made by an operator for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas, may, at the option of the operator, be deducted from gross income as an expense or charged to capital account. Such expenditures have for convenience been termed intangible drilling and development costs. They include the cost to operators of any drilling or development work (excluding amounts payable only out of production or the gross proceeds from production, and amounts properly allocable to cost of depreciable property) done for them by contractors under any form of contract, including turnkey contracts. Examples of items to which this option applies are, all amounts paid for labor, fuel, repairs, hauling, and supplies, or any of them, which are used (*a*) in the drilling, shooting, and cleaning of wells; (*b*) in such clearing of ground, draining, road making, surveying, and geological work as are necessary in preparation for the drilling of wells; and (*c*) in the construction of such derricks, tanks, pipe lines, and other physical structures as are necessary for the drilling of wells and the preparation of wells for the production of oil or gas. In general, this option applies only to expenditures for those drilling and developing items which in themselves do not have a salvage value. For the purpose of this option labor, fuel, repairs, hauling, supplies, etc., are not considered as having a salvage value, even though used in connection with the installation of physical property which has a salvage value. Included in this option are all costs of drilling and development undertaken (directly or through a contract) by an operator of an oil and gas property whether incurred by him prior or subsequent to the formal grant or assignment to him of operating rights (a leasehold interest, or other form of operating rights, or working interest); except that in any case where any drilling or development project is undertaken for the grant or assignment of a fraction of the operating rights, only that part of the costs thereof which is attributable to such fractional interest is within this option. In the excepted cases, costs of the project undertaken, including depreciable equipment furnished, to the extent allocable to fractions of the operating rights held by others, must be capitalized as the depletable capital cost of the fractional interest thus acquired.

(ii) If deductions for depreciation or depletion have either on the books of the taxpayer or in his returns of net income been included in the past on expense or other accounts, rather than specifically as depreciation or depletion, or if capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return.

(2) Recovery of optional items, if capitalized:

(i) Items returnable through depletion: If the taxpayer charges such expenditures as fall within the option to capital account, the amounts so capitalized and not deducted as a loss are returnable through depletion insofar as they are not represented by physical property. For the purposes of this section the expenditures for clearing ground, draining, road making, surveying, geological work, excavation, grading, and the drilling, shooting, and cleaning of well, are considered not to be represented by physical property, and when charged to capital account are returnable through depletion.

(ii) Items returnable through depreciation: If the taxpayer charges such expenditures as fall within the option to capital account, the amounts so capitalized and not deducted as a loss are returnable through depreciation insofar as they are represented by physical property. Such expenditures are amounts paid for wages, fuel, repairs, hauling, supplies, etc., used in the installation of casing and equipment and in the construction on the property of derricks and other physical structures.

(iii) In the case of capitalized intangible drilling and development costs incurred under a contract, such costs shall be allocated between the foregoing classes of items for the purpose of determining the depletion and depreciation allowances.

(iv) Option with respect to cost of nonproductive wells: If the operator has elected to capitalize intangible drilling and development costs, then an additional option is accorded with respect to intangible drilling and development costs incurred in drilling a nonproductive well. Such costs incurred in drilling a nonproductive well may be deducted by the taxpayer as an ordinary loss provided a proper election is made in the return for the first taxable year

[1] 26 CFR, Supp., 3.23 (m)–16; 9.23 (m)–16; 19.23 (m)–16.

beginning after December 31, 1942, in which such a nonproductive well is completed. Such election with respect to intangible drilling and development costs of nonproductive wells is a new election, and, when made, shall be binding for all subsequent years. Any taxpayer who incurs optional drilling and development costs in drilling a nonproductive well must make a clear statement of election under this option in the return for the first taxable year beginning after December 31, 1942, in which such nonproductive well is completed. The absence of a clear indication in such return of an election to deduct as ordinary losses intangible drilling and development costs of nonproductive wells shall be deemed to be an election to recover such costs through depletion to the extent that they are not represented by physical property, and through depreciation to the extent that they are represented by physical property.

(3) Nonoptional items distinguished:

(i) Capital items: The option with respect to intangible drilling and development costs does not apply to expenditures by which the taxpayer acquires tangible property ordinarily considered as having a salvage value. Examples of such items are the costs of the actual materials in those structures which are constructed in the wells and on the property, and the cost of drilling tools, pipe, casing, tubing, tanks, engines, boilers, machines, etc. The option does not apply to any expenditure for wages, fuel, repairs, hauling, supplies, etc., in connection with equipment, facilities, or structures, not incident to or necessary for the drilling of wells, such as structures for storing or treating oil or gas. These are capital items and are returnable through depreciation.

(ii) Expense items: Expenditures which must be charged off as expense, regardless of the option provided by paragraph (b) of this section, are those for labor, fuel, repairs, hauling, supplies, etc., in connection with the operation of the wells and of other facilities on the property for the production of oil or gas.

(4) Paragraph (b) of this section grants a new option with respect to intangible drilling and development costs incurred by an operator in a taxable year beginning after December 31, 1942, in the development of oil and gas properties, and requires a new election under such option. Any operator who incurs such costs must make a clear statement of election under this option in the return for the first taxable year beginning after December 31, 1942, in which such costs are incurred. The absence of a clear indication in such return of an election to deduct as expenses intangible drilling and development costs shall be deemed to be an election to recover such costs through depletion to the extent that they are not represented by physical property, and through depreciation to the extent that they are represented by physical property. This election is binding for all subsequent years.

§ 29.23 (m)–17 *Depreciation in case of mines.* (a) The Internal Revenue Code provides that deductions for depreciation of improvements on mining property may be taken "according to the peculiar conditions in each case." This is deemed to include exhaustion and wear and tear of the property used in mining of deposits, including a reasonable allowance for obsolescence. (See §§ 29.23 (l)–1 to 29.23 (l)–10, inclusive, as to deductions for depreciation and obsolescence generally. See particularly § 29.23 (l)–5 with regard to information which must be furnished in substantiation of deductions claimed for depreciation and obsolescence.)

(b) It shall be optional with the taxpayer, subject to the approval of the Commissioner, whether the cost or other basis of the plant and equipment plus allowable capital additions but minus estimated salvage value shall be recovered (1) at a rate established by current exhaustion of mineral, or (2) by reasonable charges for depreciation (see § 29.23 (l)–1) at a rate determined by the physical life or the economic life of such plant and equipment, or, (3) according to the peculiar conditions of the case, by a method satisfactory to the Commissioner.

(c) The estimated physical life of a plant or unit thereof (including buildings, machinery, apparatus, roads, railroads, and other equipment and improvements whose principal use is in connection with the mining or treatment or other necessary handling of mineral products) may be defined as the estimated time such plant, or unit, when given proper care and repair, can be continued in use despite physical deterioration, decay, and wear and tear.

(d) The estimated economic life of a plant or unit thereof is the estimated time during which the plant or unit may be utilized effectively and economically for its intended purposes and may be limited by the life of the property or of that portion of the mineral deposits which it serves but can never exceed the physical life.

(e) Any difference between the salvage value of plant and equipment and the basis provided in section 113 (a), adjusted as provided in section 113 (b), remaining at the termination of mining operations shall be returned as profit or loss in the year in which it is realized.

(f) Nothing in these regulations shall be interpreted as meaning (1) that the cost or other basis of a mining plant and equipment may be reduced by depreciation deductions to a sum below the value of the salvage when the property shall have become obsolete or shall have been abandoned for the purpose of mining, or (2) that proper deductions for depreciation on account of obsolescence and decay shall not be made during periods when the mine is idle or is producing at a rate below its normal capacity. In estimating the salvage value of the equipment at the end of its estimated economic life due consideration may be given to its specialized character and the cost of dismounting and dismantling and transporting it to market.

(g) Nothing in these regulations shall be interpreted to permit expenditures charged to expense in any taxable year or any part of the value of land for purposes other than mining to be recovered through depletion or depreciation.

§ 29.23 (m)–18 *Depreciation of improvements in case of oil and gas wells.* Taxpayers operating oil or gas properties will, in addition to and apart from the deduction allowable for depletion as hereinbefore provided, be permitted to deduct a reasonable allowance for depreciation of physical property, such as machinery, tools, equipment, pipes, etc., so far as not in conflict with the option exercised by the taxpayer under § 29.23 (m)–16. The amount deductible on this account shall be such an amount based upon its cost or other basis equitably distributed over its useful life as will bring such property to its true salvage value when no longer useful for the purpose for which such property was acquired. Accordingly, where it can be shown to the satisfaction of the Commissioner that the reasonable expectation of the economic life of the oil or gas deposit with which the property is connected is shorter than the normal useful life of the physical property, the amount annually deductible for depreciation on such property may be based upon the length of life of the deposit. (See §§ 29.23 (l)–1 to 29.23 (l)–10, inclusive, as to deductions for depreciation and obsolescence generally. See particularly § 29.23 (l)–5 with regard to information which must be furnished in substantiation of deductions claimed for depreciation and obsolescence.)

§ 29.23 (m)–19 *Depletion and depreciation of oil and gas wells in years before 1916.* If upon examination it is found that in respect of the entire drilling cost of wells, including physical property and incidental expenses, between March 1, 1913, and December 31, 1915, a taxpayer has been allowed a reasonable deduction sufficient to provide for the elements of exhaustion, wear and tear, and depletion, it will not be necessary to reopen the returns for years prior to 1916 in order to show separately in these years the portions of such deduction representing depletion and depreciation, respectively. Such separation will be required to be made of the reserves for depreciation at January 1, 1916, and proper allocation between depreciation and depletion must be maintained after that date.

§ 29.23 (m)–20 *Capital recoverable through depletion allowance in case of timber.* In general, the capital remaining in any year recoverable through depletion allowances is the basis provided by section 113 (a) adjusted as provided by section 113 (b). For capitalization of carrying charges, see § 29.113 (b) (1)–1. The apportionment of deductions between the several owners of economic interests in timber properties will be made as specified in § 29.23 (m)–7. The cost of timber properties shall be determined in accordance with the principles indicated in § 29.23 (m)–6. For method of determining fair market value and quantity of timber, see §§ 29.23 (m)–25 to 29.23 (m)–27, inclusive. For depletion purposes the cost of the timber shall not include any part of the cost of the land.

§ 29.23 (m)–21 *Computation of allowance for depletion of timber for given year.* The allowance for depletion of timber in any taxable year shall be based upon the number of units of timber felled during the year and the depletion unit of the timber in the timber account or accounts pertaining to the timber cut. The depletion unit of the timber for a given timber account in a given year shall be the quotient obtained by dividing (a) the basis, provided by section 113 (a) and adjusted as provided by section 113 (b), of the timber on hand at the beginning of the year plus the cost of the number of units acquired during the year plus proper additions to capital, by (b) the total number of units of timber on hand in the given account at the beginning of the year plus the number of units acquired during the year plus (or minus) the number of units required to be added (or deducted) by way of correcting the estimate of the number of units remaining available in the account. The amount of the deduction for depletion in any taxable year with respect to a given timber account shall be the product of the number of units of timber cut from the given account during the year multiplied by the depletion unit of the timber for the given account for the year. Those taxpayers who keep their accounts on a monthly basis may, at their option, keep their depletion accounts on a monthly basis, in which case the amount deductible on account of depletion for a given month will be determined in the manner outlined above for a given year. The total amount of the deduction for depletion in any taxable year shall be the sum of the amounts deductible for the several timber accounts. For description of timber accounts, see §§ 29.23 (m)–27 and 29.23 (m)–28.

The depletion of timber takes place at the time the timber is felled. Since, however, it is not ordinarily practicable to determine the quantity of timber immediately after felling, depletion for purposes of accounting will be treated as taking place at the time when, in the process of exploitation, the quantity of timber felled is first definitely determined.

§ 29.23 (m)–22 *Revaluation of timber not allowed.* No revaluation of a timber property whose value as of any specific date has been determined and approved will be made or allowed during the continuance of the ownership under which the value was so determined and approved, except in the case of misrepresentation or fraud or gross error as to any facts known on the date as of which the valuation was made. Revaluation on account of misrepresentation or fraud or such gross error will be made only with the written approval of the Commissioner. The depletion unit should be changed when a revision of the remaining number of units of recoverable timber in the property has been made in accordance with § 29.23 (m)–26.

§ 29.23 (m)–23 *Depreciation of improvements in case of timber.* The cost or other basis of development not represented by physical property having an inventory value shall be recoverable through depreciation. It shall be optional with the taxpayer, subject to the approval of the Commissioner:

(a) Whether the cost or other basis of the property subject to depreciation shall be recovered at a rate established by current exhaustion of stumpage, or

(b) Whether the cost or other basis shall be recovered by appropriate charges for depreciation calculated by the usual rules for depreciation or according to the peculiar conditions of the taxpayer's case by a method satisfactory to the Commissioner.

In no case may charges for depreciation be based on a rate which will extinguish the cost or other basis of the property prior to the termination of its useful life. Nothing in these regulations shall be interpreted to mean that the value of a timber plant and equipment may be reduced by depreciation deductions to a sum below the value of the salvage when the plant and equipment shall have become obsolete or worn out or shall have been abandoned, or that any part of the value of cut-over land may be recoverable through depreciation. (See §§ 29.23 (l)–1 to 29.23 (l)–10, inclusive, as to deductions for depreciation and obsolescence generally. See particularly § 29.23 (l)–5 with regard to information which must be furnished in substantiation of deductions claimed for depreciation and obsolescence.)

§ 29.23 (m)–24 *Information to be furnished by taxpayer claiming depletion of timber.* To the income tax return of the taxpayer claiming a deduction for depletion or depreciation or both there shall be attached a map and statement (Form T—Timber) for the taxable year covered by the income tax return. Form T—Timber requires the following:

(a) Map showing timber and land acquired, timber cut, and timber and land sold;

(b) Description of, cost of, and terms of purchase or lease of, timber and land acquired;

(c) Proof of profit or loss from sale of capital assets;

(d) Description of timber with respect to which claim for loss, if any, is made;

(e) Record of timber cut;

(f) Changes in each timber account as the result of purchase, sale, cutting, re-estimate, or loss;

(g) Changes in physical property accounts as the result of additions to or deductions from capital and depreciation;

(h) Operation data with respect to raw and finished material handled and inventoried;

(i) Unit production costs; and

(j) Any other data which will be helpful in determining the reasonableness of the depletion or depreciation deductions claimed in the return.

Similar information is required for certain years prior to the 1919 taxable year from those taxpayers who have not already furnished it. The specific nature of the information required for the earlier years is given in detail in Form T—General forest industries questionnaire for the years prior to 1919.

§ 29.23 (m)–25 *Determination of fair market value of timber.* If the fair market value of the property at a specified date is the basis for depletion and depreciation deductions, such value shall be determined, subject to approval or revision by the Commissioner upon audit, by the owner of the property in the light of the most reliable and accurate information available with reference to the condition of the property as it existed at that date, regardless of all subsequent changes, such as changes in surrounding circumstances, in methods of exploitation, in degree of utilization, etc. The value sought will be the selling price, assuming a transfer between a willing seller and a willing buyer, as of the particular date. Such factors as the following will be given due consideration:

(a) Character and quality of the timber as determined by species, age, size, condition, etc.;

(b) The quantity of timber per acre, the total quantity under consideration, and the location of the timber in question with reference to other timber;

(c) Accessibility of the timber (location with reference to distance from a common carrier, the topography and other features of the ground upon which the timber stands and over which it must be transported in process of exploitation, the probable cost of exploitation, and the climate and the state of industrial development of the locality); and

(d) The freight rates by common carrier to important markets.

The timber in each particular case will be valued on its own merits and not on the basis of general averages for regions; however, the value placed upon it, taking into consideration such factors as those mentioned above, will be consistent with that of the other timber in the region. The Commissioner will give due weight and consideration to any and all facts and evidence having a bearing on the market value, such as cost, actual sales and transfers of similar properties, the margin between the cost of production and the price realized for timber products, market value of stock or shares, royalties and rentals, value fixed by the owner for the purpose of the capital stock tax, valuation for local or State taxation, partnership accountings, records of litigation in which the value of the property has been involved, the amount at which the property may have been inventoried or appraised in probate or similar proceedings, disinterested appraisals by approved methods, and other factors. For depletion purposes the fair market value at a specified date shall not include any part of the value of the land.

If, for the purpose of the equitable apportionment of depletion among the several owners of economic interests, the value of any timber property must be ascertained as of any specific date for the determination of the basis for depletion, the values of the several interests therein may be determined separately, but, when

determined as of the same date, shall together never exceed the value at that date of the timber property in fee simple.

§ 29.23 (m)–26 *Determination of quantity of timber.* Each taxpayer claiming or expecting to claim a deduction for depletion is required to estimate with respect to each separate timber account the total units (feet board measure, log scale, cords, or other units) of timber reasonably known, or on good evidence believed, to have existed on the ground on March 1, 1913, or on the date of acquisition of the property, as the case may be. This estimate shall state as nearly as possible the number of units which would have been found present by a careful estimate made on the specified date with the object of determining 100 percent of the quantity of timber which the area would have produced on that date if all of the merchantable timber had been cut and utilized in accordance with the standards of utilization prevailing in that region at that time. If subsequently during the ownership of the taxpayer making the return, as the result of the growth of the timber, of changes in standards of utilization, of losses not otherwise accounted for, of abandonment of timber, or of operations or development work, it is ascertained either by the taxpayer or the Commissioner that there remain on the ground, available for utilization, more or less units of timber than remain in the timber account or accounts on the basis of the original estimate, then the original estimate (but not the basis for depletion) shall be revised and the annual depletion allowance with respect to the property for subsequent taxable years shall be based upon the revised estimate.

§ 29.23 (m)–27 *Aggregating timber and land for purposes of valuation and accounting.* With a view to logical and reasonable valuation of timber, the taxpayer shall include his timber in one or more accounts. In general, each such account shall include all of the taxpayer's timber which is located in one "block," a block being an operation unit which includes all of the taxpayer's timber which would logically go to a single given point of manufacture. In those cases in which the point of manufacture is at a considerable distance, or in which the logs or other products will probably be sold in a log or other market, the block may be a logging unit which includes all of the taxpayer's timber which would logically be removed by a single logging development. In exceptional cases, provided there are good and substantial reasons, and subject to approval or revision by the Commissioner on audit, the taxpayer may divide the timber in a given block into two or more accounts, e. g., timber owned on February 28, 1913, and that purchased subsequently may be kept in separate accounts, or timber owned on February 28, 1913, and the timber purchased since that date in several distinct transactions may be kept in several distinct accounts, or individual tree species or groups of tree species may be carried in distinct accounts, or special timber products may be carried in distinct accounts, or blocks may be divided into two or more accounts based on the character of the timber or its accessibility, or scattered tracts may be included in separate accounts. If such a division is made, a proper portion of the total value or cost, as the case may be, shall be allocated to each account.

The timber accounts mentioned in the preceding paragraph shall not include any part of the value or cost, as the case may be, of the land. In a manner similar to that prescribed in the foregoing part of this section the land in a given "block" may be carried in a single land account or may be divided into two or more accounts on the basis of its character or accessibility. When such a division is made, a proper portion of the total value or cost, as the case may be, shall be allocated to each account.

The total value or total cost, as the case may be, of land and timber shall be equitably allocated to the timber and land accounts, respectively.

Each of the several land and timber accounts carried on the books of the taxpayer shall be definitely described as to their location on the ground either by maps or by legal descriptions.

For good and substantial reasons satisfactory to the Commissioner, or as required by the Commissioner, the timber or the land accounts may be readjusted by dividing individual accounts, by combining two or more accounts, or by dividing and recombining accounts.

§ 29.23 (m)–28 *Timber depletion and depreciation accounts on books.* Every taxpayer claiming or expecting to claim a deduction for depletion or depreciation of timber property (including plants, improvements, and equipment used in connection therewith) shall keep accurate ledger accounts in which shall be recorded the cost or other basis provided by section 113 (a), as the case may be, of the property, and the plants, improvements, and equipment, together with subsequent allowable capital additions to each account and all of the other adjustments provided by section 113 (b) and §§ 29.113 (a) (14)–1 and 29.113 (b) (1)–1 to 29.113 (b) (3)–2, inclusive.

In such accounts there shall be set up separately the quantity of timber, the quantity of land, and the quantity of other resources, if any, and a proper part of the total cost of value shall be allocated to each. (See § 29.23 (m)–27.) These accounts shall be credited with the amount of the depreciation and depletion deductions computed in accordance with § 29.23 (m)–20 each year, or the amount of the depreciation and depletion shall be credited to depreciation and depletion reserve accounts, to the end that when the sum of the credits for depreciation and depletion equals the cost or other basis of the property, plus subsequent allowable capital additions, no further deduction for depreciation and depletion will be allowed.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act, 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(o) *Charitable and other contributions.* In the case of an individual, contributions or gifts payment of which is made within the taxable year to or for the use of:

(1) The United States, any State, Territory, or any political subdivision thereof or the District of Columbia, or any possession of the United States, for exclusively public purposes;

(2) a corporation, trust, or community chest, fund, or foundation, created or organized in the United States or in any possession thereof or under the law of the United States or of any State or Territory or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

(3) the special fund for vocational rehabilitation authorized by section 12 of the World War Veterans' Act, 1924, 43 Stat. 611 (U.S.C., Title 38, § 440);

(4) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(5) a domestic fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals;

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection or of subsection (x). Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary.

For unlimited deduction if contributions and gifts exceed 90 per centum of the net income, see section 120.

§ 29.23 (o)–1 *Contributions or gifts by individuals.* A deduction is allowable under section 23 (o) only with respect to contributions or gifts which are actually paid during the taxable year, regardless of when pledged and regardless of the method of accounting employed by the taxpayer in keeping his books and records. A deduction is not allowable, however, for the actual payment of a contribution or gift if the amount of such payment already has been deducted on the accrual basis in computing net income for any taxable year beginning before January 1, 1938. A contribution or gift to an organization described in section 23 (o) is deductible even though some portion of the funds of such organization is or may be used in foreign countries for charitable and educational purposes. This section does not apply to contributions or gifts by estates and trusts (see section 162). For computation of deductions for charitable contributions where the taxpayer also has an allowable deduction for medical expenses, see § 29.23 (x)–1.

A contribution or gift to the United States, any State, Territory, or any po-

litical subdivision thereof, or the District of Columbia, or any possession of the United States, exclusively for public purposes, is deductible.

No deduction is allowed in computing the net income of a common trust fund or a partnership for contributions or gifts made to organizations described in section 23 (o). (See sections 169 and 183.) However, a partner's proportionate share of contributions or gifts actually paid by a partnership during its taxable year to such organizations may be allowed as a deduction in his individual personal return for his taxable year with or within which the taxable year of the partnership ends, to an amount which, when added to the amount of contributions made by the partner individually and claimed as a deduction, is not in excess of 15 percent of his net income computed without the benefit of the deduction for contributions. In the case of a nonresident alien individual or a citizen of the United States entitled to the benefits of section 251, see sections 213 (c) and 251. For contributions or gifts by corporations, see § 29.23 (q)–1.

In the case of a husband and wife making a joint return, the deduction for contributions or gifts is the aggregate of such contributions or gifts made by the spouses, and is limited to 15 percent of the aggregate net income of the spouses (computed without regard to such contributions or gifts) as shown by the joint return.

A donation made by an individual to an organization other than one referred to in section 23 (o) which bears a direct relationship to his business and is made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute an allowable deduction as business expense.

Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses, are not deductible from gross income.

If the contribution or gift is other than money, the basis for calculation of the amount thereof shall be the fair market value of the property at the time of the contribution or gift.

In connection with claims for deductions under section 23 (o), there shall be stated in returns of income the name and address of each organization to which a contribution or gift was made and the amount and the approximate date of the actual payment of the contribution or gift in each case. Claims for deductions under section 23 (o) must be substantiated, when required by the Commissioner, by a statement from the organization to which the contribution or gift was made showing whether the organization is a domestic organization, the name and address of the contributor or donor, the amount of the contribution or gift and the date of the actual payment thereof, and by such other information as the Commissioner may deem necessary.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 503 (b), 2d Rev. Act 1940; sec. 10 (b) Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(p) *Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan*—(1) *General rule.* If contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under subsection (a) but shall be deductible, if deductible under subsection (a) without regard to this subsection, under this subsection but only to the following extent:

(A) In the taxable year when paid, if the contributions are paid into a pension trust, and if such taxable year ends within or with a taxable year of the trust for which the trust is exempt under section 165 (a), in an amount determined as follows:

(i) an amount not in excess of 5 per centum of the compensation otherwise paid or accrued during the taxable year to all the employees under the trust, but such amount may be reduced for future years if found by the Commissioner upon periodical examinations at not less than five-year intervals to be more than the amount reasonably necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan, plus

(ii) any excess over the amount allowable under clause (i) necessary to provide with respect to all of the employees under the trust the remaining unfunded cost of their past and current service credits distributed as a level amount, or a level percentage of compensation, over the remaining future service of each such employee, as determined under regulations prescribed by the Commissioner with the approval of the Secretary, but if such remaining unfunded cost with respect to any three individuals is more than 50 per centum of such remaining unfunded cost, the amount of such unfunded cost attributable to such individuals shall be distributed over a period of at least 5 taxable years, or

(iii) in lieu of the amounts allowable under (i) and (ii) above, an amount equal to the normal cost of the plan, as determined under regulations prescribed by the Commissioner with the approval of the Secretary, plus, if past service or other supplementary pension or annuity credits are provided by the plan, an amount not in excess of 10 per centum of the cost which would be required to completely fund or purchase such pension or annuity credits as of the date when they are included in the plan, as determined under regulations prescribed by the Commissioner with the approval of the Secretary, except that in no case shall a deduction be allowed for any amount (other than the normal cost) paid in after such pension or annuity credits are completely funded or purchased.

(iv) Any amount paid in a taxable year in excess of the amount deductible in such year under the foregoing limitations shall be deductible in the succeeding taxable years in order of time to the extent of the difference between the amount paid and deductible in each such succeeding year and the maximum amount deductible for such year in accordance with the foregoing limitations.

(B) In the taxable year when paid, in an amount determined in accordance with subparagraph (A) of this paragraph, if the contributions are paid toward the purchase of retirement annuities and such purchase is a part of a plan which meets the requirements of section 165 (a), (3), (4), (5), and (6), and if refunds of premiums, if any, are applied within the current taxable year or next succeeding taxable year towards the purchase of such retirement annuities.

(C) In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 165 (a), in an amount not in excess of 15 per centum of the compensation otherwise paid or accrued during the taxable year to all employees under the stock bonus or profit-sharing plan. If in any taxable year beginning after December 31, 1941, there is paid into the trust, or a similar trust then in effect, amounts less than the amounts deductible under the preceding sentence, the excess, or if no amount is paid, the amounts deductible, shall be carried forward and be deductible when paid in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any such succeeding taxable year shall not exceed 15 per centum of the compensation otherwise paid or accrued during such succeeding taxable year to the beneficiaries under the plan. In addition, any amount paid into the trust in a taxable year beginning after December 31, 1941, in excess of the amount allowable with respect to such year under the preceding provisions of this subparagraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year together with the amount allowable under the first sentence of this subparagraph shall not exceed 15 per centum of the compensation otherwise paid or accrued during such taxable year to the beneficiaries under the plan. The term "stock bonus or profit-sharing trust", as used in this subparagraph, shall not include any trust designed to provide benefits upon retirement and covering a period of years, if under the plan the amounts to be contributed by the employer can be determined actuarily [1] as provided in subparagraph (A). If the contributions are made to two or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for the purposes of applying the limitations in this subparagraph.

(D) In the taxable year when paid, if the plan is not one included in paragraphs (A), (B), or (C), if the employees' rights to or derived from such employer's contribution or such compensation are nonforfeitable at the time the contribution or compensation is paid.

(E) For the purposes of subparagraphs (A), (B), and (C), a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made within sixty days after the close of the taxable year of accrual.

(F) If amounts are deductible under subparagraphs (A) and (C), or (B) and (C), or (A), (B), and (C), in connection with two or more trusts, or one or more trusts and an annuity plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed 25 per centum of the compensation otherwise paid or accrued during the taxable year to the persons who are the beneficiaries of the trusts or plans. In addition, any amount paid into such trust or under such annuity plans in a taxable year beginning after December 31, 1941, in excess of the amount allowable with respect to such year under the preceding provisions of this subparagraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year together with the amount allowable under the first sentence of this subparagraph shall not exceed 30 per centum of the com-

[1] So in original.

pensation otherwise paid or accrued during such taxable years to the beneficiaries under the trusts or plans. This subparagraph shall not have the effect of reducing the amount otherwise deductible under subparagraphs (A), (B), and (C), if no employee is a beneficiary under more than one trust, or a trust and an annuity plan.

If there is no plan but a method of employer contributions or compensation has the effect of a stock bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation, this paragraph shall apply as if there were such a plan.

(2) *Deductions under prior income tax acts.* Any deduction allowable under section 23 (q) of the Revenue Act of 1928 (45 Stat. 802), or the Revenue Act of 1932 (47 Stat. 182), or the Revenue Act of 1934 (48 Stat. 691), under section 23 (p) of the Revenue Act of 1936 (49 Stat. 1661), or the Revenue Act of 1938 (52 Stat. 464), or the Internal Revenue Code for a taxable year beginning before January 1, 1943, which under such section was apportioned to any taxable year beginning after December 31, 1942, shall be allowed as a deduction for the years to which so apportioned to the extent allowable under such section if it had remained in force with respect to such year.

[NOTE: Prior to its amendment by section 162 (b), Rev. Act 1942, section 23 (p) read, as follows:

"(p) *Pension trusts*—(1) *General rule.* An employer establishing or maintaining a pension trust to provide for the payment of reasonable pensions to his employees shall be allowed as a deduction (in addition to the contributions to such trust during the taxable year to cover the pension liability accruing during the year, allowed as a deduction under subsection (a) of this section) a reasonable amount transferred or paid into such trust during the taxable year in excess of such contributions, but only if such amount (1) has not theretofore been allowable as a deduction, and (2) is apportioned in equal parts over a period of ten consecutive years beginning with the year in which the transfer or payment is made.

"(2) *Deductions under prior income tax acts.* Any deduction allowable under section 23 (q) of the Revenue Act of 1928, 45 Stat. 802, or the Revenue Act of 1932, 47 Stat. 182, or the Revenue Act of 1934, 48 Stat. 691, under section 23 (p) of the Revenue Act of 1936, 49 Stat. 1661, or the Revenue Act of 1938, 52 Stat. 464, which under such section was apportioned to any taxable year beginning after December 31, 1937, shall be allowed as a deduction in the years to which so apportioned to the extent allowable under such section if it had remained in force with respect to such year.

"(3) *Exemption of trusts under section 165.* The provisions of paragraphs (1) and (2) of this subsection shall be subject to the qualification that the deduction under either paragraph shall be allowable only with respect to a taxable year (whether the year of the transfer or payment or a subsequent year) of the employer ending within or with a taxable year of the trust with respect to which the trust is exempt from tax under section 165."]

SEC. 162. PENSION TRUSTS. (Revenue Act of 1942, Title I.)

* * * * *

(d) *Taxable years to which amendments applicable.* The amendments made by this section shall be applicable as to both the employer and employees only with respect to taxable years of the employer beginning after December 31, 1941, except that—

(1) In the case of a stock bonus, pension, profit-sharing, or annuity plan in effect on or before September 1, 1942,

(A) such a plan shall not become subject to the requirements of section 165 (a) (3), (4), (5), and (6) until the beginning of the first taxable year beginning after December 31, 1942,

(B) such a plan shall be considered as satisfying the requirments of section 165 (a) (3), (4), (5), and (6) for the period beginning with the beginning of the first taxable year following December 31, 1942, and ending December 31, 1943, if the plan satisfies such requirements by December 31, 1943.

(C) if the contribution of an employer to such a plan in the employer's taxable year beginning in 1942 exceeds the maximum amount deductible for such year under section 23 (p) (1), as amended by this section, the amount deductible in such year shall be not less than the sum of—

(i) the amount paid in such taxable year prior to September 1, 1942, and deductible under section 23 (a) or 23 (p) prior to amendment by this section, and

(ii) with respect to the amount paid in such taxable year on or after September 1, 1942, that proportion of the amount deductible for the taxable year under section 23 (p) (1), as amended by this section, which the number of months after August 31, 1942, in the taxable year bears to twelve.

(2) In the case of a stock bonus, pension, profit sharing or annuity plan put into effect after September 1, 1942, such a plan shall be considered as satisfying the requirements of section 165 (a) (3), (4), (5) and (6) for the period beginning with the date such plan is put into effect and ending December 31, 1943, if the plan satisfies such requirements by December 31, 1943.

* * * * *

§ 29.23 (p)–1 *Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan; in general.* Section 23 (p) prescribes limitations upon deductions for amounts contributed by an employer under a pension, annuity, stock bonus, or profit-sharing plan, or under any plan of deferred compensation. It is immaterial whether the plan covers present employees only, or present and former employees, or only former employees. Section 23 (p) does not cover contributions or compensation which give the employee or former employee present benefits such as life insurance protection. The cost of such benefits is deductible to the extent allowable under section 23 (a). See § 29.165–6. Section 23 (p), however, is applicable to all contributions under a stock bonus, pension, profit-sharing, or annuity plan, whether or not the employee's rights in such contributions are nonforfeitable.

A contribution to be deductible under section 23 (p) must be an ordinary and necessary expense which would be deductible under section 23 (a) if it were not for the fact that the statute specifically provides that it shall be deductible under section 23 (p). A contribution by a corporation under a plan which is created primarily for the purpose of benefiting shareholders of the company is not deductibe. Such contribution may constitute a dividend within the meaning of section 115 (a). A contribution under a plan that is set up for the exclusive benefit of employees as such, and thus represents an item of expense, is of the nature of compensation for personal services rendered by the employees covered by the plan. The amount of contributions allowable as a deduction has an over-all limitation—the entire contributions for the taxable year when added to other compensation paid must represent reasonable compensation for services rendered by the employee beneficiaries. In the case of contributions for pensions for employees, any contributions on behalf of an employee in excess of the amount necessary to provide a reasonable pension for the employee in view of his past and current services is not deductible. What constitutes a reasonable pension will depend upon the facts in the particular case. Compensation otherwise paid the employee, length of service, and retirement age are among the elements to be considered in determining what is a reasonable pension. In the case of a stock bonus or profit-sharing plan which provides for additional compensation for employees not paid as a pension, a contribution will not be fully deductible unless it can be justified as a reasonable addition to the compensation otherwise paid to employees who are beneficiaries under the plan. In addition to the over-all limitation referred to above, section 23 (p) sets forth further limitations as to the amounts that may be deductible for the taxable year.

Section 23 (p) is not confined to formal stock bonus, pension, profit-sharing, and annuity plans, or deferred compensation plans, but it includes any method of contributions or compensation having the effect of a stock bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation. Thus, a corporation paying pensions to such of its retired employees and in such amounts as may be determined from time to time by the board of directors or responsible officers of the company has a plan in effect that is governed by section 23 (p). If an employer on the accrual basis defers paying any compensation to an employee until a later year or years under an arrangement having the effect of a stock bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation, he shall not be allowed a deduction until the year in which the compensation is paid. This provision is not intended to cover the case where an employer on the accrual basis defers payment of compensation after the year of accrual merely because of inability to pay such compensation in the year of accrual, as, for example, where the funds of the company are not sufficient to enable payment of the compensation without jeopardizing the solvency of the company, or where the liability accrues in the earlier year, but the amount payable cannot be exactly determined until the later year.

Deductions under section 23 (p) are generally allowable only for the year for which the contribution or compensation is paid, regardless of the fact that the taxpayer may make his return on the accrual basis. Exceptions are made in the case of overpayments as provided in subparagraphs (A), (C), and (F) of section 23 (p) (1), and, as provided by section 23 (p) (1) (E), in the case of payments made by a taxpayer on the accrual basis within 60 days after the close of the taxable year of accrual. This latter provision is intended to permit a taxpayer on the accrual basis to

deduct such accrued contribution or compensation, provided payment is actually made within 60 days after the close of the year of accrual.

Any payments shall be disallowed as a deduction under section 23 (p), if determined by the National War Labor Board, the Secretary of Agriculture, or the Commissioner to have been made in contravention of the Act of October 2, 1942, entitled "An Act to amend the Emergency Price Control Act of 1942, to aid in preventing inflation, and for other purposes," as amended (Public Law 729, Seventy-seventh Congress; Public Law 34, Seventy-eighth Congress), or of the regulations, orders, or rulings promulgated thereunder.

§ 29.23 (p)–2 *Information to be furnished by employer claiming deductions.* If a deduction from gross income is claimed under section 23 (p) (1) (A), (B), (C), or (F) the employer must file the following information to establish that the plan or plans meet the requirements of sections 165 (a) or 23 (p) (1) (B), and that the deductions claimed do not exceed the amount allowable under subparagraphs (A), (B), (C), or (F) of section 23 (p) (1), as the case may be:

(a) Verified copies of all the instruments constituting the plan or plans intended to qualify under section 165 (a), including trust indentures, group annuity contracts, and specimen copy of each type of individual contract, with all amendments to any such instruments.

(b) A statement describing the plan or plans which indicates the name or names of the employers, date of inception of each plan, type of administration (whether a trust or insured plan), and a summary of the provisions relating to:

(1) Employee eligibility requirements for participation in the plan,

(2) Employee contributions, if any,

(3) Employer contributions,

(4) The basis or formula for determining the amount of each type of benefit and the requirements for obtaining such benefits,

(5) The vesting requirements,

(6) The method of funding, and

(7) The basis of distribution upon liquidation.

(c) A tabulation in columnar form showing the information specified below with respect to each of the 25 highest paid employees, listed in the order of their compensation, covered by the plan:

(1) Name.

(2) Whether an officer.

(3) Percentage of each class of stock owned directly or indirectly by the employee or members of his family.

(4) Whether the principal duties consist in supervising the work of other employees.

(5) Year of birth.

(6) Length of service for employer on date of statement.

(7) Total compensation paid or accrued during the taxable year showing separately (i) basic salary, (ii) other direct payments, such as bonuses and commissions, (iii) compensation paid other than in cash, such as goods, services, insurance protection, etc.

(8) Amounts contributed during the taxable year with respect to the employee by the employer under each other plan of deferred compensation.

(9) Amounts paid under the plan during the taxable year by the employer for the benefit of the employee for (i) retirement annuity or other deferred benefits, showing amounts paid for (a) past service and (b) current service, (ii) life insurance protection, if any, (iii) percentage which each such contribution bears to total of such contributions made for all employees under the plan.

(10) Based on the actuarial method and assumptions used in determining the total employer contributions, the amount of employer liability under the plan (i) with respect to service rendered by the employee prior to the taxable year and (ii) with respect to current service of the employee for the taxable year.

(11) If a pension plan, the amount of benefit to be normally payable annually to each such employee.

(d) The total for items (7) and (8) set forth in paragraph (c) of this section with respect to all of the employees included under the plan and also with respect to all of the employees; also the total for item (9) with respect to all of the employees included under the plan.

(e) A schedule showing the total number of employees as of the close of the taxable year for each of the following groups:

(1) All seasonal and part-time employees excluded under the percentage calculation of section 165 (a) (3) (A) (reasonably estimated).

(2) All employees excluded under the years of service requirement (reasonably estimated).

(3) All employees excluded because older than a maximum age (reasonably estimated).

(4) All employees excluded because younger than a minimum age (reasonably estimated).

(5) All employees excluded because of maximum salary requirement.

(6) All employees excluded solely because of minimum salary requirement and by separate schedule all employees excluded both because of minimum salary requirement and other reason or reasons.

(7) All employees excluded for reasons other than those listed above, specifying reasons.

(8) All employees covered by the plan.

(9) All employees of the employer.

(f) A detailed balance sheet together with or including actuarially determined assets and liabilities, showing equities under insurance or annuity contracts, if any; and a statement of receipts and disbursements during the year.

(g) A statement or schedules showing the valuation assumptions with respect to interest, mortality, turn-over, rate of salary increase, etc., used in determining the costs under the plan. In addition, a statement showing the method of application of such factors to the data, in sufficient detail to permit actuarial analysis as to adequacy thereof and a summary of the total costs claimed, by risk or other pertinent groups, showing the basis for determining the amount of deduction claimed.

If a deduction is claimed under section 23 (p) (1) (D) for the taxable year, the taxpayer shall furnish such information as is necessary to show that the deduction is not allowable under the other subparagraphs of section 23 (p) (1), that the amount paid is an ordinary and necessary expense, and that the employees' rights to or derived from such employer's contribution or such compensation were nonforfeitable at the time the contribution or compensation was paid.

The Commissioner may, in addition, require any further information that he considers necessary to establish deductions under section 23 (p), and may waive the filing of such information required herein which he considers unnecessary in the particular case. If the data and information required to be filed under paragraphs (a), (b), and (g) of this section are filed for the first taxable year for which deductions are claimed under section 23 (p), such data and information need not be filed for subsequent years unless a change is made in the plan, instruments, or valuation assumptions described in paragraph (g) of this section, in which case a statement shall be filed at the close of the taxable year showing what changes have been made and the effect thereof. The information required under the other paragraphs of this section shall be filed annually, unless the Commissioner waives the filing of any portion thereof in any particular case.

Records substantiating all data and information specified in this section must be kept at all times available for inspection by internal revenue officers at the main office or place of business of the employer.

§ 29.23 (p)–3 *Amounts deductible under a plan in effect on or before September 1, 1942 for a taxable year beginning in 1942.* Section 162 (d) of the Revenue Act of 1942 (set forth immediately preceding § 29.23 (p)–1 allows additional deductions for a taxable year of an employer beginning in 1942 if the deductions are taken under a plan in effect on or before September 1, 1942. For the taxable year mentioned such plan need not meet the requirements of section 165 (a) (3), (4), (5), and (6) of the Internal Revenue Code. See § 29.165–5. If the plan meets the other requirements of section 165 (a) at all times during the taxable year, the employer will be entitled to the amount deductible under section 23 (p), as amended by the Revenue Act of 1942, for such taxable year, or for the amount determined under the following computation, whichever is the greater: The amount paid in such taxable year prior to September 1, 1942, to the extent that such amount is deductible under section 23 (a) and section 23 (p), prior to its amendment by the Revenue Act of 1942, plus such portion of the amount paid on or after September 1, 1942, and deductible under section 23 (p) (1), as amended by the Revenue Act of 1942, which the number of months after August 31, 1942, in the taxable year bears to 12. For ex-

ample, an employer making a return on the calendar year basis paid into a pension trust on March 1, 1942, the sum of $200,000, and on October 1, 1942, he made a further contribution of $100,000. Assume that the total contributions of $300,000 would have been deductible under section 23 (a) and section 23 (p), prior to its amendment by the Revenue Act of 1942, but that only $240,000 thereof is deductible under section 23 (p), as amended by the Revenue Act of 1942, without giving effect to section 162 (d) (1) (C) of the Revenue Act of 1942. A deduction of $280,000 will be allowable for 1942, determined as follows:

Amount contributed prior to September 1, 1942, and deductible under section 23 (a) and section 23 (p), prior to its amendment	$200,000
Pro-rata portion of total 1942 contributions allowed under section 23 (p), as amended (⅓ of $240,000)	80,000
	280,000

§ 29.23 (p)–4 *Contribution of an employer to an employees' pension trust; in general (section 23 (p) (1) (A)).* A contribution of an employer to a pension trust to be deductible under section 23 (p) (1) (A) must be paid within the taxable year of the employer which ends within or with a taxable year of the trust for which the trust is exempt under section 165 (a). The term "pension trust" as used in section 23 (p) (1) (A) means a trust created or availed of by an employer to provide definite actuarially determinable benefits for his employees, which may include former employees, or their beneficiaries, to be paid over a period of years, generally for life, after the retirement of employees, based on service prior to retirement. The retirement benefits may be forfeitable or nonforfeitable. Retirement benefits are basically only life annuities payable after retirement. However, for purposes of this section a retirement benefit may include the following additional benefits: (a) a death benefit, as provided in the plan but not to exceed the excess of the reserve at retirement over the annuity payments received prior to the death of the retired employee (payable either in cash or over a period of years), (b) a benefit upon death or separation from service or upon termination of participation in the plan of an amount as provided in the plan but not to exceed the reserve accumulated for the retirement annuity at the time. Any additional benefits, such as life insurance payments exempt under section 22 (b) (1), will not be considered as part of the retirement annuity for purpose of this section. The cost of such life insurance benefits as distinguished from the cost of an annuity is deductible under section 23 (a) to the extent it is an ordinary and necessary expense, and is includible in the income of the employee as additional compensation in the year or years payments for such life insurance are made. See § 29.165–6. An amount to be deductible under section 23 (p) (1) (A) must also meet the requirements of section 23 (a). It must be an ordinary and necessary expense. See § 29.23 (p)–1. In addition to the requirement that a contribution to be deductible must be an ordinary and necessary expense, the amount of contributions to a pension trust deductible for any taxable year is subject to the further limitations set out in section 23 (p) (1) (A).

In determining allowable deductions all calculations must consider discount for expected mortality and anticipated interest and may consider expected turnover, anticipated salary increases, variable retirement ages, variations in mortality for different classes of risks, other pertinent factors of an actuarial nature, and expenses of operation. In any case, the amount of deduction otherwise allowable for the taxable year shall be reduced by any decrease in liability which may arise from an experience during the next preceding taxable year more favorable than the assumed experience on which the cost calculations were based for each year. In no event shall an interest rate be less than, nor shall any mortality table require premiums greater than, reasonable amounts warranted under the circumstances. In the case of contributions made to a trust where the employer incurs expenses, not payable out of such contributions, such as trustee's fees, actuary's fees, and other expenses, the employer shall be allowed deductions for such expenses under section 23 (a) to the extent they are ordinary and necessary. A properly weighted retirement age determined from reasonable analyses of the experience of the employees included in the plan may be used as the normal retirement age. Different basic assumptions or premium rates may be used for different classes of risks or different groups where such differences are justified by conditions or required by contract, so long as the results of the application thereof are reasonable and do not cause any discrimination.

§ 29.23 (p)–5 *Contributions of an employer to an employees' pension trust; amounts deductible under section 23 (p) (1) (A) (i).* If the amount of contributions for the first taxable year that section 23 (p) (1) (A) is applicable does not exceed 5 percent of the compensation otherwise paid or accrued during the taxable year to all the employees covered by the trust, it will not be necessary for the taxpayer for such taxable year to submit actuarial data to show that such amount is reasonably necessary to provide the remaining unfunded cost of past and current service credits to all employees under the plan. The term "compensation otherwise paid or accrued" means all of the compensation paid or accrued except that for which a deduction is allowable under a plan that qualifies under section 165 (a), including a plan that qualifies under section 23 (p) (1) (B). However, the Commissioner will make periodical examinations from time to time, at not less than 5-year intervals, and will reduce the amount allowable as a deduction below the 5 percent figure for the years following the taxable year with respect to which the examination is made, if he finds that such percentage is producing contributions in excess of the amount reasonably necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan.

For the second year and each fifth year thereafter the taxpayer shall submit with his return a certification by a qualified actuary or the company underwriting the pension of the amount determined to be necessary to provide the remaining unfunded cost of past and current service credits. Such certificate shall be accompanied by appropriate supporting data. If the Commissioner determines that the deduction claimed for the taxable year is excessive, the percentage limitation for future years shall be reduced to such amount as may be determined by the Commissioner. During each future year the amount deductible shall be limited to such lower percentage as has been approved by the Commissioner, and no change will be permitted in such percentage until a subsequent actuarial valuation shows such change to be necessary. Such subsequent valuation may be made at any time by the taxpayer and submitted to the Commissioner.

§ 29.23 (p)–6 *Contributions of an employer to an employees' pension trust; amounts deductible under section 23 (p) (1) (A) (ii).* The level amount or level percentage of compensation under clause (ii) of section 23 (p) (1) (A) may be determined by any reasonable and generally accepted actuarial method selected by the employer. While the need for actuarial calculations is implicit in clause (ii), the statute leaves the determination of specific methods to regulations to be prescribed by the Commissioner with the approval of the Secretary. Clause (ii) must be construed in the light of its obvious relationship to clauses (i) and (iii) and the interplay of clauses (i), (ii), and (iii). Each employer desiring to fund under clause (ii) shall submit the proposed method to the Commissioner and receive approval of such method before the results will be acceptable. Any method which does not fund cost of past service credits more rapidly than that permitted under clause (iii) will be acceptable, and the approval of the Commissioner will not be necessary in such a case.

If the total costs computed under clause (ii) exceed the amount allowable under clause (i), the amount allowable under clause (ii) will be the excess of such total cost over the amount allowable in clause (i). In other words, if a deduction is claimed under clause (ii), the total amount allowable under both clauses (i) and (ii) will be the total cost for the year with respect to either the "level amount" basis or the "level percentage" of payroll basis.

§ 29.23 (p)–7 *Contributions of an employer to an employees' pension trust; amounts deductible under section 23 (p) (1) (A) (iii).* The basic limitation on deductions for any year under clause (iii) of section 23 (p) (1) (A) is the sum of the "normal" cost, plus an amount equal to one-tenth of the cost of "past service or other supplementary pension or annuity credits" not provided by such "normal" cost.

"Normal cost" for any taxable year is the cost actuarially determined which would be required during such year to maintain the plan assuming that the plan had been in effect from the beginning of the service of each then included employee and that such costs for prior years had been paid and all assumptions as to interest, mortality, time of payment, etc., had been fulfilled. Such normal cost may be determined under any reasonable and generally accepted actuarial method and may be expressed either as (a) a level amount or a level percentage of payroll or (b) the total for all of the employees of the single premiums for the unit benefits of each accruing during the year. The method of funding used for determining normal costs must be reasonable and consistent with the provisions of the plan. No method of deteremining normal cost will be permitted which results in discrimination or manipulation.

Past service or supplementary cost at any time is the amount which would be required at such time to meet all the future retirement annuity benefits provided by the plan which will not be met by the expected payments of normal costs and expected future contributions of employees.

§ 29.23 (p)–8 *Contributions of an employer to an employees' pension trust; deduction of excessive amounts paid in a taxable year (section 23 (p) (1) (A) (iv)).* Any amount paid in a taxable year in excess of the amount deductible in such year under clause (ii) or (iii) of section 23 (p) (1) (A) shall be deductible under the provisions of clause (iv) in the succeeding taxable years in order of time to the extent of the difference between the amounts paid and deductible in each such succeeding taxable year and the maximum amounts deductible for such year in accordance with the limitations under clause (ii) or (iii), whichever is applicable. Thus, if the normal cost of the plan required the taxpayer to pay under the plan $100,000 for the taxable year 1942, and he paid $150,000, he would be allowed a deduction of $100,000 for 1942, but if the normal cost continued to be $100,000 for 1943, and he paid in $75,000 that year, he would be allowed a deduction of $100,000 for 1943, and he would be allowed to take the remaining $25,000 in 1944, or for the first succeeding year or years, in which he pays in less than the normal cost for that year.

§ 29.23 (p)–9 *Contributions of an employer toward the purchase of retirement annuities (section 23 (p) (1) (B)).* Section 23 (p) (1) (B) relates to the deduction of amounts paid by an employer for retirement annuities for his employees. If amounts are contributed by an employer to a pension trust and the trust purchases such annuities, the amounts so contributed are deductible under section 23 (p) (1) (A). In order that an employer's payments for retirement annuities may be deductible under section 23 (p) (1) (B), the annuity contracts must be purchased under a plan that meets the requirements with respect to coverage and discrimination in contributions and benefits set out in section 165 (a) (3), (4), (5), and (6). See §§ 29.165–3 to 29.165–5, inclusive. In the case of an annuity plan in effect on or before September 1, 1942, the annuity plan need not meet the requirements of section 165 (a) (3), (4), (5), and (6) except for taxable years beginning after December 31, 1942. (See section 162 (d) of the Revenue Act of 1942, set forth immediately preceding § 29.23 (p)–1.) In addition, no deduction will be allowable for any taxable year under section 23 (p) (1) (B) if any refund of premiums which may be made under the annuity contracts is not applied within the taxable year in which received, or within the next succeeding taxable year, toward the purchase of such retirement annuities for the employees covered under the annuity plan. This provision applies whether the refund is made upon the termination of any annuity contract or prior thereto. If the annuity plan is discontinued, any amount refunded shall be applied during the taxable year of the employer in which the refund is made or during his next succeeding taxable year toward the purchase of annuity contracts for all employees covered by the plan, whether or not the rights of such employees are nonforfeitable. Such refund shall be applied equitably, and, so far as the amount of refund will permit, to the liability under the plan, including contingent liability, with respect to each included employee. See § 29.165–2 for similar requirements upon termination of a pension trust. All amounts refunded under an annuity contract shall be considered a return of premiums to the extent that the amounts recovered do not exceed the total premiums paid. Any amounts credited to an employer under an annuity contract toward the payment of premiums then or thereafter due and which are not refunded, are not required to be credited against the premiums due for the current taxable year or the next succeeding taxable year, but may be credited against premiums due for any taxable year. If under the terms of any annuity contract it is possible for refunds of premiums to be made and not applied within the taxable year in which the refund is received or the next succeeding taxable year toward the purchase of such retirement annuities, no deduction will be allowable under section 23 (p) (1) (B). However, section 23 (p) (1) (B) shall be applicable if under the terms of the annuity contract any refunds are required to be made to a trustee, other than the employer, under an irrevocable trust indenture which provides that such refunds shall be used solely for the payment of premiums for the current year or subsequent years, under the annuity contract.

