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Treasury Department : : : Bureau of Internal Revenue

Internal Revenue Bulletin

Cumulative Bulletin 1940-1

JANUARY-JUNE, 1940

SPECIAL ATTENTION is directed to the cautionary notice on this page that published rulings of the Bureau do not have the force and effect of Treasury Decisions and that they are applicable only to facts presented in the published case

U.S. Treasury Department : : : : : Bureau of Internal Revenue Service

Internal Revenue Bulletin

Cumulative Bulletin 1940-1

JANUARY-JUNE, 1940

IN THIS ISSUE

The rulings reported in the Internal Revenue Bulletin are for the information of taxpayers and their counsel as showing the trend of official opinion in the administration of the Bureau of Internal Revenue; the rulings other than Treasury Decisions have none of the force or effect of Treasury Decisions and do not commit the Department to any interpretation of the law which has not been formally approved and promulgated by the Secretary of the Treasury. Each ruling embodies the administrative application of the law and Treasury Decisions to the entire state of facts upon which a particular case rests. It is especially to be noted that the same result will not necessarily be reached in another case unless all the material facts are identical with those of the reported case. As it is not always feasible to publish a complete statement of the facts underlying each ruling, there can be no assurance that any new case is identical with the reported case. As bearing out this distinction, it may be observed that the rulings published from time to time may appear to reverse rulings previously published.

Officers of the Bureau of Internal Revenue are especially cautioned against reaching a conclusion in any case merely on the basis of similarity to a published ruling, and should base their judgment on the application of all pertinent provisions of the law and Treasury Decisions to all the facts in each case. These rulings should be used as aids in studying the law and its formal construction as made in the regulations and Treasury Decisions previously issued.

In addition to publishing all Internal Revenue Treasury Decisions, it is the policy of the Bureau of Internal Revenue to publish all rulings and decisions, including opinions of the Chief Counsel for the Bureau of Internal Revenue, which, because they announce a ruling or decision upon a novel question or upon a question in regard to which there exists no previously published ruling or decision, or for other reasons, are of such importance as to be of general interest. It is also the policy of the Bureau to publish all rulings or decisions which revoke, modify, amend, or affect in any manner whatever any published ruling or decision. In many instances opinions of the Chief Counsel for the Bureau of Internal Revenue are not of general interest because they announce no new ruling or no new construction of the revenue laws but simply apply rulings already made public to certain situations of fact which are without special significance. It is not the policy of the Bureau to publish such opinions. Therefore, the numbers assigned to the published opinions of the Chief Counsel for the Bureau of Internal Revenue are not consecutive. No unpublished ruling or decision will be cited or relied upon by any officer or employee of the Bureau of Internal Revenue as a precedent in the disposition of other cases. Unless otherwise specifically indicated, all published rulings and decisions have received the consideration and approval of the Chief Counsel for the Bureau of Internal Revenue.

UNITED STATES GOVERNMENT PRINTING OFFICE: WASHINGTON : 1940

For sale by the Superintendent of Documents, Washington, D. C. - - - - See back of title for prices

The Internal Revenue Bulletin service for 1940 will consist of weekly bulletins and semiannual cumulative bulletins.

The weekly bulletins will contain the rulings and decisions to be made public and all Treasury Department decisions (known as Treasury decisions) pertaining to Internal Revenue matters. The semiannual cumulative bulletins will contain all rulings and decisions (including Treasury decisions) published during the previous six months.

The complete Bulletin service may be obtained, on a subscription basis, from the Superintendent of Documents, Government Printing Office, Washington, D. C., for $3 per year; foreign, $4.25. Single copies of the weekly Bulletin, 5 cents each.

New subscribers and others desiring to obtain the 1919, 1920, and 1921 Income Tax Service may do so from the Superintendent of Documents at prices as follows: Digest of Income Tax Rulings No. 19 (containing digests of all rulings appearing in Cumulative Bulletins 1 to 5, inclusive), 50 cents per copy; Cumulative Bulletins Nos. 1 to 5, containing in full all rulings published since April, 1919, to and including December, 1921, as follows: No. 1, 30 cents; No. 2, 25 cents; No. 3, 30 cents; No. 4, 30 cents; No. 5, 25 cents.

Persons desiring to obtain the Sales Tax Cumulative Bulletins for January–June and July–December, 1921, may procure them from the Superintendent of Documents at 5 cents per copy.

Persons desiring to obtain the Internal Revenue Bulletin service for the years 1922 to 1939, inclusive, may do so at prices as follows:

Year.	Cumulative Bulletin.		Price. (cents)
	First 6 months.	Second 6 months.	
1922	I-1	I-2	40, 30
1923	II-1	II-2	30, 40
1924	III-1	III-2	50, 50
1925	IV-1	IV-2	40, 35
1926	V-1	V-2	40, 30
1927	VI-1	VI-2	40, 40
1928	VII-1	VII-2	35, 50
1929	VIII-1	VIII-2	50, 55
1930	IX-1	IX-2	50, 50
1931	X-1	X-2	65, 30
1932	XI-1	XI-2	30, 30
1933	XII-1	XII-2	30, 50
1934	XIII-1	XIII-2	50, 60
1935	XIV-1	XIV-2	50, 50
1936	XV-1	XV-2	55, 45
1937	1937-1	1937-2	60, 50
1938	1938-1	1938-2	60, 50
1939	1939-1:		
	Part 1		60
	Part 2		50
		1939-2	$1
1940	1940-1		30

Persons desiring to obtain the service in digest form may do so at prices as follows: Digest No. 13 (1922–1924), 60 cents; Digest No. 17 (1925), 25 cents; Digest No. 21 (1926), 15 cents; Digest No. 22 (1925–1927), 35 cents; and Digest A (income tax rulings only, April, 1919, to December, 1930, inclusive), $1.50.

All inquiries in regard to these publications and subscriptions should be sent to the Superintendent of Documents, Government Printing Office, Washington, D. C.

INTRODUCTORY NOTES.

The Internal Revenue Cumulative Bulletin 1940–1, in addition to all decisions of the Treasury Department (called Treasury decisions) pertaining to Internal Revenue matters, contains opinions of the Chief Counsel, and rulings and decisions pertaining to income, estate, gift, sales, capital stock, excess profits, employment, social security, and miscellaneous taxes, as indicated on the title page of this Bulletin, published in the weekly Bulletins (1940, Nos. 1 to 26, inclusive) for the period January 1 to June 30, 1940. It also contains a cumulative list of announcements relating to decisions of the United States Board of Tax Appeals published in the Internal Revenue Bulletin Service from January 1 to June 30, 1940.

Income Tax rulings are printed in three parts. The rulings in Part I are printed as Part I, "A" (Internal Revenue Code and Revenue Act of 1939) and "B" (Revenue Act of 1938), the law headings corresponding with the sections of the Code and 1939 and 1938 Acts, respectively, and the regulations headings corresponding with the section headings of Regulations 103 and the article headings of Regulations 101. Rulings under the Revenue Acts of 1937 and 1936 are printed as Part II, the law headings corresponding with the section headings of those Acts and the regulations headings corresponding with the article headings of Regulations 94. Rulings under the Revenue Acts of 1935 and 1934 or prior Acts are printed as Part III, the law headings corresponding with the section headings of the Revenue Act of 1934 and the regulations headings corresponding with the article headings of Regulations 86.

Rulings under Titles VIII and IX of the Social Security Act and under Subchapters A and C, Chapter 9, of the Internal Revenue Code in force prior to January 1, 1940, are published under article headings of Regulations 91 and 90, respectively; rulings under Subchapters A and C, Chapter 9, of the Code in force on and after January 1, 1940, are published under the section headings of Regulations 106 and 107, respectively; rulings under the Carriers Taxing Act of 1937 and under Subchapter B, Chapter 9, of the Internal Revenue Code are published under the article headings of Regulations 100; and rulings under Title III of the Revenue Act of 1936—Tax on Unjust Enrichment—are coded under the sections of that Act and the article headings of Regulations 95.

ABBREVIATIONS.

The following abbreviations are used throughout the Bulletin:

A, B, C, etc.—The names of individuals.
A. R. M.—Committee on Appeals and Review memorandum.
A. R. R.—Committee on Appeals and Review recommendation.
A. T.—Alcohol Tax Unit.
B. T. A.—Board of Tax Appeals.
C. B.—Cumulative Bulletin.
Ct. D.—Court decision.
C. S. T.—Capital Stock Tax Division.
C. T.—Taxes on Employment by Carriers.
D. C.—Treasury Department circular.

E. T.—Estate Tax Division.
G. C. M.—General Counsel's, Assistant General Counsel's, or Chief Counsel's memorandum.
I. R. B.—Internal Revenue Bulletin.
I. T.—Income Tax Unit.
M, N, X, Y, Z, etc.—The names of corporations, places, or businesses, according to context.
Mim.—Mimeographed letter.
MS.—Miscellaneous Division.
O. or L. O.—Solicitor's law opinion.
O. D.—Office decision.
Op. A. G.—Opinion of the Attorney General.
P. T.—Processing Tax Division.
S. T.—Sales Tax Division.
Sil.—Silver Tax Division.
S. M.—Solicitor's memorandum.
Sol. Op.—Solicitor's opinion.
S. R.—Solicitor's recommendation.
S. S. T.—Taxes on Employment by others than Carriers.
T.—Tobacco Division.
T. B. M.—Advisory Tax Board memorandum.
T. B. R.—Advisory Tax Board recommendation.
T. D.—Treasury decision.
x and *y* are used to represent certain numbers, and when used with the word "dollars" represent sums of money.

The practice of promulgating Treasury decisions that embody court decisions relating to the internal revenue has been discontinued. Hereafter opinions of the courts, with appropriate headnotes for the information and guidance of taxpayers and officers and employees of the Bureau of Internal Revenue, will be published in the Internal Revenue Bulletin without formal approval and promulgation by the Secretary of the Treasury.

ANNOUNCEMENT RELATING TO BOARD OF TAX APPEALS DECISIONS.

Under the provisions of the recent Revenue Acts, relating to appeals to the Board of Tax Appeals, the Commissioner may acquiesce in the decision of the Board or he may, if the appeal was heard by the Board prior to the passage of the 1926 Act, cause to be instituted a proceeding in court for the collection of any part of a tax determined by the Commissioner to be due but disallowed by the Board, provided that such proceeding is commenced within one year after final decision of the Board. As to appeals heard by the Board after the passage of the 1926 Act, the Commissioner may, within six months after the Board's decision is rendered, file a petition for a review of the decision by a Circuit Court of Appeals or by the United States Court of Appeals for the District of Columbia; however, as to decisions rendered on and after June 7, 1932, petitions for review must be filed within three months after the decision is rendered. In order that taxpayers and the general public may be informed as to whether or not the Commissioner has acquiesced in a decision of the Board of Tax Appeals disallowing a tax determined by the Commissioner to be due, announcement will be made in the weekly Bulletin at the earliest practicable date. A notice that the Commissioner has acquiesced or has nonacquiesced in a Board decision relates, however, only to the issue or issues decided in favor of the taxpayer. Decisions so acquiesced in should be relied upon by officers and employees of the Bureau of Internal Revenue as precedents in the disposition of other cases before the Bureau.

CONTENTS

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January–June, 1920 (No. 2)	656–1033
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Sales Tax:	
1920 (S. T. 1–20)	1–112
January–June, 1921	113–265
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Internal Revenue Bulletin:	
January–June, 1922 (No. I–1)	1–383
July–December, 1922 (No. I–2)	384–665
January–June, 1923 (No. II–1)	666–956
July–December, 1923 (No. II–2)	957–1276
January–June, 1924 (No. III–1)	1277–1641
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January–June, 1926 (No. V–1)	2524–2813
July–December, 1926 (No. V–2)	2814–3026
January–June, 1927 (No. VI–1)	3027–3291
July–December, 1927 (No. VI–2)	3292–3557
January–June, 1928 (No. VII–1)	3558–3784
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January–June, 1930 (No. IX–1)	4488–4683
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January–June, 1931 (No. X–1)	4888–5124
July–December, 1931 (No. X–2)	5125–5338
January–June, 1932 (No. XI–1)	5339–5531
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BOARD OF TAX APPEALS.

CUMULATIVE LIST OF ANNOUNCEMENTS RELATING TO DECISIONS OF THE UNITED STATES BOARD OF TAX APPEALS PUBLISHED IN THE INTERNAL REVENUE BULLETIN SERVICE FROM JANUARY 1, 1940, TO JUNE 30, 1940, INCLUSIVE.

[Announcements relating to the acquiescence or nonacquiescence of the Commissioner in decisions of the United States Board of Tax Appeals, as published in the weekly Internal Revenue Bulletins from December 22, 1924, to December 31, 1931, inclusive, are printed in Cumulative Bulletin X-2, pages 1-106. Those printed in weekly Bulletins from January 1, 1932, to December 31, 1939, inclusive, are published in Cumulative Bulletin 1939-2, pages 1-73. The list below, therefore, contains only such announcements published in the weekly Bulletins from January 1, 1940, to June 30, 1940, inclusive.]

[a] 1940-26-10300

The Commissioner acquiesces in the following decisions of the United States Board of Tax Appeals:

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Board of Tax Appeals. Page.
A.			
Abbott, John, executor of estate of Richard E. Traiser [1]	91958	41	228
Allen, Laura, estate of [2]	89703	40	721
Anderson, John, transferee of estate of Frank O. Burridge	93334	40	944
Apex Brewing Co., Inc	91977	40	1109
Augustus, Elizabeth G	96061	40	1200
B.			
Baker, Inc., Emerit E	92366 94401	40	554
Benaglia et ux., Arthur [3]	87638	36	838
Black Motor Co., Inc	97232	41	300
Bondholders Committee [4]	90452 90486 90487	40	881
Briggs-Killian Co	92562	40	894
Brookman, Murray	95871	41	557
C.			
Carter, Shirley, estate of	93917	40	749
Cavett et al., K., executors of estate of W. T. Hales [5]	93208	40	1244

[1] Acquiescence relates only to the Board's mathematical formula for apportionment of the dividend credit between the estate and the distributees.
[2] Estate tax decision.
[3] Nonacquiescence published in Cumulative Bulletin 1938-1, page 35, withdrawn.
[4] Acquiescence does not relate to issue respecting bases for depreciation of petitioners' assets.
[5] Acquiescence is only as to the issue, Do certain dividends declared and credited on the stock of the Local Building and Loan Association and made available to the petitioners in January, 1935, but applied by them against the purchase of stock in the Local Federal Savings and Loan Association into which the building and loan association was converted, represent income in 1935 subject to normal tax and surtax?

[a] Ruling No. 10300 includes all acquiescence and nonacquiescence notices published in the Internal Revenue Bulletin service from January 1, 1940, to June 30, 1940.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
Claiborne et al., Austin Leigh, executors of the estate of Laura Allen [1]	89703	40	721
Columbia Oil & Gas Co.[2]	90624	41	38
Combs Lumber Co	91543	41	339
Cooledge, Norman	92289	40	1324
Cooper, Eugene B., administrator of the estate of Lewis F. Cooper	94088	40	749
Cooper, Lewis F., estate of	94088	40	749
Crawford Music Corporation	85389, 88290	40	284
D.			
Dallas Title & Guaranty Co.[3]	90466	40	1021
Dashiell, C. R.[4]	75056	36	313
Davison-Joseph Campau Realty Co., Inc	97366	41	675
Dean, Mason L.[5]	61205, 69832	35	839
E.			
Eustis, Augustus H.[6]	71637	30	820
F.			
Ferree, C. B.[7]	61542	32	725
First Mortgage Bonds [8]	90452, 90486, 90487	40	881
Fleischmann, Raoul H	90305	40	671
Foreman, Frank C	93915	40	749
Friend, Henry, estate of	90672, 91415	40	767
Friend et al., Milton H., trustees of estate of Henry Friend	90672, 91415	40	767
G.			
G. B. R. Oil Corporation	92604	40	737
Gardner, J. Willis [9] [10]	92115	41	679
George Bros. & Co	93248	41	287
Gilmore, Helen, estate of, transferee of estate of Frank O. Burridge	93231	40	944
Graff, Everett D	92212	40	919
Grim, Clifford D	93919	40	749
H.			
Hales, George A.[11]	93210	40	1244
Hales, Mrs. Oneta [11]	93209	40	1244
Hales, Jr., W. T.[11]	93211	40	1244
Hales, W. T., estate of [11]	93208	40	1244

[1] Estate tax decision.
[2] Acquiescence does not relate to issue pertaining to allocation of cost of equipment on the property in question.
[3] Acquiescence relates only to the issue whether or not petitioner is an insurance company as that term is used in section 701(c)2 of the Revenue Act of 1934.
[4] Nonacquiescence published in Cumulative Bulletin 1937–2, page 36, withdrawn.
[5] Prior nonacquiescence published in Cumulative Bulletin 1937–2, page 36, withdrawn.
[6] Prior nonacquiescence published in Cumulative Bulletin XIV–2, page 30 (1935), withdrawn.
[7] Nonacquiescence published in Cumulative Bulletin XIV–2, page 30 (1935), withdrawn.
[8] Acquiescence does not relate to issue respecting bases for depreciation of petitioners' assets.
[9] Gift tax decision.
[10] Acquiescence relates only to the issue, If the beneficiaries of a certain trust be treated as donees, were the gifts made to them gifts of present interests or future interests?
[11] Acquiescence is only as to the issue, Do certain dividends declared and credited on the stock of the Local Building and Loan Association and made available to the petitioners in January, 1935, but applied by them against the purchase of stock in the Local Federal Savings and Loan Association into which the building and loan association was converted, represent income in 1935 subject to normal tax and surtax?

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Higgins, Eugene	80052 85961	39	1005
Hooper, James P., estate of [1 2]	85776	41	114
Hooper, Mathilde B., administratrix of estate of James P. Hooper [1 2]	85776	41	114
Huey & Philp Hardware Co	92801	40	780
Hummel-Ross Fibre Corporation	93077	40	820
Hyde, Suffolk & Berks, Marguerite [3]	81417 93257	40	1120
J.			
Johnston, J. Edward	93768	41	550
K.			
Kaufmann, Joel W	95082	41	408
Kaufmann, Mildred B	95083	41	408
Keller, Charlotte	93026	41	478
Kessler Oil & Gas Co	93041	41	31
Knowles, Edwin C. F	91495	40	860
L.			
Legg, Mildred Sheppard, estate of [1]	89942	40	1073
M.			
MacConaughey, Harry E	92052	41	408
Macon, Dublin & Savannah Railroad Co	90592	40	1265
Marlborough House, Inc., et al.[4]	90452 90486 90487	40	881
Marlborough Investment Co.[4]	90452 90486 90487	40	881
Marthe, Louise, transferee of estate of Frank O. Burridge	93333	40	944
Martin, Thomas W	93916	40	749
McCormac, Gertrude A., trustee for H. B. McCormac, Jr	93920	40	749
McCormac, Jr., H. B. (trust)	93920	40	749
Morton, Arthur F	91494	41	742
Mott, Dee Furey [5]	71903	35	195
N.			
Norweb, Emery May Holden [6]	92575	41	179
P.			
Patton, T. B	93918	40	749
Pittsburg Canners, Inc	93560	41	467
Plunkett, Theodore R	94017	41	700
Pupin, Michael I., estate of [1 7]	92177	38	1218

[1] Estate tax decision.
[2] Acquiescence relates only to the determination of the value of the stock of William E. Hooper & Sons Co. on August 3, 1933.
[3] Acquiescence on the following issue is as to result only: In determining the net income of a trust currently distributable to the beneficiaries, should there be included the rent due under a long-term lease, the lessee having improved the premises with an office building which would become the lessor's property on forfeiture, the trust on the accrual basis having accrued the rent but also having charged it to a reserve for uncollected rents?
[4] Acquiescence does not relate to issue respecting bases for depreciation of petitioners' assets.
[5] Nonacquiescence published in Cumulative Bulletin 1937-1, page 43, withdrawn.
[6] Gift tax decision.
[7] Prior nonacquiescence published in Cumulative Bulletin 1939-1, (Part 1), page 60, withdrawn.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Board of Tax Appeals. Page.
R.			
Rosenstock, Anna, individually and as executrix of estate of Isaac M. Rosenstock [1]	91686	41	635
Rosenstock, Isaac M., estate of [1]	91686	41	635
Rossi, Andrew E.[2]	96470	41	734
Rotorite Corporation	88606	40	1303
Rowley, Edward G., transferee of estate of Frank O. Burridge	93332	40	944
S.			
Safe Deposit & Trust Co. of Baltimore, executor of estate of Mildred Sheppard Legg [1]	89942	40	1073
Seavey & Flarsheim Brokerage Co	91618	41	198
Shenandoah Valley National Bank (Shirley Carter estate)	93917	40	749
Sherman, Doris Bond [3 4]	95300	41	898
Simon, Jose, estate of [1]	91840	40	650
Simon et al., Jose P., executors	91840	40	650
Smith, Charles G	93914	40	749
Smith, Varvara Pupin, administratrix of estate of Michael I. Pupin [1 5]	92177	38	1218
Smyth, Jr., Francis G., transferee of estate of Frank O. Burridge	93331	40	944
Smyth, Herbert C., transferee of estate of Frank O. Burridge	93232	40	944
Smyth, Herbert C., administrator of the estate of Helen Gilmore, transferee of estate of Frank O. Burridge	93231	40	944
Sporl, Sr., Cyprian A., estate of [1]	92588	40	924
Springford, Herbert H	97247	41	1001
Staley, Augustus E.[3]	88772	41	752
Staley, Emma L.[3]	88773	41	752
Stern, Allison L. S.[6]	93134	40	756
Suffolk & Berks, Marguerite Hyde [7]	81417 93257	40	1120
Sultana Oil Corporation (Delaware)	90078 90079	40	1195
Swastika Oil & Gas Co	90861	40	797
T.			
Terhune, Wesley V. E	93894	40	749
Thatcher, Lester A., transferee of estate of Frank O. Burridge	93335	40	944
Traiser, Richard E., estate of [8]	91958	41	228
Trevor, Emily [3]	89820	40	1240

[1] Estate tax decision.
[2] Unjust enrichment tax decision.
[3] Gift tax decision.
[4] Acquiescence relates only to the year 1935.
[5] Prior nonacquiescence published in Cumulative Bulletin 1939-1, (Part 1), page 60, withdrawn.
[6] Acquiescence relates only to the issue, Is the petitioner taxable on the income of a trust which was created for the support and maintenance of his wife and minor child?
[7] Acquiescence on the following issue is as to result only: In determining the net income of a trust currently distributable to the beneficiaries, should there be included the rent due under a long-term lease, the lessee having improved the premises with an office building which would become the lessor's property on forfeiture, the trust on the accrual basis having accrued the rent but also having charged it to a reserve for uncollected rents?
[8] Acquiescence relates only to the Board's mathematical formula for apportionment of the dividend credit between the estate and the distributees.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
U.			
United States Fidelity & Guaranty Co	91398	40	1010
Universal Winding Co	87354	39	962
W.			
Washington Railway & Electric Co	92435	40	1248
Winthrop, Beekman [1]	79850	36	314
Wolf, Edith A	92429	41	1231
Wood, Orrin G.[2] [3]	92489	40	904
Y.			
Young, Du Bois [4]	78345	34	648

The Commissioner does NOT acquiesce in the following decisions of the United States Board of Tax Appeals:

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
A.			
Abbott, John, executor of estate of Richard E. Traiser [5]	91958	41	228
Alabama Asphaltic Limestone Co	91793	41	324
Allen, Jr., et al., Bona	93809	41	206
Allen, Jr., et al., Bona, executors	93811		
Allen, H. Wadleigh, estate of	93811		
Allen, John Q	93812		
Allen et al., Victor H	93810		
Alling, Noyes, E., estate of [6]	87136	41	191
B.			
Bell et al., Maude K., executors of estate of Ida A. White	93575	41	525
Bernheimer Co., S. E. & M. E	88978	41	249
Bingham, Mary Lily (Flagler), estate of	94985	40	823
Bondholders Committee [7]	90452, 90486, 90487	40	881
Bonfils, F. G., estate of [8]	91501	40	1079
Bonfils Trust, F. G.[8]	93148	40	1085

[1] Nonacquiescence published in Cumulative Bulletin 1937-2, page 56, withdrawn.
[2] Gift tax decision.
[3] Acquiescence relates only to the issues involving (1) the valuation of 388 shares of Brown Paper Mill stock, and (2) the question whether the relinquishment of a power to prevent future amendments to a trust instrument constitutes a complete gift.
[4] Acquiescence relates only to this issue: Was the exchange of certain certificates of ownership in a trust for underlying portfolio stock represented there by an exchange of different assets, resulting in a capital loss? Previous nonacquiescence published in Cumulative Bulletin XV-2, page 51 (1936), withdrawn with respect to this issue only.
[5] Nonacquiescence relates only to that part of the Board's opinion which holds, without supporting evidence, that gains on the sale of corpus of the estate constituted income available for distribution to the beneficiaries.
[6] Estate tax decision.
[7] Nonacquiescence relates to issue pertaining to bases for depreciation of petitioner's assets.
[8] Previous acquiescence published in Internal Revenue Bulletin 1940-15, page 1, withdrawn.

NONACQUIESCENCES—Continued.

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Bonfils et al., Helen G., executors of estate of F. G. Bonfils [1]	91501	40	1079
Branch, Claude R	94248	40	1043
Bridgeport City Trust Co. et al., The, executors of estate of Noyes E. Alling [2]	87136	41	191
Buck, Ellsworth B	93330	41	99
Burnett, O. L	90248	40	604
C.			
Carling Holding Co	86776 87378 88616	41	493
Caspersen, Freda R	92765	40	758
Cavett et al., K., executors of estate of W. T. Hales [3]	93208	40	1244
Chamberlain, Park	88067	41	10
Chase National Bank of the City of New York, The, trustee under agreements with American Depositor Corporation	93854 93855 93856 93857	41	430
Colonial Trust Co. et al., executors	93648	41	213
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D.			
Dallas Title & Guaranty Co.[5]	90466	40	1021
Deering, Frank C., estate of	95996	40	983
Deering et al., Joseph Godfrey, executors of the estate of Frank C. Deering	95996	40	983
Delaware Terminal Corporation	86105	40	1179
Denholm & McKay Co	89606	39	767
Denver National Bank et al., trustees u/w F. G. Bonfils [1]	93148	40	1085
Durkheimer, S. F	95209	41	585
E.			
Elmhirst, Dorothy Whitney	85040 85880 95298	41	348
Erb et al., Arthur L., executors of estate of Giles W. Mead [6]	97566	41	424
Ewing, Sherman	93013	40	911

[1] Previous acquiescence published in Internal Revenue Bulletin 1940-15, page 1, withdrawn.
[2] Estate tax decision.
[3] Nonacquiescence is only as to the issue, Is the cash received by petitioners in 1935 from the Local Federal Savings and Loan Association, which is admitted to be income, taxable as ordinary income or as capital gain?
[4] Nonacquiescence relates to issue pertaining to allocation of cost of equipment on the property in question.
[5] Nonacquiescence relates only to the issue involving the taxability of an amount of $40,000 transferred from "Premium reserve account" to "Undivided profits account" pursuant to resolution of the board of directors on July 5, 1934.
[6] Gift tax decision.

NONACQUIESCENCES—Continued.

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F.			
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Frazier, Frederic H	91412	41	146
G.			
Gardner, J. Willis [2] [3]	92115	41	679
Goodman, Edwin	87799	41	472
Greene, A. Crawford, guardian of estate of Alice H. Lester [2]	93404, 96315	41	515
Grote et ux., Ben	94442, 94443	41	247
H.			
Hales, George A.[4]	93210	40	1244
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Hales, W. T., estate of [4]	93208		
Hartford-Connecticut Trust Co., The, extr. of estate of Mary W. Cushman [5]	92882	40	947
Hercules Motor Corporation	92225	40	998
Hoffman, Katherine M	96741	40	459
Hoffman, W. W	96742		
Hoffman et ux., W. W	92414		
Hooper, James P., estate of [5] [6]	85776	41	114
Hooper, Mathilde B., administratrix of estate of James P. Hooper [5] [6]	85776	41	114
Hughes Tool Co	90002	40	962
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Johnson et al., Thomas M., trustees	86776, 87378, 88616	41	493
Jonas, Louise B	91010	40	970
K.			
Kellogg, Cornelia V. W., executrix of estate of Frederick R. Kellogg [5]	89143	40	915
Kellogg, Frederick R., estate of [5]	89143	40	915
Kenan et al., William R., Jr., trustees u/w Mary Lily (Flagler) Bingham	94985	40	823
Klyce, A. S., estate of	90174	41	194
Klyce, M. P., administrator	90174	41	194
Knapp, George O	91699	40	1144

[1] Nonacquiescence relates to issue pertaining to bases for depreciation of petitioner's assets.

[2] Gift tax decision.

[3] Nonacquiescence relates only to the issue, in the case of a gift of securities in trust, should the trust be treated as the donee, resulting in only one exclusion, or should the beneficiaries be treated as donees, resulting in one exclusion for each beneficiary?

[4] Nonacquiescence is only as to the issue, Is the cash received by petitioners in 1935 from the Local Federal Savings and Loan Association, which is admitted to be income, taxable as ordinary income or as capital gain?

[5] Estate tax decision.

[6] Nonacquiescence relates only to the issue, Was the sum of $132,345.73, representing the net proceeds of certain life insurance policies assigned by the decedent to a certain trust, properly includible in the gross estate; and, if so, may the sum of $40,000 be excluded under the provisions of section 302(g) of the Revenue Act of 1926?

NONACQUIESCENCES—Continued.

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M.			
Marlborough House, Inc., et al.[2]	90452, 90486, 90487	40	881
Marlborough Investment Co.[2]	90452, 90486, 90487	40	881
McGovern, Inc., Patrick	91846	40	705
Mead, Giles W., estate of [1]	97566	41	424
Michigan Silica Co	96786	41	511
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N.			
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Nebraska Bridge Supply & Lumber Co	90846	40	40
Newport Industries, Inc	92331	40	977
P.			
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Phoenix State Bank & Trust Co., trustee under deed of trust from Mary W. Cushman, as trustee and transferee [3]	92883	40	947
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R.			
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Rhodes, Mamie D., estate of [3]	91284	41	62
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S.			
Sherman, Doris Bond [1 4]	95300	41	898
Sobel, Inc., N	93822	40	1262
Sporl & Co., Inc., C. A	90354	40	828
Stein, Nathan	83178	40	847
Stern, Allison L. S.[5]	93134	40	756

[1] Gift tax decision.
[2] Nonacquiescence relates to issue pertaining to bases for depreciation of petitioner's assets.
[3] Estate tax decision.
[4] Nonacquiescence relates only to the year 1936.
[5] Nonacquiescence relates only to the issue, where termination of a trust could occur only at the election of the grantor with concurrence of attorneys who represented two persons interested in the trust, is the interest of the attorneys a substantial adverse interest?

NONACQUIESCENCES—Continued.

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Swope, Lorenzo W., estate of	93648	41	213
T.			
Thompson, Mary H., executrix of estate of William G. Thompson [1]	96358	41	901
Thompson, William G., estate of [1]	96358	41	901
Trico Securities Corporation	85176	41	306
Traiser, Richard E., estate of [2]	91958	41	228
W.			
Walker, William T.[3]	92600	40	762
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[1] Estate tax decision.

[2] Nonacquiescence relates only to that part of the Board's opinion which holds, without supporting evidence, that gains on the sale of corpus of the estate constituted income available for distribution to the beneficiaries.

[3] Gift tax decision.

[4] Nonacquiescence relates only to the issue, is the value of life insurance policies to be determined by the cost to purchase similar contracts as determined by the Commissioner, or is the value limited to the cash surrender value as contended by petitioner?

INCOME TAX RULINGS.—PART I.

A. INTERNAL REVENUE CODE AND REVENUE ACT OF 1939.

CHAPTER 1.—INCOME TAX.

SUBCHAPTER B.—GENERAL PROVISIONS.

PART II.—COMPUTATION OF NET INCOME.

SECTION 22(a).—GROSS INCOME: GENERAL DEFINITION.

(Also Section 113(a).)

1940-12-10205
I. T. 3357

INTERNAL REVENUE CODE.

The transfer of securities by the M Company to a pension trust for the benefit of its employees resulted in taxable income to the company to the extent that the fair market value of the securities at the time of transfer exceeded the cost or other basis thereof to the company. The basis for determining gain or loss upon the sale of such securities by the trustee will be the fair market value of the securities at the time of the transfer to the trust.

Advice is requested whether the transfer of securities by the M Company to a pension trust for the benefit of its employees, the market value of the securities at the time of transfer being in excess of cost or other basis, resulted in taxable income to the company to the extent of the difference between such market value and the cost or other basis; also, whether income will accrue to the trust in the event the securities are sold by the trustee for an amount in excess of the basis at which they were contributed to the trust.

In the opinion of this office, the M Company derived taxable income upon the transfer of securities to a pension trust for the benefit of its employees to the extent that the fair market value of the securities at the time of transfer exceeded the cost or other basis thereof to the company. (See generally section 19.22(a)-16 of Regulations 103 and G. C. M. 16651, C. B. XV-2, 130 (1936).)

The basis for determining gain or loss upon the sale of such securities by the trustee will be the fair market value of the securities at the time of the transfer to the trust.

SECTION 19.22(a)-1: What included in gross income.

1940-6-10170
I. T. 3349

INTERNAL REVENUE CODE.

The amount received by the M Company from a foreign purchasing commission (acting as agent for a foreign country) upon execution of an agreement between the company and the purchasing commission does not constitute taxable income to the company at that time.

Advice is requested as to the proper treatment for Federal income tax purposes of an amount received by the M Company from a foreign purchasing commission (acting as agent for a foreign country) upon the execution of an agreement negotiated between that company and the commission, relative to the purchase and sale of a certain product, for the manufacture of which the M Company will be required to construct a new unit at its plant.

The agreement recites that to assist in the financing of the erection of the new plant the foreign purchasing commission has lent to the M Company the sum of x dollars, evidenced by the M Company's nonnegotiable promissory note to the said commission, of even date therewith, payable in 10 years or upon termination of the agreement (by cancellation or otherwise), whichever shall first occur. The agreement, however, contains certain provisions relative to payment by the purchasing commission to the M Company, upon termination or cancellation of the agreement, of certain sums of money which, if not otherwise paid to the M Company, may be offset against the obligation represented by the company's note.

It is held, upon the basis of the facts presented, that the amount of x dollars received by the M Company upon execution of the contract, which amount was advanced by the purchasing commission, does not constitute taxable income to the M Company at that time.

SECTION 19.22(a)-1: What included in gross income.

INTERNAL REVENUE CODE.

Mileage allowance of member of State legislature. (See I. T. 3368, page 29.)

SECTION 19.22(a)-2: Compensation for personal services. 1940-24-10286 I. T. 3382
(Also Section 23(a), Section 19.23(a)-1, and Section 23(c), Section 19.23(c)-1.)

INTERNAL REVENUE CODE.

Where the Philadelphia income tax on salaries, wages, commissions, and other compensation earned after January 1, 1940, is paid by the employer without deduction therefor from the employee's compensation, the amount thereof constitutes additional compensation and, as such, is includible in the gross income of the employee for Federal income tax purposes and may be deducted by the employer as a business expense. The amount of tax thus assumed and paid by the employer for the employee is deductible by the employee as a tax under section 23(c) of the Internal Revenue Code.

Advice is requested concerning the proper treatment for Federal income tax purposes of the amount of the tax imposed by the city of Philadelphia on salaries, wages, commissions, and other compensation earned after January 1, 1940, where the tax is assumed and paid by the employer in addition to the employee's regular compensation.

The tax is imposed under an income tax ordinance passed by the city council of Philadelphia and approved by its acting mayor on December 13, 1939, pursuant to authority granted by an enabling act enacted by the Pennsylvania State Legislature on August 5, 1932

(P. L. 45, Extra Session, 1932). The pertinent provisions of the ordinance are set forth in I. T. 3370 (page 32, this Bulletin). As indicated in that ruling, the taxes imposed by the ordinance (section 2) of 1½ per cent on salaries, wages, commissions, and other compensation earned after January 1, 1940, are deductible by the employees whether paid by them or withheld by their employers from their salaries, wages, commissions, or other compensation. While the employer in the instant case did not withhold the amount of the tax (as required under section 4 of the ordinance), but assumed and paid the tax without deduction from the employee's regular compensation, the tax so assumed and paid by the employer is, nevertheless, the tax of the employee.

Section 23(c) of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not material here. Section 19.23(c)-1 of Regulations 103 states that in general taxes are deductible only by the person upon whom they are imposed.

In view of the foregoing, the amount of the tax assumed and paid by the employer in the instant case is not deductible by the employer as a tax under section 23(c), supra. (I. T. 3154, C. B. 1938-1, 113.) However, since the assumption and payment of the tax by the employer without deduction from the employee's regular compensation manifestly was as additional compensation for personal services actually rendered, the amount thereof is deductible by the employer under section 23(a) of the Code as a part of his ordinary and necessary business expenses. (I. T. 3154, supra.)

Consistently, the amount of the tax thus assumed and paid by the employer for the employee as additional compensation to the employee is includible as such in the employee's gross income under section 22(a) of the Code. (I. T. 3154, supra; *Old Colony Trust Co.* v. *Commissioner*, 279 U. S., 716, Ct. D. 80, C. B. VIII-2, 222 (1929), and decisions cited therein.) Furthermore, the amount of the tax thus assumed and paid by the employer for the employee is deductible by the employee as a tax under section 23(c), supra. (I. T. 3370, supra; Mim. 4595, C. B. 1937-1, 63.) The tax in this case is distinguishable in this respect from the taxes involved in *Old Colony Trust Co.* v. *Commissioner*, supra, and I. T. 3154, supra, which were nondeductible for Federal income tax purposes under express statutory provisions.

SECTION 19.22(a)-3: Compensation paid other than in cash. 1940-10-10195
T. D. 4965

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PARTS 3, 9, AND 19.—INCOME TAX.

Regulations 103, 101, 94, 86, and 77, amended.—Compensation paid other than in cash.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Section 19.22(a)-3 of Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.], article 22(a)-3 of Regulations 101

[Part 9, Title 26, Code of Federal Regulations, 1939 Sup.], article 22(a)-3 of Regulations 94, as amended by Treasury Decision 4724, approved January 18, 1937 [C. B. 1937-1, 58] [Part 3, Title 26, Code of Federal Regulations], article 22(a)-3 of Regulations 86, as amended by such Treasury Decision 4724, and article 53 of Regulations 77, as amended by such Treasury Decision 4724, are amended by striking out the fourth sentence in such section and in each of such articles reading as follows:

If living quarters such as camps are furnished to employees for the convenience of the employer, the ratable value need not be added to the cash compensation of the employees, but if a person receives as compensation for services rendered a salary and in addition thereto living quarters, the value to such person of the quarters furnished constitutes income subject to tax.—

and by substituting in lieu thereof the following two sentences:

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.

(This Treasury decision is prescribed pursuant to sections 22(a) and 62 of the Internal Revenue Code (53 Stat., Part 1) and of sections 22(a) and 62 of the Revenue Acts of 1938, 1936, 1934, and 1932 (52 Stat., 457, 480, 49 Stat., 1657, 1673, 48 Stat., 686, 700, 47 Stat., 178, 191; 26 U. S. C., 22, 62, and Sup.).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved February 29, 1940.

H. MORGENTHAU, Jr.,
Secretary of the Treasury.

(Filed with the Division of the Federal Register March 1, 1940, 10.46 a. m.)

SECTION 19.22(a)-3: Compensation paid other than in cash. 1940-16-10235
Mim. 5023

Taxability of compensation other than in cash—living quarters furnished employees.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., March 22, 1940.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Others Concerned:

1. Treasury Decision 4965, approved February 29, 1940 (page 13, this Bulletin), amends article 53 of Regulations 77, as amended by Treasury Decision 4724, approved January 18, 1937 [C. B. 1937-1, 58], articles 22(a)-3 of Regulations 86 and 94, as amended by such Treasury Decision 4724, article 22(a)-3 of Regulations 101, and section 19.22(a)-3 of Regulations 103, by striking out the fourth sentence in each of such articles and such section, which reads as follows:

If living quarters such as camps are furnished to employees for the convenience of the employer, the ratable value need not be added to the cash compensation of the employees, but if a person receives as compensation for services rendered a salary and in addition thereto living quarters, the value to such person of the quarters furnished constitutes income subject to tax.—

and substituting in lieu thereof the following two sentences:

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.

2. The purpose of the foregoing amendments of the several regulations mentioned is to clarify the position of the Bureau on the question as to the circumstances under which the value of living quarters or meals furnished to employees by their employer is to be included in the gross income of the employees. Except as indicated below, if living quarters or meals are furnished to an employee, the value thereof to him constitutes income subject to tax and must, therefore, be included in his gross income as compensation. If, however, the living quarters or meals furnished are not compensatory or are furnished for the convenience of the employer, the value thereof need not be added to the compensation otherwise received by the employee.

3. As a general rule, the test of "convenience of the employer" is satisfied if living quarters or meals are furnished to an employee who is required to accept such quarters and meals in order to perform properly his duties. For example, if an employee is subject to immediate service at any time during the 24 hours of the day and, therefore, can not obtain quarters or meals elsewhere without material interference with his duties and on that account is required by the employer to accept quarters or meals furnished by the employer, the value thereof need not be included in the gross income of the employee. (See O. D. 915, C. B. 4, 85 (1921).)

4. The rental value of living quarters furnished by a State to its Governor need not be added to the compensation otherwise received by him for the performance of his official duties.

5. For examples of circumstances under which living quarters or allowances therefor are not compensatory see the fifth sentence of section 19.22(a)-3 of Regulations 103 and the corresponding sentence of prior regulations, G. C. M. 14710 (C. B. XIV-1, 44 (1935)), and G. C. M. 14836 (C. B. XIV-1, 45 (1935)), relating to Federal foreign service employees. For further examples of circumstances under which it has been held that quarters were furnished for the convenience of the employer and the value thereof need not be included in the gross income of the employees, see O. D. 814 (C. B. 4, 84 (1921)), relating to fishermen and canners, and I. T. 2253 (C. B. V-1, 32 (1926)), relating to household servants.

6. Inquiries regarding this mimeograph should refer to the number thereof and the symbols IT: TM.

GUY T. HELVERING,
Commissioner.

SECTION 19.22(a)-7: Gross income of farmers. 1940-23-10277
(Also Section 143, Section 19.143-1.) I. T. 3379

INTERNAL REVENUE CODE AND REVENUE ACTS OF 1936 AND 1938.

Amounts received under the Soil Conservation and Domestic Allotment Act, as amended, the Price Adjustment Act of 1938, section 303 of the Agricultural Adjustment Act, as amended, and the Sugar Act of 1937 constitute taxable income to the recipients for Federal income tax purposes. Payments made under those Acts to nonresident alien owners of land located in the United States are subject to deduction and withholding of tax at the source at the rate of 5 per cent when made to nonresident alien residents of Canada and at the rate of 10 per cent when made to all other nonresident aliens.

Advice is requested as to the taxability of, and the application of section 143(b) of the Internal Revenue Code and section 143(b) of the Revenue Acts of 1936 and 1938 to, payments made under the Soil Conservation and Domestic Allotment Act, as amended (Public, No. 461, Seventy-fourth Congress), the Price Adjustment Act of 1938 (Title V of Public Resolution No. 122, Seventy-fifth Congress), section 303 of the Agricultural Adjustment Act, as amended (Public, No. 430, Seventy-fifth Congress), and the Sugar Act of 1937 (Public, No. 414, Seventy-fifth Congress).

Payments under the Soil Conservation and Domestic Allotment Act, as amended, accrue to persons who, as landowners, tenants, or sharecroppers, comply with certain requirements concerning acreages devoted to soil-depleting or soil-conserving crops or perform certain soil-building practices on farms located in the continental United States or in the Territories of the United States.

Under the Price Adjustment Act of 1938, payments are made to wheat, cotton, corn, and rice producers whose acreage planted to any such commodity for harvest on the farm in 1939 was not in excess of the farm acreage allotment established for that commodity under the 1939 agricultural conservation program. Similar payments with respect to 1940 crops are to be made pursuant to section 303 of the Agricultural Adjustment Act of 1938, as amended.

Payments under the Sugar Act of 1937 are made to producers of sugar beets and sugar cane who do not employ child labor, who pay the wages for farm labor determined by the Secretary of Agriculture to be fair and reasonable, who hold their marketings within the farm proportionate share, who carry out such farming practices as are determined by the Secretary of Agriculture to be soil-conserving, and, in the case of producers who are also processors of sugar beets and sugar cane, who pay for such sugar beets and sugar cane a price determined by the Secretary of Agriculture to be fair and reasonable.

In I. T. 2767 (C. B. XIII-1, 35 (1934)) it was held that the rental or benefit payments made to producers under the provisions of the Agricultural Adjustment Act for the reduction in acreage, or the reduction in production for market of any basic agricultural commodity specified in section 11 of the Act, as amended, constitute taxable income to the recipients for Federal income tax purposes. It was also held in I. T. 2992 (C. B. XV-2, 75 (1936)) that payments or grants made to agricultural producers pursuant to the provisions of the Act entitled "An Act to provide for the protection of land resources against soil erosion, and for other purposes" (Public, No.

46, Seventy-fourth Congress), as amended by the Soil Conservation and Domestic Allotment Act, supra, constitute taxable income to the recipients for Federal income tax purposes.

Amounts received by persons who, as landowners, tenants, or sharecroppers, comply with the requirements concerning acreage devoted to soil-depleting or soil-conserving crops or perform certain soil-building practices, who plant wheat, cotton, corn, and rice for harvest in an acreage not in excess of the farm acreage allotment established for the commodity under the 1939 and 1940 agricultural conservation program, who hold their marketings of sugar beets and sugar cane within the farm proportionate share (while not employing child labor and while paying the wages for farm labor determined by the Secretary of Agriculture to be fair and reasonable) and, in the case of producers who are also processors of sugar beets and sugar cane, who pay for such sugar beets and sugar cane a price determined by the Secretary of Agriculture to be fair and reasonable, constitute payments similar, for Federal income tax purposes, to the payments considered in I. T. 2767, supra, and I. T. 2992, supra. Hence, it is held that the amounts received under the Acts cited in the first paragraph of this ruling constitute taxable income to the recipients for Federal income tax purposes.

Under section 143(b) of the Internal Revenue Code and section 143(b) of the Revenue Acts of 1936 and 1938, all disbursing officers and employees of the United States are required to deduct and withhold income tax at the rate of 10 per cent (the rate of 10 per cent has been reduced to 5 per cent in the case of residents of Canada under the terms of the tax convention between the United States and Canada) from payments to nonresident aliens of interest (except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having an office or place of business therein), dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income from sources within the United States.

The amounts received under the above Acts by nonresident alien owners of land located in the United States constitute fixed or determinable annual or periodical income from sources within the United States. (See sections 119(a)4, 143(b), and 211(a) of the Internal Revenue Code and the Revenue Acts of 1936 and 1938; cf. I. T. 2976, C. B. XV-1, 138 (1936).) Such payments, therefore, are subject to deduction and withholding of tax at the source at the rate of 5 per cent when made to nonresident alien residents of Canada and at the rate of 10 per cent when made to all other nonresident aliens.

SECTION 22(b).—GROSS INCOME: EXCLUSIONS FROM GROSS INCOME.

SECTION 19.22(b)(2)-2: Annuities.

INTERNAL REVENUE CODE.

Treatment of annuity contracts and payments thereon in connection with several trusts (not qualified under section 165) maintained for the benefit of employees. (See I. T. 3346, page 62.)

SECTION 19.22(b)(2)-2: Annuities.   1940-14-10218
I. T. 3362

INTERNAL REVENUE CODE.

Amounts deducted from the salaries of municipal employees and paid into the municipal employees' annuity and benefit fund of the city of R, State of Illinois, pursuant to the act of the General Assembly of the State of Illinois, approved June 29, 1921, as amended, should be included in the gross income of the employees for Federal income tax purposes.

Advice is requested with respect to the inclusion in gross income of the amounts deducted from the salaries of municipal employees and paid into the municipal employees' annuity and benefit fund of the city of R, State of Illinois (hereinafter referred to as the fund), pursuant to the act of the General Assembly of the State of Illinois, approved June 29, 1921, as amended.

In support of the position that such amounts should not be included in gross income, the case of *Hughes* v. *Traeger* (264 Ill., 612, 106 N. E., 431) is cited. In that case the Supreme Court of Illinois construed the act of the general assembly of that State, approved May 31, 1911, providing for the deduction of a specified amount from the salaries and wages of certain municipal employees for the establishment and maintenance of a pension fund for such employees. The court stated that the amounts deducted did not become the property of the employee and could not be controlled or disposed of by him. However, the act of May 31, 1911, was superseded as to cities of over 200,000 inhabitants by an act, approved June 29, 1921, entitled "An act to provide for the creation, setting apart, maintenance, and administration of a municipal employees' annuity and benefit fund in cities having a population exceeding 200,000 inhabitants," and was later repealed by an act approved February 21, 1931. (See Laws of Illinois, 1921, page 205, and Laws of Illinois, 1931, page 856.)

The act of June 29, 1921, as amended, provides in part as follows:

SEC. 16. (c) Each such deduction from salary and corresponding contribution by the city shall be allocated to the account of and credited to the future entrant for whose benefit it is made for age and service annuity purposes.

* * * * * * *

(e-e) * * * Each amount credited to any future entrant in accordance with the foregoing provision of this section shall be improved to the credit of such future entrant by interest at the rate of four (4) per cent per annum during all time thereafter that such future entrant shall be in the service, until such future entrant shall attain an age of sixty-five (65) years. * * *

* * * * * * *

SEC. 39. (a) 1. Any municipal employee, without regard to the period of time he shall have served, who shall resign or be discharged from the service after the 1st day in the month of January of the first year after the year in which this act shall come in force and effect in such city, and before he shall become fifty-five (55) years of age, and any municipal employee, who shall have served less than ten (10) years, who shall resign or be discharged from the service after the 1st day in the month of January of the first year after the year in which this act shall come in force and effect in such city and before he shall have become sixty (60) years of age, shall have a right to have refunded to him the entire amount which shall have accumulated to his credit for age and service annuity and widow's annuity purposes on the date of such resignation or discharge from the service from amounts deducted from his salary in accordance with the provisions of this act. * * *

The act of May 31, 1911, did not contain provisions similar to those quoted. Therefore, even if it be conceded that the Illinois Supreme Court in the case of *Hughes* v. *Traeger*, supra, laid down a rule of property which would be controlling in the determination of a similar question under the act of May 31, 1911, it is the opinion of this office that the decision of the court in that case would not of necessity be followed by the United States courts in cases arising under the act approved June 29, 1921, the pertinent provisions of which are materially different from those of the prior act.

This office is also of the opinion that the rights of the beneficiaries under the fund are not distinguishable from the rights of beneficiaries under the Civil Service Retirement Act and similar legislation. The Bureau has consistently held that deductions made from salaries of civil service employees to be applied to the purchase of retirement annuities are to be included in the gross income of such employees. (See T. D. 3112, C. B. 4, 76 (1921).) A similar conclusion was reached with respect to amounts withheld from the salaries of American foreign service officers (I. T. 2162, C. B. IV-1, 29 (1925)).

In view of the foregoing, it is held that the gross amount of the salaries of the municipal employees of the city of R, State of Illinois, without diminution for the amounts deducted therefrom and paid into the fund, are to be included in the gross income of the employees for Federal income tax purposes. It follows, therefore, that the amounts refunded to the employees from the fund in the event that they do not become eligible for annuities are not to be treated as compensation for such purposes.

With regard to the taxability of retirement annuities received by the employees, it is held that such annuities are taxable to the extent provided in section 22(b)2 of the Internal Revenue Code.

With respect to annuities paid from the fund to beneficiaries of the employees, it is held that such annuity payments are taxable to the beneficiaries on the same basis as to the retired employees.

SECTION 19.22(b)(2)-2: Annuities. 1940-15-10226
I. T. 3364

INTERNAL REVENUE CODE.

Treatment for Federal income tax purposes of annuities received in 1939 by retired municipal employees.

Advice is requested relative to the taxability for Federal income tax purposes of annuity payments received in 1939 by a retired employee of the city of S.

The question arises under section 22(b)2 of the Internal Revenue Code, relating to annuities, which section provides in part as follows:

> * * * 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 * * * until the aggregate amount excluded from gross income under this chapter or prior income tax laws in respect to such annuity equals the aggregate premiums or consideration paid for such annuity. * * *

Similar provisions are contained in the Revenue Acts of 1934, 1936, and 1938.

In the present case the employee retired in 1934 and receives an annuity of $2,000. The amount of the annuity received by him in 1934 and 1935 equaled the amount of $4,000 which he had paid into the retirement fund. The question presented is whether the retired employee, a single person, should include in gross income for 1939 the full amount of the annuity of $2,000, or whether for the year 1939 he should include only 3 per cent of $4,000, the consideration paid by him for the annuity, and only 3 per cent of $4,000 for each year thereafter until the total consideration paid by him has been excluded from gross income in 1939 and subsequent years.

Prior to the year 1939 a retired municipal employee did not include any part of such an annuity in his Federal income tax returns. It is contended, however, that because no part of the retired employee's annuity was excluded from gross income for the years prior to 1939 on account of the statutory provisions contained in section 22(b)2 of the Revenue Acts of 1934, 1936, and 1938, 3 per cent of $4,000, or $120, should be included in gross income for Federal income tax purposes for 1939, and $1,880 excluded; that a like amount ($120) should be included in gross income for 1940; that in 1941, $1,760 (the remainder of the total consideration not previously excluded) will be includible in gross income; and that thereafter a total of $2,000 will be required to be included in gross income each year.

The evident intent of the above-quoted provisions of law is to provide that until the capital invested, that is, the amounts contributed to the retirement fund by an annuitant (the employee in the instant case) are recovered, it can not be said that the annuitant is receiving income other than the income of 3 per cent upon the capital invested by him, and for that reason it is provided that any amount in excess of the estimated return (3 per cent) on the amount invested shall be excluded from gross income until the aggregate amount so excluded equals the aggregate premiums or consideration paid for the annuity. It is apparent in the instant case that the employee, who retired in 1934 and had paid into the retirement fund $4,000, and had, from 1934 up to and including 1938, received $2,000 a year, has recovered tax-free the entire amount paid by him into the retirement fund. Therefore, it is held, under the facts presented, that the total amount of $2,000 received by the retired employee in 1939 should be included in gross income for Federal income tax purposes for that year.

In the case of an employee who retired in 1937, his annuity to become effective on January 1, 1938, the result is different. In such a case, the provisions of section 22(b)2 of the Internal Revenue Code should be applied in the following manner: In 1939 and subsequent years, the employee receiving the annuity of $2,000 must include in gross income the taxable portion of his annuity. In determining such taxable portion, it should be considered that in the year 1938 he received as income an amount equal to 3 per cent of the aggregate premiums or consideration paid for his annuity, or $120, with the result that $1,880 was excluded from gross income for that year. Then for 1939 he should return for Federal income tax purposes 3 per cent of the consideration paid, that is, $120, and exclude from gross income $1,880 of the annuity of $2,000 received by him in that year.

On such basis, $3,760 of the consideration paid for the annuity will have been recovered in 1938 and 1939. For the year 1940, $1,760 is includible in gross income, the retired employee having already recovered all but $240 of the total consideration of $4,000 paid by him for the annuity. It is apparent that had the employee retired in 1936, the annuity to become effective on January 1, 1937, it would be for the year 1939 that he would include in gross income $1,760 and, further, that if he had retired in 1935 and his annuity became effective on January 1, 1936, the total amount of $2,000 would be includible in gross income for 1939.

SECTION 19.22(b)(4)-4: Interest upon United States obligations. 1940-4-10147 I. T. 3343

INTERNAL REVENUE CODE.

Exemption of interest (increment in value) on United States savings bonds in the case of an individual who keeps his accounts and makes his Federal income tax returns on the cash receipts and disbursements basis.

Where an individual citizen or resident alien of the United States, regularly employing the cash receipts and disbursements basis in making Federal income tax returns, purchases each year, during a period of 10 years, United States savings bonds in an amount not in excess of $5,000 (purchase price) which mature 10 years from date of issue and surrenders them for redemption at maturity, the interest (increment in value) received therefrom, i. e., on such bonds of a principal amount (purchase price) not in excess of $5,000, is then income and is wholly exempt from income taxation, including Federal surtax, excess-profits tax, and war-profits tax, provided he claims no exemption from any Federal surtax, excess-profits tax, or war-profits tax with respect to any interest received (actually or constructively) in the same taxable year on account of other bonds which were issued under the authority of the Second Liberty Bond Act, as amended. (See I. T. 2958, C. B. XV-1, 120 (1936); I. T. 3262, C. B. 1939-1 (Part 1), 96; and I. T. 3324, C. B. 1939-2, 135.)

In the case of the death of such taxpayer, however, interest accrued but not received up to the date of his death is income for the taxable year or period in which falls the date of his death, as well as any interest received by him during that taxable period. (Section 42, Internal Revenue Code.) The interest (increment in value) accrued on unredeemed United States savings bonds is shown in a table of redemption values thereon. (Cf. G. C. M. 15875, C. B. XIV-2, 100 (1935).) His interest on United States savings bonds to the extent that it is on an amount of such bonds the principal (purchase price) of which does not exceed in the aggregate $5,000 (and provided no exemption from Federal surtax, excess-profits tax, or war-profits tax, is claimed for the taxable period with respect to interest on account of other bonds which were issued under the authority of the Second Liberty Bond Act, as amended), being wholly exempt from income taxation, shall be excluded from his gross income and net income. (Sections 21 and 22(b)4, Internal Revenue Code.) The balance, if any, of his interest on United States savings bonds, being not exempt from Federal surtax (or from any Federal excess-profits or war-profits taxes then imposed), shall be included in his gross income and net income (sections 21 and 22(b)4, supra), but, inasmuch as interest on United States savings bonds is exempt, without limit, from normal tax, a credit for the amount of such interest included in his gross income and net income shall be allowed, for the purpose of the normal tax only, against his net income. (Section 25(a)1, Internal Revenue Code.)

Whether or not the interest on United States savings bonds is wholly exempt, there must be submitted in the taxpayer's Federal income tax return a statement showing the number and amount of such obligations owned by him and the income therefrom, in such form and with such information as the Commissioner may require. (Section 22(b)4, supra.)

SECTION 19.22(b)(4)-4: Interest upon United States obligations. 1940-10-10191 I. T. 3355

INTERNAL REVENUE CODE.

Interest upon bonds issued under the provisions of section 15c of the Tennessee Valley Authority Act of 1933, which was added by the Act of July 26, 1939, is subject to Federal income tax.

Advice is requested as to the status, for Federal income tax purposes, of interest upon bonds of the Tennessee Valley Authority, issued under section 15c of the Act of July 26, 1939 (Public, No. 224, Seventy-sixth Congress, chapter 366, first session), which amended the Tennessee Valley Authority Act of 1933 (48 Stat., 58), as amended by the Act of August 31, 1935 (49 Stat., 1075).

Section 15c of the Tennessee Valley Authority Act of 1933, which was added by the Act of July 26, 1939, supra, authorizes the issuance by the Tennessee Valley Authority, with the approval of the Secretary of the Treasury, of bonds not to exceed in the aggregate $61,500,000.

Under section 22(b)4 of the Internal Revenue Code, relating to tax-free interest, it is provided that interest upon obligations of a corporation organized under an Act of Congress, if such corporation is an instrumentality of the United States, shall be exempt from taxation only if and to the extent provided for in the Acts authorizing the issue thereof. There is no provision in the Act of July 26, 1939, whereby the interest upon bonds issued under the provisions of section 15c of the Tennessee Valley Authority Act of 1933, as amended, is exempt from Federal income tax. It follows, therefore, that the interest upon such bonds is subject to Federal income tax.

SECTION 22(d) (AMENDED BY SECTION 219, REVENUE ACT OF 1939).—GROSS INCOME: INVENTORIES IN CERTAIN INDUSTRIES.

SECTION 19.22(d)-1: Inventories under elective method. 1940-2-10137 T. D. 4959

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 9, SUBPART H; SUBCHAPTER E, PART 465, SUBPART B.—INCOME TAX.

Regulations relating to elective method of taking inventories for years beginning subsequent to December 31, 1938.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

In order to conform Regulations 101 (Part 9, Subpart H, Title 26, Code of Federal Regulations), as made applicable to the Internal Revenue Code (53 Stat., Part 1) by Treasury Decision 4885, approved February 11, 1939 [C. B. 1939-1 (Part 1), 396] (Part 465, Subpart B, Title 26, Code of Federal Regulations), to section 219 of the Revenue Act of 1939 (Public, No. 155, Seventy-sixth Congress, first session) amending section 22(d) of the Internal Revenue Code, such regulations are amended as follows:

(1) The following is inserted immediately preceding article 22(d)-1 (section 9.22(d)-1, Title 26, Code of Federal Regulations), as made applicable to the Internal Revenue Code:

Section 219. Inventories (Revenue Act of 1939).

SEC. 219. INVENTORIES.

(a) AMENDMENT TO CODE.—Section 22(d) of the Internal Revenue Code (relating to inventories in certain industries) is amended to read as follows:

"(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 (to ascertain income, profit, or loss, for credit purposes, or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries) such goods for any period beginning with or during the first taxable year for which the method described in paragraph (1) is to be used.

"(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 period beginning with or during any subsequent taxable year some procedure other than that specified in subparagraph (B) of paragraph (1) in inventorying (for ascertaining income, profit, or loss, for credit purposes, or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries) the goods specified in the application, 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."

(b) TAXABLE YEARS TO WHICH APPLICABLE.—The amendment made by subsection (a) shall be applicable to taxable years beginning after December 31, 1938.

(c) AMENDMENT TO 1938 ACT.—Section 22(d) of the Revenue Act of 1938 (relating to inventories in certain industries) is amended to read as follows:

"(d) If the inventory method described in section 22(d)(1), as amended, of the Internal Revenue Code is used for the first taxable year beginning after December 31, 1938, then, in determining income for the preceding taxable year, the closing inventory of such year of the goods specified in the application under section 22(d)(2), as amended, of such Code shall be at cost."

(2) Article 22(c)–1 [section 9.22(c)–1, Title 26, Code of Federal Regulations] is amended by inserting at the end thereof the words,

(But see article 22(d)–1.)

(3) Article 22(c)–2 [section 9.22(c)–2, Title 26, Code of Federal Regulations] is amended by inserting at the end of the first sentence of the fourth paragraph thereof the words,

except as to those goods inventoried under the elective method authorized by section 22(d),

so that the sentence so amended will read as follows:

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).

(4) Article 22(c)–2 is further amended by inserting in lieu of the sixth sentence of the fourth paragraph thereof the following sentence:

But see section 22(d) as to inventories under elective method.

(5) Article 22(c)–7 [section 9.22(c)–7, Title 26, Code of Federal Regulations] is amended by inserting in lieu of the last sentence thereof the following sentence:

See section 22(d) as to inventories under elective method.

(6) Articles 22(d)–1 to 22(d)–4 [sections 9.22(d)–1 to 9.22(d)–4, Title 26, Code of Federal Regulations], inclusive, are stricken out and there is substituted in lieu thereof the following:

ART. 22(d)–1 [section 9.22(d)–1, Title 26, Code of Federal Regulations, 1939 Sup.]. *Inventories under elective method.*—Any taxpayer permitted or required to take inventories pursuant to the provisions of section 22(c) of the Internal Revenue Code, and pursuant to the provisions of articles 22(c)–1 to 22(c)–8 of these regulations [sections 9.22(c)–1 to 9.22(c)–8, Title 26, Code of Federal Regulations] 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) of the Code as amended by section 219 of the Revenue Act of 1939. 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 beginning after December 31, 1938.

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

ART. 22(d)-2 [section 9.22(d)-2, Title 26, Code of Federal Regulations, 1939 Sup.]. *Requirements incident to adoption and use of elective method.*—The adoption and use of the elective inventory method is, by statute and by these regulations, made subject to the following requirements:

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

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

(3) 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, such actual cost of the aggregate being determined pursuant to the inventory method employed by the taxpayer under the regulations applicable to the preceding taxable year;

(4) 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:

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

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

(*c*) 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

(*d*) 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 in accordance with these regulations 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 1939 with an opening inventory of 10 units at 10 cents per unit, that it makes 1939 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 1939 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 1940 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 1938)		=100
	1 @ 13 (July, 1939)	=	13
	2 @ 14 (October, 1939)	=	28
Totals:	13		141

or

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

	10 @ 10 (from 1938)		=100
	1 @ 11 (January, 1939)	=	11
	2 @ 12 (April, 1939)	=	24
Totals:	13		135

or

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

	10 @ 10 (from 1938)		=100
	3 @ 13 (from 1939)	=	39
Totals:	13		139

(5) The taxpayer shall establish to the satisfaction of the Commissioner that the taxpayer has not, in the taxable year for which the elective inventory method is first used or in any subsequent taxable year, used in determining income, profit, or loss, for credit purposes, or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, any inventory method other than that referred to in article 22(d)-1 [section 9.22(d)-1, Title 26, Code of Federal Regulations, 1939 Sup.] or at variance with the requirement referred to in paragraph (3) of this article, the taxpayer's use of market value in lieu of cost not being considered at variance with this requirement;

(6) 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, whether such preceding taxable year began before or after December 31, 1938, shall be included in the taxpayer's inventory for such preceding taxable year at cost;

(7) 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—

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

(*b*) The Commissioner determines that the taxpayer has used in ascertaining income, profit, or loss, for credit purposes, or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, and for years subsequent to his adoption of the elective inventory method, an inventory method at variance with that referred to in article 22(d)-1 and requires of the taxpayer a change to a different method for such subsequent taxable year or any taxable year thereafter;

(8) The taxpayer shall maintain such accounting records as will enable the Commissioner readily to verify the taxpayer's inventory computations as well as his compliance with these several requirements.

ART. 22(d)-3 [section 9.22(d)-3, Title 26, Code of Federal Regulations, 1939 Sup.]. *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 the ninetieth day after the approval of these regulations, then at any time prior to the expiration of such ninetieth day), in triplicate on Form 970 (revised), and pursuant to the instructions printed thereon and to the requirements of these regulations, 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 taxpayer'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.

ART. 22(d)-4 [section 9.22(d)-4, Title 26, Code of Federal Regulations, 1939 Sup.]. *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.

ART. 22(d)-5 [section 9.22(d)-5, Title 26, Code of Federal Regulations, 1939 Sup.]. *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 application therefor filed with him as provided in article 41-2 of these regulations [section 9.41-2, Title 26, Code of Federal Regulations].

ART. 22(d)-6 [section 9.22(d)-6, Title 26, Code of Federal Regulations, 1939 Sup.]. *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 article 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.

(This Treasury decision is issued under the authority of section 22(d) of the Internal Revenue Code (53 Stat., Part 1) as amended by section 219 of the Revenue Act of 1939 (Public, No. 155, Seventy-sixth Congress, first session) and section 62 of the said Internal Revenue Code.)

JOHN L. SULLIVAN,
Acting Commissioner of Internal Revenue.

Approved December 28, 1939.

JOHN W. HANES,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 29, 1939, 12.44 p. m.)

SECTION 23(a).—DEDUCTIONS FROM GROSS INCOME: EXPENSES.

SECTION 19.23(a)-1: Business expenses. 1940-21-10262
I. T. 3373

INTERNAL REVENUE CODE.

The cost of helmets, rubber coats, and rubber boots required to be purchased and worn by city firemen, and the cost of rubber coats and rubber boots required to be purchased and worn by city policemen, constitute allowable deductions for Federal income tax purposes.

Advice is requested whether the cost of helmets, rubber coats, and rubber boots required to be purchased and worn by firemen, and the cost of rubber coats and rubber boots required to be purchased and worn by policemen, all employees of the city of R, are allowable deductions for Federal income tax purposes.

The Bureau holds that where certain articles of wearing apparel are specifically required by the taxpayer's business, being used solely in his business, and such articles are not adaptable to general or continued wear to the extent that they may be said to replace the wearer's regular clothing, the cost thereof is a deductible business expense. (See G. C. M. 19662, C. B. 1938-1, 118, and G. C. M. 19790, C. B. 1938-1, 118.) This rule applies to helmets, rubber coats, and rubber boots purchased and worn by firemen and policemen in the employ of the city of R. The cost of such articles is, therefore, an allowable deduction for Federal income tax purposes.

SECTION 19.23(a)-2: Business expenses. 1940-23-10278
I. T. 3380

INTERNAL REVENUE CODE.

Traveling expenses incurred by teachers on sabbatical leave, who receive compensation while engaged in the required traveling and who must report relative to their travel, are deductible for Federal income tax purposes.

Advice is requested whether traveling expenses incurred by teachers during sabbatical leave are deductible for Federal income tax purposes.

The traveling referred to is required of teachers by the board of education. Each month a report must be sent in by the teacher showing the places visited by him and the amount of time spent in each place. Not more than 30 days are allowed for traveling in any one State. A monthly salary is paid to the teacher during sabbatical leave, which leave is permitted after seven years of continuous teaching.

Section 23(a)1 of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions the ordinary and necessary expenses paid or incurred during the taxable year, including traveling expenses while away from home in pursuit of the individual's trade or business. It is accordingly held that traveling expenses incurred by teachers on sabbatical leave, who receive compensation while engaged in required traveling and who must report relative to their travel, are deductible for Federal income tax purposes.

SECTION 19.23(a)-1: Business expenses.

INTERNAL REVENUE CODE.

City of Philadelphia employee's tax paid by the employer for the employee. (See I. T. 3382, page 12.)

SECTION 19.23(a)-2: Traveling expenses. 1940-17-10239
(Also Section 22(a), Section 19.22(a)-1.) I. T. 3368

INTERNAL REVENUE CODE.

Hotel expenses incurred by a member of the State legislature of the State of R while away from home performing his legislative duties during the session of the State legislature are deductible in determining his net income for Federal income tax purposes. The mileage allowance received by him should be included in gross income and the actual expense incurred in travel to perform his legislative duties is deductible.

Advice is requested whether a member of the legislature of the State of R may deduct from his gross income the hotel expenses incurred by him while away from home during the period the State legislature is in session, and whether his mileage allowance should be included in gross income. It appears that the State legislature meets infrequently and is in session for a very short time.

It is held that a member of the legislature of the State of R, who is away from home while he is engaged in the performance of legislative duties in the State capital, may deduct his hotel expenses incurred during such period. It is also held that his mileage allowance should be included in gross income and that his actual expense of travel to perform his legislative duties may be deducted.

SECTION 19.23(a)-6: Compensation for personal services.

INTERNAL REVENUE CODE.

Deductibility of contributions to several trusts (not qualified under section 165) maintained for the benefit of employees. (See I. T. 3346, page 62.)

SECTION 23(b).—DEDUCTIONS FROM GROSS INCOME: INTEREST.

SECTION 19.23(b)-1: Interest. 1940-20-10260
T. D. 4969

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 19.—INCOME TAX.

Amending section 19.23(b)-1 of Regulations 103 relative to the deductibility of Maryland and Pennsylvania ground rents.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

The last sentence of the second paragraph of section 19.23(b)-1 of Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.] is hereby amended to read as follows:

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.

(This Treasury decision is issued under the authority contained in sections 23 and 62 of the Internal Revenue Code (53 Stat., 12, 32).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved May 6, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register May 7, 1940, 3.14 p. m.)

SECTION 23(c).—DEDUCTIONS FROM GROSS INCOME: TAXES GENERALLY.

SECTION 19.23(c)-1: Taxes. 1940-12-10206
I. T. 3358

INTERNAL REVENUE CODE.

The cost of the stamps which are required by the laws of the State of New Hampshire to be purchased and affixed to packages of tobacco products is an allowable deduction as a tax in the return of the distributor or dealer purchasing and affixing the stamps.

Advice is requested relative to the deductibility for Federal income tax purposes of the tax imposed on tobacco products by the State of New Hampshire in 1939.

The law under which the tax is imposed is contained in chapter 167, sections 1 to 19, inclusive, approved June 7, 1939, as amended by chapter 180, approved June 14, 1939, of the New Hampshire Public Acts and Joint Resolutions of the Legislature of 1939.

Under the provisions of those statutes, any person in the State of New Hampshire who is engaged in the business of selling tobacco products must secure a license. With the exception of certain nonresidents engaged in the business of selling and shipping tobacco products into the State, stamps are sold only to licensed distributors and licensed dealers. It is clear that under the State law the tax is imposed upon the distributors or dealers who, in purchasing and affixing the stamps, pay the tax.

Section 23(c) of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Section 19.23(c)-1 of Regulations 103, issued under the Internal Revenue Code, states that in general taxes are deductible only by the person upon whom they are imposed.

It is held that for Federal income tax purposes the cost of the stamps which are required by the laws of the State of New Hampshire to be purchased and affixed to packages of tobacco products is an allowable deduction as a tax in the return of the distributor or dealer purchasing and affixing the stamps. The cost of the stamps, however, may not be deducted separately as a tax if it is included as a part of the business expense of the distributor or dealer, or is otherwise used to reduce his net income. To the purchaser or consumer of the tobacco products, the cost of the stamps is merely additional cost of the article purchased.

SECTION 19.23(c)-1: Taxes. 1940-15-10227
I. T. 3365

INTERNAL REVENUE CODE.

Amounts deposited in parking meters in the District of Columbia are not allowable deductions as taxes under section 23(c) of the Internal Revenue Code. If, however, amounts deposited in the meters represent expenditures in connection with the taxpayer's trade or business, such amounts may be deducted as a business expense.

Advice is requested whether the amounts deposited by taxpayers in parking meters in the District of Columbia constitute allowable deductions as taxes for Federal income tax purposes.

Section 11 of the Act of April 4, 1938 (52 Stat., 156, 192), provides:

SEC. 11. The Commissioners of the District of Columbia are hereby authorized and empowered, in their discretion, to secure and to install experimentally, at no expense to the said District, mechanical parking meters or devices on the streets, avenues, roads, highways, and other public spaces in the District of Columbia under the jurisdiction and control of said Commissioners, such installations to be limited to a linear footage not to exceed the total of the perimeters of four normally sized squares in such District; and said Commissioners are authorized and empowered to make and enforce rules and regulations for the control of the parking of vehicles on such streets, avenues, roads, highways, and other public spaces, and as an aid to such regulation and control of the parking of vehicles the Commissioners may prescribe fees for the privilege of parking vehicles where said meters or devices are installed.

The Commissioners are further authorized and empowered to pay the purchase price and cost of installation of the said meters or devices from the fees collected, which are hereby appropriated for such purpose, for the fiscal years 1938 and 1939, and thereafter such meters or devices shall become the property of said District, and all fees collected shall be paid to the collector of taxes for deposit in the Treasury of the United States to the credit of the revenues of said District.

The question whether a particular charge is to be regarded as a tax depends upon its real nature. In 26 Ruling Case Law, page 17, the general rule distinguishing taxation from regulations is stated in the following language:

4. *Taxation distinguished from regulation.*—Some governments derive a considerable revenue from a judicious exercise of the power of regulation; but since a tax is a charge imposed for the purpose of raising revenue, a charge primarily imposed for the purpose of regulation is not a tax, and is not subject to the constitutional limitations upon the power of taxation. * * * If the primary purpose of the legislature in imposing such a charge is to regulate the occupation or the act, the charge is not a tax, even if it produces revenue for the public. * * *

In the instant case the statute clearly shows that the fee prescribed is for regulatory purposes and is not for the purpose of raising revenue. Accordingly, it is held that amounts deposited by taxpayers in parking meters in the District of Columbia are not allowable deductions as taxes under section 23(c) of the Internal Revenue Code. If, however, amounts deposited in the meters represent expenditures in connection with the taxpayer's trade or business, such amounts may be deducted as a business expense.

SECTION 19.23(c)-1: Taxes. 1940-18-10245
I. T. 3370

INTERNAL REVENUE CODE.

Deductibility for Federal income tax purposes of income taxes imposed by the city of Philadelphia.

Advice is requested concerning the deductibility for Federal income tax purposes of income taxes imposed by the city of Philadelphia.

Under authority granted by an enabling act enacted by the Pennsylvania State Legislature on August 15, 1932, the city council of Philadelphia passed an income tax ordinance approved by the acting mayor on December 13, 1939. The pertinent provisions of the ordinance are quoted below:

SEC. 2. *Imposition of tax.*—An annual tax for general revenue purposes of 1½ per centum is hereby imposed on (*a*) salaries, wages, commissions and other compensation earned after January 1, 1940, by residents of Philadelphia; and on (*b*) salaries, wages, commissions and other compensation earned after January 1, 1940, by nonresidents of Philadelphia for work done or services performed or rendered in Philadelphia; and on (*c*) the net profits earned after January 1, 1939, of businesses, professions or other activities conducted by such residents, and on (*d*) the net profits earned after January 1, 1939, of businesses, professions or other activities conducted in Philadelphia by nonresidents.

* * * * * * *

SEC. 4. *Collection at source.*—Each employer within the city of Philadelphia who employs one or more persons on a salary, wage, commission or other compensation basis shall deduct, monthly or more often than monthly, at the time of the payment thereof, the tax of 1½ per centum of salaries, wages, commissions or other compensation due by the said employer to the said employee and shall, on or before the 15th day of the month next following the said deduction make a return and pay to the receiver of taxes the amount of tax so deducted. * * *

Section 23(c) of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material.

In accordance with the provisions of the Internal Revenue Code referred to above, it is held that income taxes paid by an individual taxpayer or withheld by his employer from his salary, wages, commissions, or compensation under the Philadelphia income tax ordinance approved December 13, 1939, are deductible as taxes in his Federal income tax return for the year in which paid by him or withheld by the employer. (See I. T. 1273, C. B. I-1, 125 (1922).)

A taxpayer deriving net profits earned after January 1, 1939, from "businesses, professions or other activities" and employing the accrual method of accounting, whose returns are made on the calendar year basis, may claim a deduction for the Philadelphia income tax as an accrued liability as of December 31, 1939, the end of his taxable year. However, a taxpayer deriving such profits and employing the accrual method of accounting, whose returns are made on the fiscal year basis, is not entitled to the benefit of such deduction for his fiscal year ended in 1939 because the tax can not be held to have accrued prior to December 13, 1939, the date the Philadelphia income tax ordinance was approved. (See O. D. 505, C. B. 2, 121 (1920).) Therefore, a taxpayer employing the accrual method of accounting who derives income from "businesses, professions or other activities" and makes his return on the fiscal year basis may claim as a deduction for his taxable year ending in 1940 the Philadelphia income taxes with respect to the income earned during the period January 1, 1939, to the close of his fiscal year in 1939, as well as such taxes for his fiscal year ending in 1940. (See I. T. 2281, C. B. V-1, 58 (1926), and G. C. M. 8553, C. B. IX-2, 109 (1930).) If the taxes are deducted as a business expense or otherwise used to reduce his net income, they may not be deducted separately as taxes.

SECTION 19.23(c)-1: Taxes. 1940-20-10257
I. T. 3372

INTERNAL REVENUE CODE.

The cost of the stamps which are required by the laws of the city of New York and the State of New York to be purchased and affixed to packages of cigarettes is an allowable deduction as a tax in the return of the dealer purchasing and affixing the stamps.

Advice is requested as to the deductibility for Federal income tax purposes of the cigarette taxes imposed by the city of New York and the State of New York.

The law under which the taxes are imposed by the city of New York is contained in No. 23 of the Local Laws of the City of New York for the year 1938, approved June 30, 1938, as amended. The law is entitled "*A local law*—To amend the administrative code of the city of New York, in relation to raising revenue for the purpose of relieving the people of the city of New York from the hardships and suffering caused by unemployment and the effects thereof on the public health and welfare, by imposing a tax upon sales of cigarettes in the city of New York, to enable such city to defray the cost of granting unemployment work and home relief." The provisions of the law pertinent to the present question are contained in Title T, sections T41-1.0, T41-2.0, T41-3.0, subsection a, T41-4.0 and T41-9.0, as amended. Section T41-2.0 of the law provides in subsection a that the tax shall be paid upon every sale of cigarettes at retail, and in subsection c that all dealers shall be liable to the city as taxpayers for the payment of the tax and shall pay the tax by purchasing stamps from the treasurer.

The law under which the taxes are imposed by the State of New York is contained in chapter 470 of the Laws of New York, 1939, entitled "An act to amend the tax law, by imposing, temporarily, a tax upon sales of cigarettes, providing for the application of the revenues from such source, and making an appropriation for the department of taxation and finance." The law was approved May 17, 1939, but the tax imposed thereby did not become effective until July 1, 1939. The pertinent provisions of the law are contained in Article XX, sections 470, 471, 476, and 481. Section 471 of the New York State cigarette tax law provides that the tax is imposed and shall be paid on all cigarettes possessed in the State by any person for sale on and after July 1, 1939. It is also provided that the taxes shall be imposed upon only one sale of the same package of cigarettes in New York.

Section 23(c) of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Section 19.23(c)-1 of Regulations 103, relating to the Internal Revenue Code, states that in general taxes are deductible only by the person upon whom they are imposed.

For Federal income tax purposes, the cost of the stamps which are required by the laws of the city of New York and the State of New York to be purchased and affixed to packages of cigarettes is an allowable deduction as a tax in the return of the dealer purchasing and affixing the stamps. The cost of the stamps, however, may not be deducted separately as a tax if it is included as a part of the business expense of the dealer or is otherwise used to reduce his net income. To the purchaser or consumer of the cigarettes, the cost of the stamps is merely additional cost of the article purchased.

SECTION 19.23(c)-1: Taxes. 1940-21-10263
I. T. 3374

INTERNAL REVENUE CODE.

Real and personal property taxes in the State of Washington accrue for the year 1939 and subsequent years as of January 1 of each year.

Advice is requested relative to the deductibility by taxpayers who keep their accounts on the accrual basis of property taxes imposed by the State of Washington for 1939 and subsequent years.

I. T. 3224 (C. B. 1938-2, 144) holds (syllabus):

Real and personal property taxes assessed in the State of Washington for the year 1937 should be accrued for Federal income tax purposes as of March 1, 1937, in accordance with G. C. M. 6667 (C. B. VIII-2, 94 (1929)). Real and personal property taxes assessed in the State of Washington for the year 1938 should be accrued as of January 1, 1938, in accordance with the law as changed by chapter 122, Laws of Washington, 1937.

The law of the State of Washington relating to taxes on real and personal property was changed in 1939 (Laws of Washington, Twenty-sixth Session, chapters 136 and 206), but an examination of those provisions of law discloses that they do not affect the basis of the ruling published as I. T. 3224, supra. Inasmuch as the changes in the existing law made by chapters 136 and 206, Laws of Washington, 1939, do not affect the conclusion reached in I. T. 3224 that property taxes in the State of Washington for the year 1938 should be accrued as of January 1, 1938, such accrual date (January 1) is applicable to 1939 and subsequent years.

Although the taxes assessed as of January 1, 1939, are, under section 2, chapter 136, Laws of Washington, 1939, "known and designated" as taxes of the year 1940, they are nevertheless generally accruable as of January 1, 1939.

SECTION 19.23(c)-1: Taxes. 1940-21-10264
I. T. 3375

INTERNAL REVENUE CODE.

The cost of stamps required by the laws of the State of Texas to be purchased and affixed to packages of cigarettes is an allowable deduction as a tax in the return of the first seller within the State purchasing and affixing the stamps.

Advice is requested as to the deductibility for Federal income tax purposes of cigarette taxes imposed pursuant to Texas Laws of 1935, chapter 241, as amended.

The law under which the taxes are imposed is contained in article 7047c of Vernon's Civil Statutes of the State of Texas, Annotated. The pertinent provisions of law are contained in section 1, subdivisions (a), (e), (m), (n), (o), and (p); section 2, paragraph 1; section 3, paragraphs 2 and 3; section 3B; and section 9(a).

Under section 2 of the Texas cigarette tax act, it is provided that the taxes shall be paid only once by the person making the "first sale" of the cigarettes in Texas. Under section 1(m) of the act, the term "distributor" includes every person in the State of Texas who manufactures or produces cigarettes, or who ships, transports, or imports into the State, or in any manner acquires or possesses cigarettes, and makes a "first sale" of the same in the State. "Distributor" also includes every person in the State who in any manner acquires or possesses unstamped cigarettes for the purpose of making a "first sale" of the cigarettes within the State.

Section 23(c) of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Section 19.23(c)-1 of Regulations 103, relating to the Internal Revenue Code, states that in general taxes are deductible only by the person upon whom they are imposed.

From an examination of the State law, it is evident that the person who pays the tax by affixing the stamps required by the act is the taxpayer and is the only one who is entitled to a deduction for such payment for Federal income tax purposes. The tax is paid but once, that is by the person making the first sale of cigarettes within the State. The act defines the person making the first sale as the "distributor."

For Federal income tax purposes, therefore, the cost of the stamps is an allowable deduction as a tax in the return of the first seller within the State of cigarettes to which he has affixed the stamps as required by the State law. The amount paid for the stamps may not be deducted separately as a tax if it is included as a part of the business expense of the taxpayer or is otherwise used to reduce his net income. With respect to the purchaser or consumer of cigarettes, the additional amount paid for the cigarettes because of the stamp tax paid by the first seller is merely additional cost of the article purchased.

SECTION 19.23(c)-1: Taxes. 1940-21-10265
I. T. 3376

INTERNAL REVENUE CODE.

Taxes imposed under the District of Columbia Income Tax Act, approved July 26, 1939, are deductible for Federal income tax purposes in the year in which paid or accrued.

Advice is requested as to the deductibility for Federal income tax purposes of the District of Columbia income tax.

The law under which the tax is imposed is contained in Title II of Public, No. 225, chapter 367, Seventy-sixth Congress, first session, entitled "An Act to provide revenue for the District of Columbia, and for other purposes," and was approved July 26, 1939. The pertinent provisions of the law are contained in section 1 and section 2 (a), (b), and (c).

Section 23(c) of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Section 19.23(c)-1 of Regulations 103, relating to the Internal Revenue Code, states that in general taxes are deductible only by the person upon whom they are imposed.

It is held that the District of Columbia income tax is deductible for Federal income tax purposes in the year in which it is actually paid by a taxpayer who employs the cash receipts and disbursements method of accounting. A taxpayer employing the accrual method of accounting should deduct the District of Columbia income tax in the year in which it accrues.

SECTION 19.23(c)-1: Taxes. 1940-22-10270
I. T. 3378

INTERNAL REVENUE CODE.

The manufacturers' excise tax on gasoline imposed by section 3412 of the Internal Revenue Code is deductible for Federal income tax purposes by the manufacturer, producer, or importer.

The tax on gasoline imposed by the law of the Territory of Hawaii is deductible by the distributor.

Advice is requested concerning the deductibility for Federal income tax purposes of the manufacturers' excise tax on gasoline imposed by section 3412 of the Internal Revenue Code and the tax on gasoline imposed by the law of the Territory of Hawaii.

Section 3412 of the Internal Revenue Code reads in part as follows:

(a) There shall be imposed on gasoline sold by the producer or importer thereof, or by any producer of gasoline, a tax of 1 cent a gallon, except that under regulations prescribed by the Commissioner with the approval of the Secretary the tax shall not apply in the case of sales to a producer of gasoline.

(b) If a producer or importer uses (otherwise than in the production of gasoline) gasoline sold to him free of tax, or produced or imported by him, such use shall for the purposes of this chapter [Chapter 29] be considered a sale. Any person to whom gasoline is sold tax-free under this section shall be considered the producer of such gasoline.

Section 23(c) of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Section 19.23(c)-1 of Regulations 103, relating to the income tax under the Internal Revenue Code, states that in general taxes are deductible only by the person upon whom they are imposed.

The manufacturers' excise tax on gasoline imposed by section 3412 of the Internal Revenue Code is clearly imposed upon the manufacturer, producer, or importer, and is, therefore, deductible by him for Federal income tax purposes. (See Mim. 3988, C. B. XI-2, 25 (1932).) The tax is not deductible from gross income in the return of the consumer even though the amount thereof is passed on to him.

The law under which the tax on gasoline is imposed by the Territory of Hawaii is found in chapter 64 of the Laws of the Territory of Hawaii, Regular Session of 1939, effective as of July 1, 1939, and reads in part as follows:

SEC. 2013. *Distributors to pay certain license taxes.*—(a) Every distributor shall, in addition to any other taxes provided by law, pay a license tax to the treasurer of 4 cents for each gallon of liquid fuel * * * refined, manufactured, produced or compounded by such distributor and sold or used by him in the Territory, or imported by such distributor, or acquired by him from persons not licensed distributors, and sold or used by him in the Territory * * *.

No provision is made for refund of any portion of the tax paid with respect to the sale of gasoline (included in the term "liquid fuel").

Under the above-quoted provisions of Hawaiian law, the tax of 4 cents required to be paid on each gallon of gasoline is a license tax imposed upon and payable by the distributor. The tax is, therefore, deductible by him for Federal income tax purposes. The amount of such tax, which is included as a part of the cost of the gasoline, is not deductible by the consumer.

SECTION 19.23(c)-1: Taxes.

INTERNAL REVENUE CODE.

City of Philadelphia employee's tax paid by the employer for the employee. (See I. T. 3382, page 12.)

SECTION 19.23(c)-1: Taxes. 1940-24-10287
I. T. 3383

INTERNAL REVENUE CODE.

The stamp tax, effective June 1, 1939, imposed upon the sale of tobacco products in Rhode Island is a tax upon the sale by the distributor or dealer and is deductible by him as a tax under section 23(c) of the Internal Revenue Code.

Advice is requested as to who is entitled to deduct for Federal income tax purposes the tax imposed upon the sale of tobacco products in Rhode Island. The tax is imposed by chapter 663 of the 1939 Session Laws of the State of Rhode Island and Providence Plantations entitled "An act imposing a tax upon the sale of tobacco products," effective June 1, 1939.

Section 1 of the act provides that whenever used in the act, the word "distributor" shall mean any person engaged in the State in manufacturing, importing, or procuring tobacco products for sale to dealers in the State; any person who purchases tobacco products for the purpose of resale in the State, provided at least 75 per cent of all tobacco products sold is purchased directly from the manufacturers thereof; and any person engaged in operating 50 or more machines for vending tobacco products who shall sell direct to the consumer by means of such machines.

Section 6 of the act imposes a tax "on all tobacco products sold or held for sale in the State by any person, the payment thereof to be evidenced by stamps affixed to the packages containing the tobacco products. * * *" Section 11 of the act provides that each distributor shall affix, or cause to be affixed, to each package of tobacco products sold or distributed by him stamps of the proper denominations.

Under the provisions of the act in question, it is held that the tax thereby imposed is a tax upon the sale of tobacco products by the distributor or dealer, and for Federal income tax purposes the tax is deductible by him under section 23(c) of the Internal Revenue Code. When added to the sale price of the tobacco products, the tax is merely an additional cost to the purchaser or consumer and is not deductible by him.

SECTION 23(m).—DEDUCTIONS FROM GROSS INCOME: DEPLETION.

SECTION 19.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits and timber; depreciation of improvements. 1940-2-10136
T. D. 4960

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 9; SUBCHAPTER E, PART 465, SUBPART B.—INCOME TAX.

Amending Regulations 101 as made applicable to the Internal Revenue Code by Treasury Decision 4885 [C. B. 1939-1 (Part 1), 396] in so far as such regulations prescribe rules relative to the allowance of depletion and depreciation deductions under sections 23(m) and 114 of the Internal Revenue Code.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Regulations 101 [Part 9, Title 26, Code of Federal Regulations, 1939 Sup.], as made applicable to the Internal Revenue Code by Treasury Decision 4885, approved February 11, 1939 [C. B. 1939-1 (Part 1), 396] [Part 465, Subpart B of such Title 26], in so far as they prescribe rules relative to the allowance of depletion and depreciation deductions under sections 23(m) and 114 of the Internal Revenue Code, are hereby amended as follows:

(1) The second, third, and fourth paragraphs of article 23(m)-1 [section 9.23(m)-1] are amended to read as follows:

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 article 115-6 [section 9.115-6].) 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 article 23(l)-1 [section 9.23(l)-1].)

(2) The first sentence of article 23(m)-1(*c*) [section 9.23(m)-1(*c*)] is amended to read as follows:

The term "mineral deposit" refers to minerals in place.

(3) Article 23(m)-1(*e*) [section 9.23(m)-1(*e*)], defining the term "operating profits," is stricken out.

(4) The designation of article 23(m)-1(*f*) [section 9.23(m)-1(*f*)] is changed to (*e*).

(5) The designation of article 23(m)-1(*g*) [section 9.23(m)-1(*g*)] is changed to (*f*), and such article is further amended to read as follows:

(*f*) "Gross income from the property," as used in section 114(b) (3) and (4) and articles 23(m)-1 to 23(m)-28 [sections 9.23(m)-1 to 9.23(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) of 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 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, or silver 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 transporation 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 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 article 23(m)-10(*e*) [section 9.23(m)-10(*e*)].

(6) The designation of article 23(m)-1(*h*) [section 9.23(m)-1(*h*)] is changed to (*g*), and (*g*) wherever appearing in the text thereof is changed to (*f*).

(7) The designation of article 23(m)-1(*i*) [section 9.23(m)-1(*i*)] is changed to (*h*), and (*g*) appearing in the text thereof is changed to (*f*).

(8) The designation of article 23(m)-1(*j*) [section 9.23(m)-1(*j*)] is changed to (*i*), and the first sentence thereof is further amended to read as follows:

"The property," as used in section 114(b) (2), (3), and (4), and articles 23(m)-1 to 23(m)-19 [sections 9.23(m)-1 to 9.23(m)-19], inclusive, means the interest owned by the taxpayer in any mineral property.

(9) The second sentence of the first paragraph of article 23(m)-3 [section 9.23(m)-3] is amended to read as follows:

The value must be equitably apportioned between the owners of the economic interests therein.

(10) The reference to (*h*) appearing in the last sentence of the third paragraph of article 23(m)-3 [section 9.23(m)-3] is changed to (*g*).

(11) The references to (*g*) and (*h*) appearing in article 23(m)-4 [section 9 23(m)-4] are changed to (*f*) and (*g*), respectively.

(12) The references to (*g*) and (*h*) appearing in the last sentence of the first paragraph of article 23(m)-5 [section 9.23(m)-5] are changed to (*f*) and (*g*), respectively.

(13) Article 23(m)-6 [section 9.23(m)-6] is amended to read as follows:

ART. 23(m)-6 [Sec. 9.23(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.

(14) The second, third, and fourth sentences of article 23(m)-7(*b*) [section 9.23(m)-7(*b*)] are amended as follows:

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 (A) the total quantity of oil and gas in terms of the principal or customary unit (or units) paid for in the product marketed, (B) the quantity of oil and gas expected to be recovered during each operating period, (C) the average quality or grade of the oil and gas reserves, (D) the allocation of the total expected profit to the several processes or operations necessary for the preparation of the oil and gas for market, (E) the probable operating life of the deposit in years, (F) the development cost, and (G) 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.

(15) Article 23(m)-7 (*e*) and (*f*) [section 9.23(m)-7 (*e*) and (*f*)] is amended to read as follows:

(*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.

(16) Article 23(m)-10 [section 9.23(m)-10] is amended to read as follows:

ART. 23(m)-10 [Sec. 9.23(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 thereto 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 per cent 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 beginning after December 31, 1938, for which he first makes return in respect of the property (and for subsequent taxable years in case an election to have depletion computed on a percentage basis has been exercised in the proper return) 23 per cent, 15 per cent, and 5 per cent, respectively, of the amount thereof; but the deduction shall not in any case exceed 50 per cent 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 article [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.

(17) Article 23(m)-12(*a*)(2) [section 9.23(m)-12(*a*)(2)] is amended to read as follows:

(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;

(18) The references to (*g*) and (*h*) in article 23(m)-13(*a*)(1) and (2) [section 9.23(m)-13(*a*)(1) and (2)] are changed to (*f*) and (*g*), respectively.

(19) The first sentence of article 23(m)-17(*a*) [section 9.23(m)-17(*a*)] is amended to read as follows:

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."

(20) The first sentence of article 23(m)-18 [section 9.23(m)-18] is amended to read as follows:

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 article 23(m)-16 [section 9.23(m)-16].

(21) The third sentence of article 23(m)-20 [section 9.23(m)-20] is amended to read as follows:

The apportionment of deductions between the several owners of economic interests in timber properties will be made as specified in article 23(m)-7 [section 9.23(m)-7].

(22) The last paragraph of article 23(m)-25 [section 9.23(m)-25] is amended to read as follows:

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.

(This Treasury decision is issued under the authority contained in sections 23(m), 62, and 114 of the Internal Revenue Code (53 Stat., 14, 32, 45).)

JOHN L. SULLIVAN,
Acting Commissioner of Internal Revenue.

Approved January 3, 1940.

HERBERT E. GASTON,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 4, 1940, 10.03 a. m.)

SECTION 19.23(m)-10: Depletion—Adjustments of accounts based on bonus or advanced royalty. 1940-14-10224 T. D. 4968

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 19.—INCOME TAX.

Amending section 19.23(m)-10(*a*) of Regulations 103 so as to permit amortization of cost of unproductive oil and gas leaseholds in taxable years beginning prior to January 1, 1940.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Section 19.23(m)-10(*a*) of Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.] is hereby amended by adding at the end thereof a new sentence reading as follows:

However, a taxpayer who for any taxable year beginning prior to January 1, 1940, would, except for the provisions of the preceding sentence, have been permitted to amortize the cost of unproductive leaseholds will be permitted to do so for such taxable year.

(This Treasury decision is issued under the authority contained in sections 23(m), 62, and 114 of the Internal Revenue Code (53 Stat., 14, 32, 45).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved March 25, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 26, 1940, 2.54 p. m.)

SECTION 23(o).—DEDUCTIONS FROM GROSS INCOME: CHARITABLE AND OTHER CONTRIBUTIONS.

SECTION 19.23(o)-1: Contributions or gifts by individuals.

INTERNAL REVENUE CODE.

Base for determining the 15 per cent limitation where taxpayer derives a net long-term capital gain or sustains a net long-term capital loss and computes his tax under section 117(c). (See I. T. 3345, page 54.)

SECTION 24.—ITEMS NOT DEDUCTIBLE.

SECTION 19.24-4: Amounts allocable to exempt income, other than interest.

1940-9-10186
I. T. 3353

INTERNAL REVENUE CODE.

State income taxes paid in 1939 on compensation received in 1938 by officers or employees of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, which, under the provisions of the Public Salary Tax Act of 1939, is not subject to Federal income tax, are not deductible from gross income by such officers and employees in their 1939 Federal income tax returns.

Advice is requested whether that part of the State income tax paid in 1939, which was applicable to the salary received in 1938 by an officer or employee, as such, of a State or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, is deductible from gross income in the 1939 income tax return filed by such officer or employee.

Section 24 of the Internal Revenue Code reads in part as follows:

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) GENERAL RULE.—In computing net income no deduction shall in any case be allowed in respect of—

* * * * * * *

(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.

It is the opinion of the Bureau that section 24(a)5 of the Internal Revenue Code prohibits the deduction of any amount of income tax paid to a State by an individual which is allocable to compensation for personal services, if such compensation may not be taxed on account of the provisions of sections 201, 202 or 203 of the Public Salary Tax Act of 1939.

In view of the foregoing, it is held that State income taxes paid in 1939 with respect to compensation received in 1938 by officers or employees of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, which, under the provisions of the Public Salary Tax Act of 1939, is not subject to Federal income tax, are not deductible from gross income in their 1939 Federal income tax returns.

SECTION 25.—CREDITS OF INDIVIDUAL AGAINST NET INCOME.

SECTION 19.25-2: Earned income credit.

INTERNAL REVENUE CODE.

Base for determining the earned income credit where taxpayer derives a net long-term capital gain or sustains a net long-term capital loss and computes his tax under section 117(c). (See I. T. 3345, page 54.)

SECTION 19.25-4: Personal exemption of head of family. 1940-12-10207
I. T. 3359

INTERNAL REVENUE CODE.

First cousins by blood and cousins of lesser degree are not "closely connected" by blood relationship within the meaning of section 19.25-4 of Regulations 103, relating to the personal exemption of the head of a family.

Advice is requested whether first and second cousins by blood are "closely connected" by blood relationship within the meaning of section 19.25-4 of Regulations 103, relating to the personal exemption of the head of a family.

Section 19.25-4 of Regulations 103, supra, reads in part as follows:

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. * * *

It is held that first cousins by blood are not "closely connected" by blood relationship within the meaning of section 19.25-4 of Regulations 103, supra. It follows that cousins of lesser degree are not "closely connected" by blood relationship within the meaning of that section of the regulations.

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

SECTION 41.—GENERAL RULE.

SECTION 19.41-1: Computation of net income. 1940-5-10154
I. T. 3344

INTERNAL REVENUE CODE.

The following rates of exchange are accepted by the Bureau of Internal Revenue as the current or market rates of exchange prevailing as of December 30, 1939:

Country or city.	Monetary unit.	Value in terms of United States money.	Country or city.	Monetary unit.	Value in terms of United States money.
Argentina	Peso	$0. 297733	Japan	Yen	$0. 234475
Australia	Pound	3. 153125	Mexico	Peso	. 169550
Belgium	Belga	. 167581	Netherlands	Guilder	. 532487
Brazil	Milreis [1]	. 060580	New Zealand	Pound	3. 165416
British India	Rupee	. 300878	Norway	Krone	. 227012
Canada	Dollar	. 886160	Panama	Balboa	1. 000000
Chile	Peso [1]	. 051740	Peru	Sol	. 183000
China (Shanghai)	Yuan	. 076441	Philippine Islands	Peso	. 500000
Colombia	Peso	. 569850	Portugal	Escudo	. 036166
Cuba	Peso	. 880000	Rumania	Leu	. 007016
Denmark	Krone	. 192975	South Africa	Pound	3. 974000
England	Pound	3. 956944	Spain	Peseta	. 099500
Finland	Markka	. 018200	Straits Settlements	Dollar	. 463875
France	Franc	. 022417	Sweden	Krona	. 238025
Germany	Reichsmark	. 400840	Switzerland	Franc	. 224237
Greece	Drachma	. 007085	Uruguay	Peso [2]	. 658300
Hong Kong	Dollar	. 246233	Venezuela	Bolivar	. 314000
Hungary	Pengo	. 176012	Yugoslavia	Dinar	. 022647
Italy	Lira	. 050471			

[1] Official rate.
[2] Controlled rate.

SECTION 19.41-1: Computation of net income. 1940-17-10243
I. T. 3369

INTERNAL REVENUE CODE.

Method to be used by publishers of periodicals who keep their accounts and file their returns on the accrual basis in reporting income and deductions with respect to prepaid subscriptions where the subscription period extends beyond the taxable year in which the subscription income is received.

Advice is requested regarding the proper method to be used by publishers of periodicals who keep their accounts and file their returns on the accrual basis in reporting income and deductions with respect to prepaid subscriptions where the subscription period extends beyond the taxable year in which the subscription income is received.

There are two methods employed by publishers with respect to such income. By the first method, the publisher reports all of the income received from prepaid subscriptions, which cover periods extending beyond the taxable year, for the year of receipt of the income. By the second method, the publisher reports an aliquot part of the subscription income for each year of the subscription period.

It is held that where a publisher of periodicals has, over a period of years, followed consistently either of the two methods outlined above, he may continue to file his returns on such basis, he will not be required to change to the other basis, and his net income for the past years will not be redetermined on such other basis. However, if the publisher uses the second method of reporting subscription income, all expenses incurred during the year in which the subscriptions are obtained, which are applicable to the obtaining of the subscriptions, or to the subscriptions themselves, shall be spread allocably over the subscription periods in the same manner as the subscription income.

SECTION 44.—INSTALLMENT BASIS.

SECTION 19.44–5: Gain or loss upon disposition of installment obligations. 1940–22–10269 T. D. 4972

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PARTS 3, 9, AND 19.—INCOME TAX.

Regulations 103, 101, and 94, amended.—Gain or loss upon disposition of installment obligations.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Section 19.44–5 of Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.], article 44–5 of Regulations 101, as amended by Treasury Decision 4899, approved May 9, 1939 [C. B. 1939–1 (Part 1), 78] [Part 9, Title 26, Code of Federal Regulations, 1939 Sup.], and article 44–5 of Regulations 94, as amended by Treasury Decision 4899 [Part 3, Title 26, Code of Federal Regulations and 1939 Sup.], are amended by substituting for the last sentence of the next to the last paragraph, which reads as follows:

The bond on Form 1132 may be (1) executed by a surety company holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds, or (2) secured by deposit of bonds or notes of the United States, or the installment obligations, in such amounts as the Commissioner may deem necessary to insure collection of the tax.—

the following:

A corporation will not be accepted as a surety on such bond unless the corporation holds a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds. In lieu of surety or sureties there may be deposited bonds or notes of the United States.

(This Treasury decision is prescribed pursuant to sections 44(d) and 62 of the Internal Revenue Code (53 Stat., 25, 32); sections 44(d) and 62 of the Revenue Acts of 1938 and 1936 (52 Stat., 473, 480, 49 Stat., 1667, 1673; 26 U. S. C., 44, 62 Sup.); and section 1126 of the Revenue Act of 1926, as amended by the Act of February 4, 1935 (44 Stat., 122, 49 Stat., 22; 6 U. S. C., 15, and Sup.).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved May 22, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register May 23, 1940, 11.26 a. m.)

PART V.—RETURNS AND PAYMENT OF TAX.

SECTION 51.—INDIVIDUAL RETURNS.

SECTION 19.51-4: Verification of returns. 1940-24-10288
I. T. 3384

INTERNAL REVENUE CODE.

Persons commissioned under the Act of Congress approved April 25, 1935 (49 Stat., 162), to administer oaths relating to claims against or applications to the United States of officers and employees under the Naval Establishment may not administer oaths on Federal income tax returns.

Naval officers authorized to administer oaths for the purposes of the Naval Service may not administer oaths on Federal income tax returns of civilian employees of the Naval Establishment.

Advice is requested whether, under the provisions of the Act of Congress approved April 25, 1935 (49 Stat., 162), chief clerks attached to field services of the Naval Establishment are authorized to administer oaths on Federal income tax returns of the civilian and naval personnel of that establishment. Advice is also requested whether naval officers may properly administer oaths on Federal income tax returns of civilian employees of the Naval Establishment.

The above-mentioned Act of Congress authorizes certain designated personnel of the Naval Establishment to administer any oath required or authorized by any law of the United States, or regulation promulgated thereunder, relating to any claim against or application to the United States of officers and employees of the Naval Establishment. The authority conferred by the Act in question is restricted specifically to claims against or applications to the United States. Federal income tax returns do not constitute either claims or applications of the above description.

In I. T. 2228 (C. B. IV-2, 104 (1925)) the Bureau held that the authority of an Army officer commissioned to administer oaths, being limited and not general, does not come within the purview of section 1002(d) of the Revenue Act of 1924, relating to the administration of oaths required by that Act. The Bureau regulations with respect to verification of income tax returns are substantially identical with the provisions in section 1002(d), supra. (See second sentence in section 19.51-4, Regulations 103.) Therefore, the position taken in I. T. 2228, supra, is applicable in construing such regulations.

On the basis of the foregoing, since the authority granted under the Act of April 25, 1935, referred to above, is limited and not general, the persons commissioned thereunder to administer oaths may not administer oaths on Federal income tax returns.

With regard to the question whether naval officers authorized to administer oaths may acknowledge Federal income tax returns of civilian employees of the Naval Establishment, the answer is also in the negative. The Bureau construes the phrase "persons in the naval or military service of the United States," contained in section 19.51-4 of Regulations 103, to mean only the commissioned, noncommissioned, and enlisted personnel of the naval and military services.

SECTION 55.—PUBLICITY OF RETURNS.

SECTION 19.55(b)-5: Inspection of original returns. 1940-4-10152
T. D. 4962

TITLE 26—INTERNAL REVENUE.—CHAPTER I, PART 458, SUBPART E.—INSPECTION OF RETURNS.

Regulations governing the inspection by the Committee on Education and Labor, United States Senate, of income, profits, and capital stock tax returns and returns of employment tax on employers.

TREASURY DEPARTMENT,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Section 458.203. Pursuant to the provisions of sections 55(a), 351, and 503 of the Revenue Act of 1936, section 358 of the Revenue Act of 1936 as amended by the Revenue Act of 1937, sections 55(a), 409, 601(e), and 602(c) of the Revenue Act of 1938, section 905(c) of the Social Security Act, and sections 55(a), 1204, and 1604(c) of the Internal Revenue Code, income, profits, and capital stock tax returns made under the Revenue Act of 1936, under the Revenue Act of 1936 as amended by the Revenue Act of 1937, under the Revenue Act of 1938, and under the Internal Revenue Code, and returns of employment tax under Title IX of the Social Security Act and Subchapter C of Chapter 9 of the Internal Revenue Code, may be inspected by the Committee on Education and Labor, United States Senate, or any duly authorized subcommittee thereof, for the purpose of, and to the extent necessary in the investigation which such committee or subcommittee is authorized to make by Senate Resolution 266, Seventy-fourth Congress, second session, passed June 6, 1936. The inspection of returns herein authorized may be by such committee or subcommittee or by or through such examiners or agents as such committee or subcommittee may designate or appoint. Upon written notice by the chairman of such committee or subcommittee to the Secretary of the Treasury, giving the names and addresses of the taxpayers whose returns it is necessary to inspect and the taxable periods covered by the returns, the Secretary and any officer or employee of the Treasury Department shall furnish such committee or subcommittee with any data relating to or contained in any such return, or shall make such return available for inspection by such committee or subcommittee or by such examiners or agents as such committee or subcommittee may designate or appoint, in the office of the Commissioner of Internal Revenue. Any information thus obtained by such committee or subcommittee which is relevant or pertinent to the purpose of the investigation, may be submitted by such committee or subcommittee to the United States Senate.

H. MORGENTHAU, Jr.,
Secretary of the Treasury.

Approved January 10, 1940.
FRANKLIN D. ROOSEVELT,
The White House.

(Filed with the Division of the Federal Register January 13, 1940, 12.10 p. m.)

EXECUTIVE ORDER—AUTHORIZATION OF COMMITTEE ON EDUCATION AND LABOR, UNITED STATES SENATE, TO INSPECT INCOME, PROFITS, AND CAPITAL STOCK TAX RETURNS AND RETURNS OF EMPLOYMENT TAX ON EMPLOYERS.

By virtue of and pursuant to the authority vested in me by sections 55(a), 351, and 503 of the Revenue Act of 1936 (49 Stat., 1648), section 358 of the Revenue Act of 1936 as amended by the Revenue Act of 1937 (50 Stat., 813, 817), sections 55(a), 409, 601(c), and 602(c) of the Revenue Act of 1938 (52 Stat., 447, 478, 564, 566, 568), sections 55(a), 1204, and 1604(c) of the Internal Revenue Code (53 Stat., Part 1), and section 905 of the Social Security Act (49 Stat., 620, 641), it is hereby ordered that income, profits, and capital stock tax returns made under the Revenue Act of 1936, under the Revenue Act of 1936 as amended by the Revenue Act of 1937, under the Revenue Act of 1938, and under the Internal Revenue Code, and returns of employment tax on employers under Title IX of the Social Security Act and under Subchapter C of Chapter 9 of the Internal Revenue Code shall be open to inspection by the Committee on Education and Labor, United States Senate, or any duly authorized subcommittee thereof, which committee or subcommittee is authorized by Senate Resolution 266, Seventy-fourth Congress, second session, passed June 6, 1936, to make an investigation of violations of the rights of free speech and assembly and undue interference with the right of labor to organize and bargain collectively; such inspection to be in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in the Treasury decision relating to the inspection of returns by that committee, or any duly authorized subcommittee thereof, approved by me this date.

FRANKLIN D. ROOSEVELT.

THE WHITE HOUSE,
January 10, 1940.

(8318)

(Filed with the Division of the Federal Register January 13, 1940, 12.10 p. m.)

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A.—RATES OF TAX.

SECTION 101.—EXEMPTIONS FROM TAX ON CORPORATIONS.

1940-12-10208
I. T. 3360

INTERNAL REVENUE CODE.

Federal savings and loan associations meet the requirements of section 101(15) of the Internal Revenue Code and are entitled to exemption from Federal income taxation.

Advice is requested whether Federal savings and loan associations are entitled to exemption under section 101(15) of the Internal Revenue Code.

That section provides that corporations organized under Act of Congress shall be exempt from taxation under Chapter 1 (Income Tax) of the Internal Revenue Code, if such corporations are instrumentalities of the United States and if, under such Act, as amended and supplemented, such corporations are exempt from Federal income taxes.

Subsection (a) of section 5 of the Home Owners' Loan Act of 1933 (48 Stat., 128) authorizes the Federal Home Loan Bank Board, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as "Federal savings and loan associations," and to issue charters therefor. Subsection (h) of section 5 of the Home Owners' Loan Act of 1933 provides, among other things, that such associations (Federal savings and loan associations), including their franchises, capital, reserves, and surplus, and their loans and income, shall be exempt from all taxation imposed by the United States.

Section 5(k) of the Home Owners' Loan Act of 1933, as amended, provides, among other things, that when designated by the Secretary of the Treasury, any Federal savings and loan association may be employed as fiscal agent of the Government under such regulations as may be prescribed by the Secretary, and that such an association may act as agent for any other instrumentality of the United States when designated for that purpose by such instrumentality of the United States. The Secretary of the Treasury has designated Federal savings and loan associations as fiscal agents of the United States for certain purposes. In S. S. T. 62 (C. B. 1937-1, 409) the Bureau held that Federal savings and loan associations are instrumentalities of the United States.

In view of the foregoing, it is held that Federal savings and loan associations meet the requirements of section 101(15) of the Internal Revenue Code and are entitled to exemption from Federal income taxation.

SUPPLEMENT B.—COMPUTATION OF NET INCOME.

SECTION 113(a).—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS: BASIS (UNADJUSTED) OF PROPERTY.

INTERNAL REVENUE CODE.

Sale by trustee of securities transferred by an employer company to a pension trust. (See I. T. 3357, page 11.)

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION.

SECTION 19.114-1: Basis for allowance of depreciation and depletion.

INTERNAL REVENUE CODE.

Development expenses in computing depletion based on a percentage of income in the case of oil and gas wells. (See G. C. M. 21926, page 157.)

SECTION 116.—EXCLUSIONS FROM GROSS INCOME.

SECTION 19.116-1: Income of foreign governments, ambassadors, and consuls. 1940-5-10162 Mim. 4967 (Rev.)

Exemption from Federal income tax of compensation received for services rendered in the United States by certain foreign consuls stationed in the United States and certain employees of foreign consulates in the United States.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., January 18, 1940.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Other Officers and Employees of the Bureau of Internal Revenue Concerned:

In view of the certification made by the Secretary of State under section 116(h) of the Internal Revenue Code, the official compensation for services rendered within the United States of foreign consular officers stationed in the United States (who are not citizens of the United States) and the employees of foreign consulates in the United States (who are not citizens of the United States) of the following countries is exempt from Federal income tax:

Albania, Argentina, Australia, Bolivia, Brazil, Bulgaria, Canada, Chile, China, Colombia, Cuba, Czechoslovakia, Denmark, Dominican Republic, El Salvador, Ecuador, Egypt, Finland, France, Germany, Great Britain and Northern Ireland, Greece, Guatemala, Haiti, Honduras, Hungary, India, Iraq, Iran, Ireland, Italy, Japan, Latvia, Liberia, Lithuania, Mexico, Morocco, Netherlands, Netherlands Indies, New Zealand, Nicaragua, Norway, Panama, Peru, Poland, Portugal, Rumania, Siam, Spain, Sweden, Switzerland, Turkey, Union of South Africa, Union of Soviet Socialist Republics, Uruguay, Venezuela, Yugoslavia.

In view of the certification referred to above, the official compensation for services rendered within the United States of foreign consular officers stationed in the United States (who are not citizens of the United States) of the following countries (but not the employees of their consulates in the United States) is exempt from Federal income tax:

Belgium, Costa Rica, Estonia, Paraguay.

Correspondence relating to the provisions of this mimeograph should refer to its number and the symbols IT: TM.

GUY T. HELVERING,
Commissioner.

SECTION 19.116-1: Income of foreign governments, ambassadors, and consuls. 1940-23-10279 Mim. 4967 (Rev.)

Exemption from Federal income tax of compensation received for services rendered in the United States by certain foreign consuls stationed in the United States and certain employees of foreign consulates in the United States.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., May 10, 1940.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Other Officers and Employees of the Bureau of Internal Revenue Concerned:

In view of the certification made by the Secretary of State under section 116(h) of the Internal Revenue Code, the official compensation for services rendered within the United States of foreign consular officers stationed in the United States (who are not citizens of the United States) and the employees of foreign consulates in the United States (who are not citizens of the United States) of the following countries is exempt from Federal income tax:

Albania, Argentina, Australia, Belgium, Bolivia, Brazil, Bulgaria, Canada, Chile, China, Colombia, Cuba, Czechoslovakia, Denmark, Dominican Republic, El Salvador, Ecuador, Egypt, Finland, France, Germany, Great Britain and Northern Ireland, Greece, Guatemala, Haiti, Honduras, Hungary, India, Iraq, Iran, Ireland, Italy, Japan, Latvia, Liberia, Lithuania, Mexico, Morocco, Netherlands, Netherlands Indies, New Zealand, Nicaragua, Norway, Panama, Peru, Poland, Portugal, Rumania, Siam, Spain, Sweden, Switzerland, Turkey, Union of South Africa, Union of Soviet Socialist Republics, Uruguay, Venezuela, Yugoslavia.

In view of the certification referred to above, the official compensation for services rendered within the United States of foreign consular officers stationed in the United States (who are not citizens of the United States) of the following countries (but not the employees of their consulates in the United States) is exempt from Federal income tax:

Costa Rica, Estonia, Paraguay.

Correspondence relating to the provisions of this mimeograph should refer to its number and the symbols IT: TM.

GUY T. HELVERING,
Commissioner.

SECTION 117.—CAPITAL GAINS AND LOSSES.

SECTION 19.117-2: Percentage of capital gain or loss taken into account: Net loss carry-over. 1940-15-10228
(Also Section 162, Section 19.162-1.) I. T. 3366

INTERNAL REVENUE CODE.

For the purpose of determining the amount of a net short-term capital loss which may be carried forward under section 117(e) of the Internal Revenue Code in the case of an estate or trust, the term "net income," which is prescribed as the limitation on the amount which may be carried forward, is the net income after deduction of distributions to the beneficiaries, as provided by section 162(b) of the Code.

Advice is requested relative to the amount of the net short-term capital loss sustained in the calendar year 1938 which may be carried forward to the calendar year 1939 in the case of the M Trust.

The return of the M Trust for the calendar year 1938 shows a gross income of 200*x* dollars after deduction of a net long-term capital loss of x dollars, and income of $150x$ dollars after certain allowable deductions, not including distributions to beneficiaries. The amount shown as distributable to the beneficiaries is $151x$ dollars, so that the return reflected a net loss of x dollars. In addition to the deductions claimed, the trust had a net short-term capital loss of $100x$ dollars which was not allowable as a deduction.

Section 117(e) of the Internal Revenue Code, as amended by section 212 of the Revenue Act of 1939, provides in part that if a taxpayer (other than a corporation) sustains in any taxable year beginning after December 31, 1937, a net short-term capital loss, such loss (in an amount not in excess of the net income for such year) shall be treated in the succeeding taxable year as a short-term capital loss, with an exception not here material. The question presented is, therefore, whether the net short-term capital loss of $100x$ dollars sustained by the M Trust in the calendar year 1938 may be carried forward as a short-term capital loss for the calendar year 1939. As section 117(e) of the Internal Revenue Code, as amended, limits the amount of the net short-term capital loss which may be carried forward to an amount not in excess of the *net income* for the particular year, it is necessary to determine the *net income* of the trust for 1938.

Section 19.142-1 of Regulations 103, in defining net income for the purpose of the requirement for the filing of a return by an estate or trust, provides in paragraph (*b*) that the net income shall be " as computed under section 162." Section 162(b) of the Internal Revenue Code provides that there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries.

It is the opinion of the Bureau that the term " net income " should be defined in the same manner for purposes of section 117, section 142, and section 162. It is held, therefore, that for the purpose of determining the amount of a net short-term capital loss which may be carried forward under section 117(e) of the Internal Revenue Code in the case of an estate or trust, the term " net income," which is prescribed as the limitation on the amount which may be carried forward, is the net income after deduction of the distributions to the beneficiaries, as provided by section 162(b).

In the case presented, inasmuch as the M Trust had no net income for 1938 after deduction of the distributions to the beneficiaries, the trust is not entitled to carry forward to 1939 any part of the net short-term capital loss sustained in 1938.

SECTION 19.117-3: Alternative tax in case of net long-term capital gain or loss. 1940-5-10155 I. T. 3345

(Also Section 23(a), Section 19.23(o)-1; Section 25, Section 19.25-2.)

INTERNAL REVENUE CODE.

Where a taxpayer derives a net long-term capital gain and computes his tax under section 117(c)1, relating to alternative taxes, the base for determining the 15 per cent limitation on the charitable contributions deduction provided by section 23(o) and the earned income credit provided by section 25(a)3 is " net income."