§ 29.23 (p)–10 *Contributions of an employer to a stock bonus or profit sharing trust (sections 23 (p) (1) (C)).* Section 23 (p) (1) (C) is applicable to contributions of an employer to a stock bonus or profit-sharing trust that meets the requirements of section 165 (a). The contributions to be deductible under this section must be paid in a taxable year of the employer which ends within or with a taxable year of the trust with respect to which the trust is exempt under section 165 (a). Any amount deductible under any of the subdivisions of section 23 (p) (1) (A) is not deductible under section 23 (p) (1) (C), since such amounts represent contributions to a pension trust and not to a stock bonus or profit-sharing trust. As to the types of contributions deductible under section 23 (p) (1) (A), see §§ 29.23 (p)–4 to 29.23 (p)–7, inclusive.

The amount of contributions deductible under section 23 (p) (1) (C) in any taxable year is limited to 15 percent of the compensation otherwise paid or accrued during the taxable year to all of the employees covered by the stock bonus or profit-sharing plan. The term "compensation otherwise paid or accrued" means all of the compensation paid or accrued except that for which a deduction is allowable under a plan that qualifies under section 165 (a). If contributions are made by an employer during a taxable year to two or more stock bonus or profit-sharing trusts, he is limited in his deduction to 15 percent of the compensation otherwise paid or accrued during the taxable year to all of the employees covered by such trusts. If an employer contributes in any taxable year beginning after December 31, 1941, an amount in excess of the maximum amount for which he is allowed a deduction under section 23 (p) (1) (C), such excess shall be deductible in the succeeding taxable years in order of time, but the total amount deductible in any one taxable year shall not exceed 15 percent of the compensation otherwise paid or accrued during such succeeding taxable year to the employees covered by the plan in such year. For example, if an employer pays into a profit-sharing trust during 1943 $100,000, and he is limited to a deduction of $60,000 for such year under the 15 percent limitation provision, and he pays in $70,000 in 1944, although entitled to a deduction of $100,000 for 1944, if he had paid in that amount, nevertheless he will be allowed a deduction of $100,000 for 1944. The remaining $10,000 of the 1943 overpayment not deductible for 1943 or 1944 shall be allowable as a deduction in any succeeding year or years in order of time to the extent that he has not made a contribution of the maximum allowable for such succeeding year or years.

If such contributions are made in any taxable year beginning after December 31, 1941, and such contributions are less than the maximum amount that would have been deductible for such year if contributed, the excess of such maximum amount over the amount actually contributed, or if no amount was contributed, then such maximum amount shall be carried forward and be deductible for the succeeding taxable years, in order of time, but the amount so carried forward shall not be deductible for any taxable year in an amount in excess of 15 percent of the compensation otherwise paid or accrued during such taxable year to the employees covered by the plan. For example, an employer paid into an exempt

profit-sharing trust in 1942 $50,000. Fifteen percent of the total compensation paid or accrued to the employees covered by the trust, not including the amounts contributed to the trust on behalf of such employees, for such year amounted to $150,000. For 1943, 15 percent of such compensation for such employees amounted to $125,000. The employer contributed $200,000 to such a trust during that year. The amount deductible for 1943 is limited by section 23 (p) (1) (C) to $225,000; $125,000 (amount equal to 15 percent of the compensation otherwise paid in 1943) plus $100,000 (amount carried forward from 1942, which amount is not in excess of such 15 percent of such compensation).

§ 29.23 (p)–11 *Contributions of an employer under a plan that does not meet the requirements of section* 165 (a) *(section 23 (p) (1) (D)).* Subparagraph (D) of section 23 (p) (1) covers all cases for which deductions are allowable under section 23 (p) (1) but not allowable under subparagraphs (A), (B), (C), or (F) of such section. No deduction is allowable under section 23 (p) (1) (D) for any contribution paid or accrued by an employer under a stock bonus, pension, profit-sharing, or annuity plan, or for any compensation paid or accrued on account of any employee under a plan deferring the receipt of such compensation, except for the year when paid, and then only to the extent allowable under section 23 (p) (1). See § 29.23 (p)–1. If payments are made under such a plan and the amounts are not deductible under the other subparagraphs of section 23 (p) (1), they are deductible under subparagraph (D) to the extent that individual employees' rights to or derived from such employer's contribution or such compensation are nonforfeitable at the time the contribution or compensation is paid. As to what constitutes nonforfeitable rights of an employee, see § 29.165–7. If an amount is accrued but not paid during the taxable year, or if paid during the taxable year and the employees' rights are forfeitable at the time the amount is paid, no deduction will be allowed the employer for such amount for such taxable year.

§ 29.23 (p)–12 *Contributions of an employer to two or more employees' trusts, or annuity plans (section 23 (p) (1) (F)).* Section 23 (p) (1) (F) covers cases where an employer makes contributions either to (a) a pension trust and a profit-sharing or stock bonus trust, or (b) a profit-sharing or stock bonus trust and under an annuity plan, or (c) both pension and profit-sharing or stock bonus trusts and under an annuity plan, and such contributions are made under a plan or plans that meet the requirements of section 165 (a). It does not cover cases where an employer makes contributions to two or more pension trusts or to a pension trust and under an annuity plan or plans. In such cases deductions are determined under section 23 (p) (1) (A) if made under a plan that meets the requirements of section 165 (a) or, if not meeting such requirements, then under section 23 (p) (1) (D). Neither is it applicable to a case where there are only two or more stock bonus or profit-sharing trusts. See § 29.23 (p)–10. If no employee is a beneficiary under more than one trust, or a trust and an annuity plan, section 23 (p) (1) (F) is not applicable.

The amount deductible under section 23 (p) (1) (F) is limited to 25 percent of the compensation otherwise paid or accrued during the taxable year to the employees covered by the plans. The term "compensation otherwise paid or accrued" means all of the compensation paid or accrued except that for which a deduction is allowable under a plan that qualifies under section 165 (a). If an employer contributes an amount under such plans in excess of the 25 percent limitation, he shall be allowed deductions for such excess in the succeeding years in order of time but limited in amount in any one year so that the total amount allowable under section 23 (p) (1) (F) for any one taxable year shall not exceed 30 percent of the compensation otherwise paid or accrued during such taxable year to the employees covered by the plans. For example, if an employer on the calendar year basis contributed during 1942 to pension and profit-sharing trusts amounts equal to 40 percent of the compensation otherwise paid employees covered by the plans, and in 1943 contributed to such trusts an amount equal to 25 percent of such compensation, he would be allowed a deduction for 1943 for the excess for which no deduction was allowable for 1942 plus the amount otherwise allowable for 1943 in an aggregate amount not in excess of 30 percent of the compensation otherwise paid such employees for 1943. If there remained a portion of such excess for which no deduction was allowable for 1943, such portion could be carried over to 1944 and succeeding taxable years, subject to the 30 percent limitation.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(q) *Charitable and other contributions by corporations.* In the case of a corporation, contributions or gifts payment of which is made within the taxable year to or for the use of:

(1) The United States, any State, Territory, or any political subdivision thereof or the District of Columbia, or any possession of the United States, for exclusively public purposes; or

(2) A corporation, trust, or community chest, fund, or foundation, created or organized in the United States or in any possession thereof or under the law of the United States, or of any State or Territory, or of the District of Columbia, or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children (but in the case of contributions or gifts to a trust, chest, fund, or foundation, payment of which is made within a taxable year beginning after the date of the cessation of hostilities in the present war, as proclaimed by the President, only if such contributions or gifts are to be used within the United States or any of its possessions exclusively for such purposes), no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

to an amount which does not exceed 5 per centum of the taxpayer's net income as computed without the benefits of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary.

§ 29.23 (q)–1 *Contributions or gifts by corporations.* A corporation may deduct from its gross income contributions or gifts to organizations described in section 23 (q) (see § 29.22 (b) (4)–1 for definition of "political subdivision"). Where payment is made in a taxable year beginning prior to the first taxable year beginning after the date of the cessation of hostilities in the present war, as proclaimed by the President, the charitable deduction prescribed is allowable to corporations even though the gifts or contributions are used outside of the United States or its possessions. Such deduction shall, to the extent provided by that section, be allowed only for the taxable year in which such contributions or gifts are actually paid, regardless of when pledged and regardless of the method of accounting employed by the corporation in keeping its books and records. As to charitable contributions by corporations not deductible under section 23 (a), see § 29.23 (a)–13. Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income.

The provisions of the last paragraph of § 29.23 (o)–1, relating to (1) the statement in returns of the name and address of each organization to which a contribution or gift was made and the amount and the approximate date of the actual payment of the contribution or gift, (2) the substantiation of the claims for deductions when required by the Commissioner, and (3) the basis for calculation of the amount of a contribution or gift which is other than money, are equally applicable to claims for deductions of contributions or gifts by corporations under section 23 (q).

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act. 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(r) *Dividends paid by banking corporations.* For deduction of dividends paid by certain banking corporations, see section 121.

(s) *Net operating loss deduction.* For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

(t) *Amortization deduction.* The deduction for amortization provided in section 124.

(u) *Alimony, etc., payments.* In the case of a husband described in section 22 (k),

amounts includible under section 22 (k) in the gross income of his wife, payment of which is made within the husband's taxable year. If the amount of any such payment is, under section 22 (k) or section 171, stated to be not includible in such husband's gross income, no deduction shall be allowed with respect to such payment under this subsection. [NOTE: Under section 120 (g) of the Revenue Act of 1942, this provision is applicable only with respect to taxable years beginning after December 31, 1941; except that if the first taxable year beginning after December 31, 1941, of the husband does not begin on the same day as the first taxable year beginning after December 31, 1941, of the wife, this provision shall first become applicable in the case of the husband on the first day of the wife's first taxable year beginning after December 31, 1941, regardless of the taxable year of the husband in which such day falls.]

§ 29.23 (u)–1 *Periodic alimony payments.* A deduction is allowable under section 23 (u) with respect to periodic payments in the nature of, or in lieu of, alimony or an allowance for support actually paid by the taxpayer during his taxable year and required to be included in the income of the payee wife or former wife, as the case may be, under section 22 (k). As to the amounts required to be included in the income of the wife or former wife, as the case may be, see § 29.22 (k)–1. (For definition of husband and wife in such cases, see section 3797 (a) (17).)

The deduction is allowed only for such amounts as are actually paid on or after January 1, 1942, in a taxable year of the wife or former wife beginning after December 31, 1941. For this purpose, the taxpayer is treated as if he makes his income tax returns on the cash receipts and disbursements basis, regardless of the method of accounting actually employed by him in making such returns.

The deduction under section 23 (u) is allowed only to the obligor spouse. It is not allowed to an estate, trust, corporation, or any other person who may pay the alimony obligation of such obligor spouse. The obligor spouse, however, is not allowed a deduction for any periodic payment includible under section 22 (k) in the income of the wife or former wife, as the case may be, which payment is attributable to property transferred in discharge of his obligation and which, under section 22 (k) or section 171 is stated not to be includible in his gross income.

The following examples illustrate cases in which a deduction is or is not allowed under section 23 (u):

Example (1). Pursuant to the terms of a decree of divorce, H, in 1940, transfers securities valued at $100,000 in trust for the benefit of W, which fully discharges all his obligations to W. For 1942 and thereafter the periodic payments made by the trust to W are required to be included in W's income under section 22 (k). Such payments are stated in section 22 (k) not to be includible in H's income and, therefore, under section 23 (u) are not deductible from his income.

Example (2). A decree of divorce obtained by W from H incorporated a previous agreement of H to establish a trust, the trustees of which were instructed to pay W $5,000 a year for her life. The court retained jurisdiction to order H to provide further payments if necessary for the support of W. In 1942 the trustees paid to W $4,000 from the income of the trust and $1,000 from the corpus of the trust. Under the provisions of sections 22 (k) and 171 (b), W will include $5,000 in her income for 1942. (The trustees will deduct $4,000 from the income of the trust under section 162.) H will not include any part of the $5,000 in his income nor take a deduction therefor. If H had paid the $1,000 to W, rather than allowing the trustees to pay it out of corpus, he would have been entitled to a deduction for $1,000 under the provisions of section 23 (u).

For other examples, see § 29.22 (k)–1.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941; secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(v) *Bond premium deduction.* In the case of a bondholder, the deduction for amortizable bond premium provided in section 125.

(w) *Deductions of estate, etc., on account of decedent's deductions.* (1) In the case of a person described in section 126 (b), the amount of the deductions in respect of a decedent to the extent allowed by such subsection.

(2) In the case of a person described in section 126 (a), the amount of the deductions in respect of a decedent to the extent allowed by section 126 (c). [NOTE: Subsection (w) is, under sec. 134 (f), Rev. Act 1942, applicable only with respect to taxable years ending after December 31, 1942.]

(x) *Medical, dental, etc., expenses.* Except as limited under paragraph (1) or (2), expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent specified in section 25 (b) (2) (A) of the taxpayer. The term "medical care," as used in this subsection, shall include amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance).

(1) A husband and wife who file a joint return may deduct only such expenses as exceed 5 per centum of the aggregate net income of such husband and wife, computed without the benefit of this subsection, and the maximum deduction for the taxable year shall be not in excess of $2,500 in the case of such husband and wife.

(2) An individual who files a separate return may deduct only such expenses as exceed 5 per centum of the net income of the taxpayer, computed without the benefit of this subsection, and the maximum deduction for the taxable year shall be not in excess of $2,500 in the case of the head of a family, and not in excess of $1,250 in the case of all other such individuals.

§ 29.23 (x)–1 *Medical, dental, etc., expenses.* Section 23 (x) permits a deduction from gross income of payments for certain medical expenses. The deduction is allowable only to individuals and only with respect to medical expenses actually paid during the taxable year, regardless of when the incident or event which occasioned the expenses occurred and regardless of the method of accounting employed by the taxpayer in making his income tax return. If the medical expenses are incurred but not paid during the taxable year, no deduction can be taken for such year. Thus, if an expenditure was incurred in December, 1942, but not paid until January, 1943, no deduction can be taken for the year 1942.

The expenses paid must be for medical care of the taxpayer, his spouse, or a dependent of the taxpayer (see § 29.25–6 for description of dependents), not compensated for by insurance or otherwise. Where reimbursement, from insurance or otherwise, for medical expenses is not received until a taxable year subsequent to the year in which allowable medical expenses were paid, the reimbursement so received must be included in the gross income of the taxpayer for the taxable year received to the extent attributable to (and not in excess of) deductions allowed under section 23 (x) for any prior taxable year (see section 22 (b) (5)). Where during the year for which the deduction is taken payments are made for medical care which are not compensated for during such year but for which compensation is received in a subsequent year, the portion of the compensation so received which is attributable to the deduction taken is that proportion of such compensation which the amount of the deduction bears to the total amount of the payments made in the prior year not compensated for during such prior year.

It is unnecessary for the purposes of this section that the spouse or dependent of the taxpayer for whom the medical expenses are paid be such at the time of payment, or at the time they were incurred. Thus, payments made in June, 1942, by A, for medical services rendered B, his wife, in 1941, may be deducted by A for 1942 even though prior to payment for that year B died or secured a divorce; and payments made in July, 1942, by C for medical services rendered D in 1941 may be deducted by C for 1942 even though C and D were not married until June, 1942.

Only such medical expenses are deductible as exceed 5 percent of the net income computed without the deduction for medical expenses. Where a taxpayer has allowable deductions in the taxable year for both charitable contributions and medical expenses the allowable deductions for charitable contributions should be computed first, without regard to deduction for medical expenses, and thereafter the deduction for medical expenses should be calculated (see § 29.23 (o)–1). The maximum deduction allowable for medical expenses paid in any one taxable year is $2,500 in the case of the head of a family or a husband and wife filing a joint return. In all other cases, the maximum is $1,250.

The term "medical care" as used in this section and in section 23 (x) includes amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance). Payments for hospitalization insurance, or for membership in an association furnishing cooperative or so-called free-choice medical service, or group hospitalization and

clinical care are amounts which may be deducted. Amounts paid for operations or treatments affecting any portion of the body, including obstetrical expenses and expenses of X-rays or therapy treatments, are deemed to be for the purpose of affecting any structure or function of the body and are therefore deductible. Amounts expended for illegal operations or treatments or illegally procured drugs are not deductible. Allowable deductions under section 23 (x) will be confined strictly to expenses incurred primarily for the prevention or alleviation of a physical or mental defect or illness. Thus, payments for expenses for hospital, nursing (including nurses' board where paid by the taxpaper), medical, laboratory, surgical, dental and other diagnostic and healing services, for drugs and medical and dental supplies (including artificial teeth or limbs), and for ambulance hire and travel primarily for and essential to the rendition of the medical services or to the prevention or alleviation of a physical or mental defect or illness, are deductible.

In connection with claims for deductions under section 23 (x), the taxpayer shall furnish the name and address of each person to whom payment for medical expenses was made and the amount and the approximate date of the actual payment thereof in each case. If payment was in kind, then such fact shall be so reflected. Claims for deduction must be substantiated, when requested by the Commissioner, by a statement from the individual or entity to which payment for medical expenses was paid showing the nature of the service rendered, to or for whom rendered, the amount paid therefor, and the date of the actual payment thereof, and by such other information as the Commissioner may deem necessary.

The application of section 23 (x) and this section may be illustrated by the following example:

Example. Taxpayer A, divorced from B in December 1941 and having one dependent child, had net income for 1942 of $3,000 before deduction of medical expenses. During 1942 he paid $300 for medical care, of which $100 was for treatment of his dependent child and $200 for an operation in September 1941 on B, his wife at the time of the operation. In 1942 he received a payment of $50 for health insurance covering B's illness during 1941.

The deduction allowable under section 23 (x) for the calendar year 1942 is $100, computed as follows:

Payment for medical care in 1942	$300
Less: Amount of insurance received in 1942	50
Payment for medical care in 1942 not compensated for during 1942	250
Less: 5 percent of $3,000 (net income before deduction of medical expenses)	150
Excess, allowable as deduction for 1942	100

Assuming in the above example that, in 1943, A brings suit and receives $150 upon a hospital insurance policy covering the expenses incurred by B in 1941, the amount included in taxable income for 1943 is $60, computed as follows (see section 22 (b) (5)):

Compensation received in 1943	$150
Less: Portion thereof attributable to the deduction allowed for prior year 1942: 100 (deduction for 1942) / 250 (payments not compensated for in 1942) × $150 (compensation received in 1943)	60
Amount to be excluded from gross income for 1943	90
Taxable income for 1943	60

[SEC. 23 DEDUCTIONS FROM GROSS INCOME—as amended by secs. 211 (a), 224, Rev. Act 1939; secs. 301, 506 (b), 2d Rev. Act. 1940; sec. 10 (b), Excess Profits Tax Amendments 1941; sec. 202 (a), Rev. Act 1941, secs. 105 (c), 120 (b), 121 (a) (c), 122, 123 (a), 124 (a), 125, 126 (a), 127 (a) (c), 128, 134 (d), 158 (b), 162 (b), Rev. Act 1942.]

[In computing net income there shall be allowed as deductions:]

(z) *Amounts representing taxes and interest paid to cooperative apartment corporation*—(1) *In general.* In the case of a tenant-stockholder (as defined in paragraph (2)), amounts, not otherwise deductible, paid or accrued to a cooperative apartment corporation within the taxable year, if such amounts represent that proportion of the real estate taxes on the apartment building and the land on which it is situated, allowable as deductions under subsection (c), paid or incurred by the corporation, or of the interest paid or incurred by the corporation on its indebtedness contracted in the acquisition, construction, alteration, rehabilitation, or maintenance of such apartment building or in the acquisition of the land on which the building is located, which the stock of the corporation owned by the tenant-stockholder is of the total outstanding stock of the corporation, including that held by the corporation.

(2) *Definitions.* For the purposes of this subsection—

(A) *Cooperative apartment corporation.* The term "cooperative apartment corporation" means a corporation—

(i) having one and only one class of stock outstanding,

(ii) all of the stockholders of which are entitled, solely by reason of their ownership of stock in the corporation, to occupy for dwelling purposes apartments in a building owned or leased by such corporation, and who are not entitled, either conditionally or unconditionally, except upon a complete or partial liquidation of the corporation, to receive any distribution not out of earnings and profits of the corporation, and

(iii) 80 per centum or more of the gross income of which for the taxable year in which the taxes and interest described in paragraph (1) are paid or incurred is derived from tenant-stockholders.

(B) *Tenant-stockholder.* The term "tenant-stockholder" means an individual who is a stockholder in a cooperative apartment corporation, and whose stock is fully paid-up in an amount not less than an amount shown to the satisfaction of the Commissioner as bearing a reasonable relationship to the portion of the value of the corporation's equity in the building and the land on which it is situated which is attributable to the apartment which such individual is entitled to occupy.

§ 29.23 (z)–1 *Amounts representing taxes and interest paid to cooperative apartment corporation.* A tenant-stockholder may deduct from his gross income amounts paid or accrued within his taxable year to a cooperative apartment corporation representing certain taxes or interest paid or incurred by such corporation. Such amounts are not allowable as a deduction unless they represent the tenant-stockholder's proportionate share of the real estate taxes on the apartment building and the land on which it is situated, allowable as deductions under section 23 (c), paid or incurred by the cooperative apartment corporation prior to the close of the taxable year of the tenant-stockholder, or of the interest paid or incurred by the corporation prior to such time on its indebtedness contracted in the acquisition, construction, alteration, rehabilitation, or maintenance of such apartment building or in the acquisition of the land on which the building is situated.

The deduction allowable under section 23 (z) shall not exceed the amount of the tenant-stockholder's proportionate share of the taxes and interest described therein. In case a tenant-stockholder pays or incurs all or a part of his proportionate share of such taxes and interest to the corporation, the amount so paid or incurred representing taxes and interest is allowable as a deduction if the requirements of section 23 (z) are otherwise satisfied. As used in this section the tenant-stockholder's proportionate share is that proportion which the stock of the cooperative apartment corporation owned by the tenant-stockholder is of the total outstanding stock of the corporation, including that held by the corporation. If a tenant-stockholder pays or incurs to the corporation an amount on account of such taxes and interest and other items, such as maintenance, overhead expenses, and curtailment of mortgage indebtedness, the amount representing such taxes and interest is an amount which bears the same ratio to the total amount of the tenant-stockholder's payment or liability, as the case may be, as the total amount of the tenant-stockholder's proportionate share of such taxes and interest bears to the total amount of the tenant-stockholder's proportionate share of the taxes, interest, and other items on account of which such payment is made or liability incurred. No deduction is allowable under section 23 (z) for such part of amounts representing the taxes or interest described therein as is deductible by a tenant-stockholder under any other provision of the Internal Revenue Code.

In order to qualify as a "cooperative apartment corporation" under section 23 (z), the corporation shall have only one class of stock outstanding. Each stockholder of the corporation shall be entitled to occupy for dwelling purposes an apartment in a building owned or leased by such corporation. The stockholder is not required to occupy the apartment. The right as against the corporation to occupy the apartment is sufficient. Such right shall be conferred on each stockholder solely by reason of his ownership of stock in the corporation, that is, the stock shall entitle the owner thereof either to occupy the apartment or to a lease of the apart-

ment. The fact that the right to continue to occupy the apartment is dependent upon the payment of charges to the corporation in the nature of rentals or assessments is immaterial. None of the stockholders of the corporation shall be entitled, either conditionally or unconditionally, except upon a complete or partial liquidation of the corporation, to receive any distribution other than out of earnings or profits of the corporation. It is a prerequisite to the allowance of a deduction under section 23 (z) that at least 80 percent of the gross income of the corporation for the taxable year of the corporation in which the taxes and interest are paid or incurred is derived from tenant-stockholders.

The term "tenant-stockholder" means an individual who is a stockholder in a cooperative apartment corporation as defined in section 23 (z), and whose stock is fully paid up in an amount at least equal to an amount shown to the satisfaction of the Commissioner as bearing a reasonable relationship to the portion of the fair market value, as of the date of the original issuance of the stock, of the corporation's equity in the building and the land on which it is situated which is attributable to the apartment which such individual is entitled to occupy.

The application of section 23 (z) may be illustrated by the following examples:

Example (1). The X Corporation is, and at all times since 1940 has been, a cooperative apartment corporation within the meaning of section 23 (z). In 1940 it purchased a site and constructed thereon a building with 10 apartments at a total cost of $200,000. The fair market value of the land and building was likewise $200,000 at the time of completion of the building. Each apartment is of equal value. Upon completion of the building, the X Corporation mortgaged the land and building for $100,000, and sold its total authorized capital stock, consisting of 1,000 shares of common stock, for $100,000. The stock was purchased by 10 individuals, who each paid $10,000 for 100 shares. Each certificate for 100 shares provides that the holder thereof is entitled to a lease of a particular apartment in the building for a specified term of years. Each lease provides that the lessee shall pay his proportionate part of the corporation's expenses. In 1940 the original owner of 100 shares of the common stock of the X Corporation and of the lease to apartment No. 1 made a gift of the stock and lease to A, an individual. The taxable year of A and of the X Corporation is the calendar year. The corporation computes its net income on the accrual basis, while A computes his net income on the cash basis. In 1941 the X Corporation incurred expenses aggregating $13,800, namely, $4,000 for the real estate taxes on the land and building, $5,000 for the interest on the mortgage, $3,000 for the maintenance of the building, and $1,800 for other expenses. In 1942, A pays the X Corporation $1,380, representing his proportionate part of the expenses incurred by the corporation. The entire gross income of the X Corporation for 1941 was derived from tenant-stockholders. A is entitled under section 23 (z) to a deduction of $900 in computing his net income for 1942. The deduction is computed as follows:

Shares of stock of X Corporation owned by A		100
Shares of stock of X Corporation owned by 9 other tenant-stockholders		900
Total shares of stock of X Corporation outstanding		1,000
Proportion of outstanding stock of X Corporation owned by A		1/10
Expenses incurred by X Corporation:		
Real estate taxes	$4,000	
Interest	5,000	
Maintenance	3,000	
Other expenses	1,800	
		$13,800
Amount paid by A representing his proportionate part of such expenses (1/10 of $13,800)		1,380
A's proportionate share of real estate taxes and interest based on his stock ownership (1/10 of $9,000)		900
A's proportionate share of total corporate expenses based on his stock ownership (1/10 of $13,800)		1,380
Amount of A's payment representing real estate taxes and interest (900/1380 of $1,380)		900
A's allowable deduction		900

Since the stock which A acquired by gift was fully paid up by his donor in an amount equal to the portion of the fair market value, as of the date of the original issuance of the stock, of the corporation's equity in the land and building which is attributable to apartment No. 1, the requirement of section 23 (z) in this regard is satisfied. The fair market value at the time of the gift of the corporation's equity attributable to the apartment is immaterial.

Example (2). The facts are the same as in example (1) except that the building constructed by the X Corporation contained, in addition to the 10 apartments, business space on the ground floor, which the corporation rented at $2,400 for the calendar year 1941; the corporation deducted the $2,400 from its expenses in determining the amount of the expenses to be prorated among its tenant-stockholders; the amount paid by A to the corporation in 1942 is $1,140 instead of $1,380; and more than 80 percent of the gross income of the corporation for 1941 was derived from tenant-stockholders. A is entitled under section 23 (z) to a deduction of $743.48 in computing his net income for 1942. The deduction is computed as follows:

Expenses incurred by X Corporation		$13,800.00
Less rent from business space		2,400.00
Expenses to be prorated among tenant-stockholders		11,400.00
Amount paid by A representing his proportionate part of such expenses (1/10 of $11,400)		1,140.00
A's proportionate share of real estate taxes and interest based on his stock ownership (1/10 of $9,000)		900.00
A's proportionate share of total corporate expenses based on his stock ownership (1/10 of $13,800)		1,380.00
Amount of A's payment representing real estate taxes and interest (900/1380 of $1,140)		743.48
A's allowable deduction		743.48

Since the portion of A's payment allocable to real estate taxes and interest is only $743.48, that amount instead of $900 is allowable as a deduction in computing A's net income for 1942.

Example (3). The facts are the same as in example (2) except that the amount paid by A to the X Corporation in 1942 is $1,000 instead of $1,140. A is entitled under section 23 (z) to a deduction of $652.17 in computing his net income for 1942. The deduction is computed as follows:

Total amount paid by A	$1,000.00
A's proportionate share of real estate taxes and interest based on his stock ownership (1/10 of $9,000)	900.00
A's proportionate share of total corporate expenses based on his stock ownership (1/10 of $13,800)	1,380.00
Amount of A's payment representing real estate taxes and interest (900/1380 of $1,000)	652.17
A's allowable deduction	652.17

Since the portion of A's payment allocable to real estate taxes and interest is only $652.17, that amount instead of $900 is allowable as a deduction in computing A's net income for 1942.

SEC. 24. ITEMS NOT DEDUCTIBLE [as amended by secs. 121 (b), 127 (b), 129, 130 (a), Rev. Act 1942].

(a) *General rule.* In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses, except extraordinary medical expenses deductible under section 23 (x);

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

(3) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made;

(4) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy;

(5) Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this chapter, or any amount otherwise allowable under section 23 (a) (2) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this chapter.

(6) Any amount paid or accrued on indebtedness incurred or continued to purchase a single premium life insurance or endowment contract. For the purposes of this paragraph, if substantially all the premiums on a life insurance or endowment contract are paid within a period of four years from the date on which such contract is purchased, such contract shall be considered a single premium life insurance or endowment contract; or

(7) Amounts paid or accrued for such taxes and carrying charges as, under regulations prescribed by the Commissioner with the approval of the Secretary, are chargable to capital account with respect to property, if the taxpayer elects, in accordance with such regulations, to treat such taxes or charges as so chargeable.

(b) *Losses from sales or exchanges of property*—(1) *Losses disallowed.* In computing net income no deduction shall in any case be

allowed in respect of losses from sales or exchanges of property, directly or indirectly—

(A) Between members of a family, as defined in paragraph (2) (D);

(B) Except in the case of distributions in liquidation, between an individual and a corporation more than 50 per centum in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(C) Except in the case of distributions in liquidation, between two corporations more than 50 per centum in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale or exchange was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company;

(D) Between a grantor and a fiduciary of any trust;

(E) Between the fiduciary of a trust and the fiduciary of another trust, if the same person is a grantor with respect to each trust; or

(F) Between a fiduciary of a trust and a beneficiary of such trust.

(2) *Stock ownership, family, and partnership rule.* For the purposes of determining, in applying paragraph (1), the ownership of stock—

(A) Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust, shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;

(B) An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family;

(C) An individual owning (otherwise than by the application of subparagraph (B)) any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner;

(D) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

(E) Constructive Ownership as Actual Ownership.—Stock constructively owned by a person by reason of the application of subparagraph (A) shall, for the purpose of applying subparagrah (A), (B), or (C), be treated as actually owned by such person, but stock constructively owned by an individual by reason of the application of subparagraph (B) or (C) shall not be treated as owned by him for the purpose of again applying either of such subparagraphs in order to make another the constructive owner of such stock.

(c) *Unpaid expenses and interest.* In computing net income no deduction shall be allowed under section 23 (a), relating to expenses incurred, or under section 23 (b), relating to interest accrued—

(1) If such expenses or interest are not paid within the taxable year or within two and one half months after the close thereof; and

(2) If, by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not, unless paid, includible in the gross income of such person for the taxable year in which or with which the taxable year of the taxpayer ends; and

(3) If, at the close of the taxable year of the taxpayer or at any time within two and one half months thereafter, both the taxpayer and the person to whom the payment is to made are persons between whom losses would be disallowed under section 24 (b).

(d) *Holders of life or terminable interest.* Amounts paid under the laws of any State, Territory, District of Columbia, possession of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time, nor by any deduction allowed by this chapter (except the deductions provided for in subsections (1) and (m) of section 23) for the purpose of computing the net income of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled.

(e) *Tax withheld on tax-free covenant bonds.* For nondeductibility of tax withheld on tax-free covenant bonds, see section 143 (a) (3).

§ 29.24–1 *Personal and family expenses.* Insurance paid on a dwelling owned and occupied by a taxpayer is a personal expense and not deductible. Premiums paid for life insurance by the insured are not deductible. In the case of a professional man who rents a property for residential purposes, but incidentally receives clients, patients, or callers there in connection with his professional work (his place of business being elsewhere), no part of the rent is deductible as a business expense. If, however, he uses part of the house for his office, such portion of the rent as is properly attributable to such office is deductible. If the father is entitled to the services of his minor children, any allowances which he gives them, whether said to be in consideration of services or otherwise, are not allowable deductions in his return of income. Amounts paid as damages for breach of promise to marry, attorneys' fees and other costs of suit to recover such damages, and attorneys' fees paid in a suit for separation are not deductible from gross income. Amounts paid as alimony or allowance for support upon divorce or separation are not deductible except as provided in section 23 (u). The cost of equipment of an Army officer to the extent only that it is especially required by his profession and does not merely take the place of articles required in civilian life is deductible. Accordingly, the cost of a sword is an allowable deduction, but the cost of a uniform is not. For deduction of extraordinary medical expenses (including amounts paid for accident or health insurance), see section 23 (x) and § 29.23 (x)–1.

§ 29.24–2 *Capital expenditures.* Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23 (l).) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price, except that in the case of dealers in securities such commissions may be treated as an ordinary and necessary business expense. Expenses of the administration of an estate, such as court costs, attorneys' fees, and executors' commissions, are chargeable against the corpus of the estate and are not allowable deductions. Amounts to be assessed and paid under an agreement between bondholders or shareholders of a corporation, to be used in a reorganization of the corporation, are investments of capital and not deductible for any purpose in returns of income. (See § 29.22 (a)–16.) An assessment paid by a shareholder of a national bank on account of his statutory liability is ordinarily not deductible but, subject to the provisions of the Internal Revenue Code, may in certain cases represent a loss. Expenses of the organization of a corporation, such as incorporation fees, attorneys' and accountants' charges, are capital expenditures and not deductible from gross income. A holding company which guarantees dividends at a specified rate on the stock of a subsidiary corporation for the purpose of securing new capital for the subsidiary and increasing the value of its stock holdings in the subsidiary may not deduct amounts paid in carrying out this guaranty in computing its net income, but such payments may be added to the cost of its stock in the subsidiary.

§ 29.24–3 *Premiums on business insurance.* Premiums paid by a taxpayer on an insurance policy on the life of an officer, employee, or other individual financially interested in the taxpayer's business, for the purpose of protecting the taxpayer from loss in the event of the death of the officer or employee insured are not deductible from the taxpayer's gross income. If, however, the taxpayer is not a beneficiary under such a policy, the premiums so paid will not be disallowed as deductions merely because the taxpayer may derive a benefit from the increased efficiency of the officer or employee insured. (See §§ 29.22 (a)–3 and 29.23 (a)–6 to 29.23 (a)–9, inclusive.) In either case the proceeds of such policies paid by reason of the death of the insured may be excluded from gross income whether the beneficiary is an individual or a corporation, except in the case of certain transferees as provided in § 29.22 (b) (2)–3 and in the case of a spouse to whom such proceeds are income under section 22 (k). (See generally section 22 (b) (1) and (2) and §§ 29.22 (b) (1)–1 and 29.22 (b) (2)–3.)

§ 29.24–4 *Amounts allocable to exempt income, other than interest*—(a) *Class of exempt income.* As used in this section, the term "class of exempt income" means any class of income, including interest only to the extent that amounts otherwise allowable under section 23 (a) (2) are allocable thereto (whether or not any amount of income of that class or classes is received or accrued), wholly exempt from the taxes imposed by chapter 1. Included are any item or class of income, including interest only to the extent that amounts otherwise allowable under section 23 (a) (2) are allocable thereto, constitutionally exempt from the taxes imposed by chapter 1; any item or class, as above defined,

excluded from gross income under any provision of section 22 or section 116; and any item or class of income, as above defined, exempt under the provisions of any other law from the taxes imposed by chapter 1. The term "taxable income" as used in this section means income which is required to be included in gross income; and the term "exempt income" means income which is not required to be included in gross income.

The object of section 24 (a) (5) is to segregate the exempt income from the taxable income, in order that a double exemption may not be obtained through the reduction of taxable income by expenses and other items incurred in the production of items of income wholly exempt from tax. Accordingly, just as exempt items of income are excluded from the computation of gross income under section 22, so section 24 (a) (5) excludes from the computation of deductions under section 23 all items referable to the production of exempt income, as above defined.

(b) *Determination of amounts allocable to a class of exempt income.* No deduction may be allowed for the amount of any item or part thereof allocable to a class or classes of exempt income. For example, expenses paid or incurred for the production or collection of income which is wholly exempt from income taxes, such as interest or dividends of a type not includible in gross income, are not deductible expenses. Items, or parts of such sums, directly attributable to any class or classes of exempt income, shall be allocated thereto; and items, or parts of such items, directly attributable to any class or classes of taxable income, shall be allocated thereto.

If an item is indirectly attributable both to taxable income and exempt income, a reasonable proportion thereof, determined in the light of all the facts and circumstances in each case, shall be allocated to each. Apportionments must in all cases be reasonable.

(c) *Statement of items of exempt income, records.* A taxpayer receiving any class of exempt income or holding any property or engaging in any activity the income from which is exempt shall submit with his return as a part thereof an itemized statement, in detail, showing (1) the amount of each class of exempt income, and (2) the amount of items, or parts of items, allocated to each such class (the amount allocated by apportionment being shown separately) as required by paragraph (b) of this section. If an item is apportioned between a class of exempt income and a class of taxable income, the statement shall show the basis of the apportionment. Such statement shall also recite that each deduction claimed in the return is not in any way referable to exempt income. The taxpayer shall keep such records as will enable him to make the allocations required by this section (see section 54).

§ 29.24-5 *Taxes and carrying charges chargeable to capital account and treated as capital items*—(a) *General.* In accordance with section 24 (a) (7), items enumerated in paragraph (b) of this section may be capitalized at the election of the taxpayer. Thus, taxes and carrying charges with respect to property, of the type described in this section, are chargeable to capital acount at the election of the taxpayer notwithstanding that they are expressly deductible under section 23. No deduction is permitted for any items so treated.

(b) *Taxes and carrying charges.* The following items may upon the election of the taxpayer, in the manner provided in paragraph (c) of this section, be treated as chargeable to capital account (either as a component of original cost or other basis, for the purposes of section 113 (a), or as an adjustment to basis, for the purposes of section 113 (b) (1) (A)), notwithstanding that they are expressly deductible under section 23:

(1) In the case of unimproved and unproductive real property, annual taxes, interest on a mortgage, and other carrying charges;

(2) In the case of real property, whether improved or unimproved and whether productive or unproductive, expenditures (otherwise deductible) paid or incurred in the development thereof or in the construction of an improvement or additional improvement thereon, up to the time the development or construction work has been completed, such as interest on a loan made or continued to furnish funds for this purpose (but not including theoretical interest of a taxpayer using his own funds), taxes of the owner of the property measured by compensation paid to his employees and taxes of such owner imposed on the purchase of materials for such work or on the storage, use, or other consumption in the State of materials for such work which are purchased for storage, use, or other consumption in that State, and other necessary expenditures paid or incurred in connection therewith up to the time the development or construction work has been completed. The development or construction work with respect to which such items are incurred may relate to unimproved and unproductive real estate whether the construction work will make the property productive of taxable income (as in the case of a factory) or not (as in the case of a personal residence), or may relate to property already improved or productive (as in the case of a plant addition or improvement, such as the construction of another floor on a factory or the installation of insulation therein);

(3) In the case of personal property, taxes of an employer measured by compensation for services rendered in transporting machinery or other fixed assets to his plant or in installing them therein, interest on a loan to purchase such property or to pay for transporting or installing the same, and taxes of the owner thereof imposed on the purchase of such property or on the storage, use, or other consumption of such property in the State which is purchased for storage, use, or other consumption in that State, paid or incurred up to the date of installation or the date when such property is first put into use by the taxpayer, whichever date is later.

(4) Any other taxes and carrying charges with respect to property, otherwise deductible, which in the opinion of the Commissioner are, under sound accounting principles, chargeable to capital account.

If for any taxable year there are two or more items, such as social security taxes, use taxes, or any other type of items above described, relating to the same project to which the election is applicable, the taxpayer may elect to capitalize any one or more of such items even though he does not elect to capitalize the remaining items or to capitalize items of the same type relating to other projects. However, if several items of the same type are incurred with respect to a single project the election to capitalize must, if exercised, be exercised as to all of items of that type.

Once, however, such an election is made under subparagraph (2), (3), or (4), above, to capitalize a given charge incurred with respect to a particular project, charges of the same type incurred with respect to the particular project in subsequent years, whether they be social security taxes, use taxes, sales taxes, or any other item enumerated in any of these paragraphs, must also be capitalized for the entire period to which the election so to treat items of that type is applicable. The term "project" for this purpose in the case of items included in subparagraph (2) means the particular development or construction work with respect to which the charge as to which the election was exercised was incurred, and in the case of items included in subparagraph (3) this term means the act of transporting, installing, or putting into use of the machinery or other fixed assets. An election under subparagraph (1), however, may be exercised for a given year without regard to the manner in which the same type of item with respect to the same property was treated by the taxpayer for a prior year.

Example (1). A in 1942 and 1943 pays annual taxes and interest on a mortgage on a piece of vacant and unproductive property. Throughout 1943 he operates the property as a parking lot. A may capitalize the taxes and mortgage interest paid in 1942 but not the taxes and mortgage interest paid in 1943.

Example (2). X began in February, 1942, the erection of a building for himself. X in 1942 paid $6,000 social security taxes in connection with the erection of the building, which in his 1942 return he elected to capitalize. X must continue to capitalize the social security taxes paid in connection with the erection of this building until its completion in 1944.

Example (3). Assume the facts in example (2) except that in November, 1942, X also begins to build a hotel which will be completed in 1945. In 1942 X pays $3,000 social security taxes in connection with the erection of the hotel. X is not bound by the election to capitalize exercised in connection with the social security taxes paid in erecting the building started in February, 1942, but may deduct the $3,000 social security taxes.

Example (4). X in 1942 began the erection of a building for himself, which would take three years to complete. X in 1942 paid $4,000 social security taxes and $8,000 interest on a building loan in connection with this building. X may elect to capitalize the social security taxes although he deducts the interest charges.

Example (5). A purchases machinery in 1943 for use in his factory. He pays social security taxes on the labor for transportation

and installation, as well as interest on a loan to obtain funds to pay for the machinery and for installation costs. A may capitalize the social security taxes and the interest up to the date of installation or until the machinery is first put into use by him, whichever is later.

The sole effect of section 24 (a) (7) is to permit such items to be properly charged to capital account notwithstanding that a deduction is expressly provided therefor in section 23. Any item not charged to capital account which is otherwise deductible under section 23 is still deductible. An item may not be charged to capital account under this section where such treatment would be disallowed whether or not a deduction were expressly provided therefor in section 23 (such, for example, as maintenance expenses and the cost of repairs and upkeep of a personal residence). This section does not have the effect of disallowing an item to be treated as a capital item which would otherwise be allowed to be so treated nor does it have the effect of making deductible an item which is not so under section 23 (such, for example, as salaries or other compensation paid or incurred for services rendered in the construction of property.)

In the absence of provision in this section for treating a given item as a capital item, this section has no effect on the treatment otherwise accorded such item. Thus, items which are otherwise deductible are deductible notwithstanding the provisions of this section, and items which are otherwise treated as capital items are to be so treated. Nor is the absence of a provision in this section to be construed as withdrawing or modifying the right now given to the taxpayer under some other provision of chapter 1 of the Code or of the regulations promulgated thereunder to elect to capitalize or to deduct a given item. (See § 29.23 (m)–16, making intangible drilling and development costs chargeable to capital or to expenses at the taxpayer's option and § 29.23 (c)–2, making certain Federal duties and excise taxes deductible unless the taxpayer has added them to the expenses of the business or the cost of the articles of merchandise.)

(c) *Manner of exercising election.* If the taxpayer elects to capitalize an item or items under this section, such election shall be exercised by filing with the original return a statement for that year indicating the item or items (whether with respect to the same project or to different projects) which the taxpayer elects to treat as chargeable to capital account (either as a component of original cost or other basis, for the purposes of section 113 (a), or as an adjustment to basis, for the purposes of section 113 (b) (1) (A)).

(d) *Allocation.* If any tax or carrying charge with respect to property is in part a type of item described in paragraph (b) of this section and in part a type of item or items with respect to which no option to treat as a capital item or as an allowable deduction is given, a reasonable proportion of such tax or carrying charge, determined in the light of all the facts and circumstances in each case, shall be allocated to each item. Apportionment must in all cases be reasonable.

Example. A, the owner of a factory on which a new addition is under construction, in 1942 pays its general manager, B, a salary of $4,000 and social security taxes of $90 measured thereby. B spends nine tenths of his time in the general business of the firm and the remaining tenth in supervising the construction work. A treats as expenses $3,600 of B's salary and charges the remaining $400 to capital account. A may also capitalize $9 of the $90 social security taxes.

§ 29.24–6 *Losses from sales or exchanges between certain classes of persons*—(a) *Individuals (including fiduciaries).* In the case of sales or exchanges of property, directly or indirectly, between individuals (including fiduciaries) section 24 (b) (1) provides that no deduction shall be allowed with respect to losses arising therefrom in the following cases: (1) between members of a family as defined in section 24 (b) (2) (D); (2) between fiduciaries of trusts having a common grantor; (3) between a grantor and a fiduciary of the same trust; or (4) between a fiduciary of a trust and a beneficiary of such trust.

(b) *Corporations (including shareholders).* In the case of sales or exchanges of property (except in the case of distributions in liquidation) where a corporation not acting in a fiduciary capacity is a party to the transaction, section 24 (b) (1) also provides that under certain circumstances no deduction shall be allowed with respect to losses arising from such sales or exchanges, directly or indirectly, between a corporation and an individual shareholder (see section 24 (b) (1) (B) or between two corporations (see section 24 (b) (1) (C)). Under section 24 (b) (1) (B) it is necessary that there be owned, directly or indirectly, by or for the individual a party to the transaction, more than 50 percent in value of the stock of the other party to the transaction on the date of the sale or exchange. Under section 24 (b) (1) (C), however, as provided therein, not only must more than 50 percent in value of the outstanding stock of each of such corporations be owned, directly or indirectly, on the date of the sale or exchange by or for the same individual, but one of the corporations must be either a personal holding company as defined in section 501, or a foreign personal holding company as defined in section 331, for the taxable year preceding the date of the sale or exchange. It is not necessary that either of the corporations be a personal holding company or a foreign personal holding company on the date of the sale or exchange.

(c) *Stock ownership rule.* For the purpose of paragraph (b) of this section, the ownership of stock shall be determined in accordance with the rules provided in section 24 (b) (2). In order that an individual shall be considered under section 24 (b) (2) (C) as constructively owning the stock of a corporation owned, directly or indirectly, by or for his partner, such individual must himself own, directly or indirectly, stock of such corporation. On the other hand, under section 24 (b) (2) (B) an individual need not own any stock of a corporation, either directly or indirectly, in order to be considered as constructively owning the stock of such corporation which is owned, directly or indirectly, by or for any member of his family.

(d) *Illustrations of the application of section 24 (b).* The application of section 24 (b) may be illustrated by the following examples:

Example (1). On July 1, 1942, the M Corporation owned all of the stock of the O Corporation which for the calendar year 1941 was a personal holding company under section 501. On that day all of the outstanding stock of the M Corporation was owned by A. By the application of the rule provided in section 24 (b) (2) (A), the stock in the O Corporation owned by the M Corporation is considered to be owned constructively by A, the sole stockholder of the M Corporation. Such constructive ownership of the stock of the O Corporation by A is considered as actual ownership for the purpose of applying the family rule provided in section 24 (b) (2) (B) to make a member of A's family, as, for example, his wife AW, the constructive owner of the stock of the O Corporation. But the constructive ownership of the O Corporation stock by AW may not be considered as actual ownership by AW for the purpose of again applying the family rule so as to make a member of AW's family, for example, her father, AWF, in turn constructive owner of such stock. These rules apply in the same manner and with the same effect in determining the ownership of stock in the M Corporation.

Accordingly, assuming that A, AW, AWF, the M Corporation and the O Corporation make their income returns on the basis of a calendar year and that there was no distribution in complete or partial liquidation of the M or O Corporation, no deduction is allowable under section 24 (b) (1) with respect to losses from sales or exchanges of property made on July 1, 1942, between any of such individuals or corporations, except as between A and AWF and between AWF and the M or O Corporation.

Example (2). On June 15, 1942, all of the stock of the N Corporation was owned in equal proportions by A and A's partner, AP. Except in the case of distributions in complete or partial liquidation by the N Corporation, no deduction is allowable with respect to losses from sales or exchanges of property made on June 15, 1942, between A and the N Corporation or AP and the N Corporation inasmuch as, by the application of section 24 (b) (2) (C), each partner is considered as having owned the stock owned by the other and, therefore, is considered as having owned more than 50 percent in value of the outstanding stock of the N Corporation. Deductions for losses from sales or exchanges between A's brother, AB, and the N Corporation, or between AP and A, or AP and AB are not prohibited by section 24 (b).

§ 29.24–7 *Disallowance of deductions for unpaid expenses and interest.* The application of section 24 (c) may be illustrated by the following example:

Example. A is the holder and owner of an interest-bearing note executed by the M Corporation all of the stock of which is owned by him. A and the M Corporation make their income returns on the basis of a calendar year but the M Corporation makes its returns on the accrual basis and A makes his returns on the cash receipts and disbursements basis. The M Corporation does not pay any interest on such note during the calendar year 1942 or within two and one-half months after the close thereof, but claims a deduction for the year 1942 with respect to the interest accruing on the note in that year. A, being on the cash receipts

and disbursements basis, does not include such interest in his return for the year 1942. By the application of section 24 (c), no deduction for such interest is allowable in computing the net income of the M Corporation for the year 1942. The provisions of such section 24 (c) do not otherwise affect the general rules governing the allowance of deductions under the accrual basis. Hence, in the event the M Corporation should pay such interest after March 15, 1943, no deduction therefor would be allowable in computing its net income for the year in which the payment was made.

§ 29.24–8 *Life or terminable interests.* Amounts paid to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be subject to any deduction for shrinkage (whether called depreciation or any other name) in the value of such interest due to the lapse of time. In other words, the holder of such an interest so acquired may not set up the value of the expected future payments as corpus or principal and claim deductions for shrinkage or exhaustion thereof due to the passage of time. (See section 113 (a) (5).)

No deductions shall be allowed in the case of a life or terminable interest acquired by gift, bequest, or inheritance, if the estate or trust is entitled to a deduction under chapter 1 but there is no reduction of the income of the life or terminable interest. For example, an estate or a trust in a certain State sells securities at a loss; if, under the laws of that State, the beneficiary suffers no actual loss, then even though the estate or trust is permitted to deduct such loss in making its return, the beneficiary whose income has not been diminished thereby is not entitled to a deduction on account of such loss, but must include in his return the full amount distributed or distributable. (See section 162.) However, in the case of property held by one person for life with remainder to another person and in the case of property held in trust, see section 23 (l) as to depreciation and section 23 (m) as to depletion.

§ 29.24–9 *Single premium life insurance or endowment contracts.* Amounts paid or accrued on indebtedness incurred or continued, directly or indirectly, to purchase a single premium life insurance or endowment contract are not deductible under section 23 (b) or any other provision of chapter 1. This prohibition applies even though the insurance is not on the life of the taxpayer. A contract shall be considered a single premium life insurance or endowment contract, for the purposes of this section, if substantially all the premiums on such contracts are paid within a period of four years from the date on which the contract was purchased.

SEC. 25. CREDITS OF INDIVIDUAL AGAINST NET INCOME [as amended by sec. 6 (a), Rev. Act 1940; secs. 111 (a), 113, Rev. Act 1941; secs. 112 (b), 120 (e), 126 (l), 131 (a) (b), Rev. Act 1942].

(a) *Credits for normal tax only.* There shall be allowed for the purpose of the normal tax, but not for the surtax, the following credits against the net income:

(1) *Interest on United States obligations.* The amount received as interest upon obligations of the United States, if such interest is included in gross income under section 22, and if, under the Act authorizing the issue of such obligations, as amended and supplemented, such interest is exempt from normal tax.

(2) *Interest on obligations of instrumentalities of the United States.* The amount received as interest on obligations of a corporation organized under Act of Congress, if (A) such corporation is an instrumentality of the United States; and (B) such interest is included in gross income under section 22; and (C) under the Act authorizing the issue thereof, as amended and supplemented, such interest is exempt from normal tax. (For reduction of credit under paragraph (1) or (2) on account or amortizable bond premium, see section 125).

(3) *Earned income credit.* 10 per centum of the amount of the earned net income, but not in excess of 10 per centum of the amount of the net income.