Where a taxpayer sustains a net long-term capital loss and computes his tax under section 117(c)2, the base for determining the charitable contributions deduction is "ordinary net income," that is "net income" plus the amount of the net long-term capital loss, and the base for determining the earned income credit is "ordinary net income" as adjusted for the charitable contributions deduction.

Advice is requested with respect to certain questions involving the applicability of the Supreme Court decision in *Helvering* v. *Bliss* (293 U. S., 144, Ct. D. 884, C. B. XIII-2, 191 (1934)) and *United States* v. *Pleasants* (305 U. S., 357, Ct. D. 1379, C. B. 1939-1 (Part 1), 239)) to similar cases arising under the Internal Revenue Code. The questions have arisen by reason of section 23(o) and section 25(a)3 of the Code, which place a limit on allowable deductions for contributions and earned net income credit, such limitation in both cases being based on "net income."

The principal provision of law involved is section 117(c) of the Internal Revenue Code, which reads as follows:

(c) ALTERNATIVE TAXES.—

(1) IN CASE OF NET LONG-TERM CAPITAL GAIN.—If for any taxable year a taxpayer (other than a corporation) derives a net long-term capital gain, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of the net long-term capital gain, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 30 per centum of the net long-term capital gain.

(2) IN CASE OF NET LONG-TERM CAPITAL LOSS.—If for any taxable year a taxpayer (other than a corporation) sustains a net long-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is greater than the tax imposed by such sections:

A partial tax shall first be computed upon the net income increased by the amount of the net long-term capital loss, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax minus 30 per centum of the long-term capital loss.

In *Helvering* v. *Bliss*, supra, the Supreme Court held that the taxpayer was entitled to include capital net gain in "net income" in determining the base for computing the 15 per cent deduction allowable for charitable contributions under section 23(n) of the Revenue Act of 1928, although the taxpayer elected to be taxed on capital net gain at a flat rate of 12½ per cent under the Revenue Act of 1928. The contention of the Government in that case was that the base for the deduction should be "ordinary net income" after excluding all items of capital gain and capital loss. The Court pointed out in its opinion that the base upon which the tax was computed was the "net income," i. e., gross income minus statutory deductions.

In *United States* v. *Pleasants*, supra, which arose under the Revenue Act of 1932, the Court held that where a taxpayer sustained a "capital net loss" the base of the tax was the "ordinary net income" and that contributions were allowable under section 23(n) of the Revenue Act of 1932 to the extent of 15 per cent of such ordinary income. As pointed out in the latter case, there is "nothing to the contrary" in the Bliss case.

The general effect of the Pleasants case was given consideration in I. T. 3271 (C. B. 1939-1 (Part 1), 105). In that case it is stated in part as follows:

The effect of the Supreme Court decision in the Pleasants case is very similar under the Revenue Acts of 1932 and 1938, and may be summarized as follows: In cases where the special tax provided by section 101(b) of the Revenue Act of 1932 and by section 117(c)2 of the Revenue Act of 1938 *is applicable*, the 15 per cent maximum deduction which may be taken for charitable contributions under section 23(n) of the Revenue Act of 1932 and section 23(o) of the Revenue Act of 1938 is based upon the same "net income" upon which the special tax is *in fact* computed and paid.

It is the opinion of this office that in every case where there is a net long-term capital gain the tax is computed on "net income." If the tax is computed under section 117(c)1 of the Internal Revenue Code, it is computed upon both the ordinary net income and the net long-term capital gain, the two added together being the same as the net income. It follows that the base for measuring the charitable contributions where there is a net long-term capital gain is "net income," regardless of whether the tax is computed under section 117(c)1 or under sections 11 and 12 of the Code.

Where there is a net long-term capital loss, the situation is different. The tax is not computed on the net income of the taxpayer, but is computed on ordinary income and such tax is reduced by 30 per cent of the net long-term capital loss. It would be impossible in some cases, where there is a net long-term capital loss, to use as a base of the tax the so-called "net income" for the reason that the taxpayer may not have any statutory net income, and thus would not be allowed a deduction for any contributions although he would be subject to tax. Inasmuch as the income upon which the tax is computed in such cases is the ordinary income (from which there is excluded the net long-term capital loss), such ordinary income is the base for computing the 15 per cent limitation on contributions as well as the earned income credit.

It is therefore concluded that where a taxpayer derives a net long-term capital gain and computes his tax under section 117(c)1, relating to alternative taxes, the base for determining the 15 per cent limitation on the charitable contributions deduction provided by section 23(o) and the earned income credit provided by section 23(a)3 is "net income." On the other hand, where the taxpayer sustains a net long-term capital loss and computes his tax under section 117(c)2, the base for determining the charitable contributions deduction is "ordinary net income," that is, "net income" plus the amount of the net long-term capital loss, and the base for determining the earned income credit is "ordinary net income" as adjusted for the charitable contributions deduction.

SECTION 119.—INCOME FROM SOURCES WITHIN UNITED STATES.

SECTION 19.119-2: Interest.

INTERNAL REVENUE CODE.

Interest allowed and included in judgment for damages recovered by nonresident aliens. (See G. C. M. 21968, page 67.)

SUPPLEMENT C.—CREDITS AGAINST TAX.

SECTION 131.—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

SECTION 19.131-1: Analysis of credit for taxes. 1940-23-10280
I. T. 3381

INTERNAL REVENUE CODE.

The tax imposed by the Mexican statute known as the "Law of Taxation on Excess Profits" is a tax on excess profits within the scope of section 131 of the Internal Revenue Code. The M Company, a domestic corporation which keeps its books on the accrual basis and paid such tax to Mexico in 1940 for the calendar year 1939, may claim credit for such tax accrued to Mexico in the calendar year 1939 against the tax due the United States for that year, subject to the limitation contained in section 131(b) of the Code. For taxable years beginning January 1, 1940, and thereafter, the credit is not available as an offset to the tax imposed under section 102 of the Internal Revenue Code.

Advice is requested whether taxes paid in 1940 by the M Company, pursuant to a recent Mexican law known as the "Law of Taxation on Excess Profits," constitute a proper credit against the 1939 Federal income tax liability of that company.

The taxpayer is incorporated under the laws of the State of Texas, but its operations are confined to the city of R, State of S, Mexico. It keeps its books on the accrual basis and files its income tax returns on the calendar year basis.

The Mexican statute referred to was made effective on December 28, 1939, under a decree issued by the President of Mexico. Article 13(b) of the Mexican law provides that the profits subject to calculation of excess profits are the profits declared for the income tax less the amount of such tax. Article 2 of the law provides that "excess profit" is any profit obtained over and above 15 per cent of the net worth as shown by the books of the company, or over 20 per cent of the profits where there is no net worth shown on the books.

Section 131 of the Internal Revenue Code provides in part as follows:

(a) *Allowance of credit.*—If the taxpayer signifies in his return his desire to have the benefits of this section, the tax imposed by this chapter shall be credited with:

(1) *Citizen and domestic corporation.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States * * *.

(Section 131(a) was amended by the Revenue Act of 1939, effective for taxable years beginning after December 31, 1939, to insert the words "except the tax imposed under section 102" after the word "chapter.")

Section 131(b) of the Code places certain limitations on the amount of such credit.

It is held that the tax imposed by the Mexican statute, known as the "Law of Taxation on Excess Profits," is a tax on excess profits within the scope of section 131, supra. Accordingly, the M Company, a domestic corporation, paying such tax to Mexico in 1940 for the calendar year 1939 may, under the provisions of section 131, supra, claim credit for such tax accrued to Mexico in the calendar year 1939 against the tax due the United States for that year, subject to the limitations contained in section 131(b). For taxable years beginning January 1, 1940, and thereafter, the credit is not available as an offset to the tax imposed under section 102 of the Internal Revenue Code. (See sections 216(a) and 229 of the Revenue Act of 1939.)

SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX.

SECTION 143.—WITHHOLDING OF TAX AT SOURCE.

SECTION 19.143-1: Withholding tax at source.

INTERNAL REVENUE CODE.

Payments by the United States under certain Acts of Congress to nonresident alien owners of land located in the United States. (See I. T. 3379, page 16.)

SECTION 19.143-4: Ownership certificates for bond interest. 1940-3-10141 I. T. 3342

INTERNAL REVENUE CODE.

Where interest-bearing promissory notes were issued by the M Company to holders of 10-year debenture bonds in exchange for interest coupons covering a 5-year period, the filing of ownership certificates will not be required until payments on the principal amounts of the notes are made, and the holders of notes will not be required to include the amounts thereof as income until such payments are received. Any interest paid on the promissory notes prior to payment of the principal of the notes should be reported as income for the year of receipt.

Advice is requested with respect to the filing of ownership certificates in connection with the issuance of notes in lieu of debenture coupons under the following circumstances, and whether the notes should be treated as income in the year of receipt.

The M Company, a corporation, has outstanding 10-year debenture bonds (with interest coupons attached) maturing in 1947 and bearing interest at 6 per cent per annum payable semiannually. The company's cash position was so reduced on September 1, 1939, that promissory notes bearing interest payable annually from September 1, 1940, to September 1, 1944, were issued to the holders of the debentures in exchange for their interest coupons. These debentures are not listed on any exchange, and no sales thereof have been made within the past two years, but there have been offers to sell at a price as low as 20 per cent of their par or face value.

It appears that at the time the notes in question were issued only the interest coupons due on September 1, 1939, represented an existing obligation, and that the transaction, instead of effecting a substantial satisfaction of a real and existing obligation, simply amounted to a substitution of notes for coupons payable for the most part in future years. The notes and coupons represented unearned interest, and thus the transaction constituted, in effect, merely an extension of time for the payment of interest coupons maturing in the future rather than advance payment of such coupons. The notes had no fair market value when received by the holders of the debenture bonds.

Under the facts in this case, it is held that ownership certificates should not be filed until payments on the principal amounts of the promissory notes are made, and that the holders of the notes will not be required to include the amounts thereof as income until such payments are received. (See generally *Aaron Wolfson* v. *Reinecke*, 72 Fed. (2d), 59; *K. E. Merren* v. *Commissioner*, 18 B. T. A., 156, acquiescence, C. B. IX-2, 40 (1930), affirmed on another issue, 51 Fed. (2d), 44; *Claire D. Schlemmer* v. *United States*, 94 Fed. (2d), 77; *George J. Mellinger et al., Trustees*, v. *United States*, 21 Fed. Supp., 964; and *Great Southern Life Insurance Co.* v. *Commissioner*, 36 B. T. A., 828, acquiescence, C. B. 1938-1, 13.)

Any interest paid on the promissory notes prior to payment of the principal of the notes should be reported as income for the year of receipt.

SECTION 147.—INFORMATION AT SOURCE.

SECTION 19.147-3: Cases where no return of information required. 1940-9-10187 I. T. 3354

INTERNAL REVENUE CODE.

Amounts paid to rural mail carriers as equipment maintenance need not be reported in returns of information on Form 1099. Section 19.147-3(*k*) of Regulations 103 is not to be regarded as relieving such employees from reporting these amounts as gross income in their Federal income tax returns, even though they are entitled to deduct the expenditures actually made.

Advice is requested whether amounts (in addition to salaries) paid to rural mail carriers as equipment maintenance should be reported in returns of information on Form 1099.

Section 19.147-3 of Regulations 103 provides in part as follows:

CASES WHERE NO RETURN OF INFORMATION REQUIRED.—Payments of the following character, although over $1,000, need not be reported in returns of information on Form 1099:

* * * * * * *

(*k*) Amounts paid by the United States to persons in its service (civil, military, or naval), as an allowance for traveling expenses, including an allowance for meals and lodging, as, for example, a per diem allowance in lieu of subsistence, and amounts paid as reimbursements for traveling expenses.

Amounts paid to rural mail carriers for equipment maintenance are regarded as being in the nature of traveling expenses. Therefore, in accordance with the provisions of section 19.147-3(*k*) of Regulations 103, supra, such amounts need not be reported on Form 1099. The foregoing regulation is not to be regarded, however, as relieving the recipient employees from reporting such amounts as gross income in their Federal income tax returns, even though they are entitled to deduct the expenditures actually made.

SECTION 148.—INFORMATION BY CORPORATIONS.

SECTION 19.148-4: Information respecting compensation of officers and employees in excess of $75,000. 1940-26-10301 I. T. 3387

INTERNAL REVENUE CODE.

As the total salary and commissions paid by the M Company to A, its president, during the year 1939 exceeded $75,000, the corporation is required to file Schedule H-1 as a part of its 1939 income tax return, regardless of the fact that the commissions were gross income of a business carried on by A under a sales agency contract with the corporation distinct from his contract as president.

Advice is requested whether the M Company should file Schedule H-1 (compensation of officers and employees in excess of $75,000) in connection with its income tax return for the calendar year 1939 and disclose therein the compensation paid to its president, A.

The M Company is engaged in the investment business and issues and sells to the public certificates of participation as a part of its business operations. A is president of the corporation and in 1939 received a substantial salary in that capacity, which, however, was less than $75,000. In 1938 a contract was entered into between the M Company and A, separate and distinct from A's contract as president of the company, for the selling of the certificates of participation on a commission basis. A developed the selling of these certificates into an extensive business. The expenses of this business were paid out of the commissions which inured to A under the terms of the above-mentioned agreement. During the year 1939 the gross commissions received by A exceeded $100,000, out of which the expenses of the business were paid. Inasmuch as the total amount paid to A (salary and commissions) by the M Company exceeded $75,000, but his salary was less than that amount, the question is presented whether Schedule H-1 must be filed.

Section 148(f) of the Internal Revenue Code, as amended, provides in part as follows:

(f) *Compensation of officers and employees.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, every corporation subject to taxation under this chapter shall, in its return, submit a list of the names of all officers and employees of such corporation and the respective amounts paid to them during the taxable year of the corporation by the corporation as salary, commission, bonus, or other compensation for personal services rendered, if the aggregate amount so paid to the individual is in excess of $75,000.

Section 19.148-4 of Regulations 103, relating to section 148(f) of the Code, reads in part as follows:

Every corporation subject to taxation under chapter 1 which during any taxable year beginning after December 31, 1938, has paid to any officer or employee of the corporation, salary, commission, bonus, or other compensation for personal services rendered, in an aggregate amount in excess of $75,000 (in whatever form paid), shall in respect of each such taxable year, make and file, in duplicate, Schedule H-1, as a part of its income tax return, in accordance with the instructions contained in the prescribed return.

In the present case A was an officer of the M Company during the year 1939 and during that year the corporation paid to him salary and commissions for personal services rendered in an aggregate amount in excess of $75,000. It is held, therefore, that the M Company is required to file Schedule H-1 as a part of its 1939 income tax return and disclose therein the information prescribed with respect to the salary and commission paid to A during that year.

SUPPLEMENT E.—ESTATES AND TRUSTS.

SECTION 162.—NET INCOME.

SECTION 19.162-1: Income of estates and trusts.

INTERNAL REVENUE CODE.

Net short-term capital loss carry-over. (See I. T. 3366, page 53.)

SECTION 19.162-1: Income of estates and trusts. 1940-16-10236
I. T. 3367

INTERNAL REVENUE CODE.

The income of the trust, created under the will of A, for the period from the beginning of the taxable year to the date within that year when a beneficiary reaches the age of 30 years, and then becomes entitled to his share of the trust income without restriction, is taxable to the beneficiary.

Advice is requested whether certain income of a trust created under the will of A, deceased, is taxable to the trust or to the beneficiaries.

Under the will of A, a trust was created for the benefit of the testator's children and their issue. The children of the testator are now deceased and their surviving issue are the beneficiaries of the trust. The share of trust income of a beneficiary who has reached the age of 30 years is payable to such beneficiary without restriction. The trustees are directed prior to the time a beneficiary reaches the age of 30 years to apply only so much of the income of the trust for the maintenance and support of the beneficiary as the trustees in their uncontrolled discretion shall deem best. That part of a beneficiary's share of trust income accumulated prior to his reaching the age of 30 years is to be paid to the beneficiary upon his attaining such age. All of the grandchildren of the testator have reached the age of 30 years except one who will become 30 years old in June, 1940, and one who will become 30 years old in May, 1941.

Inquiry is made whether, where a beneficiary reaches the age of 30 years during a taxable year, the income of the trust for the period from the beginning of the taxable year to the date the beneficiary reaches the age of 30 years which has not been applied to the maintenance and support of the beneficiary should be taxed to the beneficiary of the trust.

It is the opinion of this office that where a beneficiary reaches the age of 30 years during a taxable year he is taxable on his share of the income of the trust for the entire taxable year, since, upon reaching that age, he is entitled to his share of the income of the trust without restriction, and such share should include any accumulated income for that year up to the time he became 30 years of age, at which time such income becomes " currently distributable " within the meaning of section 162(b) of the Internal Revenue Code. (Contra, *Roebling* v. *Commissioner*, 78 Fed. (2d), 444, and *Spreckels* v. *Commissioner*, 101 Fed. (2d), 721.)

SECTION 165.—EMPLOYEES' TRUSTS.

SECTION 19.165–1: Employees' trusts. 1940–6–10165
(Also Section 22(b), Section 19.22(b)(2)–2, I. T. 3346
and Section 23(a), Section 19.23(a)–6.)

INTERNAL REVENUE CODE.

Status for Federal income tax purposes of three trusts created by the M Company for the benefit of certain employees of the company, and treatment of various transactions in connection with the operation of the trusts.

Advice is requested whether the M Company pension trusts Nos. 1, 2, and 3, which are operated for the benefit of certain of its employees, are pension trusts within the meaning of section 165 of the Internal Revenue Code. Advice is also requested as to the Federal income tax liability of the M Company and the employees involved arising from the various transactions in connection with the operation of the trusts.

The trust instruments creating the trusts in question were executed by and between the M Company, a corporation, and the N National Bank, trustee. The trusts cover 60 employees, all of whom are key men in the operation of the business. The division of employees into groups under pension trusts Nos. 1, 2, and 3 is based upon their relative importance to the corporation. Trust No. 1 covers 50 employees selected by the corporation (4 of whom are elective officers); trust No. 2 covers 9 employees selected by the corporation (4 of whom are elective officers); and trust No. 3 covers one individual, the president (elective officer) of the corporation. The corporation employs approximately 25,000 persons and it is stated that the corporation at the present time can not afford to include all employees in the pension trusts. The trust instruments are all similar in their provisions. In pension trust No. 1 the corporation pays a sum equal to — per cent of the annual salary of the employee into the trust fund, 50 per cent of which represents the contribution of the corporation and 50 per cent the contribution of the employee. In pension trust No. 2 the payment of the corporation is — per cent of the annual salary of the employee and represents a contribution by the corporation and by the employee to the trust fund in the same proportions as in pension trust No. 1. In pension trust No. 3 the sole beneficiary is the president of the corporation. The corporation contributes *x* dollars each year to that trust fund but the sole beneficiary, the president, does not contribute thereto.

The purposes of the trusts so created are stated to be (1) to provide financial protection for the employee after attaining the age of 65, and (2) to provide financial protection for the objects of the employee's bounty after death. It is provided that the total contributions made to the trust " shall be invested in a life insurance contract and/or annuity contract issued on the life of such employee." The corporation's annual contribution to the trustee under the trusts as now constituted is approximately $6x$ dollars. Provision is made that under no circumstances shall any contribution of the corporation or of the employee ever revert or inure to the benefit of the corporation.

If an employee resigns or is discharged prior to five years from the date he became a party to the trust agreement, he will have no right or interest as to contributions made for his benefit by the corporation and will be entitled only to the funds contributed by him or any insurance policy on his life, the premiums for which have been paid by his contributions. In the event of resignation or discharge by an employee after five years from the date he became a party to the trust agreement, he will be entitled to receive any funds in the pension premium account earmarked in his name and representing contributions by the corporation, and any insurance policy on his life, the premiums for which have been paid from contributions made by the corporation. In pension trust No. 3 for the benefit of the president, if his employment is discontinued at the instance of the corporation, he will be entitled to all benefits thereunder and the insurance policies on his life will be delivered to him free and clear from the terms of the trust agreement, but if his employment is discontinued at his own instance with the intent of accepting a position with another company, he will be entitled to no benefits under the agreement.

Section 165 of the Internal Revenue Code provides in part that:

SEC. 165. EMPLOYEES' TRUSTS.

(a) EXEMPTION FROM TAX.—A trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of some or all of his employees—

(1) if contributions are made to the trust by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, and

(2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees,

shall not be taxable under section 161, but the amount actually distributed or made available to any distributee shall be taxable to him in the year in which so distributed or made available to the extent that it exceeds the amounts paid in by him. * * *

Article 165-1(*a*) of Regulations 101 provides that:

Plans and trusts for employees.—A "stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of some or all of his employees" is a definite written program and arrangement signed by such employer and communicated to such employees, solely designed and applied to enable all or a large percentage of the total number of the employer's clerks and workmen (as distinguished from persons in positions of authority) to share in the capital or profits of such employer's trade or business or to provide for the livelihood of such employees upon their retirement from employment. A "trust forming part of a stock bonus, pension, or profit-sharing plan" is a trust formed and availed of solely to aid in the proper execution of one of the plans defined in the preceding sentence. This phrase does not include devices for paying profits or salaries to shareholders or officers, but a trust, applied without discrimination to all the employees and officers of an employer as one group, may be within its meaning.

Under the facts presented, it is held:

(1) The trusts under consideration are not sufficiently broad in their application to employees of the corporation to constitute pension trusts within the meaning of section 165 of the Internal Revenue Code.

(2) Contributions to the trust, whether made by the company or by the employees, are not taxable income to the trust.

(3) Contributions made by the company to the trust are deductible by the corporation to the extent that such contributions when added to the stipulated salaries of the employees constitute reasonable compensation for the services rendered.

(4) To the extent that the corporation's share of such contributions is applied toward the payment of premiums on life insurance policies covering the lives of employees, such amounts constitute additional income to the employees and should be included in their returns for the year or years in which paid. In G. C. M. 8432 (C. B. IX-2, 114 (1930)) it is stated in part as follows:

> It must be noted that generally the premiums paid by corporations on individual life insurance policies taken out by or on behalf of their officers and covering their lives constitute additional income to the officers and should be included in their returns for the year or years in which paid. * * *

(5) To the extent that the corporation's share of such contributions is applied toward the purchase of retirement annuity contracts for the benefit of employees, such amounts are not considered as having been received by the employees in the year or years in which such payments are so applied, and are not, therefore, required to be included in their returns for those years. Upon retirement the entire amount of each annuity payment will be taxable income to the employee if he made no contribution toward the purchase of the retirement annuity. If he made contributions, he will be taxed on the annuity payments in the manner and to the extent provided in section 22(b)2 of the Internal Revenue Code and article 22(b)(2)-2 of Regulations 101.

(6) All amounts received by employees upon resignation or discharge after five years representing the corporation's share of contributions are to be included in the employees' returns for the year or years in which received. If, upon such termination of service, an annuity contract having a cash surrender value is assigned to an employee, he realizes no taxable income upon the assignment of the annuity contract. However, if the employee actually exercises his right to receive the cash surrender value of the annuity contract, he then realizes income to the extent that the amount received exceeds the amount paid in by him.

SECTION 19.165-1: Employees' trusts. 1940-7-10172
I. T. 3350

INTERNAL REVENUE CODE AND PRIOR REVENUE ACTS.

> Under section 165 of the Internal Revenue Code, as amended, professional partnerships, composed of attorneys, physicians, etc., are entitled to the same privileges as corporations in the establishment of pension trusts for the benefit of the *bona fide* employees of such partnerships. However, a general partner, as such, is not an employee of the partnership and is precluded from participation in the benefits of a trust such as is contemplated by section 165 of the Internal Revenue Code, as amended, and similar provisions of prior Revenue Acts.

Advice is requested whether professional partnerships, composed of attorneys, physicians, etc., have the same rights as corporations, under section 165 of the Internal Revenue Code, as amended, to establish pension trusts for their employees and, if so, whether such pension trusts may include the partners as beneficiaries as well as those who are strictly employees.

Section 165 of the Internal Revenue Code, as amended, provides that a trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of some or all of his employees shall not be taxable under section 161 of the Code (the section imposing the tax on estates and trusts) if (1) contributions are made to the trust by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, and (2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of such employees.

Article 165–1 of Regulations 101, promulgated under the Revenue Act of 1938, which is made applicable to section 165 of the Code by Treasury Decision 4885 (C. B. 1939–1 (Part 1), 396), provides in part as follows:

ART. 165–1. *Employees' trusts.*—(*a*) *Plans and trusts for employees.*—A "stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of some or all of his employees" is a definite written program and arrangement signed by such employer and communicated to such employees, solely designed and applied to enable all or a large percentage of the total number of the employer's clerks and workmen (as distinguished from persons in positions of authority) to share in the capital or profits of such employer's trade or business or to provide for the livelihood of such employees upon their retirement from employment. A "trust forming part of a stock bonus, pension, or profit-sharing plan" is a trust formed and availed of solely to aid in the proper execution of one of the plans defined in the preceding sentence. This phrase does not include devices for paying profits or salaries to shareholders or officers, but a trust, applied without discrimination to all the employees and officers of an employer as one group, may be within its meaning.

From the foregoing, it appears that such professional partnerships are entitled to the same privileges as corporations in the establishment of pension trusts for the benefit of the *bona fide* employees of the partnerships. However, it is the view of the Bureau that a general partner, as such, is not an employee of the partnership and is precluded, under the provisions of section 165 of the Internal Revenue Code, as amended, from participating in the benefits of a trust such as is contemplated by that section and by similar provisions of prior Revenue Acts.

SECTION 19.165–1: Employees' trusts. 1940–24–10294
T. D. 4973

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PARTS 9 AND 19.—INCOME TAX.

Amending article 165–1 of Regulations 101, and section 19.165–1 of Regulations 103, relating to employees' trusts.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Paragraph (*a*) of article 165–1 of Regulations 101 [section 9.165–1, Title 26, Code of Federal Regulations, 1939 Sup.] and paragraph (*a*) of section 19.165–1 of Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.] are each amended to read as follows:

(*a*) *Plans and trusts for employees.*—A "stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of some or all of his employees" is a definite written program and arrangement communicated to such employees, solely designed and applied to enable such employees to share in the capital or profits of such employer's trade or business or to provide for the livelihood of such employees upon their retirement from employment. A "trust forming part of a stock bonus, pension, or profit-sharing plan" is a trust formed and availed of solely to aid in the proper execution of one of the plans defined in the preceding sentence. This phrase includes only trusts created for the exclusive benefit of employees, and does not include devices for distributing profits to shareholders. All the surrounding and attending circumstances and the details of the plan will be indicative of whether it is a bona fide stock bonus, pension, or profit-sharing plan for the exclusive benefit of employees within the meaning of section 165.

(This Treasury decision is issued under the authority contained in sections 62 and 165 of the Revenue Act of 1938 (52 Stat., 480, 518; 26 U. S. C., Sup. 62, 165); and sections 62 and 165 of the Internal Revenue Code (53 Stat., 32, 67).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved June 3, 1940.
JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register June 5, 1940, 10.25 a. m.)

SUPPLEMENT H.—NONRESIDENT ALIEN INDIVIDUALS.

SECTION 211.—TAX ON NONRESIDENT ALIEN INDIVIDUALS.

SECTION 19.211–2: Definition. 1940–25–10296
I. T. 3386

INTERNAL REVENUE CODE.

A, a subject of a foreign country who entered the United States in October, 1938, on a temporary visa which has been renewed from time to time during the continuance of the war, has the status of a nonresident alien.

Advice is requested whether the extension of A's temporary visa from time to time through the R Embassy and the fact that due to war conditions abroad A does not intend to depart from the United States until such conditions are over have any effect on A's status as a nonresident alien for Federal income tax purposes. He entered the United States in October, 1938.

It is stated in section 19.211–2 of Regulations 103, promulgated under the Internal Revenue Code, which is applicable to taxable years beginning after December 31, 1938, that an alien whose residence is not within the United States is a nonresident alien. An alien actually present in the United States who is not a transient is a resident for Federal income tax purposes. Whether an alien is a transient is determined by his intentions with regard to the length and nature of his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. An alien whose stay in the United States is limited to a definite period by the immigration laws is not a resident of the United States within the meaning of section 19.211-2 in the absence of exceptional circumstances.

Inasmuch as A is in the United States on a temporary visa, issued by the Bureau of Immigration, which has been renewed from time to time during the continuance of the war, and his intention is to return to a foreign country as soon as war conditions will permit, his status is that of a nonresident alien. Under the circumstances of this case, exceptional circumstances do not exist within the meaning of the regulations so as to warrant A's classification as a resident of the United States. The ruling is, of course, applicable only to the taxpayer's present status.

SECTION 19.211-7: Taxation of nonresident alien individuals. 1940-19-10251
(Also Section 119; Section 19.119-2.) G. C. M. 21968

INTERNAL REVENUE CODE.

Where nonresident aliens obtained a judgment of 65*x* dollars against the M Company, 26*x* dollars thereof representing the "principal amount" of the damages recovered and 39*x* dollars representing interest allowed from the dates of sales of certain property to the date of judgment, the principal amount of the judgment is not subject to Federal income tax. The 39*x* dollars interest allowed by the court from the dates of sales to the date of judgment, and the 9*x* dollars interest which accrued on the judgment from date of rendition to date of payment, are taxable under section 211(a) of the Internal Revenue Code.

An opinion is requested whether, under the circumstances herein set forth, any part of the payments received by certain nonresident alien individuals as the result of a judgment is subject to Federal income tax.

In January, 1940, a judgment obtained by the nonresident alien individuals against the M Company was paid. The amount received, namely, 74*x* dollars, consisted of 65*x* dollars paid pursuant to the judgment entered in 1938 and 9*x* dollars accrued interest on the judgment to the date of payment. The action was one for fraud against the M Company as their agent in inducing plaintiffs (the nonresident aliens) to sell certain lands for an amount less than their true value. The judgment itself consisted of two items—26*x* dollars, which may be termed the principal amount of the judgment, as it represented the difference between the value of the lands at the time of the several sales and the amount received therefor by the plaintiffs, and 39*x* dollars, interest computed from the dates of the sales to the date of the judgment.

The recipients file returns on the cash receipts and disbursements basis. They are nonresident aliens not engaged in trade or business in the United States and not having an office or place of business therein.

Section 211(a)1(A) of the Internal Revenue Code provides in part as follows:

Imposition of tax.—There shall be levied, collected, and paid for each taxable year, in lieu of the tax imposed by sections 11 and 12, upon the amount received, by every nonresident alien individual not engaged in trade or business within the United States and not having an office or place of business therein, *from sources within the United States as interest* (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, *or other fixed or determinable annual or periodical gains, profits, and income,* a tax of 10 per centum of such amount * * *. [Italics supplied.]

Section 119(a) of the Internal Revenue Code provides in part as follows:

Gross income from sources in United States.—The following items of gross income shall be treated as income from sources within the United States:

(1) *Interest.*—Interest from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and *interest* on bonds, notes or other *interest-bearing obligations of residents, corporate or otherwise,* not including— * * *. [Italics supplied.]

It is the opinion of this office that the principal amount of the judgment, 26x dollars (i. e., such portion of the judgment as represented the difference between the value of the lands when the owners were fraudulently induced to sell and the amounts received by them at that time), does not constitute "fixed or determinable annual or periodical gains, profits, and income" within the meaning of section 211(a)(1)(A) of the Internal Revenue Code and is not subject to Federal income tax when received by the nonresident alien individuals.

With respect to the amount of 39x dollars, which was computed from the dates of the sales to the date upon which judgment was entered, the proper treatment of that amount presents the following issues: (1) Is the 39x dollars interest, or is it but a part of a total judgment for pecuniary damages, the parts of which are inseparable for tax purposes; (2) is such amount income from sources within the United States as defined in section 119(a), supra. These two matters are discussed infra.

(1) The decree of the court in the instant case formally provided for the payment of interest by the defendant. The 39x dollars was paid in accordance with the decree. Moreover, that amount is in substance interest, based upon the following reasoning: Sales of the properties actually were consummated in prior years. These sales gave rise to a cause of action against the wrongdoing fiduciary for the amount of the difference (26x dollars) between the value of the properties at the time of the sales and the sums then received by the plaintiffs. As indicated above, it appears that the 26x dollars was not the receipt of annual or periodical gains, profits, and income contemplated by section 211(a). But the additional sum of 39x dollars, computed by the court upon an annual basis and at a certain per cent on the 26x dollars, constitutes compensation for the use of money to which the plaintiffs equitably became entitled when the fraud was consummated. Compensation for the use of money is merely another name for interest. To conclude that the 39x dollars is an inseparable part of a total judgment for damages to the plaintiffs would ignore both the form and the substance of the decree. The substance of the decree is that the plaintiffs first became entitled to restitution in damages, not when the judgment was entered but when the fraud

was committed, and that the plaintiffs are being awarded a separate sum as compensation for the delay in payment of the damages. Accordingly, it is concluded that the 39*x* dollars is interest in the sense in which that term normally is used.

(2) The amount of 39*x* dollars appears to constitute "interest on * * * interest-bearing obligations of residents, corporate or otherwise," within the meaning of section 119(a), supra, and, hence, is income from sources within the United States. (See *Helvering* v. *Stockholms Enskilda Bank*, 293 U. S., 84, Ct. D. 887, C. B. XIII-2, 299 (1934).) Corollary to the plaintiffs' right to restitution in damages was a liability or "obligation" on the part of the fiduciary. Such an obligation is similar to the Government's obligation to refund taxes illegally or erroneously collected, which was the type of obligation involved in the Stockholms Enskilda Bank case. The court's decree in the instant case recognized and enforced such obligation. That it might be, and actually was, an "interest-bearing obligation" was also determined by the court's decree. In this respect, the decree was analogous to the express statutory direction to pay interest on the tax refunds involved in the Stockholms Enskilda Bank case, supra.

It follows from the foregoing that the 9*x* dollars interest which accrued on the judgment to the date of payment is also interest income from sources within the United States and is subject to tax under section 211(a), supra.

It is the opinion of this office, therefore, that the part of the judgment termed the "principal amount" is not subject to Federal income tax, but the 39*x* dollars interest allowed by the court from the dates of sales to the date of the judgment, and 9*x* dollars interest accrued from the date of the judgment to date of payment, are taxable under section 211(a) of the Internal Revenue Code.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

SUBCHAPTER B.—LIEN FOR TAXES.

SECTION 3670.—PROPERTY SUBJECT TO LIEN.

1940-6-10166
I. T. 3347

INTERNAL REVENUE CODE.

The lien of B and C, mortgagees, on real estate mortgaged by A does not extend to the rents and profits flowing from the property. An assignment of the rents by the mortgagor to the mortgagees to be applied to back interest is inferior to a Federal tax lien recorded prior to the assignment.

Advice is requested relative to the priority of a Federal tax lien for unpaid income taxes, interest, and penalties assessed against A over an assignment to the mortgagees of the rents collected from real estate mortgaged by A.

In 1932 a Federal tax lien was filed against A in the clerk's office of —— County, N. Y., in which county are located certain properties belonging to A. B and C are mortgagees of these properties under mortgages recorded prior to the recording of the tax lien. There is now due on the mortgages $18x$ dollars plus back interest in the amount of approximately $5x$ dollars. During the last several years, under an oral arrangement with A, the rents have been collected and the sum of x dollars has been paid each month to the collector of internal revenue to liquidate in part A's indebtedness. On February 1, 1939, A made a written assignment of rents to B and C, the amounts collected to be applied to back interest and current interest. The question arises whether monthly payments to the collector of internal revenue after the assignment constitute a preference unfair to the mortgagees on the ground that the rights of the Government are inferior to those of the mortgagees.

It is the opinion of this office that even though the mortgage abovementioned was recorded before the filing of the Federal notice of tax lien, the lien of the mortgage applied only to the real estate and not to the rents and profits. It did not cover and was not good as to the latter. In *Kountze* v. *Omaha Hotel Co.* (107 U. S., 378), the Supreme Court said:

> * * * in the case of a mortgage, the land is in the nature of a pledge; and it is only the land itself—the specific thing—which is pledged. The rents and profits are not pledged; they belong to the tenant in possession, whether the mortgagor or a third person claiming under him. * * * The taking of the rents and profits prior to the sale does not injure the mortgagee, for the simple reason that they do not belong to him. * * *

The rule is stated in Tiffany's Real Property, volume 3, second edition, section 613, as follows: "A mortgagor who is in possession of the land is entitled to receive and apply to his own use the rents and profits of the land; and this is so, even when the mortgage expressly includes rents and profits." In *Gillman* v. *Illinois & Mississippi Telephone Co.* (91 U. S., 603), the court said that "possession draws after it the right to receive and apply the income," as if no mortgage existed; and in *American Bridge Co.* v. *Heidelbach* (94 U. S., 798), although rents, issues, and profits had been pledged by the mortgagor to the payment of interest on mortgage bonds, and default occurred, nevertheless a judgment creditor of the mortgagor prevailed over the mortgage trustees with respect to the right to receive such income, the court holding that until possession was taken under the mortgage or a receiver appointed, the mortgagor was "owner to all the world, and entitled to all the profit made."

The foregoing rule was applied in *Freedman's Saving & Trust Co.* v. *Shepherd* (127 U. S., 494). There the mortgagor had assigned a lease of the mortgaged premises to one, Shepherd, and thereafter pledged or assigned accrued rents to a creditor of Shepherd. In a contest between the creditor and the mortgagee as to the right to such rents (subsequent to the mortgagor's default and before the mortgagee took possession of the premises), the creditor prevailed. The court said that even though the income were expressly pledged as security for the mortgage debt, the mortgagee would not be entitled to it as against a third party claimant prior to taking possession of the property after the mortgagor's default.

In *Elmore* v. *Symonds* (183 Mass., 321, 67 N. E., 314), there was involved a suit by a mortgagor's trustee in bankruptcy against a mortgagee to recover rents collected by the mortgagee after the mortgagor's bankruptcy under an oral agreement by the mortgagor before bankruptcy to pay over to the mortgagee the rents as they accrued until the latter was reimbursed for money advanced for taxes and improvements. The trustee prevailed, the court holding that such a transfer of rents (after bankruptcy) was void for the reason that title to the rents was then vested in the trustee in bankruptcy, and that a mere agreement for such transfer before bankruptcy, whether oral or in writing, made no difference. The court said in part:

* * * and it is doubtful whether a notice given by a mortgagee to tenants that they are to pay their rent to him, or any other act on his part not amounting to an entry or equivalent to taking possession by him, can defeat the right of a mortgagor, or those claiming under him, to take the rents and profits of the mortgaged real estate. (*Field* v. *Swan*, 10 Metc., 112, 114.) Under the facts found in this case, the defendant stands no better under the agreement. There was no assignment of the rents, or even an order to the tenants to pay to him. * * * Before any lien can arise at law in favor of the defendant, it is not enough that there is an express promise to pay from a particular fund, but there must be some positive act of appropriation on the part of the debtor, whereby he ceases to control the fund, and the creditor, without his aid or consent, can collect the same, and apply it in payment of his debt. * * *

The court held further that the defendant had no equitable lien, by virtue of the agreement, on the rents as they accrued, and that he was not otherwise entitled to relief in equity.

The same general rule that a mortgagee acquires no right to the rents of mortgaged property, even by an assignment of rents in the mortgage, in the absence of entry and possession and/or the securing of the appointment of a receiver of the rents and profits in his behalf under the mortgage, has been applied by the New York courts and appears to be the accepted rule in that State. (*New York Life Insurance Co.* v. *Fulton Development Corporation*, 265 N. Y., 348, 193 N. E., 169; *Woman's Hospital* v. *Sixty-Seventh Street Realty Co., Inc.*, 240 App. Div., 33, 268 N. Y. Supp., 725; *Dime Savings Bank of Brooklyn* v. *Fox*, 147 Misc., 24, 264 N. Y. Supp., 262; *One-Hundred Forty-Eight Realty Co., Inc.*, v. *Conrad et al.*, 125 Misc., 142, 210 N. Y. Supp., 400; *Rhinelander* v. *Richards*, 184 App. Div., 67, 171 N. Y. Supp., 436; *Conley* v. *Fine*, 181 App. Div., 675, 169 N. Y. Supp., 162; *Sullivan* v. *Rosson*, 223 N. Y., 217, 119 N E., 405; *Harris* v. *Lesster et al.*, 35 App. Div., 462, 54 N. Y. Supp., 864, appeal dismissed in 159 N. Y., 533, 53 N. E., 1126.)

The foregoing cases disclose that certain qualifications upon the general rule have been recognized by the New York courts, as where there is an absolute and unqualified assignment of rents incorporated in or separate from the mortgage clearly intended to operate *in praesenti* or immediately upon default, or where a prior mortgagee takes an assignment of rents after default and before a subsequent mortgagee takes steps to recover them, but the facts submitted in the present case do not bring it within the application of any of the adjudicated qualifications to the usual rule. In *Conley* v. *Fine*, supra, the court said "it is axiomatic that the assignee of a nonnegotiable chose in action can obtain no greater right than his assignor had"; and in the present case a Federal statutory lien had attached to the leases and to the assignor's (taxpayer's) right to the rents under them before the execution of the assignment to the mortgagees.

In the instant case, by the filing of its notice of tax lien in 1932, the Government acquired a lien "upon all property and rights to property, whether real or personal, belonging to such person," that is, belonging to A. (Section 3186, R. S., as amended; now sections 3670 to 3677, inclusive, Internal Revenue Code.) At the time the Government acquired its lien, the mortgagees appear to have had no legal claim or preference of any kind to the rents of the mortgaged property, for there seems to have been no legally recognizable appropriation of the rents to them, and when they did take an assignment of the rents on February 1, 1939, they necessarily took that assignment subject to the Government's prior lien. Such lien therefore attached to all contracts or leases for the payment of rent to A, and to his right to receive rent thereunder, and the collector could have distrained and levied thereon to secure liquidation of the unsatisfied tax liability. (Sections 3187 and 3188, R. S., as amended; now sections 3690, 3691, and 3692, Internal Revenue Code.) A subsequent assignment by the mortgagor to the mortgagees of the contracts or leases for rent would clearly have been inferior to the Government's prior lien thereon for taxes, and *a fortiori*, a subsequent assignment of rents could stand in no better position. The assignment was merely a transfer of rents subject to existing equities or liens without otherwise affecting the mortgagor's possession of the property and his rights in and to the property prior to actual entry and taking over of possession by the mortgagees. It has been held that a lien for taxes is superior to a mortgage or deed of trust executed subsequent to a demand for payment and embraces every species of property subject to ownership. (*Blacklock* v. *United States*, 208 U. S., 75.) It follows that a lien for taxes is superior to a subsequent assignment of leases or rents.

It is held under the facts presented that the rights of the Government under the tax lien are superior to those of the mortgagees under the assignment.

SUBCHAPTER C.—DISTRAINT.

PART I.—DISTRAINT ON PERSONAL PROPERTY.

SECTION 3690.—AUTHORITY TO DISTRAIN.

1940–11–10197
I. T. 3356

INTERNAL REVENUE CODE.

A partnership checking account in a bank is not subject to distraint to satisfy a tax assessed against an individual partner. However, the Government's tax lien attaches to the taxpayer's interest in the partnership itself, and that interest may be levied upon and sold in effecting satisfaction of the taxpayer's outstanding tax liability.

Advice is requested whether a partnership checking account in a bank is subject to distraint to satisfy a tax assessed against an individual partner.

Following service of a notice of levy on the M Bank covering unpaid income tax in the amount of $10x$ dollars due from A, the taxpayer, for the year 1938 and assessed in March, 1939, it was discovered that the bank was not in possession of any property or rights to property belonging to A individually. However, it has been ascertained that the N Company, a partnership of which A is a member, has a checking account in the M Bank, which account contained $16x$ dollars as of the date levy was made. This is a partnership account and checks drawn thereon require two signatures, namely, A and B.

Section 3670 of the Internal Revenue Code, entitled "Property subject to lien," formerly section 3186, R. S., as amended, provides as follows:

> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount * * * shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

Section 3690 of the Internal Revenue Code, entitled "Authority to distrain," formerly section 3187, R. S., as amended, provides as follows:

> If any person liable to pay any taxes neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the collector or his deputy to collect the said taxes, with such interest and other additional amounts as are required by law, by distraint and sale, in the manner provided in this subchapter, of the goods, chattels, or effects, including stocks, securities, bank accounts, and evidences of debt, of the person delinquent as aforesaid.

Section 3692 of the Internal Revenue Code, entitled "Levy," formerly section 3188, R. S., provides as follows:

> In case of neglect or refusal under section 3690, the collector may levy, or by warrant may authorize a deputy collector to levy, upon all property and rights to property, except such as are exempt by the preceding section, belonging to such person, or on which the lien provided in section 3670 exists, for the payment of the sum due, with interest and penalty for nonpayment, and also of such further sum as shall be sufficient for the fees, costs, and expenses of such levy.

Under the provisions of law quoted above, the Government's tax lien attaches to all property and rights to property belonging to the taxpayer, A, and the collector or his deputy may levy on such property and rights to property. The question then arises whether the partnership checking account, or any part thereof, is included within such leviable property.

In the opinion of this office, the answer is in the negative for the reason that the partnership checking account is an asset and property of the partnership and not an asset or property of the individual partner (see *United States et al.* v. *Kaufman, Trustee, etc.*, 267 U. S., 408, T. D. 3689, C. B. IV-1, 248 (1925)), and because it is conceded law that one partner may not pay his individual debts out of partnership assets without the consent of the other partner or partners, as to do so would be taking the money of one person to pay the debts of another (*Gallagher's Appeal*, 114 Pa. St., 353, 7 Atl., 237). In other words, the Government's rights must be worked out through the partner's interest in the partnership itself or in its assets, since the partner has no severable interest in any particular partnership asset in specie of which he can avail himself in his own right for the payment of his private obligations and debts.

In the bankruptcy case of *United States* v. *Kaufman*, supra, involving the distribution of the assets of a partnership and of its partners, the equitable rule of marshaling assets was applied, and it was held that the United States was not entitled to priority of payment out of partnership assets for a tax due from an individual partner, except to the extent of the share of such partner, if any, in the surplus remaining after the payment of partnership debts. (Idem, *United States* v. *Hack*, 8 Pet., 271.) It was also held in the Kaufman case that the lien created in favor of the Government for unpaid taxes by section 3186, R. S., as amended (now section 3670, Internal Revenue Code), supra, includes only the property of the person owing the tax, and in the case of a partner owing an individual tax, it extends only to his interest in the surplus of the partnership property.

It must be borne in mind, however, that the equitable rule as to marshaling assets applies only where the administration or distribution of the assets is within the control of a court, as in an insolvency or bankruptcy proceeding, and that it has no application to acts done by a partner or partnership while in the full control of his or its property. (*Case* v. *Beauregard*, 99 U. S., 119; *Gallagher's Appeal*, supra.) Since a solvent and operating partnership may have certain valuable intangible property rights, such as good will, it is apparent that a partner's disposable interest in a partnership may have a value much in excess of what the partner's interest would be in the surplus remaining after the payment of partnership debts in a liquidation case involving a marshaling of assets.

In the instant case the Government's tax lien attaches to the taxpayer's interest in the partnership itself (such interest being property of the taxpayer), and that interest may be levied upon and sold in effecting satisfaction of the taxpayer's outstanding tax liability. (See the statutes quoted supra; see also *Case* v. *Beauregard*, supra.)

CHAPTER 38.—MISCELLANEOUS PROVISIONS.

SECTION 3798 (AMENDED BY SECTION 406, REVENUE ACT OF 1939).—EXEMPTION OF INSOLVENT BANKS FROM TAX.

1940–1–10134
T. D. 4958

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 464A.—INSOLVENT BANKS.

Regulations relating to assessment and collection of taxes of insolvent banks and trust companies. Treasury Decision 4882 [C. B. 1939–1 (Part 1), 154] revoked.[1]

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[1] Sections 464A.0 to 464A.14 are issued under the authority contained in section 3791 (53 Stat., Part 1; Rev. Stat., 3447; 26 U. S. C., 1691); and interpret section 3798 (53 Stat., Part 1); section 406 (Public, No. 155, Seventy-sixth Congress, first session); section 22 (20 Stat., 35); and section 818 (52 Stat., 579; 12 U. S. C., Sup. IV, 570).

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

TABLE OF CONTENTS.

SECTION 464A.0. *Introductory.*—Section 3798 of the Internal Revenue Code, approved February 10, 1939 (53 Stat., Part 1 (reenacting section 22 of the Act of March 1, 1879, as amended by section 818 of the Revenue Act of 1938, 52 Stat., 579; 12 U. S. C., Sup. IV, 570)), reads as follows:

SEC. 3798. EXEMPTION OF INSOLVENT BANKS FROM TAX.

(a) Whenever and after any bank or trust company, a substantial portion of the business of which consists of receiving deposits and making loans and discounts, has ceased to do business by reason of insolvency or bankruptcy, no tax shall be assessed or collected, or paid into the Treasury of the United States on account of such bank, or trust company, which shall diminish the assets thereof necessary for the full payment of all its depositors; and such tax shall be abated from such national banks as are found by the Comptroller of the Currency to be insolvent; and the Commissioner of Internal Revenue, when the facts shall appear to him, is authorized to remit so much of the said tax against any such insolvent banks and trust companies organized under State law as shall be found to affect the claims of their depositors.

(b) Whenever any bank or trust company, a substantial portion of the business of which consists of receiving deposits and making loans and discounts, has been released or discharged from its liability to its depositors for any part of their claims against it, and such depositors have accepted, in lieu thereof, a lien upon subsequent earnings of such bank or trust company, or claims against assets segregated by such bank or trust company or against assets transferred from it to an individual or corporate trustee or agent, no tax shall be assessed or collected, or paid into the Treasury of the United States on account of such bank, or trust company, such individual or corporate trustee or such agent, which shall diminish the assets thereof which are available for the payment of such depositor claims and which are necessary for the full payment thereof.

(c) Any such tax so collected shall be deemed to be erroneously collected, and shall be refunded subject to all provisions and limitations of law, so far as applicable, relating to the refunding of taxes, but tax so abated or refunded after May 28, 1938, shall be reassessed whenever it shall appear that payment of the tax will not diminish the assets as aforesaid. The running of the statute of limitations on the making of assessment and collection shall be suspended during, and for ninety days beyond, the period for which, pursuant to this section, assessment or collection may not be made, and a tax which has been abated may be reassessed and collected during the time within which, had there been no abatement, collection might have been made.

(d) This section shall not apply to any tax imposed by Subchapter A[1] or Subchapter C[1] of Chapter 9.

Section 406 of the Revenue Act of 1939 (Public, No. 155, Seventy-sixth Congress, first session) reads as follows:

SEC. 406. INSOLVENT BANKS.

(a) Section 3798(c) of the Internal Revenue Code is amended to read as follows:

"(c) (1) Any such tax collected, whether collected before, on, or after the date of enactment of the Revenue Act of 1938, shall be deemed to be erroneously collected, and shall be refunded subject to all provisions and limitations of law, so far as applicable, relating to the refunding of taxes.

"(2) Any tax, the assessment, collection, or payment of which is barred under subsection (a) of this section, or any such tax which has been abated or remitted after May 28, 1938, shall be assessed or reassessed whenever it shall appear that payment of the tax will not diminish the assets as aforesaid.

"(3) Any tax, the assessment, collection, or payment of which is barred under subsection (b) of this section or any such tax which has been refunded after May 28, 1938, shall be assessed or reassessed after full payment of such claims of depositors to the extent of the remaining assets segregated or transferred as described in subsection (b).

"(4) The running of the statute of limitations on the making of assessment and collection shall be suspended, during, and for ninety days beyond, the period for which, pursuant to this section, assessment or collection may not be made, and a tax may be reassessed as provided in paragraphs (2) and (3) of this subsection, and collected, during the time within which, had there been no abatement, collection might have been made."

(b) The term "agent" as used in 3798(b) of the Internal Revenue Code shall be deemed to include a corporation acting as a liquidating agent.

(c) The amendments made by this section shall be effective as of the date of enactment of the Revenue Act of 1938.

Pursuant to the authority contained in section 3791 of the Internal Revenue Code, and other provisions of the internal revenue laws, the following regulations are hereby prescribed:

SECTION 464A.1. *Effect of statutory amendments.*—The amendment of section 22 of the Act of March 1, 1879, made by section 818 of the Revenue Act of 1938, was effective on May 28, 1938, the date of enactment of the Revenue Act of 1938. Section 406 of the Revenue Act of 1939 in substance makes identical amendments of subsection (c) of section 22, as amended by the Revenue Act of 1938, and section 3798(c) of the Internal Revenue Code. The amendments made by section 406 of the Revenue Act of 1939 are effective as of May 28, 1938. Therefore section 22, as amended, of the Act of March 1, 1879, and section 3798 of the Internal Revenue Code, as amended by section 406 of the Revenue Act of 1939, in substance constitute a continuous section effective on May 28, 1938.

SEC. 464A.2. *Banks and trust companies covered.*—Section 22 (as amended) of the Act of March 1, 1879, and section 3798 of the Internal Revenue Code, both as amended by section 406 of the Revenue Act of 1939, in substance apply as a continuous section to any national bank, or bank or trust company organized under State law, a substantial portion of the business of which consists of receiving deposits and making loans and discounts, and which has—

(*a*) ceased to do business by reason of insolvency or bankruptcy, or

(*b*) been released or discharged from its liability to its depositors for any part of their deposit claims, and the depositors have accepted in lieu thereof

[1] Replaces "the Social Security Act" in section 818 of the Revenue Act of 1938.

a lien upon its subsequent earnings or claims against its assets either (1) segregated and held by it for benefit of the depositors or (2) transferred to an individual or corporate trustee or agent who liquidates, holds or operates the assets for the benefit of the depositors.

SEC. 464A.3. *Definitions.*—As hereinafter used in these regulations:

(*a*) (1) The term "section," unless otherwise indicated by the context, means section 22 (as amended) of the Act of March 1, 1879, section 3798 of the Internal Revenue Code (reenacting such section 22), and section 3798 of the Code as amended by section 406 of the Revenue Act of 1939, such sections in substance constituting a continuous section in effect on and after May 28, 1938. See section 464A.1 of these regulations.

(2) Unless otherwise indicated, the term "subsection" means a subdivision of the "section" as defined herein.

(*b*) The term "bank," unless otherwise indicated by the context, means any national bank, or bank or trust company organized under State law, within the scope of the section. See section 464A.2 of these regulations.

(*c*) The terms "statute of limitations" and "limitations" mean all applicable provisions of law (including the section as herein defined) which impose, change, or affect limitations, conditions, or requirements relative to the allowance of refunds and abatements, or the assessment or collection of tax, as the case may be.

(*d*) The term "segregated assets" includes transferred or trusteed assets, or assets set aside or earmarked, and to all or a portion of which, or the proceeds of which, the depositors are absolutely or conditionally entitled.

(*e*) The term "effective date" means May 28, 1938.

(*f*) The term "Commissioner" means the Commissioner of Internal Revenue.

(*g*) The term "collector" means collector of internal revenue.

SEC. 464A.4. *Scope of section generally.*—(*a*) *Purpose.*—The section prior to amendment by the Revenue Act of 1938 was intended to assist depositors of a bank which had ceased to do business by reason of insolvency to recover their deposits, by prohibiting collection of taxes of the bank which would diminish the assets necessary for payment of its depositors. By the amendments like assistance is given to depositors of banks which are in financial difficulties but which, in certain conditions, continue in business.

(*b*) *Requisites of application.*—In order that the section shall operate in a case where the bank continues business it is necessary that the depositors shall agree to accept, in lieu of all or a part of their deposit claims as such, claims against segregated assets, or a lien upon subsequent earnings of the bank, or both. When such an agreement exists, no tax diminishing such assets or earnings, or both, otherwise available and necessary for payment of depositors, may be collected therefrom. If, under such an agreement, the depositors have the right also to look to the unsegregated assets of the bank for recovery, in whole or part, the unsegregated assets are likewise, until they exceed the amount of the depositors' claims chargeable thereto, unavailable for tax collection. Any tax of such a bank, or part of any tax, which is once uncollectible under the sections, can not thereafter be collected except from any residue of segregated assets remaining after claims of depositors against such assets have been paid.

(*c*) *Interest.*—For the purposes of the section, depositors' claims include bona fide interest, either on the deposits as such, or on the claims accepted in lieu of deposits as such.

(*d*) *Limitations on immunity.*—The section is not primarily intended for the relief of banks as such. It does not prevent tax collection, from assets not necessary, or not available, for payment of depositors, from a bank within subsection (a), at any time within the statute of limitations. In other words the immunity of such a bank is not complete, but ceases whenever, within the statutory period for collection, it becomes possible to make collection without diminishing assets necessary for payment of depositors. In the case of a bank within subsection (b), any immunity to which the bank is entitled is absolute except as to segregated assets. Any tax coming within such immunity may never be collected. With respect to segregated assets, such a bank is subject to the same rule as a bank within subsection (a), that is to say, after claims of depositors against segregated assets have been paid, any surplus is subject, within the statute of limitations, to collection of any tax, due at any time, the collection of which was suspended by the section. The section is not for the relief of creditors other than depositors, although it may incidentally operate for their benefit. See sections 464A.6 and 464A.11(*b*) of these regulations.

SEC. 464A.5. *Segregated or transferred assets.*—(*a*) *General.*—In a case involving segregated or transferred assets, it is not necessary, for application of the section, that the assets shall technically constitute a trust fund. It is sufficient that segregated assets be definitely separated from other assets of the bank and that transferred assets be definitely separated both from other assets of the bank and from other assets held or owned by the trustee or agent to whom assets of the bank have been transferred; that the bank be wholly or partially released from liability for repayment of deposits as such; and that the depositors have claims against the separated assets. Any excess of separated assets over the amount necessary for payment of such depositors will be available for tax collection after full payment of depositors' claims under the agreement against such assets. But see section 464A.11(*a*) of these regulations.

(*b*) *Corporate transferees.*—Where the segregated assets are transferred to a separate corporate trustee or corporate agent, the assets and earnings therefrom are within the protection of the section, until full payment of depositors' claims against such assets and earnings, no matter by whom the stock of such corporation is held, and no matter whether the assets be liquidated or operated or held for benefit of the depositors.

Property of a separate corporation not conveyed to it by the bank pursuant to an agreement with depositors, is not within the immunity of the section, even though the corporation's stock is owned by the bank. Tax due from a separate corporation to which assets of an insolvent bank are conveyed is collectible, even though such tax be due to the property so conveyed, except in so far as tax collection will diminish assets conveyed by the bank for benefit of depositors or the earnings from such assets to which the depositors are entitled, and which are necessary for payment of the depositors' claims. Other assets and earnings of a separate corporation are available for collection of the taxes of such corporation even though the assets and earnings of such corporation if received by the bank would be available for satisfaction of claims of the bank's depositors and such claims can not otherwise be paid.

SEC. 464A.6. *Unsegregated assets.*—(*a*) *Depositors' claims against assets.*—Claims of depositors, to the extent that they are to be satisfied out of segregated assets, will not be considered in determining the availability of unsegregated assets for tax collection. If depositors have agreed to accept payment out of segregated assets only, collection of tax from unsegregated assets will not diminish the assets available and necessary for payment of the depositors' claims. Thus, it may be possible to collect taxes from the unsegregated assets of a bank although the segregated assets are immune under the section.

If the unsegregated assets of the bank are subject to any portion of the depositors' claims, such unsegregated assets will be within the immunity of the section only to the extent necessary to satisfy the claims to which such assets are subject. Taxes will still be collectible from the unsegregated assets to the extent of the amount by which the total value of such assets exceeds the liability to depositors to be satisfied therefrom. Therefore, if, for example, in the case of a bank having a tax liability, not previously immune under the section, of $50,000, the deposit claims against the bank are in the amount of $75,000, and the assets available for satisfaction of deposit claims amount to $100,000, the $50,000 tax is collectible to the extent of the $25,000 excess of assets over deposit claims. Collection is not to be postponed until the full amount of the tax is collectible.

(*b*) *Depositors' claims against earnings.*—Even though under a bona fide agreement a bank has been released from depositors' claims as to unsegregated assets, if all or a portion of its earnings are subject to depositors' claims, all assets the earnings from which, in whole or part, are charged with the payment of depositors' claims, will be immune from tax collection. But see section 464A.7(*a*) of these regulations.

SEC. 464A.7. *Earnings.*—(*a*) *Availability for tax collection.*—Earnings of a bank within subsection (*b*), whether from segregated or unsegregated assets, which are necessary for, applicable to, and actually used for, payment of depositors' claims under an agreement, are within the immunity of the section. If only a portion or percentage of income from segregated or unsegregated assets is available and necessary for payment of depositors' claims, the remaining income is available for tax collection. Earnings of the bank's first fiscal year ending after the making of the agreement not applicable to payment of depositors will be assumed to be applicable for collection of any tax due prior or subsequent to execution of the agreement. Earnings of subsequent fiscal periods from unsegregated assets not applicable to depositors' claims will be assumed to be applicable to payment of taxes as to which immunity under the section has not previously attached. Earnings from segregated assets are available for collection of tax, whether previously uncollectible under the section or not, after depositors' claims against such assets have been paid in full. See sections 464A.5(*a*) and 464A.11(*a*) of these regulations.

(*b*) *Tax computation.*—The fact that earnings of a given year may be wholly or partly unavailable under the section for collection of taxes does not exempt the income for that year, or any part thereof, from tax liability. The section affects collectibility only, and is not concerned with taxability. Accordingly, the taxpayer's income tax return shall correctly compute the tax liability, even though in the opinion of the taxpayer it is immune from tax collection under the section. The tax shall be determined with respect to the entire taxable income and not merely with respect to the portion of the earnings out of which tax may be collected. As to establishment of immunity from tax collection see section 464A.9 of these regulations.

(*c*) *Example.*—An agreement, executed in the year 1938 between a bank subject to tax under section 14(d) of the Revenue Act of 1938 and its depositors, provides (1) that certain assets are to be segregated for the benefit of the depositors who have waived (as claims against unsegregated assets of the bank) a percentage of their deposits; (2) that 60 per cent of the bank's net earnings for fiscal years beginning with the fiscal year ending December 31, 1938, from unsegregated assets, shall be paid to the depositors until the portion of their claims waived with respect to unsegregated assets of the bank has been paid; and (3) that the unsegregated assets shall not be subject to depositors' claims. The special class net income of the bank for the calendar year 1938 is $10,000, $4,000 produced by the segregated, and $6,000 produced by the unsegregated assets, and that amount, $10,000, also constitutes its net earnings for that year before deducting Federal income taxes. Such amount shall be considered the net earnings for the purpose of these regulations in computing the portion of the earnings to be paid to depositors. The bank has an outstanding tax liability for prior years of $7,000. The income tax liability of the bank for 1938 is 16½ per cent of $10,000, or $1,650, making a total outstanding tax liability of $8,650. The portion of the earnings of the bank for 1938 remaining after provision for depositors is $2,400 ($6,000 less 60 per cent thereof, or $3,600). It will be assumed that of the total outstanding tax liability of $8,650, $2,400 may be assessed and collected, leaving $6,250 to be collected from any excess of the segregated assets after claims of depositors against such segregated assets have been paid in full. No part of the $6,250 immune from collection from 1938 earnings may be collected thereafter from unsegregated assets of the bank or earnings therefrom, so that except for any possible surplus of the segregated assets the $6,250 is uncollectible.

In the year 1939 the earnings are again $10,000, $4,000 from segregated and $6,000 from unsegregated assets, as in the previous year. However, the return filed shows income of $5,000 and a tax liability of $900. An investigation shows the true income to be $10,000, on which the tax is $1,800. The full $1,800 will be assumed to be collectible. The $600 difference between $2,400 (the excess of earnings from unsegregated assets over the amount going to the depositors), and the $1,800 tax for 1939, is not available for collection of the tax for prior years, which became immune as described above, but may be available for collection of tax for subsequent years.

No significance attaches to the selection of the years 1938 and 1939 for the example. The rules indicated by the example are equally applicable to subsequent or prior years not excluded by limitations.

SEC. 464A.8. *Abatement and refund.*—An assessment or collection, no matter when made, if contrary to the section as amended by the Revenue Act of 1938 and the Revenue Act of 1939, is subject to abatement or refund within the applicable statutory period of limitations.

An abatement or refund after May 28, 1938, the effective date of the amendments, is equally allowable whether assessment or collection was erroneous because contrary to the amended section, or because, in the case of a bank within subsection (a), the same tax had been properly abated or refunded, or in the case of a bank within subsection (b), had been properly refunded, on or before the effective date of the amendments, and reassessed or collected after such date. See section 464A.12(*b*) of these regulations. If there was a prior proper abatement or refund in the case of a bank within subsection (a), or a proper refund in the case of a bank within subsection (b), on or before the effective date of the amendments, a claim for abatement or refund of the same tax reassessed or recollected after the effective date of the amendments may be allowed even though the second assessment or collection was otherwise in accordance with the amended section. However, in the absence of abatement or refund in the case of a bank within subsection (a), or of a refund in the case of a bank within subsection (b), on or before the effective date of the amendments, the mere fact that the tax was due before the effective date of the amendments will not be ground for allowance of a claim.

Collection from a bank within subsection (b) which diminished assets necessary for payment of depositors, if made prior to agreement with depositors, is not contrary to the amended section, and affords no ground for refund.

Any abatement or refund is subject to existing statutory periods of limitation, which periods are not suspended or extended by the amended section. In order to secure refund of any taxes paid for any taxable year during the period of immunity the bank must file claim therefor.

SEC. 464A.9. *Establishment of immunity.*—The mere allegation of insolvency, or that depositors have claims against segregated or other assets or earnings will not of itself secure immunity from tax collection. It must be affirmatively established to the satisfaction of the Commissioner that collection of tax will be contrary to the amended section. See also section 464A.10 of these regulations.

Any claim, by a bank, of immunity under subsection (b), shall be supported by a statement, under oath or affirmation, which shall show: (*a*) the total of depositors' claims outstanding, and (*b*) separately and in detail, the amount of each of the following, and the amount of depositors' claims properly chargeable against each—(1) segregated or transferred assets; (2) unsegregated assets; (3) estimated future average annual earnings and profits; (4) amount collectible from shareholders; and (5) any other resources available for payment of depositors' claims. The detail shall show the full amount of depositors' claims chargeable against each of the items (1) to (5), inclusive, even though part or all of the amount chargeable against a particular item is also chargeable against some other item or items. There shall also be filed a copy of any agreement between the bank and its depositors, and any other agreement or document bearing on the claim of immunity under the section. The statement shall show the basis, as "book," "market," etc., of valuation of the assets.

SEC. 464A.10. *Procedure during immunity.*—(*a*) *Statements to be filed.*—As long as, pursuant to the section complete or partial immunity is claimed, a bank within subsection (b) shall file with each income tax return a statement as required by section 464A.9 of these regulations, in duplicate, and shall also file such additional statements as the Commissioner may require. Whether or not additional statements shall be required, and the frequency thereof, will depend on the circumstances, including the financial status and apparent prospects of the bank, and the time which is available for assessment and collection. If a copy of an agreement or document has once been filed, a copy of the same agreement or document need not again be filed with a subsequent statement, if it is shown by the subsequent statement, when and where and with what return the copy was filed. In case of amendment a copy of the amendment must be filed with the return for the taxable year in which the amendment is made.

(*b*) *Failure to file.*—Failure of a bank to file any required statement will be treated as indicating that the bank is not entitled to immunity under the section.

SEC. 464A.11. *Termination of immunity.*—(*a*) *General.*—In the case of a bank within subsection (a) immunity will end whenever, and to the extent that, taxes may be assessed and collected, within the applicable limitation periods as extended by the section, without diminishing the assets available and necessary for payment of depositors. Immunity of a bank within subsection (b) is terminated, as to segregated assets, whenever claims of depositors against such assets have been paid in full. See section 464A.5 of these regulations. As to segregated assets, the termination of immunity is complete, and any balance remaining after payment of depositors is available, within statutory limitations, for collection of tax due at any time. However, taxes of the bank will be collectible from segregated assets only to the extent that the bank has a legal or equitable interest therein. Assets as to which there has been a complete conveyance for benefit of depositors, and the bank has bona fide been divested of all legal and equitable interest, are not available for collection of the bank's tax liability.

As to unsegregated assets of a bank within subsection (b), immunity terminates only as to taxes thereafter becoming due. When taxes are once immune from collection, the immunity as to unsegregated assets is absolute. But see the second paragraph of section 464A.6(*a*) of these regulations.

(*b*) *General creditors.*—While the immunity from tax collection is for protection of depositors, and not for benefit of general creditors, in some cases the immunity will not end until the assets are sufficient to cover indebtedness of creditors generally. This situation will exist where under applicable law the claims of general creditors are on a parity with those of depositors, so that to pay depositors in full it is necessary to pay all creditors in full.

(*c*) *Shareholder liability.*—In determining the sufficiency of the assets to satisfy the depositors' claims, shareholders' liability to the extent collectible shall be treated as available assets. See section 464A.9 of these regulations.

(*d*) *Deposit insurance.*—Deposit insurance payable to depositors shall not be treated as an asset of the bank and shall be disregarded in determining the sufficiency of the assets to meet the claims of depositors.

(*e*) *Notice by bank.*—A bank within subsection (b), upon termination of immunity with respect to (1) earnings, (2) segregated or transferred assets, or (3) unsegregated assets, shall immediately notify the collector for the district in which the taxpayer's returns were filed of such termination of immunity. See section 464A.10(*b*) of these regulations.

(*f*) *Payment by bank.*—As immunity terminates with respect to any assets, it will be the duty of the bank, without notice from the collector, to make payment of taxes collectible from such assets.

SEC. 464A.12. *Collection of tax after termination of immunity.*—(*a*) *General.*—If, in the case of a bank within subsection (b), segregated assets (including earnings therefrom), in excess of those necessary for payment of outstanding deposits become available, such excess of segregated assets shall be applied toward satisfaction of accumulated outstanding taxes previously immune under the section, and not barred by the statute of limitations. But see section 464A.5 of these regulations. Where sufficient segregated or unsegregated assets are available, statutory interest shall be collected with the tax. When unsegregated assets or earnings therefrom previously immune become available for tax collection, they will be available only for collection of taxes (including interest and other additions) becoming due after immunity ceases. See example in section 464A.7(*c*) of these regulations.

(*b*) *Tax due before the effective date of the amendments.*—In the case of a bank within subsection (a), the section does not permit assessment or reassessment or collection of tax abated or refunded, if the abatement or refund was in accordance with the section prior to the amendments by the Revenue Acts of 1938 and 1939.

In the case of a bank within subsection (b) the section does not permit assessment or reassessment of collection, from segregated or unsegregated assets, of tax refunded on or before May 28, 1938, if the refund was in accordance with the section prior to the amendments by the Revenue Acts of 1938 and 1939.

With the exceptions indicated by the preceding two paragraphs, tax due on or before May 28, 1938, and still outstanding on the said date, is within the provisions of the amended section and collectibility is determinable in accordance with the amended section the same as in the case of tax due after such date. Accordingly, a tax due prior to the effective date of the amendments and then collectible under the section may not be assessed or collected thereafter if such assessment or collection would be contrary to the section as amended. See section 464A.8 of these regulations.

If the statutory period for assessment or collection had expired before the effective date of the amendments, the section does not revive it. Accordingly, in such situation the tax is not collectible under the amended section, regardless of other circumstances.

SEC. 464A.13. *Social security taxes.*—These regulations do not relate to social security taxes, since the immunity granted by the amended section does not apply to taxes imposed by the Social Security Act.

SEC. 464A.14. *Effective date of regulations.*—These regulations are effective as of May 28, 1938, the effective date of the amendments made by section 818 of the Revenue Act of 1938, and section 406 of the Revenue Act of 1939. Treasury Decision 4882 (C. B. 1939-1 (Part 1), 154) (Part 464, Title 26, Code of Federal Regulations), is hereby revoked as of the date of its approval.

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved December 26, 1939.

JOHN W. HANES,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 28, 1939, 12.22 p. m.)

B. REVENUE ACT OF 1938.

SUBTITLE B.—GENERAL PROVISIONS.

PART II.—COMPUTATION OF NET INCOME.

SECTION 22(a).—GROSS INCOME: GENERAL DEFINITION.

ARTICLE 22(a)-3: Compensation paid other than in cash.

REVENUE ACT OF 1938.

Regulations 101 amended. (See T. D. 4965, page 13.)

ARTICLE 22(a)-7: Gross income of farmers.

REVENUE ACT OF 1938.

Payments by the United States under certain Acts of Congress to nonresident alien owners of land located in the United States. (See I. T. 3379, page 16.)

SECTION 22(b).—GROSS INCOME: EXCLUSIONS FROM GROSS INCOME.

ARTICLE 22(b)(2)-2: Annuities.

1940-2-10138
G. C. M. 21716

REVENUE ACT OF 1938.

Certain combined life insurance and annuity contracts, called "Life Annuity with Death Benefit" contracts, issued by the M Company are not life insurance or annuity contracts within the meaning of section 22(b)2 of the Revenue Act of 1938, but constitute contracts for the payment of interest or earnings on a certain fund.
G. C. M. 6395 (C. B. VIII-1, 67 (1929)) revoked.

An opinion is requested regarding the method of determining the amount to be reported by the M Company on Form 1099 with respect to amounts paid during the year 1938 to A who holds one of its "Life Annuity with Death Benefit" contracts, the provisions of which are herein set forth.

Prior to the year 1938 the company issued a Life Annuity with Death Benefit contract to A in the principal amount of $25,000, the purchase price, $26,250, being distributed as follows:

Annuity consideration	$14,110.25
Single premium—Life insurance	12,139.75
Total purchase price	26,250.00

The contract provided for an annual payment of $875 (3½ per cent of $25,000), to which amount would be added such additional dividends as the company might declare. The contract provided that the principal sum ($25,000) would be paid upon the death of the annuitant, and a further provision permitted the annuitant to take as a surrender value either a part or the whole of such principal sum. The regular annual payment was made in 1938 and the annuitant, deciding to reduce his contract by 50 per cent, took a partial surrender value of $12,500. Inasmuch as the original purchase price was allocated between the annuity and life insurance features of the contract, the purchase price of the remaining portion of the contract has been reallocated, prorating the original allocation in line with the percentage of withdrawal, as follows:

Principal sum	$12,500.00
Annuity consideration	7,055.125
Single premium—Life insurance	6,069.875
Reallocated purchase price	13,125.00
Annual annuity payment	437.50

The aggregate of the annual payments made has not yet equaled the original cost of the annuity portion of the contract, leaving what might be termed a free balance of $3,025.676, and the question presented is whether in applying section 22(b)2 of the Revenue Act of 1938 in the light of G. C. M. 6395 (C. B. VIII-1, 67 (1929)) the 3 per cent limitation should be based upon the original annuity cost or the original cost reduced to reflect the cancellation of one-half thereof as of the date the cancellation was effective.

It is the view of the Bureau that the conclusion reached in G. C. M. 6395 should be modified by reason of the decision of the Board of Tax Appeals in the case of *Old Colony Trust Co. et al., Executors of the Will of Everett Morss*, v. *Commissioner* (37 B. T. A., 435), affirmed on appeal by the Circuit Court of Appeals, First Circuit (102 Fed. (2d), 380), and that of the Supreme Court of Oregon in the case of *Ballou* v. *Fisher* (154 Ore., 548, 61 Pac. (2d), 423).

In the former case the Board of Tax Appeals held that the "sum payable at death" under a contract substantially identical with the contract involved in the instant case was not "insurance under policies taken out by the decedent upon his own life" within the meaning of section 302(g) of the Revenue Act of 1926.

In the case of *Ballou* v. *Fisher*, supra, the Oregon Supreme Court held that a contract identical with the one here involved was not an annuity contract. The question before the Oregon court in that case was the method of treatment, under the Oregon Intangibles Income Tax Act of 1931, of the periodic payments made pursuant to such a contract. This statute imposed a tax "with respect to the taxpayer's net income * * *." The specific provisions of the statute there involved are substantially identical with the provisions of the Federal

Income Tax Acts here involved. (Compare section 8(2)b, ch. 335, page 576, Oregon Laws of 1931, and section 22(b)2 of the Revenue Act of 1938 and the corresponding sections of prior Revenue Acts.) In disposing of the question presented the Oregon Supreme Court said:

It is practically immaterial what cognomen we attach to these contracts. The law will look behind the name of the contracts. We are inclined to the belief that discussion of the exact kind of policies or combination of policies does not assist in solving the problem involved. We think, however, that the contracts with the Penn Mutual Life Insurance Co., under which plaintiff received the payments in question, are not life insurance or annuity contracts within the meaning of section 8, ch. 335 (page 576), Oregon Laws of 1931.

* * * * * * *

Under the provisions of these favorable contracts evidencing the investments, the plaintiff received a cash income which left his principal unimpaired. The receipts were income to him in every sense of the word. He had the benefit of the protection of the State and its laws, and it is entirely appropriate that he should contribute by a tax upon the receipts in question.

Under the contracts in the instant case the insurer agrees to pay a stated sum per annum. However, this sum is based on the presumed interest to be earned on the net premium and is increased by such dividends as may be allotted by the company out of its surplus earnings. Therefore, the sum payable under the contracts is not fixed in any real sense but is contingent upon the earnings of the company. These periodic payments do not exhaust the capital or consideration for the contract. On the contrary, a sum equal to the consideration is payable to the life beneficiary on reasonable demand during his life, or to a person named by him on his death. Furthermore, the life beneficiary under this contract does not surrender any substantial rights when he relinquishes his contract for the surrender value thereof, as is the case of the insured under an ordinary life insurance contract. This is so for the reason that the consideration for the contract does not change notwithstanding an increase in age of the life beneficiary. For these reasons it is believed that the surrender value of such contract is unqualifiedly subject to the demand of the life beneficiary to the same extent that a savings bank deposit is subject to the demand of the depositor.

Considering the substance of the obligation of the company issuing the contracts and the rights of the beneficiaries thereunder, it is the opinion of this office that the contracts in question are contracts for the payment of the interest or earnings on a certain fund, and are not life insurance or annuity contracts within the meaning of the provisions of the Revenue Act of 1938 referred to herein and the corresponding provisions of prior Revenue Acts.

The information returns, Form 1099, required to be filed by insurance companies showing amounts paid to beneficiaries under the contracts in question should, therefore, show the entire amount of the periodic payments received by the beneficiaries thereunder.

In reaching the above conclusion this office has given consideration to the recent decision of the United States Circuit Court of Appeals for the Third Circuit in the case of *Bodine* v. *Commissioner* (103 Fed. (2d), 982), certiorari denied October 9, 1939. In that case the court concluded that the amount received upon the surrender of a contract of the type here involved was received under a "life insurance * * * or annuity contract" within the meaning of section 22(b)2 of the Revenue Act of 1932 and that the resulting gain was taxable as ordinary income. Although the Old Colony Trust Co. case, supra, involved the status of a similar contract for Federal estate tax purposes, it is believed that the decisions must be taken as representing conflicting views by the two courts with respect to the nature of these contracts. This office is of the opinion that the decision in the Old Colony Trust Co. case represents the sounder construction of such contracts and should be followed rather than the decision in the Bodine case.

G. C. M. 6395 (C. B. VIII-1, 67 (1929)) is revoked.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

Article 22(b)(4)-1: Interest upon State obligations. 1940-13-10213
G. C. M. 21890

REVENUE ACT OF 1938.

Where interest-bearing State bonds were purchased by A at a discount and, pursuant to provisions contained in the bonds, they were redeemed in 1938 at a premium and accrued interest prior to maturity, the accrued interest and the discount received upon redemption of the bonds constitute interest upon the obligations of a State and are exempt from Federal income tax under section 22(b)4 of the Revenue Act of 1938. However, the premium received is not interest within the meaning of that section but is a part of the amount "received in exchange" for the bonds under section 117(f) of that Act.

An opinion is requested whether A, the taxpayer, who purchased interest-bearing State bonds at a discount, the bonds providing that they are "redeemable at 104 and interest on 30 days notice" realized taxable income upon the redemption of the bonds before maturity pursuant to the terms thereof. The bonds in question were redeemed in 1938.

The taxpayer contends that the amount of the discount and premium is part of the interest in this case, and, therefore, represents nontaxable income under section 22(b)4 of the Revenue Act of 1938, which provides for the exclusion from gross income and exempts from Federal income tax interest upon the obligations of a State.

In addition to the return of the cost upon redemption of the bonds, the taxpayer received (1) accrued interest, (2) discount, and (3) premium. The question presented is whether such items constitute "interest" upon the obligations of a State.

Interest means the "amount which one has contracted to pay for the use of borrowed money." (*Old Colony Railroad Co.* v. *Commissioner*, 284 U. S., 552; see also *Fall River Electric Light Co.* v. *Commissioner*, 23 B. T. A., 168). The court and the Board of Tax Appeals in the foregoing cases denied the Commissioner's contention that premium received by the issuing corporation on the sale of its bonds reduced the "effective rate" of interest and consequently reduced the allowable deduction from gross income of "interest * * * on indebtedness."

In the instant case, the amount designated "interest" on the bonds (classified as (1) above) which had accrued at the date of redemption clearly comes within the purview of section 22(b)4 and is nontaxable income.

The amount designated "discount" (classified as (2) above) may be subdivided into two classes, namely, earned discount and unearned discount; or, amortized and unamortized discount, respectively, were a private issuing corporation involved.

The amount of discount received at maturity on Treasury bills (T. D. 4276, C. B. VIII-2, 83 (1929)), on noninterest-bearing State bonds (G. C. M. 10452, C. B. XI-1, 18 (1932)), and on interest-bearing municipal obligations (I. T. 2629, C. B. XI-1, 20 (1932)) is held to be nontaxable income, and each purchaser of the bond before maturity is entitled to apportion the amount of discount at which the obligation was issued according to the period of his holding. The earned discount in the present case is, therefore, nontaxable income to the taxpayer.

The courts have considered the nature of discount in cases involving private corporations and have held it to be in the "nature of deferred interest" which may be amortized, for income tax purposes, over the life of the bonds by deducting the annual proportion thereof from the issuing corporation's gross income each year as "accrued interest." (*Western Maryland Railway Co.* v. *Commissioner*, 33 F. (2d), 695; *Chicago R. I. & P. Ry. Co.* v. *Commissioner*, 13 B. T. A., 988, affirmed on this point, 47 F. (2d), 990, certiorari denied, 284 U. S., 618; *Helvering* v. *Union Pacific Railroad Co.*, 293 U. S., 282.) On retirement of such a bond issue before maturity, the unamortized discount is deductible from gross income. (*Great Western Power Co. of California* v. *Commissioner*, 297 U. S., 543; *San Joaquin Light & Power Corporation* v. *McLaughlin*, 65 F. (2d), 677; *Helvering* v. *Union Public Service Co.*, 75 F. (2d), 723.) "At the time of redemption the bondholder is paid the par value of the bond so that he is in effect paid for the use of the money he lent the amount of the discount (both amortized and unamortized) * * *." (*San Joaquin Light & Power Corporation* v. *McLaughlin*, supra; *Helvering* v. *Union Public Service Co.*, supra.) The nature of discount on the purchase of bonds is not altered by the fact that part of it may be received by the purchaser before the maturity of the bond issue. Whenever paid, it is still in the nature of "deferred interest" or "the amount which one has contracted to pay for the use of borrowed money." It is the opinion of this office, therefore, that the unearned discount received by A on the redemption of the bonds is the same character of income as the earned discount and is, consequently, nontaxable income.

While some cases have treated premium and discount the same for deduction purposes (including *San Joaquin Light & Power Corporation* v. *McLaughlin*, supra, and *Helvering* v. *Union Public Service Co.*, supra), there was no necessity in those cases, as there is here, to inquire whether there were any differentiating characteristics between the two. Nevertheless, there is a vital distinction in the nature of the two which has been recognized in a case where one private corporation purchases the assets of another and assumes its liabilities. In such a case, the successor corporation is not permitted to deduct from its gross income the unamortized discount on the bonds of the predecessor corporation, but it may deduct a premium paid to retire such bonds, although the bond indenture itself provided for such redemption. The reason underlying this differentiation is set out in *American Gas & Electric Co.* v. *United States* (17 F. Supp., 151), wherein the court said in part:

> The right to a deduction on account of its bonds having been sold at a discount originated with the Virginian Company [the issuing corporation] itself. It came into existence when the bonds were sold, but we have held that this right did not pass to a successor company which acquired the property of the first corporation by purchase or transfer and assumed its liabilities. On the other hand, the right

to the deduction by reason of having redeemed the bonds at a premium was not brought into existence by the Virginian Company. The right to call the bonds at a specified price was one that ran with the bonds and belonged to any party who assumed their payment. It was an entirely different right from that which arose by reason of having issued the bonds at a discount.

The right to claim a deduction on account of having redeemed the bonds at a price above par did not come into existence until the bonds were so redeemed and, as we think, belonged to the corporation making the payment.

It is the opinion of this office that the *premium* paid to A upon redemption of the bonds by the State is not "interest" within the meaning of section 22(b)4, since it is not an "amount which one has contracted to pay for the use of borrowed money." Had the bonds not been redeemed prior to maturity, the taxpayer would have received no premium. It was paid by reason of the action of the State in calling the bonds before maturity and not as a sum for the use of the money. Its payment in such case was for the relinquishment of the obligation so that no further interest need be paid thereon rather than for the use of the borrowed money. To increase the stipulated interest in the bond contract, including the discount, by the amount of the premium to ascertain the amount of the "interest" exempted by section 22(b)4, supra, on the theory that the premium must necessarily be considered to arrive at the "effective rate" of interest would be contrary to the ordinary meaning of the word "interest" as used in the statute. (*Old Colony Railroad Co.* v. *Commissioner*, supra.)

Section 117(f) of the Revenue Act of 1938 provides as follows:

RETIREMENT OF BONDS, ETC.—For the purposes of this title, amounts received by the holder upon the retirement of 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, shall be considered as amounts received in exchange therefor.

The bonds in the present case fall under section 117(f), supra. The premium must, therefore, be considered as an amount "received in exchange" and, consequently, taxable as a capital gain rather than as ordinary income.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

SECTION 23(e).—DEDUCTIONS FROM GROSS INCOME: LOSSES BY INDIVIDUALS.

ARTICLE 23(e)-1: Losses by individuals. 1940-8-10178
(Also Section 23(g), Article 23(g)-1.) I. T. 3351

REVENUE ACT OF 1938.

Where bank stock was determined to be worthless in a taxable year prior to the year 1938, and the stockholders, who keep their accounts and file their returns on the cash receipts and disbursements basis, paid their statutory liability (so-called double liability) in the year 1938, such payments constitute losses to which section 23(e) of the Revenue Act of 1938 applies and not losses within the purview of section 23(g)1 and section 23(g)2 of that Act.

Advice is requested whether payments in 1938 of their statutory liability (so-called double liability) by bank stockholders, who keep their accounts and file their returns on the cash receipts and disbursements basis, constitute losses to which section 23(e) of the Revenue Act of 1938 applies or losses within the purview of section 23(g)1 and section 23(g)2 of that Act.

The inquiry relates to the stock of the M Trust Co. which became worthless in 1934. Deductions on account of such worthlessness have been allowed in Federal income tax returns for 1934 under section 23(e) of the Revenue Act of 1934.

Section 23 of the Revenue Act of 1938 reads in part as follows:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

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; * * *.

* * * * * * *

(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 title, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets. * * *

It is held that where bank stock was determined to be worthless in a taxable year prior to the year 1938, payments in 1938 of their statutory liability (so-called double liability) by stockholders, who keep their accounts and file their returns on the cash receipts and disbursements basis, constitute losses to which section 23(e) of the Revenue Act of 1938 applies and not losses within the purview of section 23(g)1 and section 23(g)2 of that Act. (See I. T. 2843, C. B. XIV-1, 77 (1935).)

SECTION 23(g).—DEDUCTIONS FROM GROSS INCOME: CAPITAL LOSSES.

ARTICLE 23(g)-1: Capital losses.

REVENUE ACT OF 1938.

Payments of statutory liability by bank stockholders where stock became worthless in prior taxable year. (See I. T. 3351, page 87.)

SECTION 25.—CREDITS OF INDIVIDUAL AGAINST NET INCOME.

ARTICLE 25-3: Amount of personal exemption allowable.

REVENUE ACT OF 1938.

Citizen of United States entitled to benefits of section 251. (See I. T. 3363, page 92.)

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

SECTION 44.—INSTALLMENT BASIS.

ARTICLE 44-5: Gain or loss upon disposition of installment obligations.

REVENUE ACT OF 1938.

Regulations 101 amended. (See T. D. 4972, page 47.)

PART V.—RETURNS AND PAYMENT OF TAX.

SECTION 55.—PUBLICITY OF RETURNS.

REVENUE ACT OF 1938.

Regulations governing the inspection by the Committee on Education and Labor, United States Senate, of income, profits, and capital stock tax returns and returns of employment tax on employers. (See T. D. 4962, page 49.)

SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT B.—COMPUTATION OF NET INCOME.

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION.

ARTICLE 114-1: Basis for allowance of depreciation and depletion.

REVENUE ACT OF 1938.

Development expenses in computing depletion based on a percentage of income in the case of oil and gas wells. (See G. C. M. 21926, page 157.)

SUPPLEMENT C.—CREDITS AGAINST TAX.

SECTION 131.—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

ARTICLE 131-1: Analysis of credit for taxes.

REVENUE ACT OF 1938.

I. T. 3288 (C. B. 1939-1 (Part 1), 139) modified. (See I. T. 3385, page 103.)

SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX.

SECTION 143.—WITHHOLDING OF TAX AT SOURCE.

ARTICLE 143–1: Withholding tax at source.

REVENUE ACT OF 1938.

Payments by the United States under certain Acts of Congress to nonresident alien owners of land located in the United States. (See I. T. 3379, page 16.)

SUPPLEMENT E.—ESTATES AND TRUSTS.

SECTION 162.—NET INCOME.

ARTICLE 162–1: Income of estates and trusts. 1940–25–10297
G. C. M. 22034

REVENUE ACT OF 1938.

Distributions of income, including gains on the sale of capital assets, to beneficiaries of the estate of A by the executor of the estate during the period of administration of the estate, the will making no provision for distributions of income during the period of administration, the State law not providing for such distribution, and the income being sufficient to cover the distributions in question, are deductible by the estate for Federal income tax purposes as income "properly paid" under the provisions of section 162(c) of the Revenue Act of 1938. Such income is taxable to the beneficiaries. Distributions of income by the executor during the period of administration of the estate to testamentary trustees are not deductible by the estate for Federal income tax purposes as income "properly paid" to any legatee, heir, or beneficiary under the provisions of section 162(c) of the Revenue Act of 1938. Such income is taxable to the estate.

Advice is requested whether in the case of the estate of A, which was in process of administration during the year 1938, the income, including gains on the sale of capital assets realized and distributed by the executor in the year 1938, is taxable to the estate or to the distributees.

A died testate on April —, 1938, a resident of the State of California. After providing for several specific bequests and the payment of his debts, the testator directed that the residue of the estate be divided into a specified number of equal parts and distributed to certain named persons. During the period from April —, 1938, to December 31, 1938, the estate had a net taxable income of $17x$ dollars, including capital gains of $13x$ dollars derived from the sale of corpus of the estate. On November —, 1938, the probate court ordered a payment of $55x$ dollars to residuary legatees, the order expressly providing that $17x$ dollars be paid out of income and the balance out of corpus. Payments were made by checks dated November —, 1938, and on the income tax return filed for the estate a deduction was claimed for the amount of the payments from income. A's will made no provision for the distribution of income during the period of administration. Furthermore, with the exception of section 1000 of the Probate Code of California, which permits any heir, devisee, or legatee to petition for a distribution after four months, the code of the State is silent regarding the distribution of income of an estate during administration.

Section 162(c) of the Revenue Act of 1938 provides in part as follows:

In the case of income received by estates of deceased persons during the period of administration or settlement of the estate * * * there shall be allowed as an additional deduction in computing the net income of the estate * * * the amount of the income of the estate * * * for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

In G. C. M. 4596 (C. B. VII-2, 133 (1928)) it was held (syllabus):

Where a will is silent as to the disposition of income received during the period of administration, the laws of the particular State involved must be considered in order to determine whether current income or gain on sales of property may be "properly" paid or credited to residuary or other legatees during any given taxable year.

It was stated in the last paragraph of that memorandum that "Unless the will or the laws of the State make such payment or credit improper the amount paid or credited is deductible in computing the net income of the estate."

Under the facts in the present case, it is the opinion of this office that the distributions directly to the beneficiaries of income, including capital gains, by the executor of the estate of A during the period of administration of the estate are deductible by the estate for Federal income tax purposes as income "properly paid" under the provisions of section 162(c) of the Revenue Act of 1938. Such income is taxable to the beneficiaries.

The will of A not only directs that portions of the residuary estate be paid directly to certain named beneficiaries but it directs that a part of such estate be paid to certain named persons in trust for the benefit of others. With respect to the distribution of estate income to trustees, it was held in *Weigel et al.* v. *Commissioner*, 96 Fed. (2d), 387, that the residue of an estate, including income, is received by a testamentary trustee as a bequest or devise of trust corpus and, therefore, the payment of such income is not deductible by an estate under the provisions of section 162(c) of the Revenue Act of 1928.

Applying the rule laid down in the Weigel case, supra, the distributions of income to testamentary trustees by the executor of the estate of A during the period of administration are not deductible by the estate for Federal income tax purposes as income "properly paid" to any legatee, heir, or beneficiary under the provisions of section 162(c) of the Revenue Act of 1938. Such income is taxable to the estate.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

SECTION 165.—EMPLOYEES' TRUSTS.

Article 165-1: Employees' trusts.

REVENUE ACT OF 1938.

Partnerships of attorneys, physicians, etc. (See I. T. 3350, page 64.)

ARTICLE 165-1: Employees' trusts.

REVENUE ACT OF 1938.

Regulations 101 amended. (See T. D. 4973, page 65.)

SUPPLEMENT J.—POSSESSIONS OF THE UNITED STATES.

SECTION 251.—INCOME FROM SOURCES WITHIN POSSESSIONS OF UNITED STATES.

ARTICLE 251-1: Citizens of the United States and domestic corporations deriving income from sources within a possession of the United States. 1940-14-10219 I. T. 3363
(Also Section 25, Article 25-3.)

REVENUE ACT OF 1938.

Where no benefits are conferred by section 251 of the Revenue Act of 1938, the taxpayer is entitled to file his Federal income tax return and compute the tax thereon without regard to that section. I. T. 3327 (C. B. 1939-2, 173) revoked.

Reconsideration has been given to I. T. 3327 (C. B. 1939-2, 173), in which it was held that the provisions of section 251(f) of the Revenue Act of 1938 preclude the allowance to a citizen of the United States "entitled to the benefits" of section 251 of a personal exemption of more than $1,000, and that a taxpayer "entitled to the benefits" of section 251 of the Revenue Act of 1938 may not waive such benefits in order to obtain credit for the personal exemption prescribed in section 25(b) of that Act.

In the case on which I. T. 3327, supra, was based, the taxpayer's income for two months of the year met the requirements of section 251 of the Revenue Act of 1938, and he was entitled to the benefit of exemption from Federal income tax on his salary for that period. If he had reported his entire income for the year received from sources both within and without the United States as taxable income and claimed the full personal exemption allowed by section 25(b) of the Revenue Act of 1938, the tax would have been less than the tax due by claiming the benefits of section 251.

Section 251 of the Revenue Act of 1938 provides in part as follows:

(a) GENERAL RULE.—In the case of citizens of the United States or domestic corporations, satisfying the following conditions, gross income means only gross income from sources within the United States—

(1) If 80 per centum or more of the gross income of such citizen or domestic corporation (computed without the benefit of this section), for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States; and

* * * * * * *

(3) If, in case of such citizen, 50 per centum or more of his gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States either on his own account or as an employee or agent of another.

* * * * * * *

(f) CREDITS AGAINST NET INCOME.—A citizen of the United States entitled to the benefits of this section shall be allowed a personal exemption of only $1,000 and shall not be allowed the credit for dependents provided in section 25(b) (2).

The ruling published as I. T. 3327 was based on the conclusion that the provisions of section 251(f), supra, are mandatory. That conclusion was reached by a literal interpretation of the statute, i. e., if a citizen satisfies the conditions of section 251(a), then he is "entitled to the benefits" of the section and, hence, is entitled to a personal exemption of only $1,000. It should be noted, however, that in order for section 251(f) to apply, the citizen must be "entitled to the benefits" of the section. To satisfy the conditions of section 251(a) is not necessarily to become entitled to benefits. In order for section 251(f) to apply, it may properly be said that the taxpayer must be entitled to some actual benefit by reason of the provisions of section 251. Even a literal interpretation of the section does not compel the conclusion that because a taxpayer satisfies the conditions of section 251(a) he becomes subject to the provisions of section 251(f). Although section 251(a) provides that gross income means only gross income from sources within the United States as to citizens satisfying certain conditions, and upon its face permits of no election, section 251(f) indicates that section 251(a) is intended to confer benefits, and where no benefits are thereby conferred, it is reasonable to conclude that section 251(a) does not necessarily operate.

Upon reconsideration of the question, it is held that where no benefits are conferred by section 251 of the Revenue Act of 1938, the taxpayer is entitled to file his Federal income tax return and compute the tax thereon without regard to that section. Accordingly, I. T. 3327 (C. B. 1939-2, 173) is revoked.

ARTICLE 251-2: Income received within the United States. 1940-6-10167
I. T. 3348

REVENUE ACT OF 1938.

Pay due officers of the United States Army actually in the Philippine Islands does not become income received within the United States merely because, instead of being paid to the officer in the Philippine Islands, it is, for convenience, upon order of the payee, transmitted direct by the finance officer in the Philippine Islands to a bank or insurance company in the United States to be credited to the account of the payee.

Advice is requested whether, under the circumstances herein set forth, certain portions of the pay of A, an officer in the United States Army stationed in the Philippine Islands, should be treated as having been received within the United States for the purposes of section 251 of the Revenue Act of 1938.

A's gross income for 1938 consisted of a salary of $48x$ dollars for services rendered in the Philippine Islands to the United States Army. The salary was payable in the Philippines in monthly installments. Under the regulations of the War Department, the taxpayer was entitled to have his salary, or any part thereof, paid by check of the disbursing officer to a designated bank in the United States to be credited to his account, or to have any specified portion paid by check direct to insurance concerns to cover insurance premiums. In accordance with the taxpayer's request, the United States Government remitted $2x$ dollars per month, or a total of $24x$ dollars during 1938, of his salary to insurance concerns in the United States for the taxpayer's account and $11x$ dollars per month to the M National Bank at the city of R, Kansas, for the taxpayer's account. The balance of the taxpayer's salary was paid to him in the Philippines. The monthly amounts remitted to the bank for the taxpayer's account were covered by checks drawn in the Philippines. The checks were mailed by the disbursing officer of the United States Army in the Philippines direct to the bank in the United States. The taxpayer did not indorse the checks nor have physical possession of them.

Transactions of the nature referred to above are authorized by Army regulations for the convenience of the Government and officers concerned. Payments of this nature are made by local finance officers or vouchers executed by the officer being paid. This procedure has been authorized and followed by the War Department for many years at all stations in the United States and in foreign countries for the convenience of the Army personnel.

In the instant case, the taxpayer could have taken the cash in the Philippines and forwarded a check to the bank in the United States. He was in the Philippines when the money was earned and when the payments were made, and the disbursing officer was also in the Philippines. As a matter of convenience for the taxpayer and the Government, the procedure adopted by the War Department was used. The taxpayer, under the procedure, authorized the disbursing officer to forward the check to the designated bank or to other persons. The disbursing officer was carrying out his duty of paying the officer's salary in accordance with the Army regulations which have been approved by the Comptroller General of the United States. While it is true that the disbursing officer may not be regarded as the agent of the Army officer within the ordinary legal concept of agency, as between private persons, his acts in the performance of his official duties with respect to the payment of the officer's salary amounted, in effect, to acts of an agent in that it was the official duty of the disbursing officer to pay the salary in the manner directed by the officer under authority of the Army regulations.

It is held that the pay of officers in the United States Army actually in the Philippine Islands does not become income received within the United States merely because, upon order of the payee, it is transmitted by the finance officer in the Philippine Islands to a bank or insurance company in the United States to be credited to the account of the payee.

TITLE V.—MISCELLANEOUS PROVISIONS.

SECTION 818.—TAXES OF INSOLVENT BANKS.

REVENUE ACT OF 1938.

Regulations relating to assessment and collection of taxes of insolvent banks and trust companies. Treasury Decision 4882 (C. B. 1939-1 (Part 1), 154) revoked. (See T. D. 4958, page 74.)

INCOME TAX RULINGS.—PART II.

REVENUE ACTS OF 1937 AND 1936.

SUBTITLE B.—GENERAL PROVISIONS.

PART I.—RATES OF TAX.

SECTION 14.—SURTAX ON UNDISTRIBUTED PROFITS.

ARTICLE 14-1: Surtax on undistributed profits of corporations. 1940-13-10214 I. T. 3361

REVENUE ACT OF 1936.

A corporation in computing its "adjusted net income" for 1936 and 1937 is entitled to a credit under section 14(a)1(B) of the Revenue Act of 1936 for the amount received as interest on bonds of the Home Owners' Loan Corporation issued under the Home Owners' Loan Act of 1933, as amended. I. T. 2873 (C. B. XIV-1, 51 (1935)) not applicable.

Advice is requested whether I. T. 2873 (C. B. XIV-1, 51 (1935)), wherein it was held that interest on obligations of the Home Owners' Loan Corporation issued under the Home Owners' Loan Act of 1933, as amended, is not exempt from surtax, is applicable in determining, under section 14 of the Revenue Act of 1936, the undistributed profits surtax liability of a corporation.

Section 14 of the Revenue Act of 1936 provides in part as follows:

(a) DEFINITIONS.—As used in this title—

(1) The term "adjusted net income" means the net income minus the sum of—

* * * * * * *

(B) The credit provided in section 26(a), relating to interest on certain obligations of the United States and Government corporations.

Section 26 of the Act, which relates to credits of corporations, provides in part as follows:

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).

Section 25 of the Act, which relates to credits of individuals against net income, provides in part as follows:

(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 which is included in gross income under section 22.

(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.

Section 4(a) of the Home Owners' Loan Act of 1933 (48 Stat., 128) directed the Federal Home Loan Bank Board "to create a corporation to be known as the Home Owners' Loan Corporation, which shall be an instrumentality of the United States * * *."

Section 4(c) of the Home Owners' Loan Act of 1933, supra, authorizes the Home Owners' Loan Corporation to issue bonds, and provides that:

> * * * The bonds issued by the Corporation under this subsection shall be exempt, both as to principal and interest, from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any District, Territory, dependency or possession thereof, or by any State, county, municipality, or local taxing authority. * * *

In computing the "adjusted net income" of a corporation for the purpose of the surtax on undistributed profits imposed by section 14 of the Revenue Act of 1936, the corporation is entitled under section 26(a) of that Act to the same credit allowed an individual under section 25(a) (1) and (2) of all interest on bonds of the Home Owners' Loan Corporation which, under the Home Owners' Loan Act of 1933, as amended, authorizing the issue thereof, is exempt from normal tax.

In view of the foregoing, it is held that a corporation in computing its "adjusted net income" for the taxable years 1936 and 1937 is entitled to a credit under section 14(a)1(B) of the Revenue Act of 1936 for the amount received as interest on bonds of the Home Owners' Loan Corporation, irrespective of the provisions of the Home Owners' Loan Act of 1933, as amended, which does not exempt the interest on such bonds from surtaxes. The ruling published as I. T. 2873, supra, is, therefore, not applicable in determining, under section 14 of the Revenue Act of 1936, the undistributed profits surtax liability of a corporation.

PART II.—COMPUTATION OF NET INCOME.

SECTION 22(a).—GROSS INCOME: GENERAL DEFINITION.

Article 22(a)-3: Compensation paid other than in cash.

REVENUE ACT OF 1936.

Regulations 94 amended. (See T. D. 4965, page 13.)

Article 22(a)-7: Gross income of farmers.

REVENUE ACT OF 1936.

Payments by the United States under certain Acts of Congress to nonresident alien owners of land located in the United States. (See I. T. 3379, page 16.)

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

SECTION 44.—INSTALLMENT BASIS.

ARTICLE 44–5: Gain or loss upon disposition of installment obligations.

REVENUE ACT OF 1936.

Regulations 94 amended. (See T. D. 4972, page 47.)

PART V.—RETURNS AND PAYMENT OF TAX.

SECTION 55.—PUBLICITY OF RETURNS.

REVENUE ACT OF 1936.

Regulations governing the inspection by the Committee on Education and Labor, United States Senate, of income, profits, and capital stock tax returns and returns of employment tax on employers. (See T. D. 4962, page 49.)

SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A.—RATES OF TAX.

SECTION 101(16).—EXEMPTIONS FROM TAX ON CORPORATIONS.

1940–17–10240
G. C. M. 21323

REVENUE ACTS OF 1934 AND 1936.

Contributions by the M Company to the Employees' Benefit Association, composed of employees of the M Company, do not constitute amounts collected from a member, and the association is not entitled to exemption from Federal income taxation under the provisions of section 101(16) of the Revenue Acts of 1934 and 1936 where less than 85 per cent of the income of the association consisted of amounts collected from members.

An opinion is requested whether the Employees' Benefit Association of the M Company is entitled to exemption from Federal income taxation under the provisions of section 101(16) of the Revenue Acts of 1934 and 1936. That section provides for the exemption from income tax of—

Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents, if (A) no part of their net earnings inures (other than through such payments) to the benefit of any private shareholder or individual and (B) 85 per centum or more of the income consists of amounts collected from members for the sole purpose of making such payments and meeting expenses.

The Employees' Benefit Association is a voluntary, incorporated association, organized under the laws of the State of R, to administer a fund without profit and at the lowest possible cost to its employee members, and to pay disability benefits to them in case of sickness and accident, and death benefits to their designated beneficiaries in case of death (except all accidents, disabilities, and death claims compensated under the workmen's compensation laws or the workmen's occupational diseases act). In the regulations of the association it is stated that the Employees' Benefit Association consists of the M Company and affiliated companies operating in the United States and Canada and such employees of those companies as elect to join therein. The regulations provide that "Beginning January 1, 1936, the M Company will contribute to the fund an amount equal to twenty per cent (20%) of all contributions paid by members." The management and control of the association are fixed in a board of trustees, the trustees being chosen one-half by the M Company and one-half by the employee members. The "company" is defined as meaning the M Company and affiliated companies operating in the United States and Canada.

During the taxable years 1935, 1936, and 1937, the association's income was derived from the following sources:

	1935	1936	1937
	Dollars.	*Dollars.*	*Dollars.*
Contributions by employee members	1,037x	1,464x	2,324x
Interest	138x	144x	180x
Contributions by the M Company	50x	292x	464x
Profits on sales of securities	50x	97x	7x
Dividends		x	12x
Total	1,275x	1,998x	2,987x
85 per cent of income equals	1,083.75x	1,698.30x	2,538.95x

It is the contention of the association that the M Company is a "member" of the association within the meaning of section 101(16), supra, and that the amounts paid in by that company should be considered as "amounts collected from members" within the meaning of that section and added to contributions by employee members for the purpose of applying the 85 per cent limitation.

Section 101(16) had its inception as section 103(16) of the Revenue Act of 1928. The wording was identical in the Revenue Act of 1928 and all subsequent Revenue Acts. The report of the Committee on Ways and Means on the revenue bill of 1928 (H. R. Report No. 2, December 7, 1927), at page 17, reads in part as follows:

> Voluntary employees' beneficiary associations providing for the payment of life, sick, accident or other benefits to members and their dependents are common to-day and it appears desirable to provide specifically for their exemption from the ordinary corporation tax. Consequently, it is provided in section 103(15) that such associations shall be exempt if they provide for the payment of life, sick, accident, or other benefits to members of the association or their dependents, and if no part of their net earnings inures to the benefit of any private shareholder or individual and if 85 per centum or more of the net income is collected from the members for the purpose of paying expenses and meeting losses.

The Committee on Finance of the Senate made a clarifying amendment to the above paragraph, which did not, however, change the purpose of the House bill. (Senate Report No. 960, Seventieth

Congress, first session, page 25 (1928).) (See section 101(16), supra, for the minor differences in the language above quoted and the language of the provision as finally approved.)

It is the opinion of this office that the language used by the committees of both the House and Senate and the eventual wording of section 101(16) show that Congress was associating the word " members " with *employee* members, that is, with those individuals who were to receive " payment of life, sick, accident, or other benefits." Had Congress intended that the word " members " should apply to employers also, the word " employers " could easily have been inserted. Furthermore, the wording of section 101(16), supra, leads to the conclusion that the same interpretation must be given to " members " throughout the entire section.

In the present case there is no basis for holding that the M Company, the employer, is a " member " of the association within the meaning of section 101(16), supra. No benefits are ever payable to the company, but the employees of the company, who join the association, receive the benefits of the association as a matter of right. They are the only " members " thereof.

It is, therefore, the opinion of this office that the contributions made by the M Company to the Employees Benefit Association do not constitute amounts collected from a " member " under section 101(16), supra. Such amounts, however, constitute a part of the income of the association within the meaning of that section and must be included in determining whether 85 per cent or more of the income of the association consists of amounts collected from its members. (See generally *Appeal of Philadelphia and Reading Relief Association*, 4 B. T. A., 713.)

The evidence in the instant case shows that during each of the taxable years 1935, 1936, and 1937 less than 85 per cent of the income of the association consisted of amounts collected from its members. Therefore, the Employees Benefit Association of the M Company is not entitled to exemption under section 101(16) of the Revenue Acts of 1934 and 1936.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT B.—COMPUTATION OF NET INCOME.

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION.

Article 114–1: Basis for allowance of depreciation and depletion.

REVENUE ACT OF 1936.

Development expenses in computing depletion based on a percentage of income in the case of oil and gas wells. (See G. C. M. 21926, page 157.)

SECTION 116.—EXCLUSIONS FROM GROSS INCOME.

1940–24–10289
G. C. M. 22065

REVENUE ACT OF 1936.

A citizen of the United States must be absent from the United States for more than six *calendar* months to come within the exemption provided by section 116(a) of the Revenue Act of 1936. Fractional parts of months from several trips may not be added to make whole calendar months, since whole calendar months must consist of consecutive days of absence from the United States in any one trip.

G. C. M. 12167 (C. B. XII–2, 126 (1933)) modified.

An opinion is requested whether in 1937 A, a citizen of the United States, was a "bona fide nonresident of the United States for more than six months during the taxable year" within the meaning of section 116(a) of the Revenue Act of 1936, which provides in part as follows:

In addition to the items specified in section 22(b), the following items shall not be included in gross income and shall be exempt from taxation under this title:

(a) *Earned income from sources without United States.*—In the case of an individual citizen of the United States, a bona fide nonresident of the United States for more than six months during the taxable year, amounts received from sources without the United States * * * if such amounts would constitute earned income as defined in section 25(a) if received from sources within the United States * * *.

The taxpayer (A) claims exemption under section 116(a), supra, for certain portions of his 1937 income as representing earnings from sources without the United States. He contends that he was a "bona fide nonresident of the United States for more than six months during the taxable year" because of four absences from the United States consisting of two trips to Europe and two trips to Canada. In computing the time he was absent from the United States, the taxpayer has added the hours and minutes of each period of his absence. The aggregate time of his absence so computed exceeds 6 months by 22 hours and 30 minutes.

The specific inquiry presented in the instant case relates to the proper basis upon which the 6-month statutory period should be computed.

This office has held that mere physical absence from the United States is sufficient to constitute a taxpayer a "bona fide nonresident of the United States" for the purposes of the exemption. (S. M. 5446, C. B. V–1, 49 (1926).) It has also been held that the absence need not be continuous, but may be made up of several trips where the periods of absence from the United States amount in the aggregate to more than six months during the taxable year. (G. C. M. 9848, C. B. X–2, 178 (1931).)

As previously pointed out, the taxpayer has added hours and minutes of his absence from the United States during the taxable year in order to bring himself within the exemption provided by section 116(a), supra. To come within that exemption, it is necessary for the taxpayer to be absent from the United States for more than *six months* during the taxable year. Federal courts, as well as

State courts, have consistently held that where the term "month" is employed in statutes (and it does not appear to have been used here in a different sense), it denotes a calendar month, that is, a period terminating with the day of the succeeding month numerically corresponding to the day of its beginning, less one. (*Guaranty Trust & Safe Deposit Co.* v. *Green Cove Springs & Melrose Railroad Co.*, 139 U. S., 137; *In re Custer*, 55 Fed. (2d), 718; *Siegelschiffer* v. *Penn Mut. Life Ins. Co. et al.*, 248 Fed., 226; *Salios* v. *Swift*, 25 Ga. App., 148, 102 S. E., 869.)

This office is, therefore, of the opinion that to come within the exemption provided by section 116(a) a taxpayer must be absent from the United States for more than six *calendar* months. Where several trips are made by a taxpayer in any one year, only full calendar months of absence from the United States are to be recognized in computing time under the statute in question. For example, if a taxpayer leaves the United States on March 10 and returns on April 17, he will be deemed to have been absent from the United States for one calendar month for purposes of section 116(a). On the other hand, if a taxpayer leaves the United States on March 10 and returns on April 5, the period of his absence being less than a calendar month may not be used in computing the number of whole calendar months such taxpayer was absent from the United States for the purposes of the exemption provided in section 116(a). Under this view, fractional parts of months from several trips may not be added to make whole calendar months, since whole calendar months must consist of consecutive days of absence from the United States in any *one* trip.

In the instant case, A, the taxpayer, took four trips during the taxable year 1937. He sailed to Europe on May 5 and returned on June 8, which period is to be treated as a whole calendar month for the purposes of the exemption. The second trip extending from June 16 to November 8 constitutes only four full calendar months. The period of absence from October 16 to November 8 is a fractional part of a calendar month and is not, therefore, to be recognized in the computation. The taxpayer's third and fourth trips, which were to Canada and which extended from November 26 to November 28 and from December 16 to December 18, respectively, may not be recognized for the same reason. It follows that A was absent from the United States during the taxable year 1937 for five whole calendar months. Accordingly, he was not a "bona fide nonresident of the United States for more than six months during the taxable year" and so fails to come within the exemption provided by section 116(a), supra.

G. C. M. 12167 (C. B. XII-2, 126 (1933)), which involves exemption under section 116(a) of the Revenue Act of 1928, and which is not consistent with the conclusion reached herein, is modified accordingly.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

SUPPLEMENT C.—CREDITS AGAINST TAX.

SECTION 131.—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

ARTICLE 131-1: Analysis of credit for taxes. 1940-19-10252
I. T. 3371

REVENUE ACT OF 1936.

The tax imposed by the Netherlands upon distribution by a corporation of its profits, "Wet op de dividend-en tantiemebelasting 1917," is allowable as a credit under section 131(f) of the Revenue Act of 1936.

Advice is requested whether the tax imposed by the Netherlands upon distribution by a corporation of its profits, "Wet op de dividend-en tantiemebelasting 1917," is an allowable credit under section 131(f) of the Revenue Act of 1936, which provides in part as follows:

(f) *Taxes of foreign subsidiary.*—For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits: *Provided,* That the amount of tax deemed to have been paid under this subsection shall in no case exceed the same proportion of the tax against which credit is taken which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. * * *

In Volume II of "Taxation of Foreign and National Enterprises," published by the League of Nations in 1933, the tax system in the Netherlands is discussed. Part I contains a general description of the income-tax and property-tax system. The following statements are made in the publication referred to:

The *tax on dividends and tantiemes* [referred to on page 334 as "Wet op de dividend-en tantiemebelasting 1917"] is principally levied upon the net profits of Netherlands share companies, even if derived from real property situated in the Netherlands; profits, however, are taxed only on distribution. (Page 332.)

Foreign enterprises which receive profits distributed by Netherlands companies * * * are not themselves liable to the tax on dividends and tantiemes. (Page 355.)

It will be remembered that dividends distributed by companies the fiscal domicile of which is in the Netherlands are liable to the tax on dividends and tantiemes, which tax is paid by the company distributing the dividends, that company having no claim for tax against the persons to whom these dividends accrue. (Page 356.)

It is held that the Netherlands tax in question is an income tax within the meaning of section 131(f) of the Revenue Act of 1936. In the case of a domestic corporation owning the majority of the voting stock of a Netherlands company which has paid the tax, the computation of the credit to which the domestic corporation is entitled should be made under section 131(f) of that Act.

ARTICLE 131-1: Analysis of credit for taxes. 1940-24-10290
I. T. 3385

REVENUE ACTS OF 1936 AND 1938.

The tax imposed under article 20 of the Mexican law, "Ley del Impuesto sobre la Renta," upon interest is an income tax, and credit therefor is allowable under section 131 of the Revenue Act of 1936.

I. T. 3288 (C. B. 1939-1 (Part 1), 139) modified.

Advice is requested whether the tax imposed under article 20 of the Mexican law, "Ley del Impuesto sobre la Renta," upon interest is an income tax, credit for which is allowable under section 131 of the Revenue Act of 1936, relating to credits for income taxes imposed by foreign countries, or whether I. T. 3288 (C. B. 1939-1 (Part 1), 139) applies.

The ruling published as I. T. 3288, supra, was based upon the tax imposed by articles 20 and 21 of the Mexican law under consideration with respect to the total revenue of distributors and lessors of motion picture films. It was held that since the basis for the tax is total revenue, the tax is in the nature of an excise tax based on the gross receipts of the taxpayer and credit therefor is not allowable under section 131 of the Revenue Act of 1938. The syllabus of I. T. 3288, supra, reads as follows:

The tax imposed under articles 20 and 21 of the Mexican law, "Ley del Impuesto sobre la Renta" is not an income tax, and credit therefor is not allowable under section 131 of the Revenue Act of 1938. The amount of such tax, however, is allowable as a deduction under section 23(c) of that Act.

The concluding paragraph of I. T. 3288, supra, contains similar language.

The following is an excerpt from article 20 of the Mexican law referred to above:

Taxpayers who, normally or occasionally, receive income from any of the following sources, are included under this schedule:

I.—Simple or compound interest on loans of all kinds.

II.—Interest on amounts owing as purchase or sale price.

When the seller is liable for the tax under schedule I, income under this section from transactions of his business, and entered in his books, shall not be taxable under this schedule.

III.—Interest on advances on account of the price of property or rights of all kinds, with the exception set forth in the preceding section, if the purchaser pays this tax under schedule I.

IV.—Interest earned on current accounts.

Article 21 of the same Mexican law provides in part as follows:

Income taxable under this schedule shall be computed in its entirety—except in the case of the leasing of businesses (article 20, Section XI), when the deductions authorized by the regulations shall be applicable—and the tax shall be payable on the total amount of such income, in accordance with the following tariff * * *.

Then follows the schedule of the graduated tax rates depending upon the amount of the income.

I. T. 3288, supra, does not apply to all classes of taxes imposed under article 20, supra. That article imposes taxes on various types of receipts or profits. Accordingly, a separate determination must be made in each case to ascertain whether the tax meets the American concept of an income tax.

Taxes imposed on interest under article 20 may, generally, be claimed as a credit against Federal income tax. (See I. T. 2620, C. B. XI–1, 44 (1932).) As the tax which is the subject of the present inquiry is a tax on the interest referred to in article 20, such tax is an income tax, and credit therefor is allowable under section 131 of the Revenue Act of 1936.

In view of the foregoing, the last paragraph and syllabus of I. T. 3288, supra, are modified to read as follows:

The tax of 5 per cent imposed under articles 20 and 21 of the Mexican law, "Ley del Impuesto sobre la Renta," upon the total revenue derived from the exploitation of moving picture films is not an income tax, and credit therefor is not allowable under section 131 of the Revenue Act of 1938. The amount of such tax, however, is allowable as a deduction under section 23(c) of that Act.

SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX.

SECTION 143.—WITHHOLDING OF TAX AT SOURCE.

ARTICLE 143–1: Withholding tax at source.

REVENUE ACT OF 1936.

Payments by the United States under certain Acts of Congress to nonresident alien owners of land located in the United States. (See I. T. 3379, page 16.)

SUPPLEMENT E.—ESTATES AND TRUSTS.

SECTION 165.—EMPLOYEES' TRUSTS.

REVENUE ACT OF 1936.

Partnerships of attorneys, physicians, etc. (See I. T. 3350, page 64.)

INCOME TAX RULINGS.—PART III.

REVENUE ACTS OF 1935 AND 1934 OR PRIOR ACTS.

SUBTITLE B.—GENERAL PROVISIONS.

PART II.—COMPUTATION OF NET INCOME.

SECTION 22(a).—GROSS INCOME: GENERAL DEFINITION.

ARTICLE 22(a)-1: What included in gross income. 1940-11-10199
Ct. D. 1444

INCOME TAX—REVENUE ACT OF 1934—DECISION OF SUPREME COURT.

1. IRREVOCABLE SHORT TERM TRUST—INCOME—GRANTOR TREATED AS OWNER OF CORPUS—APPLICABILITY OF SECTION DEFINING GROSS INCOME.