(4) *Earned income definitions.* For the purposes of this section—

(A) "Earned income" means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered, but does not include any amount not included in gross income, nor that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the cast of a taxpayer engaged in a trade or business in which both personal services and capital are material income producing factors, a reasonable allowance as compensation for the personal services actually rendered by the taxpayer, not in excess of 20 per centum of his share of the net profits of such trade or business, shall be considered as earned income.

(B) "Earned income deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against earned income.

(C) "Earned net income" means the excess of the amount of the earned income over the sum of the earned income deductions. If the taxpayer's net income is not more than $3,000, his entire net income shall be considered to be earned net income, and if his net income is more than $3,000, his earned net income shall not be considered to be less than $3,000. In no case shall the earned net income be considered to be more than $14,000.

(b) *Credits for both normal tax and surtax.* There shall be allowed for the purposes of the normal tax and the surtax the following credits against net income:

(1) *Personal exemption.* In the case of a single person or a married person not living with husband or wife, a personal exemption of $500; or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $1,200. A husband and wife living together shall receive but one personal exemption. The amount of such personal exemption shall be $1,200. If such husband and wife make separate returns, the personal exemption may be taken by either or divided between them.

(2) *Credit for dependents*—(A) *Allowance in general.* $350 for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer if such dependent person is under eighteen years of age or is incapable of self-support because mentally or physically defective. A payment to a wife which is includible under section 22 (k) or section 171 in the gross income of such wife shall not be considered a payment by her husband for the support of any dependent.

(B) *Exception for certain heads of families.* If the taxpayer would not occupy the status of head of a family except by reason of there being one or more dependents for whom he would be entitled to credit under subparagraph (A), the credit under such subparagraph shall be disallowed with respect to one of such dependents.

(3) *Change of status.* If the status of the taxpayer, insofar as it affects the personal exemption or credit for dependents, changes during the taxable year, the personal exemption and credit shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary in accordance with the number of months before and after such change. For the purpose of such apportionment a fractional part of a month shall be disregarded unless it amounts to more than half a month in which case it shall be considered as a month.

§ 29.25–1 *Credits of individual against net income.* For the purpose of computing the normal tax the taxpayer's net income as determined pursuant to sections 21 to 24, inclusive, is first reduced by the sum of the allowable credits. These include interest exempt from normal tax only (and hence included in gross income) received upon (1) obligations of the United States and (2) obligations of corporations organized under Act of Congress which are instrumentalities of the United States; an earned income credit; a personal exemption; and a credit for dependents. (See section 22 (b) (4).) For the purpose of computing the surtax the taxpayer's net income is entitled to none of these credits, except the credit for personal exemption and credit for dependents.

§ 29.25–2 *Earned income credit.* Under section 25 (a) (3) the earned income credit allowable for the purpose of computing the normal tax is 10 percent of the amount of the earned net income, but not in excess of 10 percent of the amount of the entire net income.

The entire amount received as professional fees may be treated as earned income if the taxpayer is engaged in a professional occupation, such as a doctor or a lawyer, even though he employs assistants to perform part or all of the services, provided the clients or patients are those of the taxpayer and look to the taxpayer as the person responsible for the services performed. In the case of a husband and wife domiciled in a so-called community property State and rendering separate income tax returns on the community income basis, one-half of the income derived from personal services rendered by one spouse may be treated as earned income in the separate return of the other spouse.

In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, a reasonable allowance as compensation for the personal services actually rendered by the taxpayer shall be considered earned income, but the total amount which shall be treated as the earned income of the taxpayer from such a trade or business shall, in no case, exceed 20 percent of his share of the net profits of such trade or business. No general rule can be prescribed defining the trades or businesses in which personal services and capital are material income-producing factors, but this question must be determined with respect to the facts of the individual cases.

The provisions of sections 25 (a) (3) and 25 (a) (4) may be illustrated generally by the following examples:

Example (1). An individual received income from interest on bonds during the calendar year 19424 amounting to $6,000. His allowable deductions under section 23 for that year amounted to $2,000. He is entitled to an earned income credit of $300, computed as follows:

Gross income	$6,000
Allowable deductions	2,000
Entire net income	4,000
Earned net income allowable under section 25 (a) (4) (C)	3,000
Earned income credit allowance (10 percent of $3,000)	300

Example (2). An individual received a salary of $20,000 as a traveling salesman for the calendar year 1942. His allowable deductions under section 23 for that year amounted to $12,000, of which $2,000 was for traveling expenses in the course of his business and $10,000 was for a loss of his home from fire. His net income is $20,000 minus $12,000, or $8,000. He is entitled to an earned income credit of $800, computed as follows:

Earned income	$20,000
Earned income deductions	2,000
Earned net income before applying limitation in section 25 (a) (4) (C)	18,000
Earned net income as limited to maximum amount prescribed by section 25 (a) (4) (C)	14,000
Earned income credit before applying limitation in section 25 (a) (3) (10 percent of $14,000)	1,400
Earned income credit allowable as limited by section 25 (a) (3) (10 percent of $8,000, net income)	800

Example (3). During the calendar year 1942 an individual was engaged in a business in which both personal services and capital were income-producing factors. A reasonable allowance as compensation for the personal services actually rendered by the taxpayer in the conduct of the business for that year was $10,000. The net profits of the business were $35,000, which constituted his net income for the year. He is entitled to an earned income credit of $700, computed as follows:

Earned income before applying limitation in section 25 (a) (4) (A)	$10,000
Earned income as limited by section 25 (a) (4) (A) (20 percent of $35,000)	7,000
Earned income credit allowable (10 percent of $7,000)	700

In the case of a husband and wife making a joint return, there is but one earned income credit, computed upon the combined income of the spouses, and the maximum and minimum limitations prescribed with respect to such credit shall be based upon the combined income as if the joint return were the return of one individual.

§ 29.25–3 *Amount of personal exemption allowable.* A single person or a married person not living with husband or wife is entitled to a personal exemption of $500, and the head of a family or a married person living with husband or wife is entitled to a personal exemption of $1,200. A husband and wife living together have but one personal exemption, which is $1,200. If they make separate returns, each may claim one-half of the personal exemption, or such exemption may, in accordance with an agreement entered into by them, be taken by either or divided between them in any proportion. With regard to returns by husband and wife under Supplement T, see section 404.

§ 29.25–4 *Personal exemption of head of family.* A head of a family is an individual who actually supports and maintains in one household one or more individuals who are closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation. In the case of spouses who are divorced or legally separated under a decree of divorce or of separate maintenance, periodic payments (in the nature of, or in lieu of, alimony or an allowance for support) received by one spouse which she is required under section 22 (k) or section 171 (a) to include in her gross income and which she uses for support of dependents are considered payments by her for such support and not payments by the other spouse for support of any person. In the absence of continuous actual residence together, whether or not a person with dependent relatives is a head of a family within the meaning of the Internal Revenue Code must depend on the character of the separation. If a father is absent on business, or a child or other dependent is away at school or on a visit, the common home being still maintained, the additional exemption applies. If, moreover, through force of circumstances a parent is obliged to maintain his dependent children with relatives or in a boarding house while he lives elsewhere, the additional exemption may still apply. If, however, without necessity the dependent continuously makes his home elsewhere, his benefactor is not the head of a family, irrespective of the question of support. A resident alien with children abroad is not thereby entitled to credit as the head of a family. As to the amount of the exemption, see § 29.25–3.

§ 29.25 *Personal exemption of married person.* In the case of a married man or married woman the joint exemption replaces the individual exemption only if the man lives with his wife or the woman lives with her husband. In the absence of continuous actual residence together, whether or not a man or woman has a wife or husband living with him or her within the meaning of the Internal Revenue Code must depend on the character of the separation. If merely occasionally and temporarily a wife is away on a visit or a husband is away on business, the joint home being maintained, the additional exemption applies. The unavoidable absence of a wife or husband at a sanatorium or asylum on account of illness does not preclude claiming the exemption. If, however, the husband voluntarily and continuously makes his home at one place and the wife hers at another, they are not living together within the meaning of the Code, irrespective of their personal relations. A resident alien with a wife residing abroad is not entitled to the joint exemption.

§ 29.25–6 *Credit for dependents.* A taxpayer, other than a nonresident alien who is not a resident of Canada or Mexico (see section 214), receives a credit of $350 for each person (other than husband or wife), whether related to him or not and whether living with him or not, dependent upon and receiving his chief support from the taxpayer, provided the dependent is either (a) under 18, or (b) incapable of self-support because defective. For credit for dependents in computing tax under Supplement T, see sections 400 and 401.

The credit is based upon actual financial dependency and not mere legal dependency. It may accrue to a taxpayer who is not the head of a family. But a father whose children receive half or more of their support from a trust fund or other separate source is not entitled to the credit. In the case of spouses who are divorced or legally separated under a decree of divorce or of separate maintenance, payments (in the nature of, or in lieu of, alimony or an allowance for support) received by one spouse which she is required under section 22 (k) or section 171 (a) to include in her gross income and which she uses for support of dependents are considered payments by her for such support and not payments by the other spouse for support of any person.

If a taxpayer occupies the status of the head of a family solely by reason of the existence of one or more dependents for whom he would be entitled to credit under section 25 (b) (2) (A) were it not for section 25 (b) (2) (B), the credit in respect of one of such dependents is disallowed. For example, a widower who occupies the status of the head of a family solely by reason of the fact that he is maintaining a home for two dependent children under 18 years of age is entitled to the credit of $350 allowed for one such dependent, and the credit for the other dependent is disallowed. If, however, in addition to the two dependent children under 18 years of age, the widower also supports and maintains in the home a child who is over 18 years of age and who is not mentally or physically defective, he is entitled to a credit of $350 for each of the two children under 18 years of age, since his support and maintenance of the child over 18 years of age is in itself sufficient to give him the status of head of a family, and therefore he does not occupy such status solely by reason of the existence of dependent children under 18 years of age.

§ 29.25–7 *Personal exemption and credit for dependents where status changes.* If the status of the taxpayer changes during the taxable year, the personal exemption allowed by section 25 (b) (1) to a single person, a married person not living with husband or wife, a head of a family, or a married person living with husband or wife, and the credit for dependents allowed by section 25 (b) (2) will be apportioned according to the number of months during which the taxpayer occupied each status. A taxpayer not having the status of a head of a family or the status of a married person living with husband or wife shall be considered as having the status of a single person. For the purpose of

the apportionment of the personal exemption and credit for dependents a fractional part of a month shall be disregarded unless it amounts to more than half a month, in which case it shall be considered as a month. In general, the personal exemption and credit for dependents allowable to any taxpayer will be the sum of the amounts apportioned to the several periods of the taxable year during which each status was occupied.

The return for the period in which falls the date of the death of a taxpayer is a return only for the period during which the taxpayer was alive. The personal exemption and credit for dependents must be determined on the basis of the period for which the return was made. If during such period the status of the taxpayer did not change, the personal exemption and credit for dependents shall be reduced to that proportion of the full credit which the number of months in such period bears to 12 months. See § 29.47–1. If the status of the taxpayer changed during such period, the full personal exemption and credit for dependents allowable for each status occupied by the taxpayer shall be apportioned to the period during which such status was occupied in such proportion as the number of months during which such status was occupied bears to 12 months.

Example (*1*). A and B, who were heads of families during the first six months of 1942, were married on July 1, 1942, and lived together during the remainder of the year. If a joint return is made by A and B on the calendar year basis for 1942, the personal exemption will be $1,800; that is, ½ of $1,200 for A while the head of a family, plus ½ of $1,200 for B while the head of a family, plus ½ of $1,200 for the period during which they were married and living together. If separate returns are made by A and B on the calendar year basis for 1942, each may claim a personal exemption of $900; that is, ½ of $1,200, plus ½ of ½ of $1,200. In the latter case, however, the joint exemption of ½ of $1,200 might by agreement be taken either by A or B or divided between them in any proportion.

Example (*2*). A, a widower, qualifies as the head of a family until March 31, 1942, on which date his one dependent child died. On September 30, 1942, A dies. The executor or administrator making a return for A may claim a personal exemption of $550; that is, $^3/_{12}$ of $1,200, or $300, for the period from January 1, 1942, to March 31, 1942, during which period A was the head of a family, and $^6/_{12}$ of $500 or $250, for the period from April 1, 1942, to September 30, 1942, during which period A was a single person not the head of a family.

Example (*3*). A and B were married and living together until November 30, 1942, when B, the wife, died. They had no dependents. The taxable period of B is January 1, 1942, to November 30, 1942, the date of her death. The combined personal exemption of A and B for the period during which they were married and living together, that is, $^{11}/_{12}$ of $1,200, or $1,100, may by agreement be taken either by A, or by B's executor or administrator in behalf of B, or divided between them in any proportion. The personal exemption for the last taxable period of B is the amount of the combined personal exemption so taken by B's executor or administrator. If A, the surviving spouse, files a return for the calendar year 1942, he may claim, in addition to his portion of the combined personal exemption, a personal exemption for the period from the date of the death of B to the close of his taxable year, that is, $^1/_{12}$ of $500.

Example (*4*). A and B were married and living together until June 30, 1942, when A, the husband, died. Prior to the date of death, A was the chief support of a child 10 years of age. B, the surviving spouse, supported and maintained the child in her household during the remainder of the year. The executor or administrator in making a return for A is entitled, in addition to a personal exemption, to a credit for dependents in the amount of $175; that is, $^6/_{12}$ of $350. However, since B qualifies as head of a family for the the last six months solely by reason of the fact that she maintained a home for such dependent child, the credit for such dependent is disallowed.

SEC. 26. CREDITS OF CORPORATIONS [as amended by sec. 211 (j), Rev. Act 1939; secs. 105 (d) (e), 126 (l), 132 (a), 133, Rev. Act 1942].

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

(a) *Interest on obligations of the United States and its instrumentalities.* The amount received as interest upon obligations of the United States or of corporations organized under Act of Congress which is allowed to an individual as a credit for purposes of normal tax by section 25 (a) (1) or (2). (For reduction of credit under this subsection on account of amortizable bond premium, see section 125).

(b) *Dividends received.* 85 percentum of the amount received as dividends from a domestic corporation which is subject to taxation under this chapter, but not in excess of 85 per centum of the adjusted net income reduced by the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in subsection (e). The credit allowed by this subsection shall not be allowed in respect of dividends received from a corporation organized under the China Trade Act, 1922, 42 Stat. 849 (U.S.C., Title 15, c. 4), or from a corporation which under section 251 is taxable only on its gross income from sources within the United States by reason of its receiving a large percentage of its gross income from sources within a possession of the United States.

(c) *Net operating loss of preceding year*—(1) *Amount of credit.* The amount of net operating loss (as defined in paragraph (2)) of the corporation for the preceding taxable year (if beginning after December 31, 1937), but not in excess of (A) the section 102 net income for the taxable year, in the case of the tax imposed by section 102; (B) the Supplement P net income for the taxable year, in the case of the computations required under Supplement P; or (C) the Subchapter A net income for the taxable year, in the case of the tax imposed under Subchapter A.

(2) *Definition.* As used in this section the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the following exceptions and limitations—

(A) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114 (b) (2), (3), or (4);

(B) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations.

(C) For the purposes of this paragraph, the net operating loss deduction provided in section 122 shall not be allowed.

In the case of a taxable year beginning after December 31, 1937, and before January 1, 1939, the term "net operating loss" means net operating loss as defined in section 26 (c) of the Revenue Act of 1938, 52 Stat. 467.

(d) *Bank affiliates.* In the case of a holding company affiliate (as defined in section 2 of the Banking Act of 1933), the amount of the earnings or profits which the Board of Governors of the Federal Reserve System certifies to the Commissioner has been devoted by such affiliate during the taxable year to the acquisition of readily marketable assets other than bank stock in compliance with section 5144 of the Revised Statutes. The aggregate of the credits allowable under this subsection for all taxable years beginning after December 31, 1935, shall not exceed the amount required to be devoted under such section 5144 to such purposes, and the amount of the credit for any taxable year shall not exceed the adjusted net income for such year.

(e) *Income subject to excess-profits tax.* In the case of any corporation subject to the tax imposed by Subchapter E of Chapter 2, an amount equal to its adjusted excess-profits net income (as defined in section 710 (b)). In the case of any corporation computing such tax under section 721 (relating to abnormalities in income in the taxable period), section 726 (relating to corporations completing contracts under the Merchant Marine Act of 1936), section 731 (relating to corporations engaged in mining strategic minerals), or section 736 (b) (relating to corporations with income from long-term contracts), the credit shall be the amount of which the tax imposed by such subchapter is 90 per centum. For the purpose of the preceding sentence the term "tax imposed by Subchapter E of Chapter 2" means the tax computed without regard to the limitation provided in section 710 (a) (1) (B) (the 80 per centum limitation), without regard to the credit provided in section 729 (c) and (d) for foreign taxes paid, and without regard to the adjustments provided in section 734. This subsection shall not apply to any corporation exempt from such tax under section 725 or section 727.

(f) *Dividends paid credit.* For corporation dividends paid credit, see section 27.

(g) *Consent dividends credit.* For corporation consent dividends credit, see section 28.

(h) *Credit for dividends paid on certain preferred stock*—(1) *Amount of credit.* In the case of a public utility, the amount of dividends paid during the taxable year on its preferred stock. The credit provided in this subsection shall be subtracted from the basic surtax credit provided in section 27.

(2) *Definitions.* As used in this subsection and section 15 (a)—

(A) *Public utility.* The term "public utility" means a corporation engaged in the furnishing of telephone service or in the sale of electric energy, gas, or water, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof or by an agency or instrumentality of the United States or by a public utility or public service commission or other similar body of the District of Columbia or of any State or political subdivision thereof.

(B) *Preferred stock.* The term "preferred stock" means stock issued prior to October 1, 1942, which during the whole of the taxable year (or the part of the taxable year after its issue) was stock the dividends in respect of which were cumulative, limited to the same amount, and payable in preference to the payment of dividends on other stock.

§ 29.26–1 *Credit of corporation for interest on obligations of the United States and its instrumentalities.* The credit

allowed by section 26 (a) is an amount equal to the interest received upon obligations of the United States or of a corporation organized under Act of Congress (if such corporation is an instrumentality of the United States and under the Act authorizing the issue of such obligations, as amended and supplemented, such interest is in the case of individuals exempt from normal tax) which is included in gross income under section 22.

§ 29.26–2 *Credit of corporation for net operating loss of preceding year.* Since the net operating loss credit allowed by section 26 (c) cannot exceed (a) the section 102 net income for the taxable year, in the case of the tax imposed by section 102; (b) the Supplement P net income for the taxable year, in the case of the computations required under Supplement P; or (c) the subchapter A net income for the taxable year in the case of the tax imposed under subchapter A of chapter 2, it is the smaller of the following amounts:

(1) The excess of the deductions allowed by chapter 1 for the preceding taxable year over gross income for such year, both computed in accordance with the exceptions and limitations provided by section 26 (c) (2).

(2) (i) The section 102 net income for the taxable year, in the cases of the tax imposed by section 102; (ii) the Supplement P net income for the taxable year, in the case of the computations required under Supplement P; (iii) the subchapter A net income for the taxable year, in the case of the tax imposed under subchapter A of chapter 2.

In computing deductions for the preceding taxable year any deduction for depletion shall be computed without reference to discovery value or percentage depletion under section 114 (b) (2), (3), or (4) (see § 29.23 (m)–2). The basis for such depletion is the basis provided in section 113 (a), adjusted as provided in section 113 (b), for the purpose of determining the gain upon the sale or other disposition of the property involved.

In computing deductions for the preceding taxable year the net operating loss provided in section 122 shall not be allowed.

In computing the gross income for the preceding taxable year there must be included the excess, if any, of the amount of any interest received which is wholly exempt from taxes imposed by chapter 1 over the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations.

Example. For 1942 the X Corporation, which makes its income tax returns on the calendar year basis, has a net income of $1,000,000, computed on the accrual basis and without the net operating loss deduction provided in section 23 (s), capital losses of $550,000, and no capital gains. Its Federal normal tax and surtax for 1942, not allowable as a deduction under section 23, are $300,000, and it made no contributions during that year. For 1941 its gross income was $500,000, and its allowable deductions were $1,500,000. Included in such deductions was $500,000 for net operating loss, allowed as a deduction under section 23 (s) and computed under section 122. There was likewise included in such deductions $300,000 for depletion based on discovery value. If depletion had been computed without reference to discovery value or to percentage depletion, the amount of such deduction would have been $100,000. For 1941 the corporation had $300,000 of wholly tax-exempt interest, and paid $200,000 in interest on indebtedness incurred to carry obligations from which such tax-exempt interest was derived. The net operating loss credit available to such corporation for 1942 is computed as follows:

Deductions for 1941		$1,500,000
Less excess of depletion deduction computed on basis of discovery value over amount allowable for depletion without reference to discovery value or percentage depletion ($300,000 minus $100,000)	$200,000	
Less net operating loss deduction	500,000	
		700,000
Deductions as limited by section 26 (c) (2) (A) and 26 (c) (2) (C)		800,000
Gross income for 1941	$500,000	
Plus tax-exempt interest minus interest paid ($300,000 minus $200,000)	100,000	
Gross income contemplated by section 26 (c) (2) (B)		600,000
Excess of deductions over gross income for 1941		200,000
Net income for 1942 (computed without net operating loss deductions provided in section 23 (s))		1,000,000
Less capital losses not allowed by section 117 (d)	$550,000	
Less Federal normal tax and surtax for 1942 not allowed as a deduction under section 23	300,000	
		850,000
Section 102 net income for 1942		150,000

The credit for the net operating loss for the preceding year available to the X Corporation for 1942 is $150,000. Inasmuch as the excess of deductions over gross income for 1941, as computed above, is greater than the section 102 net income for 1942 the net operating loss credit available to the X Corporation for 1942 is equal to the section 102 net income for 1942. If the excess of deductions over gross income for 1941, as computed above, were smaller than the section 102 net income for 1942, the entire amount of such excess would be allowed as the net operating loss for 1942.

Similar rules for the computation of the net operating loss credit are applicable in the case of computations required under Supplement P, or the tax imposed under subchapter A of chapter 2.

§ 29.26–3 *Bank affiliates.* The credit provided in section 26 (d) is allowed:

(a) To a holding company affiliate of a bank, as defined in section 2 of the Banking Act of 1933, which holding company affiliate holds, at the end of the taxable year, a general voting permit granted by the Board of Governors of the Federal Reserve System;

(b) In the amount of the earnings or profits of such holding company affiliate which, in compliance with section 5144 of the Revised Statutes, has been devoted by it during the taxable year to the acquisition of readily marketable assets other than bank stock;

(c) Upon certification by the Board of Governors of the Federal Reserve System to the Commissioner that such an amount of the earnings or profits has been so devoted by such affiliate during the taxable year.

No credit is allowable under section 26 (d) for the amount readily marketable assets in excess of what is required by such section 5144 to be acquired by such affiliate, or in excess of the adjusted net income for the taxable year. Nor may the aggregate of the credits allowable under section 26 (d) exceed the amount required to be devoted under section 5144 to the acquisition of readily marketable assets other than bank stock.

Every taxpayer claiming and making a deduction for the credit provided for in section 26 (d) shall attach to its return a supplementary statement, in duplicate, setting forth all the facts and information upon which the claim is predicated, including such facts and information as the Board of Governors of the Federal Reserve System may prescribe as necessary to enable it, upon the request of the Commissioner subsequent to the filing of the return, to certify to the Commissioner the amount of earnings or profits devoted to the acquisition of such readily marketable assets. A certified copy of such supplementary statement shall be forwarded by the taxpayer to the Board of Governors at the time of the filing of the return. The holding company affiliate shall also furnish the Board of Governors such further information as the Board shall require. For the requirements with respect to the amount of such readily marketable assets which must be acquired and maintained by a holding company affiliate to which a voting permit has been granted, see section 5144 (b) and (c) of the Revised Statutes.

§ 29.26–4 *Credit for income subject to excess profits tax.* A credit is provided in section 26 (e) allowable under sections 13 (a) (2) and 15 (a) in computing normal tax net income and surtax net income, respectively. See section 108 as to certain fiscal years. The credit is allowed only in the case of corporations subject to the excess profits tax imposed by subchapter E of chapter 2. The credit does not apply to a corporation exempt from such tax under section 725 (relating to personal service corporations) or section 727 (relating to corporations exempt from excess profits tax).

In general, the credit is the amount of the corporation's adjusted excess profits net income, as defined in section 710 (b). In the case of the following corporations, however, the credit is an amount of which the tax imposed by subchapter E of chapter 2 is 90 percent:

(a) Corporations computing such excess profits tax under section 721, relat-

ing to abnormalities in income in the taxable period.

(b) Corporations computing such excess profits tax under section 726, relating to corporations completing contracts under the Merchant Marine Act of 1936.

(c) Corporations computing such excess profits tax under section 731, relating to corporations engaged in mining strategic minerals.

(d) Corporations computing such excess profits tax under section 736 (b), relating to corporations with income from long-term contracts.

For the purpose of the credit in the case of such corporations, the excess profits tax (upon which the credit is to be computed) is the tax imposed under subchapter E of chapter 2 computed without regard to the limitation of tax to 80 percent of surtax net income, as provided in section 710 (a) (1). The excess profits tax is also determined for this purpose without regard to any credit for foreign taxes allowed in section 729 (c) and (d) and without regard to the adjustments provided in section 734.

The determination of this credit may be illustrated by the following example:

Example. The X Corporation is a domestic corporation computing its excess profits tax under section 731. It makes its income tax returns on the calendar year basis. The portion of its excess profits net income attributable to mining in the United States of platinum (a strategic mineral) is $60,000 and the remainder is attributable to other activities. For 1942, its total excess profits net income is $120,000 and its adjusted excess profits net income is $50,000. The portion of the adjusted excess profits net income subject to excess profits tax is $25,000 $\left(\frac{60,000}{120,000}\text{ of }\$50,000\right)$ The tax (computed without regard to section 731) on $50,000 under section 710 (a) (1) (A) (90 percent rate) is $45,000. The tax under section 731 is $\frac{25,000}{50,000}$ of $45,000, or $22,500. Accordingly, the credit under section 26 (e) is $25,000, the amount of which such $22,500 tax is 90 percent.

If the excess profits tax of a corporation imposed by subchapter E of chapter 2 for a taxable year beginning after December 31, 1941, is finally determined by the use of the excess profits credit based upon constructive average base period net income determined under section 722 or if the corporation is entitled to and uses such excess profits credit in the computation of its excess profits tax for such year without the necessity of filing an application for relief under section 722 (see § 30.722–5 (e) of this chapter), the credit under section 26 (e) allowable in computing the normal tax and surtax shall be the amount of the corporation's adjusted excess profits net income, as defined in section 710 (b), computed with the use of the excess profits credit based upon constructive average base period net income. However, if such corporation computes its excess profits tax as provided in (a), (b), (c), or (d) of this section, the credit under section 26 (e) shall be the amount of which the tax imposed by subchapter E of chapter 2, computed as provided by the second paragraph of this section, is 90 percent.

§ 29.26–5 *Credit for dividends paid on preferred stock of public utilities.* The credit provided in section 26 (h) is an amount equal to the dividends paid during the taxable year by certain public utility corporations on certain classes of preferred stock. As used in this section, the term "public utility" means a corporation engaged in the furnishing of telephone service, or in the sale of electric energy, gas, or water if the rates charged by such corporation for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof or by an agency or instrumentality of the United States or by a public utility or public service commission or other similar body of the District of Columbia or of any State or political subdivision thereof. If a schedule of rates has been filed with any of the above bodies having the power to disapprove such rates, then such rates shall be considered as established or approved rates even though such body has taken no action on the filed schedule. Rates fixed by contract between the corporation and the purchaser, except where the purchaser is the United States, a State, the District of Columbia, or an agency or political subdivision of the United States, a State, or the District of Columbia, shall not be considered as established or approved rates in those cases where they are not subject to direct control, or where no maximum rate for such contract rates has been established, by the United States, a State, the District of Columbia, or by an agency or political subdivision thereof. The credit provided in section 26 (h) will not be denied solely because part of the gross income of the corporation consists of revenue derived from such furnishing or sale at rates which are not so regulated, provided the corporation establishes to the satisfaction of the Commissioner (1) that the revenue from regulated rates and the revenue from unregulated rates are derived from the operation of a single interconnected and coordinated system within a single area or region, in one or more States and (2) that the regulation to which it is subject in part of its operating territory is effective to control rates within the unregulated territory so that the rates within the unregulated territory have been and are substantially as favorable to users and consumers as are the rates within the regulated territory.

For the purposes of section 26 (h) preferred stock means stock which was issued prior to October 1, 1942, and which during the whole of the taxable year (or the part of the taxable year after its issue) was stock nonparticipating as to earnings or profits either currently or in liquidation, the dividends in respect of which were cumulative and payable in preference to the payment of dividends on other stock. In addition, the preferred stock must be such that the rate of return is fixed and cannot be changed by a vote of the board of directors or by some similar method. However, if there are several classes of preferred stock, all of which meet the above requirements, the credit provided in section 26 (h) shall not be denied in the case of a given class of preferred stock merely because there is another class of preferred stock whose dividends are to be paid before those of the given class of stock. Likewise, it is immaterial for the purposes of this section whether the stock be voting or nonvoting stock.

The amount allowable as a credit under section 26 (h) shall be subtracted from the basic surtax credit otherwise computed under section 27 (b).

SEC. 27. CORPORATION DIVIDENDS PAID CREDIT [as amended by sec. 222 (a), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; sec. 132 (b) (c), Rev. Act 1942].

(a) *Definition in general.* As used in this chapter with respect to any taxable year the term "dividends paid credit" means the sum of:

(1) The basic surtax credit for such year, computed as provided in subsection (b);

(2) The dividend carry-over to such year, computed as provided in subsection (c);

(3) The amount, if any, by which any deficit in the accumulated earnings and profits, as of the close of the preceding taxable year (whether beginning on, before, or after January 1, 1939), exceeds the amount of the credit provided in section 26 (c) (relating to net operating losses), for such preceding taxable year (if beginning after December 31, 1937); and

(4) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness. As used in this paragraph the term "indebtedness" means only an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to, and in existence at, the close of business on such date. Where the indebtedness is for a principal sum, with interest, no credit shall be allowed under this paragraph for amounts used or set aside to pay such interest. A renewal (however evidenced) of an indebtedness shall be considered an indebtedness.

§ 29.27 (a)–1 *Dividends paid credit.* The amount of the dividends paid credit provided by section 27 (a) is an amount equivalent to the sum of the following:

(a) The basic surtax credit for the taxable year. For computation of the basic surtax credit see section 27 (b).

(b) The dividend carry-over to the taxable year. For computation of the dividend carry-over see section 27 (c).

(c) The deficit credit provided by section 27 (a) (3).

(d) Amounts used or irrevocably set aside to pay or to retire indebtedness as provided in section 27 (a) (4).

§ 29.27 (a)–2 *Deficit credit.* Included in the dividends paid credit is an amount equal to the excess of any deficit in accumulated earnings and profits as of the close of the preceding taxable year over the net operating loss credit allowed by section 26 (c) for such preceding taxable year.

A deficit in accumulated earnings and profits can arise only out of the operation of the business at a loss and cannot be caused by distributions to shareholders in excess of the amount of accumulated earnings and profits. If distributions are made to shareholders out of accumulated earnings and profits,

however, such distributions may contribute to the creation of a deficit by so exhausting the accumulated earnings and profits that they are incapable of absorbing a loss thereafter resulting from the business. It is the subsequent operating loss, however, and not the distribution which creates the deficit. For example, the X Corporation, which makes its income tax returns on the calendar year basis, has on January 1, 1942, accumulated earnings and profits of $100,000. During 1942 there are no further earnings and profits. On February 1, 1942, operating losses have reduced the accumulated earnings and profits account to $50,000. On March 1, 1942, $90,000 is distributed to shareholders. On April 1, 1942, an operating loss of $40,000 is incurred. There is no further change during the taxable year. Though the corporation closes its year with total assets of $180,000 less than it had on January 1, 1942, and $90,000 of that amount was attributable to operating losses, only $40,000 constitutes a deficit in accumulated earnings and profits as of the close of the year. If, however, no operating losses were incurred up to February 1, $90,000 was distributed to shareholders on February 1, a $50,000 operating loss was incurred on March 1, and a $40,000 operating loss on April 1, the corporation's deficit in accumulated earnings and profits would be $80,000 as of the close of the year.

§ 29.27 (a)–3 *Amounts used or irrevocably set aside to pay or to retire indebtedness*—(a) *Indebtedness.* The term "indebtedness" means an obligation of a corporation, absolute and not contingent, to pay, on demand or within a given time, in cash or other medium, a fixed amount, existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to, and in existence at, the close of business on December 31, 1937. If the indebtedness was so evidenced at the close of business on December 31, 1937, it is still an indebtedness within the meaning of section 27 (a) (4) though, prior to the time payment is made or amounts are irrevocably set aside, it has been renewed. Such renewal need not be evidenced by one of the types of instruments enumerated in section 27 (a) (4), but it is sufficient if the debtor-creditor relationship evidenced by one of such instruments at the close of business on December 31, 1937, continues. An indebtedness once so renewed may be again renewed without depriving the corporation of the benefits of section 27 (a) (4). Indebtedness incurred after December 31, 1937, is not indebtedness within the meaning of section 27 (a) (4) even though the proceeds of the loan are used to discharge an indebtedness falling within the provisions of that section, as, for example, where money is borrowed from A to pay B, but, if the creditor remains the same and the transaction is in effect a renewal, the mere fact that it takes the form of a new borrowing, the proceeds of which are simultaneously used to discharge the prior obligation, will not of itself prevent the transaction from being a renewal within the meaning of section 27 (a) (4) and this section.

The mere substitution, after December 31, 1937, of several instruments for one instrument, or one instrument for several instruments, existing at the close of business on such date, where there is no change in terms except the substitution of a series of different amounts equal in the aggregate to the total principal amount of the instrument or instruments surrendered (as, for example, where two $50,000 bonds are issued in exchange for one $100,000 bond, or where one $100,000 bond is issued in exchange for two $50,000 bonds), or the reissue of a lost or destroyed instrument, or the issue of a new instrument to a transferee, will not deprive a corporation of the benefits of section 27 (a) (4).

Indebtedness incurred through the assumption of the liabilities of another is not indebtedness within the meaning of section 27 (a) (4) unless such assumption took place prior to January 1, 1938, and such indebtedness was evidenced at the close of business on December 31, 1937, by one or more of the instruments enumerated in such section, issued by the taxpayer prior to, and in existence at, the close of business on such date.

The credit provided by section 27 (a) (4) extends only to amounts used or irrevocably set aside to pay or to retire the principal of indebtedness evidenced by the types of obligations enumerated in that section. The denial of a credit for amounts used or set aside to discharge an obligation to pay interest applies whether the interest involved became due on, before, or after January 1, 1938. If interest is allowable as a deduction under section 23 (b) or a corresponding section of a prior income tax law when paid or accrued or would be so allowable if it were not for the exception contained in such section or section 24 (c), no credit will be allowed under section 27 (a) (4) with respect to such interest, despite the fact that such interest may have been funded and forms part or all of the principal amount of an obligation of the character described in section 27 (a) (4).

(b) *Amounts used or irrevocably set aside.* The credit is allowable, in any taxable year, only for amounts used or irrevocably set aside in that year. The use or irrevocable setting aside must be to effect the extinguishment or discharge of indebtedness. The issuance of a renewal obligation will, therefore, not result in an allowable credit. If amounts are set aside in one year, no credit is allowable for such amounts for a later year in which actually paid. As long as all other conditions are satisfied, the aggregate amount allowable as a credit for any taxable year includes all amounts (from whatever source) used and, as well, all amounts (from whatever source) irrevocably set aside, irrespective of whether in cash or other medium. Double credits are not permitted.

(c) *Reasonableness of the amounts with reference to the size and terms of the indebtedness.* The reasonableness of the amounts used or irrevocably set aside must be determined by reference to the size and terms of the particular indebtedness. Hence, all the facts and circumstances with respect to the nature, scope, conditions, amount, maturity, and other terms of the particular indebtedness must be shown in each case.

Ordinarily an amount used to pay or retire an indebtedness, in whole or in part, at or prior to the maturity and in accordance with the terms thereof will be considered reasonable, and may be allowable as a credit for the year in which so used, if no adjustment is required by reason of an amount set aside in a prior year for payment or retirement of the same indebtedness.

All amounts irrevocably set aside for the payment or retirement of an indebtedness in accordance with and pursuant to the terms of the obligation, for example, the annual contribution to trustees required by the provisions of a mandatory sinking fund agreement, will be considered as complying with the statutory requirement of reasonableness. To be considered reasonable it is not necessary that the plan of retirement provide for a retroactive setting aside of amounts for years prior to that in which the plan is adopted. However, if a voluntary plan was adopted prior to 1938, no adjustment is allowable in respect of the amounts set aside in the years prior to 1938.

[SEC. 27. CORPORATION DIVIDENDS PAID CREDIT —as amended by sec. 222 (a), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; sec. 132 (b) (c), Rev. Act 1942.]

(b) *Basic surtax credit.* As used in this chapter the term "basic surtax credit" means the sum of:

(1) The dividends paid during the taxable year, increased by the consent dividends credit provided in section 28, and reduced by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations;

(2) The net operating loss credit provided in section 26 (c) (1);

(3) The bank affiliate credit provided in section 26 (d).

The aggregate of the amounts under paragraphs (2) and (3) shall not exceed (A) the section 102 net income for the taxable year, in the case of the tax imposed by section 102; (B) the Supplement P net income for the taxable year, in the case of the computations required under Supplement P; or (C) the Subchapter A net income for the taxable year, in the case of the tax imposed under Subchapter A.

§ 29.27 (b)–1 *Basic surtax credit.* The amount constituting the basic surtax credit of a corporation for the taxable year consists of the sum of the following, less the amount allowable as a credit under section 26 (h) (relating to the credit for dividends paid on certain preferred stock of certain public utility corporations), and less the amount allowable as a deduction under section 121 (relating to the deduction of dividends paid on certain preferred stock of certain banks and trust companies):

(a) The dividends paid during the taxable year (subject to the qualifications, limitations, and exceptions provided in section 27 (d) to 27 (i), inclusive) plus the consent dividends credit

provided by section 28, less the credit for interest on certain obligations of the United States and its instrumentalities, provided by section 26 (a); and

(b) The smaller of the following:

(1) The sum of the net operating loss credit for the preceding taxable year provided in section 26 (c) (1) and the bank affiliate credit provided in section 26 (d).

(2) (i) The section 102 net income for the taxable year, in the case of tax imposed by section 102; (ii) the Supplement P net income for the taxable year, in the case of computations required under Supplement P; or (iii) the subchapter A net income for the taxable year, in the case of tax imposed under subchapter A of chapter 2.

§ 29.27 (b)-2 *Dividends paid*—(a) *When dividends are considered paid.* A dividend will be considered as paid when it is received by the shareholder. An allowance for dividends paid will not be permitted unless the shareholder receives the dividend during the taxable year for which the credit is claimed.

If a dividend is paid by check and the check bearing a date within the taxable year is deposited in the mails, in a cover properly stamped and addressed to the shareholder at his last known address, at such time that in the ordinary handling of the mails the check would be received by the shareholder within the taxable year, a presumption arises that the dividend was paid to the shareholder in such year.

The payment of a dividend during the taxable year to the authorized agent of the shareholder will be deemed payment of the dividend to the shareholder during such year.

If a corporation, instead of paying the dividend directly to the shareholder, credits the account of the shareholder on the books of the corporation with the amount of the dividend, the allowance for a dividend paid will not be permitted unless it be shown to the satisfaction of the Commissioner that such crediting constituted payment of the dividend to the shareholder within the taxable year.

An allowance will not be permitted for the amount of a dividend credited during the taxable year upon an obligation of the shareholder to the corporation unless it is shown to the satisfaction of the Commissioner that such crediting constituted payment of the dividend to the shareholder within the taxable year.

In the case of a stock dividend, if the shares (other than fractional shares payable to bearer) constituting the dividend are not entered or registered on the books of the corporation in the name of the shareholder (or his nominee or transferee) within the taxable year, the dividend will not be deemed to have paid in such year. Delivery of a certificate, or certificates, for such new shares, within the taxable year, constitutes prima facie evidence of the payment of the dividend.

If the dividend is payable in obligations of the corporation, they should be entered or registered in the taxable year on the books of the corporation, in the name of the shareholder (or his nominee or transferee), and, in the case of obligations payable to bearer, should be received in the taxable year by the shareholder (or his nominee or transferee), to constitute payment of the dividend within the taxable year.

In the case of a dividend from which the tax has been deducted and withheld as required by section 143 or 144, the dividend is considered as paid when such deducting and withholding occur.

(b) *Methods of accounting.* The determination of whether a dividend has been paid to the shareholder by the corporation during its taxable year is in no way dependent upon the method of accounting regularly employed by the corporation in keeping its books or upon the method of accounting upon the basis of which the net income of the corporation is computed. See section 43.

(c) *Records.* Every corporation claiming an allowance for dividends paid shall keep such permanent records as are necessary (1) to establish that the dividends with respect to which such allowance is claimed were actually paid during the taxable year and (2) to supply the information required to be filed with the income tax return of the corporation. Such corporation shall file with its return (i) a copy of the dividend resolution; and (ii) a concise statement of the pertinent facts relating to the payment of the dividend, clearly specifying (*a*) the medium of payment and (*b*), if not paid in money, the fair market value and adjusted basis (or face value, if paid in its own obligations) on the date of distribution of the property distributed, and the manner in which such fair market value and adjusted basis were determined. Canceled dividend checks and receipts obtained from shareholders acknowledging payment of dividends paid otherwise than by check need not be filed with the return but shall be kept by the corporation as a part of its records.

[SEC. 27. CORPORATION DIVIDENDS PAID CREDIT—as amended by sec. 222 (a), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; sec. 132 (b) (c), Rev. Act 1942.]

(c) *Dividend carry-over.* There shall be computed with respect to each taxable year of a corporation a dividend carry-over to such year from the two preceding taxable years, which shall consist of the sum of—

(1) The amount of the basic surtax credit for the second preceding taxable year, reduced by the subchapter A net income for such year, and further reduced by the amount, if any, by which the subchapter A net income for the first preceding taxable year exceeds the sum of—

(A) The basic surtax credit for such year; and

(B) The excess, if any, of the basic surtax credit for the third preceding taxable year over the subchapter A net income for such year; and

(2) The amount, if any, by which the basic surtax credit for the first preceding taxable year exceeds the subchapter A net income for such year. In the case of a preceding taxable year referred to in this subsection, the subchapter A net income shall be determined as if the corporation was, under the law applicable to such taxable year, a personal holding company.

§ 29.27 (c)-1 *Dividend carry-over.* The dividend carry-over to a given taxable year is computed as follows:

(a) If the basic surtax credit for the first preceding taxable year exactly equals the subchapter A net income for such year, the dividend carry-over is the amount of the excess of the basic surtax credit for the second preceding taxable year over the subchapter A net income for such year.

(b) If the basic surtax credit for the first preceding taxable year exceeds the subchapter A net income for such year, the dividend carry-over is the amount of such excess plus the excess of the basic surtax credit for the second preceding taxable year over the subchapter A net income for such year.

(c) If the basic surtax credit for the first preceding taxable year is less than the subchapter A net income for such year, the dividend carry-over is the amount by which the basic surtax credit for the second preceding taxable year exceeds the subchapter A net income for such year reduced by the excess of the subchapter A net income for the first preceding taxable year over the sum of the basic surtax credit for such year and the excess of the basic surtax credit for the third preceding taxable year over the subchapter A net income for such year.

In computing the dividend carry-over the subchapter A net income of any preceding taxable year shall be determined as if the corporation was, under the law applicable to such taxable year, a personal holding company.

Every corporation claiming a dividend carry-over for any taxable year shall file with its return for such year a concise statement setting forth the amount of the dividend carry-over claimed and all material and pertinent facts relative thereto, including a detailed schedule showing the computation of the dividend carry-over claimed.

The computation of the dividend carry-over may be illustrated by the following examples:

Example (1). The X Corporation, which makes its income tax returns on the calendar year basis, has subchapter A net income of $150,000 and a basic surtax credit of $225,000 for 1939. For 1940 its subchapter A net income is $200,000 and its basic surtax credit is $350,000, and for 1941 its subchapter A net income and its basic surtax credit are each $175,000. Its dividend carry-over to 1942 is $150,000, computed as follows:

(1) Basic surtax credit for 1940	$350,000
(2) Less subchapter A net income for 1940	200,000
(3) Dividend carry-over to 1942 ((1) minus (2))	150,000

Since the basic surtax credit for 1941 exactly equals the subchapter A net income for that year, neither that year nor the year 1939 need be taken into acocunt. The preceding taxable year (1941) is taken into account only if the basic surtax credit for such year exceeds the subchapter A net income for such year or if the subchapter A net income for such year exceeds the sum of the basic surtax credit for such year and the excess of the basic surtax credit for the third preceding taxable year (1939) over the subchapter A net income for such year. The third preceding taxable year (1939) is taken into account only if the subchapter A net income for the first preceding taxable year (1941) exceeds the basic surtax credit

for such year, in which case it operates to reduce the amount of such excess which must be deducted from the carry-over from the second preceding taxable year (1940).

Example (2). The Y Corporation, which makes its income tax returns on the calendar year basis, has subchapter A net income of $100,000 and a basic surtax credit of $150,000 for 1939. For 1940 its subchapter A net income is $50,000 and its basic surtax credit is $75,000, and for 1941 its subchapter A net income and its basic surtax credit are $25,000 and $100,000, respectively. Its dividend carry-over to 1942 is $100,000, computed as follows:

Year 1940		
(1) Basic surtax credit	$75,000	
(2) Less subchapter A net income	50,000	
(3) Excess of basic surtax credit over subchapter A net income		$25,000
Year 1941		
(4) Basic surtax credit	$100,000	
(5) Less subchapter A net income	25,000	
(6) Excess of basic surtax credit over subchapter A net income		75,000
(7) Dividend carry-over to 1942 (sum of (3) and (6))		100,000

For the reason why the year 1939 is not taken into account, see explanation at end of example (1).

Example (3). The Z Corporation, which makes its income tax returns on the calendar year basis, has a subchapter A net income of $90,000, and a basic surtax credit of $150,000 for 1939. For 1940 its subchapter A net income is $60,000 and its basic surtax credit is $160,000, and for 1941 its subchapter A net income and its basic surtax credit are $120,000 and $25,000, respectively. Its dividend carry-over to 1942 is $65,000, computed as follows:

Year 1940		
(1) Basic surtax credit	$160,000	
(2) Less subchapter A net income	60,000	
(3) Excess of basic surtax credit over subchapter A net income		$100,000
Year 1941		
(4) Subchapter A net income	$120,000	
(5) Basic surtax credit	25,000	
Year 1939		
(6) Basic surtax credit	$150,000	
(7) Less subchapter A net income	90,000	
(8) Excess of basic surtax credit over subchapter A net income	60,000	
Sum of (5) and (8)	85,000	
(9) Excess of subchapter A net income for the first preceding taxable year (1941) over sum of items (5) and (8)		35,000
(10) Dividend carry-over to 1942 ((3) minus (9))		65,000

[SEC. 27. CORPORATION DIVIDENDS PAID CREDIT—as amended by sec. 222 (a), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; sec. 132 (b) (c), Rev. Act 1942.]

(d) *Dividends in kind.* If a dividend is paid in property other than money (including stock of the corporation if held by the corporation as an investment) the amount with respect thereto which shall be used in computing the basic surtax credit shall be the adjusted basis of the property in the hands of the corporation at the time of the payment, or the fair market value of the property at the time of the payment, whichever is the lower.

§ 29.27 (d)-1 *Dividends in kind.* Section 27 (d) imposes limitations upon the extent to which dividends paid in assets (other than money) may be recognized for purposes of determining the amount of the allowance for dividends paid which may be included in the basic surtax credit. Irrespective of the form of the corporate resolution by which a dividend is declared, if the dividend is ultimately and actually paid by the corporation in any property other than money, constituting its corporate assets, the amount of the allowance for dividends paid to which the corporation is entitled with respect thereto cannot exceed the lesser of the two following amounts determined as of the time of payment;

(a) The adjusted basis of such property in the hands of the corporation as provided for in section 113; or

(b) The fair market value of such property.

As used in this section the term "property" includes shares of capital stock of the corporation making the dividend distribution if such shares of stock are held by it as an investment. Unless shown to the contrary, shares of capital stock once issued but thereafter acquired by the corporation in any manner whatsoever, but not retired, shall be deemed to be held by the corporation as an investment. The term "property" also includes obligations upon which the corporation making the distribution is liable as a guarantor, indorser, or surety.

The application of section 27 (d) may be illustrated by the following example:

Example. The S Corporation, in 1934, purchased stock of the Y Corporation for $100,000. In 1942 such stock had a fair market value of $70,000. During the period of its ownership of such stock, the S Corporation received distributions amounting to $5,000 out of earnings or profits of the Y Corporation accumulated before March 1, 1913. In 1942 the corporation used such stock for the payment of a dividend. The allowance for dividends paid for purposes of inclusion in the basic surtax credit for 1942 is $70,000, computed as follows:

Purchase price, or cost of stock	$100,000
Less tax-free distribution	5,000
Adjusted basis of stock in the hands of the corporation at the time of the dividend payment	95,000
Fair market value of stock at the time of the dividend payment	70,000
Allowance for dividends paid for purposes of inclusion in the basic surtax credit for 1942	70,000

Since the fair market value of the stock ($70,000) at the time of the dividend payment is less than the adjusted basis ($95,000) of the stock in the hands of the corporation at the time of the dividend payment, the lesser amount ($70,000) should be used as the allowance for dividends paid for purposes of computing the basic surtax credit for 1942 with respect to such stock.

[SEC. 27. CORPORATION DIVIDENDS PAID CREDIT—as amended by sec. 222 (a), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; sec. 132 (b) (c), Rev. Act, 1942.]

(e) *Dividends in obligations of the corporation.* If a dividend is paid in obligations of the corporation, the amount with respect thereto which shall be used in computing the basic surtax credit shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. If the fair market value of any such dividend paid in any taxable year of the corporation beginning after December 31, 1935, is lower than the face value, then when the obligation is redeemed by the corporation the excess of the amount for which redeemed over the fair market value of the time of the dividend payment (to the extent not allowable as a deduction in computing net income for any taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs.

§ 29.27 (e)-1 *Dividends in obligations of the corporation.* Section 27 (e) is concerned solely with the amount of the allowance for dividends paid for purposes of inclusion in the basic surtax credit to the extent that dividends are paid by a corporation in its own obligations. If the corporation ultimately pays a dividend in its own obligations (regardless of the form of the corporate resolution by which the dividend is declared), the amount of the allowance for dividends paid to which it is entitled with respect thereto for the year in which such dividend is paid is liimted to the lesser of the face value or fair market value of such obligations as of the date of payment. If in a taxable year of the corporation beginning after December 31, 1935, the allowance for dividends paid as of the date of payment is limited to the fair market value of the corporate obligations distributed and the corporation redeems such obligations, the corporation becomes entitled to an additional allowance for dividends paid in computing the basic surtax credit for the taxable year in which it redeems such obligations, but only in the event that the amount at which such obligations are redeemed is higher than their fair market value at the time of the distribution. The amount of such additional allowance is the excess of the price at which such obligations are redeemed over their fair market value at the time of the distribution, subject to the restriction that such excess be diminished by any amounts which were allowable as deductions for amortized bond discount or bond issue commissions and expenses allocable to the obligations redeemed in computing the net income of the corporation for any taxable year. A corporation is entitled to such additional allowance regardless of the identity of the holders of the obligations at the time of their redemption.

The term "obligations" as used in this section means any legal liability on the part of the corporation (not including liability as a guarantor, indorser, or

surety), regardless of when incurred, to pay a fixed or determinable sum of money, evidenced in writing executed by the corporation. The terms "redeemed" as used in this section includes (1) repurchase in the open market for investment or sinking fund purposes, (2) retirement, or (3) cancellation of the obligations before, at, or after maturity.

The application of section 27 (e) may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, declared a dividend of $85,000 in 1936, payable in that year in its 5 percent bonds at 85. Pursuant to such declaration, bonds having an aggregate face value of $100,000 were issued during 1936 in payment of the dividend. The fair market value of the bonds at the time of issuance was $75,000. The dividends paid credit for 1936 was the fair market value of the bonds at the time of the dividend payment ($75,000), since such fair market value was lower than the face value ($100,000) of the obligations.

The bonds were redeemed in 1942. The corporation prior to the redemption of the bonds at face value deducted in its returns over the life of the bonds the $15,000 bond discount resulting from the payment in 1936 of the $85,000 dividend in bonds having a face value of $100,000. The allowance for dividends paid for purposes of computing the basic surtax credit with respect to the bond redemption for the taxable year 1942, in which the redemption of the bonds occurs, is $10,000, computed as follows:

Redemption price of bonds	$100,000
Less fair market value of bonds when dividend was paid in 1936	75,000
Difference	25,000
Less bond discount allowed as a deduction in computing net income	15,000
Amount treated as dividend paid in 1942	10,000

[SEC. 27. CORPORATION DIVIDENDS PAID CREDIT—as amended by sec. 222 (a), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; sec. 132 (b) (c), Rev. Act 1942.]