An individual established an irrevocable short term trust, retaining substantially the same dominion and control over the corpus as he had before, the trust instrument providing that the net income was to be held for the exclusive benefit of his wife and paid over to her in his absolute discretion, and that on termination of the trust the entire corpus was to go to him and all accrued or undistributed net income and any proceeds from the investment of such net income treated as property owned absolutely by the wife. *Held:* That the grantor continued to be the owner of the corpus for purposes of section 22(a) of the Revenue Act of 1934, and the income therefrom was taxable to him. Liability under section 22(a) is not foreclosed by reason of the fact that Congress made specific provision in section 166 for revocable trusts but failed to adopt the Treasury recommendation that similar specific treatment should be accorded income from short term trusts. Such choice, while relevant to the scope of section 166, can not be said to have subtracted from section 22(a) what was already there.

2. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Eighth Circuit (1939) (105 F. (2d), 586), reversing memorandum opinion of the United States Board of Tax Appeals (1938); reversed.

SUPREME COURT OF THE UNITED STATES.

Guy T. Helvering, Commissioner of Internal Revenue, petitioner, v. *George B. Clifford, Jr.*

[309 U. S., 331.]

On writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[February 26, 1940.]

OPINION.

Mr. Justice DOUGLAS delivered the opinion of the Court.

In 1934 respondent declared himself trustee of certain securities which he owned. All net income from the trust was to be held for the "exclusive benefit" of respondent's wife. The trust was for a term of five years, except that it would terminate earlier on the death of either respondent or his wife. On termination of the trust the entire corpus was to go to respondent, while all "accrued or undistributed net income" and "any proceeds from the investment of such net income" was to be treated as property owned absolutely by the wife. During the continuance of the trust respondent was to pay over to his wife the whole or such part of the net income as he in his "absolute discretion" might determine. And during that period he had full power (*a*) to exercise all voting powers incident to the trusteed shares of stock; (*b*) to "sell, exchange, mortgage, or pledge" any of the securities under the declaration of trust "whether as part of the corpus or principal thereof or as investments or proceeds and any income therefrom, upon such terms and for such consideration" as respondent in his "absolute discretion may deem fitting"; (*c*) to invest "any cash or money in the trust estate or any income therefrom" by loans, secured or unsecured, by deposits in banks, or by purchase of securities or other personal property "without restriction" because of their "speculative character" or "rate of return" or any "laws pertaining to the investment of trust funds"; (*d*) to collect all income; (*e*) to compromise, etc., any claims held by him as trustee; (*f*) to hold any property in the trust estate in the names of "other persons or in my own name as an individual" except as otherwise provided. Extraordinary cash dividends, stock dividends, proceeds from the sale of unexercised subscription rights, or any enhancement, realized or not, in the value of the securities were to be treated as principal, not income. An exculpatory clause purported to protect him from all losses except those occasioned by his "own willful and deliberate" breach of duties as trustee. And finally it was provided that neither the principal nor any future or accrued income should be liable for the debts of the wife; and that the wife could not transfer, encumber, or anticipate any interest in the trust or any income therefrom prior to actual payment thereof to her.

It was stipulated that while the "tax effects" of this trust were considered by respondent they were not the "sole consideration" involved in his decision to set it up, as by this and other gifts he intended to give "security and economic independence" to his wife and children. It was also stipulated that respondent's wife had substantial income of her own from other sources; that there was no restriction on her use of the trust income, all of which income was placed in her personal checking account, intermingled with her other funds, and expended by her on herself, her children and relatives; that the trust was not designed to relieve respondent from liability for family or household expenses and that after execution of the trust he paid large sums from his personal funds for such purposes.

Respondent paid a Federal gift tax on this transfer. During the year 1934 all income from the trust was distributed to the wife who included it in her individual return for that year. The Commissioner, however, determined a deficiency in respondent's return for that year on the theory that income from the trust was taxable to him. The Board of Tax Appeals sustained that redetermination (38 B. T. A., 1532). The circuit court of appeals reversed (105 F. (2d), 586). We granted certiorari because of the importance to the revenue of the use of such short term trusts in the reduction of surtaxes.

Section 22(a) of the Revenue Act of 1934 (48 Stat., 680) includes among "gross income" all "gains, profits, and income derived * * * 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." The broad sweep of this language indicates the purpose of Congress to use the full measure of its taxing power within those definable categories. (Cf. *Helvering* v. *Midland Mutual Life Insurance Co.*, 300 U. S., 216 [Ct. D. 1206, C. B. 1937-1, 178].) Hence our construction of the statute should be consonant with that purpose. Technical considerations, niceties of the law of trusts or conveyances, or the legal paraphernalia which inventive genius may construct as a refuge from surtaxes should not obscure the basic issue. That issue is whether the grantor after the trust has been established may still be treated, under this statutory scheme, as the owner of the corpus. (See *Blair* v. *Commissioner*, 300 U. S., 5, 12 [T. D. 4141, C. B. VII-1, 189 (1928)].) In absence of more precise standards or guides supplied by statute or appropriate regulations,[1] the answer to that question must depend on an analysis of the terms of the trust and all the cir-

[1] We have not considered here article 166-1 of Treasury Regulations 86 promulgated under section 166 of the 1934 Act and in 1936 amended (T. D. 4629 [C. B. XV-1, 140 (1936)]) so as to rest on section 22(a) also, since the tax in question arose prior to that amendment.

cumstances attendant on its creation and operation. And where the grantor is the trustee and the beneficiaries are members of his family group, special scrutiny of the arrangement is necessary lest what is in reality but one economic unit be multiplied into two or more[2] by devices which, though valid under State law, are not conclusive so far as section 22(a) is concerned.

In this case we can not conclude as a matter of law that respondent ceased to be the owner of the corpus after the trust was created. Rather, the short duration of the trust, the fact that the wife was the beneficiary, and the retention of control over the corpus by respondent all lead irresistibly to the conclusion that respondent continued to be the owner for purposes of section 22(a).

So far as his dominion and control were concerned it seems clear that the trust did not effect any substantial change. In substance his control over the corpus was in all essential respects the same after the trust was created, as before. The wide powers which he retained included for all practical purposes most of the control which he as an individual would have. There were, we may assume, exceptions, such as his disability to make a gift of the corpus to others during the term of the trust and to make loans to himself. But this dilution in his control would seem to be insignificant and immaterial, since control over investment remained. If it be said that such control is the type of dominion exercised by any trustee, the answer is simple. We have at best a temporary reallocation of income within an intimate family group. Since the income remains in the family and since the husband retains control over the investment, he has rather complete assurance that the trust will not effect any substantial change in his economic position. It is hard to imagine that respondent felt himself the poorer after this trust had been executed or, if he did, that it had any rational foundation in fact. For as a result of the terms of the trust and the intimacy of the familial relationship respondent retained the substance of full enjoyment of all the rights which previously he had in the property. That might not be true if only strictly legal rights were considered. But when the benefits flowing to him indirectly through the wife are added to the legal rights he retained, the aggregate may be said to be a fair equivalent of what he previously had. To exclude from the aggregate those indirect benefits would be to deprive section 22(a) of considerable vitality and to treat as immaterial what may be highly relevant considerations in the creation of such family trusts. For where the head of the household has income in excess of normal needs, it may well make but little difference to him (except income-tax-wise) where portions of that income are routed—so long as it stays in the family group. In those circumstances the all-important factor might be retention by him of control over the principal. With that control in his hands he would keep direct command over all that he needed to remain in substantially the same financial situation as before. Our point here is that no one fact is normally decisive but that all considerations and circumstances of the kind we have mentioned are relevant to the question of ownership and are appropriate foundations for findings on that issue. Thus, where, as in this case, the benefits directly or indirectly retained blend so imperceptibly with the normal concepts of full ownership, we can not say that the triers of fact committed reversible error when they found that the husband was the owner of the corpus for the purposes of section 22(a). To hold otherwise would be to treat the wife as a complete stranger; to let mere formalism obscure the normal consequences of family solidarity; and to force concepts of ownership to be fashioned out of legal niceties which may have little or no significance in such household arrangements.

The bundle of rights which he retained was so substantial that respondent can not be heard to complain that he is the "victim of despotic power when for the purpose of taxation he is treated as owner altogether." (See *Dupont* v. *Commissioner*, 289 U. S., 685, 689 [Ct. D. 687, C. B. XII-1, 259 (1933)].)

We should add that liability under section 22(a) is not foreclosed by reason of the fact that Congress made specific provision in section 166 for revocable trusts, but failed to adopt the Treasury recommendation in 1934 (*Helvering* v. *Wood*, — U. S., — [Ct. D. 1445, page 162, this Bulletin], that similar specific treatment should be accorded income from short term trusts. Such choice, while relevant to the scope of section 166, *Helvering* v. *Wood*, supra, can not be said to have substracted from section 22(a) what was already there.

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[2] See Paul, The Background of the Revenue Act of 1937 (5 Univ. Chic. L. Rev., 41).

Rather, on this evidence it must be assumed that the choice was between a generalized treatment under section 22(a) or specific treatment under a separate provision[8] (such as was accorded revocable trusts under section 166); not between taxing or not taxing grantors of short term trusts. In view of the broad and sweeping language of section 22(a), a specific provision covering short term trusts might well do no more than to carve out of section 22(a) a defined group of cases to which a rule of thumb would be applied. The failure of Congress to adopt any such rule of thumb for that type of trust must be taken to do no more than to leave to the triers of fact the initial determination of whether or not on the facts of each case the grantor remains the owner for purposes of section 22(a).

In view of this result we need not examine the contention that the trust device falls within the rule of *Lucas* v. *Earl* (281 U. S., 111) and *Burnet* v. *Leininger* (285 U. S., 136), relating to the assignment of future income; or that respondent is liable under section 166, taxing grantors on the income of revocable trusts.

The judgment of the circuit court of appeals is reversed and that of the Board of Tax Appeals is affirmed.

It is so ordered.

ARTICLE 22(a)-1: What included in gross income. 1940-23-10281
Ct. D. 1456

INCOME TAX—REVENUE ACT OF 1932—DECISION OF SUPREME COURT.

1. INCOME—DEFERRED PAYMENT SALE OF OIL AND GAS PROPERTIES—RESERVATION OF INTEREST IN THE FEE—TAXABILITY OF GROSS PROCEEDS FROM PRODUCTION.

A corporation in 1931 entered into a written contract providing for the conveyance to petitioners of certain royalty interests, fee interests, and deferred oil payments in properties in Oklahoma, for an agreed consideration payable partly in cash and partly from one-half of the proceeds which might be derived from oil and gas produced from the properties and from the sale of fee title to any or all of the land conveyed. The properties were thereupon conveyed to petitioners, and during 1932 one-half of the gross proceeds derived from the production and sale of oil was distributed to the corporation, pursuant to the contract. *Held:* The transaction is in effect a sale with a reservation of an interest in the fee as additional security for the deferred payments, the corporation is not dependent entirely upon the production of oil for the deferred payments, and the petitioners, as purchasers and owners of the properties, are therefore taxable upon the gross proceeds derived from the oil production, notwithstanding the arrangement to pay over one-half of such proceeds to the corporation.

2. CASE DISTINGUISHED.

Thomas v. *Perkins* (301 U. S., 655, Ct. D. 1237, C. B. 1937-1, 162) distinguished.

3. DECISION AFFIRMED.

Decision of the United States Circuit Court of Appeals, Tenth Circuit (1939) (107 F. (2d), 459), affirming memorandum opinion of the United States Board of Tax Appeals (1938), affirmed.

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[8] As to the disadvantage of a specific statutory formula over more generalized treatment see Volume I, Report, Income Tax Codification Committee (1936), a committee appointed by the Chancellor of the Exchequer in 1927. In discussing revocable settlements the committee stated, page 298:

"This and the three following clauses reproduce section 20 of the Finance Act, 1922, an enactment which has been the subject of much litigation, is unsatisfactory in many respects, and is plainly inadequate to fulfill the apparent intention to prevent avoidance of liability to tax by revocable dispositions of income or other devices. We think the matter one which is worthy of the attention of Parliament."

SUPREME COURT OF THE UNITED STATES.

J. Steve Anderson, petitioner, v. *Guy T. Helvering, Commissioner of Internal Revenue.*

L. H. Prichard, petitioner, v. *Guy T. Helvering, Commissioner of Internal Revenue.*

[60 S. Ct., 952.]

On writs of certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

[May 20, 1940.]

OPINION.

Mr. Justice MURPHY delivered the opinion of the Court.

Oklahoma City Co. in 1931 owned certain royalty interests, fee interests, and deferred oil payments in properties in Oklahoma. During that year it entered into a written contract with petitioner Pritchard providing for the conveyance to him of these interests for the agreed consideration of $160,000, payable fifty thousand in cash and one hundred ten thousand from one-half of the proceeds received by him which might be derived from oil and gas produced from the properties and from the sale of fee title to any or all of the land conveyed. Interest at the rate of 6 per cent per annum was to be paid from the proceeds of production and of sales upon the unpaid balance. Oklahoma Company was to have in addition a first lien and claim against "that one-half of all oil and gas production and fee interest * * * from which the $110,000 is payable," the lien and claim "not in any way [to] affect the one-half interest in all oil and gas production and fee interest or the revenue therefrom which * * * [it] is to have and receive under this agreement." The proceeds derived from the oil and gas produced and from sales of the fee interests were to be paid directly to Pritchard who was to deposit one-half of them at a designated bank, at intervals of 90 days, to the credit of Oklahoma Company. The agreement recited that Oklahoma Company desired "to sell all of its right, title and interest of whatsoever nature" in the described properties, and provided that a copy of the agreement and a release be placed in escrow for delivery to Pritchard upon payment in full of the $110,000 and interest. Immediately upon the execution of the contract the properties were conveyed to Pritchard without reservation.[1] In entering into the agreement Pritchard acted not only for himself but also for petitioner Anderson, each of them having a 45 per cent interest.[2]

The gross proceeds derived from the production and sale of oil from the properties[3] during 1932 amounted to some $81,000. Pritchard, upon receiving this sum, distributed one-half to Oklahoma Company pursuant to the contract. The question for decision is whether the proceeds thus paid over to Oklahoma Company should be included in the gross income of petitioners for the tax year 1932.[4] The ruling of the Board of Tax Appeals against petitioners was affirmed by the circuit court of appeals. (107 F. (2d), 459.) Because of an asserted conflict with the applicable decisions of this Court, we granted certiorari. (March 4, 1940.)

It is settled that the same basic issue determines both to whom income derived from the production of oil and gas is taxable and to whom a deduction for depletion is allowable. That issue is, who has a capital investment in the oil and gas in place and what is the extent of his interest. (*Helvering* v.

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[1] Petitioners state that "the instruments of transfer of those properties were absolute and unqualified assignments and conveyances" and that there was "no reservation of any sort of interest, much less any legal interest, specified in those assignments and conveyances."

[2] The remaining 10 per cent interest was acquired for one Olsen, whose case was consolidated with those of Pritchard and Anderson, and disposed of in the same opinion below, but who has not sought review here.

[3] The record does not indicate what portion of the gross proceeds was derived from the production and sale of oil and gas and what portion, if any, was derived from sales of fees and from royalties on leases. The Commissioner in determining deficiencies against petitioners, however, added $11,276.39 to the gross income of each with the explanation that this amount represented "In-oil payments received in connection with the Patterson [Oklahoma Company] deal" not reported by petitioners. Respondent, in view of this explanation by the Commissioner and the omission from the record of any disclosure of the method of computing the $11,276.39 addition to gross income, accepts petitioners' statement that "the only income from the properties here in dispute is from oil production."

[4] Revenue Act of 1932 (ch. 209, 47 Stat., 169).

Bankline Oil Co., 303 U. S., 362, 367 [Ct. D. 1323, C. B. 1938-1, 306]; *Helvering* v. *O'Donnell*, 303 U. S., 370 [Ct. D. 1340, C. B. 1938-1, 497]; *Helvering* v. *Elbe Oil Co.*, 303 U. S., 372 [Ct. D. 1322, C. B. 1938-1, 293]; *Thomas* v. *Perkins*, 301 U. S., 655, 661, 663 [Ct. D. 1237, C. B. 1937-1, 162]; *Helvering* v. *Twin Bell Oil Syndicate*, 293 U. S., 312, 321 [Ct. D. 905, C. B. XIV-1, 253 (1935)]; *Palmer* v. *Bender*, 287 U. S., 551 [Ct. D. 641, C. B. XII-1, 235 (1935)]. Compare *Helvering* v. *Clifford*, No. 383, October Term, 1939 [Ct. D. 1444, page 105, this Bulletin].)

Oil and gas reserves like other minerals in place, are recognized as wasting assets. The production of oil and gas, like the mining of ore, is treated as an income-producing operation, not as a conversion of capital investment as upon a sale, and is said to resemble a manufacturing business carried on by the use of the soil. (*Burnet* v. *Harmel*, 287 U. S., 103, 106-107 [Ct. D. 611, C. B. XI-2, 210 (1932)]; *Bankers Coal Co.* v. *Burnet*, 287 U. S., 308 [Ct. D. 618, C. B. XII-1, 272 (1933)]; *United States* v. *Biwabik Mining Co.*, 247 U. S., 116; *Von Baumbach* v. *Sargent Land Co.*, 242 U. S., 503, 521, 522; *Stratton's Independence* v. *Howbert*, 231 U. S., 399, 414.) The depletion effected by production is likened to the depreciation of machinery or the using up of raw materials in manufacturing. (*United States* v. *Ludey*, 274 U. S., 295, 302-303 [T. D. 4046, C. B. VI-2, 157 (1927)]; *Lynch* v. *Alworth-Stephens Co.*, 267 U. S., 364, 370 [T. D. 3690, C. B. IV-1, 162 (1925)]. Compare *Von Baumbach* v. *Sargent Land Co.*, supra, at 524-525.) The deduction is therefore permitted as an act of grace and is intended as compensation for the capital assets consumed in the production of income through the severance of the minerals. (*Helvering* v. *Bankline Oil Co.*, 303 U. S., 362, 366-367.) The granting of an arbitrary deduction, in the interests of convenience, of a percentage of the gross income derived from the severance of oil and gas, merely emphasizes the underlying theory of the allowance as a tax-free return of the capital consumed in the production of gross income through severance. (*Helvering* v. *Twin Bell Oil Syndicate*, 293 U. S., 312, 321; *United States* v. *Dakota-Montana Oil Co.*, 288 U. S., 459, 467 [Ct. D. 655, C. B. XII-1, 243 (1933)].)

The sole owner and operator of oil properties clearly has a capital investment in the oil in place, if anyone has, and so is taxable on the gross proceeds of production and is granted a deduction from gross income as compensation for the consumption of his capital. (See *Burnet* v. *Harmel*, supra, at 107-108; *Helvering* v. *Clifford*, No. 383, October Term, 1939.) By an outright sale of his interest for cash, such an owner converts the form of his capital investment, severs his connection with the production of oil and gas and the income derived from production, and thus renders inapplicable to his situation the reasons for the depletion allowance. "The words 'gross income from the property,' as used in the statute governing the allowance for depletion, mean gross income received from the operation of the oil and gas wells by one who has a capital investment therein,—not income from the sale of the oil and gas properties themselves." (*Helvering* v. *Elbe Oil Land Co.*, 303 U. S., 372, 375-376.)

Other situations, falling between the two mentioned, have been put on one side or the other as the cases arose. The holder of the royalty interest—that is, a right to receive a specified percentage of all oil and gas produced during the term of the lease—is deemed to have "an economic interest" in the oil in place which is depleted by severance. (*Palmer* v. *Bender*, 287 U. S., 551, 557; *Murphy Oil Co.* v. *Burnet*, 287 U. S., 299 [Ct. D. 619, C. B. XII-1, 231 (1933)]; *Burnet* v. *Harmel*, 287 U. S., 103. See *Lynch* v. *Alworth-Stephens Co.*, 267 U. S., 364.) Cash bonus payments, when included in a royalty lease, are regarded as advance royalties, and are given the same tax consequences. (*Burnet* v. *Harmel*, 287 U. S., 103; *Murphy Oil Co.* v. *Burnet*, 287 U. S., 299; *Bankers Pocahontas Coal Co.* v. *Burnet*, 287 U. S., 308. Compare *Helvering* v. *Elbe Oil Land Co.*, 303 U. S., 372, 375.) A share in the net profits derived from development and operation, on the contrary, does not entitle the holder of such interest to a depletion allowance even though continued production is essential to the realization of such profits. (*Helvering* v. *O'Donnell*, 303 U. S., 370; *Helvering* v. *Elbe Oil Co.*, 303 U. S., 372.) Similarly, the holder of a favorable contract to purchase wet gas at the mouth of the well is denied a depletion allowance on the difference between the contract price and the fair market value. (*Helvering* v. *Bankline Oil Co.*, 303 U. S., 362.) Such an interest has been characterized by us as a "mere economic advantage derived from production, through a contractual relation to the owner." (*Helvering* v. *Bankline Oil Co.*, supra, at 367.)

Thomas v. *Perkins* (301 U. S., 655), relied upon by petitioners, presented the issue whether the right to oil payments—that is, the right to a specified sum of money, payable out of a specified percentage of the oil, or the proceeds received from the sale of such oil, if, as and when produced—should be treated for tax purposes like the right to oil royalties or like the right to cash payments upon a sale. In that case, the assignment of lease provided for payments in oil only without the reservation of a royalty interest. The question was whether the assignees' gross income should include moneys paid to the assignors by purchasers of the oil. We stated (page 659): "The granting clause in the assignment would be sufficient, if standing alone, to transfer all the oil to the assignee. It does not specifically except or exclude any part of the oil. But it is qualified by other parts of the instrument. The provisions for payment to assignors in oil only, the absence of any obligation of the assignee to pay in oil or in money, and the failure of assignors to take any security by way of lien or otherwise unmistakably show that they intended to withhold from the operation of the grant one-fourth of the oil to be produced and saved up to an amount sufficient when sold to yield $395,000." Under these circumstances, the moneys received by the assignors from the sale of the oil were deemed not to be income to the assignees. (See also *Palmer* v. *Bender*, 287 U. S., 551.)

The holder of an oil payment right, as an original proposition, might be regarded as having no capital investment in the oil and gas in place. The value of the right, even though dependent upon the extent of the oil reserves, is fixed at the moment of creation and does not vary directly with the severance of the mineral from the soil. In this sense it resembles the right to cash payments more closely than the right to royalty payments. Yet it does depend upon the production of oil, ordinarily can be realized upon only over a period of years, and permits of a simple and convenient allocation between lessor and lessee of both the gross income derived from production and the allowance for depletion. (Compare *Burnet* v. *Harmel*, 287 U. S., 103, 106–107.) Accordingly, this Court in *Thomas* v. *Perkins* decided that the provision in the lease for payments solely out of oil production should be regarded as a reservation from the granting clause of an amount of oil sufficient to make the agreed payments, and should be given the same tax consequences as a provision for oil royalties. The decision did not turn upon the particular instrument involved, or upon the formalities of the conveyancer's art, but rested upon the practical consequences of the provision for payments of that type. (See *Palmer* v. *Bender*, 287 U. S., 551, 555–557; *Burnet* v. *Harmel*, 287 U. S., 103, 111.)

The Government maintains that the present case is distinguishable from *Thomas* v. *Perkins* for the reason that the basis for decision there was that ownership of sufficient oil to make the payments had not been conveyed to the assignee but remained in the assignor. It asserts that the terms of the contract and the instruments of conveyance here negative any intention on the part of the parties to withhold from the operation of the grant an amount of oil equal to the oil payments. The following factors, among others, are relied upon as supporting this contention: (1) the contract contains no qualifying language reserving from the grant any interest in the oil and gas in place; (2) the deferred payments of $110,000 were payable in cash and not directly in oil; (3) the deferred payments drew interest until paid; (4) Oklahoma Company had a first lien and claim against one-half of the oil and gas production and fee interest; (5) petitioner Pritchard had the right to sell the fee interest covered by the contract and discharge the deferred payments out of the proceeds of such sale rather than out of the proceeds of the oil and gas production.

Several of the distinctions urged upon us by the Government are without substance. The economic consequences of the transaction are not materially affected by the circumstance that the provision for oil payments is not phrased in terms of a reservation from the conveyance to Oklahoma Company of an interest in the oil and gas in place. And the fact that the payments to Oklahoma Company are in cash rather than directly in oil is of no moment in determining the issues presented for decision. Compare, however, *General Utilities Co.* v. *Helvering* (296 U. S., 200 [Ct. D. 1055, C. B. XV-1, 214 (1936)]). Similarly, the retention of a lien, if it were construed as a lien only upon the oil and gas production, and nothing more,[5] would not make Oklahoma Company any the less dependent upon such production for payment of the amounts reserved.

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[5] The lien here appears to cover both the oil and gas production and the fee interest from which the deferred payments were to be derived.

The reservation of an interest in the fee, in addition to the interest in the oil production, however, materially affects the transaction. Oklahoma Company is not dependent entirely upon the production of oil for the deferred payments; they may be derived from sales of the fee title to the land conveyed. It is clear that payments derived from such sales would not be subject to an allowance for depletion of the oil reserves, for no oil would thereby have been severed from the ground; an allowance for depletion upon the proceeds of such a sale would result, contrary to the purpose of Congress, in a double deduction—first, to Oklahoma Company; second, to the vendee-owner upon the production of oil. (*Helvering* v. *Twin Bell Oil Syndicate*, 293 U. S., 312, 321.) We are of opinion that the reservation of this additional type of security for the deferred payments serves to distinguish this case from *Thomas* v. *Perkins*. It is similar to the reservation in a lease of oil payment rights together with a personal guarantee by the lessee that such payments shall at all events equal the specified sum. In either case, it is true, some of the payments received may come directly out of the oil produced. But our decision in *Thomas* v. *Perkins* does not require that payments reserved to the transferor of oil properties shall for tax purposes be treated distributively, and not as a whole, depending upon the source from which each dollar is derived. An extension of that decision to cover the case at bar would create additional, and in our opinion unnecessary, difficulties to the allocation for income tax purposes of such payments and of the allowance for depletion between transferor and transferee. In the interests of a workable rule, *Thomas* v. *Perkins* must not be extended beyond the situation in which, as a matter of substance, without regard to formalities of conveyancing, the reserved payments are to be derived solely from the production of oil and gas. The deferred payments reserved by Oklahoma Company, accordingly, must be treated as payments received upon a sale to petitioners, not as income derived from the consumption of its capital investment in the reserves through severance of oil and gas.

Petitioners, as purchasers and owners of the properties, are therefore taxable upon the gross proceeds derived from the oil production, notwithstanding the arrangement to pay over such proceeds to Oklahoma Company. (See *Helvering* v. *Clifford*, No. 383, October Term, 1939; *Reinecke* v. *Smith*, 289 U. S., 172, 177 [Ct. D. 664, C. B. XII-1, 256 (1933)]; *Old Colony Trust Co.* v. *Commissioner*, 279 U. S., 716 [Ct. D. 80, C. B. VIII-2, 222 (1929)].)

Affirmed.

Article 22(a)-3: Compensation paid other than in cash.

REVENUE ACTS OF 1932 AND 1934.

Regulations 86 and 77 amended. (See T. D. 4965, page 13.)

Article 22(a)-13: Improvements by lessees.

1940-15-10229
Ct. D. 1450

INCOME TAX—REVENUE ACT OF 1932—DECISION OF SUPREME COURT.

1. Gross Income—Lease—Improvements by Lessee—Realization of Taxable Gain to Lessor Upon Forfeiture.

On July 1, 1915, land with building thereon was leased for a term of 99 years, the lease providing that, under certain conditions, the lessee might remove any building, and that upon termination of the lease the land with all buildings and improvements should be surrendered. In 1929 the lessee demolished the existing building and erected a new one having a useful life of not more than 50 years. July 1, 1933, the lease was canceled for default in payment of rent and taxes, and the lessor regained possession. *Held:* That the lessor realized taxable gain in 1933 from the forfeiture of the leasehold, in the amount of the stipulated net fair market value of the new building as of July 1, 1933. The definition of gross income in section 22(a) of the Revenue Act of 1932 is broad enough to embrace such gain. It is not necessary to recognition of taxable gain that the improvement begetting the gain should be severable from the original capital.

2. Decision Reversed.

Decision of the United States Circuit Court of Appeals, Eighth Circuit (1939) (105 F. (2d), 442), affirming an unreported decision of the United States Board of Tax Appeals (1938), reversed.

3. Decision Overruled in Principle.

Miller v. *Gearin* (C. C. A., Ninth Circuit, 1919) (258 Fed., 225) overruled in principle.

4. Decisions Distinguished.

Hewitt Realty Co. v. *Commissioner* (C. C. A., Second Circuit, 1935) (76 F. (2d), 880) and *M. E. Blatt Co.* v. *United States* (1938) (305 U. S., 267 [Ct. D. 1373, C. B. 1939-1 (Part 1), 221]) distinguished.

Supreme Court of the United States.

Guy T. Helvering, Commissioner of Internal Revenue, petitioner, v. *Charles A. Bruun.*

[309 U. S., 461.]

On writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[March 25, 1940.]

OPINION.

Mr. Justice Roberts delivered the opinion of the Court.

The controversy had its origin in the petitioner's assertion that the respondent realized taxable gain from the forfeiture of a leasehold, the tenant having erected a new building upon the premises. The court below held that no income had been realized.[1] Inconsistency of the decisions on the subject led us to grant certiorari.

The Board of Tax Appeals made no independent findings. The cause was submitted upon a stipulation of facts. From this it appears that on July 1, 1915, the respondent, as owner, leased a lot of land and the building thereon for a term of 99 years.

The lease provided that the lessee might, at any time, upon giving bond to secure rentals accruing in the two ensuing years, remove or tear down any building on the land, provided that no building should be removed or torn down after the lease became forfeited, or during the last 3½ years of the term. The lessee was to surrender the land, upon termination of the lease, with all buildings and improvements thereon.

In 1929 the tenant demolished and removed the existing building and constructed a new one which had a useful life of not more than 50 years. July 1, 1933, the lease was canceled for default in payment of rent and taxes and the respondent regained possession of the land and building.

The parties stipulated "that as at said date, July 1, 1933, the building which had been erected upon said premises by the lessee had a fair market value of $64,245.68 and that the unamortized cost of the old building, which was removed from the premises in 1929 to make way for the new building, was $12,811.43, thus leaving a net fair market value as at July 1, 1933, of $51,434.25, for the aforesaid new building erected upon the premises by the lessee."

On the basis of these facts, the petitioner determined that in 1933 the respondent realized a net gain of $51,434.25. The Board overruled his determination and the Circuit Court of Appeals affirmed the Board's decision.

The course of administrative practice and judicial decision in respect of the question presented has not been uniform. In 1917 the Treasury ruled that the adjusted value of improvements installed upon leased premises is income to the lessor upon the termination of the lease.[2] The ruling was incorporated in two succeeding editions of the Treasury regulations.[3] In 1919 the Circuit Court of Appeals for the Ninth Circuit held in *Miller* v. *Gearin* (258 Fed., 225) that the regulation was invalid as the gain, if taxable at all, must be taxed as of the year when the improvements were completed.[4]

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1 *Helvering* v. *Bruun* (105 F. (2d), 442).

2 Treasury Decision 2442 (19 Treas. Dec. Int. Rev., 25).

3 Regulations 33 (1918 ed.), article 4, paragraph 50; Regulations 45 (2d 1919 ed.), article 48.

4 This Court denied certiorari (250 U. S., 667).

The regulations were accordingly amended to impose a tax upon the gain in the year of completion of the improvements, measured by their anticipated value at the termination of the lease and discounted for the duration of the lease. Subsequently the regulations permitted the lessor to spread the depreciated value of the improvements over the remaining life of the lease, reporting an aliquot part each year, with provision that, upon premature termination, a tax should be imposed upon the excess of the then value of the improvements over the amount theretofore returned.[5]

In 1935 the Circuit Court of Appeals for the Second Circuit decided in *Hewitt Realty Co.* v. *Commissioner* (76 F. (2d), 880) that a landlord received no taxable income in a year, during the term of the lease, in which his tenant erected a building on the leased land. The court, while recognizing that the lessor need not receive money to be taxable, based its decision that no taxable gain was realized in that case on the fact that the improvement was not portable or detachable from the land, and if removed would be worthless except as bricks, iron, and mortar. It said (page 884): " The question as we view it is whether the value received is embodied in something separately disposable, or whether it is so merged in the land as to become financially a part of it, something which, though it increases its value, has no value of its own when torn away."

This decision invalidated the regulations then in force.[6]

In 1938 this Court decided *M. E. Blatt Co.* v. *United States* (305 U. S., 267 [Ct. D. 1373, C. B. 1939-1 (Part 1), 221]). There, in connection with the execution of a lease, landlord and tenant mutually agreed that each should make certain improvements to the demised premises and that those made by the tenant should become and remain the property of the landlord. The Commissioner valued the improvements as of the date they were made, allowed depreciation thereon to the termination of the leasehold, divided the depreciated value by the number of years the lease had to run, and found the landlord taxable for each year's aliquot portion thereof. His action was sustained by the Court of Claims. The judgment was reversed on the ground that the added value could not be considered rental accruing over the period of the lease; that the facts found by the Court of Claims did not support the conclusion of the Commissioner as to the value to be attributed to the improvements after a use throughout the term of the lease; and that, in the circumstances disclosed, any enhancement in the value of the realty in the tax year was not income realized by the lessor within the Revenue Act.

The circumstances of the instant case differentiate it from the Blatt and Hewitt cases; but the petitioner's contention that gain was realized when the respondent, through forfeiture of the lease, obtained untrammeled title, possession and control of the premises, with the added increment of value added by the new building, runs counter to the decision in the Miller case and to the reasoning in the Hewitt case.

The respondent insists that the realty,—a capital asset at the date of the execution of the lease,—remained such throughout the term and after its expiration; that improvements affixed to the soil became part of the realty indistinguishably blended in the capital asset; that such improvements can not be separately valued or treated as received in exchange for the improvements which were on the land at the date of the execution of the lease; that they are, therefore, in the same category as improvements added by the respondent to his land, or accruals of value due to extraneous and adventitious circumstances. Such added value, it is argued, can be considered capital gain only upon the owner's disposition of the asset. The position is that the economic gain consequent upon the enhanced value of the recaptured asset is not gain derived from capital or realized within the meaning of the sixteenth amendment and may not, therefore, be taxed without apportionment.

We hold that the petitioner was right in assessing the gain as realized in 1933.

We might rest our decision upon the narrow issue presented by the terms of the stipulation. It does not appear what kind of a building was erected by the tenant or whether the building was readily removable from the land. It is not stated whether the difference in the value between the building removed and that erected in its place accurately reflects an increase in the value of land and

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[5] Treasury Decision 3062 (C. B. 3, 109); Regulations 45 (1920 ed.), article 48; Regulations 62, 65, and 69, article 48; Regulations 86, 94, and 101, article 22(a)-13.

[6] The Hewitt case was followed in *Hilgenberg* v. *United States* (21 F. Supp., 453), *Staples* v. *United States* (21 F. Supp., 737), and *English* v. *Bitgood* (21 F. Supp., 641).

building considered as a single estate in land. On the facts stipulated, without more, we should not be warranted in holding that the presumption of the correctness of the Commissioner's determination has been overborne.

The respondent insists, however, that the stipulation was intended to assert that the sum of $51,434.25 was the measure of the resulting enhancement in value of the real estate at the date of the cancellation of the lease. The petitioner seems not to contest this view. Even upon this assumption we think that gain in the amount named was realized by the respondent in the year of repossession.

The respondent can not successfully contend that the definition of gross income in section 22(a) of the Revenue Act of 1932 [7] is not broad enough to embrace the gain in question. That definition follows closely the sixteenth amendment. Essentially the respondent's position is that the amendment does not permit the taxation of such gain without apportionment amongst the States. He relies upon what was said in *Hewitt Realty Co.* v. *Commissioner*, supra, and upon expressions found in the decisions of this Court dealing with the taxability of stock dividends to the effect that gain derived from capital must be something of exchangeable value proceeding from property, severed from the capital, however invested or employed, and received by the recipient for his separate use, benefit, and disposal.[8] He emphasizes the necessity that the gain be separate from the capital and separately disposable. These expressions, however, were used to clarify the distinction between an ordinary dividend and a stock dividend. They were meant to show that in the case of a stock dividend, the stockholder's interest in the corporate assets after receipt of the dividend was the same as and inseverable from that which he owned before the dividend was declared. We think they are not controlling here.

While it is true that economic gain is not always taxable as income, it is settled that the realization of gain need not be in cash derived from the sale of an asset. Gain may occur as a result of exchange of property, payment of the taxpayer's indebtedness, relief from a liability, or other profit realized from the completion of a transaction.[9] The fact that the gain is a portion of the value of property received by the taxpayer in the transaction does not negative its realization.

Here, as a result of a business transaction, the respondent received back his land with a new building on it, which added an ascertainable amount to its value. It is not necessary to recognition of taxable gain that he should be able to sever the improvement begetting the gain from his original capital. If that were necessary, no income could arise from the exchange of property; whereas such gain has always been recognized as realized taxable gain.

Judgment reversed.

The CHIEF JUSTICE concurs in the result in view of the terms of the stipulation of facts.

Mr. Justice MCREYNOLDS took no part in the decision of this case.

SECTION 22(b).—GROSS INCOME: EXCLUSIONS FROM GROSS INCOME.

ARTICLE 22(b)(2)-2: Annuities.

REVENUE ACTS OF 1926 AND 1928.

G. C. M. 6395 (C. B. VIII-1, 67 (1929)) revoked. (See G. C. M. 21716, page 82.)

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[7] Ch. 209, 47 Stat., 169, 178.

[8] See *Eisner* v. *Macomber* (252 U. S., 189, 207 [T. D. 3010, C. B. 3, 25 (1920)]); *United States* v. *Phellis* (257 U. S., 156, 169 [Ct. D. 19, C. B. 5, 37 (1921)]).

[9] *Cullinan* v. *Walker* (262 U. S., 134 [Ct. D. 32, C. B. II-1, 51 (1923)]); *Marr* v. *United States* (268 U. S., 536 [T. D. 3755, C. B. IV-2, 116 (1925)]); *Old Colony Trust Co.* v. *Commissioner* (279 U. S., 716 [Ct. D. 80, C. B. XIII-2, 222 (1922)]); *United States* v. *Kirby Lumber Co.* (284 U. S., 1 [Ct. D. 420, C. B. X-2, 356 (1931)]); *Helvering* v. *American Chicle Co.* (291 U. S., 426 [Ct. D. 809, C. B. XIII-1, 265 (1934)]); *United States* v. *Hendler* (303 U. S., 564 [Ct. D. 1328, C. B. 1938-1, 285]).

ARTICLE 22(b)(2)-2: Annuities.

1940-4-10148
G. C. M. 21666

REVENUE ACT OF 1934.

Where the proceeds of a single premium endowment policy are payable at maturity in 120 equal monthly installments, the installments received constitute annuity payments and are taxable in accordance with article 22(b)(2)-2, Regulations 86.

I. T. 2380 (C. B. VI-2, 32 (1927)) distinguished.

An opinion is requested as to the proper treatment for Federal income tax purposes of the proceeds of an endowment policy issued on the life of A, payable in 120 equal installments, under the circumstances herein set forth.

The policy was issued as a single premium endowment policy payable as follows:

In monthly installments, 120 stipulated, as provided in option 1 herein, to B, the insured's wife, if living, otherwise the whole or the commuted value of any unpaid installments to be paid in one sum to his children, C, D, E, and F, equally, or to the survivors or survivor of them, if living, otherwise in accordance with the optional methods of settlement.

The following indorsement appears on the face of the policy:

In the event of the death of the said B prior to maturity of the policy, the proceeds are to be payable to the insured at the end of the endowment period in monthly installments, 120 stipulated, as provided in option 1 herein, if living, otherwise the commuted value of any unpaid installments to be paid to the insured's children, C, D, E, and F, equally, or to the survivors or survivor of them, if living, otherwise in accordance with the optional methods of settlement.

During the year 1935 the policy matured and in that year the company began making monthly payments to A in accordance with the above-quoted indorsement. The question has been raised whether the amount of $11x$ dollars, which is the excess of the payments to become due in the future on the policy plus the dividend accumulation thereon over the premium paid, should be treated as taxable income to the insured in the year 1935 under the conclusions reached in I. T. 2380 (C. B. VI-2, 32 (1927)), issued under the Revenue Acts of 1924 and 1926 and relating to the method of determining income derived upon the maturity of certain endowment insurance policies where the insured survived the endowment period. That ruling, in effect, held that the settlements under the policies there involved resulted in the constructive receipt of the proceeds of the policies at the maturity dates and the reinvestment of such proceeds in accordance with the terms of settlement.

Prior to the enactment of the Revenue Act of 1934, amounts received under a life insurance endowment or annuity contract were excluded from gross income until the annuitant had received an aggregate amount of payments equal to the total amount paid for the annuity. (See section 22(b)2 of the Revenue Act of 1932 and the corresponding provisions of earlier Revenue Acts.) However, in the Revenue Act of 1934, section 22(b)2, Congress provided as follows with respect to annuities:

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

* * * * * * *

(2) *Annuities, etc.*—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 title or prior income tax laws in respect of such annuity equals the aggregate premiums or consideration paid for such annuity. * * *

Article 22(b)(2)-1, Regulations 86, promulgated under the Revenue Act of 1934, provides as follows:

Art. 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, and amounts received as annuities) 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.

Article 22(b)(2)-2 of Regulations 86 provides in part that:

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. If an annuity is payable in annual installments, there shall be included in gross income only such portion of the amounts received in any taxable year as is equal to 3 per cent of the aggregate premiums or consideration paid for such annuity, whether or not paid during such year. * * * 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.

The change in the law and regulations in regard to annuities, especially in specifying annuities under an endowment contract, appears to govern the present case. (See article 22(b)(2)-2, Regulations 86, supra.) In this case the policy matured as an endowment payable in 120 equal monthly installments. It is the opinion of this office that such installments are "received as an annuity under an * * * endowment contract" within the meaning of the statute. An annuity has been defined as a stated sum payable periodically at stated times during life, or a specified number of years, under an obligation to make the payments in consideration of a gross sum paid for such obligation, which gross sum is exhausted in the making of the periodic payments. (See generally Sol. Op. 160, C. B. III-2, 60 (1924), and cases cited therein; also Report No. 558, Senate Committee on Finance, relating to section 22(b)2 of the Revenue Act of 1934, C. B. 1939-1 (Part 2), 604.) The periodic payments to A in the present case meet this definition of an annuity.

Since section 22(b)2 of the Revenue Act of 1934 does not require the taxpayer to return for the year 1935 more than 3 per cent of the consideration paid for the annuity, there is no basis for the application of the principles of constructive receipt embodied in I. T. 2380, supra, which was promulgated under the Revenue Acts of 1924 and 1926. The law as changed in the Revenue Act of 1934 and subsequent Revenue Acts with respect to the taxation of annuities will not permit the general application of the constructive receipt theory embodied in I. T. 2380, supra. Accordingly, that ruling is not applicable to the present case arising under the Revenue Act of 1934.

It is the opinion of this office that article 22(b)(2)-2 of Regulations 86 is applicable to the instant case, and that the installments received under the annuity contract should be reported for Federal income tax purposes in accordance with the provisions of that article.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

SECTION 23(a).—DEDUCTIONS FROM GROSS INCOME: EXPENSES.

Article 23(a)-1: Business expenses. 1940-4-10149
(Also Section 23(b), Article 23(b)-1.) Ct. D. 1435

INCOME TAX—REVENUE ACT OF 1928—DECISION OF SUPREME COURT.

1. Gross Income—Deductions—Payments Made as Compensation for Loan of Stock—Ordinary Expenses—Interest on Indebtedness.

The taxpayer, beneficial owner of a substantial portion of the stock of the X Company, in 1929 borrowed from the Y Company a sufficient number of shares of stock of the X Company to discharge an obligation incurred by him in 1919, when he had borrowed from another corporation, under agreement to return in kind, such stock which he had sold to executives of the X Company in order that they might have a financial interest in the company; the taxpayer having agreed to make the sale to the executives because the company had been advised that it could not legally do so. Pursuant to agreement made when the 1929 loan was negotiated, the taxpayer in 1931 paid to the Y Company an amount equivalent to the dividends received from the X Company on the borrowed shares and the amount of Federal income taxes imposed upon the Y Company by reason of such payments. *Held:* That, in computing the taxpayer's net income for 1931, such payments were not deductible as ordinary expenses nor as interest on indebtedness under section 23 (a) or (b) of the Revenue Act of 1928.

2. Decision Reversed.

Decision of the United States Circuit Court of Appeals, Third Circuit (1939) (103 F. (2d), 257), reversing the judgment of the District Court of the United States, District of Delaware (1938) (22 F. Supp., 589), reversed.

Supreme Court of the United States.

Pearl E. Deputy and the Sussex Trust Co., a Corporation of the State of Delaware, as Administratrix and Administrator of the Estate of Willard P. Deputy, Deceased, Late Collector of Internal Revenue, petitioner, v. *Pierre S. du Pont.*

[60 S. Ct., 363.]

On writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[January 8, 1940.]

OPINION.

Mr. Justice Douglas delivered the opinion of the Court.

This case presents the question of whether respondent in computing his taxable net income for the year 1931 may deduct payments of $647,711.56 made by him in that year to the Delaware Realty & Investment Co. (hereinafter called the Delaware company). The deduction is sought either under section 23(a) of the Revenue Act of 1928 (45 Stat., 791) as "ordinary and necessary expenses paid or incurred during the taxable year in carrying on" the "trade or business" of respondent; or under section 23(b) as "interest paid or accrued within the taxable year on indebtedness." The Commissioner disallowed the deduction and determined a deficiency, which respondent paid and now seeks to recover. It is agreed that if the deduction is allowed, respondent is entitled to judgment for $172,351.64. The judgment of the district court against respondent (22 F. Supp., 589) was reversed by the circuit court of appeals (103 F. (2d), 257). We granted certiorari because of the asserted inconsistency of that ruling with *Welch* v. *Helvering* (290 U. S., 111 [Ct. D. 755, C. B. XII-2, 112 (1933)]), which construed the meaning of the words "ordinary and necessary expenses"; and with *Burnet* v. *Clark* (287 U. S., 410 [Ct. D. 620, C. B. XII-1, 175 (1933)]), which limited such deductions to losses directly connected with the taxpayer's business.

Respondent's claim to the deduction arose out of the following transactions, briefly summarized. Respondent was beneficial owner of about 16 per cent of the stock of E. I. du Pont de Nemours & Co. (hereinafter called the du Pont company). In 1919 the du Pont company constituted a new executive committee composed of nine young men. For business reasons, it thought it desirable that these men have a financial interest in the company. Alleged legal difficulties stood in the way of the du Pont company selling them the 9,000 shares desired.[1] Accordingly, respondent undertook to sell them 1,000 shares each. But since he did not have readily available that amount from his own holdings,[2] he borrowed 9,000 shares of the du Pont company from Christiana Securities Co.,[3] under an agreement whereby he agreed to return the stock loaned in kind within 10 years and in the interim to pay to the lender all dividends declared and paid on the shares so loaned.[4] Respondent thereupon sold the shares to the nine executives, the purchase price being furnished by the du Pont company.[5] In October, 1929, when the 10-year period was about to expire, respondent did not have available the number of shares which he was obligated to return to Christiana Securities Co.[6] Therefore, he arranged for a loan from the Delaware company of the number of shares necessary to discharge that obligation.[7] Under a contract with that company, respondent agreed to return in kind the number of shares loaned (plus any increase by stock dividend or otherwise)

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[1] As stated by the district court, counsel advised that the du Pont company could issue stock only for money paid, labor performed, or real or personal property acquired; and that if the stock were to be issued for cash, it must first be offered to existing stockholders. According to the findings the du Pont company did not have 9,000 shares of its stock, other than unissued stock; that stock was not then listed on the New York Stock Exchange; and the over-the-counter market was quite inactive. Nine thousand shares could not have been purchased on this market without substantially raising the price per share.

[2] Respondent had available only 74 shares. He had a reversionary interest in two trusts which held 24,000 shares. And he was the owner of 29,125 shares of common stock of Christiana Securities Co. out of a total of 75,000 shares issued and outstanding. That company was then the owner of 183,000 shares of common stock of the du Pont company out of a total of 588,542 shares issued and outstanding.

[3] Supra, note 2.

[4] As security respondent gave Christiana Securities Co. 3,800 shares of its capital stock. All dividends on that stock were to be paid to respondent.

[5] These sales were made at the price of $320 a share, that being approximately their book value. The du Pont company loaned to each of the nine executives the necessary funds to purchase his 1,000 shares. They paid respondent $2,880,000 in cash for the 9,000 shares. According to respondent's brief, he turned over this sum through transactions in General Motors stock which ultimately yielded him a great profit. (See *du Pont* v. *Commissioner*, 37 B. T. A., 1198.)

By March, 1921, the stock of the du Pont company had declined in value and the bargain made by the executives had become a disadvantageous one. Respondent thereupon offered to turn over 400 shares of the Christiana Securities Co. (of a net value of $160,000) to be held by the du Pont company as additional collateral on the loan made to these executives, respondent to have the right to redeem those 400 shares by payment of $160,000 on maturity of the loan, that payment, if made, to be applied to the loan. If respondent failed to redeem those shares, they were to become the property of the executives on payment of their loans. Meanwhile dividends on the 400 shares up to $8,000 per annum were to go to the executives, the balance to respondent who was, however, to return his portion to the executives if he did not redeem the stock. This offer was accepted by the executives. Respondent when he proposed it, stated that he did so "as a large stockholder, and, perhaps, the one to be most benefited by the recovery in value of the company's shares." He also stated that he wanted the executives to be "free of worry over the unexpended outcome" of the stock purchase plan.

[6] Due to stock dividends and split-ups respondent was obligated to return to Christiana Securities Co. 142,212 shares to replace the 9,000 shares which he had borrowed.

[7] Respondent was not a stockholder of the Delaware company, although it appears that his brother was one of its executive officers.

within 10 years; to pay to the Delaware company an amount equivalent to all dividends declared and paid on the borrowed shares until returned; and to reimburse the Delaware company for all taxes accruing against it by reason of the agreement.

Pursuant to that agreement respondent paid the Delaware company in 1931, the sum of $567,648, being an amount equivalent to the dividends received by him during that period from the du Pont company on the borrowed shares; and the sum of $80,063.56, being the amount of the Federal income tax imposed upon the lender by reason of the foregoing payments which it had received from respondent. These are the expenditures claimed as a deduction in the present suit.

The district court concluded, on the basis of respondent's large and diversified investment holdings and his wide financial and business interests, that his business was primarily that of conserving and enhancing his estate. The petitioners challenge that conclusion, asserting that respondent's activities in connection with conserving and enhancing his estate did not constitute a "trade or business" within the meaning of section 23(a) of the Act.

But as we view the case it is unnecessary for us to pass on that contention and to make the delicate dissection of administrative practice which that would entail. For we are of the opinion that the deductions are not permitted either within the rule of *Burnet* v. *Clark* or *Welch* v. *Helvering*, supra, even though we were to assume that the activities of respondent constituted a business, as found by the district court.

There is no intimation in the record that the transactions whereby the stock was borrowed were not in good faith or were entered into for any reason except a *bona fide* business purpose. Nor is there any suggestion that the transactions were cast in that form for purposes of tax avoidance. And it is true that as respects the dividends received by respondent and paid over to the Delaware company, he was little more than a conduit. But allowance of deductions from gross income does not turn on general equitable considerations. It "depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed." (*New Colonial Ice Co., Inc.*, v. *Helvering*, 292 U. S., 435, 440 [Ct. D. 841, C. B. XIII-1, 194 (1934)].) And when it comes to construction of the statutory provision under which the deduction is sought, the general rule that "popular or received import of words furnishes the general rule for the interpretation of public laws," *Maillard* v. *Lawrence* (16 How., 251, 261), is applicable.

By those standards the claimed deduction falls for two reasons. In the first place, the payments in question do not meet the test enunciated in *Kornhauser* v. *United States* (276 U. S., 145 [T. D. 4222, C. B. VII-2, 267 (1928)]). since they proximately result not from the taxpayer's business but from the business of the du Pont company. The original transactions had their origin in an effort by that company to increase the efficiency of its management by selling its stock to certain of its key executives. The respondent undertook to furnish the necessary stock only after the company had been advised that it could not legally do so. In that posture of the case these payments are no more deductible than were the payments made by the stockholder in *Burnet* v. *Clark*, supra, as a result of his indorsements of the obligations of his corporation. Those payments were disallowed as deductions from his gross income though they arose out of transactions which were intended to preserve his investment in the corporation. Similar payments were disallowed in *Dalton* v. *Bowers* (287 U. S., 404). Hence, the fact that the transaction out of which the carrying charges here in question arose might benefit respondent does not bring it within the ambit of his alleged business of conserving and enhancing his estate. The well established decisions of this Court do not permit any such blending of the corporation's business with the business of its stockholders. Accordingly, the payments made under the 1919 agreement would certainly not be deductible. And the fact that a new and different arrangement was made in 1929 with the Delaware company does not alter the conclusion, for it is the origin of the liability out of which the expense accrues which is material. Otherwise carrying charges on any short sale whether or not related to the business of the taxpayer would be allowable as deductible expenses. That can not be if the notion of proximate result implicit in the statutory words "expenses paid or incurred * * * in carrying on any trade or business" is to have any vitality.

In the second place, these payments were not "ordinary" ones for the conduct of the kind of business in which, we assume *arguendo*, respondent was engaged. The district court held that they were "beyond the norm of general and accepted business practice" and were in fact "so extraordinary as to occur in the lives of ordinary business men not at all" and in the life of the respondent "but once."[8] Certainly there are no norms of conduct to which we have been referred or of which we are cognizant which would bring these payments within the meaning of ordinary expenses for conserving and enhancing an estate. We do not doubt the correctness of the district court's finding that respondent embarked on this program to the end that his beneficial stock ownership in the du Pont company might be conserved and enhanced. But that does not make the cost to him an "ordinary" expense within the meaning of the Act. Ordinary has the connotation of normal, usual, or customary. To be sure, an expense may be ordinary though it happen but once in the taxpayer's lifetime. (Cf. *Kornhauser* v. *United States*, supra.) Yet the transaction which gives rise to it must be of common or frequent occurrence in the type of business involved. (*Welch* v. *Helvering*, supra, 114.) Hence, the fact that a particular expense would be an ordinary or common one in the course of one business and so deductible under section 23(a) does not necessarily make it such in connection with another business. Thus, it has been held that one who was an active trader in securities might take as deductions carrying charges on short sales since selling short was common in that business.[9] But the carrying charges on respondent's short sale in this case can not be accorded the same privilege under section 23(a). The record does not show that respondent was in the business of trading in securities. Nor does it show that a stockholder engaged in conserving and enhancing his estate ordinarily makes short sales or similarly assists his corporation in financing stock purchase plans for the benefit of its executives. As stated in *Welch* v. *Helvering*, supra, pages 113-114; "* * *. What is ordinary, though there must always be a strain of constancy within it, is none the less a variable affected by time and place and circumstance." One of the extremely relevant circumstances is the nature and scope of the particular business out of which the expense in question accrued. The fact that an obligation to pay has arisen is not sufficient. It is the kind of transaction out of which the obligation arose and its normalcy in the particular business which are crucial and controlling.

Review of the many decided cases is of little aid since each turns on its special facts. But the principle is clear. And on application of that principle to these facts, it seems evident that the payments in question can not be placed in the category of those items of expense which a conservator of an estate, a custodian of a portfolio, a supervisor of a group of investments, a manager of wide financial and business interests, or a substantial stockholder in a corporation engaged in conserving and enhancing his estate would ordinarily incur. We can not assume that they are embraced within the normal overhead or operating costs of such activities. There is no evidence that stockholders or investors, in furtherance of enhancing and conserving their estates, ordinarily or frequently lend such assistance to employee stock purchase plans of their corporations. And in absence of such evidence there is no basis for an assumption, in experience or common knowledge, that these payments are to be placed in the same category as typically ordinary expenses of such activities, e. g., rental of safe deposit boxes, cost of investment counsel or of investment services, salaries of secretaries and the like. Rather these payments seem to us to represent most extraordinary expenses for that type of activity. Therefore, the claim for deduction falls, as did the claim of an officer of a corporation who paid its debts to strengthen his own standing and credit. (*Welch* v. *Helvering*, supra.) And the fact that the payments might have been necessary in the sense that consummation of the transaction with the Delaware company was beneficial to respondent's estate is of no aid. For Congress has not decreed

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[8] 22 F. Supp., 589, 597.

[9] *Dart* v. *Commissioner* (74 F. (2d), 845). Cf. *Terbell* v. *Commissioner* (29 B. T. A., 44, aff'd 71 F. (2d), 1017), where such carrying charges were disallowed as deductions. The Board of Tax Appeals said, page 45, "We have only the stipulated facts and there is no suggestion in those facts that the decedent was engaged in the business of making short sales or in dealing in securities generally."

that all necessary expenses may be deducted. Though plainly necessary they can not be allowed unless they are also ordinary. (*Welch* v. *Helvering*, supra.)

We conclude then on this phase of the case that as the district court, on a correct interpretation of the Act, found that these payments did not proximately result from, and were not ordinary expenses for the conduct of, respondent's alleged business, it was error for the circuit court of appeals to reverse the judgment for petitioners. (*McCaughn* v. *Real Estate Land Title & Trust Co.*, 297 U. S., 606.)

There remains respondent's contention that these payments are deductible under section 23(b) as "interest paid or accrued * * * on indebtedness." Clearly respondent owed an obligation to the Delaware company. But although an indebtedness is an obligation, an obligation is not necessarily an "indebtedness" within the meaning of section 23(b). Nor are all carrying charges "interest." In *Old Colony Railroad Co.* v. *Commissioner* (284 U. S., 552 [Ct. D. 456, C. B. XI-1, 274 (1932)]) this Court had before it the meaning of the word "interest" as used in the comparable provision of the 1921 Act (42 Stat., 227). It said, page 560, "* * * as respects 'interest,' the usual import of the term is the amount which one has contracted to pay for the use of borrowed money." It there rejected the contention that it meant "effective interest" within the theory of accounting or that "Congress used the word having in mind any concept other than the usual, ordinary and everyday meaning of the term." (Page 561.) It refused to assume that the Congress used the term with reference to "some esoteric concept derived from subtle and theoretic analysis." (Page 561.)

We likewise refuse to make that assumption here. It is not enough, as urged by respondent, that "interest" or "indebtedness" in their original classical context may have permitted this broader meaning.[10] We are dealing with the context of a Revenue Act and words which have to-day a well-known meaning. In the business world "interest on indebtedness" means compensation for the use or forbearance of money.[11] In absence of clear evidence to the contrary, we assume that Congress has used these words in that sense. In sum, we can not sacrifice the "plain, obvious and rational meaning" of the statute even for "the exigency of a hard case." (See *Lynch* v. *Alworth-Stephens Co.*, 267 U. S., 364, 370 [T. D. 3690, C. B. IV-1, 162 (1925)].)

Petitioners throughout have referred to these payments by respondent as being capital in nature. (Cf. *Bonwit Teller & Co.* v. *Commissioner*, 53 F. (2d), 381; *Hutton* v. *Commissioner*, 39 F. (2d), 459 [Ct. D. 249, C. B. IX-2, 353 (1930)]; *Bing* v. *Helvering*, 76 F. (2d), 941.) What appropriate treatment may be accorded these items of cost under other provisions of the Act we do not undertake to say, as that issue is not here.

The judgment of the circuit court of appeals is reversed and that of the district court is affirmed.

It is so ordered.

SECTION 23(b).—DEDUCTIONS FROM GROSS INCOME: INTEREST.

Article 23(b)-1: Interest.

REVENUE ACT OF 1928.

Payments made as compensation for loan of stock. (See Ct. D. 1435, page 118.)

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[10] Respondent refers to the *mutuum* in Roman law. Ledlie's Sohm's Institutes of Roman Law (2d. ed.), page 395; Hare, The Law of Contracts, page 73.

[11] This makes irrelevant other lines of authority cited by respondent where "interest" in a different context has been used to describe damages or compensation for the detention or use of money or of property. See *United States* v. *North Carolina* (136 U. S., 211, 216); New York General Business Law, section 370, which provides, "The rate of interest upon the loan or forbearance of any money, goods, or things, in action * * * shall be six dollars upon one hundred dollars, for one year. * * *."

SECTION 23(c).—DEDUCTIONS FROM GROSS INCOME: TAXES GENERALLY.

ARTICLE 23(c)-1: Taxes.

1940-26-10302
G. C. M. 22113

REVENUE ACT OF 1934.

Deductibility of New Jersey real property taxes where a conveyance is made after the annual assessment of such taxes.

An opinion is requested as to the extent of the application of the decision of the Circuit Court of Appeals for the Third Circuit in *Commissioner* v. *Minnie M. Coward* (110 F. (2d), 725, Ct. D. 1458 [below]), relating to the deduction for Federal income tax purposes of New Jersey real property taxes in cases where there is a conveyance of realty subsequent to the annual assessment of such taxes.

The court in the Coward case held that as between grantor and grantee in such cases there should be an apportioned deduction for Federal income tax purposes under section 23(c) of the Revenue Act of 1934. It held that the purchaser of realty in New Jersey is entitled to deduct that proportion of the taxes for the entire calendar year which the length of time he owned the property during such year bears to the entire calendar year, even though assessment therefor had been made while the seller held the property.

Since the conclusion reached by the court in the Coward case is based upon statutes peculiar to New Jersey, the application of that decision will be confined to cases involving New Jersey real property taxes. The Bureau position relating to the general question of accrual of such taxes, set forth in G. C. M. 15305 (C. B. XIV-2, 80 (1935)), is not disturbed by the decision in the Coward case, since the court's ruling is applicable only where there has been a conveyance of the assessed realty.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

ARTICLE 23(c)-1: Taxes.

1940-26-10303
Ct. D. 1458

INCOME TAX—REVENUE ACT OF 1934—DECISION OF COURT.

DEDUCTION—TAXES PAID OR ACCRUED WITHIN TAXABLE YEAR—TAXES ON REAL ESTATE—NEW JERSEY LAW.

A taxpayer who paid 1934 real estate taxes to the State of New Jersey on properties acquired on October 16, 1933, and January 8, 1934, is entitled, under section 23(c) of the Revenue Act of 1934, to a deduction from gross income in the amount of taxes so paid, except as to eight three hundred and sixty-fifths of the tax paid on the property acquired on January 8, 1934, such fractional part not being deductible in view of the local law which provided, as to themselves alone, for apportionment of taxes between seller and buyer on the basis of the time property was held by each during the calendar year. Although under the local law real estate taxes are assessed on October 1 of each year to the owner thereof with reference to the amount then owned, such taxes constitute a liability in rem the preexistence of which does not deprive a purchaser who later discharges it of the benefit of a deduction for Federal income tax purposes.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

Commissioner of Internal Revenue, petitioner, v. *Minnie M. Coward, respondent.*
[110 F. (2d), 725.]

Petition for review from the United States Board of Tax Appeals.

Before BIGGS, CLARK, and JONES, Circuit Judges.

[February 23, 1940.]

OPINION.

CLARK, Circuit Judge: The controversy at bar centers about the long standing provision for the deduction from gross income of "taxes paid or accrued within the taxable year" (26 U. S. C. A., section 23(c)). The enactment is simple: its application is, in our circumstance, anything but simple. We must struggle first, with the perplexing intricacies of the New Jersey scheme of real estate taxation, and second, in order to appraise the pertinent Federal decisions with the equally perplexing diversities existing between that and other local tax systems. (See Paul, The Effect on Federal Taxation of Local Rules of Property, Selected Studies in Federal Taxation, 1, 23-24.)

On October 1 of each year all property in the State of New Jersey is "assessed to the owner thereof with reference to the amount" then owned.[1] In the year 1933, that property included two parcels of improved income producing real estate owned by one X. But within a few months respondent had acquired (presumably by purchase) these parcels from X, one on October 16, 1933, the other on January 8, 1934. Then on January 10, 1934, the list of assessments which had been in the course of preparation since the 1st of October previous was filed with the county board of taxation.[2] Thereupon the board considered the revision of assessments[3] and the amount of revenue to be raised during the current year (1934) for school,[4] State,[4] and local,[5] purposes. It fixed the local tax rate on March 10, 1934,[6] and by April 1, 1934, a revised and corrected duplicate list of assessments certified as a true (and public) record of the taxes assessed was delivered to the collector.[7] Meanwhile however, and on February 1, 1934, the first installment of the 1934 taxes had become payable (the amount being estimated with reference to the taxes for the previous year).[8] The second installment (likewise estimated) became payable on May 1, 1934, and the third and fourth (adjusted to the estimates so as to total the by then determined amount of the 1934 tax) on August and November 1, 1934, respectively.[8] Respondent paid each installment of the 1934 tax on her properties without delay. If she had not done so, a lien for them would have attached on December 1, 1934.[9]

From this welter of chronology, the Commissioner deduces that respondent, who keeps her books on the cash basis, is not entitled to deduct from her gross income for 1934 the real estate taxes paid by her in 1934. As he reasons, the sums paid were not taxes at all, but, rather part of the cost of the two parcels. The argument is founded on precedent rather than principle, and proceeds syllogistically as follows. Major premise: one who purchases real estate upon which local taxes have *accrued* may not deduct the later payment of those taxes as "taxes paid." Minor premise: New Jersey real estate taxes had already *accrued* (at the date of assessment, October 1, 1933) on respondent's properties by the time she acquired them (October 16, 1933, January 8, 1934). Conclusion: Respondent is not entitled to her deduction.

The Board denies the minor premise and hence reaches an opposite conclusion. Yet in doing so it does not look behind the misleading terminology of accrual employed in both premises. As a consequence all concerned succumb to the influence of a line of cases which, we think, are completely beside the

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[1] 2 Cum. Supp. (1924) Comp. Stat., section 208-66d (202).
[2] 2 Cum. Supp. (1924) Comp. Stat., section 208-66d (501).
[3] 2 Cum. Supp. (1924) Comp. Stat., section 208-66d (507).
[4] 2 Cum. Supp. (1924) Comp. Stat., section 208-66d (503).
[5] 2 Cum. Supp. (1924) Comp. Stat., section 208-66d (504).
[6] 2 Cum. Supp. (1924) Comp. Stat., section 208-66d (508).
[7] Cum. Supp. (1924) Comp. Stat., section 208-66d (509).
[8] P. L. 1933, ch. 266, 716.
[9] 2 Cum. Supp. (1924) Comp. Stat., section 208, 44a (6).

point. These have to do with the interpretation of the word "accrued." That interpretation, as is expressly provided by statute (26 U. S. C. A., 48), lies in the field of accountancy on the accrual basis. The decisions are accordingly directed to the particular point of time when accounts payable (including taxes) may be listed on the taxpayer's books offsetting accounts receivable so as to fairly reflect the taxpayer's net income. (See *United States* v. *Anderson*, 269 U. S., 422 [T. D. 3829, C. B. V-1, 179 (1926)]; 3 Paul & Mertens, Law of Federal Income Taxation 23, 33.) Here, on the other hand, the word under construction is "taxes" not "accrued." We must determine whether a given payment is a forced contribution to the expense of government, or whether it is something else—a voluntary capital expenditure, for example. Its solution must lie in a close analysis of the transaction of payment. It can not, in our judgment, be solved by any rule of thumb that a property owner's payment is not one of a tax on his property because a prior owner (on the accrual basis) might have been permitted to accrue it. For that permission to accrue may depend on technical exigencies of accounting utterly foreign to the later owner's economic position in actually making the payment. That being so, our decision may be neither framed within the Commissioner's syllogism, nor guided by the accrual basis cases.

Turning then, to the decisions which have actually come to grips with the problem at bar, we find them suggesting two and only two types of transactions where real estate taxes are not "taxes" within the meaning of the statute. In the first, property is sold and the buyer promises the seller to pay certain taxes on the property. There, by express contract, the payment of taxes is part of the consideration for the sale, and not a payment qua taxes. (*Falk Corporation* v. *Commissioner*, 60 F. (2d), 204 (C. C. A. 7).) It is also possible that such a contract might be implied in fact if the seller were personally liable for the tax, for it would be difficult otherwise to account for the buyer's munificence in paying it. (See *Walsh McGuire Co.* v. *Commissioner*, 97 F. (2d), 983 (C. C. A. 6).) The second transaction is the purchase of property to which a tax lien has attached. That property has in a sense two owners, the seller, and, through the lien, the State. Hence its full acquisition entails two payments, the nominal purchase price, and the taxes represented by the lien. Both have been treated alike as capital expenditures.[10] Where, on the other hand, the tax payment falls into neither of these two categories—where it neither discharges (by contract, express or implied) the personal liability of another, nor what was originally a tax lien on another's property—the deduction has been permitted. (*Commissioner* v. *Plestscheeff*, 100 F. (2d), 62 (C. C. A. 6) [Ct. D. 1410, C. B. 1939-2, 200].)

Tested by these authorities, respondent's payment to the New Jersey tax collector in 1934 is clearly one of "taxes." There is no indication of any express contract for their payment, Mr. X, from whom she purchased, was not personally liable for them,[11] and the property was not subject to any lien for them when she acquired it—indeed no such lien was possible until a year or so after title passed to her (see *Empress Mfg. Co.* v. *Newark*, 109 N. J. L., 131, 133, 160 A., 388, 389). Those authorities, however, do not deal with the New Jersey tax system and are not in strictness, applicable for it. It is necessary, then, to consider the effect of one of the features of that system which is not stressed in the cases arising from other States.

Respondent's two parcels were, in theory, already "liable" for the 1934 taxes when she purchased them. That is to say, nothing which occurred after the assessment of October 1, 1933, could alter the fact that the land itself must ultimately yield those taxes either directly through the eventual foreclosure of a tax lien, or indirectly through the medium of its then or subsequent owner's pocketbook. If, for instance, the land assumed a tax exempt status on October 2, 1933, it would, nevertheless, bear its full share of 1934 tax.[12] The presence of

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[10] *Lifson* v. *Commissioner* (98 F. (2d), 508 (C. C. A. 8), certiorari denied, 305 U. S., 662, rehearing denied, 306 U. S., 618 [Ct. D. 1409, C. B. 1939-2, 198]); *Helvering* v. *Missouri State Life Ins. Co.* (78 F. (2d), 778, 781 (C. C. A. 8)); *Walsh McGuire Co.* v. *Commissioner* (97 F. (2d), 983 (C. C. A. 6)), above cited; *Merchants Bank Bldg. Co.* v. *Helvering* (84 F. (2d), 478 (C. C. A. 8) [Ct. D. 1189, C. B. 1937-1, 189]).

[11] *Boyd* v. *Brown* (115 N. J. L., 611, 181 A., 142); *Bea* v. *Turner* (115 N. J. Eq., 189, 169 A., 832); *Borough of Wrightstown* v. *Salvation Army* (97 N. J. L., 89, 123 A., 607) and cases cited.

[12] *Jersey City* v. *Montville Township* (84 N. J. L., 43, 85 A., 838), affirmed 85 N. J. L., 372 91 A., 1069); *United States* v. *Mayor and Council of Hoboken, N. J.* (29 F. (2d), 932, 940); and see, *Young Men's Christian Association* v. *Orange* (3 N. J. Misc., 404, 128 A., 580); *Longport* v. *Bamberger Seashore Home* (91 N. J. L., 330, 102 A., 633), *Institute of Holy Angels* v. *Fort Lee* (80 N. J. L., 545, 77 A., 1035).

this liability in rem may well afford a basis for "accruing" the tax in the accounting sense.[13] But does its preexistence deprive the purchaser who later discharges it of his income tax deduction?

We think not. A New Jersey statute provides that in the absence of an express agreement to the contrary the buyer of real estate may hold the seller liable for such proportion of the current year's taxes as the time between January 1 and the date of the deed bears to the full calendar year (2 Cum. Supp. (1929) Comp. Stat., section 203–C6d (514)). This statute does not affect the lien for unpaid taxes—the crystallization of the land's liability in rem. So the fact that the property has been assessed prior to sale, does not in the eyes of the New Jersey Legislature, mean that the tax resulting from that assessment is to be borne by the seller. It is always borne by the land in the first instance. But as between buyer and seller it is apportioned on the basis of the calendar year. In other words, it is considered fair that the owner of land in any given year shall be called upon to contribute to the year's revenues only a sum commensurate with the length of time the land has been held in that year—except of course, in the rare case of the prior owner's insolvency. Such a contribution is, in our judgment, a tax in every sense of the word. And that, with the exception of eight three hundred sixty-fifths of the tax on the parcel acquired on January 8, 1934, is what respondent paid here.

We may say that any other conclusion tends to work a hardship on the taxpayer hardly contemplated by the broad language of the statute. In this class of cases too great an insistence upon assessment—or, indeed, upon the lien when it relates back to the time of assessment, will often lead to puzzling anomalies. If all the property in one State were to change hands immediately after assessment, taxes levied on that assessment would, presumably, be paid by the new owners. The taxes so collected would be used by the State to defray the expenses of government. Yet should none of the inhabitants of that State be permitted a Federal income tax deduction for "taxes paid"? Finally, we observe that respondent's taxable income for 1934 was for the most part derived from her real estate. With the exception, again, of eight three hundred sixty-fifths of the tax on the parcel acquired January 8, 1934—that parcel yielded respondent no income for the first eight days of the tax year—one can not imagine a clearer economic case for the deduction.

As indicated by our reasoning, however, respondent should not be permitted to deduct a small fraction (eight three hundred sixty-fifths) of the tax on one of her holdings. Indeed for aught that appears in the record she could proceed under the New Jersey apportionment statute and recover that sum. It follows that a slight error was committed in allowing respondent to deduct the full amount claimed in her return "for taxes." The cause is accordingly remanded to the Board of Tax Appeals for further proceedings in conformity with the views expressed in this opinion.

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[13] A General Counsel's memorandum so holds, saying:

"* * * the Bureau has never taken the position that in so far as the accrual of real property taxes is concerned the owner must be personally liable for such taxes.

* * * * * * *

"In the normal course of events the owner of real property in New Jersey on October 1 of any given year will pay the taxes levied as of that date. This is sufficient for the purpose of accrual." (G. C. M. 15305, C. B. XIV–2 (1935), 80–83.)

This ruling is not in harmony with the theory, generally announced, that real estate taxes "accrue" in the absence of personal liability at the time the tax lien takes effect (see *Schimmel* v. *Commissioner*, 39 B. T. A., 989, 993, and cases there cited (income tax), *Thomson et al.* v. *United States*, 8 F. (2d), 175 (estate tax), *Clairborne* v. *Commissioner*, 40 B. T. A., 721, 732 (estate tax), *Peoples Water & Gas Co.* v. *City of Vancouver*, 106 F. (2d), 909 (C. C. A. 9) ("accrued" used in contract)). Unlike many jurisdictions, however, the attachment of the tax lien occurs in New Jersey as the last rather than the first step in the tax cycle. Since there is no use accruing taxes which are already delinquent, the General Counsel's failure to follow the general theory is readily understandable. His position, on the other hand, is open to the practical objection that no New Jersey taxpayer knows what amount to accrue between October 1 (date of assessment) and December 31 (the end of the Federal tax year) (Ellis, Deductions for Accrued Taxes, 14 Tax Mag., 1471). But if the accrual date is shifted back to the time the amount of tax has been fixed, two installments will have already become delinquent. We recite this dilemma in order to reemphasize the divergence in approach and principle between the accrual basis cases and the case at bar.

SECTION 23(e).—DEDUCTIONS FROM GROSS INCOME: LOSSES BY INDIVIDUALS.

ARTICLE 23(e)-1: Losses by individuals.

1940-4-10150
Ct. D. 1434

INCOME TAX—REVENUE ACT OF 1932—DECISION OF SUPREME COURT.

1. GROSS INCOME—DEDUCTION—LOSS ON SALE OF STOCK BY INDIVIDUAL TO WHOLLY OWNED CORPORATION.

A taxpayer, wholly owning a corporation and directing its transactions which were restricted largely to operations in buying securities from or selling them to the taxpayer, is not entitled, under section 23(e) of the Revenue Act of 1932, to deduct a loss arising in 1932 from the sale of securities to the corporation at a price less than their cost to him.

2. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Second Circuit (1939) (102 F. (2d), 456), reversed.

SUPREME COURT OF THE UNITED STATES.

Joseph T. Higgins, Collector of Internal Revenue for the Third District of New York, petitioner, v. John Thomas Smith.

[60 S. Ct., 355.]

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[January 8, 1940.]

OPINION.

Mr. Justice REED delivered the opinion of the Court.

Certiorari was allowed[1] from the judgment of the Circuit Court of Appeals for the Second Circuit[2] on account of an asserted conflict between the decision below and that of the Circuit Court of Appeals for the Seventh Circuit in *Commissioner* v. *Griffiths.*[3]

The issue considered here is whether a taxpayer under the circumstances of this case is entitled to deduct a loss arising from the sale of securities to a corporation wholly owned by the taxpayer. The statute involved is section 23(e) of the Revenue Act of 1932.[4]

The Innisfail Corporation was wholly owned by the taxpayer, Mr. Smith. It was organized in 1926 under the laws of New Jersey. The officers and directors of the corporation were subordinates of the taxpayer. Its transactions were carried on under his direction and were restricted largely to operations in buying securities from or selling them to the taxpayer. While its accounts were kept completely separate from those of the taxpayer, there is no doubt that Innisfail was his corporate self. As dealings by a corporation offered opportunities for income and estate tax savings, Innisfail was created to gain these advantages for its stockholder. One of its first acts was to take over an option belonging to the taxpayer for the acquisition by exchange

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[1] 308 U. S., —.
[2] 102 F. (2d), 456.
[3] 103 F. (2d), 110, affirmed *sub nom. Griffiths* v. *Commissioner* (308 U. S., —), No. 49, October term 1939, decided December 18, 1939.
[4] 47 Stat., 169, 179–180:
"SEC. 23. DEDUCTIONS FROM GROSS INCOME.
"In computing net income there shall be allowed as deductions:
* * * * * * *
"(e) *Losses by individuals.*—Subject to the limitations provided in subsection (r) of this section, 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; * * *."

of a block of Chrysler common stock. Through mutual transactions in buying and selling securities, and receiving dividends, the balance of accounts between Innisfail and the taxpayer resulted, on December 29, 1932, in an indebtedness from him to Innisfail of nearly $70,000. On that date, as a partial payment on this indebtedness, a number of shares of stock were sold to the corporation by the taxpayer at market. The securities sold had cost the taxpayer more than the price charged to the corporation, and in carrying out the transaction the taxpayer had in mind the tax consequences to himself.

In computing his net taxable income for 1932, the taxpayer deducted as a loss the difference between the cost of these securities and their sale price to his wholly owned corporation. The Commissioner of Internal Revenue ruled against the claim, whereupon respondent paid the tax and brought this suit for refund in the United States District Court for the Southern District of New York. The case was tried before a jury and the verdict was adverse to the taxpayer's claim that the purported sales of these securities to Innisfail marked the realization of loss on their purchase. On appeal the judgment was reversed and the case remanded to the district court for a new trial. It was the opinion of the court of appeals that the facts as detailed above, as a matter of law, established the transfer of the securities to Innisfail as an event determining loss.

Under section 23(e) deductions are permitted for losses "sustained during the taxable year." The loss is sustained when realized by a completed transaction determining its amount.[5] In this case the jury was instructed to find whether these sales by the taxpayer to Innisfail were actual transfers of property "out of Mr. Smith and into something that existed separate and apart from him" or whether they were to be regarded as simply "a transfer by Mr. Smith's left hand, being his individual hand, into his right hand, being his corporate hand, so that in truth and fact there was no transfer at all." The jury agreed the latter situation existed. There was sufficient evidence of the taxpayer's continued domination and control of the securities, through stock ownership in the Innisfail Corporation, to support this verdict, even though ownership in the securities had passed to the corporation in which the taxpayer was the sole stockholder. Indeed this domination and control is so obvious in a wholly owned corporation as to require a peremptory instruction that no loss in the statutory sense could occur upon a sale by a taxpayer to such an entity.

It is clear an actual corporation existed. Numerous transactions were carried on by it over a period of years. It paid taxes, State and National, franchise and income. But the existence of an actual corporation is only one incident necessary to complete an actual sale to it under the Revenue Act. Title, we shall assume, passed to Innisfail but the taxpayer retained the control. Through the corporate forms he might manipulate as he chose the exercise of shareholder's rights in the various corporations, issuers of the securities, and command the disposition of the securities themselves. There is not enough of substance in such a sale finally to determine a loss.

The Government urges that the principle underlying *Gregory* v. *Helvering*[6] finds expression in the rule calling for a realistic approach to tax situations. As so broad and unchallenged a principle furnishes only a general direction, it is of little value in the solution of tax problems. If, on the other hand, the Gregory case is viewed as a precedent for the disregard of a transfer of assets without a business purpose but solely to reduce tax liability, it gives support to the natural conclusion that transactions, which do not vary control or change the flow of economic benefits, are to be dismissed from consideration. There is no illusion about the payment of a tax exaction. Each tax, according to a legislative plan, raises funds to carry on government. The purpose here is to tax earnings and profits less expenses and losses. If one or the other factor in any calculation is unreal, it distorts the liability of the particular taxpayer to the detriment or advantage of the entire taxpaying group.[7]

The taxpayer cites *Burnet* v. *Commonwealth Improvement Co.*[8] as a precedent for treating the taxpayer and his solely owned corporation as separate entities.

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[5] *Burnett* v. *Huff* (288 U. S., 156, 161).
[6] 293 U. S., 465 [Ct. D. 911, C. B. XIV-1, 193 (1935)].
[7] Cf. *Stone* v. *White* (301 U. S., 532, 537 [Ct. D. 1232, C. B. 1937-1, 224]).
[8] 287 U. S., 415 [Ct. D. 622, C. B. XII-1, 277 (1933)].

In that case the corporation sold stock to the sole stockholder, the estate of P. A. B. Widener. The transaction showed a book profit and the corporation sought a ruling that a sale to its sole stockholder could not result in a taxable profit. This Court concluded otherwise and held the identity of corporation and taxpayer distinct for purposes of taxation.[9] In the Commonwealth Improvement Co. case, the taxpayer, for reasons satisfactory to itself voluntarily had chosen to employ the corporation in its operations. A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax disadvantages.[10]

On the other hand, the Government may not be required to acquiesce in the taxpayer's election of that form for doing business which is most advantageous to him. The Government may look at actualities and upon determination that the form employed for doing business or carrying out the challenged tax event is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute. To hold otherwise would permit the schemes of taxpayers to supersede legislation in the determination of the time and manner of taxation. It is command of income and its benefits which marks the real owner of property.[11]

Such a conclusion, urges the respondent, is inconsistent with the prior interpretations of the income tax laws and consequently unfair to him. He points to the decisions of four courts of appeals which have held losses determined by sales to controlled corporations allowable[12] and further calls attention to the fact that the Board of Tax Appeals has consistently reached the same conclusion.[13] But this judicial and administrative construction has no significance for the respondent. The Bureau of Internal Revenue has insistently urged since February 18, 1930, the date of the Board of Tax Appeals' decision in *Jones* v. *Helvering*,[14] that a transfer from a taxpayer to a controlled corporation was ineffective to close a transaction for the determination of loss. Every case cited by respondent in the courts of appeals and before the Board of Tax Appeals found the Government supporting that contention. The Board's ruling in the Jones case was standing unreversed at the time of the transaction here involved, December 29, 1932. It was only after the transactions here involved and after the reversal of the Board in the Jones case on April 23, 1934, or this Court's refusal of certiorari on October 8, 1934, that the Board of Tax Appeals and the courts of appeals, over Government protests, ruled in line with the opinion of the Court of Appeals of the District of Columbia in the Jones case. If the Bureau's stand in the Jones case represented a change in administrative practice, there can be no doubt that the change operated validly at least from 1930 on.[15] After the Jones defeat the Government sought relief in Congress and after the judgment in *Commissioner* v. *Griffiths*, supra, certiorari here on a conflict in principle between circuits. Certainly there was no acquiescence by the Government which would justify the taxpayer in relying upon prior interpretations of the law.[16]

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[9] See also *Klein* v. *Board of Supervisors* (282 U. S., 19); *Dalton* v. *Bowers* (287 U. S., 404); *Burnet* v. *Clark* (287 U. S., 410 [Ct. D. 620, C. B. XII-1, 175 (1933)]).

[10] Cf. *Edwards* v. *Chile Copper Co.* (270 U. S., 452, 456 [T. D. 3857, C. B. V-1, 410 (1926)]).

[11] *Lucas* v. *Earl* (281 U. S., 111); *Corliss* v. *Bowers* (281 U. S., 376 [Ct. D. 188, C. B. IX-1, 254 (1930)]); *Griffiths* v. *Commissioner* (308 U. S., —, No. 49, October term 1939, decided December 18, 1939).

[12] *Jones* v. *Helvering* (71 F. (2d), 214) (April 23, 1934, reversing 18 B. T. A., 1225, decided February 18, 1930), certiorari denied, October 8, 1934 (293 U. S., 583); *Commissioner* v. *Eldridge* (79 F. (2d), 629) (November 4, 1935, affirming 30 B. T. A., 1322, decided July 31, 1934); *Commissioner* v. *McCreery* (83 F. (2d), 817) (May 13, 1936, affirming B. T. A. memorandum opinion of June 19, 1935); *Foster* v. *Commissioner* (96 F. (2d), 130) (April 18, 1938, affirming B. T. A. memorandum opinion of December 23, 1935); *Commissioner* v. *Johnson* (104 F. (2d), 140) (June 1, 1939, affirming 37 B. T. A., 155, decided January 21, 1938), affirmed by an equally divided Court (308 U. S., —), No. 317, October term 1939, decided December 11, 1939.

[13] *David Stewart* v. *Commissioner* (17 B. T. A., 604); *Corrado & Galiardi, Inc.*, v. *Commissioner* (22 B. T. A., 847); *Edward Securities Corporation* v. *Commissioner* (30 B. T. A., 918); *Ralph Hochstetter* v. *Commissioner* (34 B. T. A., 791); *John Thomas Smith* v. *Commissioner*, supra (40 B. T. A., 387).

[14] 18 B. T. A., 1225, a rehearing affirmed May 26, 1932, unpublished.

[15] *Helvering* v. *Wilshire Oil Co.* (308 U. S., —), No. 1, October term 1939, decided November 6, 1939.

[16] Cf. *Sanford* v. *Commissioner* (308 U. S., —), No. 34, October term 1939, decided November 6, 1939.

Respondent makes the further point that the passage of section 24(a)6 of the Revenue Act of 1934 [17] which explicitly forbids any deduction for losses determined by sales to corporations controlled by the taxpayer is convincing proof that the law was formerly otherwise. This does not follow. At most it is evidence that a later Congress construed the 1932 Act to recognize separable taxable identities between the taxpayer and his wholly owned corporation. As the new provision goes much further than the former decisions in disregarding transfers between members of the family it may well have been passed to extend as well as clarify the existing rule. The suggestion is not sufficiently persuasive to give vitality to a futile transfer.

The taxpayer has preserved two objections to the district judge's rulings on the evidence. He claims that evidence as to transactions between the taxpayer and the corporation which took place prior to the sale here involved was remote and highly prejudicial. We think it apparent that this evidence was entirely relevant to the present issue; the history of the taxpayer's relations with the corporation shed considerable light on the actual effect of the sale in question. The second contention is that the district judge charged the jury to give less effect to the book entries of Smith and the corporation than they were entitled to under the applicable book entry statute. [18] The alleged departure from the statute has but dubious support in the record, resting on a single statement of the judge lifted from its context as part of an extended colloquy with counsel. In the circumstances there is no merit in the claim of prejudice to the taxpayer.

The judgment of the circuit court of appeals is reversed and that of the district court affirmed.

Reversed.

ARTICLE 23(e)-1: Losses by individuals. 1940–16–10237
G. C. M. 21966

REVENUE ACTS OF 1932 AND 1934.

> In view of the decision in *Commissioner* v. *Beekman Winthrop* (98 Fed. (2d), 74), G. C. M. 14207 (C. B. XIV–1, 68 (1935)), relating to the taxable year in which the stockholders of the M Company sustained a loss due to liquidation of that corporation, is revoked.
>
> Recommended that nonacquiescence in *Beekman Winthrop* v. *Commissioner* (36 B. T. A., 314, nonacquiescence, C. B. 1937–2, 53) be withdrawn.

Advice is requested whether, in view of the decision of the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Beekman Winthrop* (98 Fed. (2d), 74), G. C. M. 14207 (C. B. XIV–1, 68 (1935)) should be revoked.

G. C. M. 14207, supra, involved the question whether stockholders of the M Company who sustained losses upon the liquidation of that company could deduct such losses in the year 1932 or in the year 1934. The facts upon which the ruling was based are as follows:

In 1932 the assets of the M Company consisted of bonds of another company and cash. Pursuant to the plan of liquidation, the stockholders in that year surrendered their stock and received from the corporation the bonds of the

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[17] 48 Stat., 680, 691:

"SEC. 24. ITEMS NOT DEDUCTIBLE.

"(a) *General rule.*—In computing net income no deduction shall in any case be allowed in respect of—

* * * * * * *

"(6) Loss from sales or exchanges of property, directly or indirectly, (A) between members of a family, or (B) except in the case of distributions in liquidation, between an individual and a corporation in which such individual owns, directly or indirectly, more than 50 per centum in value of the outstanding stock. For the purpose of this paragraph—(C) an individual shall be considered as owning the stock owned, directly or indirectly, by his family; and (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."

[18] 49 Stat., 1561 (28 U. S. C., section 695).

other company together with participation certificates entitling the stockholders to proportionate interests in final distribution. It was estimated that the amount of — cents per share would be paid to holders of the participation certificates and that amount was paid on January —, 1934.

It was concluded that the stockholders could not deduct their losses until the year 1934 notwithstanding the fact that cash of only a few cents per share (less than 1 per cent of the company's assets) represented the only remaining asset of the M Company after the surrender of stock by the stockholders in 1932 and the distribution to them by the M Company of bonds of another corporation and participation certificates entitling the stockholders to a further cash distribution which was accurately determinable in 1932.

In *Commissioner* v. *Beekman Winthrop*, supra, involving like facts, the Circuit Court of Appeals for the Second Circuit, in affirming the decision of the Board of Tax Appeals (*Beekman Winthrop* v. *Commissioner*, 36 B. T. A., 314, nonacquiescence, C. B. 1937-2, 56), held that the loss was sustained in 1932 and was deductible for that year. Under the particular facts involved, this office is of the opinion that the decision of the court, affirming the decision of the Board, is correct.

The decision in the Winthrop case is distinguishable from the decision of the Court of Claims in *Dresser et al.* v. *United States* (55 Fed. (2d), 499, certiorari denied, 287 U. S., 635, Ct. D. 503, C. B. XI-1, 267 (1932)). The corporation in that case had remaining, after the initial distribution, valuable tangible assets, the amount of which was not then determinable.

In view of the foregoing, G. C. M. 14207, supra, is revoked, and it is recommended that nonacquiescence in the decision of the Board in *Beekman Winthrop* v. *Commissioner*, supra, be withdrawn. (See page 5, this Bulletin.)

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

SECTION 23(l).—DEDUCTIONS FROM GROSS INCOME: DEPRECIATION.

Article 23(l)-6: Obsolescence. 1940-5-10156
Ct. D. 1437

INCOME TAX—REVENUE ACT OF 1928—DECISION OF SUPREME COURT.

1. Deduction—Obsolescence—Storage of Property Not Needed in Business.

A company which acquired two title search plants as the result of a statutory consolidation or merger of title companies is not entitled to a deduction for obsolescence of one of the plants which it stored in order to effect economies of operation. More than nonuse or disuse is necessary to establish obsolescence within the meaning of section 23(k) of the Revenue Act of 1928 and article 206 of Regulations 74; obsolescence connotes functional depreciation and requires that the operative cause of the present or growing uselessness arise from external forces which make it desirable or imperative that the property be replaced. The plant was discarded only as a proximate result of the company's voluntary action in acquiring excess capacity.

2. Suit—Claim for Refund—Basis.

In a suit for refund of taxes based solely upon a claim for deduction on account of obsolescence under section 23(k) of the Revenue Act of 1928, the petitioner is precluded from changing the basis of its claim to losses sustained under section 23(f), in the absence of a proper amendment or of facts establishing a waiver by the Government.

3. Decision Affirmed.

Decision of the United States Circuit Court of Appeals, Third Circuit (1939) (102 F. (2d), 582), affirmed.

Supreme Court of the United States.

The Real Estate-Land Title & Trust Co., petitioner, v. *The United States of America.*

[309 U. S., 13.]

On writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[January 15, 1940.]

OPINION.

Mr. Justice Douglas delivered the opinion of the Court.

Petitioner, a Pennsylvania corporation, was formed in October, 1927, as a result of a statutory consolidation or merger of three companies. Two of the constituent companies owned title search plants which were among the assets acquired by petitioner as a result of the consolidation. While it was known that two title plants would be acquired on the consolidation, there was at that time no definite plan for their disposition. But an immediate investigation was made and it was decided to store one of the plants in order to effect economies of operation. That was done substantially simultaneously with the consummation of the consolidation. About two months thereafter it was decided that the plant retained in use was adequate and that the one in storage would not be needed. Although for a brief period some slight use appears to have been made of the stored plant,[1] it was not kept up to date by the addition of current recordings. As a result it had only a salvage value by October 31, 1928. Meanwhile, negotiations for its sale had been unsuccessful.

In this action petitioner seeks a refund of income taxes for the fiscal year ended October 31, 1928, based on the refusal of the collector of internal revenue to allow a deduction for obsolescence of this plant. It had been carried on the books of the constituent company at $275,000 and was brought into the consolidation at $800,000. The district court, however, found that its value on March 1, 1913, was $1,000,000; on October 31, 1928, $125,000—making an actual loss of $875,000, which that court allowed as a deduction for obsolescence for the taxable year 1928. It accordingly allowed a refund. That judgment was reversed by the circuit court of appeals (102 F. (2d), 582). We granted certiorari because of the asserted conflict of that decision with *Crooks* v. *Kansas City Title & Trust Co.* (46 F. (2d), 928).

Section 23(k) of the Revenue Act of 1928 (45 Stat., 791) allows as a deduction from gross income a "reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence." Admittedly, if the deduction is allowed under this provision it must be for obsolescence, as there has been no exhaustion, wear or tear of the title plant within the meaning of the Act. Now it is true that in the popular sense a thing which is obsolete is one which is no longer used, a meaning which gives color to petitioner's claim for deduction since there is no question that the title plant here involved is no longer utilized to any degree whatsoever. But the term "allowance for obsolescence," as used in the Act and in the Treasury regulations, has a narrower or more technical meaning than that derived from the common, dictionary definition of obsolete. The Treasury regulations[2] state the

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[1] Evidence of use subsequent to the consolidation or merger is quite tenuous, the only specific instances occurring immediately prior to the actual consummation of the consolidation on October 31, 1927

[2] Treasury Regulations 74, article 206, promulgated under the Revenue Act of 1928, provides in full:

"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 circumstances under which an allowance for obsolescence of physical property may be allowed, viz, where such property is "being affected by economic conditions that will result in its being abandoned at a future 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." This Court, without undertaking a comprehensive definition, has held that obsolescence for purposes of the Revenue Acts "may arise from changes in the art, shifting of business centers, loss of trade, inadequacy, supersession, prohibitory laws and other things which, apart from physical deterioration, operate to cause plant elements or the plant as a whole to suffer diminution in value," (*United States Cartridge Co.* v. *United States*, 284 U. S., 511, 516. See also *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S., 648, 654.) Such specific examples illustrate the type of "economic conditions" whose effect on physical property is recognized as obsolescence by the Treasury regulations. Others could be mentioned which similarly cause or contribute to the relentless march of physical property to the junk pile. But in general, obsolescence under the Act connotes functional depreciation, as it does in accounting and engineering terminology.[3] More than nonuse or disuse is necessary to establish it.[4] To be sure, reasons of economy may cause a management to discard a title plant either where it has become outmoded by improved devices or where it is acquired as a duplicate and therefore is useless. But not every decision of management to abandon facilities or to discontinue their use gives rise to a claim for obsolescence. For obsolescence under the Act requires that the operative cause of the present or growing uselessness arise from external forces which make it desirable or imperative that the property be replaced. What those operative causes may be will be dependent on a wide variety of factual situations. "New and modern methods" appear to have been one of the real causes of abandonment of the title plant in *Crooks* v. *Kansas City Title & Trust Co.*, supra. Suffice it here to say that no such external causes are present, for the record shows little more than the desire of a management to eliminate one plant which was a needless duplication of another but which functionally was adequate.[5] The fact that fewer employees were required to operate the one retained than the one discarded is inconclusive here. For this is not the case of acquisition of a new plant to take the place of one outmoded or less efficient. Rather the conclusion is irresistible that the plant was discarded only as a proximate result of petitioner's voluntary action in acquiring excess capacity.

In view of this conclusion, we do not reach respondent's further objections to allowance of this claim on grounds of obsolescence.

But petitioner contends that in any event it has abandoned the plant and hence is entitled to a deduction under section 23(f) of the 1928 Act which allows a corporation to deduct "losses sustained during the taxable year and not compensated for by insurance or otherwise." Whether petitioner has satisfied those requirements we do not decide, for its claim for refund was based exclusively and solely on the ground that it was entitled to an allowance for obsolescence.

Hence, in the absence of a waiver by the Government (*Tucker* v. *Alexander*, 275 U. S., 228), or a proper amendment, petitioner is precluded in this suit from resting its claim on another ground. (*United States* v. *Felt & Tarrant Mfg. Co.*, 283 U. S., 269 [Ct. D. 336, C. B. X-1, 431 (1931)].) There has been no amendment and there are no facts establishing a waiver.

Accordingly, the judgment of the circuit court of appeals is affirmed.

Mr. Justice ROBERTS and Mr. Justice REED took no part in the consideration or decision of this case.

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abandoned at a future 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 can not be held applicable to an entire property unless all portions thereof are affected by the conditions to which obsolescence is found to be due." See also Bureau of Internal Revenue Bulletin "F," January, 1931.

[3] Kester, Advanced Accounting (3rd ed. 1933), ch. 10; Hatfield, Accounting (1927), ch. V; Saliers, Depreciation Principles and Applications (3rd ed., 1939), ch. 4; Kester, Depreciation (1924); Transactions, Amer. Soc. C. E., volume 81, page 1527 (1917); Marston & Agg, Engineering Valuation (1936), pages 83-85.

[4] 2 Paul & Mertens, Law of Federal Income Taxation, section 20.114.

[5] According to petitioner's own witnesses, the discarded plant was a "more complete plant than any other plant in the city"; and it had a "background which went all the way back to William Penn."

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

SECTION 43.—PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

ARTICLE 43-2: When charges deductible.

1940-15-10230
Ct. D. 1451

INCOME TAX—REVENUE ACT OF 1932—DECISION OF SUPREME COURT.

1. DEDUCTION—LOSS—CONTRACT OF GUARANTY—PAYMENT BY NOTE.

The taxpayer, with other stockholders of a bank which merged with another in 1929, executed a contract of guaranty, and in 1931, at the request of the bank that the guaranty be put into bankable form, gave notes to the bank, with collateral. In 1932 the bank called upon the taxpayer to make final settlement of his obligations, and he accordingly made his note to the bank, and received back notes previously given or indorsed by him. *Held:* That the taxpayer, who kept his accounts upon a cash basis, was not entitled to a deduction in 1932 under section 23(e) of the Revenue Act of 1932 for a loss upon his contract of guaranty, since neither the substitution of his own note nor the giving of collateral constituted a payment in cash or its equivalent.

2. BOARD OF TAX APPEALS—FINDINGS OF FACT—LEGAL EFFECT REVIEWABLE BY COURT.

The legal effect of an entire transaction disclosed by findings of the Board of Tax Appeals, in the application of section 23(e) of the Revenue Act of 1932, as to the deduction of loss sustained during the taxable year, is reviewable by the circuit court of appeals, and its decision is reviewable by this Court.

3. DECISION FOLLOWED.

Eckert v. *Burnet* (1931) (283 U. S., 140 [Ct. D. 325, C. B. X-1, 241]) followed.

4. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Fourth Circuit (1939) (106 F. (2d), 336), reversing unreported decision of the United States Board of Tax Appeals (1938), reversed.

SUPREME COURT OF THE UNITED STATES.

Guy T. Helvering, Commissioner of Internal Revenue, petitioner, v. *Julian Price.*
[60 S. Ct., 673.]

On writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[March 25, 1940.]

OPINION.

Mr. Chief Justice HUGHES delivered the opinion of the Court.

Respondent in his income tax return for 1932 claimed a deduction for a loss upon a contract of guaranty. The Board of Tax Appeals sustained the Commissioner in refusing to allow the deduction, and the circuit court of appeals reversed. (106 F. (2d), 336.) Because of an alleged conflict with *Eckert* v. *Burnet* (283 U. S., 140 [Ct. D. 325, C. B. X-1, 241 (1931)]), *Jenkins* v. *Bitgood* (C. C. A. 2) (101 F. (2d), 17), and *Ferris* v. *Commissioner* (C. C. A. 2) (102 F. (2d), 985), we granted certiorari. January 15, 1940.

The facts as found may be thus summarized: In 1929 the Atlantic Bank & Trust Co. of Greensboro, N. C., was merged with the North Carolina Bank & Trust Co. The latter accepted conditionally certain assets of the Atlantic Bank called "A" assets, and certain other assets, called "B" assets, were pledged to that bank with authority to charge against them any losses which might be established in realizing upon the "A" assets. Respondent and three other stockholders of the Atlantic Bank executed an agreement of guaranty, to the effect that if the North Carolina Bank failed to realize a certain sum from the "A" assets within two years they would make up the deficiency in an amount not exceeding $500,000. The agreement provided that any sum realized from the " B " assets were to be applied first to any losses occurring in the "A" assets and then to the reimbursement of the four guarantors. The period for realizing upon the "A" assets was extended until September, 1932.

In June, 1931, the North Carolina Bank advised the guarantors that the " B " assets were not in such shape that the bank could use them to the extent necessary for banking purposes and requested the guarantors to put their guaranty into a bankable form so that it could be used by the bank to obtain credit. Respondent accordingly gave to the bank his note for $125,000 and indorsed the note of C. W. Gold, another guarantor, for a like amount and assigned certain securities to the bank as collateral for the payment of his guaranty. The bank agreed that respondent's ultimate liability should not exceed $250,000. At the end of 1931, the guaranty agreement was still in effect. The " B " assets were still in the process of collection. No demand had been made upon respondent. While it was known that there would be some loss to the guarantors, it was not definitely known in 1931 what the loss would be, and the guarantors had reason to believe that there would be a substantial reimbursement from the " B " assets of any losses.

In the early part of 1932, financial conditions being worse, the bank concluded that it would have to collect upon the guaranty and called upon respondent to make a final settlement of his obligations. Accordingly, in March, 1932, respondent made his note to the bank for $250,000 and received back the two notes. The Board of Tax Appeals found that both respondent and the bank considered this to be a final payment of the two notes which had been given under the guaranty. The bank retained the same collateral for the $250,000 note that it had previously held, and in December, 1932, respondent substituted therefor certain securities of his own.

Respondent claimed a loss in 1932 in the amount of $125,000, that is, for his one-half of the guaranty. He did not then claim a loss on the other one-half because he still had a claim against the estate of Gold (who had died in 1932) for reimbursement. For that one-half, representing Gold's part of the guaranty, respondent claimed a loss in 1933 and that deduction is not here involved.

Respondent kept his accounts upon a cash basis. The Board of Tax Appeals ruled that respondent was not entitled to the deduction of $125,000 in 1932, upon the ground that " he made no outlay of cash " in the purported payment; he had satisfied his liability as guarantor " by a shifting of the form of his liability." His loss would be deductible " in the year in which he pays the note."

Respondent insists initially that the transaction in 1932 was considered by the parties as constituting a payment of respondent's liability under the guaranty, and that this payment is a fact found by the Board of Tax Appeals and is not open to review. But the findings of the Board disclose the entire transaction, and its legal effect in the application of section 23(e) of the Revenue Act of 1932, as to the deduction of losses sustained during the taxable year, was reviewable by the circuit court of appeals. Its decision on that point is reviewable here.

Both the Commissioner and the Board of Tax Appeals relied upon our decision in *Eckert* v. *Burnet*, supra. In that case, the taxpayer's return was on the cash basis, and the question was as to a claim of deduction for the year 1925. The taxpayer and his partner were joint indorsers of notes issued by a corporation they had formed. In 1925, in settlement of their liability for an ascertained amount, they made a joint note for the amount due to the bank that held the corporation's paper, " received the old notes, marked paid, and destroyed them." We affirmed the ruling that the deduction should not be allowed.

The court below considered that decision as definite authority only for the holding that a loss of the sort set forth was not deductible under the " bad debt " provision of the statute. That indeed was stated in the opinion as the taxpayer's claim. But the taxpayer had also presented here as an alternative ground the theory of a loss sustained during the taxable year, a ground which the Board of Tax Appeals had considered and held to be untenable. (17 B. T. A., 263, 265, 266.) And the Government argued both questions. The Government did not contend that the taxpayer might not at some time be entitled to a deduction " either on account of a bad debt or for a business loss "; the " sole question in dispute was whether he was entitled to the deduction in 1925, the year in which his note was given, or in the later year in which the taxpayer's liability on the note is actually liquidated by payment."

The reasoning of this Court was broad enough to cover both aspects of the case. We said:

"For the purpose of a return upon a cash basis, there was no loss in 1925. As happily stated by the Board of Tax Appeals, the petitioner 'merely exchanged his note under which he was primarily liable for the corporation's notes under which he was secondarily liable, without any outlay of cash or property having a cash value.' A deduction may be permissible in the taxable year in which the petitioner pays cash. The petitioner says that it was definitely ascertained in 1925 that the petitioner would sustain the losses in question. So it was, if the petitioner ultimately pays his note."

We think that this decision is controlling in the instant case. As the return was on the cash basis, there could be no deduction in the year 1932, unless the substitution of respondent's note in that year constituted a payment in cash or its equivalent. There was no cash payment and under the doctrine of the Eckert case the giving of the taxpayer's own note was not the equivalent of cash to entitle the taxpayer to the deduction.

Respondent urges that his note was secured, but the collateral was not payment. It was given to secure respondent's promise to pay, and if that promise to pay was not sufficient to warrant the deduction until the promise was made good by actual payment, the giving of security for performance did not transform the promise into the payment required to constitute a deductible loss in the taxable year. (See *Jenkins* v. *Bilgood,* 101 F. (2d), 17, 19.)

The judgment of the circuit court of appeals is reversed and the decision of the Board of Tax Appeals is affirmed.

It is so ordered.

Mr. Justice McReynolds took no part in the decision of this case.

SECTION 44.—INSTALLMENT BASIS.

Article 44–1: Sale of personal property on installment plan. 1940–1–10128 Ct. D. 1431

INCOME TAX—REVENUE ACT OF 1932—DECISION OF SUPREME COURT.

1. Income—When and to Whom Taxable—Disregard of Corporation Formed as Conduit Through Which Income Already Realized by Taxpayer Was to be Paid to Him in Annual Installments.

The petitioner in 1931 sold at a loss certain stock purchased in 1926, and was allowed a deduction therefor in that year. In 1933 he concluded negotiations for settlement of a claim for fraud against the seller in connection with the 1926 sale, by an arrangement under which he was to reacquire the shares, convey them to a newly created corporation wholly controlled by him, which corporation in turn was to transfer the stock back to the seller for the original purchase price, such sum to be paid by the corporation to petitioner in annual installments over a period of 40 years. The essentials of this scheme were carried out; the transfer of the shares to the seller being made without revealing to him the existence of the new corporation, the petitioner giving a personal release of all claims against the seller and personally receiving the total amount paid, which he then turned over to the corporation. *Held:* That the petitioner having been allowed a deduction for the loss attributable to the original transaction, and having recouped such loss through settlement of his claim, the amount of the settlement was taxable income to him when paid in 1933, notwithstanding the arrangement for installment payments to him through the conduit corporation, and he is not entitled to the benefits of section 44 of the Revenue Act of 1932.

2. DECISION AFFIRMED.

Decision of the United States Circuit Court of Appeals, Seventh Circuit (1939) (103 F. (2d), 110), reversing decision of the United States Board of Tax Appeals (1938) (37 B. T. A., 314), affirmed.

SUPREME COURT OF THE UNITED STATES.

George W. Griffiths, petitioner, v. *Guy T. Helvering, Commissioner of Internal Revenue.*

[308 U. S., 355.]

On writ of certiorari to the Circuit Court of Appeals for the Seventh Circuit.

[December 18, 1939.]

OPINION.

Mr. Justice FRANKFURTER delivered the opinion of the Court.

The case is here to review a decision of the Circuit Court of Appeals for the Seventh Circuit (103 F. (2d), 110) reversing an order of the Board of Tax Appeals (37 B. T. A., 314) which had overruled a deficiency assessment by the Commissioner of Internal Revenue in petitioner's income tax return for 1933. We granted certiorari (308 U. S., —), because of an alleged conflict between the decision below and that of the Circuit Court of Appeals for the Second Circuit in *Smith* v. *Higgins* (102 F. (2d), 456) (No. 146 this term).

The facts are undisputed, and, for purposes of our decision, may be thus abridged: In 1926 Griffiths, the petitioner, paid one Lay $100,000 for some stock. The investment was unprofitable, and the upshot of a complicated series of transactions was allowance to Griffiths by the Commissioner of a deductible loss of $92,500 for the year 1931 resulting from a sale of the stock by Griffiths to a family corporation. Thereafter, in 1932, Griffiths got wind of the fact that Lay had defrauded him in the 1926 sale. Negotiations were begun for a settlement of Griffiths' claim against Lay, and by January, 1933, Griffiths' lawyer had devised an arrangement for such a settlement. The gist of the arrangement was this: Griffiths was to reacquire the shares, convey them to a corporation newly created for the purpose of furthering the scheme and wholly controlled by Griffiths, which in turn was to transfer the stock back to Lay for $100,000 to be paid by him, and that sum was to be paid over by the corporation to Griffiths in annual installments for 40 years, with interest on the deferred payments.[1] The essentials of this scheme were carried out. Its purpose—to disguise by intervening elaborations what in fact was a rescission of the original purchase by Griffiths for $100,000—was made more manifest by these facts: Griffiths personally reacquired and transferred the shares to Lay without revealing the existence of the new corporation, gave Lay a personal release of all claims against him, and personally received from Lay the $100,000 which he then turned over to the corporation.

On these findings the Commissioner ruled that Griffiths, having been allowed a deduction for loss attributable to the stock purchased from Lay and having now recouped that loss through settlement of his claim against Lay, was subject to tax for the amount of the settlement in 1933. We think the Commissioner was right, and that the Circuit Court of Appeals properly reversed the Board of Tax Appeals.

The facts leave little scope for legal explication. Griffiths had a claim for fraud against Lay which, when satisfied, wiped out the loss for which he had received an earlier deduction. Had satisfaction of the claim come to him without any conduit, it would have indisputably been his income. The claim having been recognized by Lay and cast into a form realizable by Griffiths, a lawyer's ingenuity devised a technically elegant arrangement whereby an intricate outward appearance was given to the simple sale from Griffiths to Lay and the passage of money from Lay to Griffiths. That was the crux of the business to Griffiths, and that is the crux of the business to us.

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[1] Of the total sum paid, $15,000 was to be applied by the corporation in payment of a personal indebtedness owed by Griffiths. This sum, of course, was clearly income to petitioner. The remainder was to be paid in installments by the corporation to Griffiths. Petitioner contends that these installments alone are taxable to him as they are paid, under the provisions of section 44 of the Revenue Act of 1932 (ch. 209, 47 Stat., 169).

We can not too often reiterate that "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid." (*Corliss* v. *Bowers*, 281 U. S., 376, 378 [Ct. D. 188, C. B. IX-1, 254 (1930)].) And it makes no difference that such "command" may be exercised through specific retention of legal title or the creation of a new equitable but controlled interest, or the maintenance of effective benefit through the interposition of a subservient agency. (Cf. *Gregory* v. *Helvering*, 293 U. S., 465 [Ct. D. 911, C. B. XIV-1, 193 (1935)].) "A given result at the end of a straight path," this Court said in *Minnesota Tea Co.* v. *Helvering* (302 U. S., 609, 613 [Ct. D. 1305, C. B. 1938-1, 288]), "is not made a different result because reached by following a devious path." Legislative words are not inert, and derive vitality from the obvious purposes at which they are aimed, particularly in the provisions of a tax law like those governing installment sales in section 44 of the Revenue Act of 1932. Taxes can not be escaped "by anticipatory arrangements and contracts however skillfully devised * * * by which the fruits are attributed to a different tree from that on which they grew." (*Lucas* v. *Earl*, 281 U. S., 111, 115.) What Lay gave, Griffiths in reality got, and on that he must be taxed. The judgment is affirmed.

SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A.—RATES OF TAX.

SECTION 101(16).—EXEMPTIONS FROM TAX ON CORPORATIONS.

REVENUE ACT OF 1934.

Contributions by a corporation to an employees' benefit association composed of employees of the corporation. (See G. C. M. 21323, page 97.)

SUPPLEMENT B.—COMPUTATION OF NET INCOME.

SECTION 111.—DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

ARTICLE 111-1: Computation of gain or loss. 1940-13-10216
Ct. D. 1448

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. GAIN OR LOSS—BASIS—MARCH 1, 1913, VALUE OF CEMETERY PROPERTY—RETAIL SALES ONLY ONE ELEMENT IN DETERMINING FAIR MARKET VALUE—TOTAL BASIS OF SEPARATE SALES CAN NOT EXCEED VALUE OF UNSOLD PROPERTY IN 1913.

In determining the gain derived in 1931 from sales of cemetery property acquired prior to March 1, 1913, retail sales of burial space made prior to or during the basic year are not conclusive evidence of the fair market value of space unsold and available in that year, but constitute only one element to be considered and weighed in the light of all other factors pertinent to the determination of value. The total of the basis for all of the separate sales in subsequent years can not exceed the value of the unsold land in 1913, and it is therefore immaterial whether the basis applicable to the footage sold in 1931 be determined directly or whether the value of the entire unsold land in 1913 be first determined and then an allocation made to the space sold in 1931.

2. BOARD OF TAX APPEALS—DETERMINATION OF VALUE—FINDING CONCLUSIVE UPON REVIEW WHEN SUPPORTED BY SUBSTANTIAL EVIDENCE.

It is within the discretion of the Board of Tax Appeals to fix an independent finding of the fair market value of property as of March 1, 1913, after considering all the evidence pertinent to the question of valuation. Such a finding, when supported by substantial evidence, is in accordance with law and is conclusive upon review by the court.

3. DECISION AFFIRMED PER CURIAM.

Decision affirmed by per curiam opinion of the Supreme Court on February 5, 1940.[1]

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Montrose Cemetery Co., a Corporation, petitioner, v. *Commissioner of Internal Revenue, respondent.*

[105 F. (2d), 238.]

Petition for review of decision of the United States Board of Tax Appeals.

Before SPARKS, MAJOR, and KERNER, Circuit Judges.

[June 21, 1939.]

OPINION.

KERNER, Circuit Judge: This petition for review involves income taxes imposed upon gains made in 1931 from the sale of burial space. The cemetery lots sold in 1931 had been acquired prior to 1913 at a cost admittedly less than the fair market value thereof on March 1, 1913, and the controversy here is over the proper value of the unadjusted basis to be used in determining the recognized gain in 1931.

The Commissioner of Internal Revenue (hereinafter referred to as the "Commissioner") fixed the value at 21.5 cents per square foot. The taxpayer (hereinafter also referred to as "Montrose") appealed to the United States Board of Tax Appeals (hereinafter referred to as the "Board"), which determined the value at 23 cents per square foot.

In 1902 one Kircher, Chicago undertaker, founded the Montrose Cemetery Co. and for 18 years until his death in 1920 personally managed and controlled its operations. In 1902 Kircher purchased an 80.02-acre tract of land in the northwest part of the city of Chicago for the sum of $75,000, which he immediately transferred to Montrose in exchange for its entire capital stock of $300,000. In 1912 Montrose purchased an adjacent tract of 19.485 acres for $23,500 and a 20-acre tract in 1918 for $20,000.

The last two tracts of land are not considered in this case, because as yet they have not been dedicated to cemetery purposes. However, it should be noted that the acquisition values of these tracts did not vary very much. In this connection, the Bohemian National Cemetery, across the street from the Montrose Cemetery, acquired 60.125 acres in 1902 for $60,000 and refused to buy 60 acres in 1910 for $55,000. The evidence indicates that during all these years the value of land unimproved for cemetery purposes was around $1,200 an acre or 2.75 cents a square foot.

By March 1, 1913 Montrose had made capital expenditures in the sum of $77,196.88 for buildings, furniture and fixtures, horses, wagons, and tools. These additional capital assets were indispensable to the operation of the cemetery, and enabled it to compete with the other 39 cemeteries in the Chicago area. This, of course, facilitated the sale and increased the value of the unsold graves, Montrose's main asset, mostly unrealizable on March 1, 1913.

This unrealizable asset on the basic date consisted of an available net area of 2,214,786 square feet of burial grounds. Of this area 932,466 square feet were in

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[1] The Chief Justice on the date indicated announced the following order:
No. 370, *Montrose Cemetery Co., petitioner,* v. *Commissioner of Internal Revenue.* On writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit. Per curiam: As it appears that the Board of Tax Appeals received and considered the evidence pertinent to the question of the valuation of the cemetery lots on March 1, 1913, we find no ground for disturbing its ruling. The judgment of the circuit court of appeals is affirmed.

improved sections, the improvement cost of which is not disclosed by the record, and 1,282,320 square feet were to be found in unimproved sections. It is important to add that, of the 14,993.67 square feet of burial space sold in 1931, 4,498.10 square feet were from the improved area in 1913 and 10,495.57 were from the unimproved area in 1913.

On the valuation date 932,466 square feet of burial space were improved, but the record failed to reveal the cost of improvement. The record, however, does disclose figures as to the subsequent improvements of the unimproved area in 1913. Montrose made sales of space from land unimproved in 1913 after having expended only about 8 cents per square foot for improvements thereto. From 1913 to 1931 4.99 cents per square foot was expended, and counsel for Montrose uses this figure in his brief, to improve the land unimproved as of March 1, 1913, to salable condition in 1931. In addition, subsequent improvements costing 3.1 cents were made, which benefited the area improved and unimproved at the basic date.

In this connection, Buswell, president of Montrose since 1928, testified that 25 cents per square foot would meet the total cost of improving and maintaining the entire cemetery throughout its entire life, starting from the raw land, grading out roads, putting in sewers, making title and water lines, and providing for a reasonable amount of work on trees, shrubbery and lawns. Lightfoot, called by the Commissioner, was even more conservative, stating that in his opinion the cost of improving each square foot of acreage from raw land to a salable condition and maintenance thereof to the day of the sale of that last grave was 30 to 35 cents.

We are mindful that development and maintenance go on over the entire life of a cemetery, so that on any given date, e. g., say March 1, 1913, it is safe to conclude that the total 25 cents had not been expended as to every square foot of area. In fact, some of the footage might have been improved and sold at a lower figure than 25 cents. For instance, to take the 10,495.57 square feet of burial space here in question, unimproved in 1913 but salable and sold in 1931, the record reveals that the conversion cost from raw land to salable land was 4.99 cents per square foot. Yet, it might be said that upon the final accounting, when the last grave has been sold, the total cost of improvement spread equally over every square foot of the cemetery would come to 25 cents or 30 to 35 cents.

Around 1913 statistics in the record indicated that in the future Montrose could hope to sell approximately 31,000 square feet of burial ground each year. It was then competing favorably with 39 other cemeteries in the city, the population was increasing, and it was accessible to the public by city street car lines. In the basic year burial space in general sold for 88.2 cents per square foot. In particular, lots and select graves sold between $1 and $1.13 per square foot, and sales of common graves occurred at 52.95 cents per square foot. In 1904, in comparison, the retail sale prices were 33.07 cents, 32.45 cents to 93.75 cents, and 47.55 cents, respectively. On the other hand, in 1931, retail sale prices were $2.49, $2.41 to $2.60, and $1.31, respectively.

According to Buswell, the fair market retail sale prices on the basic date, in his opinion, included the 2.75 cents given above as cost of the raw land, the 25 cents as cost of the entire improvement and maintenance of the cemetery, and a profit. Schrade, called by Montrose, thinking the same way, stated that the retail sale prices reflected various adjustment such as those made for land costs, ratable distribution of operating cost, discounts for time required to sell the graves, and a profit.

Buswell and Schrade based their fair market value opinions on the retail sales prior to and during the basic year of 1913. Yet, since Montrose sold burial space to ultimate users only, and not for speculation, it is clear that in 1913, and Buswell and Schrade so admitted, there was in fact no retail market for the balance of the footage then available and unsold. It is undisputed that many years would pass before the lots could be sold. In fact, the burial space in question, although available in 1913, was not in public demand until 1931. In 1913, as in any given year, the demand for cemetery lots was limited by actual deaths and prospective deaths in the community.

In addition to selling burial space, Montrose performed various incidental services in 1913, from which income was derived. Such services consisted *inter alia* of providing perpetual care for graves, making cremations and interments, setting all foundations for stone work, selling plants and shrubbery, and renting the use of the chapel. Prior to 1913, excepting the year 1910, the income from these sources surpassed the expenses, and in 1913 the income margin was $3,846.07. Moreover, in 1913, the net income of the cemetery was $31,902.48. A prospective buyer at this time could reasonably have expected future earnings around $30,000 annually.