(f) *Taxable stock dividends.* In case of a stock dividend or stock right which is a taxable dividend in the hands of shareholders under section 115 (f), the amount with respect thereto which shall be used in computing the basic surtax credit shall be the fair market value of the stock or the stock right at the time of the payment.

§ 29.27 (f)-1 *Taxable stock dividends.* The allowance for dividends paid provided by section 27 (b) (1) is limited by section 27 (f), in the case of distributions in stock dividends or stock rights, to distributions which are taxable dividends in the hands of shareholders under section 115 (f). Such allowance, however, is limited in amount to the fair market value of such stock or stock rights at the time of the payment of the dividend. As to a distribution by a corporation or its own capital stock held as an investment, see § 29.27 (d)-1.

[SEC. 27. CORPORATION DIVIDENDS PAID CREDIT—as amended by sec. 222 (a), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; sec. 132 (b) (c), Rev. Act. 1942.]

(g) *Distributions in liquidation.* In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the basic surtax credit under this section, be treated as a taxable dividend paid.

§ 29.27 (g)-1 *Dividends paid credit for distributions in liquidation*—(a) *Distributions which diminish earnings or profits.* To the general rule that an allowance for dividends paid is permitted only with respect to taxable dividends paid, section 27 (g) makes one exception, namely, for that part of an amount distributed in liquidation which, under the Internal Revenue Code, constitutes a distribution of, and is properly chargeable to, earnings or profits accumulated after February 28, 1913. Thus, a distribution either in complete or partial liquidation of a corporation is treated by the Code as one constituting in part a distribution of, and being properly chargeable to, earnings or profits, if:

(1) Under the provisions of section 115 (c), the amounts distributed in liquidation are treated as received in payment in exchange for the stock; and

(2) Under the provisions of section 112, the gain or loss, if any, from such exchange is recognized.

In such a case, an allowance for dividends paid may be included in the basic surtax credit for the amount actually involved in such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, even though the method of taxation of the distribution is that ordinarily employed with respect to the gain or loss realized and recognized upon an exchange, rather than that employed with respect to a taxable dividend.

On the other hand, certain transactions described in sections 112 and 115 are treated, for the purposes of the Internal Revenue Code, not as distributions to the shareholders of earnings or profits, but as transfers of such earnings or profits intact to another corporation in whose hands such earnings or profits, being available for distribution by it as dividends to its shareholders, have essentially the same status for the purposes of the Code as earnings or profits derived from its own operations. Characteristic of these transactions is the circumstance that the gain or loss realized from the receipt by the shareholders of property is not recognized by the Code. No allowance for dividends paid is permissible with respect to such transactions.

(b) *Amount properly chargeable to earnings or profits.* In the case of a distribution in liquidation with respect to which an allowance for dividends paid is permissible (see paragraph (a) of this section) the amount of the allowance is equal to the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913. To determine the amount properly chargeable to the earnings or profits accumulated since February 28, 1913, there must be deducted from the amount of the distribution that part allocable to capital account. The capital account, for purposes of these regulations, includes not only amounts representing the par or stated value of the stock with respect to which the liquidating distribution is being made but also that stock's proper share of the paid-in surplus, and such other corporate items, if any, which, for purposes of income taxation, are treated like capital in that they are not taxable dividends when distributed but are applied against and reduce the basis of the stock. The remainder of the distribution in liquidation is, ordinarily, properly chargeable to the earnings or profits accumulated since February 28, 1913. The application of this paragraph may be illustrated by the following example:

Example. The Y Corporation, which makes its income tax returns on the calendar year basis, was organized on January 1, 1910, with an authorized and outstanding capital stock of 2,000 shares of common stock of a par value of $100 each and 1,000 shares of participating preferred stock of a par value of $100 each. The preferred stock was to receive annual dividends of $7 per share and $100 per share on complete liquidation of the corporation in priority to any payments on common stock, and was to participate equally with the common stock in either instance after the common stock had received a similar amount. However, the preferred stock was redeemable in whole or in part at the option of the board of directors at any time at $106 per share plus its proportion of the earnings of the company at the time of such redemption. In 1910 the preferred stock was issued at $106 per share, for a total of $106,000, and the common stock was issued, at $100 per share, for a total of $200,000. On July 15, 1942, the company had a paid-in surplus of $6,000, consisting of the premium received on the preferred stock, earnings or profits of $30,000 accumulated prior to March 1, 1913, and earnings or profits accumulated since February 28, 1913, of $75,000. On July 15, 1942, the option with respect to the preferred stock was exercised and the entire amount of such stock was redeemed at $141 per share or a total of $141,000 in a transaction upon which gain or loss to the distributees resulting from the exchange was determined and recognized under the Internal Revenue Code, such transaction being only a partial liquidation under section 115 (c). The amount of the distribution allocable to capital account was $116,000 ($100,000 attributable to par value, $6,000 attributable to paid-in surplus, and $10,000 attributable to earnings or profits accumulated prior to March 1, 1913). The remainder, $25,000 ($141,000, the amount of the distribution, less $116,000, the amount allocable to capital account) is properly chargeable to the earnings or profits accumulated since February 28, 1913, and is allowable as dividends paid.

(c) *Credit in respect of earnings or profits transferred under certain tax-free transactions.* If, as a result of one or more transactions described in section 112, a corporation's earnings or profits accumulated after February 28, 1913, and its undistributed earnings or profits of the taxable year, shall have become the earnings or profits of another corporation subject to distribution as dividends by such other corporation, any dividend paid by the transferee corporation during that portion of the transferor's taxable year subsequent to the consummation of such tax-free transaction may, subject to the provisions of section 115, be apportioned and allocated to the transferor as a distribution out of such earnings or profits of transferor. The resolution of the board of directors of the transferee shall specifically designate the distribution, or part thereof, so apportioned and allocated. For the pur-

poses of the allowance for dividends paid, any such distribution so allocated shall be treated as a dividend paid only in the computation of the basic surtax credit allowable to the transferor, and must be consistently so treated by both corporations for the current and succeeding taxable years. Each corporation shall file as a part of its return for the taxable year involved (1) a statement setting forth concisely all of the material facts, including the date and the character of the transaction under section 112, the status at that time of the earnings or profits of both corporations, the date and amount of all dividend distributions subsequently made, and the particular distribution or portion thereof designated as effecting a distribution of the earnings or profits of the transferor corporation; and (2) a certified copy of the resolution of the board of directors of the transferee corporation with respect to the distribution. No allowance for dividends paid based upon such apportionment and allocation will be permitted unless the Commissioner is satisfied that the transferor corporation is entitled thereto pursuant to the provisions of this paragraph and that there has been a full compliance with the requirements of this paragraph. The provisions of this paragraph may be illustrated by the following example:

Example. The P Corporation, which makes its income tax returns on the basis of a fiscal year ending March 31, owned all of the capital stock of the S Corporation. The S Corporation, which makes its returns on the calendar year basis, was completely liquidated on December 1, 1942. At that time, the S Corporation had earnings or profits accumulated subsequent to February 28, 1913, in the amount of $50,000, in addition to earnings or profits for 1942 of $20,000, and an adjusted net income of $45,000. It had paid no dividends prior to its liquidation. The P Corporation had earnings or profits accumulated subsequent to February 28, 1913, in the amount of $60,000 in addition to earnings or profits of the taxable year computed as of the end of the year in the amount of $80,000, and an adjusted net income in the amount of $60,000. The P Corporation pays dividends as follows: June 15, 1942, $25,000; September 15, 1942, $25,000; December 15, 1942, $25,000; and March 15, 1943, $25,000. No portion of the dividends paid on June 15 and September 15 prior to the liquidation and no portion of the dividend paid on March 15, 1943, after the close of the taxable year of the S Corporation may be allocated to the S Corporation. The dividend paid on December 15 may, by appropriate corporate action, be made as one effecting a distribution out of the current earnings or profits of the S Corporation to the extent of $20,000. No part of that distribution may be allocated to the S Corporation's accumulated earnings or profits since, under section 115 (b), the earnings or profits of the P Corporation and the S Corporation for the taxable year ($100,000) are sufficient in amount to cover all the distributions made during that year ($100,000).

[SEC. 27. CORPORATION DIVIDENDS PAID CREDIT—as amended by sec. 222 (a), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; sec. 132 (b) (c), Rev. Act 1942.]

(h) *Preferential dividends.* The amount of any distribution (although each portion thereof is received by a shareholder as a taxable dividend), not made in connection with a consent distribution (as defined in section 28 (a) (4)), shall not be considered as dividends paid for the purpose of computing the basic surtax credit, unless such distribution is pro rata, with no preference to any share of stock as compared with other shares of the same class, and with no preference to one class of stock as compared with another class except to the extent that the former is entitled (without reference to waivers of their rights by shareholders) to such preference.

For a distribution made in connection with a consent distribution, see section 28.

§ 29.27 (h)–1 *Preferential distributions.* Section 27 (h) imposes a limitation upon the general rule that corporation is entitled to an allowance for dividends paid with respect to all dividends which it actually pays during the taxable year. Before a corporation may be entitled to any such allowance with respect to a distribution, regardless of the medium in which the distribution is made, every shareholder of the class of stock with respect to which the distribution is made must be treated the same as every other shareholder of that class, and no class of stock may be treated otherwise than in accordance with its dividend rights as a class. The limitation imposed by section 27 (h) is unqualified, except in the case of a partial distribution (see section 28 (a) (5)) made in connection with a consent distribution as defined in section 28 (a) (4), if the entire distribution composed of such partial distribution and consent distribution (see section 28 (e)) is not preferential. The existence of a preference is sufficient to prohibit allowance regardless of the fact (1) that such preference is authorized by all the shareholders of the corporation, or (2) that the part of the distribution received by the shareholder benefited by the preference is taxable to him as a dividend. A corporation will not be entitled to an allowance for dividends paid with respect to any distribution upon a class of stock if there is distributed to any shareholder of such class (in proportion to the number of shares held by him) more or less than his pro rata part of the distribution as compared with the distribution made to any other shareholder of the same class. Nor will a corporation be entitled to an allowance for dividends paid in the case of any distribution upon a class of stock if there is distributed upon such class of stock more or less than the amount to which it is entitled as compared with any other class of stock. A preference exists if any rights to preference inherent in any class of stock are violated. The disallowance, where any preference in fact exists, extends to the entire amount of the distribution and not merely to a part of such distribution. The term "distribution," as used in this section, includes a dividend as defined in section 115, and a distribution in liquidation referred to in section 27 (g).

The application of the provisions of section 27 (h), relating to distributions which are preferential, may be illustrated by the following examples:

Example (1). A, B, C, and D are the owners of all the shares of class A common stock in the M Corporation, which makes its income tax returns on a calendar year basis. With the consent of all the shareholders, the M Corporation, on July 15, 1942, declared a dividend of $5 a share payable in cash on August 1, 1942, to A. On September 15, 1942, it declared a dividend of $5 a share payable in cash on October 1, 1942, to B, C, and D. No allowance for dividends paid for the taxable year 1942 is permitted to the M Corporation with respect to any part of the dividends paid on August 1, 1942, and October 1, 1942.

Example (2). The N Corporation, which makes its income tax returns on the calendar year basis, has a capital of $100,000 (consisting of 1,000 shares of common stock of a par value of $100) and earnings or profits accumulated after February 28, 1913, in the amount of $50,000. In the year 1942, the N Corporation distributes $7,500 in cancellation of 50 shares of the stock owned by three of the four shareholders of the corporation. No allowance for dividends paid is permissible under section 27 (h) with respect to such distribution.

Example (3). The P Corporation has two classes of stock outstanding, 10 shares of cumulative preferred, owned by E, entitled to $5 per share and on which no dividends have been paid for two years, and 10 shares of common, owned by F. On December 31, 1942, the corporation distributes a dividend of $125, $50 to E and $75 to F. The corporation is entitled to no allowance for any part of such dividend paid, since there has been a preference to F. If, however, the corporation had distributed $100 to E and $25 to F, it would have been entitled to include $125 in its basic surtax credit as a dividend paid.

[SEC. 27. CORPORATION DIVIDENDS PAID CREDIT—as amended by sec. 222 (a), Rev. Act 1939; sec. 1, Pub. Law 18, approved March 17, 1941; sec. 132 (b) (c), Rev. Act 1942.]

(i) *Nontaxable distributions.* If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this chapter for the period in which the distribution is made, such part shall not be included in computing the basic surtax credit.

§ 29.27 (i)–1 *Nontaxable distributions.* No allowance for dividends paid is permitted with respect to any part of the distribution by a corporation to its shareholders which is:

(a) Not out of earnings or profits of the taxable year or out of earnings or profits of the corporation accumulated subsequent to February 28, 1913 (see section 115), or, in the case of distributions in liquidation, not properly chargeable to earnings or profits of the corporation accumulated after February 28, 1913, under § 29.27 (g)–1;

(b) In the case of a corporation which was classified as a personal service corporation under the Revenue Act of 1918 or the Revenue Act of 1921, out of earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or section 218 of the Revenue Act of 1921 (see section 115 (e)); or

(c) A distribution in stock of the corporation or rights to acquire its stock which does not constitute income to its shareholders within the meaning of the sixteenth amendment to the Constitution (see section 115 (f) and §§ 29.115–3 and 29.115–4).

The effect of sections 27 (h) and (i) is that no allowance for dividends paid may be included in the basic surtax credit with respect to any distribution unless each of the shareholders of that class, who are subject to taxation under chapter 1 for the period in which the distribution is made, receives a taxable divi-

dend as a result of the distribution. (See also section 27 (g).)

The application of section 27 (l) may be illustrated by the following examples:

Example (1). A, B, C, and D are the shareholders of the Y Corporation, which makes its income tax returns on the calendar year basis, D being an educational corporation exempt from income tax under section 101. On July 15, 1943, the Y Corporation paid a dividend (within the meaning of section 115) in cash of $1,000. A and B make their returns on the calendar year basis, but C makes his return on the basis of the fiscal year ending July 31. The Y Corporation is entitled to an allowance for dividends paid in the amount of $1,000 with respect to the dividends paid on July 15.

Example (2). If the facts in the preceding example are the same, except that A and B make their returns on the basis of the fiscal year ending July 31, the Y Corporation is entitled to an allowance for dividends paid in the amount of $1,000 with respect to the dividends paid on July 15.

SEC. 28. CONSENT DIVIDENDS CREDIT [as amended by sec. 186 (e), Rev. Act 1942].

(a) *Definitions.* As used in this section—

(1) *Consent stock.* The term "consent stock" means the class or classes of stock entitled, after the payment of preferred dividends (as defined in paragraph (2)), to a share in the distribution (other than in complete of partial liquidation) within the taxable year of all the remaining earnings or profits, which share constitutes the same proportion of such distribution regardless of the amount of such distribution.

§ 29.28 (a) (1)–1 *Consent stock.* The term "consent stock," as defined in section 28 (a) (1), includes what is generally known as common stock. It also includes participating preferred stock, the participation rights of which are unlimited. The application of section 28 (a) (1) may be illustrated as follows:

If in the case of the X Corporation there is only one class of stock outstanding, it would all be consent stock. If, on the other hand, there were two classes of stock, class A and class B, and class A was entitled to 6 percent before any distribution could be made on class B, but class B was entitled to everything distributed after class A had received its 6 percent, only class B stock would be consent stock. Similarly, if class A, after receiving its 6 percent, was to participate equally or in some fixed proportion with class B until it had received a second 6 percent, after which class B alone was entitled to any further distributions, only class B stock would be consent stock. The same result would follow if the order of preferences were class A 6 percent, then class B 6 percent, then class A a second 6 percent, either alone or in conjunction with class B, then class B the remainder. If, however, class A stock is entitled to ultimate participation without limit as to amount, then it, too, may be consent stock. For example, if class A is to receive 3 percent and then share equally or in some fixed proportion with class B in the remainder of the earnings or profits distributed, both class A stock and class B stock are consent stock.

[SEC. 28. CONSENT DIVIDENDS CREDIT—as amended by sec. 186 (e), Rev. Act 1942.]

[(a) *Definitions.* As used in this section—]

(2) *Preferred dividends.* The term "preferred dividends" means a distribution (other than in complete or partial liquidation), limited in amount, which must be made on any class of stock before a further distribution (other than in complete or partial liquidation) of earnings or profits may be made within the taxable year.

§ 29.28 (a) (2)–1 *Preferred dividends.* The term "preferred dividends," as defined in section 28 (a) (2), includes all fixed amounts (whether determined by percentage of par value, a stated return expressed in a certain number of dollars per share, or otherwise) the distribution (other than in liquidation) of which on any class of stock is a condition precedent to a further distribution (other than in liquidation) of earnings or profits. A distribution, though expressed in terms of a fixed amount, is not a preferred dividend, however, unless it is preferred over a subsequent distribution within the taxable year upon some other class or classes of stock than the one on which it is payable. The application of section 28 (a) (2) may be illustrated as follows:

If, in the case of the X Corporation, there are only two classes of stock outstanding, class A and class B, and class A is entitled to a distribution of 6 percent of par, after which the balance of the earnings and profits are distributable on class B exclusively, class A's 6 percent is a preferred dividend. If the order of preferences is class A $6 per share, class B $6 per share, then class A and class B in fixed proportions until class A receives $3 more per share, then class B the remainder, all of class A's $9 per share and $6 per share of the amount distributable on class B are preferred dividends. The amount which class B is entitled to receive in conjunction with the payment to class A of its last $3 per share is not a preferred dividend, because the payment of such amount is preferred over no subsequent distribution except one made on class B itself. Finally, if a distribution must be $6 on class A, $6 on class B, then on class A and class B share and share alike, the distribution on class A of $6 and the distribution on class B of $6 are both preferred dividends.

[SEC. 28. CONSENT DIVIDENDS CREDIT—as amended by sec. 186 (e), Rev. Act 1942.]

[(a) *Definitions.* As used in this section—]

(3) *Consent dividends day.* The term "consent dividends day" means the last day of the taxable year of the corporation, unless during the last month of such year there have occurred one or more days on which was payable a partial distribution (as defined in paragraph (5)), in which case it means the last of such days.

§ 29.28 (a) (3)–1 *Consent dividends day.* The term "consent dividends day" is defined in section 28 (a) (3). If there was no partial distribution (as defined in section 28 (a) (5)) payable during the last month of the corporation's taxable year, the consent dividends day is the last day of such taxable year. If there were one or more days during such last month on which was payable a partial distribution, the consent dividends day is the last of such days. The day upon which shareholders, under the terms of the resolution of the board of directors directing the distribution, are entitled to receive the distribution is the day it is payable.

[SEC. 28. CONSENT DIVIDENDS CREDIT—as amended by sec. 186 (e), Rev. Act 1942.]

[(a) *Definitions.* As used in this section—]

(4) *Consent distribution.* The term "consent distribution" means the distribution which would have been made if on the consent dividends day (as defined in paragraph (3)) there had actually been distributed in cash and received by each shareholder making a consent filed by the corporation under subsection (d), the specific amount stated in such consent.

§ 29.28 (a) (4)–1 *Consent distribution.* The term "consent distribution," as defined in section 28 (a) (4), does not include any actual distributions but is limited to the hypothetical distribution evidenced by shareholders' consents. The consent distribution equals the aggregate of all the amounts specified in the several consents, whether or not, if actually distributed, such amounts would have constituted in whole or in part a return of capital. Section 28 (a) (4) may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has only one class of stock outstanding, consisting of 500 shares, 200 of which are owned by A, and 300 by B. On December 15, 1942, the corporation distributes to A $5 per share, or $1,000. On December 31, 1942, B executes a consent to include $1,500 in his gross income as a taxable dividend. At the beginning of 1942 the corporation had no accumulated earnings or profits. For the taxable year 1942 the earnings or profits are $2,000. Nevertheless the corporation will be deemed to have made a consent distribution of $1,500 on December 15.

[SEC. 28. CONSENT DIVIDENDS CREDIT—as amended by sec. 186 (e), Rev. Act 1942.]

[(a) *Definitions.* As used in this section—]

(5) *Partial distribution.* The term "partial distribution" means such part of an actual distribution, payable during the last month of the taxable year of the corporation, as constitutes a distribution on the whole or any part of the consent stock (as defined in paragraph (1)), which part of the distribution, if considered by itself and not in connection with a consent distribution (as defined in paragraph (4)), would be a preferential distribution, as defined in paragraph (6).

§ 29.28 (a) (5)–1 *Partial distribution.* The term "partial distribution," as defined in section 28 (a) (5), does not include preferred dividends even though payable on consent stock. The application of section 28 (a) (5) may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has only two classes of stock outstanding, class A and class B, each of which is consent stock. Class A, consisting of 500 shares, is entitled to a preference of $3 per share, after which class B, consisting of 500 shares, is to receive $3 per share, whereupon class A and class B are entitled to share equally in any further distributions of earnings or profits. On December 15, 1942, the X Corporation distributes $6 per share or $3,000 on class A stock, and $3 per share or $1,500 on class B stock. Such distribution,

to the extent of $1,500 paid on class A stock, is a partial distribution.

[SEC. 28. CONSENT DIVIDENDS CREDIT—as amended by sec. 186 (e), Rev. Act 1942.]

[(a) *Definitions.* As used in this section—]

(6) *Preferential distribution.* The term "preferential distribution" means a distribution which is not pro rata, or which is with preference to any share of stock as compared with other shares of the same class, or to any class of consent stock as compared with any other class of consent stock.

§ 29.28 (a) (6)–1 *Preferential distribution.* A preferential distribution is an actual distribution (other than the distribution of a preferred dividend as defined in section 28 (a) (2)), or a consent distribution, or a combination of the two, upon consent stock, which involves a preference to one or more shares of stock as compared with other shares of the same class or to one class of consent stock as compared with any other class of consent stock. Such a preference exists if there is distributed to any shareholder (in proportion to the number of shares held by him) more or less than his pro rata part of a distribution as compared with the distribution made to any other shareholder of the same class, or if there is distributed to all the shareholders of one class of consent stock in the aggregate more or less than their pro rata part of a distribution as compared with the distribution made to all the shareholders of any other class of consent stock. If such preference exists, the entire distribution is preferential.

Section 28 (a) (6) may be illustrated by the following examples:

Example (1). The X Corporation, which makes its income tax returns on the calendar year basis, has one class of consent stock outstanding, owned in equal amounts by A, B, and C. On December 15, 1942, the corporation makes a distribution in cash of $5,000 each to A and B, and $3,000 to C. The distribution is preferential. If A and B each receives a distribution in cash of $5,000 and C consents to include $3,000 in gross income as a taxable dividend, the combined actual and consent distribution is preferential. Similarly, if no one receives a distribution in cash, but A and B each consents to include $5,000 as a taxable dividend in gross income but C agrees to include only $3,000, the consent distribution is preferential.

Example (2). The Y Corporation, which makes its income tax returns on the calendar year basis, has only two classes of stock outstanding, each class being consent stock and consisting of 500 shares. Class A, with a par value of $40 per share, is entitled to two-thirds of any distribution of earnings and profits. Class B, with a par value of $20 per share, is entitled to one-third of any distribution of earnings and profits. On December 15, 1942, there is distributed on the class A stock $2 per share, or $1,000, and on the class B stock $2 per share, or $1,000. The distribution is preferential, inasmuch as the class B stock has received more than its pro rata share of the distribution.

[SEC. 28. CONSENT DIVIDENDS CREDIT—as amended by sec. 186 (e), Rev. Act 1942.]

(b) *Corporations not entitled to credit.* A corporation shall not be entitled to a consent dividends credit with respect to any taxable year—

(1) Unless, at the close of such year, all preferred dividends (for the taxable year and, if cumulative, for prior taxable years) have been paid; or

(2) If, at any time during such year, the corporation has taken any steps in, or in pursuance of a plan of, complete or partial liquidation of all or any part of the consent stock.

§ 29.28 (b)–1 *Payment of preferred dividends.* Section 28 (b) (1) provides that a corporation shall not be entitled to a consent dividends credit for any taxable year, regardless of compliance with other requirements of section 28, unless at the close of such year all preferred dividends (for the taxable year and, if cumulative, for prior taxable years) have been paid. Whatever form such payment takes, it must result in the complete discharge of the obligation of the corporation to pay such dividends. For what constitutes payment of a dividend before the close of the taxable year, see § 29.27 (b)–2. For what constitutes a preferred dividend see section 28 (a) (2). A preferred dividend will be considered paid for the purposes of this requirement, even though it is paid as part of a preferential dividend as defined in section 27 (h), and the corporation receives no credit for dividends paid in consequence thereof.

§ 29.28 (b)–2 *Liquidation of consent stock.* A corporation is not entitled to a consent dividends credit for any taxable year in which it has taken any steps in, or in pursuance of a plan of, complete or partial liquidation of all or any part of the consent stock.

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has outstanding on January 1, 1942, 1,000 shares of class A stock, the dividend rights of which are limited to an annual return of $6 per share. It also has outstanding on that date 1,000 shares of class B stock, which is entitled to receive the entire amount of any distribution made of earnings or profits within the taxable year after the payment on class A of $6 per share. On April 1, 1942, the corporation makes a distribution in partial liquidation, whereby five shares of class B stock (consent stock) are canceled or redeemed. The corporation is barred from obtaining a consent dividends credit for the taxable year, regardless of compliance with other requirements of section 28. If, however, class A stock (not consent stock), instead of class B stock, had been canceled or redeemed in the liquidation, the corporation would not be barred, because of such liquidation, from obtaining a consent dividends credit.

The mere purchase by a corporation of its own stock for investment is not, within the meaning of section 28 (b) (2), the taking of any step in, or in pursuance of a plan of, complete or partial liquidation and will not prevent a corporation from obtaining a consent dividends credit for the taxable year.

[SEC. 28. CONSENT DIVIDENDS CREDIT—as amended by sec. 186 (e), Rev. Act 1942.]

(c) *Allowance of credit.* There shall be allowed to the corporation, as a part of its basic surtax credit for the taxable year, a consent dividends credit equal to such portion of the total sum agreed to be included in the gross income of shareholders by their consents filed under subsection (d) as it would have been entitled to include in computing its basic surtax credit if actual distribution of an amount equal to such total sum had been made in cash and each shareholder making such a consent had received, on the consent dividends day, the amount specified in the consent.

§ 29.28 (c)–1 *Amount of consent dividends credit.* The consent dividends credit forms part of the basic surtax credit (see section 27 (b) (1)). It consists of the amount which the corporation woud be permitted to include in its basic surtax credit as a dividend paid if it had distributed to each shareholder whose consent has been filed pursuant to section 28 (d), and each such shareholder had received, on the consent dividends day (see section 28 (a) (3)), an amount equal to the amount specified in such consent. The amount of the consent dividends credit, therefore, cannot exceed the sum of the amounts specified in the several consents. It may, however, regardless of the fact that such amounts are treated and taxed in their entirety to the consenting shareholders as a dividend (see section 28 (f)), be smaller than the sum of the specified amounts, because it is limited to the amount which would have been allowed as dividends paid if an actual distribution had been made.

The provisions of section 28 (c) may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has only one class of stock outstanding, owned in equal amounts by A and B. It makes no distributions during the taxable year. Its earnings and profits for the calendar year 1942 amount to $8,000, there being at the beginning of such year no accumulated earnings or profits. A and B execute proper consents to include $5,000 each in their gross income as a dividend received by them on December 31, 1942. The sum of the amount specified in the consents executed by A and B is $10,000, but if $10,000 had actualy been distributed by the X Corporation on December 31, 1942, only $8,000 would have constituted a dividend. The allowance for dividends paid, includible in the computation of the basic surtax credit, would have amounted to only $8,000. The consent dividends credit of the corporation, therefore, is limited to $8,000.

[SEC. 28. CONSENT DIVIDENDS CREDIT—as amended by sec. 186 (e), Rev. Act 1942.]

(d) *Shareholders' consents.* The corporation shall not be entitled to a consent dividends credit with respect to any taxable year—

(1) Unless it files (in accordance with the regulations prescribed by the Commissioner with the approval of the Secretary) with its return for such year, or within one year after the date of enactment of the Revenue Act of 1942, in the case of a corporation which is a personal holding company for the taxable year with respect to which it claims the benefits of this section, signed consents made under oath by persons who were shareholders, on the last day of the taxable year, of the corporation, of any class of consent stock; and

(2) Unless in each such consent the shareholders agrees that he will include as a taxable dividend, in his return for the taxable year in which or with which the taxable year of the corporation ends, a specific amount; and

(3) Unless the consents filed are made by such of the shareholders and the amount specified in each consent is such, that the consent distribution would not have been a preferential distribution—

(A) If there was no partial distribution during the last month of the taxable year of the corporation, or

(B) If there was such a partial distribution, then when considered in connection with such partial distribution; and

(4) Unless in each consent made by a shareholder who is taxable with respect to a dividend only if received from sources within the United States, such shareholder agrees that the specific amount stated in the con-

sent shall be considered as a dividend received by him from sources within the United States; and

(5) Unless each consent filed is accompanied by cash, or such other medium of payment as the Commissioner may by regulations authorize, in an amount equal to the amount that would be required by section 143 (b) or 144 to be deducted and withheld by the corporation if the amount specified in the consent had been, on the last day of the taxable year of the corporation, paid to the shareholder in cash as a dividend. The amount accompanying the consent shall be credited against the tax imposed by section 211 (a) or 231 (a) upon the shareholder.

§ 29.28 (d)–1 *Making and filing of consents.* A consent shall be made in duplicate on oath or affirmation on Form 972 in accordance with these regulations and the instructions on the form or issued therewith and may be made only by or on behalf of a person who was the actual owner on the last day of the corporation's taxable year of any class of consent stock, i. e., the person who would have been required to include in gross income any dividends on such stock actually distributed on the last day of such year. In the consent such person must agree:

(a) To include in his gross income for his taxable year in which or with which the taxable year of the corporation ends a specific amount as a taxable dividend; and

(b) If he is a shareholder who is taxable with respect to a dividend only if received from sources within the United States, that the specific amount stated in his consent shall be considered as a dividend received by him from sources within the United States.

A consent may be made at any time not later than the due date of the corporation's income tax return for the taxable year for which the credit is claimed (see § 29.53–4) or such consent may be made at any time not later than one year after October 21, 1942, if the corporation was a personal holding company for the taxable year for which the credit is claimed. With such return, and not later than the due date thereof, or in the case of a personal holding company referred to in section 28 (d) (1), within one year after October 21, 1942, the corporation must file two duly executed duplicate originals of each consenting shareholder's consent, and a return on oath or affirmation on Form 973, or Form 973A, in the case of a personal holding company, showing by classes the stock outstanding on the first and last days of the taxable year, the dividend rights of such stock, distribution made during the taxable year to shareholders, and giving all the other information required by the form.

In the event that any consent filed by the corporation is made by a shareholder in the payment to whom of a dividend in cash, on the last day of the taxable year of the corporation, the corporation would have been required to deduct and withhold any amount as a tax under section 143 (b) or 144, such consent, when filed by the corporation, must be accompanied by payment of the amount which would have been required to be deducted and withheld if the amount specified in such consent had, on the last day of the corporation's taxable year, been paid to the shareholder in cash as a dividend. Such payment must be in one of the following forms:

(1) Cash;

(2) United States postal money order;

(3) Certified check drawn on a domestic bank, provided that the law of the place where the bank is located does not permit the certification to be rescinded prior to presentation;

(4) A cashier's check of a domestic bank; or

(5) A draft on a domestic bank or a foreign bank maintaining a United States agency or branch and payable in United States funds.

The amount of such payment shall be credited against the tax imposed by section 211 (a) or 231 (a) upon the shareholder.

§ 29.28 (d)–2 *Consent distribution must be nonpreferential.* The application of section 28 (d) (3) may be illustrated as follows:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has 200 shares of stock outstanding, owned by A and B in equal amounts. On December 15, 1942, the corporation distributes $600 to B and $100 to A. On December 31, 1942, A executes a consent to include $500 in his gross income as a taxable dividend, though such amount is not distributed to him. The X Corporation, assuming the other requirements of section 28 have been complied with, is entitled to a consent dividends credit of $500. Though considered by themselves, both the partial distribution of $700 and the consent distribution of $500 are preferential, when considered together they constitute a single nonpreferential distribution of $1,200.

§ 29.28 (d)–3 *Overpayments and deficiencies.* For the refund or credit of any overpayment, and the assessment or collection of any deficiency referred to in section 186 (h) of the Revenue Act of 1942, see § 29.504–6.

[SEC. 28. CONSENT DIVIDENDS CREDIT—as amended by sec. 186 (e), Rev. Act 1942.]

(e) *Consent distribution as part of entire distribution.* If during the last month of the taxable year with respect to which shareholders' consents are filed by the corporation under subsection (d) there is made a partial distribution, then, for the purposes of this chapter, such partial distribution and the consent distribution shall be considered as having been made in connection with each other and each shall be considered together with the other as one entire distribution.

§ 29.28 (e)–1 *Consent and partial distributions to be considered together.* The rule provided in section 28 (e), that a consent distribution and a partial distribution are to be considered as having been made in connection with each other and as together forming parts of one entire distribution, is not limited to the purposes of section 28, but is applicable in connection with any of the purposes of chapter 1. Thus, such rule is to be applied to determine whether a partial distribution is a preferential dividend under section 27 (h). See § 29.27 (h)–1.

[SEC. 28. CONSENT DIVIDENDS CREDIT—as amended by sec. 186 (e), Rev. Act 1942.]

(f) *Taxability of amounts specified in consents.* The total amount specified in a consent filed under subsection (d) shall be included as a taxable dividend in the gross income of the shareholder making such consent, and, if the shareholder is taxable with respect to a dividend only if received from sources within the United States, shall be included in the computation of his tax as a dividend received from sources within the United States; regardless of—

(1) Whether he actually so includes it in his return; and

(2) Whether the distribution by the corporation of an amount equal to the total sum included in all the consents filed, had actual distribution been made, would have been in whole or in part a taxable dividend; and

(3) Whether the corporation is entitled to any consent dividends credit by reason of the filing of such consents, or to a credit less than the total sum included in all the consents filed.

§ 29.28 (f)–1 *Taxability of amounts specified in consents.* Once a shareholder's consent is filed, the full amount specified therein shall be included in his gross income as a taxable dividend, and, in cases where the shareholder is taxable on a dividend only if received from sources within the United States, shall be treated as a dividend so received; regardless of:

(a) Whether he actually so includes it in his return;

(b) Whether he would have been taxable on all or any part of such amount as a dividend if it had been distributed to him in cash; and

(c) Whether the corporation, as a result of filing such consents, is entitled to any consent dividends credit or to a smaller consent dividends credit than the sum of the amounts specified in the several consents.

The ground upon which a consent dividends credit is denied the corporation does not affect the taxability to a shareholder whose consent has been filed of the amount specified in his consent. Thus, he is taxable on the full amount so specified, though the corporation receives no credit or a smaller credit than the sum of the amounts specified in the consents because the corporation has no earnings and profits or a smaller amount of earnings and profits than the sum of the amounts specified in the consents. The full amount specified in a shareholder's consent which has been filed is also taxable to him as a dividend though a consent dividends credit is denied the corporation because (1) preferred dividends have not been paid, (2) part or all of the consent stock has been in a state of liquidation at any time during the taxable year, (3) the distribution of which the consent distribution is a part is preferential, (4) a consenting shareholder who is taxable with respect to a dividend only if received from sources within the United States fails to agree that the amount specified in his consent shall be considered as a dividend received by him from sources within the United States, or (5) payment has not been made as required by section 28 (d) (5) and § 29.28 (d)–1.

[SEC. 28. CONSENT DIVIDENDS CREDIT—as amended by sec. 186 (e), Rev. Act 1942.]

(g) *Corporate shareholders.* If the shareholder who makes the consent is a corporation, the amount specified in the consent

shall be considered as part of its earnings or profits for the taxable year, and shall be included in the computation of its accumulated earnings and profits.

§ 29.28 (g)–1 *Treatment of amount specified in consent of corporate shareholder.* From the standpoint of computing a shareholder's income for a taxable year relative to which he has agreed to include a specific amount in gross income, such amount is treated exactly as though such shareholder had received in cash a taxable dividend equal to the amount specified in his consent. Therefore, in the case of a corporate shareholder, such amount shall be included in the computation of its earnings and profits for the taxable year and its accumulated earnings and profits as of the close of the taxable year. The effect of a corporate shareholder's consent upon the computation of its earnings and profits may be illustrated as follows:

Example. The X Corporation has one shareholder, the Y Corporation, whose consent to include $10,000 in its gross income for the calendar year 1942 has been duly made and filed. The earnings and profits of the X Corporation for the calendar year 1942 amount to only $8,000, there being at the beginning of such year no accumulated earnings or profits. The Y Corporation must nevertheless include in its gross income $10,000 as a taxable dividend. Assume the Y Corporation to have begun the year 1942 with $5,000 accumulated earnings and profits, to have made no distributions during the year, and (without considering the amount specified in its consent) to have had neither profit nor loss during the year. Its earnings and profits for the year will be $10,000 and its accumulated earnings and profits at the close of the year will be $15,000.

[SEC. 28. CONSENT DIVIDENDS CREDIT—as amended by sec. 186 (e), Rev. Act 1942.]

(h) *Basis of stock in hands of shareholders.* The amount specified in a consent made under subsection (d) shall, for the purpose of adjusting the basis of the consent stock with respect to which the consent was given, be treated as having been reinvested by the shareholder as a contribution to the capital of the corporation; but only in an amount which bears the same ratio to the consent dividends credit of the corporation as the amount of such shareholder's consent stock bears to the total amount of consent stock with respect to which consents are made.

(i) *Effect on capital account of corporation.* The amount of the consent dividends credit allowed under subsection (c) shall be considered as paid in surplus or as a contribution to the capital of the corporation, and the accumulated earnings and profits as of the close of the taxable year shall be correspondingly reduced.

§ 29.28 (i)–1 *Effect on basis of stock in hands of shareholders and capital account of corporation.* The application of sections 28 (h) and 28 (i) may be illustrated by the following example:

Example. The X Corporation, which makes its income tax returns on the calendar year basis, has only one class of stock outstanding, owned entirely by A and B in equal amounts. A makes a consent to include $50 in his gross income as a dividend, but B refuses to do so. The X Corporation therefore distributes $50 to B in cash during the last month of its taxable year 1942. The consent distribution evidenced by A's consent and the actual distribution to B are treated together, as though one distribution of $100 had been made. The earnings and profits of the X Corporation for 1942, however amount to only $80, there being at the beginning of such year no accumulated earnings or profits. If, therefore, the entire $100, which is the sum of A's consent distribution and B's actual distribution, had been actually distributed, 80 percent thereof would have been a dividend, includible in the X Corporation's basic surtax credit, and 20 percent a return of capital. Applying this principle to the facts stated, the following results are obtained:

(1) In the case of the X Corporation—

(*a*) Its consent dividends credit is $40, being 80 percent of the amount specified in A's consent;

(*b*) Its basic surtax credit, assuming it has no net operating loss in the preceding year and no bank affiliate credit, is $80, composed of a consent dividends credit of $40 and an allowance for dividends paid of $40;

(*c*) The amount of its accumulated earnings and profits as of the close of the taxable year is zero, because of the transfer of $40 (the amount of the consent dividends credit) from earnings and profits to capital account and the deduction of an additional $40 on account of dividends paid to B. If, therefore, in the following year the X Corporation has no earnings and profits but nevertheless makes a distribution to shareholders, no part of such distribution will be a dividend, but it will all constitute a return of capital.

(2) In the case of A—

(*a*) A is taxable on $50 as a dividend;

(*b*) The basis of his stock is increased by $40, his pro rata share, i. e., all, of the consent dividends credit.

(3) In the case of B—

(*a*) B is taxable on $40 as a dividend;

(*b*) The basis of his stock is reduced by $10.

[SEC. 28. CONSENT DIVIDENDS CREDIT—as amended by sec. 186 (e), Rev. Act 1942.]

(j) *Amounts not included in shareholders' return.* The failure of a shareholder of consent stock to include in his gross income for the proper taxable year the amount specified in the consent made by him and filed by the corporation, shall have the same effect, with respect to the deficiency resulting therefrom, as is provided in section 272 (f) with respect to a deficiency resulting from a mathematical error appearing on the face of the return.

CREDITS AGAINST TAX

SEC. 31. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax, to the extent provided in section 131.

SEC. 32. TAXES WITHHELD AT SOURCE.

The amount of tax withheld at the source under section 143 or 144 shall be allowed as a credit against the tax.

SEC. 33. CREDIT FOR OVERPAYMENTS.

For credit against the tax of overpayments of taxes imposed by this chapter for other taxable years, see section 322.

SEC. 34. CREDITS AGAINST VICTORY TAX [as added by sec. 172 (f), Rev. Act 1942, and amended by sec. 2 (b), Current Tax Payment Act 1943].

For credits against victory tax, see sections 453 and 454. [NOTE: Prior to its amendment by sec. 2 (b), Current Tax Payment Act 1943, such amendment being effective July 1, 1943, section 34 reads as follows: "For credits against victory tax, see sections 453, 454, and 466 (e)."]

SEC. 35. CREDIT FOR TAX WITHHELD ON WAGES [as added by sec. 172 (f), Rev. Act 1942, and amended by sec. 3, Current Tax Payment Act 1943].

The amount deducted and withheld as tax under Subchapter D of Chapter 9 during any calendar year upon the wages of any individual shall be allowed as a credit to the recipient of the income against the tax imposed by this chapter for the taxable year beginning in such calendar year. If more than one taxable year begins in any such calendar year such amount shall be allowed as a credit against the tax for the last taxable year so beginning. [NOTE. Prior to its amendment by sec. 3, Current Tax Payment Act 1943, section 35 read as follows: "For credits against the tax withheld on wages, see section 466 (e)."]

ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

For use of inventories, see section 22 (c).

§ 29.41–1 *Computation of net income.* Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer' income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See §§ 29.42–1 to 29.42–3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

§ 29.41–2 *Bases of computation and changes in accounting methods.* Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. But see

sections 42 and 43. See also section 48. For instance, in any case in which it is necessary to use an inventory, no method of accounting in regard to purchases and sales will correctly reflect income except an accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. (See §§ 29.42–2 and 29.42–3.) On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property. (But see § 29.22 (c)–5.)

The true income, computed under the Internal Revenue Code and, if the taxpayer keeps books of account, in accordance with the method of accounting regularly employed in keeping such books (provided the method so used is properly applicable in determining the net income of the taxpayer for purposes of taxation), shall in all cases be entered in the return. If for any reason the basis of reporting income subject to tax is changed, the taxpayer shall attach to his return a separate statement setting forth for the taxable year and for the preceding year the classes of items differently treated under the two systems, specifying in particular all amounts duplicated or entirely omitted as the result of such change.

A taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. For the purposes of this section, a change in the method of accounting employed in keeping books means any change in the accounting treatment of items of income or deductions, such as a change from cash receipts and disbursements method to the accrual method, or vice versa; a change involving the basis of valuation employed in the computation of inventories (see §§ 29.22 (c)–1 to 29.22 (c)–8, inclusive); a change from the cash or accrual method to the long-term contract method, or vice versa; a change in the long-term contract method from the percentage of completion basis to the completed contract basis, or vice versa (see § 29.42–4); or a change involving the adoption of, or a change in the use of, any other specialized basis of computing net income such as the crop basis (see §§ 29.22 (a)–7 and 29.23 (a)–11). Application for permission to change the method of accounting employed and the basis upon which the return is made shall be filed within 90 days after the beginning of the taxable year to be covered by the return. The application shall be accompanied by a statement specifying the classes of items differently treated under the two methods and specifying all amounts which would be duplicated or entirely omitted as a result of the proposed change. Permission to change the method of accounting will not be granted unless the taxpayer and the Commissioner agree to the terms and conditions under which the change will be effected. See section 22 (d) and regulations thereunder with respect to changing to optional method of inventorying goods.

Section 44 contains special provisions for reporting the profit derived from the sale of property on the installment plan.

The foregoing requirements relative to a change of accounting method are not applicable if a taxpayer desires to adopt the installment basis of returning income, as provided in § 29.44–1, but are applicable if a taxpayer desires to change from such basis to a straight accrual basis. In case where permission to make such change is granted, the taxpayer will be required to return as additional income for the taxable year in which the change is made all the profit not theretofore returned as income pertaining to the payments due on installment sales contracts as of the close of the preceding taxable year.

§ 29.41–3. *Methods of accounting.* It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. (See section 54 and § 29.54–1.) Among the essentials are the following:

(a) In all cases in which the production, purchase, or sale of merchandise of any kind is an income-producing factor, inventories of the merchandise on hand (including finished goods, work in process, raw materials, and supplies) should be taken at the beginning and end of the year and used in computing the net income of the year (see section 22 (c) and §§ 29.22 (c)–1 to 29.22 (c)–8, inclusive);

(b) Expenditures made during the year should be properly classified as between capital and expense; that is to say, expenditures for items of plant, equipment, etc., which have a useful life extending substantially beyond the year should be charged to a capital account and not to an expense account; and

(c) In any case in which the cost of capital assets is being recovered through deductions for wear and tear, depletion, or obsolescence, any expenditure (other than ordinary repairs) made to restore the property or prolong its useful life should be added to the property account or charged against the appropriate reserve and not to current expenses.

§ 29.41–4 *Accounting period.* The return of a taxpayer is made and his income computed for his taxable year, which in general means his fiscal year, or the calendar year if he has not established a fiscal year. (See section 48.) The term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December. No fiscal year will, however, be recognized unless before its close it was definitely established as an accounting period by the taxpayer and the books of such taxpayer were kept in accordance therewith. A person having no such fiscal year must make his return on the basis of the calendar year. Except in the case of a first return for income tax a taxpayer shall make his return on the basis upon which he made his return for the taxable year immediately preceding, unless, with the approval of the Commissioner, he has changed his accounting period. See § 29.46–1.

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED [as amended by secs. 114, 115 (a), Rev. Act 1941; sec. 134 (a), Rev. Act, 1942].

(a) *General rule.* The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer whose net income is computed upon the basis of the accrual method of accounting, amounts (except amounts includible in computing a partner's net income under section 182) accrued only by reason of the death of the taxpayer shall not be included in computing net income for the period in which falls the date of the taxpayer's death. [For application of this subsection to taxable years beginning before January 1, 1943, see § 29.42–1 (b).]

(b) *Noninterest-bearing obligations issued at discount.* If, in the case of a taxpayer owning any noninterest-bearing obligation issued at a discount and redeemable for fixed amounts increasing at stated intervals, the increase in the redemption price of such obligation occurring in the taxable year does not (under the method of accounting used in computing his net income) constitute income to him in such year, such taxpayer may, at his election made in his return for any taxable year beginning after December 31, 1940, treat such increase as income received in such taxable year. If any such election is made with respect to any such obligation, it shall apply also to all such obligations owned by the taxpayer at the beginning of the first taxable year to which it applies and to all such obligations thereafter acquired by him and shall be binding for all subsequent taxable years, unless upon application by the taxpayer the Commissioner permits him, subject to such conditions as the Commissioner deems necessary to change to a different method. In the case of any such obligations owned by the taxpayer at the beginning of the first taxable year to which his election applies, the increase in the redemption price of such obligations occurring between the date of acquisition and the first day of such taxable year shall also be treated as income received in such taxable year.

(c) *Short-term obligations issued on discount basis.* In the case of any obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, the amount of discount at which such obligation is originally sold shall not be considered to accrue until the date on which such obligation is paid at maturity, sold, or otherwise disposed of.

§ 29.42–1 *When included in gross income*—(a) *In general.* Except as otherwise provided in section 42, gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. (See §§ 29.41–1 to 29.41–3, inclusive.) (As

to income from noninterest-bearing obligations issued at discount, see § 29.42–6, and as to income from short-term obligations issued on a discount basis, see § 29.42–7.) If no determination of compensation is had until the completion of the services, the amount received is ordinarily income for the taxable year of its determination, if the return is rendered on the accrual basis; or, for the taxable year in which received, if the return is rendered on the receipts and disbursements basis. If a person sues in one year on a pecuniary claim or for property, and money or property is recovered on a judgment therefor in a later year, income is realized in the later year, assuming that the money or property would have been income in the earlier year if then received. This is true of a recovery for patent infringement. Bad debts or accounts charged off subsequent to March 1, 1913, because of the fact that they were determined to be worthless, which are subsequently recovered, whether or not by suit, constitute income for the year in which recovered, regardless of the date when the amounts were charged off. (See § 29.23 (k)–1.) Such items as claims for compensation under canceled Government contracts constitute income for the year in which they are allowed or their value is otherwise definitely determined, if the return is rendered on the accrual basis; or for the year in which received, if the return is rendered on the basis of cash receipts and disbursements.

(b) *Last taxable year of decedent.* If the taxable year in which falls the date of the death of a taxpayer began on or after January 1, 1943, then there shall be included in computing net income for such year only amounts properly includible under the approved method of accounting followed by the taxpayer, or, if the taxpayer followed no such method, only amounts received during such year. However, if the taxpayer followed the accrual method of accounting, amounts accrued only by reason of his death shall not be included in computing net income for such year, except that, if the taxpayer was a member of a partnership, his share of the partnership income for the partnership year ending with its dissolution on account of his death shall be included in computing his net income. The approved accounting practice of the partnership in computing its income shall not be changed by reason of the taxpayer's death. Thus, if the partnership computed its income on the basis of cash receipts and disbursements, the partnership income for the year ending with the dissolution, a distributive share of which is included in the taxpayer's income, shall be so computed. If the partnership used the accrual method of accounting, its income shall be computed according to such practice. For example, if a law partnership keeping its books on the accrual method of accounting is entitled to certain contingent fees which are accrued only upon the completion of the cases involved, such partnership will compute its income for the year ending with its dissolution on account of the death of the taxpayer without accruing, on account of the death of the partner at such time, any such contingent fees in uncompleted cases. Under section 126, any distribution by the partnership to the estate or a beneficiary of the deceased partner out of such fees will be income to such estate or person. There must also be included in computing net income for the taxable year in which falls the date of death of a taxpayer the gain described in section 44 (d), relating to gain upon the disposition of installment obligations, except as otherwise provided in that section. See § 29.44–5. This amount must be included in computing net income regardless of the method of accounting followed by the taxpayer.

Section 134 (a) of the Revenue Act of 1942 changed the last sentence of section 42 (a) of the Internal Revenue Code to its present form, as set forth above. Prior to such change, the last sentence of section 42 (a) provided as follows:

> In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period.

Section 134 (f) of the Revenue Act of 1942 provides that the change in the last sentence of section 42 (a) shall be applicable to taxable years beginning after December 31, 1942. Section 134 (g) of the Revenue Act of 1942 provides that such change shall be applicable to taxable years beginning before January 1, 1943, if the executor, the administrator, or other personal representative of the taxpayer and the persons who acquire as beneficiaries of his estate or by reason of his death his right to receive any income make the election provided in such section 134 (g) (see § 29.126–4) to have the amendments made by section 134 apply to the law in effect for such taxable years. Accordingly, if the taxable year in which falls the date of the death of a taxpayer begins before January 1, 1943, the provisions of the first paragraph of this paragraph (b) are applicable only if such election has been made. See § 29.126–4, relating to such election and to the method of computing, and limitations with respect to, credit or refund of any overpayment which is a result of such election. If such election is not made, then there shall be included in computing net income for such taxable year, in addition to the amounts described in paragraph (a) of this section, all amounts accrued up to the date of the taxpayer's death which are not otherwise properly includible in respect of such taxable year or a prior taxable year, regardless of the fact that the decedent may have kept his books and made his return on the basis of cash receipts and disbursements.

§ 29.42–2 *Income not reduced to possession.* Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. A book entry, if made, should indicate an absolute transfer from one account to another. If a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt.

§ 29.42–3 *Examples of constructive receipt.* If interest coupons have matured and are payable, but have not been cashed, such interest, though not collected when due and payable, shall be included in gross income for the year during which the coupons mature, unless it can be shown that there are no funds available for payment of the interest during such year. The interest shall be included in gross income even though the coupons are exchanged for other property instead of eventually being cashed. The amount of defaulted coupons is income for the year in which paid. Dividends on corporate stock are subject to tax when unqualifiedly made subject to the demand of the shareholder. If a dividend is declared payable on December 31 and the corporation intended to and did follow its practice of paying the dividends by checks mailed so that the shareholders would not receive them until January of the following year, such dividends are not considered to have been unqualifiedly made subject to the demand of the shareholders prior to January, when the checks were actually received. As to the distributive share of the profits of a partner in a partnership, see section 188. Interest credited on savings bank deposits, even though the bank nominally has a rule, seldom or never enforced, that it may require so many days' notice before withdrawals are permitted, is income to the depositor when credited. An amount credited to shareholders of a building and loan association, when such credit passes without restriction to the shareholder, has a taxable status as income for the year of the credit. If the amount of such accumulations does not become available to the shareholder until the maturity of a share, the amount of any share in excess of the aggregate amount paid in by the shareholder is income for the year of the maturity of the share.