It should be noted in passing that if an income of $30,000 is capitalized at 5 per cent, a present valuation of $600,000 based on prospective net earnings, is reached. This valuation is equivalent to a square foot value of about 27 cents. Buswell and Schrade for the taxpayer testified that the fair market value was over $2,000,000 or over $1 per square foot. Applying the 5 per cent return on capital invested, we see that an investment of $2,000,000 should receive over $100,000 income annually, which is grossly out of line with the $30,000 annual income a prospective buyer of the cemetery could expect.

In its tax return for 1931, Montrose used an unadjusted basis of approximately $1.89 per square foot. That is, it valued the footage sold in 1931 at $28,381.66. It determined that lots were worth $2 per square foot, select graves $1, and single graves around 49 cents. These values had been used by it in its tax returns for the years 1917 through 1921.

It should be noted that in the early income tax returns a basis of 8.58 cents per square foot was used. Moreover, about 1920 Montrose had three retrospective appraisals made as of 1913 for tax purposes. Each appraiser gave as his opinion that the fair market value on March 1, 1913, was 15 cents per square foot for unimproved land and 25 cents for improved land. Furthermore, in its capital stock tax returns from 1916 to 1924 the taxpayer reported the fair value of its land at a high of $316,048.95, justifying these reports on the logical ground that the total unearned profit on future sales of unsold cemetery land on March 1, 1913, was an unrealizable asset at that time, realizable only "through the sale of lots at retail extending over a period of upwards of 50 years."

The Commissioner refused to accept Montrose's tax figures and in his deficiency assessment determined that the entire cemetery land had a fair market value of 21.5 cents per square foot on March 1, 1913. Montrose appealed to the Board and contended for a value of 94 cents per square foot, using a weighted average value which placed separate weight on the improved and unimproved footage.

Montrose's opinion witnesses testified that the fair market value of the net salable land in the cemetery was over $2,000,000 or between $1 and $1.66 per square foot. Buswell, who had no personal knowledge of the physical condition of the cemetery in 1913, did not place separate values on the improved and unimproved acreage. Schrade, who was familiar with the unsold acreage in 1913, stated the improved portion was worth between $1 and $1.66, and the unimproved portion 75 cents. These opinions measured the value of the unsold land in 1913 by retail sales of land sold prior to and during 1913.

Commissioner's three opinion witnesses were not familiar with the cemetery in question in 1913. Thomas gave a value of $235,000 for all of Montrose's assets without placing separate values thereon. Richards testified to a value of $334,691 or 15.1 cents per square foot, and Lockwood a value of $332,000 or 15 cents per square foot. These opinions measured the value of the unsold land in 1913 by an analysis of sales, expenses, earnings, and related matters.

Upon this evidence, the Board made its finding that the fair market value of the footage in question was $3,448.54 or 23 cents per square foot. Montrose now contends *inter alia* that the Board erred in its determination, because it did not follow the command of *Elmhurst Cemetery Co.* v. *Commissioner* (300 U. S., 37 [Ct. D. 1202, C. B. 1937-1, 209]), which, it is claimed, compels the application of an exclusive method for determining the fair market value in cemetery cases, namely, that retail sales of burial space sold prior to or during the basic year of 1913 are conclusive evidence of the value of the burial space unsold and available in that year. With this contention we are unable to agree, as all factors having to do with the determination of values must be considered. All the factors must be weighed in the light of the other facts developed and be given only such weight as may seem just and reasonable.

Before specifically considering Montrose's assignment of errors, it would be proper to describe what methods of determining value were actually used.[2]

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[2] The methods used by Montrose and Commissioner did not fail to give due weight to the fact that on March 1, 1913, the unsold land was in improved and unimproved sections. The methods used treated all the unsold land as improved, and deducted a certain cost per square foot as the cost necessary to bring the unimproved area up to the same state of improvement as the improved area.

The Commissioner, Richards, and Lockwood valued the unsold lots and graves in 1913 on the present-value method using Hoskold's formula with interest rate at 4 per cent and risk rate at 8 per cent. In accord with the present-value method, the average selling price to be received for the unsold land (based on the retail prices of the sold land) and the time required to sell the unsold land are first anticipated. The unsold land multiplied by the average price per square foot then gives the total expected amount to be received for the unsold land over the period of time in question (the expected life of the cemetery). This unrealized amount is then discounted to present value by the use of Hoskold's formula. In addition, Lockwood also applied the reproductive appraisal method or the cost of reproducing the cemetery as it was on March 1, 1913.

Montrose's contentions and the opinions of its witnesses measure the fair market value of the unsold lots and graves in 1913 by the retail sale of lots and graves sold on or about the basic date. In fact, it is insisted that the Elmhurst case makes retail sales the sole determinator of value. The Commissioner, on the other hand, refuses to accept retail sales except in so far as they are used in estimating the anticipated selling price of the unsold lots, and insists that the only comparable sale which could be used as a measure of the value of the unsold cemetery land would be the sale of an entire cemetery similar to the one in question. In summary, what we have here is simply this: Montrose makes the selling price the determinator of value; the Commissioner makes the selling price, less discount for years required to realize the selling price, the determinator of value.

The Board criticized each side, in effect stating that the use of the present-value method alone, or the use of retail sales alone, is not justified. The Board acted on all the evidence furnished to it and its decision indicates, and we believe correctly, that value after all is a question of fact to be determined from all the evidence. In answer to Montrose, the Board reasoned, and we believe its logic is indisputable, that the Supreme Court of the United States did not sanction, nor did it prescribe, any exclusive method for determining fair market value in cemetery cases. To us it is elementary that to confer conclusiveness upon evidence of retail sales in cemetery cases is to invade unnecessarily the field of administrative autonomy.

The fair market value is a price at which a willing seller and a willing buyer will trade, both having a reasonable knowledge of the facts. In ascertaining any particular value, the purpose for which the valuation is made is controlling. In the instant case the purpose of the valuation is to provide Montrose and the Commissioner with a substitute tax basis, so that gain or loss on sales of cemetery lots after 1913 can be determined.

Ordinarily, the cost of the entire cemetery when acquired is the unadjusted tax basis used in the determination of gain or loss from sales of burial space therein. Here the cemetery property was acquired prior to 1913, at a cost less than the fair market value thereof on March 1, 1913. In such a case the fair market value on March 1, 1913, is made the statutory substitute in place of the usual cost basis. Such a valuation manifestly does not contemplate a sale in 1913 to a buyer who intended to use the burial space himself.

Plainly, if Montrose had purchased the cemetery on March 1, 1913, for 2.75 cents per square foot, the unadjusted basis for the cemetery space sold in 1931 would have been 2.75 cents per square foot and not the price of retail sales of comparable and similar burial ground in 1913. Therefore, since the valuation here is to find a tax basis in place of the usual cost basis, the task is as follows: the Board has the job of determining what Montrose, who intends to sell after 1913, would reasonably pay for the burial space of 14,993.67 square feet in question, or the entire cemetery for that matter, as it stood on March 1, 1913.

Obviously no buyer would have purchased either the particular footage in question, or the entire cemetery in 1913, at the retail price per square foot at which cemetery space was selling prior to and during 1913. He would reasonably foresee that one must wait many years for a return of his money and would therefore offer less. Cemetery space can not be used for any other purpose than for burial, and the demand for space is limited by actual deaths and prospective deaths in the community. In other words, the supply of available cemetery space being greater than the demand in the Chicago area, the situation is one of restricted, rather than general, market.

It is for this reason that the price of retail sales, ordinarily the best evidence of value in situations commanding a general market, can not be accepted as satisfactory. Counsel for Montrose would have us go further. He insists that the Elmhurst case, supra, compels the Board to accept the retail price as the sole determinator of value. We have shown that the circumstances of this cemetery case make the retail price as evidence of value unsatisfactory, unless a discounting is provided for the time element, the period of holding before a market can be had.

The weakness of the price of retail sales is obvious from facts and circumstances other than those already shown. The cost of acquiring the raw land in 1902 was around 2.75 cents a square foot. Montrose set a value in 1913 of 94 cents a square foot. Stated in another way, the land cost $75,000 in 1902, and in 1913 a value of over $2,000,000 was claimed. The particular footage involved, i. e., 14,993.67 square feet, cost $112.23 in 1902. In 1913 a value of $14,097.47 is asserted, such value being based exclusively on the price of retail sales prior to and during 1913.

The extraordinary rise must have been due solely to the change in its use from raw land to cemetery land, for the record shows that the value of raw land remained constant from 1902 to 1913. This difference between the cost of 2.75 cents and the claimed value of 94 cents seems inconsistent with testimony of Montrose's witnesses that set 25 cents a square foot as the conversion cost from raw land to salable cemetery land. On this testimony the value in 1913 all other things being equal, might be closer to 27.75 cents per square foot than to 94 cents per square foot.

Comparing Montrose's and Commissioner's method of determining fair market value, it would seem that Montrose's undiscounted selling price is less equitable and less indicative of value than the Commissioner's discounted selling price. The value in 1913 of a cemetery lot might very well be 94 cents per square foot to a user in 1913, but the value of that same lot in 1913 to Montrose, who intended to sell that lot to a user in the future, was not an undiscounted 94 cents per square foot. To us it follows that the undiscounted retail price is not satisfactory, and surely not conclusive, evidence of the fair market value.

This does not mean to imply, however, that the discounted retail price of cemetery space sold prior to or at the basic date is conclusive evidence of the value of the balance of cemetery space unsold on the basic date. Value at any particular time is a fact. This fact is deduced from the application of judgment and discretion to a great many other facts and circumstances, and, as values are fluctuating and changeable, it is not easy to lay down a general and satisfactory rule applicable in all cases. For this reason any contention that a particular evidence is conclusive of value can not stand. The value reached will never be more than an approximation, but it should reflect the Board's application of its judgment to all the facts of the particular case.

It is also insisted that the Board did not apply a "correct principle of law to the facts found," and the argument is made that the "correct principle of law to the facts found" involves a determination based on retail sales, with counsel stating that the Board did not explain the "principle of law" used, as it did "in detail" in the Elmhurst case. We have given this contention considerable thought. We are convinced that the Board's decision is "in accordance with the law" (Title 26, U. S. C. A., section 641(c)1), and that the Board did apply the correct rule of law to the facts found (*Helvering* v. *Rankin*, 295 U. S., 123, 131 [Ct. D. 966, C. B. XIV-1, 160 (1935)]).

In its Elmhurst decision, the Board briefly stated that the taxpayer's valuation, which was based on the retail sales price, was "reasonable and should be allowed," adding that this price was substantial evidence of the fair market value. In the Board's present decision, it refused to accept any particular evidence as conclusive. In essence, the Board in this case considered all the evidence submitted and all the methods of valuation advocated by the witnesses, and then commented on this evidence and on the methods used. If its decision means anything, it means that the Board weighed all the evidence, and that it viewed the methods of valuation used by the witnesses as guides or checks on its judgment and discretion, in determining the fair market value on March 1, 1913.

Retail sales constitute only one element to be taken into consideration in the determination of the fair market value of the cemetery land, and the use of the retail price method alone is not justified. The same consideration is applicable to the element of time required to sell the cemetery land and the present-value method which is based thereon. Along with the time element and the retail selling price there should be taken into consideration the cost of acquisition of the cemetery, the location, age, size and topography, the state of development, the existence of competing cemeteries, the type of clientele, the trend of population served, annual net earnings, and other related matters. Consideration of all the evidence bearing on the value is compliance with the law. The Board in its decision clearly indicated, and the Board is correct, that value at any particular time is a fact which can only be deduced properly by judging and weighing all the pertinent evidence in the case.

We believe also that the Board's finding of 23 cents as the value per square foot meets the substantial evidence test. Although we might have found a different value had we been judge and weigher of the facts, this is not the test. Since the determination of value involves a question of discretion, and the exact value is not in the evidence of the case, we can appreciate that no two judges of the same facts would agree. At any rate, mathematical precision is impossible and it is gospel that the value reached can never be more than an approximation. We, of course, are bound by the rule that where there is substantial evidence to support the Board's finding upon a question of fact, its decision of such a question is conclusive upon review. (*Elmhurst Cemetery Co.* v. *Commissioner*, supra; *Palmer* v. *Commissioner*, 302 U. S., 63, 70 [Ct. D. 1284, C. B. 1937-2, 251]; *Helvering* v. *National Grocery Co.*, 304 U. S., 282, 294 [Ct. D. 1341, C. B. 1938-1, 279].)

That there is substantial evidence to support the administrative finding can not be disputed. The record clearly points to a value between 15 cents and 80 cents per square foot. All methods of valuation described and used in the record, except Montrose's undiscounted sales method, indicate values ranging from 15 cents to 30 cents. Thus, the present-value method gave a value of 15 cents, and it is to be noted that some consideration was given to retail sales. The reproductive appraisal also indicated a value of 15 cents, and capitalizing net earnings in 1912 or 1913 at 5 per cent would have given a value between 25 cents and 30 cents.

There were other facts and circumstances pointing to the same result. For instance, the original transaction, in which the raw land worth $75,000 was exchanged for the capital stock at $300,000, gave a value increment over cost of $225,000 at once. In addition, the capital stock returns showed a value below 20 cents, and the letters to the Commissioner, containing three retrospective appraisals, valued the unimproved land at 15 cents and the improved land at 25 cents. This brief review of the evidence, which is adequately described in the statement of facts above, leads to the conclusion that the Board's finding of 23 cents per square foot is adequately supported by the evidence.

Counsel for Montrose presses the argument that the "issue here is the March 1, 1913, fair market value of the 14,993.67 square feet of land sold in 1931 and not the fair market value of the balance of the cemetery land amounting to 2,214,786 square feet on hand March 1, 1913." We do not disagree, yet we fail to see why he raises this contention. As we have read the record, the basis applicable to the space sold in 1931 was found. The evidence by both sides was directed toward the ascertainment of the tax basis of the land sold in 1931, and the Board acted on this evidence.

Let us assume that the cemetery was acquired on March 1, 1913. Then the acquisition cost would be allocated properly to portions of the cemetery land sold in subsequent sales. Since in the instant case we are seeking a tax basis in place of the usual cost basis described in the hypothetical case, we are under the impression that the same treatment should be accorded in both cases. Montrose does not suffer injury if in the instant case the basis for the total unsold acreage is first found and allocation made later as sales therefrom are made.

Moreover, the total of the basis for all of the separate sales of burial space can not exceed the value of the unsold land in 1913. It would seem immaterial, therefore, whether the basis applicable to the footage sold in 1931 was determined directly, or whether the value of the entire unsold land in 1913 was first determined and then an allocation made to the space sold in 1931. The basis does not vary, no matter which way is used.

One other contention requires consideration. Counsel for Montrose says, "We have read and reread the decision of the Board * * * but we can not figure out from its decision how it arrived at $0.23 * * *. We maintain that from the evidence in this record the only findings that the Board could make were $0.15 per square foot, $0.94 per square foot or $0.9987 per square foot and nothing else because those valuations were the only valuations that the Board had before it * * *." In effect, this argument is another form of the broader contention that the Board applied an incorrect principle of law in arriving at its decision.

We have already answered the contention in our discussion above. In addition, the court in *Helvering* v. *Rankin*, supra, pages 132–133, stated that "even if the Board's decision had been based on an erroneous rule of law, that would not have justified its reversal, if the findings of fact, governed by the correct rule of law, were sufficient to sustain the decision and had substantial support in the evidence." We have already shown that this quoted statement is applicable here. Nor do we know of any legal principle that compels the Board to accept the exact valuations made by the interested parties. Surely there can be no dispute on the proposition that the Board in the exercise of its judgment and in the weighing of the evidence may fix an independent value.

It is true that the Board did not reveal in its opinion how it arrived at its conclusion that the value was 23 cents per square foot. Although omission in this regard is not ground for reversal (*Helvering* v. *Rankin*, supra, 132, 133), we do believe that the criticism is justified. Our system of law ordinarily accords administrative findings the same respect as that given jury verdicts, and rightly so. Yet, the Board, a body of experts in tax matters, usually acts as a judicial tribunal, and often renders opinions justifying the decisions reached therein. For this reason, more can be expected of it. To disclose how the Board arrived at its conclusion is not expecting too much from it.

We fully appreciate counsel's wrath in this regard. We, too, have noticed how carefully and thoroughly the Board stated the facts and how it commented on the evidence and the methods of valuations. Omission of the way it arrived at its conclusion, after such completeness, is ground for suspicion. We, moreover, attach no such sacrosanctity to the process by which a tax value is reached.

Counsel also suggests that the Board had fixed the value by capitalizing earnings. This suggestion probably has its birth in the suspicion engendered from the omission to state the method upon which it arrived at its conclusion, as it can not be taken from reading the Board's opinion. However that may be, in a case where the administrative findings are warranted by the evidence, even if the Board had considered earning power as a basis of valuation, this would not have been declared improper, for ordinarily earning power is a very reliable guide in the determination of value.

The decision of the Board is affirmed.

ARTICLE 111-1: Computation of gain or loss. 1940-14-10220 Ct. D. 1449

INCOME TAX—REVENUE ACT OF 1934—DECISION OF COURT.

1. GAIN OR LOSS—SALE OF CAPITAL ASSETS—GOLD CONTENT OF DOLLAR NOT A FACTOR IN DETERMINING GAIN OF LOSS.

The reduction made in the statutory gold content of the dollar in 1933 is not a significant factor in determining taxable gain derived in 1935 from the sale of capital assets acquired during the period 1931 to 1933. Such gain is to be measured by the difference between the cost in dollars and the selling price in dollars.

2. CERTIORARI DENIED.

Petition for certiorari denied on February 26, 1940.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

George A. Bates, plaintiff-appellant, v. *United States of America, defendant-appellee.*

[108 F. (2d), 407.]

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division.

[December 22, 1939.]

OPINION.

TREANOR, Circuit Judge: This action was brought in the district court to recover a refund of $7,134.17 which appellant claims was erroneously and illegally collected from him as income tax for the calendar year of 1935. This appeal is from a judgment in favor of the appellee.

The ultimate question is whether the plaintiff-appellant realized a taxable gain from a sale in 1935 of certain securities which he had purchased during the period of 1931 to 1933.

It is unquestioned that taxpayer purchased the securities in question for $134,464.01 and sold them in 1935 for $175,482.86 and that there was an apparent profit of $24,515.79, which was 60 per cent of $40,859.65, the difference stated in dollars between the purchase and sales price of the securities less a capital assets loss of $159.20. Plaintiff-appellant paid a tax of $7,134.17 on this returned taxable gain.

The taxpayer's claim to recover is based upon the claimed consequence of the legislative change in the statutory gold content of the dollar, which change occurred between the dates of purchase and sale of the securities. The consequences relied upon by plaintiff are clearly indicated by his following propositions of law:

(1) The realized gain theory of income is based upon a comparison of cost in money with selling price in the same money or its equivalent and changes in the purchasing power of that money are disregarded.

(2) Where new money supersedes the cost money after a purchase is made by an investor and the use of the old money is prohibited, there is no way in which a taxable gain can be realized.

(3) The only basis provided for comparing purchase prices with selling prices in this case is the gold content of the old dollar and the gold content of the new dollar, and if that basis is used the appellant has not realized a taxable gain but has suffered a loss.

We find nothing in the decisions of the Supreme Court to support the plaintiff's proposition that the income consisting of gain from a sale of "capital assets" must be determined by a comparison of "cost in money with selling price in the same money or its equivalent," as distinguished from a comparison of cost in money with selling price in money. It is true, as stated by plaintiff, that the Supreme Court frequently has declared that gain in the money value of property is not income within the constitutional meaning of that term until transaction has occurred which makes the gain, as such, available to the taxpayer and separable from the money cost. But we find no statements of the Court which go beyond the statutory method of determining "realized gain." The statutory definition of gain is the excess of the amount realized therefrom over the adjusted basis (of cost) and the loss is the excess of the adjusted basis over the amount realized; and the amount realized from the sale or other disposition of property "shall be the sum of any money received plus the fair market value of the property (other than money) received."[1]

We are of the opinion that judicial decisions and statutory enactments neither recognize, nor, by implication, attach any significance to the statutory gold content of the dollar as a factor in the determination of gain from the sale of capital assets. The standard unit of computation is the money dollar, an abstract or ideal unit of account.[2] This standard unit of money has not changed in money value throughout the existence of our monetary system. There have been changes from time to time in the form of the physical representatives of money, but lawful money in the United States has been the same since the Act of Congress of April 2, 1792, provided that "The money of account of the United States shall be expressed in dollars or units, dimes or tenths, cents or hundredths, and mills or thousandths, a dime being the tenth part of a dollar, a cent the hundredths part of a dollar, a mill the thousandths part of a dollar * * *."[3]

The *Legal Tender Cases*, supra note 2, held that Congress had the power to make "paper money" legal tender for the discharge of money obligations which had been assumed prior to the issue of paper money. It was argued that the unit of money value must possess intrinsic value and that the paper dollars, unlike the gold coin dollar, possessed no intrinsic value. The Supreme Court answered the foregoing contention as follows: "The Legal Tender Acts do not attempt to

[1] U. S. C. A., Title 26, section 111(b).

[2] "* * * we will notice briefly an argument presented in support of the position that the unit of money value must possess intrinsic value. * * * The coinage Acts fix its unit as a dollar; but the gold or silver thing we call a dollar is, in no sense, a standard of a dollar. It is a representative of it. * * *" (*Legal Tender Cases*, 12 Wall., 457, 553.)

[3] Ch. 16, 1 Stat., 246, section 20, U. S. C. A., Title 31, section 371.

make paper a standard of value. We do not rest their validity upon the assertion that their emission is coinage, or any regulation of the value of money; nor do we assert that Congress may make anything which has no value money. What we do assert is, that Congress has power to enact that the Government's promises to pay money shall be, for the time being, equivalent in value to the representative of value determined by the coinage Acts, or to multiples thereof." (Page 553.)

It was pointed out in *Norman* v. *B. & O. R. Co.*[4] that the Legal Tender Acts "left in circulation two kinds of money, both lawful and available, and contracts for payment of gold, one of these kinds, were not disturbed." Since there were in use after the passage of the Legal Tender Acts two forms of money authorized by law, metallic and paper, and since both were made legal tender in payment of obligations, it follows that a contract to pay in gold was not affected by the legislative Act which made paper money legal tender. But this resulted from the continuance by law of the two forms of money each of which was legal tender and each of which was circulating as lawful money of the United States, and not from any judicial recognition that paper money, dollar for dollar, was not equivalent in value to specie money.

In *Deutsche Bank* v. *Humphrey*[5] the plaintiff had deposited money payable on demand in a German bank in Germany. The money was not paid on demand and a suit was filed. As stated by the Court "the debt was a debt of German marks"; and the question raised on appeal was whether the courts below were correct in holding that the marks should be translated into dollars at the rate of exchange existing when the demand was made. The Supreme Court stated that the liability of the bank was fixed at a certain number of marks both by the terms of the contract and by the German law, and the Court assumed "that it was fixed in marks only, not at the extrinsic value that those marks then had in commodities or in the currency of another country." And the Court added: "An obligation in terms of the currency of a country takes the risk of currency fluctuations and whether creditor or debtor profits by the change the law takes no account of it. * * * Obviously, in fact a dollar or a mark may have different values at different times but to the law that establishes it it is always the same. If the debt had been due here and the value of dollars had dropped before suit was brought the plaintiff could recover no more dollars on that account. A foreign debtor should be no worse off."

Plaintiff seeks to avoid the force of the foregoing statement of the Supreme Court and insists that "the question of capital gain presents an entirely different question from that which is presented when parties enter into a contract which by its terms is to be settled in the currency of a particular country"; and plaintiff further states that in case of such a contract it is held by the courts that the parties have agreed to take their chances on the changes of the currency of the country, and, consequently, "it is held that marks are marks and francs are francs and dollars are dollars, no matter what changes may occur to affect their value or their purchasing power, or how such changes may be made."

But we see no way for plaintiff to avoid the adverse force of his own construction of the reasoning and holding in *Deutsche Bank* v. *Humphrey*. All of plaintiff's transactions were made in reference to the currency of the United States and we can not find any basis for plaintiff's claim to a greater protection against statutory changes in our laws relating to "money" than one has who is the owner of a note or bond and statutory changes have occurred between the dates of execution and maturity of the note or bond.

The recent decisions of the United States Supreme Court in *Norman* v. *B. & O. R. Co.*, supra, *Nortz* v. *United States*[6] and *Perry* v. *United States*[7] have established conclusively that under our present monetary system there can be no legally recognized inequivalency of value between dollars of what plaintiff calls "cost money" and "selling price money." Plaintiff's proposition that "the realized gain theory" of income is based upon a comparison of "cost in money with selling price in the same money or its equivalent" is in a sense true; but the proposition ignores the equivalency, dollar for dollar, of cost and selling price money. In *Perry* v. *United States*, supra, the plaintiff was the holder of an obligation of the United States for $10,000, known as "Fourth liberty loans, 4½ per cent gold bond." The bond provided "The principal and interest hereof

[4] 294 U. S., 240.
[5] 272 U. S., 517, 519.
[6] 294 U. S., 317.
[7] 294 U. S., 330.

are payable in United States gold coin of the present standard of value." It was the contention of the plaintiff that he was entitled to receive in payment of the bond 10,000 gold dollars each containing 25.8 grains of gold .9 fine or its equivalent in gold by weight, either in the form of gold coin or uncoined gold, or, in the alternative, $16,931.25 in legal tender currency. The United States refused to redeem the bond except by payment of $10,000 in legal tender currency and the plaintiff sued to recover damages "in the sum of $16,931.25, the value of defendant's obligation." The Supreme Court held that the joint resolution of June 5, 1933, "insofar as it attempted to override the obligation created by the bond in suit went beyond the congressional power"; but the Court further held that despite the breach of the obligation of the bond by the United States the facts alleged in plaintiff's petition did not show a cause of action for actual damages. The foregoing result was required, as pointed out by the Court, because the recent monetary legislation had created a domestic economy in respect to gold, and a single monetary system with an established parity in all currency and coins, under which $10,000 in the form of currency would be equivalent in value to $10,000 of what plaintiff denominates "old money," whether gold coin money or currency money.

By reason of the fact that gold coins no longer circulate as a medium of exchange and since no private citizen can lawfully possess gold coins or gold bullion, and since, with a few immaterial exceptions, the only thing that one can do with gold or gold coin is to turn it in to the United States Treasury and receive in exchange an equivalent in currency, the equivalency being determined on the basis of the present statutory content of the dollar,[8] it must follow that in law the selling price in dollars of plaintiff's securities was equivalent to the same number of dollars in any one of the forms of what plaintiff calls "cost money."

The following hypothetical situation suggested by defendant illustrates the difficulty of plaintiff's position: If the taxpayer had borrowed the dollars ($134,-464.01) necessary to buy the securities in question in 1933 and prior years and had not discharged his obligation until after he sold the securities in 1935 the taxpayer could have used $134,464.01 to discharge his obligation and would have had the excess of $41,018.85. And it is clear, as a matter of law, that his creditor who received the taxpayer's promise to pay at a time prior to the changing of the gold content of the dollar would have been required to accept in discharge of the obligation $134,464.01 of the so-called "new money," although the obligation represented what plaintiff calls "cost money."

The judgment of the district court is affirmed.

SECTION 112(a).—RECOGNITION OF GAIN OR LOSS: GENERAL RULE.

ARTICLE 112(a)-1: Sales or exchanges. 1940-25-10298
G. C. M. 21915

REVENUE ACT OF 1928.

> A, who acquired 82*y* shares in the M Trust for 125*x* dollars, each share representing a fractional interest in a unit consisting of a certain number of shares in each of 26 corporations plus a proportionate part of a reserve fund, with privilege of converting the trust certificates into the underlying stocks, sustained a recognizable loss when she exercised the right of conversion and received in lieu of her trust certificates stocks in the 26 corporations to the value of 32*x* dollars and 8*x* dollars in cash, the cash covering odd lots in conformity with the conversion plan.
>
> G. C. M. 10235 (C. B. XI-1, 68 (1932)) revoked.

An opinion is requested whether the loss sustained by A on the conversion of 82*y* shares of the M Trust (an investment trust) into

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[8] See discussion in *Norman* v. *B. & O. R. Co.; Nortz* v. *United States* and *Perry* v. *United States*, supra.

the underlying stocks held by the trust is recognizable for purposes of the Federal income tax under the circumstances herein set forth. The inquiry is made with special reference to G. C. M. 10235 (C. B. XI-1, 68 (1932)), wherein it was held that no gain or loss resulted for income tax purposes in a similar transaction.

Prior to July —, 1931, A (hereinafter referred to as the taxpayer) purchased 82y shares of the M Trust, a fixed investment trust created by an agreement, dated January —, 1929, between the N Company (hereinafter referred to as the depositor) and the O Trust Co. as trustee. The cost of these shares was 125x dollars. The trust fund was composed of shares of stock in 26 corporations. The certificates which the taxpayer received provided that each share represented 1/4000 interest in (1) a stock unit consisting of 4 shares of stock of each of 26 specified companies, and (2) the proportion of the reserve fund which might be held by the trustee from time to time. The certificate further provided as follows:

The bearer of any such certificate or certificates representing an aggregate of 10y shares of the M Trust or any multiple thereof at his option, and upon the expiration of such time as the trustee shall with reasonable diligence require for the transfer of the shares of stock involved, upon reimbursing the trustee for its actual expenses in connection with the transfer and upon such surrender to the trustee of such certificates with all unmatured coupons, shall be entitled to receive such part of the deposited property held by the trustee on the date of surrender (not then distributable with respect to matured coupons) as shall bear the same proportion to all such deposited property (not then distributable with respect to matured coupons) as the number of shares of the M Trust represented by such certificate or certificates shall bear to the total number of shares of the M Trust then outstanding. Any fractional interest in securities or other property is to be adjusted in cash as provided in the agreement; provided, however, that if the number of M Trust shares represented by such certificate or certificates shall not be evenly divisible by 10y the depositor shall have the option to purchase the certificate or certificates representing such part of the stock unit and any cash and other property deliverable therewith by paying to such bearer a sum equal to such cash and the market value of such part of the stock unit and other property (as in the agreement defined).

On December —, 1931, the taxpayer surrendered her trust certificates and received from the trustee shares of stock in the 26 corporations having an aggregate market value of 32x dollars. She also received 8x dollars in cash covering fractional shares. The taxpayer deducted in her return for the year 1931 a loss of the difference between the cost to her of the 82y shares of the trust and the value of the property received upon their surrender to the trustee. This deduction was disallowed by the Commissioner upon the theory advanced in G. C. M. 10235, supra, that the surrender of certificates of beneficial interest in such an investment trust for a pro rata share of the underlying corporate stocks representing the corpus of the trust was a merger of the legal with the equitable title and, therefore, did not constitute a sale, exchange, or other disposition of property which constituted a taxable transaction involving gain or loss for Federal income tax purposes.

The Board of Tax Appeals held with respect to a similar trust, contrary to G. C. M. 10235, supra, that a loss upon the exchange of the trust shares for the corporate stock would be recognized. (*Du Bois Young* v. *Commissioner*, 34 B. T. A., 648, nonacquiescence,

C. B. XV-2, 51 (1936).) The Board reached the same conclusion in *Commissioner* v. *Tew* (memorandum opinion dated January 9, 1940), which decision was affirmed by the Circuit Court of Appeals for the Sixth Circuit (108 F. (2d), 570). The court stated in part that:

We agree with the Board, however, that the respondent received in this transaction something different from the property right which she surrendered. She had possessed an undivided interest in the entire block of stocks owned by the trust, which was subject to change by the trustee. She received certain individual securities. The trust * * * was separate enough from the respondent so that it was a taxable entity * * *. It owned the stocks, and respondent had only an interest in them; hence respondent's ownership of the certificate was totally different from her ownership of individual segregated shares of stock.

While the respondent had an equitable interest in all stock owned by the trust, she did not have an exclusive beneficial interest therein, for she shared her interest with all other certificate holders. Moreover, when the respondent terminated the trust relationship, she surrendered her interest in the other shares remaining in the trust. The transaction thus effected a substantial change in her property interest * * * and constituted an exchange within section 112(a) of the Revenue Act of 1928.

The court reached the conclusion that in the particular trust involved the taxpayer, when she surrendered her certificates of beneficial interest and received her pro rata share of the stocks constituting the corpus of the trust, received something essentially different from what she had previously owned. This office. concurs in the decision of the court.

Since the conclusion reached in G. C. M. 10235, supra, is contrary to the decision in *Tew* v. *Commissioner*, supra, G. C. M. 10235 is hereby revoked. It is also recommended that the nonacquiescence in the decision of the Board of Tax Appeals in *Du Bois Young* v. *Commissioner*, supra, be withdrawn.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

Article 112(a)-1: Sales or exchanges. 1940-18-10247
G. C. M. 21998

REVENUE ACTS OF 1926 AND 1928.

In view of the fact that the conclusion reached in G. C. M. 8098 (C. B. IX-1, 195 (1930)), that there was a sale of an equitable interest in certain property in the transaction there involved, is contrary to the principle laid down in *Helvering* v. *F. & R. Lazarus & Co.* (308 U. S., 252, Ct. D. 1430, C. B. 1939-2, 208), that ruling is revoked.

The opinion of the United States Supreme Court in *Helvering* v. *F. & R. Lazarus & Co.* (308 U. S., 252), affirming the decision of the United States Circuit Court of Appeals, Sixth Circuit (101 F. (2d), 728), which affirmed the decision of the Board of Tax Appeals (32 B. T. A., 633), was published as Court Decision 1430, C. B. 1939-2, 208. The syllabus reads in part as follows:

A corporation occupied and used in its business three buildings, the legal title to two of which, and an assignment of a 99-year lease to the third, were in a bank as trustee for certain land-trust certificate holders. At the time of the transfer of the properties to the trustee bank, in 1928, all three buildings were leased back to the corporation by the trustee for 99 years, with option to renew and purchase. *Held*, That the Board of Tax Appeals justifiably concluded, from a consideration of all the evidence, that the transaction between the corporation and the trustee, in written form a transfer of ownership with a lease back, was in reality a mortgage loan secured by the property involved, and that, in computing its net taxable income for 1930 and 1931, the corporation was entitled to the statutory allowance for depreciation of buildings.

On facts substantially similar to those in *Helvering* v. *F. & R. Lazarus & Co.*, supra, this office held, *inter alia*, in G. C. M. 8098 (C. B. IX-1, 195 (1930)) that a sale of an equitable interest in certain property resulted. Since that conclusion is contrary to the principle laid down in *Helvering* v. *F. & R. Lazarus & Co.*, supra. G. C. M. 8098, supra, is revoked. (See also *Commissioner* v. *The H. F. Neighbors Realty Co.* (81 F. (2d), 173).)

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

SECTION 112(g).—RECOGNITION OF GAIN OR LOSS: DEFINITION OF REORGANIZATION.

Article 112(g)-2: Definition of terms. 1940-3-10143
Ct. D. 1432

INCOME TAX—REVENUE ACT OF 1928—DECISION OF SUPREME COURT.

1. Reorganization—Transfer of All Properties of One Company for Cash and Bonds of Another Company.

Pursuant to a contract between the X Company, the petitioner (its sole stockholder), and the Y Company, whereby it was agreed that all the properties owned, and to be owned, by the X Company should be transferred to the Y Company for cash and bonds of the latter payable serially over a period of years, the petitioner turned over to the X Company certain properties owned by him individually in exchange for an increased issue of the X Company's stock, the transfer agreed upon was then made, and the X Company was dissolved. *Held:* That the transaction did not amount to a reorganization within the meaning of section 112(i) of the Revenue Act of 1928, inasmuch as the transferor, by receiving bonds as partial consideration for the transfer, did not retain any proprietary interest in the enterprise but became merely a creditor of the transferee; the term of the obligations, whether long term bonds or short term notes, not being material.

2. Cross Petition—Necessity for Filing in Order to Have Adverse Judgment Reviewed.

The Court can not afford relief to the respondent from the portion of the judgment below which was adverse to him, since he did not file a cross petition asking for review. A respondent or an appellee may urge any matter appearing in the record in support of a judgment, but he may not attack it even on grounds asserted in the court below, in an effort to have the Court reverse it, when he himself has not sought review of the whole judgment, or of that portion which was adverse to him.

3. Decision Affirmed.

Decision of the United States Circuit Court of Appeals, Fifth Circuit (1939) (103 F. (2d), 20), affirmed.

SUPREME COURT OF THE UNITED STATES.

V. L. LeTulle, petitioner, v. Frank Scofield, United States Collector of Internal Revenue for the First District of Texas.

[308 U. S., 415.]

On writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[January 2, 1940.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the Court.

We took this case because the petition for certiorari alleged that the circuit court of appeals had based its decision on a point not presented or argued by the litigants, which the petitioner had never had an opportunity to meet by the production of evidence.

The Gulf Coast Irrigation Co. was the owner of irrigation properties. Petitioner was its sole stockholder. He personally owned certain lands and other irrigation properties. November 4, 1931, the Irrigation company, the Gulf Coast Water Co., and the petitioner, entered into an agreement which recited that the petitioner owned all of the stock of the Irrigation company; described the company's properties, and stated that, prior to conveyance to be made pursuant to the contract, the Irrigation company would be the owner of certain other lands and irrigation properties. These other lands and properties were those which the petitioner individually owned. The contract called for a conveyance of all the properties owned, and to be owned, by the Irrigation company for $50,000 in cash and $750,000 in bonds of the Water company, payable serially over the period January 1, 1933, to January 1, 1944. The petitioner joined in this agreement as a guarantor of the title of the Irrigation company and for the purpose of covenanting that he would not personally enter into the irrigation business within a fixed area during a specified period after the execution of the contract. Three days later, at a special meeting of stockholders of the Irrigation company, the proposed reorganization was approved, the minutes stating that the taxpayer, "desiring also to reorganize his interest in the properties," had consented to be a party to the reorganization. The capital stock of the Irrigation company was increased and thereupon the taxpayer subscribed for the new stock and paid for it by conveyance of his individual properties.

The contract between the two corporations was carried out November 18, with the result that the Water company became owner of all the properties then owned by the Irrigation company including the property theretofore owned by the petitioner individually. Subsequently all of its assets, including the bonds received from the Water company, were distributed to the petitioner. The company was then dissolved. The petitioner and his wife filed a tax return as members of a community in which they reported no gain as a result of the receipt of the liquidating dividend from the Irrigation company. The latter reported no gain for the taxable year in virtue of its receipt of bonds and cash from the Water company. The Commissioner of Internal Revenue assessed additional taxes against the community, as individual taxpayers, by reason of the receipt of the liquidating dividend, and against the petitioner as transferee of the Irrigation company's assets in virtue of the gain realized by the company on the sale of its property. The tax was paid and claims for refund were filed. Petitioner's wife having died he brought suit individually and as her executor and representative in the community property against the respondent to recover the amount of the additional taxes so assessed. He alleged that the transaction constituted a tax-exempt reorganization as defined by the Revenue Act.[1] The respondent traversed the allegations of the complaints and the causes were consolidated and tried by the district court without a jury. The respondent's contention that the transaction amounted merely to a sale of assets by the petitioner and the Irrigation company and did not fall within the statutory

[1] Section 112(i) of the Revenue Act of 1928 (ch. 852, 45 Stat., 791, 818).

definition of a tax-free reorganization was overruled by the district court and judgment was entered for the petitioner.

The respondent appealed, asserting error on the part of the district court in matters not now material and also assigning as error the court's holding that the transaction constituted a nontaxable reorganization.

The circuit court of appeals concluded that, as the Water company acquired substantially all the properties of the Irrigation company, there was a merger of the latter within the literal language of the statute, but held that, in the light of the construction this Court has put upon the statute, the transaction would not be a reorganization unless the transferor retained a definite and substantial interest in the affairs of the transferee. It thought this requirement was satisfied by the taking of the bonds of the Water company, and, therefore, agreed with the district court that a reorganization had been consummated. It added, however, "We find a reason for reversing the judgment which has not been argued." Adverting to the fact that the transfer of the petitioner's individual properties to the Irrigation company was for the purpose of including them in the latter's assets to be transferred in the proposed reorganization, the court said the statute did not extend to the reorganization of an individual's business or affairs, and the transaction was a reorganization within the meaning of the Revenue Act as respects the corporation's assets owned on November 4, 1931, but not as respects the petitioner's individual properties included in the sale. It concluded: "Only so much of the consideration as represents the price of the properties and business of the Irrigation company is entitled to be protected from taxation as arising from a reorganization. It does not appear what the proper apportionment is. The burden was upon LeTulle to show not only that he had been illegally taxed, but how much of what was collected from him was illegal. The latter he did not do. The evidence does not support the judgment for the full amount paid by him. It is accordingly reversed, that further proceedings may be had consistent herewith."[2]

The petitioner sought certiorari asserting that the circuit court of appeals had departed from the usual and accepted course of judicial proceedings by deciding the cause upon a ground not presented or argued and hence had deprived the petitioner of his day in court. The respondent, though he had contended below that the transaction in question did not amount to a tax-free statutory reorganization, did not file a cross petition asking for a review of that part of the judgment exempting from taxation gain to the Irrigation company arising from the transfer of its assets owned by it on and prior to November 4, 1931, and the part of the liquidating dividend attributable thereto.

We find it unnecessary to consider petitioner's contention that the circuit court of appeals erred in deciding the case on a ground not raised by the pleadings, not before the trial court, not suggested or argued in the circuit court of appeals, and one as to which the petitioner had never had the opportunity to present his evidence, since we are of opinion that the transaction did not amount to a reorganization and that, therefore, the petitioner can not complain, as the judgment must be affirmed on the ground that no tax-free reorganization was effected within the meaning of the statute.

Section 112(i) provides, so far as material:

"(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), * * *."

As the court below properly stated, the section is not to be read literally, as denominating the transfer of all the assets of one company for what amounts to a cash consideration given by the other a reorganization. We have held that where the consideration consists of cash and short term notes the transfer does not amount to a reorganization within the true meaning of the statute, but is a sale upon which gain or loss must be reckoned.[3] We have said that the statute was not satisfied unless the transferor retained a substantial stake in

[2] 103 F. (2d), 20.

[3] *Pinellas Ice & Cold Storage Co.* v. *Commissioner* (287 U. S., 462 [Ct. D. 630, C. B. XII-1, 161 (1933)]).

the enterprise and such a stake was thought to be retained where a large proportion of the consideration was in common stock of the transferee,[4] or where the transferor took cash and the entire issue of preferred stock of the transferee corporation.[5] And, where the consideration is represented by a substantial proportion of stock, and the balance in bonds, the total consideration received is exempt from tax under section 112(b)4 and 112(g).[6]

In applying our decision in the Pinellas case (supra) the courts have generally held that receipt of long term bonds as distinguished from short term notes constitutes the retention of an interest in the purchasing corporation. There has naturally been some difficulty in classifying the securities involved in various cases.[7]

We are of opinion that the term of the obligations is not material. Where the consideration is wholly in the transferee's bonds, or part cash and part such bonds, we think it can not be said that the transferor retains any proprietary interest in the enterprise. On the contrary, he becomes a creditor of the transferee; and we do not think that the fact referred to by the circuit court of appeals, that the bonds were secured solely by the assets transferred and that, upon default, the bondholder would retake only the property sold, changes his status from that of a creditor to one having a proprietary stake, within the purview of the statute.

We conclude that the circuit court of appeals was in error in holding that, as respects any of the property transferred to the Water company, the transaction was other than a sale or exchange upon which gain or loss must be reckoned in accordance with the provisions of the Revenue Act dealing with the recognition of gain or loss upon a sale or exchange.

Had the respondent sought and been granted certiorari the petitioner's tax liability would, in the view we have expressed, be substantially increased over the amount found due by the circuit court of appeals. Since the respondent has not drawn into question so much of the judgment as exempts from taxation gain to the Irrigation company arising from transfer of its assets owned by it on and prior to November 4, 1931, and the part of the liquidating dividend attributable thereto, we can not afford him relief from that portion of the judgment which was adverse to him.

A respondent or an appellee may urge any matter appearing in the record in support of a judgment,[8] but he may not attack it even on grounds asserted in the court below, in an effort to have this Court reverse it, when he himself has not sought review of the whole judgment, or of that portion which is adverse to him.[9]

The judgment of the circuit court of appeals is affirmed and the cause is remanded to the district court with directions to proceed in accordance with the opinion and mandate of the circuit court of appeals.

So ordered.

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[4] *Helvering* v. *Minnesota Tea Co.* (296 U. S., 378 [Ct. D. 1060, C. B. XV–1, 189 (1936)]).

[5] *Helvering* v. *Nelson* (296 U. S., 374 [Ct. D. 1062, C. B. XV–1, 274 (1936)]).

[6] 45 Stat., 816, 818. (See *Helvering* v. *Watts*, 296 U. S., 387 [Ct. D. 1063, C. B. XV–1, 276 (1936)]).

[7] *Worcester Salt Co.* v. *Commissioner* (75 F. (2d), 251); *Lilienthal* v. *Commissioner* (80 F. (2d), 411, 413); *Burnham* v. *Commissioner* (86 F. (2d), 776 [Ct. D. 1245, C. B. 1937–2, 281]); *Commissioner* v. *Kitselman* (89 F. (2d), 458); *Commissioner* v. *Freund* (98 F. (2d), 201); *Commissioner* v. *Tyng* (106 F. (2d), 55); *L. & E. Stirn* v. *Commissioner* (C. C. A. 2) (decided November 6, 1939).

[8] *Langnes* v. *Green* (282 U. S., 531, 535–537); *Helvering* v. *Gowran* (302 U. S., 238, 245 [Ct. D. 1292, C. B. 1938–1, 300]); *Ticonic Bank* v. *Sprague* (303 U. S., 406, 410, note 3).

[9] *The Stephen Morgan* (94 U. S., 599); *Mount Pleasant* v. *Beckwith* (100 U. S., 514, 527); *United States* v. *Blackfeather* (155 U. S., 180, 186); *Landram* v. *Jordan* (203 U. S., 56, 62); *Bothwell* v. *United States* (254 U. S., 231, 233); *United States* v. *American Railway Express Co.* (265 U. S., 425, 435); *Morley Construction Co.* v. *Maryland Casualty Co.* (300 U. S., 185, 191).

ARTICLE 112(g)-2: Definition of terms.

1940-6-10168
Ct. D. 1438

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

GAIN OR LOSS—REORGANIZATION—TRANSFER OF CORPORATE ASSETS FOR CASH AND STOCK—OPTION AGREEMENT FOR SALE OF STOCK.

A corporation transferred its assets and business in consideration of cash and shares of stock in a new corporation, and, pursuant to an option agreement executed prior to the receipt of the stock, received cash therefor soon after its assets were transferred. All the cash received was distributed among the stockholders and the corporation was then legally dissolved. *Held:* That, under the particular facts, the transferor corporation acquired no substantial interest in the new corporation, hence there was no consolidation or merger within the meaning of section 112(i) of the Revenue Act of 1928, and gain is to be recognized from the transaction.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

The Banner Machine Co. v. *C. F. Routzahn, Collector of Internal Revenue.*
[107 F. (2d), 147.]

Appeal from the United States District Court for the Northern District of Ohio, Eastern Division.

[November 9, 1939.]

OPINION.

ALLEN, Circuit Judge: Appeal from a judgment dismissing appellant's petition for refund of income taxes paid for the period from January 1, 1928, to July 12, 1928. Jury trial was waived, and the facts are stipulated. The sole question is whether disposition of appellant's assets and business on July 12, 1928, was made pursuant to a plan of reorganization, merger, or consolidation, to which appellant was a party, as contended by appellant, or whether, as urged by appellee, it was an outright sale. If appellant's contention is correct, no gain is recognized in the transaction under section 112(b)4 of the Revenue Act of 1928 (45 Stat., 791).

Appellant, a manufacturer of rubber machinery and equipment, was an Ohio corporation with stock outstanding of 104 shares preferred and 15,000 shares common. The majority stockholders of the corporation agreed with one Francis Quinn, a promoter, that Quinn should purchase appellant's assets and business for $500,000 cash and 4,000 shares of common stock of the National Rubber Machinery Co., a corporation to be organized to take over the business and assets of appellant and three other corporations.

The new corporation was to be organized with an issue of 152,000 shares of common stock and $1,300,000 first mortgage bonds. Certain of the common stock was to be used for the conversion of the bonds and to be sold to the underwriters and promoter, and 50,000 shares were to be distributed among the four corporations transferring their assets to the new corporation. The liabilities of appellant, totaling $42,230.97, were to be assumed by the new corporation. Under the transfer agreement, appellant could not sell the shares of the National Rubber Machinery Co. to any other than holders of shares in the new corporation for a year and a half from the date of issue.

The new corporation was organized in accordance with the plan outlined above. Quinn assigned his contracts with the four corporations to the new corporation, and all instruments of conveyance and transfer were executed by appellant in accordance with the contract. The transfer was completed, and appellant received $500,000 in cash and 4,000 shares in the new corporation. It distributed the cash among its stockholders on July 18. On July 12 the 4,000 shares had been delivered to a bank in escrow to be sold under a 60-day option agreement with the underwriter, which was accepted on behalf of appellant on July 5. The consideration paid for the option was $2,000. On September 10, 1928, the underwriter paid the escrow agent an additional $94,000 under the terms of the option, and this amount was delivered to appellant, which at once distributed the money among the stockholders. The legal dissolution of appellant corporation followed on October 1, 1928.

The case arises under the Revenue Act of 1928, the material sections of which are printed in the margin.[1]

If, as contended by appellant, the transaction was made pursuant to a plan of reorganization, merger or consolidation, no gain is recognized in the transaction under section 112(b)4. The district court held upon the authority of *Helvering* v. *Minnesota Tea Co.* (296 U. S., 378 [Ct. D. 1060, C. B. XV-1, 189 (1936)]), that no such substantial interest in the acquiring corporation was received by appellant as would bring it within the meaning of consolidation or merger as defined in section 112(i), and that section 112(b)4 therefore did not apply.

We agree with the district court that this transaction was not a consolidation or merger within the definition of the statute. In the Minnesota Tea Co. case, while the Supreme Court states that the statute covers situations outside of strict merger or consolidation, it reaffirms the limitation laid down in *Pinellas Ice & Cold Storage Co.* v. *Commissioner* (287 U. S., 462, 470 [Ct. D. 630, C. B. XII-1, 161 (1933)]), that "the mere purchase for money of the assets of one company by another is beyond the evident purpose of the provision, and has no real semblance to a merger or consolidation."

In substance, the instant case presents nothing but the purchase of appellant's assets. It is true that in addition to cash, stock was received; but the purpose to reduce that stock to cash was clearly shown by the giving of the option to the underwriter for the sale of the stock prior to the receipt thereof. Appellant in effect discounted the stock for cash. The two corporations in fact did not contemplate a reorganization, merger or consolidation. Appellant, in the letter sent to the stockholders for the purpose of explaining the transaction, stated "Your company having sold all of its assets and business on July 12, 1928, is now in process of final liquidation and dissolution." In the petition for refund appellant points out that it is in process of liquidation. Appellant did not wish to retain any interest whatever in the new corporation.

Appellant relies upon *Miller* v. *Commissioner* (84 Fed. (2d), 415) (C. C. A. 6), but this case is not controlling here. As interpreted in the Minnesota Tea Co. and the Pinellas Ice & Cold Storage Co. cases, supra, the statute embraces circumstances "difficult to delimit." It follows that cases arising under this statute will necessarily be decided upon their peculiar facts. The Supreme Court, in the Minnesota Tea Co. case, went on to say that the interest which would permit a taxpayer to claim exemption under this status "must be definite and material; it must represent a substantial part of the value of the thing transferred. This is necessary in order that the result accomplished may genuinely partake of the nature of merger or consolidation." Here the interest in the new corporation was of the value of $96,000 as compared with $500.000 cash received. We do not consider that this interest, of which the corporation immediately desired to divest itself, was so substantial a part of

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[1] Section 112(a): Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

Section 112(b)4: No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

Section 112(d): If an exchange would be within the provisions of subsection (b)(4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

Section 112(i): As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) the transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

the value of the new corporation that any genuine merger or consolidation existed in the transaction.

The Commissioner did not err in taking into consideration the entire selling price in taxing the profits.

The judgment is affirmed.

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION.

ARTICLE 114–1: Basis for allowance of depreciation and depletion. 1940–11–10198 G. C. M. 21926

REVENUE ACT OF 1926 AND SUBSEQUENT REVENUE ACTS.

The conclusion reached in G. C. M. 2315 (C. B. VI–2, 21 (1927)), that oil and gas operators who had elected to deduct development expenditures in computing net income must treat such expenditures as deductions in computing the limitation (50 per cent of the net income) on the depletion allowance, is properly applicable under the Revenue Act of 1926 as well as under subsequent Revenue Acts.

An opinion is requested whether, in view of the decisions of the Supreme Court of the United States in *Helvering* v. *Wilshire Oil Co., Inc.* (308 U. S., 90, Ct. D. 1424, C. B. 1939–2, 213), and in *F. H. E. Oil Co.* v. *Helvering* (308 U. S., 104, Ct. D. 1423, C. B. 1939–2, 212), G. C. M. 2315 (C. B. VI–2, 21 (1927)) is sound in holding that oil and gas operators, who had elected to deduct development expenditures in computing net income, must treat such expenditures as deductions in computing the limitation (50 per cent of the net income) on the depletion allowance under the Revenue Act of 1926.

While the above-cited cases did not involve years controlled by the Revenue Act of 1926, the reasoning employed by the Court in sustaining the practice first established by G. C. M. 2315, supra, as applied to years controlled by the Revenue Acts of 1928 and 1932, confirms such practice for years controlled by the Revenue Act of 1926.

The Court held that the contrary practice established under the regulations pertaining to the Revenue Acts of 1921 and 1924 had not, by subsequent reenactments of the pertinent statutory provision without change, evolved into settled law beyond the power of the Commissioner to change by regulatory action. After reviewing the evolution of the regulations bearing upon the point, the Court concluded that " it is apparent that the delimitation implied in the permission to deduct 'operating expenses' present under the earlier regulations disappeared from the 1926 regulations in case of oil and gas wells." (See footnote 10.) Also, that part of the text of the decision to which such footnote pertains points out that the earlier provision of the regulations upon which the prior contrary practice had been based was eliminated from the regulations under the Revenue Act of 1926, and that the Commissioner undertook under that Act to reverse the practice. It thus appears that the Court recognized a proper change in the regulations and in practice under the Revenue Act of 1926.

Having established the proposition that the treatment of such development expenditures in computing the net income limitation on the percentage depletion allowance was subject to regulatory change, and having pointed out that regulatory changes were in fact made under the Revenue Act of 1926 as well as under the Revenue Act of 1928, the Court then considered the question as to whether such changes were retroactive in character. Upon this point the Court stated that such regulatory changes were not retroactive in character merely by reason of the fact that they affected years in which taxpayers were bound to expense development costs by reason of an election exercised in some prior period. The Court then pointed out, in effect, that in any event Treasury Decision 4025 (C. B. VI–1, 75 (1927)), which during 1927 permitted the exercise of a new election for years beginning with the year 1925, and G. C. M. 2315, supra, which at the same time gave notice of the change in the practice in question, left the taxpayer without just ground for complaint that it was inequitable to reverse the practice after binding him by his election. As both the new election and the notice of the change in practice were announced prior to the enactment of the Revenue Act of 1928 and were made effective beginning with the year 1925, the first year controlled by the Revenue Act of 1926, such reasoning supports the applicability of G. C. M. 2315, supra, to years controlled by the Revenue Act of 1926 as well as to later years.

For the reasons stated, it is the opinion of this office that G. C. M. 2315, supra, should be applied to all years beginning with the year 1925.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

SECTION 116.—EXCLUSIONS FROM GROSS INCOME.

REVENUE ACT OF 1928.

G. C. M. 12167 (C. B. XII–2, 126 (1933)) modified. (See G. C. M. 22065, page 100.)

SUPPLEMENT C.—CREDITS AGAINST TAX.

SECTION 131.—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

Article 131–6: When credit for taxes may be taken. 1940–2–10139
G. C. M. 21788

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

The decision of the Board of Tax Appeals in *Universal Winding Co.* v. *Commissioner* (39 B. T. A., 962, acquiescence, page 5, this Bulletin) should be applied with respect to the accrual of British taxes arising under the British Income Tax Law as changed by the Finance Act of 1926. The principles outlined in G. C. M. 10613 (C. B. XI–1, 173 (1932)) and in *Columbian Carbon Co.* v. *Commissioner* (25 B. T. A., 456, acquiescence, C. B. XI–1, 2 (1932)) should be applied only with respect to British income taxes imposed under the British law before its change by the Finance Act of 1926.

G. C. M. 10613 modified.

In G. C. M. 10613 it was held that:

British income taxes assessable for the British year of assessment, April 6–April 5, regardless of whether such taxes are based on the average income of a 3-year period or on the income of the preceding year, accrue on the first day of the British tax year of assessment, for it appears that liability for the payment of the British taxes is dependent upon whether the taxpayer continues in business during the year of assessment.

In view of the decision of the Board of Tax Appeals in *Universal Winding Co.* v. *Commissioner* (39 B. T. A., 962, acquiescence, page 5, this Bulletin), the principle enunciated in G. C. M. 10613, supra, should be applied only in cases where the British income taxes were imposed under the British law existing prior to the enactment of the British Finance Act of 1926. In the Universal Winding Co. case it is pointed out that the Finance Act of 1926 accomplished the following changes in the British law:

(1) It abolished the 3-year average profit provision and substituted the full amount of profits or gains or income of the year preceding assessment.

(2) It made the taxpayer subject to tax even if he made no profit or had no gains during the year of assessment.

(3) If the taxpayer discontinued business, it rendered him liable for all income taxes chargeable to him whether his accounting period was concurrent with or different from the " year of assessment," April 6 to April 5.

The Board also pointed out that for the year in which the business is discontinued the assessment is based on the actual profits from the 6th of April of that year to the date of discontinuance.

In view of the foregoing, the ruling enunciated by the Board in the Universal Winding Co. case should be applied with respect to the accrual of British taxes arising under the British income tax law as changed by the Finance Act of 1926. As indicated above, the principles outlined in G. C. M. 10613, supra, and in the Columbian Carbon Co. case should be applied only with respect to British income taxes imposed under the British law before its change by the Finance Act of 1926. G. C. M. 10613, supra, is modified accordingly.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

SUPPLEMENT E.—ESTATES AND TRUSTS.

SECTION 162.—NET INCOME.

Article 162-1: Income of estates and trusts. 1940-8-10179
G. C. M. 21799

REVENUE ACTS OF 1926 AND 1928.

Where under the terms of a trust instrument payments of income to a certain beneficiary were to be made on January 2 and July 2 of each year provided the beneficiary was living on those dates, the income of the trust for the last half of the year which was distributable on January 2 of the following year was taxable to the trust.

G. C. M. 8724 (C. B. X-2, 197 (1931)) and G. C. M. 15401 (C. B. XIV-2, 242 (1935)) revoked. Recommended that nonacquiescences in *Eustis* v. *Commissioner* (30 B. T. A., 820, nonacquiescence, C. B. XIV-2, 30 (1935)) and *Dean* v. *Commissioner* (35 B. T. A., 839, nonacquiescence, C. B. 1937-2, 36) be withdrawn, and that the Commissioner acquiesce in those cases. Recommended that I. T. 2595 (C. B. X-2, 353 (1931)) be revoked.

This office has reconsidered G. C. M. 15401 (C. B. XIV-2, 242 (1935)), which modified G. C. M. 8724 (C. B. X-2, 197 (1931)), in view of the decision of the Circuit Court of Appeals for the Tenth Circuit in *Commissioner* v. *Dean* (102 F. (2d), 699), affirming *Dean* v. *Commissioner* (35 B. T. A., 839, nonacquiescence, C. B. 1937-2, 36).

G. C. M. 15401 involved trust income payable by the trustee on January 2 and July 2 of each year to a certain beneficiary (or beneficiaries) of a trust who, under the terms of the trust, was required to be living at the time fixed for payment in order to receive such income. The trustee contended that the income for the last half of the year, that is, for the period ended December 31, which was distributable on January 2, was taxable to the trust, and that the income of the trust distributable on July 2 was taxable to the beneficiary. This office held that the entire income was currently distributable to the beneficiary within the meaning of the applicable tax statutes, and, therefore, was income taxable to the beneficiary; that the beneficiary did not become entitled to such income until the time fixed for payment; and that such income was taxable to the beneficiary in the year in which it was received by such beneficiary.