§ 29.42–4 *Long-term contracts.* Income from long-term contracts is taxable for the period in which the income is determined, such determination depending upon the nature and terms of the particular contract. As used in this section the term "long-term contracts" means building, installation, or construction contracts covering a period in excess of one year from the date of execution of the contract to the date on which the contract is finally completed and accepted. Persons whose income is derived in whole or in part from such contracts may, as to such income,

prepare their returns upon either of the following bases:

(a) Gross income derived from such contracts may be reported upon the basis of percentage of completion. In such case there should accompany the return certificates of architects or engineers showing the percentage of completion during the taxable year of the entire work to be performed under the contract. There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied.

(b) Gross income may be reported for the taxable year in which the contract is finally completed and accepted if the taxpayer elects as a consistent practice so to treat such income, provided such method clearly reflects the net income. If this method is adopted there should be deducted from gross income all expenditures during the life of the contract which are properly allocated thereto, taking into consideration any material and supplies charged to the work under the contract but remaining on hand at the time of completion.

A taxpayer may change his method of accounting to accord with paragraph (a) or (b) of this section only after permission is secured from the Commissioner as provided in § 29.41–2.

§ 29.42–5 *Subtraction for redemption of trading stamps.* If a taxpayer, for the purpose of promoting his business, issues with sales trading stamps or premium coupons redeemable in merchandise or cash, he should in computing the income from such sales subtract only the amount which will be required for the redemption of such part of the total issue of trading stamps or premium coupons issued during the taxable year as will eventually be presented for redemption. This amount will be determined in the light of the experience of the taxpayer in his particular business and of other users of trading stamps or premium coupons engaged in similar businesses. The taxpayer shall file for each of the five preceding years, or such number of these years as stamps or coupons have been issued by him, a statement showing:

(a) The total issue of stamps during each year;

(b) The total stamps redeemed in each year; and

(c) The rate, in percentage, which the stamps redeemed in each year bear to the total stamps issued in such year, regardless of the year when such redeemed stamps were issued.

A similar statement shall also be presented showing the experience of other users of stamps or coupons whose experience is relied upon by the taxpayer to determine the amount to be subtracted from the proceeds of sales. The Commissioner will examine the basis used in each return, and in any case in which the amount subtracted in respect of such stamps or coupons is found to be excessive, appropriate adjustment will be made.

§ 29.42–6 *Noninterest bearing obligations issued at discount.* If a taxpayer owns any noninterest-bearing obligation issued at a discount and redeemable for fixed amounts increasing at stated intervals, and if the increase in redemption price of such obligation occurring in the taxable year does not constitute income for such year under the method of accounting used in computing his net income, the taxpayer may, at his election, treat such increase as constituting income for the year in which it occurs rather than in the year in which the obligation is disposed of, redeemed, or paid at maturity. The election must be made in the taxpayer's return, and may be made for any taxable year. The election shall apply also to all other obligations of the type described in this section owned by the taxpayer at the beginning of the first taxable year to which the election applies and to those thereafter acquired by him. It shall apply to the taxable year for which such return is filed, and shall be binding for all subsequent taxable years unless upon application by the taxpayer the Commissioner permits the taxpayer, subject to such conditions as the Commissioner deems necessary to change to a different method of reporting income from such obligations. Although the election, once made, is binding upon the taxpayer, it does not apply to a transferee of such taxpayer.

In any case in which an election is made under this section, the amount considered to accrue in any taxable year to which the election applies is measured by the actual increases in the redemption price occurring in that year. Such amount shall not be considered to accrue ratably between the dates on which the redemption price changes. Thus, if two dates on which the redemption price increases fall within a taxable year and if the redemption price increases in the amount of 50 cents on each such date, the amount deemed to accrue in that year would be $1. If at the beginning of the first taxable year to which the election applies the taxpayer owns noninterest-bearing bonds of the prescribed character acquired prior thereto, he is required to report in such year, in addition to the increases in the redemption price actually falling within that year, the total of the increases in such price occurring between the date of his acquisition and the beginning of such year.

Example. Throughout the calendar year 1945, a taxpayer who makes his income tax returns on the calendar year basis and computes his net income on the cash receipts and disbursements basis holds the following United States bonds:

(a) United States savings bonds having a maturity value of $10,000, which he purchased on January 1, 1938, for $7,500. The entire increase in the redemption price of these bonds is exempt from normal tax but only such part of the increase as is attributable to $5,000 in principal amount (purchase price) of such bonds is exempt from the surtax.

(b) United States Defense savings bonds, Series E, having a maturity value of $5,000, which he purchased on January 1, 1942, for $3,750. The increase in the redemption price of these bonds is subject to both the normal tax and the surtax.

(c) United States savings bonds, Defense Series F, having a maturity value of $10,000, which he purchased on January 1, 1944, for $7,400. The increase in the redemption price of these bonds is subject to both the normal tax and the surtax.

The taxpayer holds no other obligations of the type described in this section. In his return for 1945 the taxpayer elects to treat the increases in the redemption prices of such bonds occurring in such year as income to him for such year. Under this section he is required in such return to report with respect to such bonds $250 as subject to normal tax and $750 as subject to surtax, determined as follows:

	Subject to normal tax		Subject to surtax	
	Increases prior to 1945	Increases in 1945	Increases prior to 1945	Increases in 1945
Bonds acquired Jan. 1, 1938	None	None	$400	$100
Bonds acquired Jan. 1, 1942	$100	$100	100	100
Bonds acquired Jan. 1, 1944	None	50	None	50
Total	$250		$750	

In the case of the United States savings bonds acquired on January 1, 1938, the increases of $400 and $100 in the redemption price are attributable to the principal amount (purchase price) in excess of $5,000.

§ 29.42–7 *Short-term obligations issued on discount basis.* In the case of any obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, the amount of discount at which such obligation is originally sold shall not be considered to accrue until the date on which such obligation is paid at maturity, sold, or otherwise disposed of. Accordingly, if a taxpayer who computes his net income on the accrual basis purchases upon issuance a United States Treasury bill issued on or after March 1, 1941, and holds it until maturity, the entire amount of the discount at which the bill was originally sold accrues on the date of maturity; and if such a taxpayer holds a United States Treasury bill issued on or after March 1, 1941, for a period less than its life, the portion of the original discount attributable to such period accrues only on the date on which he sells or otherwise disposes of the bill or receives payment at maturity. The original discount or the portion of such discount, as the case may be, is includible only in the gross income for the taxable year in which the taxpayer sells or otherwise disposes of the bill or receives payment at maturity. For examples illustrating rules for computation of income from sale or other disposition of obligations of the type described in this section, see § 29.117–1.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN [as amended by sec. 134 (b), Rev. Act 1942].

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. In the case of the death of a taxpayer whose net income is computed upon the basis of the accrual method of accounting, amounts (except amounts includible in computing a partner's net income under section 182) accrued as deductions and credits only by reason of the death of the taxpayer shall not be allowed in computing net income for the period in which falls the date of the taxpayer's death. [NOTE. For application of this section to taxable years beginning before January 1, 1943, see § 20.43–1 (b).]

§ 29.43–1 *"Paid or incurred" and "paid or accrued."* (a) The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48 (c).) The deductions and credits provided for in chapter 1 (other than the dividends paid credit provided in section 27) must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. If a taxpayer desires to claim a deduction or a credit as of a period other than the period in which it was "paid or accrued" or "paid or incurred," he shall attach to his return a statement setting forth his request for consideration of the case by the Commissioner together with a complete statement of the facts upon which he relies. However, in his income tax return he shall take the deduction or credit only for the taxable period in which it was actually "paid or incurred," or "paid or accrued," as the case may be. Upon the audit of the return, the Commissioner will decide whether the case is within the exception provided by the Internal Revenue Code, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable.

In any case in which, owing to monetary, exchange, or other restrictions imposed by a foreign country, an amount otherwise constituting gross income for the taxable year from sources without the United States is not includible in gross income of the taxpayer for that year, the deductions and credits charged against the amount so restricted shall be deemed to have been "paid or accrued" or "paid or incurred" proportionately in any subsequent taxable year in which such amount or portion thereof is includible in gross income. See § 29.131–6 for the treatment of foreign income tax imposed with respect to such amount as a basis of credit for foreign income tax in such cases.

(b) The provisions of paragraph (a) are in general applicable with respect to the taxable year during which the taxpayer dies if such taxable year begins on or after January 1, 1943. However, if the taxpayers followed the accrual method of accounting, there shall be included in computing net income for such year no amount accrued solely by reason of his death other than his distributive share of the losses of a partnership for the year ending with the dissolution of the partnership on account of his death. No change in the accounting practice of the partnership shall be made because of the taxpayer's death when the income and losses of the partnership are computed for the year ending with the dissolution of the partnership on account of the partner's death.

Section 134 (b) of the Revenue Act of 1942 changed the last sentence of section 43 of the Internal Revenue Code to its present form, as set forth above. Prior to such change, the last sentence of section 43 read as follows:

> In the case of the death of a taxpayer there shall be allowed as deductions and credits for the taxable period in which falls the date of his death, amounts accrued up to the date of his death (except deductions under section 23 (o) if not otherwise properly allowable in respect of such period or a prior period.

Section 134 (f) of the Revenue Act of 1942 provides that the change in the last sentence of section 43 shall be applicable to taxable years beginning after December 31, 1942. Section 134 (g) of the Revenue Act of 1942 provides that such change shall be applicable to taxable years beginning before January 1, 1943, if the executor, the administrator, or other personal representative of the taxpayer and the persons who acquire as beneficiaries of his estate or by reason of his death his right to receive any income make the election provided in such section 134 (g) (see § 29.126–4) to have the amendments made by section 134 apply to the law in effect for such taxable years. Accordingly, if the taxable year in which falls the date of the death of a taxpayer begins before January 1, 1943, the provisions of the first paragraph of this paragraph are applicable only if such election has been made. See § 29.126–4, relating to such election and to the method of computing, and limitations with respect to, credit or refund of any overpayment which is a result of such election. If such election is not made, then there shall also be allowed as deductions and credits for such taxable year, in addition to the amounts described in paragraph (a) of this section, all amounts (except deductions under section 23 (o)) accrued up to the date of the taxpayer's death which are not otherwise allowable with respect to such taxable year or a prior taxable year, regardless of the fact that the decedent may have been required to keep his books and make his return on the basis of cash receipts and disbursements.

§ 29.43–2 *When charges deductible.* Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities, or deficit of one year cannot be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he cannot deduct them from the income of the next or any succeeding year. It is recognized, however, that particularly in a going business of any magnitude there are certain overlapping items both of income and deduction, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his accounts. Judgments or other binding adjudications, such as decisions of referees and boards of review under workmen's compensation laws, on account of damages for patent infringement, personal injuries, or other cause, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise. If subsequent to its occurrence, however, a taxpayer first ascertains the amount of a loss sustained during a prior taxable year which has not been deducted from gross income, he may render an amended return for such preceding taxable year including such amount of loss in the deductions from gross income and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss in the original return. (See section 322.) A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily deductible for the year in which sustained.

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in personal property.* Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of realty and casual sales of personality.*[1] In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 30 per centum of the selling price (or, in case the sale or other disposition was in a taxable year beginning prior to January 1, 1934, the percentage of the selling price prescribed in the law applicable to such year), the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

[1] So in original.

(c) *Change from accrual to installment basis.* If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

(d) *Gain or loss upon disposition of installment obligations.* If an installment obligation is satisfied at other than its face value, or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) in the case of satisfaction at other than face value or a sale or exchange—the amount realized, or (2) in case of a distribution, transmission, or disposition otherwise than by sale or exchange—the fair market value of the obligation at the time of such distribution, transmission, or disposition. Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received. The basis of the obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full. This subsection shall not apply to the transmission at death of installment obligations if there is filed with the Commissioner, at such time as he may by regulation prescribe, a bond in such amount and with such sureties as he may deem necessary, conditioned upon the return as income, by the person receiving any payment on such obligations, of the same proportion of such payment as would be returnable as income by the decedent if he had lived and had received such payment. If an installment obligation is distributed by one corporation to another corporation in the course of a liquidation, and under section 112 (b) (6) no gain or loss with respect to the receipt of such obligation is recognized in the case of the recipient corporation, then no gain or loss with respect to the distribution of such obligation shall be recognized in the case of the distributing corporation.

§ 29.44–1 *Sale of personal property on installment plan.* Dealers in personal property ordinarily sell either for cash or on the personal credit of the purchaser or on the installment plan. Dealers who sell on the installment plan usually adopt one of four ways of protecting themselves in case of default:

(a) By an agreement that title is to remain in the vendor until the purchaser has completely performed his part of the transaction;

(b) By a form of contract in which title is conveyed to the purchaser immediately, but subject to a lien for the unpaid portion of the selling price;

(c) By a present transfer of title to the purchaser, who at the same time executes a reconveyance in the form of a chattel mortgage to the vendor; or

(d) By conveyance to a trustee pending performance of the contract and subject to its provisions.

The general purpose and effect being the same in all of these cases, the same rule is uniformly applicable. The general rule prescribed is that a person who regularly sells or otherwise disposes of personal property on the installment plan, whether or not title remains in the vendor until the property is fully paid for, may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total or gross profit (that is, sales less cost of goods sold) realized or to be realized when the property is paid for, bears to the total contract price. Thus, the income of a dealer in personal property on the installment plan may be ascertained by taking as income that proportion of the total payments received in the taxable year from installment sales (such payments being allocated to the year against the sales of which they apply) which the total or gross profit realized or to be realized on the total installment sales made during each year bears to the total contract price of all such sales made during that respective year. No payments received in the taxable year shall be excluded in computing the amount of income to be returned on the ground that they were received under a sale the total profit from which was returned as income during a taxable year or years prior to the change by the taxpayer to the installment basis of returning income. But in the case of any taxpayer who, by an original return made prior to February 26, 1926, changed the method of reporting his net income for the taxable year 1924 or any prior taxable year to the installment basis, see section 705 of the Revenue Act of 1928. Deductible items are not to be allocated to the years in which the profits from the sales of a particular year are to be returned as income, but must be deducted for the taxable year in which the items are "paid or incurred" or "paid or accrued," as provided by sections 43 and 48. A dealer who desires to compute his income on the installment basis shall maintain books of accounts in such a manner as to enable an accurate computation to be made on such basis in accordance with the provisions of this section.

The income from a casual sale or other casual disposition of personal property (other than property of a kind which should properly be included in inventory) may be reported on the installment basis only if (1) the sale price exceeds $1,000 and (2) the initial payments do not exceed 30 percent of the selling price.

If for any reason the purchaser defaults in any of his payments, and the vendor returning income on the installment basis repossesses the property sold, whether title thereto had been retained by the vendor or transferred to the purchaser, gain or loss for the year in which the repossession occurs is to be computed upon any installment obligations of the purchaser which are satisfied or discharged upon the repossession or are applied by the vendor to the purchase or bid price of the property. Such gain or loss is to be measured by the difference between the fair market value of the property repossessed and the basis in the hands of the vendor of the obligations of the purchaser which are so satisfied, discharged, or applied, with proper adjustment for any other amounts realized or costs incurred in connection with the repossession. (See also § 29.44–5.) The basis in the hands of the vendor of the obligations of the purchaser satisfied, discharged, or applied upon the repossession of the property shall be the excess of the face value of such obligations over an amount equal to the income which would be returnable were the obligations paid in full. No deduction for a bad debt shall in any case be taken on account of any portion of the obligations of the purchaser which are treated by the vendor as not having been satisfied, discharged, or applied upon the repossession, unless it is clearly shown that after the property was repossessed the purchaser remained liable for such portion; and in no event shall the amount of the deduction exceed the basis in the hands of the vendor of the portion of the obligations with respect to which the purchaser remained liable after the repossession. (See also § 29.23 (k)–1.) If the property repossessed is bid in by the vendor at a lawful public auction or judicial sale, the fair market value of the property shall be presumed to be the purchase or bid price thereof in the absence of clear and convincing proof to the contrary. The property repossessed shall be carried on the books of the vendor at its fair market value at the time of repossession.

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursement basis, such a course is permissible.

§ 29.44–2 *Sale of real property involving deferred payments.* Under section 44 deferred-payment sales of real property include (a) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the selling price has been paid, and (b) sales in which there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments. Such sales, either under (a) or (b), fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of property on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do not exceed 30 percent of the selling price;

(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed 30 percent of the selling price.

In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall be included as a part of the "selling price," but the amount of the mortgage, to the extent it does not exceed the basis to the vendor of the property sold, shall not be considered as a part of the "initial payments" or of the "total contract price," as those terms are used in section 44, in §§ 29.44–1 and 29.44–3, and in this section. The term "initial payments" does not include amounts received by the

vendor in the year of sale from the disposition to a third person of notes given by the vendee as part of the purchase price which are due and payable in subsequent years. Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount of the "initial payments," the "total contract price," or the "selling price." The term "initial payments" contemplates at least one other payment in addition to the initial payment. If the entire purchase price is to be paid in a lump sum in a later year, there being no payment during the first year, the income may not be returned on the installment basis. Income may not be returned on the installment basis where no payment in cash or property, other than evidences of indebtedness of the purchaser, is received during the first year, the purchaser having promised to make two or more payments in later years.

§ 29.44–3 *Sale of real property on installment plan.* In transactions included in class (1) in § 29.44–2 the vendor may return as income from such transactions in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the property is paid for bears to the total contract price.

If the purchaser defaults in any of his payments, and the vendor returning income on the installment basis reacquires the property sold, whether title thereto had been retained by the vendor or transferred to the purchaser, gain or loss for the year in which the reacquisition occurs is to be computed upon any installment obligations of the purchaser which are satisfied or discharged upon the reacquisition or are applied by the vendor to the purchase or bid price of the property. Such gain or loss is to be measured by the difference between the fair market value of the property reacquired (including the fair market value of any fixed improvements placed on the property by the purchaser) and the basis in the hands of the vendor of the obligations of the purchaser which are so satisfied, discharged, or applied, with proper adjustment for any other amounts realized or costs incurred in connection with the reacquisition. (See also § 29.44–5.) The basis in the hands of the vendor of the obligations of the purchaser satisfied, discharged, or applied upon the reacquisition of the property will be the excess of the face value of such obligations over an amount equal to the income which would be returnable were the obligations paid in full. No deduction for a bad debt shall in any case be taken on account of any portion of the obligations of the purchaser which are treated by the vendor as not having been satisfied, discharged, or applied upon the reacquisition of the property, unless it is clearly shown that after the property was reacquired the purchaser remained liable for such portion; and in no event shall the amount of the deduction exceed the basis in the hands of the vendor of the portion of the obligations with respect to which the purchaser remained liable after the reacquisition. (See § 29.23 (k)–1). If the property reacquired is bid in by the vendor at a foreclosure sale, the fair market value of the property shall be presumed to be the purchase or bid price thereof in the absence of clear and convincing proof to the contrary. If the property reacquired is subsequently sold, the basis for determining gain or loss is the fair market value of the property at the date of reacquisition (including the fair market value of any fixed improvements placed on the property by the purchaser).

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible, and the sales will be treated as deferred-payment sales not on the installment plan.

§ 29.44–4 *Deferred-payment sale of real property not on installment plan.* In transactions included in class (2) in § 29.44–2, the obligations of the purchaser received by the vendor are to be considered as the equivalent of cash to the amount of their fair market value in ascertaining the profit or loss from the transaction.

If the vendor has retained title to the property and the purchaser defaults in any of his payments, and the vendor repossesses the property, the difference between (a) the entire amount of the payments actually received on the contract and retained by the vendor plus the fair market value at the time of repossession of fixed improvements placed on the property by the purchaser and (b) the sum of the profits previously returned as income in connection therewith and an amount representing what would have been a proper adjustment for exhaustion, wear and tear, obsolescense, amortization, and depletion of the property during the period the property was in the hands of the purchaser had the sale not been made will constitute gain or loss, as the case may be, to the vendor for the year in which the property is repossessed, and the basis of the property in the hands of the vendor will be the original basis at the time of the sale plus the fair market value at the time of repossession, of fixed improvements placed on the property by the purchaser. If the vendor has previously transferred title to the purchaser, and the purchaser defaults in any of his payments, and the vendor accepts a voluntary reconveyance of the property, in partial or full satisfaction of the unpaid portion of the purchase price, the receipt of the property so reacquired, to the extent of its fair market value at that time, including the fair market value of fixed improvements placed on the property by the purchaser, shall be considered as the receipt of payment on the obligations satisfied. If the fair market value of the property is greater than the basis of the obligations of the purchaser so satisfied (generally, such basis being the fair market value of such obligations previously recognized in computing income), the excess constitutes ordinary income, and if the value of such property is less than the basis of such obligations, the difference may be deducted as a bad debt if ascertained to be worthless and charged off within the taxable year, except that if the obligations satisfied are securities (as defined in section 23 (k) (3) and section 117 (f)), any gain or loss resulting from the transaction is a capital gain or loss subject to the provisions of section 117. If the property reacquired is subsequently sold, the basis for determining gain or loss is the fair market value of the property at the date of reacquisition including the fair market value of the fixed improvements placed on the property by the purchaser. See § 29.23 (k)–3 with respect to property reacquired in a foreclosure proceeding.

If the obligations received by the vendor have no fair market value, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold, and if in excess of such basis, shall be taxable to the extent of the excess. Gain or loss is realized when the obligations are disposed of or satisfied, the amount being the difference between the reduced basis as provided above and the amount realized therefor. Only in rare and extraordinary cases does property have no fair market value.

§ 29.44–5 *Gain or loss upon disposition of installment obligations.* The entire amount of gain or loss resulting from the disposition or satisfaction of installment obligations, computed in accordance with section 44 (d), is recognized under the Internal Revenue Code unless the disposition is within one of the exceptions made by the Code. Such an exception is provided in section 44 (d) with respect to distributions under section 112 (b) (6), and in section 112 (b) (4) and (5) with respect to exchanges.

The application of section 44 (d) may be illustrated by the following examples:

Example (1). In 1940 the M Corporation sold a piece of unimproved real estate to B for $20,000. The company acquired the property in 1918 at a cost of $10,000. During 1940 the company received $5,000 cash and vendee's notes for the remainder of the selling price, or $15,000, payable in subsequent years. In 1942, before the vendee made any further payments, the company sold the notes for $13,000 in cash. The corporation makes its returns on the calendar year basis. The income to be reported for 1942 is $5,500, computed as follows:

Proceeds of sales of notes		$13,000
Selling price of property	$20,000	
Cost of property	10,000	
Total profit	10,000	
Total contract price	20,000	
Percent of profit, or proportion of each payment returnable as income, $10,000 divided by $20,000, 50 percent.		
Face value of notes	15,000	
Amount of income returnable were the notes satisfied in full, 50 percent of $15,000	7,500	
Excess of face value of notes over amount of income returnable were the notes satisfied in full		7,500
Taxable income to be reported for 1942		5,500

Example (2). Suppose in the example given above the M Corporation, instead of selling the notes, distributed them in 1942 to its shareholders as a dividend, and at the time of such distribution the fair market value of the notes was $14,000. The income to be reported for 1942 is $6,500, computed as follows:

Fair market value of notes	$14,000
Excess of face value of notes over amount of income returnable were the notes satisfied in full (computed as in example (1))	7,500
Taxable income to be reported for 1942	6,500

If the taxpayer, referred to in the above examples (1) and (2) as Corporation M, had been an individual, the taxable income to be reported, shown above as $5,500 and $6,500, respectively, would have been limited to 50 percent thereof by section 117 (b), the real estate having been held for more than 24 months prior to its sale in 1940. See also section 117 (c).

In the case of a decedent who dies possessed of installment obligations, no gain on account of the transmission at death of such obligations is required to be reported as income in the return of the decedent for the year of his death, if the executor or administrator of the estate of the decedent or any of the next of kin or legatees files with the Commissioner a bond on Form 1132 conditioned upon the return as income, by any person receiving any payment in satisfaction of such obligations, of the same proportion of such payment as would be returnable as income by the decedent if he had lived and received such payment. The bond shall be subject to the approval of the Commissioner, shall be in an amount sufficient in his judgment to insure collection of the tax resulting from the fulfillment of the conditions stated in the bond, and shall be filed at the time of filing the return for the decedent for the year of his death or at such later time as may be specified by the Commissioner. A corporation will not be accepted as a surety on such bond unless the corporation holds a certificate of authority from the Secretary as an acceptable surety on Federal bonds. In lieu of surety or sureties there may be deposited bonds or notes of the United States.

See section 117 as to the limitation on capital losses sustained by corporations and the limitation as to both capital gains and capital losses of individuals.

SEC. 45. ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

§ 9.45–1 *Determination of the taxable net income of a controlled taxpayer*—(a) *Definitions.* When used in this section

(1) The term "organization" includes any organization of any kind, whether it be a sole proprietorship, a partnership, a trust, an estate, or a corporation (as each is defined or understood in the Internal Revenue Code or these regulations), irrespective of the place where organized, where operated, or where its trade or business is conducted, and regardless of whether domestic or foreign, whether exempt, whether affiliated, or whether a party to a consolidated return.

(2) The terms "trade" or "business" include any trade or business activity of any kind, regardless of whether or where organized, whether owned individually or otherwise, and regardless of the place where carried on.

(3) The term "controlled" includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.

(4) The term "controlled taxpayer" means any one of two or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests.

(5) The terms "group" and "group of controlled taxpayers" mean the organizations, trades, or businesses owned or controlled by the same interests.

(6) The term "true net income" means, in the case of a controlled taxpayer, the net income (or, as the case may be, any item or element affecting net income) which would have resulted to the controlled taxpayer, had it in the conduct of its affairs (or, as the case may be, in the particular contract, transaction, arrangement, or other act) dealt with the other member or members of the group at arm's length. It does not mean the income, the deductions, or the item or element of either, resulting to the controlled taxpayer by reason of the particular contract, transaction, or arrangement, the controlled taxpayer, or the interests controlling it, chose to make (even though such contract, transaction, or arrangement be legally binding upon the parties thereto).

(b) *Scope and purpose.* The purpose of section 45 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true net income from the property and business of a controlled taxpayer. The interests controlling a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer so to conduct its affairs that its transactions and accounting records truly reflect the net income from the property and business of each of the controlled taxpayers. If, however, this has not been done, and the taxable net incomes are thereby understated, the statute contemplates that the Commissioner shall intervene, and, by making such distributions, apportionments, or allocations as he may deem necessary of gross income or deductions, or of any item or element affecting net income, between or among the controlled taxpayers constituting the group, shall determine the true net income of each controlled taxpayer. The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

Section 45 and this section apply to the case of any controlled taxpayer, whether such taxpayer makes a separate or a consolidated return. If a controlled taxpayer makes a separate return, the determination is of its true separate net income. If a controlled taxpayer is a party to a consolidated return, the true consolidated net income of the affiliated group and the true separate net income of the controlled taxpayer are determined consistently with the principles of a consolidated return.

Section 45 grants no right to a controlled taxpayer to apply its provisions at will, nor does it grant any right to compel the Commissioner to apply such provisions. It is not intended (except in the case of the computation of consolidated net income under a consolidated return) to effect in any case such a distribution, apportionment, or allocation of gross income, deductions, or any item of either, as would produce a result equivalent to a computation of consolidated net income under section 141.

(c) *Application.* Transactions between one controlled taxpayer and another will be subjected to special scrutiny to ascertain whether the common control is being used to reduce, avoid, or escape taxes. In determining the true net income of a controlled taxpayer, the Commissioner is not restricted to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income or deductions. The authority to determine true net income extends to any case in which either by inadvertence or design the taxable net income, in whole or in part, of a controlled taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

SEC. 46. CHANGE OF ACCOUNTING PERIOD.

If a taxpayer changes his accounting period from fiscal year to calendar year, from calendar year to fiscal year, or from one fiscal year to another, the net income shall, with the approval of the Commissioner, be computed on the basis of such new accounting period, subject to the provisions of section 47.

§ 29.46–1 *Change of accounting period.* If a taxpayer (other than a subsidiary corporation required to change its accounting period by reason of the provisions of § 23.14 or § 33.14 of this chapter) changes his accounting period he shall, prior to the expiration of 30 days from the close of the fractional part of the year for which a return would be required to effect the change, furnish to the collector, for transmission to the Commissioner, the information required on Form 1128. However, if the fractional

part of the year for which a return would be required to effect the change ends after July 31, 1943, such taxpayer shall, before using the new period for income tax purposes, secure the consent of the Commissioner, and application for permission to change the accounting period shall be made direct to the Commissioner on Form 1128 at least 60 days prior to the close of the fractional part of the year for which a return would be required to effect the change. If a change of accounting period of a subsidiary is required for income tax purposes under § 23.14 of this chapter or for excess profits tax purposes under § 33.14 of this chapter, the information required on Form 1128 shall be furnished by the subsidiary at or before the time of filing the consolidated income tax return or the consolidated excess profits tax return, as the case may be. For the due date of returns for fractional parts of a year see § 29.53–1. If the change is approved by the Commissioner, the taxpayer shall thereafter make his returns and compute his net income upon the basis of the new accounting period. (See section 47.)

SEC. 47. RETURNS FOR A PERIOD OF LESS THAN TWELVE MONTHS [as amended by sec. 135 (a) (c), Rev. Act 1942].

(a) *Returns for short period resulting from change of accounting period.* If a taxpayer with the approval of the Commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year.

(b) *Income computed on basis of short period.* Where a separate return is made under subsection (a) on account of a change in the accounting period, and in all other cases, where a separate return is required or permitted, by regulations prescribed by the Commissioner with the approval of the Secretary, to be made for a fractional part of a year, then the income shall be computed on the basis of the period for which separate return is made.

(c) *Income placed on annual basis*—(1) *General rule.* If a separate return is made under subsection (a) on account of a change in the accounting period, the net income, computed on the basis of the period for which separate return is made (referred to in this subsection as "the short period"), shall be placed on an annual basis by multiplying the amount thereof by twelve, and dividing by the number of months in the short period. The tax shall be such part of the tax computed on such annual basis as the number of months in the short period is of twelve months.

(2) *Exception.* If the taxpayer establishes the amount of his net income for the period of twelve months beginning with the first day of the short period, computed as if such twelve-month period were a taxable year, under the law applicable to such year, then the tax for the short period shall be reduced to an amount which is such part of the tax computed on the net income for such twelve-month period as the net income computed on the basis of the short period is of the net income for the twelve-month period. The taxpayer (other than a taxpayer to which the next sentence applies) shall compute the tax and file his return without the application of this paragraph. If the taxpayer (other than a corporation) was not in existence at the end of the twelve-month period, or if the taxpayer is a corporation and has disposed of substantially all its assets prior to the end of such twelve-month period, then in lieu of the net income for such twelve-month period there shall be used for the purposes of this paragraph the net income for the twelve-month period ending with the last day of the short period. The tax computed under this paragraph shall in no case be less than the tax computed on the net income for the short period without placing such net income on an annual basis. The benefits of this paragraph shall not be allowed unless the taxpayer, at such time as regulations prescribed hereunder require (but not after the time prescribed for the filing of the return for the first taxable year which ends on or after twelve months after the beginning of the short period), makes application therefor in accordance with such regulations. Such application, in case the return was filed without regard to this paragraph, shall be considered a claim for credit or refund with respect to the amount by which the tax is reduced under this paragraph. The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary for the application of this paragraph.

(d) *Earned income.* The Commissioner with the approval of the Secretary shall by regulations prescribe the method of applying the provisions of subsections (b) and (c) (relating to computing income on the basis of a short period, and placing such income on an annual basis) to cases where the taxpayer makes a separate return under subsection (a) on account of a change in the accounting period, and it appears that for the period for which the return is so made he has received earned income.

(e) *Reduction of credits against net income.* In the case of a return made for a fractional part of a year, except a return made under subsection (a), on account of a change in the accounting period, the personal exemption and credit for dependents shall be reduced respectively to amounts which bear the same ratio to the full credits provided as the number of months in the period for which the return is made bears to twelve months.

(f) *Closing of taxable year in case of jeopardy.* For closing of taxable year in case of jeopardy, see section 146.

(g) *Returns where taxpayer not in existence for twelve months.* In the case of a taxpayer not in existence during the whole of an annual accounting period ending on the last day of a month, or, if the taxpayer has no such annual accounting period or does not keep books, during the whole of a calendar year, the return shall be made for the fractional part of the year during which the taxpayer was in existence.

§ 29.47–1 *Returns for periods of less than 12 months.* No return can be made for a period of more than 12 months. A separate return for a fractional part of a year is therefore required wherever there is a change, with the approval of the Commissioner, in the basis of computing net income from one taxable year to another taxable year. The periods to be covered by such separate returns in the several cases are stated in section 47 (a). The requirements with respect to the filing of a separate return and the payment of tax for a part of a year are the same as for the filing of a return and the payment of tax for a full taxable year closing at the same time, except as otherwise provided in § 29.53–1 and § 29.56–1 (a). (See sections 53 and 56.) If a return is made for a fractional part of a year, except where a return is made for a period of less than 12 months by reason of a change in accounting period, the personal exemption and credit for dependents shall be reduced to that proportion of the full credit which the number of months in the period for which the return is made bears to 12 months. A return is required in the case of every taxable year which is a period of less than 12 months if the gross income for such taxable year is greater than the personal exemption for such taxable year as so reduced. In the case of a return by a corporation for a fractional part of a year, the credit provided by section 26 (e) for the income of the corporation subject to excess profits tax is considered an amount of which the excess profits tax of the corporation for such period is 90 percent. For the computation of such credit in case the net income of the corporation is placed on an annual basis, see § 29.47–2.

The return of a decedent for the taxable year in which falls the date of his death is a return for the period during which he was alive.

§ 29.47–2 *Returns for period of less than 12 months on account of a change in accounting period*—(a) *Net income placed on annual basis and tax computed thereon.* In the case of a return for a period of less than 12 months on account of a change in accounting period, section 47 (c) provides that the net income computed on the return for such short period shall be placed on an annual basis by multiplying the amount thereof by 12 and dividing by the number of months in the short period. The tax is such part of the tax computed on such annual basis as the number of months in the period is of 12 months.

In placing on an annual basis the net income of a corporation for a short period, the credit for dividends received is placed on an annual basis to correspond to the amount of dividends received included in the net income, which amount is placed on an annual basis when such net income is placed on an annual basis. Similarly, the credit for interest on United States obligations should reflect the amount of such interest as increased when such amount is placed on an annual basis as part of the net income which is placed on an annual basis. If the corporation computes its excess profits tax under section 711 (a) (3) (A), the credit provided in section 26 (e) for the adjusted excess profits net income of the corporation is determined with the excess profits net income placed on an annual basis under such section 711 (a) (3) (A). The credit for the adjusted excess profits net income so determined on an annual basis is applied against the net income after such net income has been placed on an annual basis. If the corporation computes its excess profits tax under section 711 (a) (3) (B), the credit provided in section 26 (e) is computed as an amount of which the tax of the corporation for the short period under section 711 (a) (3)

(B) is 90 percent. This adjusted excess profits net income is placed on an annual basis by multiplying by 12 and dividing by the number of months in the short period, and the credit for the adjusted excess profits net income so determined on an annual basis is applied against the net income after such net income has been placed on an annual basis.

The following examples illustrate the application of this paragraph:

Example (1). A citizen of the United States made a return for a 10-month period ended October 31, 1942, on account of a change in accounting period. His net income including his earned net income for such 10-month period was $10,000 and his earned net income for such period was $4,000. He was entitled to a personal exemption of $1,200 but not to a credit for dependents. His tax for the period is $2,412.67, computed as follows:

Net income for 10-month period		$10,000.00
Multiplied by 12		120,000.00
Net income on annual basis ($120,000÷10)		12,000.00
Less: Personal exemption		1,200.00
Surtax net income		10,800.00
Earned net income for 10-month period	$4,000.00	
Multiplied by 12	48,000.00	
Earned net income on annual basis ($48,000÷10)	4,800.00	
Subtracting: Earned income credit (10 percent of $4,800)		480.00
Net income subject to normal tax		10,320.00
Normal tax (6 percent of $10,320)		619.20
Surtax on $10,800		2,276.00
Total tax on annual basis		2,895.20
Amount of tax for period ($2,895.20×10/12)		2,412.67

Example (2). The X Corporation made a return for the 8-month period ended August 31, 1942, on account of a change in accounting period. The net income of the corporation for such 8-month period was $72,000, including $4,000 interest on obligations of the United States described in section 26 (a) and $12,000 in dividends from a domestic corporation, for which the credit provided in section 26 (b) is applicable. The adjusted excess profits net income of the corporation for such period was $27,375, computed after the excess profits net income for such period was placed on an annual basis under section 711 (a) (3) (A), and its excess profits tax computed under such section was $16,402.50 ($\frac{243}{365}\times 90$ percent of $27,375). The tax for the 8-month period is $16,460, computed as follows:

Net income for 8-month period		$72,000
Multiplied by 12		864,000
Net income on annual basis ($864,000÷8)		108,000
Less: Adjusted excess profits net income		27,375
Remainder		80,625
Dividends received, subject to the credit provided in section 26 (b)	$12,000	
Multiplied by 12	144,000	
Dividends received placed on annual basis ($144,000÷8)	18,000	
Subtracting: Credit provided in section 26 (b) for dividends received (85 percent of $18,000)		15,300
Surtax net income		65,325
Interest on United States obligations subject to credit provided in section 26 (a)	$4,000	
Multiplied by 12	48,000	
Subtracting: Credit provided in section 26 (a) for interest placed on annual basis ($48,000÷8)		$6,000
Normal tax net income		59,325
Normal tax on $59,325		14,238
Surtax on $65,325		10,452
Total tax on annual basis		24,690
Amount of tax for period ($24,690×8/12)		16,460

If it had been assumed that the corporation had applied for the benefits of section 711 (a) (3) (B), and that the excess profits tax of the corporation was reduced under that section to $11,250, then in the above computations the credit for the adjusted excess profits net income of the corporation, applied against the $108,000 net income (as placed on an annual basis), would not be $27,375, the amount computed upon the application of section 711 (a) (3) (A), but would be $18,750, the adjusted excess profits net income computed on the basis of the excess profits tax determined under section 711 (a) (3) (B) and placed on an annual basis. The computation is as follows:

Excess profits tax for short period		$11,250
Adjusted excess profits net income for short period (amount of which excess profits tax is 90 percent, or $\frac{100}{90}\times$$11,250)		12,500
Multiplied by 12		150,000
Adjusted excess profits net income on annual basis ($150,000÷8)		18,750

(b) *Tax for short period determined by annual income.* If the taxpayer applies to the Commissioner in the manner provided in paragraph (c) of this section to have his tax computed under the provisions of section 47 (c) (2), and if the taxpayer establishes the amount of his net income for the 12-month period hereinafter described, then section 47 (c) (2) provides that the tax for the short period shall be reduced to an amount which is such part of the tax computed on the basis of the net income which the taxpayer has established for the 12-month period as the net income for the short period is of the net income for the 12-month period. If such amount, however, is greater than the tax computed under paragraph (a) of this section, the tax for the short period is the tax computed under paragraph (a). The 12-month period referred to above is the 12-month period beginning with the first day of the short period except that if the taxpayer (other than a corporation) is not in existence at the end of such 12-month period, or if the taxpayer is a corporation which has distributed substantially all its assets prior to the end of such 12-month period, then it is the 12-month period ending with the last day of the short period. If a corporation ceases business and distributes so much of the assets used in its business that it cannot resume its customary operations with the remaining assets, it will be considered to have distributed substantially all of its assets.

In computing the tax under section 47 (c) (2), the net income for the short period is not placed on an annual basis. The net income for the 12-month period is computed under the same provisions of law as are applicable to the short period, and is computed as if the 12-month period were an actual accounting period of the taxpayer. All items which fall in such 12-month period must be included even if they are extraordinary in amount or of an unusual nature. If the taxpayer is a member of a partnership, there shall be included in computing his income for the 12-month period his share of the partnership income for taxable years of the partnership ending with or during such 12-month period, but no amount shall be included with respect to a taxable year of the partnership ending after such 12-month period. In the case of a corporation, the credit provided by section 26 (e) for the adjusted excess profits net income of the corporation is computed as an amount of which the excess profits tax imposed for such 12-month period is 90 percent. The excess profits tax imposed for such 12-month period is the excess profits tax for the short period plus, for any taxable year which includes only part of such 12-month period, such part of the excess profits tax for such taxable year as is allocable to the part of the 12-month period included in such taxable year. The excess profits tax for such a taxable year may, in general, be allocated to the 12-month period in such proportion as the excess profits net income computed for the part of the 12-month period included in the taxable year is of the excess profits net income computed for the taxable year. However, if some other method of apportionment will more clearly reflect the portion of the excess profits tax which is attributable to the part of the 12-month period included in the taxable year, such other method shall be used.

If any other item partially applicable to such 12-month period can be determined only at the end of a taxable year which includes only part of the 12-month period, the taxpayer, subject to review by the Commissioner, shall apportion such item to the 12-month period in such manner as will most clearly reflect the income for the 12-month period. In the case of a taxpayer permitted or required to take inventories, the cost of goods sold during the part of the 12-month period included in the taxable year shall be considered, unless a more exact determination is available, as such part of the cost of goods sold during the entire taxable year as the gross receipts from sales for the part of the 12-month period included in the taxable year is of the gross receipts from sales for the entire taxable year. For example, the 12-month period of a corporation, engaged in the sale of merchandise, which has a short period from January 1, 1942, to September 30, 1942, is the calendar year 1942. The 3-month period October 1, 1942, to December 31, 1942, is a part of the fiscal year ending September 30, 1943. The cost of goods sold during such 3-month period is such part of the cost of goods sold during the entire fiscal year ending September 30,

1943, as the gross receipts from sales for such 3-month period are of the gross receipts from sales for the entire fiscal year. The Commissioner may, in granting permission to a taxpayer to change its accounting period, require as a condition to granting the change that, if the taxpayer is to obtain the benefits of section 47 (c) (2), it shall take a closing inventory upon the last day of the 12-month period. Such closing inventory will be used only for the purposes of section 47 (c) (2), and the taxpayer will not be required to use such inventory in computing the net income for the taxable year in which such inventory is taken.

The tax for the short period may not be reduced under section 47 (c) (2) to an amount which is less than the tax for the short period computed on the basis of the net income for the short period without placing such net income on an annual basis. If the tax computed under section 47 (c) (2) by reference to the net income for a 12-month period is less than such amount, the tax may be reduced only to such amount. In computing the tax of a corporation for the short period without placing its net income on an annual basis, the adjusted excess profits net income of the corporation is, for the purpose of determining the credit under section 26 (e), an amount of which the excess profits tax of the corporation for the short period is 90 percent.

The following examples illustrate the application of section 47 (c) (2):

Example (1). The facts are the same as in example (1) in paragraph (a) of this section. In the period from November 1, 1942, to December 31, 1942, the taxpayer has $1,000 net income, all of which is earned income. The net income for the 12-month period from January 1, 1942, to December 31, 1942, including the earned net income for such period, is, therefore, $11,000, of which $5,000 is earned income. The taxpayer files an application under the provisions of paragraph (c) of this section for a reduction of his tax to an amount computed on the basis of his actual net income for the 12-month period from January 1, 1942, to December 31, 1942. His tax is reduced to $2,292.73, computed as follows:

Net income for 12-month period January 1, 1942, to December 31, 1942		$11,000.00
Less: Personal exemption		1,200.00
Surtax net income		9,800.00
Less: Earned income credit (10 percent of $5,000)		500.00
Net income subject to normal tax		9,300.00
Normal tax (6 percent of $9,300)		558.00
Surtax on $9,800		1,964.00
Total tax on annual income		2,522.00
Net income for 10-month period January 1, 1942, to October 31, 1942	$10,000.00	
Net income for 12-month period January 1, 1942, to December 31, 1942	11,000.00	
Amount of tax for 10-month period $\left(\frac{10,000}{11,000}\times\$2,522\right)$		2,292.73

The amount of tax that would be due if the income for the short period were not placed on an annual basis is $2,256, computed as follows:

Net income for 10-month period January 1, 1942, to October 31, 1942		$10,000.00
Less: Personal exemption $\left(\frac{10}{12}\times\$1,200\right)$		1,000.00
Surtax net income		9,000.00
Less: Earned income credit (10 percent of $4,000)		400.00
Net income subject to normal tax		8,600.00
Normal tax (6 percent of $8,600)		516.00
Surtax on $9,000		1,740.00
Total tax for period		2,256.00

Since the tax for the short period computed under section 47 (c) (2) by reference to the actual income for the 12-month period, or $2,292.73, is greater than the tax that would be due if the income for the short period were not placed on an annual basis, or $2,256, the tax for the short period is reduced to $2,292.73, the tax computed by reference to the income for the 12-month period.

Example (2). The facts are the same as in example (1) of this paragraph, except that during the period from November 1, 1942, to December 31, 1942, the taxpayer has no income, but has deductible business expenses of $1,000. His net income for the 12-month period from January 1, 1942, to December 31, 1942, including his earned net income, is, therefore, $9,000, of which $4,000 is earned income. The taxpayer files an application under paragraph (c) of this section for a reduction of his tax under the provisions of section 47 (c) (2). The tax computed on the basis of the net income for the period from January 1, 1942, to October 31, 1942, without placing such net income on an annual basis is $2,256 (see example (1)). The tax computed under section 47 (c) (2) by reference to the actual net income for the 12-month period from January 1, 1942, to December 31, 1942, is $2,062.22, computed as follows:

Net income for 12-month period January 1, 1942, to December 31, 1942		$9,000.00
Less: Personal exemption		1,200.00
Surtax net income		7,800.00
Less: Earned income credit (10 percent of $4,000)		400.00
Net income subject to normal tax		7,400.00
Normal tax (6 percent of $7,400)		444.00
Surtax on $7,800		1,412.00
Total tax on annual income		1,856.00
Net income for 10-month period January 1, 1942, to October 31, 1942	$10,000.00	
Net income for 12-month period January 1, 1942, to December 31, 1942	9,000.00	
Amount of tax for 10-month period $\left(\frac{10,000}{9,000}\times\$1,856\right)$		2,062.22

Since the tax computed on the basis of the net income for the short period without placing such net income on an annual basis, or $2,256, is greater than $2,062.22, the tax computed by reference to the actual net income for the 12-month period, the tax for the short period under section 47 (c) (2) is $2,256.

Example (3). The facts are the same as in example (2) in paragraph (a) of this section. The taxpayer applies to have its tax reduced under the provisions of section 47 (c) (2). During the 4-month period from September 1, 1942, to December 31, 1942, the X Corporation has $16,000 net income, including $3,000 dividends from a domestic corporation for which the credit provided in section 26 (b) is applicable and $1,000 interest on obligations of the United States described in section 26 (a), and its excess profits net income computed for such 4-month period is $12,000. The net income for the 12-month period from January 1, 1942, to December 31, 1942, is, therefore, $88,000. For such 12-month period, the dividends from domestic corporations for which the credit provided in section 26 (b) is applicable amount to $15,000, and the interest on United States obligations described in section 26 (a) amounts to $5,000. The excess profits tax for the short period is $16,402.50. The excess profits tax for the taxable year from September 1, 1942, to August 31, 1943, which includes the last four months of the 12-month period, is $43,200, and the excess profits net income for such period is $96,000. The tax for the short period is reduced under section 47 (c) (2) to $15,489.61, computed as follows:

January 1, 1942, to December 31, 1942		$88,000.00
Excess profits tax for 8-month period January 1, 1942, to August 31, 1942	$16,402.50	
Excess profits tax for fiscal year September 1, 1942, to August 31, 1943	43,200.00	
Excess profits net income for period September 1, 1942, to December 31, 1942	12,000.00	
Excess profits net income for fiscal year September 1, 1942, to August 31, 1943	96,000.00	
Portion of excess profits tax allocable to period September 1, 1942, to December 31, 1942 $\left(\frac{12,000}{96,000}\times\$43,200\right)$		5,400.00
Excess profits tax imposed for 12-month period January 1, 1942, to December 31, 1942 ($16,402.50+$5,400.00)		21,802.50
Subtracting: Adjusted excess profits net income for 12-month period January 1, 1942, to December 31, 1942 (amount of which tax for 12-month period is 90 percent, or $\left(\frac{100}{90}\times\$21,802.50\right)$)		24,225.00
Less: Dividends received credit provided by section 26 (b) (85 percent of $15,000)		12,750.00
Surtax net income		51,025.00
Less: Credit provided in section 26 (a) for interest on United States obligations		5,000.00
Normal tax net income		46,025.00
Normal tax on $46,025		10,767.75
Surtax on $51,025		8,164.00
Total tax on annual income		18,931.75
Net income for 8-month period January 1, 1942, to August 31, 1942	$72,000	
Net income for 12-month period January 1, 1942, to December 31, 1942	$88,000	
Amount of tax for 8-month period January 1, 1942, to August 31, 1942		

$\left(\frac{72,000}{88,000} \times \$18,931.75\right)$	$15,489.61

The amount of tax that would be due if the income for the short period were not placed on an annual basis is $15,354.75, computed as follows:

Net income for 8-month period		$72,000.00
Excess profits tax for 8-month period	$16,402.50	
Subtracting: Adjusted excess profits net income (amount of which tax for period is 90 percent, or $\left(\frac{100}{90} \times \$16,402.50\right)$)	18,225.00	
Credit for dividends received (85 percent of $12,000)	10,200.00	
		28,425.00
Surtax net income		43,575.00
Less: Credit for interest on United States obligations		4,000.00
Normal tax net income		39,575.00
Normal tax on $39,575		8,768.25
Surtax on $43,575		6,586.50
Total tax for period		15,354.75

Since the tax for the short period computed under section 47 (c) (2) by reference to the actual income for the 12-month period, or $15,489.61, is greater than the tax that would be due if the income for the short period were not placed on an annual basis, or $15,354.75, the tax for the short period is reduced to $15,489.61, the tax computed by reference to the income for the 12-month period.

(c) *Application to compute tax under section* 47 (c) (2). A taxpayer desiring the benefit of section 47 (c) (2) must file an application therefor. If at the time the return for the short period is filed the taxpayer is able to determine that the 12-month period ending with the close of the short period will be used in the computations under section 47 (c) (2), then the tax on the return for the short period may be determined under the provisions of section 47 (c) (2). In such a case, an income tax return form covering the 12-month period shall be attached to the return as a part thereof, and the return will then be considered the application for the benefits of section 47 (c) (2) required by that section. In all other cases, the taxpayer shall file its return and compute its tax as provided in paragraph (a), and the application for the benefits of section 47 (c) (2) shall be made in the form of a claim for credit or refund. The claim shall set forth the computation of the net income and the tax thereon for the 12-month period, and must be filed not later than the time prescribed for filing the return for the first taxable year ending with or after the twelfth month after the beginning of the short period. For example, the taxpayer changes its accounting period from the calendar year basis to the fiscal year basis ending September 30, and files a return for the period from January 1, 1942, to September 30, 1942. Its application for the benefits of section 47 (c) (2) must be filed not later than the time prescribed for filing its return for the first taxable year which ends on or after the last day of December, 1942, the twelfth month after the beginning of the short period. In this case, the taxpayer must file its application not later than December 15, 1943, the time prescribed for filing the return for its fiscal year ending September 30, 1943. However, if it obtains an extension of time for filing the return for such fiscal year, it may file its application during the period of such extension. If the Commissioner determines that the taxpayer has established the amount of the net income for the 12-month period, any excess of the tax paid for the short period over the tax computed under section 47 (c) (2) will be credited or refunded to the taxpayer in the same manner as in the case of an overpayment.

SEC. 48. DEFINITIONS [as amended by sec. 135 (d), Rev. Act 1942].

When used in this chapter—

(a) *Taxable year.* "Taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this Part[1] "Taxable year" means, in the case of a return made for a fractional part of a year under the provisions of this chapter or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made.

(b) *Fiscal year.* "Fiscal year" means an accounting period of twelve months ending on the last day of any month other than December.

(c) *"Paid or incurred", "paid or accrued".* The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.[1]

(d) *Trade or business.* The term "trade or business" includes the performance of the functions of a public office.

RETURNS AND PAYMENT OF TAX

SEC. 51. INDIVIDUAL RETURNS [as amended by sec. 7, Rev. Act 1940; sec. 112 (a), Rev. Act 1941; secs. 131 (c), 136 (a), Rev. Act 1942].

(a) *Requirement.* The following individuals shall each make a return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of his gross income and the deductions and credits allowed under this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe—

(1) Every individual who is single or who is married but not living with husband or wife, if having a gross income for the taxable year of $500 or over.

(2) Every individual who is married and living with husband or wife, if no joint return is made under subsection (b) and if—

(A) Such individual has for the taxable year a gross income of $1,200 or over, and the other spouse has no gross income; or (B) Such individual and his spouse each has for the taxable year a gross income and the aggregate gross income is $1,200 or over.

(b) *Husband and wife.* In the case of a husband and wife living together the income of each (even though one has no gross income) may be included in a single return made by them jointly, in which case the tax shall be computed on the aggregate income, and the liability with respect to the tax shall be joint and several. No joint return may be made if either the husband or wife is a nonresident alien.

[1] This Part comprises sections 41 to 48, inclusive.

(c) *Persons under disability.* If the taxpayer is unable to make his own return, the return shall be made by a duly authorized agent or by the guardian or other person charged with the care of the person or property of such taxpayer.

(d) *Signature presumed correct.* The fact that an individual's name is signed to a filed return shall be prima facie evidence for all purposes that the return was actualy signed by him.

(e) *Fiduciaries.* For returns to be made by fiduciaries see section 142.

§ 29.51–1 *Individual returns*—(a) *In general.* For each taxable year a return of income shall be made by each citizen of the United States, whether residing at home or abroad, and every individual residing within the United States though not a citizen thereof, whether or not such citizen or resident is the head of a family or has dependents:

(1) If single or married but not living with husband or wife for any part of the taxable year, and if having for the taxable year a gross income (as defined in sections 22 and 116) of $500 or over, or such income is equal to, or in excess of, the credit allowed by section 25 (b) (1) and (3) (computed without regard to any credit to which he may be entitled as the head of a family). See §§ 29.25–7 and 29.47–1.

(2) If married and living with husband or wife for the entire taxable year, if no joint return is made, and if:

(i) Having for the taxable year a gross income of $1,200 or over, and the other spouse has no gross income; or

(ii) Such individual and his or her spouse each has for the taxable year a gross income and the aggregate gross income of the two is $1,200 or over; or

(iii) Such taxable year is a period of less than 12 months, if such individual has for the taxable year a gross income, and if the aggregate gross income of such individual and his or her spouse is equal to, or in excess of, the credit for personal exemption allowed by section 25 (b) (1) and (3). See §§ 29.25–7 and 29.47–1.

(3) If married and living with husband or wife for any part of the taxable year but not at the close thereof, or if married and living with husband or wife at the close of the taxable year, but not during the entire taxable year, if no joint return is made, and if:

(i) Having for the taxable year a gross income equal to, or in excess of, the credit allowed him or her by section 25 (b) (1) and (3) (computed without regard to any credit to which he or she may be entitled as the head of a family (see § 29.25–7), and the other spouse has no gross income; or

(ii) Such individual and his or her spouse each has for the taxable year a gross income, and their aggregate gross income is $1,200 or over, or is equal to, or in excess of, the credit allowed them by section 25 (b) (1) and (3) (computed without regard to any credit to which either or both may be entitled as the head of a family (see § 29.25–7)).

(b) *Joint returns.* A husband and wife, if living together at the close of the taxable year, may elect to make a joint return (see section 51 (b)), that is, to include in a single return made by them jointly the income and deductions

of each, even though one has no gross income. In such a case, the tax shall be computed on the aggregate income. The liability with respect to the tax shall be joint and several. If one spouse dies prior to the last day of the taxable year, the surviving spouse may not include the income of the deceased spouse in a joint return for such taxable year. A joint return may not be made if either the husband or wife is a nonresident alien.

A joint return of a husband and wife (if not made by an agent, see § 29.51–2) shall be signed by both spouses. An oath is not necessary, but both spouses shall verify the return as provided in section 51. If signed by one spouse as agent for the other, authorization for such action must accompany the return. (See § 29.51–2.) The spouse acting as agent for the other shall, with the principal, assume the responsibility for making the return and incur liability for the penalties provided for erroneous, false, or fraudulent returns.

For returns by fiduciaries, see section 142; by partnerships, see section 187; and by nonresident alien individuals, see section 217. For time and place for filing returns, see section 53.

§ 29.51–2 *Form of return.* The return shall be on Form 1040 except that it may be on short Form 1040A if (1) the gross income does not exceed $3,000 and consists wholly of salary, wages, compensation for personal services, dividends, interest, or annuities, (2) the return is made on a cash basis, and (3) the taxpayer (if not excluded by section 404) elects to pay the tax imposed by section 400 in lieu of the tax imposed by sections 11 and 12. The forms may be had from the collectors of the several districts. The return may be made by an agent if, by reason of illness, the person liable for the making of the return is unable to make it. The return may also be made by an agent if the taxpayer is unable to make the return by reason of continuous absence from the United States for a period of at least 60 days prior to the date prescribed by law for making the return. Whenever a return is made by an agent it must be accompanied by the prescribed power of attorney, Form 935, except that an agent holding a valid and subsisting general power of attorney authorizing him to represent his principal in making, executing, and filing the income return, may submit a certified copy thereof in lieu of the authorization on Form 935. The taxpayer and his agent, if any, are responsible for the return as made and incur liability for the penalties provided for erroneous, false, or fraudulent returns. For returns of nonresident aliens, see §§ 29.217–1 and 29.217–2.

The home or residential address of the taxpayer (including the street and number, if any) shall be given in the space provided at the top of the return for the name and address of the taxpayer. A taxpayer having a permanent business address may give that address as the principal or mailing address, provided that the complete home or residential address is also given within the space provided.

§ 29.51–3 *Return of income of minor.* An individual, although a minor, who is single, is required to render a return of income if he has a gross income of his own of $500 or over for the taxable year, regardless of the amount of his net income. If the aggregate of the gross income of such a minor from any property which he possesses, and from any funds held in trust for him by a trustee or guardian, and from his earnings which belong to him, is at least $500, regardless of the amount of his net income, a return, as in the case of any other individual, must be made by him or for him by his guardian, or other person charged with the care of his person or property. (See § 29.142–2.) If he is married, see § 29.51–1. If under the laws of a State the earnings of a minor belong to the minor, such earnings, regardless of amount, are not required to be included in the return of the parent. In the absence of proof to the contrary, a parent will be assumed to have the legal right to the earnings of the minor and must include them in his return.

§ 29.51–4 *Verification of returns.* (a) A return of an individual required to be filed under section 51 shall contain or be verified by a written declaration that it is made under the penalties of perjury. All other income tax returns must be verified under oath or affirmation. The oath or affirmation may be administered by any person duly authorized to administer oaths for general purposes by the law of the United States or of any State, Territory, or possession of the United States, or of the District of Columbia, wherein such oath or affirmation is administered, or by a consular officer of the United States. Persons in the naval or military service of the United States may verify their returns before any official authorized to administer oaths for the purposes of those respective services. Income tax returns executed abroad may be attested free of charge before United States consular officers. If a foreign notary or other foreign official having no seal should act as attesting officer, the authority of such attesting officer should be certified to by some judicial official or other proper officer having knowledge of the appointment and official character of the attesting officer.

(b) Income tax returns actually prepared by other persons for individuals required to file returns under section 51 shall be verified as provided in section 51. If any person or persons actually prepare any other income return for another person, the prescribed form of affidavit on the return shall be subscribed and sworn to by such person or persons preparing the return. Such affidavit is required on all such income returns required under the Internal Revenue Code except the following:

(1) Returns required under sections 143 and 144 (relating to withholding of tax at the source);

(2) Returns required to be made by departing aliens under section 146;

(3) Returns required under sections 147, 148, and 149 (relating to information at source);

(4) Returns by subsidiary corporations included in consolidated returns; and

(5) Returns required under sections 338 (a), 339, and 3604 (relating to monthly information returns filed by officers and directors, and also monthly and annual information returns filed by certain shareholders, of certain foreign corporations, and returns as to the formation of foreign corporations).

Such affidavit is not required if the actual preparation of the return is a regular and usual incident of the employment of one regularly and continuously employed for full time by the person for whom the return is made (as in the case of a clerk, secretary, bookkeeper, accountant, etc.). If, however, the employee is not regularly or continuously employed by the person for whom the return is made for the full time, or the actual preparation of the return is not a regular and usual incident of such employment, the requirements of this paragraph apply. Thus, if the return is prepared by an accountant or firm of accountants making periodical audits of the accounts of the person for whom the return is prepared, the affidavit is required. If the return is a separate return of a married person, the affidavit is required, although the one actually preparing the return is the husband or wife of the taxpayer. A person who renders mere mechanical assistance or preparation as, for example, a stenographer or typist, is not considered as preparing the return. If, in the course of his official duties, a deputy collector, an internal revenue agent, or other officer or employee of the Bureau of Internal Revenue actually prepares the return, the person for whom the return is made shall make in the return a brief statement to that effect, and it will not be necessary to make the sworn statement required by this pararaph.

§ 29.51–5 *Use of prescribed forms.* Copies of the prescribed return forms will so far as possible be furnished taxpayers by collectors. A taxpayer will not be excused from making a return, however, by the fact that no return form has been furnished to him. Taxpayers not supplied with the proper forms should make application therefor to the collector in ample time to have their returns prepared, verified, and filed with the collector on or before the due date. Each taxpayer should carefully prepare his return so as fully and clearly to set forth the data therein called for. Returns which have not been so prepared will not be accepted as meeting the requirements of the Internal Revenue Code. In lack of a prescribed form a statement made by a taxpayer disclosing his gross income and the deductions therefrom may be accepted as a tentative return, and if filed within the prescribed time the statement so made will relieve the taxpayer from liability to penalties, provided that without unnecessary delay

such a tentative return is supplemented by a return made on the proper form. (See further §§ 29.53–2 to 29.53–4, inclusive.)

SEC. 52. CORPORATION RETURNS [as amended by sec. 159 (f), Rev. Act, 1942.]

(a) *Requirement.* Every corporation subject to taxation under this chapter shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

(b) *Cross reference.* For provisions relating to consolidated returns, see section 141.

§ 29.52–1 *Corporation returns.* Every corporation not expressly exempt from tax must make a return of income, regardless of the amount of its net income. In the case of ordinary corporations, the return shall be on Form 1120. For returns of insurance companies, see §§ 29.201 (b)–1, 29.204 (a)–1, and 29.207–7; of foreign corporations, see section 235; and of affiliated corporations, see section 141 and § 29.141–1. A corporation having an existence during any portion of a taxable year is required to make a return. If a corporation was not in existence throughout an annual accounting period (either calendar year or fiscal year), the corporation is required to make a return for that fractional part of a year during which it was in existence. A corporation is not in existence after it ceases business and dissolves, retaining no assets, whether or not under State law it may thereafter be treated as continuing as a corporation for certain limited purposes connected with winding up its affairs, such as for the purpose of suing and being sued. If the corporation has valuable claims for which it will bring suit during this period, it has retained assets, and it continues in existence. A corporation does not go out of existence if it is merely turned over to receivers or trustees who continue to operate it. A corporation which has received a charter, but has never perfected its organization, which has transacted no business and had no income from any source, may upon presentation of the facts to the collector be relieved from the necessity of making a return as long as it remains in an unorganized condition. In the absence of a proper showing to the collector such a corporation will be required to make a return. For information returns by corporations contemplating dissolution or liquidation, see section 148 (d). For information returns by corporations of distributions in liquidations, see section 148 (e). For information returns by corporations relating to profits of the taxable year declared as dividends, see section 148 (b). For verification of returns and use of prescribed forms, see §§ 29.51–4 and 29.51–5.

§ 29.52–2 *Returns by receiver.* Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations. If a receiver has full custody of and control over the business or property of a corporation, he shall be deemed to be operating such business or property within the meaning of section 52, whether he is engaged in carrying on the business for which the corporation was organized or only in marshaling, selling, and disposing of its assets for purposes of liquidation. Notwithstanding that the powers and functions of a corporation are suspended and that the property and business are for the time being in the custody of the receiver, trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. (See sections 274 and 298 and §§ 29.274–1 and 29.274–2.) A receiver in charge of only part of the property of a corporation, however, as, for example, a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income.

SEC. 53. TIME AND PLACE FOR FILING RETURNS.

(a) *Time for filing*—(1) *General rule.* Returns made on the basis of the calendar year shall be made on or before the 15th day of March following the close of the calendar year. Returns made on the basis of a fiscal year shall be made on or before the 15th day of the third month following the close of the fiscal year.

(2) *Extension of time.* The Commissioner may grant a reasonable extension of time for filing returns, under such rules and regulations as he shall prescribe with the approval of the Secretary. Except in the case of taxpayers who are abroad, no such extension shall be for more than six months.

(b) *To whom return made*—(1) *Individuals.* Returns (other than corporation returns) shall be made to the collector for the district in which is located the legal residence or principal place of business of the person making the return, or, if he has no legal residence or principal place of business in the United States, then to the collector at Baltimore, Maryland.

(2) *Corporations.* Returns of corporations shall be made to the collector of the district in which is located the principal place of business or principal office or agency of the corporation, or, if it has no principal place of business or principal office or agency in the United States, then to the collector at Baltimore, Maryland.

§ 29.53–1 *Time for filing returns.* Returns of income (except in the case of nonresident alien individuals, as to which see section 217, and foreign corporations, as to which see section 235, and except in the case of a return for a fractional part of a year) must be made on or before the 15th day of the third month following the close of the taxable year. The return by a taxpayer (other than a nonresident alien individual or nonresident foreign corporation) for a fractional part of a year beginning in 1942 and ending in that year shall be filed on or before March 15, 1943. In all other cases, the return (other than a return by a nonresident alien individual or foreign corporation) for a fractional part of a year shall be filed on or before the 15th day of the third full calendar month following the close of the fractional part of a year, except that upon a showing by the taxpayer of unusual circumstances, the Commissioner may prescribe a later time for the filing of the return. In such a case, the time prescribed by the Commissioner shall not be later than the 15th day of the fifteenth month ending after the beginning of such fractional part of a year. A corporation going into liquidation during any taxable year may, upon the completion of such liquidation, prepare a return for that year covering its income for the part of the year during which it was engaged in business and may immediately file such return with the collector. See also section 148 (d) and (e). For provisions relating to certain cases in which the time for filing income tax returns is postponed by reason of a member (whether or not the taxpayer) of the military or naval forces of the United States serving on sea duty or outside the continental United States, by reason of any other individual (whether or not the taxpayer) being outside the Americas, or by reason of a locality being an area of enemy action or control, see Part 472 of this chapter.[1] See such part also for the circumstances under which the time for filing income tax returns of the spouses of such members or of such other individuals is in certain cases postponed. See such part also as to the time for filing income tax returns of China Trade Act corporations.

§ 29.53–2 *Extensions of time for filing returns.* It is important that the taxpayer render on or before the due date a return as nearly complete and final as it is possible for him to prepare. However, the Commissioner is authorized to grant a reasonable extension of time for filing returns under such rules and regulations as he shall prescribe with the approval of the Secretary. Accordingly, authority for granting extensions of time for filing income tax returns is hereby delegated to the various collectors of internal revenue. Application for extensions of time for filing income tax returns should be addressed to the collector of internal revenue for the district in which the taxpayer files his returns and must contain a full recital of the causes for the delay. Except in the case of taxpayers who are abroad, no extension for filing income tax returns may be granted for more than six months. For extensions of time for payment of tax, see sections 56 (c) and 272 (j) and §§ 29.53–3, 29.56–2, and 29.272–3.

§ 29.53–3 *Extensions of time in the case of foreign organizations, certain do-*

[1] 8 F.R. 9602.

mestic corporations, citizens of United States residing or traveling abroad, and nontaxable returns of fiduciaries for estates or trusts. (a) An extension of time for filing returns of income for taxable years beginning after December 31, 1941, is hereby granted up to and including the 15th day of the sixth month following the close of the taxable year in the case of:

(1) Foreign partnerships regardless of whether they maintain an office or place of business within the United States;

(2) Foreign corporations which maintain an office or place of business within the United States;

(3) Domestic corporations which transact their business and keep their records and books of account abroad;

(4) Domestic corporations whose principal income is from sources within the possessions of the United States; and

(5) American citizens residing or traveling abroad, including persons in military or naval service on duty outside the United States.

In all such cases a statement must be attached to the return showing that the person for whom the return is made is a person described in this subsection.

Taxpayers who take advantage of this extension of time will be charged with interest at the rate of 6 percent per annum on the first installment of tax, if any, from the original due date until paid.

(b) An extension of time for filing nontaxable returns of income for taxable years beginning after December 31, 1941, is hereby granted up to and including the 15th day of the fifth month following the close of the taxable year in the case of fiduciaries for estates or trusts. The extension so granted is not applicable to returns of beneficiaries or other distributees of such estates or trusts.

§ 29.53–4 *Due date of return.* The due date is the date on or before which a return is required to be filed in accordance with the provisions of the Internal Revenue Code, including, in the case of certain taxpayers to which section 3804 or 3805 is applicable, the provisions of such section and the regulations prescribed thereunder (see Part 472 of this chapter[1]), or the last day of the period covered by an extension of time granted by the Commissioner or a collector. When the due date falls on Sunday or a legal holiday, the due date for filing returns will be the day following such Sunday or legal holiday. If placed in the mails, the returns should be posted in ample time to reach the collector's office, under ordinary handling of the mails, on or before the date on which the return is required to be filed. If a return is made and placed in the mails in due course, properly addressed and postage paid, in ample time to reach the office of the collector on or before the due date, no penalty will attach should the return not actually be received by such officer until subsequent to that date. If a question may be raised as to whether the return was posted in ample time to reach the collector's office on or before the due date, the envelope in which the return was transmitted will be preserved by the collector and forwarded to the Commissioner with the return. As to additions to the tax in the case of failure to file return within the prescribed time, see section 291.

§ 29.53–5 *Place for filing individual returns.* Section 53 (b) (1) provides that individual returns shall be made to the collector for the district in which is located the legal residence or principal place of business of the person making the return, or, if he has no legal residence or principal place of business in the United States, then to the collector at Baltimore, Md.

An individual employed on a salary or commission basis who is not also engaged in conducting a commercial or professional enterprise for profit on his own account does not have a "principal place of business" within the meaning of section 53 (b) (1), and shall make his return to the collector for the district in which is located his legal residence, or, if he has no legal residence in the United States, then to the collector at Baltimore, Md.

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By taxpayer.* Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

(b) *To determine liability to tax.* Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return, render under oath, such statements, or keep such records, as the Commissioner deems sufficient to show whether or not such person is liable to tax under this chapter.

(c) *Information at the source.* For requirement of statements and returns by one person to assist in determining the tax liability of another person, see sections 147 to 150.

(d) *Copies of returns.* If any person, required by law or regulations made pursuant to law to file a copy of any income return for any taxable year, fails to file such copy at the time required, there shall be due and assessed against such person $5 in the case of an individual return or $10 in the case of a fiduciary, partnership, or corporation return, and the collector with whom the return is filed shall prepare such copy. Such amount shall be collected and paid, without interest, in the same manner as the amount of tax due in excess of that shown by the taxpayer upon a return in the case of a mathematical error appearing on the face of the return. Copies of returns filed or prepared pursuant to this subsection shall remain on file for a period of not less than two years from the date they are required to be filed, and may be destroyed at any time thereafter under the direction of the Commissioner.

(e) *Foreign personal holding companies.* For information returns by officers, directors, and large shareholders, with respect to foreign personal holding companies, see sections 338, 339, and 340.

For information returns by attorneys, accountants, and so forth, as to formation, and so forth, of foreign corporations, see section 3604.

§ 29.54–1 *Records and income tax forms.* Every person subject to the tax, except persons whose gross income (a) consists solely of salary, wages, or similar compensation for personal services rendered, or (b) arises solely from the business of growing and selling products of the soil, shall, for the purpose of enabling the Commissioner to determine the correct amount of income subject to the tax, keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of the gross income and the deductions, credits, and other matters required to be shown in any return under chapter 1. Such books or records shall be kept at all times available for inspection by internal-revenue officers, and shall be retained so long as the contents thereof may become material in the administration of any internal-revenue law.

Income-tax forms shall be prescribed by the Commissioner and shall be executed and filed in accordance with these regulations and the instructions on the form or issued therewith.

SEC. 55. PUBLICITY OF RETURNS [as amended by sec. 507, 2d Rev. Act 1940; sec 554 (d), Rev. Act 1941].

(a) *Public record and inspection.* (1) Returns made under this chapter upon which the tax has been determined by the Commissioner shall constitute public records; but, except as hereinafter provided in this section, they shall be open to inspection only upon order of the President and under rules and regulations prescribed by the Secretary and approved by the President.

(2) And all returns made under this chapter, subchapters A, B, D, and E of chapter 2, subchapter B of chapter 3, chapters 4, 7, 12, and 21, subchapter A of chapter 20, and chapter 30, shall constitute public records and shall be open to public examination and inspection to such extent as shall be authorized in rules and regulations promulgated by the President.

(3) Whenever a return is open to the inspection of any person a certified copy thereof shall, upon request, be furnished to such person under rules and regulations prescribed by the Commissioner with the approval of the Secretary. The Commissioner may prescribe a reasonable fee for furnishing such copy.

(b) *Inspection by State*—(1) *State officers.* The proper officers of any State may, upon the request of the governor thereof, have access to the returns of any corporation, or to an abstract thereof showing the name and income of the corporation, at such times and in such manner as the Secretary may prescribe.

(2) *State bodies or commissions.* All income returns filed under this chapter (or copies thereof, if so prescribed by regulations made under this subsection), shall be open to inspection by any official, body, or commission, lawfully charged with the administration of any State tax law, if the inspection is for the purpose of such administration or for the purpose of obtaining information to be furnished to local taxing authorities as provided in this paragraph. The inspection shall be permitted only upon written request of the governor of such State, designating the representative of such official, body, or commission to make the inspection on behalf of such official, body, or commission. The inspection shall be made in such manner, and at such times and places, as shall be prescribed by regulations made by the Commissioner with the approval of the Secretary. Any information thus secured by any official, body, or commission of any State may be used only for the administration of the tax laws of such State, except that upon written request of the governor of such State any such information

[1] 8 F.R. 9602.

may be furnished to any official, body, or commission of any political subdivision of such State, lawfully charged with the administration of the tax laws of such political subdivision, but may be furnished only for the purpose of, and may be used only for, the administration of such tax laws.

(c) *Inspection by shareholders.* All bona fide shareholders of record owning 1 per centum or more of the outstanding stock of any corporation shall, upon making request of the Commissioner, be allowed to examine the annual income returns of such corporation and of its subsidiaries.

(d) *Inspection by committees of Congress*—(1) *Committees on Ways and Means and Finance.* (A) The Secretary and any officer or employee of the Treasury Department, upon request from the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, or a select committee of the Senate or House specially authorized to investigate returns by a resolution of the Senate or House, or a joint committee so authorized by concurrent resolution, shall furnish such committee sitting in executive session with any data of any character contained in or shown by any return.

(B) Any such committee shall have the right, acting directly as a committee, or by or through such examiners or agents as it may designate or appoint, to inspect any or all of the returns at such times and in such manner as it may determine.

(C) Any relevant or useful information thus obtained may be submitted by the committee obtaining it to the Senate or the House, or to both the Senate and the House, as the case may be.

(2) *Joint Committee on Internal Revenue Taxation.* The Joint Committee on Internal Revenue Taxation shall have the same right to obtain data and to inspect returns as the Committee on Ways and Means or the Committee on Finance, and to submit any relevant or useful information thus obtained to the Senate, the House of Representatives, the Committee on Ways and Means, or the Committee on Finance. The Committee on Ways and Means or the Committee on Finance may submit such information to the House or to the Senate, or to both the House and the Senate, as the case may be.

(e) *Inspection in collector's office of list of taxpayers.* The Commissioner shall as soon as practicable in each year cause to be prepared and made available to public inspection in such manner as he may determine, in the office of the collector in each internal revenue district and in such other places as he may determine, lists containing the name and the post-office address of each person making an income-tax return in such district.

(f) *Penalties for disclosing information*—(1) *Federal employees and other persons.* It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or to make known in any manner whatever not provided by law to any person the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return, or to permit any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return, or any part thereof or source of income, profits, losses, or expenditures appearing in any income return; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employee of the United States he shall be dismissed from office or discharged from employment.

(2) *State employees.* Any officer, employee, or agent of any State or political subdivision, who divulges (except as authorized in paragraph 2 of subsection (b), or when called upon to testify in any judicial or administrative proceeding to which the State or political subdivision, or such State or local official, body, or commission, as such, is a party) any information acquired by him through an inspection permitted him or another under paragraph 2 of subsection (b) shall be guilty of a misdemeanor and shall upon conviction be punished by a fine of not more than $1,000, or by imprisonment for not more than one year, or both.

(3) *Shareholders.* Any shareholder who pursuant to the provisions of this section is allowed to examine the return of any corporation, and who makes known in any manner whatever not provided by law the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any such return, shall be guilty of a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both.

(4) *Cross reference.* For penalties for disclosing operations, style of work, or apparatus of any manufacturer or producer, see section 4047.

§ 29.55 (b)–1 *Inspection of returns.* Any properly authorized official, body, or commission, lawfully charged with the administration of any State tax law, or properly designated representatives of such official, body, or commission, may, in the discretion of the Commissioner, inspect income returns for the purpose of such administration. For the purposes of this section the word "returns" shall include information returns, schedules, lists, and other written statements filed with the Commissioner designed to be supplemental to or to become a part of income returns.

Requests for permission to inspect returns must be in writing signed by the governor under the seal of his State, and must be addressed to the Commissioner of Internal Revenue, Records Division, Washington, D. C. The request must state (a) the kind of returns it is desired to inspect, (b) the taxable year or years covered by the returns it is desired to inspect, (c) the name of the official, body, or commission by whom or which inspection is to be made, (d) the name of the representative of such official, body, or commission, designated to make the inspection, (e) by specific references, the State tax law which such official, body, or commission is charged with administering and the law under which he, she, or it is so charged, (f) the purpose for which the inspection is to be made, and (g) if the inspection is for the purpose of obtaining information to be furnished to local taxing authorities, (1) the name of the official, body, or commission of any political subdivision of the State, lawfully charged with the administration of the tax laws of such political subdivision, if any, to whom or to which the information secured by the inspection is to be furnished, and (2) the purpose for which the information is to be used by such official, body, or commission.

In any case where inspection of the returns is authorized in accordance with the provisions of this section, the Commissioner may, in his discretion, permit inspection of other records and reports which contain information included or required by statute to be included in the return.

For inspection of returns, other than on behalf of States or political subdivisions thereof, and furnishing copies of returns so open to inspection, see Subpart F, approved by the President on August 28, 1939, and Subpart H, approved September 20, 1939, of Part 458 of this chapter.

SEC. 56. PAYMENT OF TAX [as amended by sec. 172 (f), Rev. Act 1942; sec. 5 (d), Current Tax Payment Act 1943.]

(a) *Time of payment.* The total amount of tax imposed by this chapter shall be paid on the fifteenth day of March following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the third month following the close of the fiscal year.

(b) *Installment payments.* Except in the case of an individual (other than an estate or trust and other than a nonresident alien with respect to whose wages, as defined in section 1621 (a), withholding under Subchapter D of Chapter 9 is not made applicable), the taxpayer may elect to pay the tax in four equal installments, in which case the first installment shall be paid on the date prescribed for the payment of the tax by the taxpayer, the second installment shall be paid on the fifteenth day of the third month, the third installment on the fifteenth day of the sixth month, and the fourth installment on the fifteenth day of the ninth month, after such date. If any installment is not paid on or before the date fixed for its payment, the whole amount of the tax unpaid shall be paid upon notice and demand from the collector. [NOTE: The amendment of this provision by sec. 5 (d), Current Tax Payment Act 1943, effective with respect to taxable years beginning after December 31, 1942, added the first clause, "Except * * * is not made applicable),".]

(c) *Extension of time for payment*—(1) *General rule.* At the request of the taxpayer, the Commissioner may extend the time for payment of the amount determined as the tax by the taxpayer, or any installment thereof, for a period not to exceed six months from the date prescribed for the payment of the tax or an installment thereof. In such case the amount in respect of which the extension is granted shall be paid on or before the date of the expiration of the period of the extension.

(2) *Liquidation of personal holding companies.* At the request of the taxpayer, the Commissioner may (under regulations prescribed by the Commissioner with the approval of the Secretary) extend (for a period not to exceed five years from the date prescribed for the payment of the tax) the time for the payment of such portion of the amount determined as the tax by the taxpayer as is attributable to the short-term or long-term capital gain derived by the taxpayer from the receipt by him of property other than money upon the complete liquidation (as defined in section 115 (c)) of a corporation. This paragraph shall apply only if the corporation, for its taxable year preceding the year in which occurred the complete liquidation (or the first of the series of distributions referred to in such section), was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company. An extension under this paragraph shall be granted only if it is shown to the satisfaction of the Commissioner that the failure to grant it will result in undue hardship to the taxpayer. If an extension is granted the amount with respect to which the extension is granted shall be paid on or before the date of the expiration of the

extension. If an extension is granted under this paragraph the Commissioner may require the taxpayer to furnish a bond in such amount, not exceeding double the amount with respect to which the extension is granted, and with such sureties as the Commissioner deems necessary, conditioned upon the payment of the amount with respect to which the extension is granted in accordance with the terms of the extension.

(d) *Voluntary advance payment.* A tax imposed by this chapter, or any installment thereof, may be paid, at the election of the taxpayer, prior to the date prescribed for its payment.

(e) *Advance payment in case of jeopardy.* For advance payment in case of jeopardy, see section 146.

(f) *Tax withheld at source.* For requirement of withholding tax at source, see sections 143, 144, and Part II of Subchapter D.

(g) *Fractional parts of cent.* In the payment of any tax under this chapter a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent.

(h) *Receipts.* Every collector to whom any payment of any income tax is made shall upon request give to the person making such payment a full written or printed receipt therefor.

§ 29.56–1 *Date on which tax shall be paid.* The tax, unless it is required to be withheld at the source (see sections 143 and 144) or unless it is to be paid by a nonresident alien individual (see section 218) or a foreign corporation not having any office or place of business in the United States (see section 236), is to be paid on or before the 15th day of March following the close of the calendar year, or, if the return is made on the basis of a fiscal year, on or before the 15th day of the third month following the close of such fiscal year. In the case of a return (other than a return by a nonresident alien individual or nonresident foreign corporation) for a fractional part of a year, the tax is to be paid on or before the last day prescribed for the filing of the return (see § 29.53–1). But see § 29.53–3. The tax may, at the option of the taxpayer, be paid in four equal installments instead of in a single payment, in which case the first installment is to be paid on or before the date prescribed for the payment of the tax as a single payment, the second installment on or before the 15th day of the third month, the third installment on or before the 15th day of the sixth month, and the fourth installment on or before the 15th day of the ninth month, after such date. If the taxpayer elects to pay the tax in four installments, each of the four installments must be equal in amount, but any installment may be paid, at the election of the taxpayer, prior to the date prescribed for its payment. If an installment is not paid in full on or before the date fixed for its payment either by the Internal Revenue Code or by the Commissioner in accordance with the terms of an extension, the whole amount of the tax unpaid shall be paid upon notice and demand from the collector.

For provisions relating to certain cases in which the date otherwise prescribed for the payment of the tax or an installment thereof is postponed by reason of a member (whether or not the taxpayer) of the military or naval forces of the United States serving on sea duty or outside the continental United States, by reason of any other individual (whether or not the taxpayer) being outside the Americas, or by reason of a locality being an area of enemy action or control, see Part 472 of this chapter.[1] See such part also for the circumstances under which the date otherwise prescribed for the payment of the tax or an installment thereof of the spouses of such members or of such other individuals is in certain cases postponed. See such part also as to the time for payment of the tax by China Trade Act corporations.

§ 29.56–2 *Extension of time for payment of the tax or installment thereof.* If it is shown to the satisfaction of the Commissioner that the payment of the amount determined as the tax by the taxpayer or any part or installment thereof upon the date or dates prescribed for the payment thereof will result in undue hardship to the taxpayer, the Commissioner, at the request of the taxpayer, may grant an extension of time for the payment for a period not to exceed six months from the date prescribed for the payment of such amount, part, or installment, except that the extension may be for a period not to exceed five years from the date prescribed for the payment of the tax in the case of such portion of the amount determined as the tax by the taxpayer which is attributable to the short-term or long-term capital gain derived by the taxpayer from the receipt by him of property other than money upon the complete liquidation (as defined in section 115 (c)) of a corporation if the corporation, for its taxable year preceding the year in which occurred the complete liquidation (or the first of the series of distributions referred to in section 115 (c)), was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company. An extension will not be granted upon a general statement of hardship. The term "undue hardship" means more than an inconvenience to the taxpayer. It must appear that substantial financial loss, for example, due to the sale of property at a sacrifice price, will result to the taxpayer from making payment of the amount at the due date. If a market exists, the sale of property at the current market price is not ordinarily considered as resulting in an undue hardship.

An application for an extension of time for the payment of such tax should be made under oath on Form 1127 and must be accompanied or supported by evidence showing the undue hardship that would result to the taxpayer if the extension were refused. A sworn statement of assets and liabilities of the taxpayer and an itemized statement under oath showing all receipts and disbursements for each of the three months immediately preceding the due date of the tax are required and should accompany the application. The application, with the evidence, must be filed with the collector, who will transmit it to the Commissioner with his recommendations as to the extension. When it is received by the Commissioner, it will be examined and, if possible, within 30 days will be denied, granted, or tentatively granted, subject to certain conditions of which the taxpayer will be notified. The Commissioner will not consider an application for an extension of time for the payment of a tax unless request therefor is made to the collector on or before the date prescribed for payment of the tax or installment thereof for which the extension is desired, or on or before the date or dates prescribed for payment in any prior extension granted.

As a condition to the granting of such an extension, the Commissioner will usually require the taxpayer to furnish a bond on Form 1130 in an amount not exceeding double the amount of the tax or to furnish other security satisfactory to the Commissioner for the payment of the tax, or installment thereof, on or before the date or dates prescribed for payment in the extension, so that the risk of loss to the Government will not be greater at the end of the extension period than it was at the beginning of the period. If a bond is required it shall be conditioned upon the payment of the tax, interest, and additional amounts assessed in connection therewith in accordance with the terms of the extension granted, and shall be executed by a surety company holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds, and shall be subject to the approval of the Commissioner. In lieu of such a bond, the taxpayer may file a bond secured by deposit of bonds or notes of the United States equal in their total par value to an amount not exceeding double the amount of the tax, or installment thereof. (See section 1126 of the Revenue Act of 1926, as amended.) A request by the taxpayer for an extension of time for the payment of one installment does not operate to procure an extension of time for payment of subsequent installments. Nor does an extension of time for filing a return operate to extend the time for the payment of the tax or any part thereof, unless so specified in the extension. If an extension of time for payment of the tax or any installment is granted, the amount, time for payment of which is so extended, shall be paid on or before the expiration of the period of the extension, together with interest at the rate of 6 percent per annum on such amount from the date when the payment should have been made if no extension had been granted until the expiration of the period of the extension. (See section 295.)

§ 29.56–3 *When fractional part of cent may be disregarded.* In the payment of taxes a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent. Fractional parts of a cent should not be disregarded in the computation of taxes.

§ 29.56–4 *Receipts for tax payments.* Upon request a collector will give a re-

[1] 8 F.R. 9602.

ceipt for each tax payment. In the case of payments made by check or money order the canceled check or the money order receipt is usually a sufficient receipt. In the case of payments in cash, however, the taxpayer should in every instance require and the collector should furnish a receipt.

SEC. 57. EXAMINATION OF RETURN AND DETERMINATION OF TAX.

As soon as practicable after the return is filed the Commissioner shall examine it and shall determine the correct amount of the tax.

§ 29.57–1 *Examination of return and determination of tax by the Commissioner.* As soon as practicable after returns are filed, they will be examined and the correct amount of the tax determined under such procedure as may be prescribed from time to time by the Commissioner. (See section 272.)

SEC. 58. DECLARATION OF ESTIMATED TAX BY INDIVIDUALS [as added by sec. 5 (a), Current Tax Payment Act 1943].

(a) *Requirement of declaration.* Every individual (other than an estate or trust and other than a nonresident alien with respect to whose wages, as defined in section 1621 (a), withholding under Subchapter D of Chapter 9 is not made applicable) shall, at the time during the taxable year prescribed in subsection (d); make a declaration of his estimated tax for the taxable year if—

(1) his gross income from wages (as defined in section 1621)

(A) in case such individual is single or married but not living with husband or wife: can reasonably be expected to exceed $2,700 for the taxable year; or did exceed $2,700 for the preceding taxable year; or

(B) in case such individual is married and living with husband or wife: can, when added to the gross income which can reasonably be expected to be received by such husband or wife from wages (as so defined), reasonably be expected to exceed $3,500 for the taxable year; or did when added to the gross income of such husband or wife from wages (as so defined) for the preceding taxable year, exceed $3,500 for such preceding taxable year; or

(2) his gross income from sources other than wages (as defined in section 1621)

(A) in case such individual is single or married but not living with husband or wife: can reasonably be expected to exceed $100 for the taxable year and his gross income to be such as will require the making of a return for the taxable year under section 51; or did exceed $100 for the preceding taxable year and such individual either was required to make a return under section 51 or 455 for such preceding taxable year or would have been so required if he had been single during the whole of such preceding taxable year; or

(B) in case such individual is married and living with husband or wife: can, when added to the gross income which can reasonably be expected to be received by husband or wife from such sources, reasonably be expected to exceed $100 for the taxable year and the aggregate gross income of such husband and wife can reasonably be expected to be such as will require the making of a return under section 51 or 455; or did, when added to the gross income of such husband or wife from such sources for the preceding taxable year, exceed $100 for such preceding taxable year and such individual would have been required to make a return under section 51 or 455 for such preceding taxable year if he had been married and living with husband or wife during the whole of such preceding taxable year; or

(3) in case such taxable year is the taxable year beginning in 1943, such individual was required to make a return under section 51 for the taxable year beginning in 1942, and his gross income from wages (as defined in section 1621) for such taxable year is greater than the gross income which can reasonably be expected to be received from wages for the taxable year beginning in 1943.

(b) *Contents of declaration.* In the declaration required under subsection (a) the individual shall state—

(1) the amount which he estimates as the amount of tax under this chapter for the taxable year, without regard to any credits under sections 32, 35, and 466 (e);

(2) the amount which he estimates as the credits for the taxable year under sections 32, 35, and 466 (e); and

(3) the excess of the amount estimated under paragraph (1) over the amount estimated under paragraph (2), which excess for the purposes of this chapter shall be held and considered the estimated tax for the taxable year.

The declaration shall also contain such other information for the purposes of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall contain or be verified by a written statement that it is made under the penalties of perjury.

(c) *Joint declaration by husband and wife.* In the case of a husband and wife living together, a single declaration under this section may be made by them jointly, in which case the liability with respect to the estimated tax shall be joint and several. No joint declaration may be made if either the husband or wife is a nonresident alien. If a joint declaration is made but a joint return is not made for the taxable year, the estimated tax for such year may be treated as the estimated tax of either the husband or the wife, or may be divided between them.

(d) *Time and place for filing.* The declaration required under subsection (a) shall be filed on or before the fifteenth day of the third month of the taxable year, except that if the requirements of subsection (a) are first met after such date, the declaration shall be filed on or before the fifteenth day of the last month of the quarter of the taxable year in which such requirements are first met. An individual may make amendments or revisions of a declaration filed under this subsection, under regulations prescribed by the Commissioner with the approval of the Secretary. If so made, such amendments or revisions shall be filed on or before the fifteenth day of the last month of any quarter of the taxable year subsequent to that in which the declaration was filed and in which no previous amendments or revisions have been made or filed. Declarations and amendments and revisions thereof shall be filed with the Collector specified in section 53 (b) (1).

(e) *Extension of time.* The Commissioner may grant a reasonable extension of time for filing declarations and paying the estimated tax, under such rules and regulations as he shall prescribe with the approval of the Secretary. Except in the case of taxpayers who are abroad, no such extension shall be for more than six months.

(f) *Persons under disability.* If the taxpayer is unable to make his own declaration, the declaration shall be made by a duly authorized agent or by the guardian or other person charged with the care of the person or property of such taxpayer.

(g) *Signature presumed correct.* The fact that an individual's name is signed to a filed declaration shall be prima facie evidence for all purposes that the declaration was actually signed by him.

(h) *Publicity of declaration.* For the purposes of section 55 (relating to publicity of returns), a declaration of estimated tax shall be held and considered a return under this chapter. [NOTE: Section 58 is, under sec. 5 (f), Current Tax Payment Act 1943, effective with respect to taxable years beginning after December 31, 1942. The original section 58 consisted of cross-references.]

SEC. 59. PAYMENT OF ESTIMATED TAX [as added by sec. 5 (a), Current Tax Payment Act 1943].

(a) *In general.* The estimated tax shall be paid in four equal installments except that—

(1) if the declaration is filed (otherwise than pursuant to an extension of time) after the fifteenth day of the third month of the taxable year, the estimated tax shall be paid in equal installments the number of which is equal to the number of quarters remaining in the taxable year (including the quarter in which the declaration is filed); and

(2) if any amendment or revision of a declaration is filed, the remaining installments shall be ratably increased or decreased, as the case may be, to reflect the increase or decrease, as the case may be, in the estimated tax by reason of such amendment or revision; and

(3) at the election of the individual, any installment of the estimated tax may be paid prior to the date prescribed for its payment.

One installment of the estimated tax shall be paid at the time of making the declaration, and an installment thereof shall be paid on the fifteenth day of the last month of each succeeding quarter of the taxable year. Payment of any installment of the estimated tax shall be considered payment on account of the tax for the taxable year.

(b) *Assessment.* The estimated tax shall be assessed only to the extent paid. [NOTE: Section 59 is, under sec. 5 (f), Current Tax Payment Act 1943, effective with respect to taxable years beginning after December 31, 1942. The original section 59 consisted of cross-references.]

SEC. 60. SPECIAL RULES FOR APPLICATION OF SECTIONS 58 AND 59 [as added by sec. 5 (a), Current Tax Payment Act 1943].

(a) *Farmers.* In the case of an individual whose estimated gross income from farming for the taxable year is at least 80 per centum of the total estimated gross income from all sources for the taxable year, in lieu of the time prescribed in section 58 (d), the declaration for the taxable year may be made at any time on or before the fifteenth day of the last month of the taxable year.

(b) *Application to short taxable years.* The application of sections 58, 59, and 294 (a) (3), (4), and (5) to taxable years of less than twelve months shall be as prescribed in regulations prescribed by the Commissioner with the approval of the Secretary.

(c) *Application to taxable years beginning in 1943.* If the taxable year is the calendar year 1943, the fifteenth day of September, 1943, shall be substituted for the fifteenth day of March for the purposes of section 58 (d). If the taxable year begins in 1943 after January 1, the date which shall be substituted for the fifteenth day of the third month of the taxable year for the purposes of section 58 (d) shall be prescribed by regulations prescribed by the Commissioner with the approval of the Secretary. In either case installments of the estimated tax for such taxable year payable after September 1, 1943, shall be ratably decreased to reflect the payments on account of a taxable year beginning in 1942 which are treated as payments on account of the estimated tax for a taxable year beginning in 1943. [NOTE: Section 60 is, under sec. 5 (f), Current Tax Payment Act 1943, effective with respect to taxable years beginning after December 31, 1942. The original section 60 consisted of cross-references.]

MISCELLANEOUS PROVISIONS

SEC. 61. LAWS MADE APPLICABLE.

All administrative, special, or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, shall be extended to and made a part of this chapter.

SEC. 62. RULES AND REGULATIONS.

The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this chapter.

SEC. 63. PUBLICATION OF STATISTICS.

The Commissioner, with the approval of the Secretary, shall prepare and publish annually statistics reasonably available with respect to the operation of the income, war-profits and excess-profits tax laws, including classifications of taxpayers and of income, the amounts allowed as deductions, exemptions, and credits, and any other facts deemed pertinent and valuable.

SEC. 64. DEFINITIONS.

For definitions of a general character, see section 3797.

[Subpart C will appear in the issue for Thursday, November 4, 1943. Subparts D, E, F, and G will appear in the issue for Friday, November 5, 1943]

[SEAL] ROBERT E. HANNEGAN,
Commissioner of Internal Revenue.

Approved: October 26, 1943.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

[F. R. Doc. 43-17458; Filed, October 28, 1943; 9:43 a. m.]

TITLE 30—MINERAL RESOURCES

Chapter VI—Solid Fuels Administration for War

[Reg. 6]

PART 602—GENERAL ORDERS AND DIRECTIVES

DELIVERIES OF ANTHRACITE COAL

The present interruptions in the production of anthracite coal and the fulfilment of requirements for the defense of the United States will create a critical shortage in the supply of anthracite coal for defense, for private account, and for export. In order to insure the equitable distribution of the available supply of anthracite coal, it is necessary as a precautionary measure to place restrictions upon deliveries of anthracite by retail dealers. Accordingly, in order to effectuate the purposes of Executive Order No. 9332 and by virtue of the authority conferred by that order, the following regulation is issued by the Solid Fuels Administrator for War:

§ 602.101 *Definitions.* (a) "Anthracite" means that coal which is generally referred to as Pennsylvania anthracite and is produced in the following counties in Pennsylvania: Carbon, Columbia, Dauphin, Lebanon, Lackawanna, Luzerne, Northumberland, Schuylkill, Susquehanna, and Wayne; and is limited to the sizes generally known as broken, egg, stove, chestnut, pea, No. 1 buckwheat and No. 2 buckwheat (rice).

(b) "Retail dealer" means any person who purchases anthracite for resale to consumers.

(c) "Ten days' supply" includes all anthracite coal of any usable kind, grade or size in the consumer's bin required by reasonable estimate to meet minimum anthracite requirements of the consumer for a ten-day period.

§ 602.102 *Restrictions upon anthracite deliveries by retail dealers.* (a) No retail dealer shall deliver any anthracite coal to any consumer if such consumer has more than a ten days' supply; and no consumer shall accept delivery of any anthracite coal from a retail dealer if such consumer has more than a ten days' supply.

(b) A retail dealer may deliver anthracite coal up to but not in excess of one-half ton to any household consumer if such consumer has less than a ten days' supply.

(c) The restrictions of this section shall apply regardless of whether any consumer had title to any coal in the possession of any retail realer on the effective date of this regulation.

§ 602.103 *Contemplated activities of local committees of the office of Defense Transportation.* (a) It is understood that local committees functioning under the direction of the Office of Defense Transportation will, during the period of work stoppages in the anthracite producing districts and during the effective period of this Regulation, ascertain the amount of anthracite in retail yard storage piles in their communities, will arrange for the pooling of retail dealer deliveries and will coordinate in other ways retail dealer activities in each anthracite consuming community.

(b) It is understood that the local committees functioning under the direction of the Office of Defense Transportation will indicate to the regional offices of the Solid Fuels Administration for War the tonnages of anthracite coal critically needed by those communities having insufficient anthracite to forestall suffering threatened by weather conditions. The Solid Fuels Administrator for War will, upon the recommendation of such local committees, arrange, so far as practicable and appropriate, for the shipment of sufficient tonnages of anthracite that is now being held, pursuant to direction of the Solid Fuels Administration for War, in the anthracite producing districts for distribution into those communities whose need for anthracite appears to be critical.

§ 602.104 *Deliveries are not authorized under Office of Price Administration Ration Order No. 19 in contravention of this regulation.* As provided in section 15 of Ration Order No. 19 issued by the Office of Price Administration, no deliveries are authorized to be made under the provisions of that ration order in contravention of the provisions of this regulation.

§ 602.105 *Violations.* Any person who wilfully violates any provisions of this regulation is guilty of a crime, and upon conviction may be punished by fine or imprisonment. In addition, any such person may be prohibited from making or obtaining further deliveries of, or from processing or using material under priority control and may be deprived of priorities assistance.

§ 602.106 *Communications.* All communications regarding this regulation should be addressed to the Solid Fuels Administrator for War, Washington, D. C.

This regulation shall become effective immediately.

(E.O. 9332, 8 F.R. 5355; E.O. 9125, 7 F.R. 2719; sec. 2 (a), 54 Stat. 676, as amended by 55 Stat. 236 and 56 Stat. 176)

Issued this 30th day of October 1943.

ABE FORTAS,
Acting Solid Fuels Administrator for War.

[F. R. Doc. 43-17706; Filed, November 2, 1943; 9:28 a. m.]

[Reg. 6, Amdt. 1]

PART 602—GENERAL ORDERS AND DIRECTIVES

DELIVERIES OF ANTHRACITE COAL

It is necessary to amend Solid Fuels Administration for War Regulation No. 6 in order to prevent the imposition of undue distribution difficulties upon retail dealers of anthracite coal who serve as a source of supply for larger consumers of anthracite. Accordingly, pursuant to powers conferred by Executive Order No. 9332, Solid Fuels Administration for War Regulation No. 6 is hereby amended as follows.

1. Section 602.102 (b) is amended to read as follows:

§ 602.102 *Restrictions upon anthracite deliveries by retail dealers.* * * *

(b) A retail dealer may deliver anthracite coal up to but not in excess of one-half ton to any household consumer if such consumer has less than a ten days' supply. A retail dealer may deliver anthracite coal in any quantity to other than household consumers provided that the tonnage delivered, when added to the inventory on hand, does not exceed a ten days' supply.

This amendment shall become effective immediately.

Issued this 1st day of November 1943.

HAROLD L. ICKES,
Solid Fuels Administrator for War.

[F. R. Doc. 43-17707; Filed, November 2, 1943; 9:29 a. m.]

TITLE 32—NATIONAL DEFENSE

Chapter XI—Office of Price Administration

PART 1351—FOOD AND FOOD PRODUCTS

[MPR 490]

EDIBLE TREE NUTS

This regulation establishes maximum prices for certain sales of edible tree nuts, both in-shell and shelled, in order to aid in stabilizing the cost of living.

Such standards and specifications as are used herein were, prior to this regulation, in general use in the trade or industry affected.

A statement of the considerations involved in the issuance of this regulation has been issued and filed with the Division of the Federal Register.*

§ 1351.2010 *Maximum prices for edible tree nuts.* Under the authority vested in the Price Administrator by the Emergency Price Control Act of 1942, as amended, and Executive Orders No. 9250 and 9328, Maximum Price Regulation No. 490, (Edible Tree Nuts), which is annexed hereto and made a part hereof, is hereby issued.

AUTHORITY: (56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871, E.O. 9328, 8 F.R. 4681)

MAXIMUM PRICE REGULATION NO. 490—EDIBLE TREE NUTS

ARTICLE I—EXPLANATION OF THE REGULATION

Sec.

1. What this regulation covers.
2. General definitions.

ARTICLE II—GENERAL PROVISIONS

3. Relationship to General Maximum Price Regulation.
4. Statements to be made on invoice.
5. Records which sellers must keep.
6. Compliance with this regulation.
7. Petitions for amendment.

ARTICLE III—PRICING PROVISIONS

8. Maximum prices for sales of walnuts, filberts, almonds and pecans.
9. Maximum prices for sales of all other edible tree nuts.
10. General provisions affecting prices.

ARTICLE I—EXPLANATION OF THE REGULATION

SECTION 1. *What this regulation covers.* (a) This regulation establishes maximum prices for all sales of edible tree nuts except sales by growers and country dealers. (Fruit pits are not edible tree nuts within the purview of this regulation.)

(b) This regulation does not apply to the following sales:

(1) Export sales (see Second Revised Maximum Export Price Regulation [1]).

(2) Sales by growers or country dealers unless the particular seller is also performing functions which bring him within a class of sellers otherwise covered by this regulation.

(c) This regulation is applicable to the 48 states of the United States and the District of Columbia.

(d) This regulation becomes effective November 3, 1943.

SEC. 2. *General definitions.* (a) The following definitions are of general applicability throughout the regulation. Definitions of limited applicability are set forth in the text or tables at the specific places where they are pertinent.

1. "Grower" means a person who produces the kind of edible tree nuts being priced.

2. "Wholesaler" and "retailer" mean the persons respectively referred to as "wholesalers" and "retailers" in Maximum Price Regulations Nos. 421,[2] 422,[3] 423,[4] and include all wholesalers and retailers.

3. "Packer" means a person who cleans, grades and packs the kind of edible tree nuts being priced.

4. "Processor" means a person who cleans, grades, packs, polishes and bleaches the kind of edible tree nuts being priced. (In this industry the term "processor" is used only in the limited sense set forth. It does not include such persons as roasters and salters.)

5. "Sheller" means a person who shells the kind of edible tree nuts being priced, customarily in his own place of business, for the purpose of recovering the nut meats and selling them in the course of trade or business.

6. "Roaster" or "salter" means the person who roasted or salted the item being priced.

7. "Primary distributor" means a distributor, other than a wholesaler or retailer, who buys all he sells (for his own account) of the kind of edible tree nuts being priced, who customarily makes at least 50% of his purchases in carlot quantities, who stores them in a warehouse not owned or controlled by any of his customers, and who customarily sells in less than carlot quantities.

8. "Ultimate consumer" means a person who buys nuts for direct consumption. The term does not include a processor, or commercial or industrial user, as for example, a baker or a confectioner.

9. "Item" means the particular kind, variety, grade, size and style of pack of edible tree nuts being priced.

(b) Unless the context requires otherwise, the definitions contained in section 302 of the Emergency Price Control Act of 1942, as amended, and § 1499.20 of the General Maximum Price Regulation apply to the other terms used in this regulation.

ARTICLE II—GENERAL PROVISIONS

SEC. 3. *Relationship to the General Maximum Price Regulation.* The following provisions of the General Maximum Price Regulation, as well as any amendment thereto, shall be applicable to every sale of edible tree nuts covered by this regulation:

(a) Transfers of business or stock in trade (§ 1499.5)
(b) Federal and state taxes (§ 1499.7)
(c) Current records (§ 1499.12)
(d) Sales slips and receipts (§ 1499.14)

SEC. 4. *Statements to be made on invoice.* Sellers of items covered by this regulation shall in each case furnish the buyer with an invoice or other document of sale stating the quantity, kind, variety, grade, size and style of pack and selling price of the item being sold. If required by the state in which the sale is made, it may also show the appropriate "state grade". In addition, this information may also be shown on the container or on a tag or label attached to the container.

SEC. 5. *Records which sellers must keep.* Every person subject to this regulation shall, so long as the Emergency Price Control Act of 1942, as amended, remains in effect, preserve for examination by the Office of Price Administration all records customarily kept by him (such as invoices, sales tickets, cash receipts, or other written evidences of sale or delivery) which relate to the prices charged under this regulation.

SEC. 6. *Compliance with this regulation*—(a) *No selling or buying above maximum prices.* On and after November 3, 1943, regardless of any contract or other obligation, no person shall sell or deliver and no person, in the course of trade or business, shall buy or receive edible tree nuts at prices higher than the maximum prices established by this regulation, and no person shall agree, offer, solicit, or attempt to do any of these things. However, prices lower than maximum prices may be charged and paid.

(b) *Evasion.* Nor shall any person evade a maximum price, directly or indirectly, whether by commission, service, transportation or other charge or discount, premium or other privilege; by tying agreement or other trade understanding; by up-grading; by any change of style or pack; by a business practice relating to grading, labeling or packaging; or in any other way.

(c) *Enforcement.* Any person violating a provision of this regulation is subject to the criminal penalties, civil enforcement actions, suits for triple damages, and proceedings for suspension of licenses provided by the Emergency Price Control Act of 1942, as amended.

(d) *Licensing.* The provisions of Licensing Order No. 1,[5] licensing all persons who make sales under price control, are applicable to all sellers subject to this regulation or schedule. A seller's license may be suspended for violations of the license or of one or more applicable price schedules or regulations. A person whose license is suspended may not, during the period of suspension, make any sale for which his license has been suspended.

SEC. 7. *Petitions for amendments.* Any person seeking a modification of this regulation may file a petition therefor in accordance with the provisions of Revised Procedural Regulation No. 1,[6] issued by the Office of Price Administration.

ARTICLE III—PRICING PROVISIONS

SEC. 8. *Maximum prices for walnuts, filberts, almonds and pecans*—(a) *Explanation of zones and maximum prices.* (1) For the purpose of this regulation the territory of the United States is divided into two zones.

Zone I is all that part of the 48 states of the United States west of Zone II.

Zone II is all that part of the 48 states of the United States and District of Columbia embraced in transcontinental groups "H" and

*Copies may be obtained from Office of Price Administration.

[1] 8 F.R. 4132, 5987, 7662, 9998.

[2] 8 F.R. 9328, 10569, 10987, 13293.

[3] 8 F.R. 9395, 10569, 10987, 12443, 12611, 13294.

[4] 8 F.R. 9407, 10570, 10988, 12443, 12611, 13294.

[5] 8 F.R. 13244.

[6] 7 F.R. 8961, 8 F.R. 3313, 3533, 6173, 11806.

"J", as described in North Coast Territorial Directory No. 40-I (Agent L. E. Kipp, I. C. C. No. 1492, Agent L. N. Doe, I. C. C. No. 489, Agent W. S. Curlett I. C. C. No. A-775 and Agent B. T. Jones, I. C. C. No. 370) and all points east of those groups, being roughly all such territory on and east of a line running in a North-to-South direction through Clearmont, Casper and Cheyenne (Wyoming); Denver, Canon City, Chandler, Walsenberg and Trinidad (Colorado); Farwell, Barstow and Presidio (Texas).

(2) In the following tables maximum prices are set forth in two parallel columns, under the heads "Column 1" and "Column 2". The zone in which physical delivery of the goods is to be made determines whether the Column 1 or the Column 2 price for the item applies.

The figures in Column 1 are f. o. b. shipping point prices. They are to be used in every sale where physical delivery of the goods is to be made at a point in Zone I, regardless of the zone in which the sales contract was made or the actual shipping point is located. The cost of transportation (by the cheapest, most direct and generally available means) from shipping point to destination may be added.

The figures in Column 2 are delivered prices. They are to be used in every sale where physical delivery of the goods is to be made at a point in Zone II regardless of the zone in which the sales contract was made or the actual shipping point is located. These figures include all allowable transportation, and nothing may be added to them for cost of transportation.

There are exceptions to the foregoing rules in the cases of certain sales. They are found in the provisions immediately following the price tables.

(b) *Maximum prices for certain sales.* (All figures are cents per pound.)

TABLE 1—WALNUTS

(The following prices apply to sales in containers of more than 50 pounds of nuts in-shell, or of more than 5 pounds shelled. For sales in smaller containers see (3) in this table.)

(1) *Maximum prices for sales by growers, country dealers, packers, processors and shellers to primary distributors, wholesalers, commercial users and direct buyers other than those expressly covered by this regulation. Shellers:*

IN-SHELL

Grade	Column 1 (See explanation (in section 8 (a))	Column 2
1st quality large	31	32½
1st quality medium and No. 1 size	28½	30
2d quality large	28½	30
2d quality medium and No. 1 size	27	28½
3d quality large	28½	30
3d quality medium and No. 1 size	27	28½
Baby sizes, all types and qualities (except Eurekas)	25½	27
Eurekas babys	26½	28

SHELLED

Light halves	80½	82½
All others	75½	77½

(2) *Maximum prices for sales by primary distributors.*

IN-SHELL

Grade	Column 1 (See explanation in section 8(a))	Column 2
1st quality large	34½	36
1st quality medium and No. 1 size	31½	33
2d quality large	31½	33
2d quality medium and No. 1 size	30	31½
3d quality large	31½	33
3d quality medium and No. 1 size	30	31½
Baby sizes, all types and qualities (except Eurekas)	28½	30
Eureka babys	29½	31

SHELLED

Light halves	89	91
All others	83	85

(3) For sales of walnuts in containers of 50 pounds or less the following amounts may be added to the price listed in paragraphs (1) and (2) of this table.

IN-SHELL

Size of container:	*Amount which may be added*
More than 25 lb. to 50 lb. bags	¼
25 lb. bags or smaller and 50 pound cartons, or smaller	½

SHELLED

5 pound cartons, or smaller	1

(4) For sales of "Jumbo" size Franquette and Mayette and medium size Mammoth Mayette, Willson Wonder, Bijou and Klondike varieties, 2 cents per pound may be added to the price named for "First Quality Large".

(5) This regulation does not apply to sales of any lot of the varieties commonly known as Mayettes, Extra Large, Willson Wonder, and Soft-Shell, of which 88% or more by count will not pass through a round opening 96/64ths inches in diameter.

(6) The walnuts for which maximum prices are established by this section are the "English" (Juglans regia) varieties grown in the western part of the United States.

(7) "Grade" means the quality and size determined in accordance with the pack and quality specifications prescribed pursuant to Food Distribution Order No. 82,[1] issued by the War Food Administrator and effective October 2, 1943.

TABLE 2—FILBERTS

(The following prices apply to sales in containers of more than 50 lbs. for nuts in-shell, or more than 35 lbs. shelled. For sales in smaller containers see (3) in this table.)

(1) *Maximum prices for sales by growers, country dealers, packers, processors and shellers to primary distributors, wholesalers, commercial users and direct buyers other than those expressly covered by this regulation.*

IN-SHELL

Grade	Column 1 (See explanation in section 8(a))	Column 2
Jumbo	32	33½
Large (except Brixnuts)	28½	30
Fancy	27½	29
Baby	26	27½

SHELLED

Large	78½	80½
Medium and small	76½	78½
Broken	71	73

[1] 8 F.R. 13283.

(2) *Maximum prices for sales by primary distributors.*

IN-SHELL

Grade	Column 1 (See explanation in section 8(a))	Column 2
Jumbo	35½	37
Large (except Brixnuts)	31½	33
Fancy	30½	32
Baby	28½	30

SHELLED

Large	86½	88½
Medium and small	84½	86½
Broken	78½	80½

(3) For filberts packed in containers described below, the following amounts may be added to the prices listed in paragraphs (1) and (2 of this table:

IN-SHELL

Size of container:	*Amount which may be added*
More than 25 lb. to 50 lbs. bags	¼
25 lb. bag or smaller and 50 lb. cartons or smaller	½
48 1 lb. cellophane bags per case	2½
24 1 lb. cellophane bags per case	3

SHELLED

35 lb. cartons or smaller	½

(4) For filberts described as Large Brixnuts, one cent per pound may be added to the price listed in paragraph (1) of this table for "Large" in-shell.

(5) The filberts for which maximum prices are established by this section are the edible tree nuts of the varieties commercially known as "filberts" or "hazelnuts", and grown in the Northwestern part of the United States.

(6) "Grade" means the quality and size determined in accordance with the specifications for size, variety and quality prescribed by Oregon Laws of 1939, Chapter 194.

TABLE 3—ALMONDS

(The following prices apply to sales in containers of more than 60 pounds for nuts in-shell or more than 25 lbs. shelled. For sales in smaller containers see (3) in this table.)

(1) *Maximum prices for sales by growers, country dealers, packers, processors and shellers to primary distributors, wholesalers, commercial users and direct buyers other than those expressly covered by this regulation.*

IN-SHELL

Variety Grade	Column 1 (See explanation (in section 8(a))	Column 2
Non-pareil	48½	50
I X L	40½	42
NePlus	41	42½
Peerless	34	35½
Drake	34	35½
Texas	34	35½
Miscellaneous	34	35½

SHELLED

Grade A—Whole almonds, graded:		
16-18 count to the ounce	86	88
18-20 count to the ounce	84	86
20-22 count to the ounce	83	85
22-24 count to the ounce	82	84
24-26 count to the ounce	81	83
26-28 count to the ounce	82	84
28-30 count to the ounce	85	87
30-smaller and sheller run	86	88
Grade B—Sheller run	80	82
Grade C—Whole and broken	79	81
Grade D—pieces	78	80

(2) *Maximum prices for sales by primary distributors.*

IN-SHELL

Variety	Column 1	Column 2
	(See explanation in section 8(a))	
Non-pareil	53½	55
I X L	44½	46
Ne Plus	45½	47
Peerless	37½	39
Drake	37½	39
Texas	37½	39
Miscellaneous	37½	39

SHELLED

Grade A—Whole almonds, graded:		
16-18 count to the ounce	95	97
18-20 count to the ounce	93	95
20-22 count to the ounce	92	94
22-24 count to the ounce	90½	92½
24-26 count to the ounce	89½	91½
26-28 count to the ounce	90½	92½
28-30 count to the ounce	94	96
30-smaller and sheller run	95	97
Grade B—Sheller run	88	90
Grade C—Whole and broken	87	89
Grade D—Pieces	86	88

(3) For almonds packed in containers of 60 pounds or less the following amounts may be added to the prices set forth in subparagraphs (1) and (2) of this table.

IN-SHELL

Size of container:	*Amount which may be added*
Up to 25 lb. bag	½
More than 25 lbs. up to 50 lb. bag	¼
Up to 60 lb. carton	½
24—1 lb. pkgs	3

SHELLED

Up to 25 lb. carton	1
10—5 lb. cartons	2
24—8 ounce pkgs	4
48—8 ounce pkgs	5

(4) For shelled almonds processed as follows the following amounts may be added to the prices shown in (1) and (2) above.

Roasted and roasted salted	3
Diced or ground roasted	4
Diced or halved natural	1
Blanched	9
Sliced natural	½

(5) The almonds for which maximum prices are established above are of the species amygdalus communis grown in the western part of the United States.

(6) The term "grade" as used above applies only to shelled almonds as follows:

(i) Grade A means whole meats assorted to size, containing not more than 15 percent meats the skins of which have been nicked in the course of shelling.

(ii) Grade B or "Sheller Run" means meats ungraded as to size containing not more than 15 percent by weight broken or split meats.

(iii) Grade C or "Whole and broken meats" means meats ungraded as to size containing whole meats with not more than 30 percent by weight broken or split meats.

(iv) Grade D or "Pieces" means broken or split meats ungraded as to size.

TABLE 4—PECANS

(The following prices apply to sales in containers of more than 50 pounds for nuts in-shell, or more than 25 pounds shelled. For sales in smaller containers see (3) in this table.)

(1) *Maximum prices for sales by growers, country dealers, shellers and processors to primary distributors, wholesalers and commercial users and direct buyers other than those expressly covered in this regulation.*

IN-SHELL

Grades	Column 1	Column 2
	See explanation in section 8(a))	
U. S. No. 1:		
Oversize	36½	38
Extra large	35½	37
Large	32½	34
Medium	26½	28
Small	20	21½
Commercial:		
Oversize	33½	35
Extra large	32½	34
Large	29½	31
Medium	23½	25
Small	20	21½
Unclassified:		
Improved-cleaned and culled	29½	31
Seedlings	20	21½

SHELLED

Halves	82½	84½
Pieces	80½	82½
Ambers	50½	52½

(2) *Maximum prices for sales by primary distributors.*

IN-SHELL

Grades	Column 1	Column 2
	(See explanation in section 8(a))	
U. S. No. 1:		
Oversize	40½	42
Extra large	39½	41
Large	36	37½
Medium	29½	31
Small	22½	24
Commercial:		
Oversize	37	38½
Extra large	36	37½
Large	32½	34
Medium	26	27½
Small	22½	24
Unclassified:		
Improved-cleaned and culled	32½	34

SHELLED

Halves	91	93
Pieces	89	91
Ambers	56	58

(3) For pecans packed in containers of 50 pounds or less the following amounts may be added to the prices in (1) and (2) above.

IN-SHELL

Size of container:	*Amount which may be added (cents)*
More than 25 lb. up to 50 lb. carton	¼
More than 10 lb. up to 25 lb. carton	½
More than 5 lb. up to 10 lb. carton	1½
Up to 5 lb. carton	2

SHELLED

6—8 oz. cellophane bags	8
12—4 oz. cellophane bags	10
12—1½ oz. cellophane bags	20
12—2 oz. vacuum jars	20
12—3¼ oz. vacuum jars	18

(4) Maximum prices for in-shell Schley and Burkett pecans shall be 4 cents per pound higher than the maximum price named for other in-shell pecans in all types of sales.

(5) (i) For shelled pecans halves of 250 count to the pound and under. 5 cents may be added to the prices specified in (1) and (2) above.

(ii) One-half cent per pound shall be deducted from the prices specified in (1) and (2) above for pecans in the shell which have not been bleached and polished.

(6) "Country dealer" means a person who buys pecans from growers for resale. He may also be known as an "accumulator".

(7) The pecans for which maximum prices are established by this paragraph are nuts of the species of Hickory tree "Carya Illinoiesis" except the Hickory nut itself, grown in the Mississippi Valley, South and Southwestern portions of the United States and in Mexico.

(i) "Improved" pecans means any pecans counting less than 74 per pound, or which count from 74 to 89 inclusive and bear a specific variety name of budded or grafted pecans and have been certified by the grower that they are from budded or grafted trees.

(ii) "Seedling" pecans means any pecans counting 90 or more per pound or pecans counting from 74 to 89 inclusive per pound which do not bear a specific variety name of budded or grafted pecan, or which have not been certified by the grower that they are from budded or grafted trees.

(8) "Grade" as above means the quality and size determined by the standards set forth by the United States Department of Agriculture known as "United States Standards for Unshelled Pecans" as amended and effective September 15, 1943, which is quoted in part as follows:

"Size—The size of pecans may be stated on the basis of the following classification, provided the nuts are not below U. S. Commercial quality:

Size designation	Number of nuts per pound	10 of the smallest nuts in a representative 100-nut sample must weigh at least: [1]	
		Ounces	*Equivalent in grams*
Oversize	Not more than 52	2. 50	71
Extra large	Not more than 60	2. 25	64
Large	61 to 73	1. 75	50
Medium	74 to 90	1. 50	43
Small	91 to 115	1. 25	36

[1] When the sample for inspection consists of more than 100 nuts, 10 percent, by count, of the smallest nuts will be segregated and weighed. For example, if the sample consists of 300 nuts as will generally be the case when a carload is being inspected, 30 of the smallest nuts must weigh at least three times the amount here shown for any size designation.

In selecting the smallest nuts, those which are by observation the smallest in appearance are segregated. In deciding which is the smallest among two or more nuts which appear to be about equal in size, the lightest in weight shall be used.

"In addition to having the requisite count per pound for any size designation shown in this table, the lot must comply with the restrictions as to the smallest nuts as indicated. No tolerance shall be allowed.

"In lieu of the preceding size designations, the size of pecans in any lot may be described in accordance with the maximum number per pound or the range in number per pound without restriction as to the smallest nuts in the lot. When this method of size specification is used, no tolerance shall be allowed. The size may also be described as an exact number per pound as 65, 80, etc. When this method is used, the actual number per pound may not vary by more than 12 percent from the specified number.

"The size may also be described in terms of the diameter (10) of the smallest nuts, or range in diameters of the nuts in a lot stated in sixteenth of an inch. When so specified, not more than 12 percent, by count, of the pecans in any lot may be below the minimum diameter specified and not more than 12 percent may be above the maximum diameter specified.

"Grades—U. S. No. 1 shall consist of unshelled pecans which are fairly uniform in

color of shells (1), fairly well shaped (2), and free from damage (3) caused by stains or adhering hulls (3a), split or broken shells (3b), loose hulls or other foreign material (3), or other means. The kernels shall be well cured (4), free from rancidity (5), molds (6), decay (7), worm injury (8), and from damage (3) caused by shriveling (3c), discoloration (3d), or other means. (See "Size" as defined heretofore.)

"In order to allow for variations incident to proper grading and handling, the following tolerances shall be permitted:

"For external defects (defects of the shell) not more than 10 percent, by count, of the pecans in any lot may be below the requirements of this grade, but not more than three-tenths of this amount, or 3 percent, shall be allowed for serious damage (9) caused by stains or adhering hulls (9a), and/or by split or broken shells (9b).

"For internal defects (defects of the kernel) not more than 15 percent by count, of the pecans in any lot may be below the requirements of this grade, but not more than two-fifths of this amount, or 6 percent, shall be allowed for kernels which are rancid (5), moldy (6), decayed (7), injured by worms (8), or seriously damaged by shriveling (9c), discoloration (9d), or other means.

"U. S. commercial shall consist of unshelled pecans which are free from serious damage (9) caused by stains or adhering hulls (9a), split or broken shells (9b), loose hulls or other foreign material (9), or other means. At least 65 percent, by count, of the pecans in any lot shall have kernels which meet the requirements of U. S. No. 1 grade; and the remainder shall have kernels which are fairly well cured (4a), free from rancidity (5), molds (6), decay (7), worm injury (8), and from serious damage (9) caused by shriveling (9c), discoloration (9d), or other means. (See "Size" above.)

"In order to allow for variations incident to proper grading and handling, the following tolerances shall be permitted:

"For external defects (defects of the shell) not more than 10 percent, by count, of the pecans in any lot may be below the requirements of this grade.

"For internal defects (defects of the kernel) not more than 15 percent, by count, of the pecans in any lot may be below the requirements of this grade, but not more than two-thirds of this amount, or 10 percent, shall be allowed for kernels which are rancid (5), moldy (6), decayed (7), injured by worms (8), or so shriveled that they are virtually of no food value. No part of any tolerance shall be allowed to reduce for the lot, the 65 percent of kernels required to meet U. S. No. 1 grade.

"Unclassified shall consist of unshelled pecans which have not been classified in accordance with either of the foregoing grades. The term "unclassified" is not a grade within the meaning of these standards but is provided as a designation to show that no definite grade has been applied to the lot".

Key figures enclosed in parentheses in the above quotation refer to the "Definitions of Terms" appearing in the document quoted, namely, "U. S. Standards for Unshelled Pecans", issued by the United States Department of Agriculture to which reference is made.

(c) *Sales by roasters and salters.* For sales of walnuts, filberts, almonds and pecans by roasters and salters, the maximum price to a class of purchasers in each case shall be the highest price charged by the seller for the item being priced to a purchaser of the same class during the period October 25 to October 30, 1943 inclusive. "Highest price charged" means the highest price which the seller charged for the item in any delivery made by him during the period just mentioned, to a purchaser of the same class. If the seller made no such delivery, "highest price charged" means his highest offering price for delivery of the item during that period to a purchaser of the same class.

If the seller did not deliver or offer to deliver the item during that period to a purchaser of the same class his maximum price shall be his net cost of the item plus the difference between his net cost and his selling price for the most closely comparable item which he sold during that period to the same class of purchasers (converted to the same selling unit).

(d) *Sales to retailers and ultimate consumers.* (1) For sales to retailers made by any seller listed in section 8 (b), the maximum price in each case shall be the Column I price for sales of the item by packers or processors, plus any delivery costs incurred, regardless of the zone in which physical delivery is to be made.

(2) For sales to ultimate consumers made by packers, processors, or primary distributors the maximum price in each case shall be the sellers' Column I price for sales of the particular item to wholesalers, multiplied by 1.35, plus any delivery costs incurred regardless of the zone in which physical delivery is to be made.

(e) *Sales by wholesalers and retailers.* (1) The maximum price for sales of walnuts, filberts, almonds and pecans by wholesalers and retailers shall be, in each case, either (i) the seller's net delivered cost of the item multiplied by 1.15 if he is a wholesaler, or multiplied by 1.35 if he is a retailer, or (ii) the highest price which he charged for the item to the same class of purchasers (as explained in (c) above) during the period October 25 to October 30, 1943, inclusive, whichever is lower.

(2) If the seller did not deliver or offer to deliver the item during that period, his maximum price shall be his net delivered costs of the item multiplied by 1.15 if he is a wholesaler, or multiplied by 1.35 if he is a retailer.

(3) The provisions of this paragraph (e) expire on January 3, 1944.

(f) *Limitations on maximum prices for primary distributors.* (1) The prices named in the tables in section 8 for sales by primary distributors are available only to those primary distributors, who, prior to April 28, 1942, were engaged in the business of importing edible tree nuts, who are not owned or controlled by any other seller of edible tree nuts, and who prior to April 28, 1942 customarily bought and sold the particular kind of edible tree nuts being priced.

(2) The maximum price for sales by all other primary distributors shall be, in each case, the supplier's maximum price for the item, adjusted where necessary to include incoming freight.

(g) *Sales by all other sellers.* For all sellers not specifically mentioned in section 8 the maximum price, in each case, shall be the supplier's maximum price for the item, adjusted where necessary to include incoming freight.

SEC. 9. *Maximum prices for sales of all other edible tree nuts.* (a) For all sales of edible tree nuts whether imported or domestic, in-shell, shelled, roasted or salted, other than those listed in section 8, the maximum price to a class of purchasers in each case shall be the highest price charged by the seller for the item being priced to a purchaser of the same class during the period October 25 to October 30, 1943 inclusive. (For meaning of "highest price charged see section 8 (c).)

(b) If the seller did not deliver or offer to deliver the item during that period to a purchaser of the same class his maximum price shall be the highest price charged for the same item during that period by the most closely competitive seller to a purchaser of the same class.

(c) The provisions of this section expire on January 3, 1944.

SEC. 10. *General provisions affecting prices*—(a) *Maximum prices for sales of mixed nuts.* The maximum price for sales of mixed nuts shall be in each case, the combined maximum prices of the separate kinds, varieties, types and grades in the same proportion as these kinds, varieties, types and grades appear in the mixture, plus, in the case of nuts in the shell, 2½ cents per pound of mixture. A separate price, therefore, shall be figured for each mixture.

(b) *Position of brokers and commission merchants.* In accordance with existing trade customs every broker or commission merchant shall be deemed the agent of the seller and not of the buyer. In each case, the amount paid by the buyer to the broker or commission merchant plus the amount paid by the buyer to the seller shall not exceed the seller's maximum price, plus allowable transportation actually paid by the seller or by the broker or by the commission merchant.

(c) *Adjustable pricing.* Any person may agree to sell at a price which can be increased up to the maximum price in effect at the time of delivery; but no person may, unless authorized by the Office of Price Administration, deliver or agree to deliver at prices to be adjusted upward in accordance with action to be taken by the Office of Price Administration after delivery. Such authorization may be given when a request for a change in the applicable maximum price is pending, but only if the authorization is necessary to promote distribution and will not interfere with the purposes of the Emergency Price Control Act of 1942, as amended. The authorization may be given by the Administrator or by any official of the Office of Price Administration having authority to act upon the pending request for a change in price, or to give the authorization. The authorization will be given by order.

NOTE: All reporting and record-keeping requirements of this regulation have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

This regulation shall be effective November 3, 1943.

Issued this 30th day of October 1943.

GEORGE J. BURKE,
Acting Administrator.

Approved: October 29, 1943.

MARVIN JONES,
War Food Administrator.

[F. R. Doc. 43-17618; Filed, October 30, 1943; 4:30 p. m.]

PART 1305—ADMINISTRATION

[Gen. RO 6[1]]

WAR RATION BOOK TWO: ORDER OF REVOCATION

General Ration Order No. 6 (§ 1305.41) is hereby revoked except that any penalties or liabilities incurred or any violations which occurred or rights which arose before the effective date of this revocation order shall be governed by General Ration Order No. 6 and its amendments in effect at the time the penalties or liabilities were incurred, the violations occurred, or the rights arose, and General Ration Order No. 6 shall be treated as still remaining in force for the purpose of allowing or sustaining any proper action or prosecution with respect to such penalties, liabilities or violations, and for the purpose of requiring full performance of all acts required to be performed by any administrative exception order issued under General Ration Order No. 6.

Effective date. This order of revocation shall become effective November 1, 1943.

(Pub. Law 671, 76th Cong. as amended by Pub. Laws 89, 421, 507 and 729, 77th Cong.; E.O. 9125, 7 F.R. 2719; E.O. 9334, 8 F.R. 5423; WPB Dir. 1, 7 F.R. 562; Sec. of Agr. Food Dir. 3, 8 F.R. 2005, Food Dir. 5, 8 F.R. 2251, Food Dir. 6, 8 F.R. 3471, Food Dir. 7, 8 F.R. 3471, Food Dir. 8, 8 F.R. 7093)

Issued this 1st day of November 1943.

GEORGE J. BURKE,
Acting Administrator.

[F. R. Doc. 43-17686; Filed, November 1, 1943; 4:58 p. m.]

PART 1315—RUBBER AND PRODUCTS AND MATERIALS OF WHICH RUBBER IS A COMPONENT

[MPR 119,[2] Amdt. 6]

ORIGINAL EQUIPMENT TIRES AND TUBES

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Section 1315.1451 (i) is amended by substituting in that paragraph the phrase "December 1, 1943" for "November 1, 1943".

This amendment shall become effective November 1, 1943.

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 2190, 7257, 12483.

[2] 7 F.R. 3509, 8936, 8948; 8 F.R. 3941, 7280, 8751, 10725.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17688; Filed, November 1, 1943; 4:56 p. m.]

PART 1315—RUBBER AND PRODUCTS AND MATERIALS OF WHICH RUBBER IS A COMPONENT

[MPR 300,[1] Amdt. 12]

MAXIMUM MANUFACTURERS' PRICES FOR RUBBER DRUG SUNDRIES

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith has been filed with the Division of the Federal Register.*

Maximum Price Regulation 300 is amended in the following respects:

1. In § 1315.1772 (b) the text preceding Table II is amended to read as follows:

(b) "Victory line rubber drug sundries" means the items listed in Table II manufactured after January 31, 1943, which can meet the minimum physical specifications set forth in that table, except as noted in (1) and (2) below.

(1) Consumer Grades I and II molded hot water bottles, fountain syringes and combination syringes which contain buna-S (GR-S) or butyl (GR-I) shall be considered victory line rubber drug sundries, but the requirements as to the minimum tensile strength, elongation and resistance to heat stipulated in Table II shall not apply.

(2) If they meet the requirements in (i) to (iii), the rubber drug sundry items listed in Table II other than those covered by (1) above, shall not be considered victory line rubber drug sundries when made in whole or in part of buna-S (GR-S) or butyl (GR-I), and their maximum prices shall be determined under paragraph (b) of § 1315.1754.

(i) They must be made to the same minimum wall thickness or gauge and in the same mold or to the same minimum dimensions as the natural rubber commodity produced on December 1, 1941 or on the first date prior thereto on which it was produced.

(ii) In the case of molded hot water bottles or syringes they shall not be made in a mold which has been reported to the Office of Price Administration for use on Consumer Grades I or II of the victory line without first securing written approval from the Office of Price Administration, Washington, D. C.

(iii) In the case of molded hot water bottles or syringes, they shall retain the same percent of the original tensile strength after 6 days in boiling water and 24 hours after removal as the item made of natural rubber on December 1, 1941, or the first date prior thereto on which it was produced, and the minimum tensile strength after such test shall not be less than 660 pounds per square inch.

2. In § 1315.1772 (b) footnote 2 to Table II is amended by adding the following sentences at the end thereof: In the case of Consumer Grades I or II hot water bottles or syringes made in whole or in part of buna-S (GR-S) or butyl (GR-I) the following minimum specification shall be substituted for the percentage in Table II: The tensile strength after boiling shall not be less than 500 pounds per square inch.

3. Section 1315.1772 (c) is amended to read as follows:

(c) If after January 31, 1943, a manufacturer produces a factory second or rubber drug sundry listed in Table II which does not meet the minimum specifications set forth in paragraph (b) for victory line sundries, the maximum price for that rubber drug sundry shall be 75 percent of the price in Table I for a sale of the same type of rubber drug sundry to the same class of purchasers.

This amendment shall become effective November 6, 1943.

[1] 8 F.R. 9203, 11251, 13173.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of November 1943.

GEORGE J. BURKE,
Acting Administrator.

[F. R. Doc. 43-17687; Filed, November 1, 1943; 4:56 p. m.]

PART 1315—RUBBER AND PRODUCTS AND MATERIALS OF WHICH RUBBER IS A COMPONENT

[MPR 415,[1] Amdt. 3]

CERTAIN FEDERAL GOVERNMENT PURCHASES OF NEW RUBBER TIRES AND TUBES

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Section 1 (a) is amended by substituting in that paragraph the phrase "December 1, 1943" for "November 1, 1943".

This amendment shall become effective November 1, 1943.

(56 Stat. 23,765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17689; Filed, November 1, 1943; 4:55 p. m.]

PART 1328—HARDWOOD LUMBER

[MPR 146,[2] Amdt. 14]

APPALACHIAN HARDWOOD LUMBER

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Maximum Price Regulation No. 146 is amended in the following respects:

In § 1382.11 (b) subparagraph (24) is redesignated (27), and new subparagraphs (24), (25), and (26) are added to read as follows:

[1] 8 F.R. 8923, 10558, 10725.

[2] 7 F.R. 3776, 4179, 4852, 5520, 6053, 6998, 7600, 7747, 8198, 8350, 8384, 8948; 8 F.R. 3056, 5479, 9998.

(24) Mixed Hardwoods No. 1 Dimension

Thickness and width (inches)	Lengths (feet)										
	4	6	8	9	10	12	14	16	18	20	22 and 24
2 x 2	$27.50	$27.50	$34.50	$35.50	$34.50	$34.50	$35.50	$36.50	$38.00	$39.00	$44.50
2 x 3	26.50	26.50	33.50	34.50	33.50	33.50	34.50	35.50	37.00	38.00	43.50
2 x 4	25.50	25.50	32.50	33.50	32.50	32.50	33.50	34.50	36.00	37.00	42.50
2 x 5	29.00	29.00	36.00	38.50	37.50	37.50	37.50	38.50	42.00	44.00	48.50
2 x 6	25.50	25.50	32.50	33.50	32.50	32.50	33.50	34.00	36.00	37.00	42.50
2 x 8	25.50	25.50	32.50	33.50	32.50	32.50	33.50	34.00	36.00	37.00	42.50
2 x 10	29.00	29.00	36.00	38.50	37.50	37.50	37.50	38.50	42.00	44.00	48.50
2 x 12	31.00	31.00	38.00	40.50	39.50	39.50	39.50	40.50	44.00	46.00	50.50

(25) Mixed Hardwoods No. 2 Dimension

Thickness and width (inches)	Lengths (feet)										
	4	6	8	9	10	12	14	16	18	20	22 and 24
2 x 2	$25.50	$25.50	$31.50	$32.50	$31.50	$31.50	$32.50	$33.50	$35.00	$36.00	$41.50
2 x 3	24.50	24.50	30.50	31.50	30.50	30.50	31.50	32.50	34.00	35.00	40.50
2 x 4	23.50	23.50	29.50	30.50	29.50	29.50	30.50	31.50	33.00	34.00	39.50
2 x 5	24.00	24.00	30.00	34.00	33.00	32.00	32.00	32.00	35.50	37.50	43.00
2 x 6	22.50	22.50	28.50	29.50	28.50	28.50	29.50	30.00	32.00	33.00	38.50
2 x 8	22.50	22.50	28.50	29.50	28.50	28.50	29.50	30.00	32.00	33.00	38.50
2 x 10	24.00	24.00	30.00	34.00	33.00	32.00	32.00	32.00	35.50	37.50	43.00
2 x 12	26.00	26.00	32.00	34.00	33.00	33.00	33.00	34.00	37.50	38.50	44.00

(26) Mixed Hardwoods Industrial Blocking

	Mixed oak and hardwoods (per M'BM)
All sizes up to and including 6" x 7"	$29.00
All sizes 6" x 8" and larger	31.00
When purchaser specifies and seller furnishes stock shorter than 3', add	3.00

(27) FAS one face

This amendment shall become effective November 6, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of November 1943.

GEORGE J. BURKE,
Acting Administrator.

[F. R. Doc. 43-17690; Filed, November 1, 1943; 4:55 p. m.]

PART 1347—PAPER, PAPER PRODUCTS, RAW MATERIALS FOR PAPER AND PAPER PRODUCTS, PRINTING AND PUBLISHING

[MPR 449,[1] Amdt. 1]

GROUNDWOOD SPECIALTY PAPERS

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Appendix A is amended in the following respects:

1. In the table in paragraph (a):

a. The code for lightweight differentials for "B Printing supercalendered" is amended to read as "DLD."

b. The entire lines starting "Lt. Wt. Directory supercalendered" and "Lt. Wt. Catalog supercalendered" are deleted.

c. The code for lightweight differentials for "#1 Groundwood poster" and for "#2 Groundwood poster" is amended to read "HLD."

2. The first sentence in the second paragraph of (c) (2) is amended to read:

Lightweight differentials for any grade which is priced under paragraph (b) of this Appendix A shall be the customary lightweight differentials of the manufacturer during the period October 1, 1941 through March 31, 1942: *Provided,* That lightweight differentials for unlisted groundwood book papers superior to A-1 Printing shall be those stated herein under ALD, or, in case such paper be supercalendered, under BLD.

3. Under code listing "ALD" and under code listing "BLD" in paragraph (c) (2) the following is added:

Add 3% to selling price for each pound or fraction thereof below 31 pounds down to and including 28 pounds (25 x 38/500).
Add 4% to selling price for each pound or fraction thereof below 28 pounds down to and including 25 pounds (25 x 38/500).
Add 6% to selling price for each pound or fraction thereof below 25 pounds down to and including 22 pounds (25 x 38/500).

4. Paragraph (c) (7) is amended to read as follows:

(7) *Supercalendering.* There may be added $.25 in weight 25 x 38-31/500, or the equivalent, and heavier, and $.50 in lighter weights, when this operation is performed on a grade not already priced in paragraph (a) as supercalendered.

5. Paragraph (c) (11) (iii) is amended to read as follows:

(iii) 2,000 pounds to 4,999 pounds ..... $.50

6. Paragraph (c) (12) is amended to read:

(12) *Trim loss differential.* The trim loss differential upon sales of less than minimum acceptable trim shall be $.035 per hundred pounds per inch, or major fraction of an inch, of trim loss.

7. In paragraph (c) (14) the item "Cloud pattern" is added to the list of operations.

This amendment shall become effective November 1, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of November 1943.

GEORGE J. BURKE,
Acting Administrator.

[F. R. Doc. 43-17693; Filed, November 1, 1943; 4:56 p. m.]

PART 1351—FOOD AND FOOD PRODUCTS

[MPR 262,[1] Amdt. 11]

SEASONAL AND MISCELLANEOUS FOOD COMMODITIES

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Maximum Price Regulation No. 262 is amended in the following respects:

1. Section 1351.955c is added to read as follows:

§ 1351.955c *Maximum prices for producers of mincemeat.* (a) Any producer who figured a maximum price for an item of mincemeat under this regulation prior to November 1, 1943 may refigure his maximum price. Each producer who refigures, and any producer who figures his maximum price for an item of mincemeat under this regulation for the first time on or after the above date, shall calculate and report the new maximum price as though mincemeat were being included in this regulation by amendment for the first time on that date, but subject in each case to the additional limitations and requirements of this section. Until he reports his new maximum price (within thirty days after November 1, 1943, pursuant to § 1351.959a) a producer who refigures may not sell the item at a price in excess of his maximum price for it prior to refiguring.

(b) In ascertaining the actual or estimated cost to him of ingredients and packaging materials per unit of the item of mincemeat being priced, pursuant to § 1351.954 (a), each producer who refigures or who figures his maximum price under this regulation for the first time on or after November 1, 1943, shall calculate and include the weighted average cost delivered to his customary receiving point of the fresh apples actually used in the item (after conversion to cents per unit of the finished product). "Weighted average cost delivered to his customary point" means the total amount paid or contracted to be paid, including all charges for delivery to the producer's customary receiving point, divided by the total number of pounds purchased or contracted for between July 1, 1943 and the date of calculation under this section. In no event, however, shall

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 11515.

[1] 7 F.R. 9244, 10844; 8 F.R. 262, 273, 437, 973, 2285, 5164, 9201, 10568, 11040, 11447.

this weighted average cost delivered to his customary receiving point exceed $3.10 per one hundred pounds raw weight. The provisions of § 1351.954 (a) (3) covering computation of cost of fresh apples shall not apply to maximum prices for mincemeat refigured under this section or figured under this regulation for the first time on or after November 1, 1943.

(c) With the first delivery of the item after reporting the new maximum price, every producer who refigures his maximum price for an item of mincemeat shall supply each wholesaler and retailer who purchases from him with written notice as set forth below:

(Insert date)

NOTICE TO WHOLESALERS AND RETAILERS

Our OPA ceiling price for *(describe item by kind, grade, brand, container type and size)* has been changed by the Office of Price Administration. We are authorized to inform you that if you are a wholesaler or retailer pricing this item under Maximum Price Regulation No. 421, 422 or 423, you must refigure your ceiling price for the item on the first delivery of it to you from your customary type of supplier containing this notification. In refiguring you must follow the rules in section 6 of Maximum Price Regulation No. 421, 422 or 423, whichever is applicable to you.

For a period of 60 days after reporting the change in maximum price of the item, and with the first delivery to each wholesaler or retailer who has not made a purchase within that time, the producer shall include in each case or carton or supply with each other receptacle containing the item and shipped to a wholesaler or retailer the written notice set forth above, or securely attach it to the case, carton or other receptacle. However, for sales direct to any retailer the producer may supply the notice by attaching it to or writing it on the invoice covering the shipment instead of providing it with each case, carton or other receptacle.

The terms "wholesalers" and "retailers" mean the persons respectively referred to as "wholesalers" and "retailers" in Maximum Price Regulations Nos. 421,[3] 422[4] and 423.[4]

2. Section 1351.956a is amended to read as follows:

§ 1351.956a *Adjustable pricing.* Any person may agree to sell at a price which can be increased up to the maximum price in effect at the time of delivery; but no person may, unless authorized by the Office of Price Administration, deliver or agree to deliver at prices to be adjusted upward in accordance with action taken by the Office of Price Administration after delivery. Such authorization may be given when a request for a change in the applicable maximum price is pending, but only if the authorization is necessary to promote distribution or production and if it will not interfere with the purposes of the Emergency Price Control Act of 1942, as amended. The authorization may be given by the Price Administrator or by any official of the Office of Price Administration having authority to act upon the pending request for a change in price or to give the authorization. The authorization will be given by order.

3. Section 1351.957 is amended by deleting the phrase "or potato chips" wherever that phrase appears.

This amendment shall become effective November 1, 1943.

NOTE: All reporting requirements of this amendment have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of November 1943.

GEORGE J. BURKE,
Acting Administrator.

[F. R. Doc. 43-17694; Filed, November 1, 1943; 4:57 p. m.]

PART 1364—FRESH, CURED AND CANNED MEAT AND FISH PRODUCTS

[MPR 439,[1] Amdt. 5]

FRESH FISH AND SEAFOOD AT RETAIL

A statement of the considerations involved in the issuance of this amendment has been issued simultaneously herewith and filed with the Division of the Federal Register.*

Maximum Price Regulation 439 is amended in the following respects:

1. Section 2 (a) is amended by adding the following item:

56. Lake herring (Leucichthys artedi).

2. Section 4 is amended by inserting after the sentence ending with the words "supplier's ceiling price." the following sentence:

To compute the maximum selling price for fresh fish or seafood of any species listed in section 2 which the retailer bought outside of the United States or Alaska or which were delivered to him from outside the United States or Alaska, the retailer shall use as his "net delivered cost" whichever of the following is lower: (1) The "net delivered cost" as computed above or (2) the maximum price for the sale of such fresh fish or seafood by a primary fish shipper wholesaler as listed in Maximum Price Regulation No. 418, Article IV, section 20, Table B, plus the container price as listed in Maximum Price Regulation No. 418, Article IV, section 19, where a container, as there defined, is used, plus all transportation charges.

This amendment shall become effective November 6, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of November 1943.

GEORGE J. BURKE,
Acting Administrator.

[F. R. Doc. 43-17691; Filed, November 1, 1943; 4:58 p. m.]

PART 1439—UNPROCESSED AGRICULTURAL COMMODITIES

[MPR 487]

SOFT WHEAT

In the judgment of the Price Administrator, it is necessary and proper, in order to effectuate the purposes of the Emergency Price Control Act of 1942, as amended, and Executive Orders 9250 and 9328, to establish maximum prices for soft wheat in certain states.

Such specifications and standards as are used in this regulation were, prior to such use, in general use in the trade or industry affected and have previously been promulgated and their use lawfully required by another Government agency.

The maximum prices established by this regulation are, in the judgment of the Price Administrator, generally fair and equitable, meet all legal limitations and will effectuate the purposes of the Emergency Price Control Act of 1942, as amended, and Executive Orders 9250 and 9328. A statement of the considerations involved in the issuance of this regulation has been issued simultaneously herewith and filed with the Division of the Federal Register.*

§ 1439.353 *Maximum prices for soft wheat.* Under the authority vested in the Price Administrator by the Emergency Price Control Act of 1942, as amended, and Executive Orders 9250 and 9328, Maximum Price Regulation 487 (Soft Wheat), which is annexed hereto and made a part hereof, is hereby issued.

AUTHORITY: § 1439.353 issued under 56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681.

MAXIMUM PRICE REGULATION 487—SOFT WHEAT

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[3] 8 F.R. 9388, 10569, 10987, 13293.
[4] 8 F.R. 9395, 10569, 10987, 12443, 12611, 13294.
[4] 8 F.R. 9407, 10570, 10988, 12443, 12611, 13294.

*Copies may be obtained from the Office of Price Administration.

[1] 8 F.R. 10267, 10732, 11686, 12693, 13920.

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Section 1. *Applicability.* (a) Except as provided in paragraphs (b) and (c) hereof this regulation shall apply to all sales and deliveries, whether for immediate or future delivery, of soft wheat in the District of Columbia and the following states: Texas, Oklahoma, Kansas, Nebraska, Iowa, Wisconsin, Missouri, Arkansas, Louisiana, Illinois, and all states east of Illinois and east of the Mississippi River south of Cairo, Illinois.

(b) This regulation shall not apply to contracts for the sale of soft wheat executed prior to the effective date hereof provided delivery is made within 30 days of the effective date of this regulation.

(c) This regulation shall not apply to sales of soft wheat for seed.

SEC. 2. *Effect of maximum prices.* (a) While this regulation is in effect, regardless of any contract or obligation except as provided in section 1 (b) and (c) hereof, no person shall in the course of trade or business sell, deliver, buy or receive soft wheat at prices above the maximum prices established by this regulation nor shall any person agree, offer, solicit or attempt to do any of the foregoing.

(b) However, prices lower than the maximum prices established by this regulation may be charged and paid.

SEC. 3. *Definitions.* "Soft wheat" means wheat of the subclasses Red Winter and Western Red of the class Soft Red winter wheat and wheat of the subclasses Soft White, White Club, and Western White of the class White Wheat as defined in the Official Grain Standards of the United States for wheat.

The term "mixed wheat" means a mixture in which wheat of the above-named subclasses predominates.

"Area A" includes the following states:

Texas, Oklahoma, Kansas, Nebraska, Iowa, Missouri, Illinois, Indiana, Wisconsin, Arkansas, Michigan, Ohio, Kentucky, Tennessee, Pennsylvania, New York, District of Columbia and Maryland (except the Eastern shore south of a line drawn east and west through Chesapeake City).

"Area B" includes the following states:

The New England States, New Jersey, Delaware, Virginia, West Virginia and Eastern shore of Maryland (south of a line drawn east and west through Chesapeake City).

"Area C" includes the following states:

North Carolina, South Carolina, Georgia, Florida, Alabama, Mississippi and Louisiana (that portion lying within the territory to which rates are determined by Mississippi Valley Grain Tariff No. 133 Series).

"Area D" includes the following state:

Louisiana (except that portion lying within the territory to which rates are determined by Mississippi Valley Grain Tariff No. 133 Series).

"Bushel" as a unit of measurement of wheat means 60 pounds of wheat net weight.

"On track" refers to wheat loaded in a railroad car.

"Person" means an individual, corporation, partnership, association, or other organized group of persons or the legal successor or representative of any of the foregoing; and includes the United States or any other government or any political subdivision or agency of any of the foregoing.

"Commission merchant" is a person who arranges for the inspection and weighing of soft wheat at any of the following cities and who negotiates the first sale thereof on an organized grain exchange in one of said cities, to wit:

Chicago, Illinois; Peoria, Illinois; Kansas City, Missouri; St. Joseph, Missouri; St. Louis, Missouri; Indianapolis, Indiana; Omaha, Nebraska; Milwaukee, Wisconsin; Dallas, Texas; Fort Worth, Texas; Enid, Oklahoma; Sioux City, Iowa; Hutchinson, Kansas; Salina, Kansas; Wichita, Kansas; Buffalo, New York; Baltimore, Maryland, and Philadelphia, Pennsylvania.

"Broker" is a person who as agent of the seller or buyer (but not of both) negotiates the sale or purchase of soft wheat on a commission basis.

"Ultimate user" includes processor, feeder, or other consumer of soft wheat.

"Merchandiser" is a person, other than a producer or a country shipper except to the extent permitted by section 11 hereof.

"Carload quantity" means any lot of soft wheat weighing 60,000 pounds or more.

"Less than carload quantity" means any lot of soft wheat weighing less than 60,000 pounds.

"Transportation charges" shall be computed at: (1) The lowest common carrier rate (including the 3 percent tax provided for in section 620 of the Revenue Act of 1942) for the billing or shipment in question; or (2) if there is no such rate, the reasonable value of the service, not exceeding any maximum price thereon.

"Country shipper" is a person having facilities such as an elevator or warehouse at any interior point for the storage or marketing of soft wheat purchased from adjacent producers. He may also be a merchandiser to the extent permitted by section 11 hereof.

"Interior point" is any place outside the corporate and railroad switching limits of any terminal city.

"Interior rail point" is any interior point having facilities for the loading or unloading of railroad freight cars.

"Terminal city" refers to any place within the corporate or railroad switching limits of the cities hereinafter so designated.

"Terminal and subterminal elevators or warehouses" refer to those elevators or warehouses which receive the greater portion of the grain elevated through the same by rail or water shipments in carload quantities.

"Handling" means unloading of soft wheat into a terminal or subterminal elevator or warehouse and loading it out again.

"Feeder" is a person who buys soft wheat to feed to his own livestock.

SEC. 4. *Meaning of sale at a designated point.* (a) This regulation in speaking of sales or purchases at a given terminal city or interior point means that the purchaser shall receive manual delivery of the soft wheat in question at that terminal city or interior point. If the soft wheat in question is physically located at said terminal city or interior point at the time of sale, and there delivered to said purchaser (sometimes referred to as a sale f. o. b. or in store said terminal city or interior point), the purchaser may thereafter arrange and pay (in addition to the maximum price for the soft wheat at said terminal city or interior point) for its transportation elsewhere; and the purchaser may engage the seller as his agent to procure such transportation. If the soft wheat in question is not physically located at said terminal city or interior point at the time of the sale, then manual delivery to the purchaser must be made at said terminal city or interior point; and:

(1) If the buyer pays the seller the full maximum price, the seller must pay all said transportation or other charges required to effectuate such a delivery to said purchaser at said terminal city or interior point; or:

(2) If the buyer pays any part of the transportation or other charges required to effectuate such delivery all said transportation or other charges so paid by the buyer must be deducted from the said maximum price to determine the amount the seller may actually receive in such a case.

SEC. 5. *Transfers between distinct branches of a business performing several marketing operations.* (a) This regulation in speaking of a sale or purchase by a given person includes, in the case of a business performing several marketing operations, transfers without passage of title or payment of consideration, between distinct branches or units of such business comprising separate and segregated levels of marketing. Thus, by way of illustration only, a country shipper acting in that capacity may sell soft wheat grown by him at the maximum price established for country shippers; or a merchandiser acting through different units of such business may receive more than one markup under section 14 hereof as hereinafter provided, to cite only a few instances.

(b) However, where a seller makes a sale at the maximum price for a given class of seller, where he would also qualify to make a sale to a like purchaser at a lower maximum price as a different class of seller, the burden shall always rest upon him to establish by clear evidence that said sale was in the regular course of his conduct of a distinct and segregated branch or unit of his entire business and that said branch performs like services and functions as independents perform, who belong to that class of seller. Further, for the purposes of this regulation, only one each of the following branches or units shall be recognized in any single business performing several marketing operations; producer branch, country shipper branch, commission merchant branch and/or merchandiser branch; *Provided:*

1. If the commission merchant branch has taken a markup hereunder, no fur-

ther markups shall be permitted for a merchandiser branch; and

(2) In no event shall the markups of the merchandiser branch exceed a total of:

(i) Two carload markups as set forth in section 14 (a) or (b); and

(ii) One l. c. l. markup as set forth in in section 14 (a); or

(iii) One l. c. l. markup as set forth in section 14 (b).

SEC. 6. *Maximum prices at terminal cities.* (a) The maximum prices for No. 1 soft wheat of any class, per bushel, in carload quantities, bulk, with transit billing annexed to the lot sold, at the following terminal cities shall be as follows:

	Cents per bushel
Chicago, Illinois	164½
Milwaukee, Wisconsin	164½
St. Louis, Missouri	164½
Lower Missouri River markets (Kansas City, St. Joseph, Leavenworth, Atchison)	159½
Evansville, Indiana	166⅜
Cincinnati, Ohio	168¼
Louisville, Kentucky	168¼
Baltimore, Maryland	178¾
Philadelphia, Pennsylvania	179¼
New York City, New York	180½
Boston, Massachusetts	181¾
Memphis, Tenessee	168½
Atlanta, Georgia	186⅛
Galveston, Texas	176½

(b) The foregoing maximum prices shall be decreased for lower grades as follows:

	Cents per bushel
No. 2	1
No. 3	2
No. 4	3
No. 5	4½
Sample (other than moisture)	3
Mixed wheat	4
Light smutty	1
Smutty	3
Light garlicky	1
Garlicky	3
Weevily	1
Ergoty	5
Treated	2
Moisture: discount for each ½% or fraction thereof over 14%	1

These discounts are cumulative. For example, wheat grading "No. 2 garlicky" is subject to a discount of at least 1 cent for grading No. 2 plus a further discount of at least 3 cents for grading "garlicky", or a minimum total discount of 4 cents per bushel.

(c) The foregoing maximum prices shall be decreased 6 cents per bushel for a sale in any said terminal city without transit billing annexed to the lot sold.

SEC. 7. *Maximum prices at interior rail points.* (a) The maximum price for any soft wheat, per bushel, in carload quantities, bulk, on track, at any interior rail point in Area A shall be that maximum price specified in section 6 (a) or (b) hereof which less transportation charges at the lowest published domestic carload rail transportation rate from that interior rail point to any terminal city will result in the highest price at said interior rail point, plus, if the wheat sold at said interior rail point is accompanied by transit billing useable beyond said interior rail point, the value of the transit billing. This value shall be calculated at the difference between the amount of the transportation charges deducted from the appropriate terminal city's maximum price in calculating a maximum price for said interior rail point as above provided and the rail transportation charges payable on the transit billing for a movement of wheat from said interior rail point to said terminal city.

(b) The maximum price for any soft wheat, per bushel, in carload quantities, bulk, at any interior rail point in Area B shall be the maximum price thereof at Chicago, Illinois as specified in section 6 (a) or (b) hereof plus the charge at the lowest carload domestic proportional railroad rate from Chicago, Illinois to that interior rail point in Area B.

(c) The maximum price for any soft wheat, per bushel, in carload quantities, bulk, at any interior rail point in Area C shall be the maximum price thereof at St. Louis, Missouri as specified in section 6 (a) or (b) hereof plus the charge at the lowest carload domestic proportional railroad rate from St. Louis, Missouri to that interior rail point in Area C.

(d) The maximum price for any soft wheat, per bushel, in carload quantities, bulk, at any interior rail point in Area D shall be the maximum price thereof at Kansas City, Missouri, as specified in section 6 (a) or (b) hereof plus the charge at the lowest carload domestic proportional railroad rate from Kansas City, Missouri to that interior rail point in Area D.

SEC. 8. *Maximum prices at interior non-rail points.* (a) The maximum price for any soft wheat, bulk, in any quantity, at any interior non-rail point in Area A shall be the maximum price set forth in section 6 or 7 hereof at the rail point (either interior rail point or terminal city as the case may be) nearest thereto by the most usually travelled route, less transportation charges from said interior non-rail point to said rail point.

(b) The maximum price for any soft wheat per bushel, bulk, in any quantity at an interior non-rail point in Areas B, C and D shall be the maximum price thereof at the rail point nearest thereto by the most usually travelled route.

SEC. 9. *Who may sell under sections 6, 7 and 8 above.* No person may sell any soft wheat under section 6, 7 or 8 above save as and in the manner hereinafter expressly provided.

SEC. 10. *Maximum prices of producers.* (a) The maximum price for any sale of soft wheat, bulk, not on track, in any quantity, by the producer as to wheat grown by him (or by any farmer of wheat secured from its producer) shall be the maximum price specified in sections 6, 7 or 8 at the interior point or terminal city where delivered to the purchaser, less 3 cents per bushel.

(b) This section prescribes the exclusive mode of sale of any soft wheat by a producer (or by any farmer of soft wheat secured from its producer) save that he may sell, on track, bulk, in carload quantities at any terminal city or interior point at a like maximum price as if by a country shipper under section 11 (a) hereof.

SEC. 11. *Maximum prices of country shippers.* (a) The maximum price for the sale by a country shipper of any soft wheat purchased by him from a producer (or from any farmer of soft wheat secured from its producer) bulk, on track, in carload quantities, at any terminal city or interior rail point shall be the maximum price specified for such a sale in sections 6 or 7 hereof at that terminal city or interior rail point where sold and delivered to the purchaser.

(b) The maximum price for the sale by a country shipper of any soft wheat purchased by him from a producer (or from any farmer of soft wheat secured from its producer) bulk, in store, in carload quantities, at any terminal city or interior rail point shall be the maximum price specified in paragraph (a) of this section less the charges payable to place such soft wheat on track at the point of sale.

(c) The maximum price for the sale or delivery by a country shipper of any soft wheat in any case not provided for in paragraphs (a) and (b) of this section, shall be the maximum price for a like sale by a merchandiser as provided in section 14 hereof.

(d) This section prescribes the exclusive modes of sale of any soft wheat by a country shipper.

SEC. 12. *Maximum service charge of commission merchants.* (a) Notwithstanding any other law or regulation, the maximum service charge for the services of a commission merchant in connection with any sale of any soft wheat shall be 1½ cents per bushel. This service charge shall be in addition to the appropriate maximum price of the soft wheat so sold.

(b) Every seller who paid any service charge under this section may add the same in computing his maximum prices for any sale.

SEC. 13. *Maximum service charge of brokers.* (a) Notwithstanding any other law or regulation, the maximum service charges for the services of a broker in connection with any sale or purchase of any soft wheat shall be ¼ cent per bushel. This service charge shall be in addition to the appropriate maximum price of the soft wheat so sold or purchased.

(b) No seller who paid a brokerage hereunder may add said brokerage in computing his maximum price for any sale.

SEC. 14. *Maximum prices of merchandisers.* (a) The maximum price for the sale of any soft wheat by any merchandiser to any person other than a feeder shall be calculated by adding one of the following markups to the merchandiser's basic maximum price calculated under paragraph (c) of this section:

(1) 1½¢ per bushel for sales in carload quantities.

(2) 3¢ per bushel for sales in less than carload quantities.

(b) The maximum price for the sale of any soft wheat by any merchandiser to a feeder shall be calculated by adding one of the following maximum markups to the merchandiser's basic maximum price calculated under paragraph (c) of this section:

(1) 1½¢ per bushel for sales in carload quantities.

(2) 3¢ per bushel for sales in less than carload quantities of 150 bushels or more.

(3) 8¢ per bushel for sales of less than 150 bushels.

(c) The merchandiser's basic maximum price above referred to shall be calculated as follows:

(1) For a sale in carload quantities, the maximum price specified in sections 6, 7 or 8 hereof, at that terminal city or interior point where sold and delivered to the purchaser plus all permitted charges and increases previously added thereto under other sections hereof and plus all permitted markups previously added thereto under this Section; and

(2) For a sale in less than carload quantity, the maximum price specified in subparagraph (1) of this paragraph (c), or the maximum price specified in sections 6, 7 or 8 hereof, at the terminal city or interior point where such seller purchased the wheat in question, plus: (i) all permitted charges and increases previously added thereto under other sections hereof; (ii) all permitted markups previously added thereto under this section; and (iii) transportation charges actually incurred by the seller from said terminal city or interior point at which he purchased the same to the point where delivered to the buyer.

(d) Irrespective of the number of merchandisers or commission merchants who may have handled the soft wheat in question, the maximum price to the ultimate user otherwise established hereunder shall not be increased by the addition of markups under this section (or under sections 11 (b) or 12 hereof) to a greater extent than:

(1) 4½¢ per bushel if the ultimate user purchases in carload quantities.

(2) 7½¢ per bushel if the ultimate user is not a feeder and purchases in less than carload quantities.

(3) 7½¢ per bushel if the ultimate user is a feeder and purchases in less than carload quantities of 150 bushels or more.

(4) 17½¢ per bushel if the ultimate user is a feeder and purchases quantities of less than 150 bushels.

SEC. 15. *Increases for handling.* (a) Where any soft wheat has been handled by the seller through a terminal or subterminal elevator or warehouse, the appropriate maximum price of said seller above set forth may be increased by 1¢ per bushel.

(b) This section shall have no application to any soft wheat purchased by said seller from a producer at the terminal city or interior rail point where said terminal or subterminal elevator or warehouse is located; and no increase for handling shall be permissible in such case.

(c) Furthermore, irrespective of the number of such handlings of the soft wheat in question the maximum price to an ultimate user, as otherwise established hereunder, shall not be increased by additions under this section of more than 2¢ per bushel.

SEC. 16. *Increases for sacks and sacking.* (a) Where any seller sells soft wheat sacked and furnishes both the sacks and sacking, the foregoing maximum prices for a like sale in bulk may be increased by the reasonable value (not exceeding any maximum price established thereon) of the sacks, plus, except where the seller is the producer, 3¢ per bushel for the sacking.

(b) Where any seller other than a producer sells soft wheat sacked after furnishing the service of sacking (but not the sacks, which the buyer has supplied) the foregoing maximum prices for a like sale in bulk may be increased by 3¢ per bushel for the sacking service.

SEC. 17. *Increases for carrying charges.* (a) Notwithstanding any provision of this or any other law or regulation, any seller of soft wheat may, in addition to the appropriate maximum price of the soft wheat sold, charge and receive from the buyer, a maximum carrying charge of 1/25 of a cent per bushel per day for the time elapsing between:

(1) The date of the expiration of free time under the contract of sale; and

(2) A date five days subsequent to the date of shipment specified by the buyer in shipping instructions furnished the seller or the date on which shipment is actually made, whichever is earlier.

(b) For any resale, the maximum price of the seller shall not be increased for any such carrying charges previously paid by him in connection with his purchase of the soft wheat in question.

SEC. 18. *Sales by the Commodity Credit Corporation.* (a) Notwithstanding any other provision of this regulation the Commodity Credit Corporation may sell soft wheat at a maximum price no higher than 10 percent above the lowest prices at which said Corporation is permitted to sell under that certain act of Congress designated Pub. Law 129, 78th Congress, including any amendments.

(b) This section shall have no application to any resale of any soft wheat purchased from the Commodity Credit Corporation.

SEC. 19. *Documents and reports.* (a) Every person subject to this regulation making a sale or purchase of soft wheat in the course of trade or business on or after the effective date of this regulation shall keep for inspection by the Office of Price Administration for so long as the Emergency Price Control Act of 1942, as amended, remains in effect, complete and accurate records of such sales and purchases including the date thereof, name of the seller and purchaser, price paid or received, buyer's receiving point and the quantity of soft wheat sold or purchased: *Provided,* That producers and sellers of quantities of 100 bushels or less need keep only such records as they customarily kept as of the effective date of this regulation.[1]

(b) Persons affected by this regulation shall submit such records to the Office of Price Administration as it may from time to time require.[2]

[1] The record keeping provisions of this regulation have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

[2] Subject to the approval of the Bureau of the Budget pursuant to the Federal Reports Act of 1942.

SEC. 20. *Evasive practices.* The price limitations set forth in this regulation shall not be evaded, whether by direct or indirect methods, in connection with any offer, solicitation, agreement, sale, delivery, purchase, or receipt of or relating to soft wheat, alone or in conjunction with any other commodity, or by way of commission, service, transportation, or other charge, or discount, premium, or other privilege, or by tying agreement, or other trade understanding or by any other means.

SEC. 21. *Enforcement.* Persons violating any provision of this regulation are subject to the criminal penalties, civil enforcement actions, and suits for treble damages, and proceedings for suspension of licenses, provided for by the Emergency Price Control Act of 1942, as amended. Persons having evidence of any violation of this regulation are urged to communicate with the nearest field, state, or regional office of the Office of Price Administration, or with the principal office in Washington, D. C.

SEC. 22. *Licensing.* The provisions of Licensing Order No. 1[3] licensing all persons who make sales under price control are applicable to all sellers subject to this regulation. A seller's license may be suspended for violations of the license or of one or more applicable price schedules or regulations. A person whose license is suspended may not, during the period of suspension, make any sale for which his license has been suspended. These provisions do not apply to any producer selling wheat produced by him.

SEC. 23. *Adjustable pricing.* Any person may agree to sell at a price which can be increased up to the maximum price in effect at the time of delivery; but no person may, unless authorized by the Office of Price Administration, deliver or agree to deliver at prices to be adjusted upward in accordance with action taken by the Office of Price Administration after delivery. Such authorization may be given when a request for a change in the applicable maximum price is pending; but only if the authorization is necessary to promote distribution or production and if it will not interfere with the purposes of the Emergency Price Control Act of 1942, as amended. The authorization may be given by the Administrator or by any official of the Office of Price Administration to whom the authority to grant such authorization has been delegated. The authorization will be given by order, except that it may be given by letter or telegram when the contemplated revision will be the granting of an individual application for adjustment.

SEC. 24. *Maximum prices for export sales.* The maximum prices for export sales shall be determined in accordance with the provisions of the Second Revised Maximum Export Price Regulation[4] issued by the Office of Price Administration.

SEC. 25. *Petitions for amendment.* Any person seeking a modification of any pro-

[3] 8 F.R. 13240.

[4] 8 F.R. 4132, 7662, 5967, 9998.

vision of this regulation may file a petition for amendment in accordance with the provisions of Revised Procedural Regulation No. 1 [1] issued by the office of Price Administration.

This regulation shall become effective November 6, 1943.

Issued this 1st day of November 1943.

CHESTER BOWLES,
Acting Administrator.

Approved:

MARVIN JONES,
War Food Administrator.

[F. R. Doc. 43-17692; Filed, November 1, 1943; 4:57 p. m.]

PART 1448—EATING AND DRINKING ESTABLISHMENTS

[Restaurant MPR 5-4, Amdt. 1]

FOOD AND DRINK SOLD FOR IMMEDIATE CONSUMPTION IN DALLAS REGION, TEX.

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Section 23 of Maximum Price Regulation No. 5-4 is amended to read as follows:

SEC. 23. *Licensing.* The provisions of Licensing Order No. 1, licensing all persons who make sales under price control, are applicable to all sellers subject to this regulation or schedule. A seller's license may be suspended for violations of the license or of one or more applicable price schedules or regulations. A person whose license is suspended may not, during the period of suspension, make any sale for which his license has been suspended.

This amendment shall become effective October 14, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871 and E.O. 9328, 8 F.R. 4681)

Issued at Dallas, Texas, this 14th day of October 1943.

GUS W. THOMASSON,
District Director.

[F. R. Doc. 43-17696; Filed, November 1, 1943; 4:58 p. m.]

PART 1499—COMMODITIES AND SERVICES

[MPR 165, as Amended,[2] Amdt. 33]

SERVICES; HAWAII

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Section 1499.101 (c) (71) is added to read as follows:

(71) Any service rendered or supplied in the Territory of Hawaii in connection with the processing, distribution, storage, installation, repair or negotiation of purchase or sale of commodity and generally, without limiting the foregoing, all services which preserve or add to the value or utility of the commodity.

This amendment shall become effective as of October 1, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871, E.O. 9328, 8 F.R. 4681)

Issued this 1st day of November 1943.

GEORGE J. BURKE,
Acting Administrator.

[F. R. Doc. 43-17697; Filed, November 1, 1943; 4:58 p. m.]

PART 1499—COMMODITIES AND SERVICES

[Rev. SR 14 [1] to GMPR,[2] Amdt. 47]

"GENERAL MANAGER TYPE" GRAIN DOORS

A statement of the considerations involved in the issuance of this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Revised Supplementary Regulation 14 to the General Maximum Price Regulation is amended by revoking section 6.10 *"General manager type" grain doors.*

This amendment shall be effective as of 11:59 p. m., October 14, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of November 1943.

GEORGE J. BURKE,
Acting Administrator.

[F. R. Doc. 43-17699; Filed, November 1, 1943; 4:56 p. m.]

PART 1499—COMMODITIES AND SERVICES

[Rev. SR 14 to GMPR,[1] Amdt. 49]

CALCIUM CARBIDE

A statement of considerations involved in the issuance of this amendment issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Section 4.16 is added to read as follows:

SEC. 4.16 *Sales of calcium carbide by the Defense Supplies Corporation*—(a) *Maximum prices.* Maximum prices for sales and deliveries of calcium carbide are established as follows:

Grade and class of purchaser	Container	Quantity of shipment	Maximum price per ton
(1) Generator grades or mixed grades:			
(i) Industrial customers not receiving allocations.	100 lb. drums	LCL	$95.00, delivered warehouse cities.
(ii) Industrial customers receiving allocations.	100 lb. drums	LCL	$93.00, delivered warehouse cities.
	100 lb. drums	CL	$87.00, delivered purchaser's siding.
	All other containers	CL	$85.00, delivered purchaser's siding.
(iii) Shipyards			Appropriate price specified in (i) or (ii) less $1.00 per ton.
(iv) Acetylene plants	100 lb. drums	CL	$67.00, f. o. b. producing point.
	All other containers	CL	$65.00, f. o. b. producing point.
(v) Chemical plants allocated more than 50 tons per month.	100 lb. drums	CL	$67.00, f. o. b. producing point.
	250-400 lb. drums	CL	$55.00, f. o. b. producing point.
	600-1,100 lb. drums	CL	$53.00, f. o. b. producing point.
	5 ton bulk containers	CL	$50.00, f. o. b. producing point.
(2) Rice and 14ND			Appropriate price specified in (1) plus $7.00 per ton.
(3) Fines—all purchasers	All containers	CL	$55.00, f. o. b. producing point.

(b) *Exceptions.* Nothing in the General Maximum Price Regulation or any supplementary regulation thereto shall apply to sales and deliveries of calcium carbide by the Defense Supplies Corporation to: (1) The United States or any agency thereof or to the Government of any country whose defense the President deems vital to the defense of the United States under the terms of the Act of March 11, 1941, entitled "An Act to Promote the Defense of the United States," or any agency of any such government; nor (2) Persons (other than operators of shipyards) who will use the calcium carbide so purchased in the fulfillment of contracts with the United States or any agency thereof in which the price is determined on the basis of cost-plus-a-fee, except that, in the case of sales to persons who will use some but not all of the calcium carbide so purchased in fulfillment of such a contract, the Defense Supplies Corporation may charge for the entire amount so purchased a price other than that established by this section, making periodic settlement at the maximum prices established by this section with the buyer for that portion of the calcium carbide which the buyer satisfactorily demonstrates has not been used in the fulfillment of such contracts.

(c) *Definitions.* When used in this section, the term:

(1) "Generator grades" means calcium carbide in the sizes ¼ x ½ to and including 3½ x 2. It also includes the grade 2 x D.

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*Copies may be obtained from the Office of Price Administration.

[1] 7 F.R. 8961; 8 F.R. 3313, 3553, 6173, 11806.

[2] 7 F.R. 6428, 6966, 8239, 8431, 8798, 8943, 8948, 9197, 9342, 9343, 9785, 9971, 9972, 10480, 10619, 10718, 11010; 8 F.R. 1060, 3324, 4782, 5681, 5755, 5933, 6364, 8506, 8873, 10671, 10939, 11754, 12023, 12710, 13302, 13472.

[1] 8 F.R. 9787, 9880, 10432, 10566, 10433, 10668, 10731, 10759, 10763, 10939, 10674, 10984, 10758, 11174, 18182, 11247, 11215, 11479, 11572, 11754, 11873, 12325, 12406, 12739, 12550, 12633, 12557.

[2] 8 F.R. 3096, 3849, 4347, 4486, 4724, 4848, 4978, 6047, 6962, 8511, 9025, 9991, 11955, 13724.

[1] 8 F.R. 3096, 3849, 4347, 4486, 4724, 4978, 6047, 6962, 8511, 9025.

(2) "Rice", "14ND", and "Fines" have the meaning commonly given to these terms in the trade, except that "Fines" shall include the grade ¼ x D.

(3) "Warehouse cities", means those cities in the United States in which the Defense Supplies Corporation maintains warehouse stocks of calcium carbide.

(4) "Delivered warehouse cities" means that the price includes free delivery to customers located within such cities, and is f. o. b. warehouse for points outside of such cities.

This amendment shall become effective November 1, 1943.

(Pub. Laws 421 and 729, 77th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681; Pub. Law 151, 78th Cong.)

Issued this 1st day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17698; Filed, November 1, 1943; 4:58 p. m.]

PART 1394—RATIONING OF FUEL AND FUEL PRODUCTS

[RO 11,[1] Amdt. 88]

FUEL OIL RATIONING REGULATIONS

A rationale for this amendment has been issued simultaneously herewith and has been filed with the Division of the Federal Register.*

Ration Order No. 11 is amended in the following respects:

1. Section 1394.5653 (b) (1) is amended by inserting before the period at the end of the subparagraph the following clause, "or if the dealer or primary supplier knows or has reasonable cause to believe that at the time of the transfer the consumer has failed to surrender evidences (or delivery receipts) to any other transferor for a previous transfer of fuel oil and more than fifteen (15) days have elapsed since that surrender was required."

2. Section 1394.5655 (b) (5) (i) is amended by inserting before the period at the end of the subdivision the following clause, "or if the dealer or primary supplier knows or has reasonable cause to believe that at the time of the transfer the consumer has failed to surrender delivery receipts (or evidences) to any other transferor for a previous transfer of fuel oil and more than fifteen (15) days have elapsed since that surrender was required."

3. Section 1394.5689 (a) is amended by inserting before the period at the end of the paragraph the following clause, "of if the dealer or primary supplier knows or has reasonable cause to believe that at the time of the transfer the consumer has failed to surrender a ration check or other evidences (or delivery receipts) to any other transferor for a previous transfer of fuel oil and more than fifteen (15) days have elapsed since that surrender was required."

4. Section 1394.5707 (a) (4) is amended by inserting before the period at the end of the subparagraph the following clause, "or if the transferor knows or has reasonable cause to believe that at the time of the transfer the transferee has failed to surrender evidences to any other transferor for a previous transfer of fuel oil and more than fifteen (15) days have elasped since that surrender was required."

5. Section 1394.5725 is amended to read as follows:

§ 1394.5725 *Primary suppliers may explain losses or shortages.* (a) A primary supplier may submit with his OPA Form R-1119 an explanation for any unavoidable or unrecoverable losses or shortages of fuel oil, evidences or delivery receipts. The Washington Office may accept an explanation only for:

(1) Losses of fuel oil, evidences, or delivery receipts acquired by the applicant in accordance with this order.

(2) Other shortages of fuel oil, evidences, or delivery receipts acquired by the applicant in accordance with this order. If the fuel oil, evidences, or delivery receipts were transferred they must also have been transferred in accordance with this order.

(b) No acceptance by the Washington Office of an explanation of a loss or shortage shall operate as a waiver of any violations of this order.

6. Section 1394.5801 (k) is added as follows:

(k) No dealer or primary supplier shall transfer fuel oil to a person (other than an agency specified in § 1394.5454 (a)) who is required to surrender evidences for the transfer and no such person shall accept that transfer unless at the time of the transfer that person has on hand evidences or ration credits (excluding the gallonage value of any evidences not yet surrendered for previous transfers of fuel oil and excluding the amounts of ration checks issued which have not yet been cleared) equal in gallonage value to the fuel oil to be transferred.

This amendment shall become effective on November 1, 1943.

(Pub. Law 671, 76th Cong., as amended by Pub. Laws 89 and 507, 77th Cong., Pub. Law 421, 77th Cong.; WPB Directive No. 1, 7 F.R. 562; Supp. Directive No. 1-0, as amended, 7 F.R. 8416; E.O. 9125, 7 F.R. 2719)

Issued this 1st day of November 1943.

CHESTER BOWLES,
Acting Administrator.

[F. R. Doc. 43-17695; Filed, November 1, 1943; 4:55 p. m.]

*Copies may be obtained from the Office of Price Administration.

[1] 7 F.R. 8480.

TITLE 49—TRANSPORTATION AND RAILROADS

Chapter I—Interstate Commerce Commission

Subchapter A—General Rules and Regulations

[Service Order 137-A]

PART 95—CAR SERVICE

REROUTING OF MACHINERY

At a session of the Interstate Commerce Commission, Division 3, held at its office in Washington, D. C., on the 1st day of November, A. D. 1943.

Upon further consideration of the provisions of Service Order No. 137 of July 17, 1943, and good cause appearing therefor:

It is ordered, That Service Order No. 137, permitting the rerouting of three carloads of machinery to be moved from Newport News, Virginia, to the Grand Coulee Power Plant, Odair, Washington, is hereby vacated and set aside. (40 Stat 101, Sec. 402, 41 Stat. 476, Sec. 4, 54 Stat. 901; 49 U.S.C. 1 (10)-(17)).

It is further ordered, That this order shall become effective at 12:01 a. m., November 2, 1943; that a copy of this order and direction shall be served upon the Association of American Railroads, Car Service Division, as agent of the railroads subscribing to the car service and per diem agreement under the terms of that agreement; and that notice of this order be given to the general public by depositing a copy in the office of the Secretary of the Commission at Washington, D. C., and by filing it with the Director, Division of the Federal Register.

By the Commission, Division 3.

[SEAL] W. P. BARTEL,
Secretary.

[F. R. Doc. 43-17715; Filed, November 2, 1943; 10:49 a. m.]

[Service Order 162-A]

PART 95—CAR SERVICE

At a session of the Interstate Commerce Commission, Division 3, held at its office in Washington, D. C., on the 1st day of November, A. D. 1943.

Upon further consideration of the provisions of Service Order No. 162 (8 F.R. 14857) of October 29, 1943, and good cause appearing therefor: *It is ordered,* That:

Section 95.37 *Acceptance and movement of anthracite coal* of Service Order No. 162 (8 F.R. 14857) of October 29, 1943, is hereby vacated and set aside. (40 Stat. 101, sec. 402, 41 Stat. 476, sec. 4, 54 Stat. 901; 49 U.S.C. 1 (10)-(17).)

It is further ordered, That this order shall become effective at 12:01 p. m., November 1, 1943; that a copy of this order and direction shall be served upon

the Association of American Railroads, Car Service Division, as agent of the railroads subscribing to the car service and per diem agreement under the terms of that agreement; and that notice of this order be given to the general public by depositing a copy in the office of the Secretary of the Commission at Washington, D. C., and by filing it with the Director, Division of the Federal Register.

By the Commission, Diyision 3.

[SEAL] W. P. BARTEL, *Secretary.*

[F. R. Doc. 43-17714; Filed, November 2, 1943; 10:49 a. m.]

Chapter II—Office of Defense Transportation

[General Order ODT 29, Amdt. 1]

PART 501—CONSERVATION OF MOTOR EQUIPMENT

TAXICABS AND TAXI SERVICE IN PUERTO RICO

Pursuant to Executive Orders 8989, 9156, 9214, and 9294, § 501.194 of General Order ODT 29 (7 F.R. 11017) is hereby amended to read as follows:

§ 501.194 *Operating regulations.* (a) No person shall drive or operate a taxicab:

(1) For any purpose, including social or recreational purposes, personal to the driver or operator;

(2) For the purpose of making any commercial pick-up or delivery of merchandise other than the delivery of drugs, medicines, medical supplies, and medical equipment, at the request of a licensed pharmacy or pharmacist, dentist, physician, hospital, or veterinarian;

(3) More than 8 kilometers beyond the limits of the urban zone or contiguous urban zones in which the trip originated;

(4) For the purpose of securing passengers while cruising;

(5) On any trip that exceeds 20 kilometers from point of origin to point of destination;

(6) Without distinctly marking every such taxicab to indicate that it is a taxicab;

(7) For the purpose of transporting any member of the military or naval forces of the United States in uniform to or from any area designated by the military or naval authorities as an "off limits area." Information concerning the location of any such "off limits area" may be obtained from the Office of the Provost Marshal, United States Army Headquarters, San Juan, Puerto Rico, from any military policeman or shore patrolman on duty, or from the Regional Office of the Office of Defense Transportation, San Juan, Puerto Rico. This subparagraph (7) shall not apply to the transportation of uniformed members of the armed forces of the United States to or from any "off limits area" when such member displays a permit issued by proper authority permitting travel to such "off limits area."

(b) No person engaged in the business of furnishing taxi service shall permit a taxicab under his direction or control to be driven or operated in violation of this § 501.194, and no person shall use a taxicab as a means of transportation when to do so will require it to be driven or operated in violation of this § 501.194.

This amendment shall become effective on November 12, 1943.

(E.O. 8989, 9156, 9214, and 9294; 6 F.R. 6725, 7 F.R. 3349, 6097, 8 F.R. 221)

Issued at Washington, D. C., this 2d day of November 1943.

JOSEPH B. EASTMAN, *Director, Office of Defense Transportation.*

[F. R. Doc. 43-17716; Filed, November 2, 1943; 10:58 a. m.]

Notices

DEPARTMENT OF THE INTERIOR.

Coal Mines Administration.

[Order T-106]

E. & S. COAL CO., ET AL.

ORDER TERMINATING APPOINTMENT OF OPERATING MANAGERS

OCTOBER 30, 1943.

Orders have been issued terminating Government possession and control of the coal mines for which the persons listed in Appendix A have served as Operating Managers for the United States, and the mining companies have duly executed and delivered to the Administrator appropriate Instruments, as provided in the Regulations for the Operation of Coal Mines under Government Control, as amended (8 F.R. 6655, 10712, 11344).

Accordingly, I hereby order and direct that the appointments of the Operating Managers for the United States listed in Appendix A, attached hereto and made a part hereof, be, and they are hereby, terminated.

ABE FORTAS, *Acting Secretary of the Interior.*

APPENDIX A

Name of Operating Manager and Name of Mining Company

W. B. Swope, E. & S. Coal Co., P. O. Box 134, Welch, West Virginia.

E. P. Whitby, Eagle Hill Coal Company, Mill Creek Manor, Pottsville, Pennsylvania.

Fount Earls, Fount Earls, Cawood, Kentucky.

W. L. Slupe, East Franklin Coal Company, 606 Butler National Bank Building, Butler, Pennsylvania.

Thomas Hindman, East Windber Coal Company, 540 Central Avenue, Johnstown, Pennsylvania.

O. Eberly, Eberly Coal & Coke Co., 208 Union Trust Building, Uniontown, Pennsylvania.

Bryan Eddy, Eddy Coal Co., Athens, Illinois.

Elizabeth Fortuna, Edgar County Coal Co., Inc., R. R. 3, Paris, Illinois.

H. R. Green, Ednie Fuels, Inc., P. O. Box 399, Philipsburg, Pennsylvania.

Edra Horn, Edra Horn Coal Company, Barrett, West Virginia.

Coolidge Eichelberger, E. Eichelberger & Co., Everett, Pennsylvania.

J. K. Buttermore, Elcomb Coal Company, Inc., Harlan, Kentucky.

F. A. Lorenzo, Eleanora Coal Company, 105 Pine Street, Punxsutawney, Pennsylvania.

H. H. Kuhling, The Elkhorn Collieries Corporation, 714 First National Bank Building, Cincinnati, Ohio.

Frank Ellis, Ellis Coal Co., Bronaugh, Missouri.

W. E. Widmer, Elmira Coal Co., Excelsior Springs, Missouri.

J. H. Hillman, Jr., Emerald Coal & Coke Co., Grant Building, Pittsburgh, Pennsylvania.

Clair J. Sweitzer, Eshbaugh & Sweitzer Coal Co., R. D. No. 1, Mayport, Pennsylvania.

W. E. Starford, Eureka Coal Co., Grafton, West Virginia.

R. D. Evans, Evans Coal Company, Fourth and Main Street, Clarion, Pennsylvania.

[F. R. Doc. 43-17711; Filed, November 2, 1943; 10:01 a. m.]

General Land Office.

NEW MEXICO

REVOCATION OF STOCK DRIVEWAY WITHDRAWALS

The orders of the Secretary and the Acting Secretary of the Interior of February 28, 1918, April 29, 1919, December 16, 1921, and June 16, 1922, establishing and modifying Stock Driveway Withdrawals Nos. 9 and 81, New Mexico Nos. 3 and 12, under section 10 of the act of December 29, 1916, 39 Stat. 865, 43 U.S.C. 300, are hereby revoked so far as they affect the following-described lands, which are within New Mexico Grazing Districts Nos. 1 and 2:

NEW MEXICO PRINCIPAL MERIDIAN

T. 24 N., R. 1 W.,
Sec. 28, N½;
Sec. 33, SE¼.
T. 26 N., R. 2 W.,
Sec. 3, SE¼NE¼ and N½SE¼;
Sec. 4, lots 1, 2, and S½NE¼;
Sec. 8, NE¼NE¼, W½NE¼, SW¼, and NW¼SE¼;
Sec. 9, W½SE¼;
Sec. 17, SE¼NE¼, NE¼NW¼, W½NW¼, NW¼SW¼, and SE¼;
Sec. 18.
T. 24 N., R. 3 W.,
Sec. 10, S½;
Sec. 15, E½;
Sec. 22, E½;
Sec. 27, E½;
Sec. 34, E½.
T. 25 N., R. 3 W.,
Sec. 1, lots 3, 4, and S½NW¼;
Sec. 11, W½;
Sec. 15, NW¼;
Sec. 21, SE¼;
Sec. 22, S½;
Sec. 28;
Sec. 32, E½.
T. 3 S., R. 6 W.,
Sec. 5, S½.

The areas described aggregate 5,727.54 acres.

OSCAR L. CHAPMAN, *Assistant Secretary of the Interior.*

OCTOBER 27, 1943.

[F. R. Doc. 43-17712; Filed, November 2, 1943; 10:01 a. m.]

CIVIL AERONAUTICS BOARD.

[Docket No. SA-85]

AIRCRAFT ACCIDENTS

NOTICE OF HEARING

In the matter of investigation of accident involving aircraft of United States Registry NC 31821 and NC32129 which occurred near Spokane, Washington, on October 25, 1943, and of accident involving aircraft of United States Registry NC 29984 and NC 31333 which occurred near Spokane, Washington, on October 26, 1943.

Notice is hereby given, pursuant to the Civil Aeronautics Act of 1938, as amended, particularly section 702 of said Act, in the above-entitled proceeding, that hearing is hereby assigned to be held on Thursday, November 4, 1943, at 9:30 a. m. (PWT) in Room 338, Federal Building, Spokane, Washington.

Dated at Washington, D. C., November 1, 1943.

[SEAL] W. K. ANDREWS,
Presiding Officer.

[F. R. Doc. 43-17713; Filed, November 2, 1943; 10:28 a. m.]

OFFICE OF DEFENSE TRANSPORTATION.

[Supplementary Order ODT 3, Rev. 92]

SEATTLE-VANCOUVER, B. C. MOTOR FREIGHT LTD. AND BRITISH COLUMBIA-SEATTLE TRANSPORT

COORDINATED OPERATIONS BETWEEN SEATTLE AND BLAINE, WASH.

Upon consideration of a plan for joint action filed with the Office of Defense Transportation by Seattle-Vancouver, B. C. Motor Freight, Ltd., Vancouver, British Columbia, and Julius Daverso, Frank Daverso, and Marie Merlino, doing business as British Columbia-Seattle Transport, Seattle, Washington, to facilitate compliance with the requirements and purposes of General Order ODT 3, Revised, as amended,[1] a copy of which plan is attached hereto as Appendix 1,[2] and

It appearing that the proposed coordination of operations is necessary in order to assure maximum utilization of the facilities, services, and equipment, and to conserve and providently utilize vital equipment, materials, and supplies, of the carriers, and to provide for the prompt and continuous movement of necessary traffic, the attainment of which purposes is essential to the successful prosecution of the war; *It is hereby ordered*, That:

1. The plan for joint action above referred to is hereby approved and the carriers are directed to put the plan in operation forthwith, subject to the following provisions, which shall supersede any provisions of such plan that are in conflict therewith.

2. Each of the carriers forthwith shall file a copy of this order with the appropriate regulatory body or bodies having jurisdiction over any operations affected by this order, and likewise shall file, and publish in accordance with law, and continue in effect until further order, tariffs or supplements to filed tariffs, setting forth any changes in rates, charges, operations, rules, regulations, and practices of the carrier which may be necessary to accord with the provisions of this order and of such plan; and forthwith shall apply to such regulatory body or bodies for special permission for such tariffs or supplements to become effective on the shortest notice lawfully permissible, but not prior to the effective date of this order.

3. Shipments diverted in execution of the plan shall be transported pursuant to the lawfully applicable rates, charges, rules, and regulations of the diverting carrier.

4. The provisions of this order shall not be so construed or applied as to require any carrier subject hereto to perform any service beyond its transportation capacity, or to authorize or require any act or omission which is in violation of any law or regulation, or to permit any carrier to alter its legal liability to any shipper. In the event that compliance with any term of this order, or effectuation of any provision of such plan, would conflict with, or would not be authorized under, the existing interstate or intrastate operating authority of any carrier subject hereto, such carrier forthwith shall apply to the appropriate regulatory body or bodies for the granting of such operating authority as may be requisite to compliance with the terms of this order, and shall prosecute such application with all possible diligence. The coordination of operations directed by this order shall be subject to the carriers' possessing or obtaining the requisite operating authority.

5. All records of the carriers pertaining to any transportation performed pursuant to this order and to the provisions of such plan shall be kept available for examination and inspection at all reasonable times by accredited representatives of the Office of Defense Transportation.

6. The plan for joint action hereby approved and all contractual arrangements made by the carriers to effectuate the plan shall not continue in operation beyond the effective period of this order.

7. Communications concerning this order should refer to "Supplementary Order ODT 3, Revised 92," and, unless otherwise directed, should be addressed to the Division of Motor Transport, Office of Defense Transportation, Washington, D. C.

This order shall become effective November 6, 1943, and shall remain in full force and effect until the termination of the present war shall have been duly proclaimed, or until such earlier time as the Office of Defense Transportation by further order may designate.

Issued at Washington, D. C., this 2d day of November 1943.

JOSEPH B. EASTMAN,
Director, Office of Defense Transportation.

[F. R. Doc. 43-17717; Filed, November 2, 1943; 10:58 a. m.]

[1] 7 F.R. 5445, 6689, 7694; 8 F.R. 4660, 14582.
[2] Filed as part of the original document.

OFFICE OF PRICE ADMINISTRATION.

STEEL WARM-AIR FURNACES

[Order A-11 Under MPR 188, Amdt. 18]

MODIFICATION OF MAXIMUM PRICES

Amendment No. 18 to Order No. A-1 under § 1499.159b of Maximum Price Regulation No. 188. Manufacturers' maximum prices for specified building materials and consumers' goods other than apparel.

An opinion accompanying this amendment, issued simultaneously herewith, has been filed with the Division of the Federal Register.*

Paragraph (a) (17) is added to read as follows:

(17) *Modification of maximum prices of steel warm-air furnaces.* (i) *Scope of this subparagraph (17).* The maximum prices established by this subparagraph shall apply to sales of steel warm-air furnaces.

"Steel warm-air furnaces" means any direct coal-fired, gas-fired, or oil-fired central plant warm-air unit, the heating surface of which is wholly or partially made of steel, which is designed for the purpose of heating the interior of any structure, commonly known as a gravity or forced warm-air furnace, for use with or without air distribution pipes. The term "steel warm-air furnaces" does not include space heaters, domestic heating stoves, or floor furnaces (whether portable or fixed).

(ii) *Maximum prices for manufacturers.* (*a*) On and after November 2, 1943, regardless of any contract, agreement, lease or other obligation, no manufacturer of steel warm-air furnaces shall sell and deliver steel warm-air furnaces and no person shall buy and receive steel warm-air furnaces in the course of trade or business at prices higher than the lowest published list price for each type and size of steel warm-air furnaces in effect on November 2, 1943, plus 9 percent of such lowest published list price.

(*b*) The maximum prices fixed under subdivision (*a*) shall be subject to at least the same extension of cash, quantity, and other discounts, the same absorption of transportation charges, and the same rendition of services as the manufacturer extended, absorbed, or rendered or would have extended, absorbed, or rendered on comparable sales to purchasers of the same class during March 1942.

(iii) *Notification to purchasers by manufacturers.* All manufacturers selling steel warm-air furnaces under the authority of this subparagraph (17) shall send the following notice to every purchaser of steel warm-air furnaces at the time of billing:

Amendment No. 18 to Order No. A-1 under §1499.159b of Maximum Price Regulation No. 188 granted us an increase of the maximum prices of steel warm-air furnaces equal to 9 percent of our lowest established list price in effect on November 2, 1943, for each type and size of steel warm-air furnace. The prices charged you for steel warm-air furnaces are not higher than the maximum prices which we are permitted to charge you

*Copies may be obtained from the Office of Price Administration.

under the provisions of that amendment. The amendment further provides that any person purchasing steel warm-air furnaces for resale in substantially the same form may increase his presently established maximum price by the actual increase in cost to him resulting from the 9 percent increase.

This notice is given to you at the express direction of the Office of Price Administration.

(iv) Every manufacturer selling steel warm-air furnaces under the authority of this subparagraph (17) shall forward to the Office of Price Administration, Building Materials Branch, Washington, D. C., within 15 days after the effective date of this amendment, unless previously submitted, current catalogues, price books, and discount sheets relative to steel warm-air furnaces. Copies of all such catalogues, price books, and discount sheets issued at any time subsequent to the effective date of this amendment shall be forwarded to the Office of Price Administration, Building Materials Branch, Washington, D. C., at least 5 days prior to the issuance thereof.

(v) *Maximum prices for persons other than manufacturers.* (*a*) On and after November 2, 1943, any person who purchases steel warm-air furnaces for resale may increase his presently established maximum price for each type and size of steel warm-air furnace purchased under the authority of this subparagraph (17) by an amount equal to his actual increase in cost resulting from the 9 percent increase permitted under subdivision (ii).

(b) The maximum prices fixed under subdivision (*a*) shall be subject to at least the same extension of cash, quantity, and other discounts, the same absorption of transportation charges, and the same rendition of services which the seller extended, absorbed, or rendered or would have extended, absorbed, or rendered on comparable sales to purchasers of the same class during March 1942.

(vi) *Definitions.* Unless the context requires otherwise, the definitions set forth in § 1499.163 of Maximum Price Regulation No. 188 or § 1499.20 of the General Maximum Price Regulation, whichever is applicable, shall apply to the terms used herein.

This Amendment No. 18 shall become effective November 2, 1943.

NOTE: The reporting requirements of this amendment have been approved by the Bureau of the Budget in accordance with the Federal Reports Acts of 1942.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of November 1943.

GEORGE J. BURKE,
Acting Administrator.

[F. R. Doc. 43-17700; Filed, November 1, 1943; 4:57 p. m.]

LIST OF INDIVIDUAL ORDERS GRANTING ADJUSTMENTS, ETC., UNDER PRICE REGULATIONS

The following order was filed with the Division of the Federal Register on October 28, 1943.

Order Number and Name

MPR 246, Order 10, Amendment 2, Red Cross Mfg. Co.

The following order was filed with the Division of the Federal Register on October 29, 1943.

Order Number and Name

MPR 28, Revised Order 2, Gulf Distilling Corp.

The following orders were filed with the Division of the Federal Register on October 30, 1943.

Order Number and Name

MPR 188, Revised Order 6 under A-2, Paul Lime Plant.

MPR 188, Order 826, National Billiard Supply Co.

Copies of these orders may be obtained from the Printing and Distribution Branch of the Office of Price Administration.

ERVIN H. POLLACK,
Head, Editorial and Reference Section.

[F. R. Doc. 43-17683; Filed, November 1, 1943; 11:24 a. m.]

[Order 3 Under MPR 280]

DOUGHNUT MIXES

ADJUSTMENT OF MAXIMUM PRICES

Order No. 3 under § 1351.815 of Maximum Price Regulation No. 280—Maximum prices for specific food products. Order authorizing adjustable prices for sales of doughnut mixes in bulk by processors to producers of bakery products.

For the reasons set forth in an opinion issued simultaneously herewith, and in accordance with § 1351.815 of Maximum Price Regulation No. 280, It is ordered:

(a) Processors of doughnut mixes are authorized to sell and deliver doughnut mixes in bulk to producers of bakery products at the maximum prices in effect at the date of delivery, subject to an agreement with the buyer in each case to adjust such selling price to conform with maximum prices established for sales of doughnut mixes in bulk in Maximum Price Regulation No. 462 after delivery thereof.

(b) This order shall be automatically revoked upon the establishment by the Office of Price Administration of maximum prices in Maximum Price Regulation No. 462 for sales by processors of doughnut mixes in bulk. It may be revoked or amended by the Price Administrator at any time.

This order shall become effective November 2, 1943.

(56 Stat. 23, 765; Pub. Law 151, 78th Cong.; E.O. 9250, 7 F.R. 7871; E.O. 9328, 8 F.R. 4681)

Issued this 1st day of November 1943.

GEORGE J. BURKE,
Acting Administrator.

[F. R. Doc. 43-17701; Filed, November 1, 1943; 4:58 p. m.]

Regional and District Office Orders.

LIST OF COMMUNITY CEILING PRICE ORDERS

The following order under General Order 51 was filed with the Division of the Federal Register on October 27, 1943.

REGION III

Detroit, Order No. 5, Amendment No. 16, filed 5:11 p. m.

The following orders under General Order 51 were filed with the Division of the Federal Register on October 29, 1943.

REGION III

Cleveland, Order No. F-1, Amendment No. 3, filed 9:41 a. m.
Columbus, Order No. 8, Amendment No. 2, filed 9:41 a. m.
Louisville, Order No. 1-F, Amendment No. 1, filed 9:46 a. m.

REGION IV

Jacksonville, Order No. 1-F, filed 9:42 a. m.
Jacksonville, Order No. 11, Revocation, filed 9:42 a. m.
Montgomery, Order No. 12, Amendment No. 4, filed 9:47 a. m.
Savannah, Order No. 1-F, Amendment No. 6, filed 9:42 a. m.
Savannah, Order No. 2-F, filed 11:45 a. m.
Savannah, Order No. 2-F, Amendment No. 1, filed 9:41 a. m.

REGION VI

La Crosse, Order No. 4, Revocation, filed 9:44 a. m.
La Crosse, Order No. 5, Amendment No. 2, filed 9:43 a. m.
La Crosse, Order No. 6, Revocation, filed 9:43 a. m.
La Crosse, Order No. 7, Revocation, filed 9:43 a. m.
La Crosse, Order No. 8, Amendment No. 3, filed 9:43 a. m.
Duluth-Superior, Order No. 4, Amendment No. 5, filed 9:46 a. m.
Twin Cities, Order No. G-6, filed 9:46 a. m.
Twin Cities, Order No. G-7, filed 9:44 a. m.

Copies of these orders may be obtained from the issuing offices.

ERVIN H. POLLACK,
Head, Editorial and Reference Section.

[F. R. Doc. 43-17684, Filed, November 1, 1943; 11:24 a. m.]

SECURITIES AND EXCHANGE COMMISSION.

[File No. 70-784]

CRESCENT PUBLIC SERVICE COMPANY AND OKLAHOMA UTILITIES COMPANY

ORDER MODIFYING CONDITIONS AND GRANTING AN EXTENSION OF TIME

At a regular session of the Securities and Exchange Commission, held at its office in the City of Philadelphia, Pennsylvania, on the 30th day of October, A. D. 1943.

Declarations, and amendments thereto, having been filed with this Commission by Crescent Public Service Company, a registered holding company, and its wholly-owned subsidiary, Oklahoma Utilities Company, pursuant to sections 12 (c), 12 (d), and 12 (e) and Rules U-42, U-44, and U-61 thereunder, of the Public Utility Holding Company Act of 1935, regarding the sale of certain electric pub-

lic utility properties and the redemption of certain securities; and

The Commission having by order dated October 7, 1943, permitted the declarations, as amended, to become effective, subject to the terms and conditions prescribed in Rule U-24, which rule provides in part that, unless otherwise requested, the transactions proposed by an applicant or declarant be carried out within sixty days of the Commission's order granting an application or permitting a declaration to become effective; and

Crescent Public Service Company and Oklahoma Utilities Company having stated that said sixty-day period is inadequate to consummate the transactions proposed in the said declarations, as amended, and having requested that the said terms and conditions be modified to the extent necessary to extend the time within which the transactions, as set forth in the declarations, may be consummated; and the Commission deeming it appropriate that such request be granted;

It is ordered, That the terms and conditions contained in the order of October 7, 1943, be and hereby are modified to the extent necessary to extend the time within which such transactions may be consummated to January 31, 1944.

By the Commission.

[SEAL] ORVAL L. DUBOIS, *Secretary.*

[F. R. Doc. 43-17709; Filed, November 2, 1943; 10:01 a. m.]

[Filed No. 70-802]

STANDARD GAS AND ELECTRIC COMPANY

NOTICE OF FILING AND ORDER FOR HEARING

At a regular session of the Securities and Exchange Commission, held at its office in the City of Philadelphia, Pa., on the 30th day of October 1943.

Notice is hereby given that a declaration has been filed with this Commission pursuant to the Public Utility Holding Company Act of 1935 by Standard Gas and Electric Company, a registered holding company.

All interested persons are referred to said declaration, which is on file in the office of said Commission, for a statement of the transaction therein proposed, which is summarized below:

Standard Gas and Electric Company proposes to sell to A. C. Allyn and Company of Chicago, Illinois, and Equitable Securities Corporation of Nashville, Tennessee, for a total consideration of $800,000, in cash, certain shares of stock of and certain claims against its subsidiary, Market Street Railway Company, a California corporation, as follows: 39,250 shares of preferred stock, 6% cumulative, having a par value of $100 per share; 25,500 shares of second preferred stock, 6%, having a par value of $100 per share; 61,900 shares of common stock, having a par value of $100 per share; and an open account indebtedness of Market Street Railway Company to Standard Gas and Electric Company in the principal amount of $863,094. Interest on said open account indebtedness is computed by Standard Gas and Electric Company in the sum of $272,975.83 to September 30, 1943, whereas Market Street Railway Company computes interest to said date at $204,448.35, claiming the right to accrue interest at 4% from October 24, 1939, pursuant to a plan, approved by the Railroad Commission of the State of California, for extension of maturity of its bonds from April 1, 1940 to April 1, 1945.

The declarant has designated section 12 (f) of the Act and Rule U-43 promulgated thereunder as being applicable to the proposed transaction.

It appearing to the Commission that it is proper and in the public interest and in the interest of investors and consumers that a hearing be held with respect to said matters and that the declaration shall not be permitted to become effective except pursuant to further order of this Commission:

It is ordered, That a hearing in this proceeding be held at the offices of the Securities and Exchange Commission, 18th and Locust Streets, Philadelphia 3, Pennsylvania, at 10:00 a. m., e. w. t., on the 22d day of November 1943 in such room as may be designated on such day by the hearing room clerk. At such hearing cause shall be shown why such declaration shall be permitted to become effective.

All persons desiring to be heard or otherwise wishing to participate should notify the Commission in the manner provided in Rule XVII of the Commission's rules of practice on or before November 17, 1943.

It is further ordered, That Robert P. Reeder or any other officer or officers of the Commission designated by it for that purpose shall preside at the hearing above ordered. The officer so designated to preside at such hearing is hereby authorized to exercise all powers granted to the Commission under section 18 (c) of the Act and to a Trial Examiner under the Commission's rules of practice.

It is further ordered, That the Secretary of this Commission shall serve notice of this order by mailing copies thereof by registered mail to Standard Gas and Electric Company, A. C. Allyn and Company of Chicago, Illinois, Equitable Securities Corporation of Nashville, Tennessee, and the Railroad Commission of the State of California, and that notice shall be given to all other persons by publication thereof in the FEDERAL REGISTER.

It is further ordered, That without limiting the scope of the issues presented by such declaration, particular attention will be directed at the hearing to the following matters and questions:

(1) Generally, whether the proposed transaction complies with the provisions of the Public Utility Holding Company Act of 1935 and all rules and regulations promulgated thereunder, and is not detrimental to the public interest or the interest of investors or consumers.

By the Commission.

[SEAL] ORVAL L. DUBOIS, *Secretary.*

[F. R. Doc. 43-17710; Filed, November 2, 1943; 10:01 a. m.]

[File No. 812-337]

THE EQUITY CORP., ET AL.

NOTICE OF AND ORDER FOR HEARING

At a regular session of the Securities and Exchange Commission, held at its office in the City of Philadelphia, Pa., on the 1st day of November, A. D. 1943.

In the matter of The Equity Corporation, American General Corporation and First York Corporation.

The Equity Corporation ("Equity") and American General Corporation ("American"), registered investment companies and affiliated persons of each other, have filed a joint application pursuant to section 17 (b) of the Investment Company Act of 1940 for an order exempting from the provisions of section 17 (a) of said Act a transaction in which Equity proposes to sell and American proposes to purchase 195 shares of common stock (representing 13% of the outstanding securities) of First York Corporation ("York"), a registered investment company. American now owns the remaining 87% of York's common stock. If the exemption for which the principals make application is granted, the purchase price to be paid for the 195 shares of York common stock is to be 13% of the net asset value of York on the date that the Commission's order is issued.

It is ordered, Pursuant to section 40 (a) of said Act, that a hearing on the aforesaid application be held on November 10, 1943, at 10:15 a. m., e. w. t., in Room 318 of the Securities and Exchange Commission Building, 18th and Locust Streets, Philadelphia, Pennsylvania.

It is further ordered, That Willis E. Monty, Esquire, or any other officer or officers of the Commission designated by it for that purpose, shall preside at such hearing. The officer so designated is hereby authorized to exercise all the powers granted to the Commission under sections 41 and 42 (b) of the Investment Company Act of 1940 and to trial examiners under the Commission's rules of practice.

Notice of such hearing is hereby given to The Equity Corporation, American General Corporation, First York Corporation and to any other persons whose participation in such proceeding may be in the public interest or for the protection of investors.

By the Commission.

[SEAL] ORVAL L. DUBOIS, *Secretary.*

[F. R. Doc. 43-17708; Filed, November 2, 1943; 10:01 a. m.]

SELECTIVE SERVICE SYSTEM.

[Order 117]

EXETER PROJECT, RHODE ISLAND

ESTABLISHMENT FOR CONSCIENTIOUS OBJECTORS

I, Lewis B. Hershey, Director of Selective Service, in accordance with the provisions of section 5 (g) of the Selective Training and Service Act of 1940 (54 Stat. 885, 50 U.S.C., Sup. 301-318, inclusive); E.O. No. 8675, 6 F.R. 831, E.O. No.

9279, 7 F.R. 10177, and the authority vested in me by the Chairman of the War Manpower Commission under Administrative Order No. 26, 7 F.R. 10512, hereby designate the Exeter Project to be work of national importance, to be known as Civilian Public Service Camp No. 117. Said project, located at Exeter, Washington County, Rhode Island, will be the base of operations for work at the Exeter Training School, an institution under the State mental hospital system of Rhode Island, and registrants under the Selective Training and Service Act of 1940, who have been classified by their local boards as conscientious objectors to both combatant and noncombatant military service and have been placed in Class IV–E, may be assigned to said project in lieu of their induction for military service.

Men assigned to said Exeter Project will be engaged in clerical work, as attendants, waiters, farm hands, etc., and shall be under the direction of the Superintendent, Exeter Training School, as well as will be the project management. Men shall be assigned to and retained in camp in accordance with the provisions of the Selective Training and Service Act of 1940 and regulations and orders promulgated thereunder, as well as the regulations of the Exeter Training School. Administrative and directive control shall be under the Selective Service System through the Camp Operations Division of National Selective Service Headquarters.

LEWIS B. HERSHEY,
Director.

OCTOBER 29, 1943.

[F. R. Doc. 43–17681; Filed, November 1, 1943; 2:48 p. m.]