The ruling contained in G. C. M. 15401, supra, was contrary to the decision in *Augustus H. Eustis* v. *Commissioner* (30 B. T. A., 820), involving trust income payable on June 15 and December 15 of each year, wherein it was held that that part of the trust income which accrued between December 15 and December 31 each year was income accumulated in trust for the benefit of unascertained persons, and, therefore, was income taxable to the trust. In G. C. M. 15401 it was recommended that the acquiescence in the Eustis case (C. B. XIII-2, 7 (1934)) be withdrawn, and, consequently, nonacquiescence was published in C. B. XIV-2, 30 (1935).

The pertinent provisions of the Revenue Act of 1926, under which the original ruling (G. C. M. 8724) was made, read as follows:

ESTATES AND TRUSTS.

SEC. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, * * *;

* * * * * * *

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that—

* * * * * * *

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, * * * but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. * * *

(The corresponding provisions of other Revenue Acts are substantially the same.)

In the Dean case the trust instrument provided for payment of $10,000 each year to a beneficiary, such payment to be made on January 3 of each year. The payments could be made only out of trust income and only if the beneficiary was living at the time fixed for payment. The Circuit Court of Appeals for the Tenth Circuit, after referring to the applicable statutes, said:

* * * It thus is the duty of the trustee to include in the fiduciary return the gross income of the trust estate, but he is allowed to deduct therefrom the amount he is required to currently distribute to the beneficiary, and the beneficiary is liable for the tax on the amount currently distributable to him. If no amount is currently payable the trustee is not entitled to any deduction and the beneficiary is not liable for tax on any part of the income. It is only where an amount is presently payable that the fiduciary is entitled to a deduction and the beneficiary is taxable. (*Helvering* v. *Butterworth*, 290 U. S., 365, 54 S. Ct., 221, 78 L. Ed., 365; *Freuler* v. *Helvering*, supra.) But actual payment is not essential in order for the beneficiary to become liable for the tax on the amount distributable to him. The test under the Act is whether he has a present vested right to receive the distribution. If so, the statute commands that it be treated as his income and he becomes liable for the tax on it. (*Freuler* v. *Helvering*, supra.)

Here, the trustees and the respondent made their respective returns on the basis of the calendar year. It, therefore, was the duty of the trustees to include in the fiduciary return the income of the trust estate at the end of each calendar year. But the Commissioner contends that the item of $10,000 now in question was currently distributable at the end of the calendar year; that the fiduciary should have claimed a deduction in that amount; and that it was taxable to respondent and was properly included in computing his net income, even though not actually paid to him until later. Under the plain terms of the trust as construed by the courts of Missouri, the trustees were not authorized to pay any sum to respondent at the end of the calendar year. They had no authority whatever to pay him any amount until the close of the administrative year. And the payment authorized at that time could be made only out of net income. If there was net income at the end of the calendar year but due to intervening changes none existed at the close of the administrative year, no payment could be made. Likewise, in the event of the death of respondent intermediate the two dates he could not receive and receipt for the distribution and his estate would not become entitled to it. Plainly, respondent did not have a present vested right to the money at the end of the calendar year. He had only a prospective contingent right which could not ripen into a present vested right before the close of the administrative year. Although only three days intervened between the dates on which the respective years ended, the income was not currently distributable at the close of the calendar year. It was held at that time for the benefit of unascertained persons or persons with contingent interests; it was held for persons whose identity could not be ascertained until the end of the administrative year.

Under the principle laid down in the decision in the Dean case, the income of the instant trust for the last half of the year which is distributable on January 2 is taxable to the trust and not to the beneficiary since, under the terms of the trust instrument, such income was not currently distributable to the beneficiary at the close of the taxable year.

G. C. M. 15401, supra, and G. C. M. 8724, supra, are accordingly revoked. It is recommended that the nonacquiescences in the Eustis and Dean cases be withdrawn and that the Commissioner acquiesce in those cases. It is further recommended that I. T. 2595 (C. B. X-2, 353 (1931)), which followed G. C. M. 8724, supra, be revoked.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

ARTICLE 162–1: Income of estates and trusts. 1940–8–10180
I. T. 3352

REVENUE ACT OF 1918.

In view of G. C. M. 21799 (page 159, this Bulletin), I. T. 2595 (C. B. X–2, 353 (1931)) is revoked.

SECTION 165.—EMPLOYEES' TRUSTS.

REVENUE ACT OF 1934 AND PRIOR REVENUE ACTS.

Partnerships of attorneys, physicians, etc. (See I. T. 3350, page 64.)

SECTION 166.—REVOCABLE TRUSTS.

ARTICLE 166–1: Trusts, with respect to the corpus of which, the grantor is regarded as remaining in substance the owner. 1940–11–10200
Ct. D. 1445

INCOME TAX—REVENUE ACT OF 1934—DECISION OF SUPREME COURT.

1. IRREVOCABLE SHORT TERM TRUST—INCOME—NOT TAXABLE TO GRANTOR UNDER SECTION 166 OF THE REVENUE ACT OF 1934.

An irrevocable short term trust, the net income of which was to be paid to the wife of the grantor and the corpus to go to him upon termination of the trust, does not fall within the provisions of section 166 of the Revenue Act of 1934, and the trust income is not taxable to the grantor under that section.

2. PLEADING—WAIVER—RIGHT TO CLAIM BENEFIT OF SECTION EXPRESSLY WAIVED IN LOWER COURT.

The petitioner in his brief before the lower court having expressly waived reliance upon any section other than section 166, can not be allowed the benefit of the broader provisions of section 22(a).

3. DECISION AFFIRMED.

Decision of the United States Circuit Court of Appeals, Second Circuit (1939) (104 F. (2d), 1013), affirming decision of the United States Board of Tax Appeals (1938) (37 B. T. A., 1065), affirmed.

SUPREME COURT OF THE UNITED STATES.

Guy T. Helvering, Commissioner of Internal Revenue, petitioner, v. *Meredith Wood.*

[309 U. S., 344.]

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[February 26, 1940.]

OPINION.

Mr. Justice DOUGLAS delivered the opinion of the Court.

This case, like *Helvering* v. *Clifford* (— U. S., — [Ct. D. 1444, page 105, this Bulletin]) is here on certiorari, the problems in the two cases being the same in certain essential respects. In April, 1931, respondent, who owned 25 shares of stock of Book-of-the-Month Club, Inc., made himself trustee of those shares under an agreement which was to expire in three years[1] or earlier on the death

[1] In 1932 the term was extended to five years from April, 1931.

of either him or his wife. By the trust he was to "hold, invest, and reinvest" the shares, to "collect the net income therefrom" and to pay it to his wife. He had the power to "retain" the stock or to "sell" it or "any part thereof" at such "time and on such terms" as he should "deem proper."[2] It was provided that his power of investment or reinvestment of "any of the property or moneys held in trust" was not to be restricted by any law governing investments by trustees. He was also given power to "fix and determine" the value of the property for all purposes of the trust and to determine "whether any property or money received or held in trust shall be treated as capital or income, and the mode in which any expense incidental to the execution of the trust is to be borne as between capital and income," with the proviso, however, that stock dividends and subscription rights should be treated as principal. He was prohibited from receiving any commissions with respect to principal or income; and an exculpatory clause purported to protect him against any loss except that occasioned by his willful misconduct. He had the power to appoint a substitute trustee.[3] On termination of the trust "all property then held in trust" was to go to him. The trust contained no power of revocation nor any power to revest in the grantor at any time, prior to the date of termination, title to any part of the corpus.

During 1934 respondent paid over to his wife $8,750, which was the entire income from the trust for that year. She included it in her income tax return. The Commissioner, being of the opinion that the income was taxable to respondent, determined a deficiency in his 1934 return. Respondent appealed to the Board of Tax Appeals which held that petitioner was in error (37 B. T. A., 1065). The circuit court of appeals affirmed (104 F. (2d), 1013) on the authority of *United States* v. *First National Bank of Birmingham* (74 F. (2d), 360).

Petitioner maintains that the trust income is taxable to respondent either under section 166 or section 22(a) of the Revenue Act of 1934 (48 Stat., 680) or both.

By section 166 the income from a trust is taxable to the grantor where "at any time the power to revest in the grantor title to any part of the corpus of the trust is vested" in him or in any person "not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom."[4] Petitioner has not undertaken to establish that under New York law, which governs this trust, respondent had the power to revoke it prior to the end of the term. But in his contention that the trust here involved is covered by section 166, petitioner points out that there is no practical difference between a revocable trust and one certain to be terminated soon. And he argues that it would not be sensible to impute to Congress a purpose to impose the tax when the grantor has an executory power to revest title in himself but to withhold the tax when the grantor, by provisions in the trust deed, has already exercised that power.

Our difficulty lies not in an inability to see the similarity of those situations but in being able to say that Congress treated them the same under section 166. A power to revest or revoke may in economic fact be the equivalent of a reversion. But at least in the law of estates they are by no means synonymous. For, generally speaking, the power to revest or to revoke an existing estate is discretionary with the donee [donor]; a reversion is the residue left in the grantor on determination of a particular estate. (See Tiffany, Real Property (2d ed.), section 129 *et seq.*, section 316 *et seq.*) Congress seems to have drawn section 166 with that distinction in mind, for mere reversions are not specifically mentioned. Whether as a matter of policy such nice distinctions should be perpetuated in a tax law by selecting one type of trust but not the other for special treatment is not for us. We have only the responsibility of

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[2] His right to sell was subject to a collateral agreement, not material here, with one Scherman, granting Scherman a preemptive right in case respondent decided to sell.

[3] No substitute trustee was, however, appointed, respondent continuing to act as trustee until termination of the trust in 1936.

[4] Section 166 reads in full:

"Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

"(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

"(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor."

carrying out the congressional mandate. And where Congress has drawn a distinction, however nice, it is not proper for us to obliterate it. That seems to us to be the case here. Whether wisely or not, Congress confined section 166 to trusts where there was a "power to revest." The problem of interpretation under section 166 is therefore quite different from that under section 22(a). The former is narrowly confined to a special class; the latter by broad, sweeping language is all-inclusive. (*Helvering* v. *Clifford*, supra [Ct. D. 1444, page 105, this Bulletin].) Accordingly, the wide range for definition and specification under the latter is lacking under section 166. And so far as section 166 is concerned no apparent or lurking ambiguity requires or permits us to divine a broader purpose than that expressed. The legislative history corroborates this conclusion. When the 1934 Act was before the House committee, the Treasury recommended that income from short term trusts and from revocable trusts should be taxable to the creator.[5] The Congress adopted the latter[6] by an appropriate amendment to section 166; but it did not select the former for special treatment. When such clear choice of ideas has been made in the drafting of a specific provision of the law, its language must be taken at its face value. Section 166 is therefore not applicable to this trust since respondent is given no power to recall the corpus. He or his estate gets it at the end of the term, on the death of his wife, or on his own death—whichever is the earliest.

For a wholly different reason, petitioner's argument based on section 22(a) must fail. The Board of Tax Appeals purported to place its decision solely on section 166 and section 167 of the Act. Petitioner in his assignments of error specifically mentioned only section 166 and section 167, not section 22(a). In his brief before the circuit court of appeals petitioner expressly waived reliance upon any section other than section 166. Though petitioner in his petition for certiorari relied on section 22(a), respondent in opposition thereto took the position that that point was not available to petitioner here as it was not raised below. In view of these facts, especially the express waiver below, we do not think that petitioner should be allowed to add here for the first time another string to his bow. As we have indicated, the issues under section 166 and section 22(a) are not coterminous. Though both deal with concepts of ownership, the range of inquiry under the latter is broad, under the former confined. To open here for the first time and in face of the express disclaimer an inquiry into the broader field is not only to deprive this Court of the assistance of a decision below but to permit a shift to ground which the taxpayer had every reason to think was abandoned in the earlier stages of this litigation.[7] (See *Burnet* v. *Commonwealth Improvement Co.*, 287 U. S., 415, 418 [Ct. D. 622, C. B. XII–1, 277 (1933)].) It is not apparent why a less strict rule is necessary in order adequately to protect the revenue.

Affirmed.

Mr. Justice Roberts concurs in the result.

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[5] Revenue revision, 1934, hearings before the Committee on Ways and Means, House of Representatives, Seventy-third Congress, second session, page 151. The recommendation read: "The income from short-term trusts and trusts which are revocable by the creator at the expiration of a short period after notice by him should be made taxable to the creator of the trust."

[6] Conference Report No. 1385, House of Representatives, Seventy-third Congress, second session, page 24:

"Under existing law, the income from a revocable trust is taxable to the grantor only where such grantor (or a person not having a substantial adverse interest in the trust) has the power within the taxable year to revest in the grantor title to any part of the corpus of the trust. Under the terms of some trusts, the power to revoke can not be exercised within the taxable year, except upon advance notice delivered to the trustee during the preceding taxable year. If this notice is not given within the preceding taxable year, the courts have held that the grantor is not required under existing law to include the trust income for the taxable year in his return. The Senate amendments require the income from trusts of this type to be reported by the grantor. The House recedes."

[7] Article 166–1 of Treasury Regulations 86, originally promulgated under section 166, was not promulgated under section 22(a) until 1936 (T. D. 4629 [C. B. XV–1, 140 (1936)]), two years after the tax liability here in issue occurred. Hence we do not have a case of reliance by the Government on a regulation which during the taxable year in question rested on two legs, one of which was section 22(a).

SECTION 167.—INCOME FOR BENEFIT OF GRANTOR.

ARTICLE 167-1: Trusts in the income of which the grantor retains an interest.

1940-7-10173
Ct. D. 1439

INCOME TAX—REVENUE ACT OF 1932—DECISION OF SUPREME COURT.

1. INCOME—TRUST—MONTHLY PAYMENTS TO WIFE—TAXABLE TO HUSBAND.

Prior to divorce and in settlement of a suit for separate maintenance, a property and alimony settlement was agreed upon between husband and wife whereby a certain amount of trust income was to be paid monthly to the wife for life, the balance to the husband for his life, with provision for disposition of the trust corpus and income upon the death of either or both. The divorce decree confirmed the property and alimony settlement. *Held:* That the amounts distributed to the wife under the trust are not regarded as income of the wife but as paid in discharge of the husband's obligation to support her, and hence are to be included in his taxable income.

2. DECISION APPLICABLE.

The principle involved in *Douglas* v. *Willcuts* (1935) (296 U. S., 1 [Ct. D. 1041, C. B. XIV-2, 250 (1935)]) is applicable in the absence of clear and convincing proof that local law and the alimony trust have given the divorced husband a full discharge and leave no continuing obligation however contingent.

3. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Eighth Circuit (1939) (103 F. (2d), 702), reversed.

SUPREME COURT OF THE UNITED STATES.

Guy T. Helvering, Commissioner of Internal Revenue, petitioner, v. *F. W. Fitch.*

[309 U. S., 149.]

On writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[January 29, 1940.]

OPINION.

Mr. Justice DOUGLAS delivered the opinion of the Court.

Petitioner claimed that an amount of $7,128 distributed in 1933 under a so-called alimony trust to respondent's divorced wife should have been included in respondent's taxable income for that year. The Board of Tax Appeals agreed and found a deficiency (37 B. T. A., 1330). The circuit court of appeals reversed, one judge dissenting (103 F. (2d), 702). We granted certiorari because of the asserted failure of that court correctly to apply the principle involved in *Douglas* v. *Willcuts* (296 U. S., 1).

The so-called alimony trust in question was created a few years before the divorce, while respondent and his wife were separated, and in settlement of a suit brought by her for separate maintenance. Certain premises (a hair tonic factory and a long term lease thereon) were transferred to a trustee to hold title, collect rents and after deduction of expenses to pay the wife $600 a month during her life and the balance to respondent for his life.[1] On the

[1] Respondent and his wife separated in 1917. In 1919 respondent purchased a home for his wife, furnished it for her, and gave her an automobile. In the same year F. W. Fitch Co. was incorporated and acquired the assets of a predecessor partnership in exchange for 2,000 of its shares. Of these shares 1,860 were issued to respondent and 10 to his wife. She was also an officer and director of the company, with a monthly salary of $300.

When the separate maintenance suit was settled in 1923, respondent leased certain premises, owned by him, to the F. W. Fitch Co. for 99 years, at an annual rental of $12,000. These premises and that lease were transferred to the trustee. Upon creation of the trust the wife ceased to be an officer and director of F. W. Fitch Co. and received no further salary from it.

death of either respondent or his wife the deceased's share of the income was to be paid to their children.[2] The trust was to continue at least 15 years. On the death of both respondent and his wife the principal was to be paid over to their children. The trust was irrevocable. And while respondent covenanted to pay off certain encumbrances on the trust property, he did not underwrite in whole or in part the $600 monthly payments to his wife.

In 1925 she filed suit for a divorce in an Iowa court. A property settlement was agreed upon which included the trust agreement and, in addition, provided for a transfer to her by respondent of certain shares of stock and cash.[3] The divorce decree confirmed the property and alimony settlement.[4]

The general rule is clear. "Amounts paid to a divorced wife under a decree for alimony are not regarded as income of the wife but as paid in discharge of the general obligation to support, which is made specific by the decree." (*Douglas* v. *Willcuts*, supra, page 8.) It is plain that there the alimony trust, which was approved by the divorce decree, was merely security for a continuing obligation of the taxpayer to support his divorced wife. That was made evident not only by his agreement to make up any deficiencies in the $15,000 annual sum to be paid her under the trust. It was also confirmed by the power of the Minnesota divorce court subsequently to alter and revise its decree and the provisions made therein for the wife's benefit. Likewise consistent with the use of the alimony trust as a security device was the provision that on death of the divorced wife the corpus of the trust was to be transferred back to the taxpayer. Respondent insists that in the instant case there is no continuing obligation to which the income of the alimony trust is applied but rather that the property and alimony settlement approved by the Iowa court effected an absolute discharge of any duty or obligation on his part to support his divorced wife. It is true that there is no covenant or guarantee to make up any deficiency in the monthly payment to his divorced wife, as there was in the Douglas case. And unlike that alimony trust, the instant one, though granting the taxpayer a participation in the income, irrevocably alienates the corpus. Other indicia of the use of this alimony trust as a security device for any continuing obligation of respondent are alleged to be absent by reason of the lack of power in the Iowa court to modify the decree confirming the property and alimony settlement.

The Iowa statute provides: "When a divorce is decreed, the court may make such order in relation to the children, property, parties, and the maintenance of the parties as shall be right. Subsequent changes may be made by it in these respects when circumstances render them expedient."[5]

Admittedly the court under that statute has the power to modify provisions in the original decree for the continued support and maintenance of the wife.[6] And it likewise seems well settled by a long line of Iowa cases that where the original decree makes no provision for alimony, there is no power subsequently to modify the decree so as to provide it.[7] And, respondent contends, where alimony is allowed in a lump sum or a property settlement is ratified by the decree, the court retains no power to modify.

Spain v. *Spain* (177 Ia., 249) and *McCoy* v. *McCoy* (191 Ia., 973), on which respondent and the circuit court of appeals place reliance are not in point since those divorce decrees, unlike the instant one, made no provision for alimony. In *Spain* v. *Spain*, supra, the Supreme Court of Iowa specifically reserved the question of the power to modify a divorce decree involving a property settlement. As to that it said (pages 260–261): "As to an award in gross, or a division of the property, based upon an equitable apportionment of the property

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[2] No question of minor children is here involved, the youngest of the four children having become of age in 1927.

[3] Six hundred shares of stock of F. W. Fitch Co. and $23,500.

[4] It is, therefore, ordered, adjudged and decreed, that the plaintiff, Lettie S. Fitch, be, and she is hereby, divorced from the defendant, Fred W. Fitch, absolutely; * * * that the trust agreement which is referred to in the defendant's answer as having been entered into between these parties on or about the 23d day of April, 1923, * * * be, and the same is hereby ratified and confirmed by the court; and that the property and alimony settlement made by the parties be, and it is hereby confirmed by the court.

[5] Section 10481, Iowa Code.

[6] See *Corl* v. *Corl* (217 Ia., 812); *Junger* v. *Junger* (215 Ia., 636); *Boquette* v. *Boquette* (215 Ia., 990); *Toney* v. *Toney* (213 Ia., 398); *Morrison* v. *Morrison* (208 Ia., 1384).

[7] *Spain* v. *Spain* (177 Ia., 249); *McCoy* v. *McCoy* (191 Ia., 973); *Handsaker* v. *Handsaker* (223 Ia., 462); *Duvall* v. *Duvall* (215 Ia., 24); *Doekson* v. *Doekson* (202 Ia., 489).

of either of the parties at the time the divorce is granted, we have no occasion to speak, for that matter is not in the case."

Likewise *Barish* v. *Barish* (190 Ia., 493), cited below and urged here in support of respondent's contention, is of little aid, for in spite of a strong concurring opinion that the court had no power to modify an allowance of "gross" or "permanent" alimony, the majority applied the statute and concluded (page 501) "Whatever the extent of the power of the court may be to make such increase, it is always slow to exercise such power, except in the presence of extraordinary circumstances, such as are not present here." To be sure, there is the following strong statement in *Kraft* v. *Kraft* (193 Ia., 602, 607): "We are inclined to the view that, where alimony is allowed in a lump sum, as permanent alimony, or where there is a division of the real property of the parties, as permanent alimony, the statute does not authorize a change therein, except for such reasons as would justify the setting aside or changing of a decree in any other case; that the party awarded permanent alimony is not entitled to permanent alimony and support both * * *." And in *Carr* v. *Carr* (185 Ia., 1205), that court stated, page 1211: "Alimony is allowed in lieu of dower and the prior duty of support, and a review of the decree awarding or refusing same can be had only for such fraud or mistake as would authorize the setting aside or modification of any other decree." In that case the divorce decree required the husband, *inter alia*, to convey certain real estate to a trustee for the exclusive benefit of the wife to be held in trust for five years, during which time the income was to be paid over to the wife and at the end thereof the trustee, on demand, was to convey the property to her. Meanwhile, the trustee had the power to sell the property at not less than $100 an acre. Shortly before the expiration of the 5-year period, the divorced husband filed a cross-petition in the divorce suit asking for a modification of the trust in order to protect his former wife from her own extravagance and her inexperience in business affairs. Apparently the relief asked was not based on the Iowa statute giving the court power to make subsequent changes in the divorce decree "when circumstances render them expedient." For the court stated that the modification of the decree was sought on the grounds (1) that the donor of the trust was entitled to have it carried out in accordance with its terms and the real purpose for which it was created; and (2) that, in the alternative, he was entitled to have a guardian of the property appointed.

However that may be, much of the weight which respondent accords *Kraft* v. *Kraft* and *Carr* v. *Carr*, supra, seems to have been dissipated by *McNary* v. *McNary* (206 Ia., 942). In that case the Supreme Court of Iowa had squarely before it the question of whether or not under the foregoing statute a decree of permanent alimony awarding personal and real property to the wife could be altered. The court after stating that it knew of no case where such a decree had been subsequently modified, added (page 946): "This question is not argued by the parties, and we find it unnecessary to make a pronouncement thereon." And, significantly, it proceeded to apply the statute and finding that its conditions had not been satisfied, it denied the relief asked by the divorced husband.

On this statement of the Iowa authorities we can only speculate as to the power of the Iowa court to modify alimony awarded in a lump sum or a property settlement ratified by a divorce decree. To be sure, *Kraft* v. *Kraft*, supra, involved some features common to the instant case, since the wife was to receive the income of $4,000 to be placed in trust by the husband or, until he placed it in trust, 5 per cent on that amount. But the refusal to modify that decree was not placed squarely, or even largely, on the lack of power to do so but on other circumstances. Furthermore, the uncertainty created by *McNary* v. *McNary*, supra, makes perhaps for even greater uncertainty where an alimony trust of the kind here involved is concerned. At least respondent has not established a necessary identity in treatment of transfers of personal or real property on the one hand and allowance of income out of this kind of alimony trust on the other. Even on the authority of *Kraft* v. *Kraft*, supra, respondent has not clearly shown that in Iowa divorce law the court has lost all jurisdiction to alter or revise the amount of income payable to the wife from an enterprise which has been placed in trust. For all that we know it might retain the power to reallocate the income from that property even though it lacked the power to add to or subtract from the corpus or to tap other sources of income.[8] If it did have such power, then it could be said that a decree approving an alimony trust of the kind here involved merely placed upon the preexisting duty of the husband a particular and specified sanction. In that event, the case would be little different from one where the husband was directed to make specified payments to the divorced wife. And we see no reason why the rule of *Douglas* v. *Willcuts*, supra, should not then apply.

Enough has been said to show that respondent has not sustained the burden of establishing that his case falls outside the general rule expressed in *Douglas* v. *Willcuts*, supra. If we were to conclude that this case is an exception to that rule we would be acting largely on conjecture as to Iowa law. That we can not do. For if such a result is to obtain, it must be bottomed on clear and convincing proof, and not on mere inferences and vague conjectures, that local law and the alimony trust have given the divorced husband a full discharge and leave no continuing obligation however contingent. Only in that event can income to the wife from an alimony trust be treated under the Revenue Acts the same as income accruing from property after a debtor has transferred that property to his creditor in full satisfaction of his obligation—unless of course Congress decides otherwise.

The judgment of the circuit court of appeals is reversed.

Mr. Justice REED concurs in the result.

Mr. Justice MCREYNOLDS is of the opinion that the judgment below should be affirmed.

ARTICLE 167–1: Trusts in the income of which the grantor retains an interest.

1940–17–10241
Ct. D. 1452

INCOME TAX—REVENUE ACT OF 1934—DECISION OF COURT.

1. TRUST—INCOME FOR BENEFIT OF GRANTOR—INSURANCE PREMIUMS PAID FROM TRUST INCOME.

The taxpayer established two trusts the income from which was to be used to pay the premiums on insurance policies covering the life of her husband and of which she was the sole beneficiary. She alone had the right to loan or cash surrender values and to change the beneficiary, except that under one policy the insured also had such rights. The first trust was subject to termination, under certain conditions, upon written notice by the husband, by the taxpayer, or by their daughter, in which events the accumulated income was to go to the husband or to the daughter and the corpus to the taxpayer, or to her husband, or to the daughter. Under the second trust the insurance was made payable to the trustee instead of to the taxpayer, and only the husband had the right to terminate, in which event the accumulated income was to go to the husband and corpus to the wife. The trusts were not otherwise revocable. *Held:* That, in contemplation of law, the trust income remained in substance that of the grantor, used to purchase property for herself, and was therefore taxable to her under section 167 of the Revenue Act of 1934, even though the accumulated income was to be the property of the husband if the trusts were terminated during his lifetime.

2. DECISION FOLLOWED.

Douglas v. *Willcuts* (296 U. S., 1 [Ct. D. 1041, C. B. XIV–2, 250 (1935)]) followed.

3. DECISION REVERSED.

Decision of the United States Board of Tax Appeals (1938) (38 B. T. A., 419) reversed.

4. REHEARING DENIED.

Petition for rehearing denied February 5, 1940.

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[8] Cf. *Shaw* v. *Shaw* (59 Ill. App., 268).

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Commissioner of Internal Revenue, petitioner, v. *Sophia P. O. Morton, respondent.*

[108 F. (2d), 1005.]

Petition for review of decision of the United States Board of Tax Appeals.

Before EVANS, SPARKS, and TREANOR, Circuit Judges.

[January 12, 1940.]

OPINION.

SPARKS, Circuit Judge: This petition for review of a decision of the Board of Tax Appeals presents the question whether or not the income for the year 1934 of two trusts was taxable to the grantor. The Board held that the income of the trusts was not to be included in computing the grantor's gross income because power to revoke the trusts was in a person having an interest adverse to that of the grantor so that section 166 of the Revenue Act of 1934 was not applicable, and the income was not held for or distributable to the grantor within the meaning of section 167 of the same Act.

The facts were stipulated by the parties. Between the years 1925 and 1931, the husband of the taxpayer took out a series of eight policies insuring his life for $275,000. The taxpayer was designated as beneficiary of all of the policies in case of his death, and the policies also provided that she alone had the right to the loan or cash surrender value of each, and the right to change the beneficiary.

In February, 1933, the taxpayer entered into a trust agreement with the Bankers Trust Co. of New York City, for the purpose of creating a trust fund, the income of which was to be used to pay the premiums on the eight policies on the life of her husband. Under the terms of this agreement, the Trust company was to act as trustee, and the trust was to terminate upon the death of the last survivor of her husband, her daughter, and herself. It was also subject to termination by the husband by delivery to the trustee of a written memorandum stating that he intended to terminate on the next succeeding 1st of January, followed by delivery by him on that date to the trustee of a second written memorandum that he was thereby terminating it. Upon such termination, the trustee was obligated to deliver to the husband all accumulated income of the trust estate and all investments and reinvestments thereof, and to the taxpayer-grantor all the remainder of the trust estate if she were then living, and if not, the entire trust estate was to be delivered to the husband.

If the trust had not been terminated prior to the death of the husband, and if it continued for three years following his death, then the grantor was entitled to terminate it at any time thereafter, by written notice to the trustee, and after her death, the daughter was to be entitled to terminate by written notice to the trustee. If the trust were terminated by the grantor, the trustee was to deliver all accumulated income together with the investments thereof to the daughter, and the remainder of the trust estate to the taxpayer. If it were not terminated until after the death of the grantor, then the entire trust estate was to be delivered to the daughter. The trust was not otherwise revocable. To carry out the terms of this agreement the taxpayer delivered to the trustee certain stocks and bonds, the income of which aggregated $12,171 for the year 1934.

In March, 1934, the husband created a trust similar in all respects to that created by the taxpayer except that the positions of the husband and wife in their relation to it were reversed. This trust was also intended to provide for payment of premiums on two policies of life insurance, this time, on the life of the taxpayer, aggregating $50,000, and payable upon her death to her husband, the assured under the policies involved in the trust in suit.

In August, 1934, the taxpayer and the Manhattan Trust Co. entered into a trust agreement to provide a fund for the payment of premiums on another policy insuring the life of the taxpayer's husband, this one for $50,000, then payable to the taxpayer as beneficiary. The terms of this trust agreement differed in several respects from the one entered into between taxpayer and the Bankers' Trust the year before. It provided that the taxpayer was to have the policy modified by having it made payable to the trustee instead of to herself; after payment of premiums and the retention of such remainder of the income as seemed advisable to insure payment of subsequent premiums, the trustee was to pay the balance of the income to the taxpayer; the taxpayer and/or her husband, the insured, were entitled to any cash surrender or loan value of the policy, and they reserved to themselves the right to borrow on, assign or pledge the policy, and to change the beneficiary thereof, and to any other options which might exist under the policy; the trustee was authorized to collect the proceeds of the policy upon its maturity by the death of the insured, which proceeds were to be paid over to the taxpayer, if she were then living, and if not, then to her daughter, if living, or to the issue of the daughter, if any, if the daughter predeceased the taxpayer, and if no issue, then the proceeds were to be equally divided between Princeton University, and the trustees of the Morton Arboretum; the trust was subject to termination at any time by delivery of an instrument in writing by the husband to the trustee, which was thereupon to deliver to the husband any income of the trust estate then on hand, and to the grantor, the principal of the estate and the insurance policy; if not so terminated by action of the husband, the trust was to continue during his life, and until five years after his death, unless both the taxpayer and their daughter predeceased him, in which event, the trust was to terminate upon his death; upon termination after his death, the same disposition was to be made of the trust estate as was to be made if the trust were terminated during his life, except that the person entitled to receive the principal was also to receive the income. The trust was revocable only as provided by the instrument itself. To carry out its provisions, the taxpayer delivered to the trustee certain stocks and bonds, the income of which was expected to amount to about $2,400, approximately the amount necessary to cover the $2,228 annual premium due on the policy and pay the expenses of administering the trust.

During the tax year in question, the trustee collected dividends and interest from the stocks and bonds in the first trust estate amounting to $12,171, and in addition it also received capital net gains of $21,886, of which $7,288 was subject to income tax. During that year it expended $8,203 for premiums on the eight insurance policies; retained $250 for its own fees; and paid $25.56 for income taxes for the year 1933. The balance was accumulated in accordance with the provisions of the trust agreement.

The Commissioner contended before the Board and before this court that the income from the two trusts should be taxed to the grantor either under the provision of section 166 of the Revenue Act of 1934,[1] or section 167 of the same Act.[2] The Board ruled against the Commissioner as to the applicability of each section. It held that because the husband was entitled to receive the corpus of the trust estate in the event that the taxpayer predeceased him, and because he was entitled to receive the accumulated income upon termination of the trusts during his lifetime, he did have a substantial adverse interest,

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[1] SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor.

[2] SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes * * * relating to the so-called "charitable contribution" deduction); then such part of the income of the trust shall be included in computing the net income of the grantor.

even though that interest was contingent in nature, and that, therefore, the grantor could not be taxed for the income of the trust.

It is obvious that the income of these trusts was devoted solely to the grantor's own uses. She was the sole beneficiary of the eight policies involved in the first trust; she alone had the right to change the beneficiary; she alone was entitled to their cash surrender or loan value. With respect to the second trust, her title was somewhat less direct, but the policy was, in fact, payable to her, even though indirectly through the medium of the trustee which was obligated by the terms of the trust to pay the proceeds to her upon collection, if she were then living, and if she were not, it was her disposition of the proceeds which was to control, by the terms of the trust agreement. Thus, although by the provisions of the two trust agreements, the taxpayer divested herself of the control of the trust estate and of its income, the fact remains that that income was expended solely for her own purposes, and the property upon which it was expended, namely, the insurance policies, belonged to her and her alone, and, in the case of the eight covered by the first trust, even before their maturity by the death of the insured.

Section 167 has been construed to make possible the taxation of trusts to the grantor where the income was to be devoted to the discharge of an obligation of the grantor, whether such obligation was imposed by operation of law or by contract. (See *Douglas* v. *Willcuts*, 296 U. S., 1; *Helvering* v. *Blumenthal*, 296 U. S., 552, reversing 76 F. (2d), 507; *Helvering* v. *Schweitzer*, 296 U. S., 551, reversing 75 F. (2d), 702.) In the Willcuts case, the trust was irrevocable. However, the Court did not consider that fact controlling. In determining that the grantor was taxable on the income of the trust there involved, the Court said: "We do not regard the provisions of the statutes as to the taxation of trusts, fiduciaries and beneficiaries * * * as intended to apply to cases where the income of the trust would otherwise remain, by virtue of the nature and purpose of the trust, attributable to the creator of the trust and accordingly taxable to him. These provisions have appropriate reference to cases where the income of the trust is no longer to be regarded as that of the settlor, and we find no warrant for a construction which would preclude the laying of the tax against the one who through the discharge of his obligation enjoys the benefit of the income as though he had personally received it. * * * Nor are the provisions of the statutes * * * defining instances in which the grantor remains taxable, as in case of certain reservations for his benefit or provisions for the payment of premiums upon policies of insurance on his life, to be regarded as excluding instances not specified, where in contemplation of law the income remains in substance that of the grantor. No such exclusion is expressed and we see no ground for implying it."

In view of this ruling we are of the opinion that even though a literal interpretation of section 167 might tend to establish the immunity of the grantor from the tax, no such literal interpretation is to be accorded the section. Looking to the practical facts, we find that here the bulk of the income did remain, in contemplation of law, in substance, that of the grantor, used to purchase property for herself. We think it could hardly be argued, in view of the teaching of the Willcuts case, that if the taxpayer created a trust for the purpose of paying installments provided for by contract on the purchase of a house or any other property, title to which was taken in the name of or for the benefit of the grantor, the income would not be taxable to the grantor. We see no difference in principle between the property rights involved in the house and in the insurance policies.

It is also to be noted that the reversionary interest in the corpus of the estate remained in the taxpayer, and even though the accumulated income was to be the property of the husband, we think such segregation of income was not enough to render the taxpayer immune from taxation. (See *Du Pont* v. *Commissioner*, 289 U. S., 685 [Ct. D. 687, C. B. XII-1, 259 (1933)].)

We therefore hold that the decision of the Board of Tax Appeals must be, and it is hereby reversed.

ARTICLE 167–1: Trusts in the income of which the grantor retains an interest. 1940–19–10253 Ct. D. 1453

INCOME TAX—REVENUE ACTS OF 1928 AND 1932—DECISION OF SUPREME COURT.

1. INCOME—WEEKLY PAYMENTS UNDER SEPARATION AGREEMENT—IRREVOCABLE TRUST FOR MAINTENANCE AND SUPPORT—TRUST INCOME NOT TAXABLE TO HUSBAND—LOCAL LAW.

An agreement made between husband and wife in contemplation of divorce provided for certain weekly payments to the wife for a period of 10 years, and for payment to her of income from an irrevocable 10-year trust created for her maintenance and support, and also for the transfer of the trust property to the wife outright at the expiration of the 10-year period. The divorce decree, obtained in Nevada, ordered, adjudged, and decreed that the agreement be approved, and the trust was thereupon created. *Held:* (1) That the agreement to make weekly payments to the wife is a continuing personal obligation falling within the rule of *Douglas* v. *Willcuts* (296 U. S., 1 [Ct. D. 1041, C. B. XIV–2, 250 (1935)]), and is entirely independent of the trust although embodied in the same separation agreement; and (2) that the trust income is not taxable to the husband, since the local law and the trust have given him *pro tanto* a full discharge from his duty to support his divorced wife and leave no continuing obligation, contingent or otherwise.

2. DECISION AFFIRMED.

Decision of the United States Circuit Court of Appeals, Second Circuit (1939) (105 F. (2d), 903), reversing memorandum opinion of the United States Board of Tax Appeals (1938), affirmed.

SUPREME COURT OF THE UNITED STATES.

Guy T. Helvering, Commissioner of Internal Revenue, petitioner, v. *Alfred C. Fuller.*

[60 S. Ct., 784.]

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[April 22, 1940.]

OPINION.

Mr. Justice DOUGLAS delivered the opinion of the Court.

This case raises the question of the circumstances under which income paid to the taxpayer's divorced wife under a trust, the provisions of which have been approved in the divorce decree, is taxable to him. We granted certiorari because of the asserted misapplication by the circuit court of appeals of the rule of *Douglas* v. *Willcuts* (296 U. S., 1) to these facts.

On July 25, 1930, respondent and his wife, residing in Connecticut, entered into an agreement in contemplation of divorce which provided, *inter alia*, for the creation by him of a trust of 60,380 shares of class A common stock of the Fuller Brush Co. The trust was irrevocable and was to continue for 10 years. During that period all trust income was to be used for the maintenance and support of the wife, or in case of her prior decease, then for the children; or in case of their prior decease, then for the heirs of the wife or as she should provide in her will. At the expiration of the 10-year period the trust property was to be transferred to her outright. The agreement provided for other property settlements, for control and custody of the children, and for waiver by respondent and his wife of all claims against each other arising out of the marital relation. It also contained an agreement on the part of respondent to pay the wife $40 per week for five years, and, if at the end of that period his annual net income exceeded by the amount of the weekly payments the sum of $60,000, to continue those weekly payments for an additional five years or for such portion thereof as his annual net income exceeded the above sum.

The wife repaired to Reno, Nevada, and obtained a divorce decree on November 12, 1930, which "ordered, adjudged, and decreed that said agreement entered into between the plaintiff and the defendant on or about the 25th day of July, 1930, be and the same hereby is approved." On December 22, 1930, respondent created the trust provided for in the agreement.[1] The corporate trustee thereunder received from the Fuller Brush Co. all the dividends and income from the trusteed shares during 1931, 1932, and 1933 and disbursed them all for the benefit of the divorced wife. On the failure of respondent to include those amounts in his tax returns for the years in question, the Commissioner assessed deficiencies. The decisions of the Board of Tax Appeals (37 B. T. A., 1333), sustaining the action of the Commissioner, were reversed by the circuit court of appeals. (105 F. (2d), 903.)

I. There can be no doubt but that respondent is taxable on the $40 weekly payment to the wife. That is a continuing personal obligation falling within the rule of *Douglas* v. *Willcuts*, supra, as a result of which those payments are taxable to him, not to the wife. (*Gould* v. *Gould*, 245 U. S., 151.) But that fact does not make the income from the trust also taxable to him. Although the provisions for the weekly payments and for the trust agreement were embodied in the same separation agreement, they were not so interrelated or interdependent as to make the trust a security for the weekly payments. Functionally they were as independent of each other as were the other property settlements from either of them.

II. Petitioner does not challenge the conclusion of the circuit court of appeals that, so far as the trust agreement is concerned, the Nevada court retained no power to alter or modify the divorce decree. It seems to be admitted that under Nevada law the wife's allowance once made is final (*Sweeney* v. *Sweeney*, 42 Nev., 431), unless the decree itself expressly reserves the power to modify it (*Lewis* v. *Lewis*, 53 Nev., 398), or unless the decree approves a settlement which in turn provides for a modification (*Aseltine* v. *Second Judicial District Court*, 57 Nev., 269). Here no such power was reserved in the decree or in the trust agreement approved by the decree. Nor did respondent underwrite the principal or income from the trust or any part thereof or make any commitments, contingent or otherwise, respecting them, beyond his promise to transfer the securities to a trustee. But petitioner argues that the rule of *Douglas* v. *Willcuts*, supra, should nonetheless apply since the decree recognized the husband's preexisting duty to support and defined that duty as coextensive with what the parties had themselves arranged, and since the husband simply carved out future income from property which he then owned and devoted it in advance to the discharge of his obligation.

We take a different view. If respondent had not placed the shares of stock in trust but had transferred them outright to his wife as part of the property settlement, there seems to be no doubt that income subsequently accrued and paid thereon would be taxable to the wife, not to him. Under the present statutory scheme that case would be no different from one where any debtor, voluntarily or under the compulsion of a court decree, transfers securities, a farm, an office building, or the like, to his creditor in whole or partial payment of his debt. Certainly it could not be claimed that income thereafter accruing from the transferred property must be included in the debtor's income tax

[1] The trust agreement provided that he was to transfer the 60,380 shares of stock on the books of the company from himself personally to himself as trustee and then to deliver the certificate for such shares to the corporate trustee. This was done. Also in accordance with the provisions of the trust respondent executed a dividend order against the shares directing the Fuller Brush Co. to pay all dividends to the corporate trustee. Respondent was the founder of the company and during the years in question was its president. It had outstanding only one class of voting stock, viz, class A common. The amount outstanding during these years varied between 172,000 and 186,000 shares. Respondent owned 60,380 shares which together with the 60,380 shares under the trust constituted more than a majority of that class of stock. By terms of the trust respondent retained "exclusive voting power" of the trusteed shares during the term of the trust. If he died before its termination, the voting power would pass to the wife. During that period power to sell the stock was vested jointly in him, the wife, and the corporate trustee and could be exercised only in case all three agreed in writing. In case of such a sale, those three had the power to invest and reinvest the proceeds. They also were given the power to disburse, withhold, and accumulate the principal of the trust at their sole discretion, such power over the income being vested in the wife and the corporate trustee.

return. If the debtor retained no right or interest in and to the property, he would cease to be the owner for purposes of the Federal Revenue Acts. (See *Helvering* v. *Clifford*, 309 U. S.,—.) To hold that a different result necessarily obtains where the transfer is made or the trust is created as part of a property settlement attendant on a divorce would be to hold that for purposes of the Federal income tax the marital obligation of the husband to support his wife can not be discharged. But whether or not it can be depends on State law. For other purposes, local law determines the status of the parties and their property after a decree dissolving the matrimonial bonds. (See *Barrett* v. *Failing*, 111 U. S., 523.) And while the Federal income tax is to be given a uniform construction of national application, Congress frequently has made it dependent on State law. (See *Thomas* v. *Perkins*, 301 U. S., 655, 659 [Ct. D. 1237, C. B. 1937-1, 262] and cases cited.) In the instant situation, an inquiry into State law seems inescapable. For the provisions in the Revenue Acts [2] and regulations [3] concerning the nondeductibility of "family expenses" and of "alimony" do not illuminate the problem beyond implying the necessity for an examination of local law to determine the marital status and the obligations which have survived a divorce. The Nevada cases tell us that under such a decree as was entered here the obligation to support was *pro tanto* discharged and ended. And the trust agreement contains no contractual undertaking by respondent, contingent or otherwise, for support of the wife. Hence we can only conclude that respondent's personal obligation is not a continuing one but has been discharged *pro tanto*. To hold that it was not would be to find substantial differences between this irrevocable trust and an outright transfer of the shares to the wife, where in terms of local divorce law we can see only attenuated ones. This is not to imply that Congress lacks authority to design a different statutory scheme applying uniform standards for the taxation of income of the so-called alimony trusts. A somewhat comparable statute taxing to the grantor income from a trust applied to the payment of premiums upon insurance policies on his life was upheld in *Burnet* v. *Wells* (289 U. S., 670 [Ct. D. 688, C. B. XII-1, 261 (1933)]). But the reach of congressional power is one thing; an interpretation of a Federal Revenue Act based on local divorce law, quite another.

For the reasons we have stated, it seems clear that local law and the trust have given the respondent *pro tanto* a full discharge from his duty to support his divorced wife and leave no continuing obligation, contingent or otherwise. Hence under *Helvering* v. *Fitch* (309 U. S., —) income to the wife from this trust is to be treated the same as income accruing from property after a debtor has transferred that property to his creditor in full satisfaction of his obligation.[4]

III. One other observation is pertinent. Though the divorce decree extinguishes the husband's preexisting duty to support the wife, and though no provision of the trust agreement places such obligation on him, that agreement may nevertheless leave him with sufficient interest in or control over the trust as to make him the owner of the corpus for purposes of the Federal income tax. (*Helvering* v. *Clifford*, supra.)

As we have seen, respondent did retain considerable control over the trusteed shares. But that was not the basis for the assessment of the deficiency by the Commissioner. It was not passed upon by the Board of Tax Appeals or the Circuit Court of Appeals. It was not included in the petition for certiorari among the errors to be urged or the reasons for granting the writ. Nor did petitioner brief or argue the point here. Hence we do not pass on the applicability of the rule of *Helvering* v. *Clifford*, supra, to these facts. (Cf. *Helvering* v. *Wood*, 309 U. S., —.)

Affirmed.

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[2] Revenue Act of 1928 (45 Stat., 791), section 24(a)1. The same provision appears in section 24 of the 1932 Act (47 Stat., 169).

[3] Treasury Regulations 74, articles 83, 281, promulgated under the 1928 Act. The same provisions appear in Treasury Regulations 77, articles 83, 281, promulgated under the 1932 Act.

[4] See Paul, Five Years with *Douglas* v. *Willcuts* (53 Harv. L. Rev., 1).

ARTICLE 167-1: Trusts in the income of which the grantor retains an interest.

1940-19-10254
Ct. D. 1454

INCOME TAX—REVENUE ACT OF 1928—DECISION OF SUPREME COURT.

1. INCOME—IRREVOCABLE ALIMONY TRUST FOR MAINTENANCE AND SUPPORT—GUARANTEED PAYMENT OF BONDS—TRUST INCOME TAXABLE TO HUSBAND—LOCAL LAW—BURDEN OF PROOF.

A separation agreement made between husband and wife while divorce suit was pending in New York, which agreement provided for payment to the wife of income from an irrevocable trust created for her support and maintenance, and also for certain other payments to her annually for life, was approved and affirmed by the divorce decree and made part of the judgment. The trust agreement contained an express personal obligation of the husband to guarantee the payment of principal and interest on certain bonds included in trust corpus. *Held:* (1) That the income from the guaranteed bonds was taxable to the husband, as the trust agreement was, in effect, security for his continuing obligation which would be discharged, at least *pro tanto*, as income from the bonds was received, and he therefore benefited by such payments; and (2) that income from trust property other than the bonds was also taxable to the husband, as he has failed to establish by clear and convincing proof that the local law and the alimony trust have given him a full discharge or that the New York court lacks power to add to his personal obligations under certain circumstances, as, for example, if the trust securities should prove worthless.

2. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Second Circuit (1939) (105 F. (2d), 900), reversing decision of the United States Board of Tax Appeals (1937) (36 B. T. A., 563), reversed.

SUPREME COURT OF THE UNITED STATES.

Guy T. Helvering, Commissioner of Internal Revenue, petitioner, v. *Stephen J. Leonard.*

[60 S. Ct., 780.]

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[April 22, 1940.]

OPINION.

Mr. Justice DOUGLAS delivered the opinion of the Court.

This case involves the question of the taxability to the grantor under the Revenue Act of 1928 (45 Stat., 791) of income from a so-called alimony trust which is payable to his divorced wife. We granted certiorari because of the probable conflict of the decision below with *Douglas* v. *Willcuts* (296 U. S., 1 [Ct. D. 1041, C. B. XIV-2, 250 (1935)]) and *Helvering* v. *Fitch* (309 U. S., —).

In 1928 respondent's wife instituted suit in New York for an absolute divorce. On June 4, 1929, while that suit was pending, respondent and his wife entered into a separation agreement and, together with a corporate trustee, executed a trust agreement. Under the latter respondent contributed securities and cash of $650,000, which included $400,000 principal amount of 6 per cent first mortgage bonds of an oil company. Respondent guaranteed the "payment when due of the principal and interest" on those bonds; and on notice of any default in the payment of any interest on or principal of them, he agreed to substitute cash or securities with a "market value equal to" the principal, and cash sufficient to cover any accrued interest.[1] The trust was irrevocable[2] except that (1) it could be amended by respondent and his wife;[3] and (2) respondent re-

[1] No extension of the time of payment of principal or interest on these bonds was to be made without the consent of the wife and without the extension of the guarantee of respondent or his personal representative.
[2] Except on discontinuance or dismissal of the divorce action.
[3] It was so amended three times but in respects not material here.

tained a limited power of substitution as respects certain bank stock which was part of the corpus. The trustee agreed to use "reasonable efforts to consult" with respondent with respect to "the character of the investments" though it was not bound to follow his advice. Respondent retained no right to either the corpus or the income, or any part thereof, except as indicated above. The net income was to be paid as follows: $5,000 a year to each of three children; the remaining amount to the wife during her life for her maintenance and support, and in her sole discretion for the support, maintenance and education of the children. On death of the wife, the corpus was to be held for the children.

The separation agreement incorporated the trust agreement by reference; stated that the wife's income from the trust and from other property received from the husband would aggregate $30,000 a year; provided that respondent would pay his wife an additional $35,000 each year during her life so that her aggregate net income for the maintenance and support of herself and the children would approximate $65,000 a year, and would further pay any "extraordinary medical or surgical expenses" incurred by the wife or on behalf of the children until they attained the age of 25 years; stated that in the event that respondent's ability to pay the above $35,000 became impaired, he might apply to any court of competent jurisdiction for a reduction of his obligation to not less than $10,000 a year; made other property settlements; provided for care and custody of the children; released dower, etc.

The decree of divorce became final in October, 1929. It "approved and affirmed and made a part of the judgment herein" the separation agreement (which as we have said incorporated the trust agreement) "providing for the support and maintenance of the plaintiff," and in addition directed respondent to pay her $35,000 a year for the rest of her life. From June 4, 1929, to December 31, 1929, the trustee received $16,191.34 as dividends and interest from the trust property. It distributed $5,200 to the wife and $2,083.33 to each of the three children, leaving an undistributed balance for that period of about $4,700. Respondent did not include any of that income in his return for 1929. The Commissioner determined a deficiency. The Board of Tax Appeals held that only the amounts actually distributed to respondent's wife and minor children were taxable to him. (36 B. T. A., 563.) The circuit court of appeals reversed, holding that respondent, though taxable on income payable to his minor children, was not taxable on income payable to the wife. (105 F. (2d), 900.)

Here, as in the circuit court of appeals, it was urged by the petitioner that this alimony trust was merely security for respondent's continuing obligation to support his wife and, therefore, that the trust income payable to her was taxable to him under the rule of *Douglas* v. *Willcuts*, supra. In support of that position it was urged, *inter alia*, that under New York law respondent's obligation was not discharged since the New York court retained the power to modify the decree; and that the promise by respondent to pay the wife $35,000 (or in no event less than $10,000) a year converted the trust into at least partial security for the total allowance to her. In either of such events the rule of *Douglas* v. *Willcuts*, supra, would apply. (See *Helvering* v. *Fitch*, supra.) The circuit court of appeals, however, decided these two questions adversely to petitioner. But there is one matter not touched on by that court which we think is determinative of one phase of the case.

The trust agreement contains an express personal obligation of respondent in the form of a guarantee of payment of the principal and interest on $400,000 of the 6 per cent bonds which were part of the trust corpus. To be sure, that personal obligation was contingent. But we do not deem that to be material. We recently stated in *Helvering* v. *Fitch*, supra, that under this statutory scheme escape from the rule of *Douglas* v. *Willcuts*, supra, may be had only on "clear and convincing proof" that "local law and the alimony trust have given the divorced husband a full discharge and leave no continuing obligation however contingent." Whatever may be the correct view on the other aspects of the case, the guarantee was such a continuing obligation. The fact that the wife or other beneficiaries looked primarily to the trust and only secondarily to respondent for payment of $24,000 annually, the fact that respondent's obligation might be enforceable by the trustee, the fact that respondent might never have to make good on his promise are beside the point. The existence of wholly contingent obligations, whether contractual or otherwise, is adequate to support the results reached in *Douglas* v. *Willcuts*, supra. For in that case it was manifest that at the time of the creation and approval of the trust the divorce court might never exercise its reserved power to revise or alter the decree and the husband might never have to make good on his promise to make up deficiencies in the estimated trust income. Likewise in the instant case, it can not be said that the divorce decree and the alimony trust gave respondent an absolute discharge from his prior obligation. So far as the guarantee alone is concerned, they permitted his preexisting unconditional duty to be transformed into a limited contingent one. But nonetheless they placed a specific and adequate sanction on that duty, so that respondent's personal obligation would not be fully discharged at least until complete payment of the principal and interest on the 6 per cent bonds had been made. Thus in effect, if not in form, the trust agreement was security for his continuing obligation which would be discharged at least *pro tanto* as income from those bonds was received by the trustee. Hence the case in substance is the same as those where pursuant to contract or arrangement an obligation is discharged by another for the taxpayer's benefit (see *Old Colony Trust Co.* v. *Commissioner*, 279 U. S., 716 [Ct. D. 80, C. B. VIII-2, 222 (1929)]; *United States* v. *Boston & Maine Railroad*, 279 U. S., 732); or where the taxpayer creates a trust, the income of which is applied to the discharge of his debt. (See *Helvering* v. *Blumenthal*, 296 U. S., 552.) Here, as there, the taxpayer received a benefit by the payments. The catalogue of benefits is not depleted when primary obligations are discharged. For these reasons that portion of the trust income which was received from the guaranteed bonds was clearly taxable to respondent.

Apparently, however, a portion of that income was received from other trust property. But we think that was also taxable to respondent though for another reason.

As we have seen the divorce decree approved, affirmed and made part of the judgment the separation agreement providing for the "support and maintenance" of the wife. Her maintenance and support were secured not only by the trust agreement and other property settlements but also by the personal obligation of the husband to contribute an annual sum. The circuit court of appeals held that under New York law the terms of the trust would not be changed "unless the wife can disaffirm it for fraud, overreaching, or the like," citing *Galusha* v. *Galusha* (116 N. Y., 635, 138 N. Y., 272); *Cain* v. *Cain* (188 A. D., 780); *Hamlin* v. *Hamlin* (224 A. D., 168). If the case was here on application of local law under the rule of *Erie Railroad Co.* v. *Tompkins* (304 U. S., 64), we would not be inclined to disturb that finding. But it is not. Here respondent is seeking to escape one of the normal incidents of the Federal income tax. For that purpose he invokes the aid of New York law. In *Helvering* v. *Fitch*, supra, we stated that where the divorced husband desires to avoid the general rule expressed in *Douglas* v. *Willcuts*, supra, he carries a distinct burden of establishing not by mere inference and conjecture but by "clear and convincing proof" that local law and the alimony trust have given him a full discharge. We do not think that respondent has sustained that burden.

As stated by the circuit court of appeals, it does seem clear that mere property settlements, though incorporated into the decree, may not be modified pursuant to the reserved statutory powers of the court, contained in N. Y. Civil Prac. Act sections 1155, 1170. (See *Cain* v. *Cain*, supra; *Goldfish* v. *Goldfish*, 193 A. D., 686; *Schnitzer* v. *Buerger*, 237 A. D., 622.) Nevertheless these settlements may be remade by the court not only where an ordinary contract may be set aside but also where they are unfair, inequitable and unjust. (*Hamlin* v. *Hamlin*, supra. Cf. *Tirrell* v. *Tirrell*, 232 N. Y., 224.) As stated by the court in the Hamlin case (224 A. D. at page 171) the requirement is that "such contracts be not only free from taint of actual fraud or coercion but also fair and reasonably sufficient having regard to the station in life and circumstances of the parties." More important to this case, however, are *Kunker* v. *Kunker* (230 A. D., 641) and *Holahan* v. *Holahan* (234 A. D., 572). They make it plain that the covenants of a separation agreement are not "an insuperable obstacle to obtaining relief by modification of the allowances." (*Holahan* v. *Holahan*, supra, 574. Cf. *Severance* v. *Severance*, 260 N. Y., 432.) The reserved power apparently may be exercised where the provision in the separate agreement, approved by the decree, is for support and maintenance (*Kunker* v. *Kunker* and *Holahan* v. *Holahan*, supra) but not where it is in settlement of claims of ownership to specified property. (*Goldfish* v. *Goldfish* and *Schnitzer* v. *Buerger*, supra). The provisions of the separation agreement and the trust agreement here in question specifically relate to and were designed to afford support and maintenance for the wife. Unlike the purpose of the trust agreement in *Schnitzer* v. *Buerger*, supra, the purpose here apparently was not to compose any controversies over the securities. We need not decide whether the court retained the power to require respondent to make additional payments to the wife in case, say, all the securities in trust turned out to be worthless. All we do hold is that respondent has not shown by "clear and convincing proof" that the court lacks the power to add to his personal obligations in any such circumstances.

Reversed.

Mr. Justice REED concurs in the result for the reasons stated in the dissent in *Helvering* v. *Fuller*, decided to-day, No. 427, October term, 1939.

The CHIEF JUSTICE, Mr. Justice MCREYNOLDS, and Mr. Justice ROBERTS are of the opinion that the judgment of the circuit court of appeals should be affirmed.

SUPPLEMENT L.—ASSESSMENT AND COLLECTION OF DEFICIENCIES.

SECTION 275.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

ARTICLE 275-1: Period of limitation upon assessment of tax.

1940-11-10201
Ct. D. 1446

INCOME TAX—REVENUE ACTS OF 1926, 1932, AND 1934—DECISION OF SUPREME COURT.

1. FIDUCIARY RETURN—VENUE—PERIOD OF LIMITATION UPON ASSESSMENT—APPLICABILITY OF STATUTE PRESCRIBING LIMITATION PERIOD WHERE CORPORATION MAKES NO RETURN.

Where a trust company which created and managed a fund for the benefit of its clients filed a fiduciary return for 1932 on Form 1041, setting forth all information necessary to the calculation of any tax that might be due, and attaching a list of the beneficiaries of the fund and their shares of the income, such return was "the return of the tax in respect of which the liability arises" and governed venue of the proceeding for review under section 1002(a) of the Revenue Act of 1926, as amended, and was also a return of the tax imposed, under the terms of section 275(a) of the Revenue Act of 1932, so that the 2-year period of limitations applies and the assessment, after such period, of a deficiency against the fund as an association was barred. Section 275(c) of the Revenue Act of 1932, providing a 4-year period for assessment, is inapplicable. That section was adopted to set a period of limitations where no return is filed by the association but returns are filed only by the members, and was intended to impose a period of limitation where one had not theretofore existed.

2. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Third Circuit (1939) (106 F. (2d), 139), reversing unreported decision of the United States Board of Tax Appeals (1938), reversed.

SUPREME COURT OF THE UNITED STATES.

Germantown Trust Co., Trustee of the Germantown Trust Co. Bond Investment Fund, petitioner, v. *Commissioner of Internal Revenue.*

[309 U. S., 304.]

On writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[February 26, 1940.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the Court.

This case involves the construction and application of provisions of the Revenue Act of 1926, as amended by that of 1934, and of the Revenue Act of 1932, relating to the venue of proceedings to review a decision of the Board of Tax Appeals and setting limitations upon the assessment of income tax.

The petitioner is a trust company, doing a general business as such, including administering trust estates and acting as agent for the custody, handling, and management of its clients' investments. In 1930 it created, by an appropriate instrument, a fund to afford those for whom it acted the advantage of investing small amounts in securities at minimum expense and with opportunity of ready liquidation. The fund has since been managed according to the terms of the agreement. In the course of administration the petitioner has paid to the participants their respective shares of income from the invested principal, and has filed fiduciary returns of income on Treasury Form 1041, intended for use by trustees.

March 15, 1933, the petitioner, as trustee, filed such a return, for the calendar year 1932, with the collector of internal revenue for the first district of Pennsylvania, at Philadelphia. The return accurately set forth the gross income, the deductions, and the net income,—in short all information necessary to the calculation of any tax which might be due,—and attached a list of the beneficiaries of the fund, and their shares of the income. No corporation income tax return was filed on Treasury Form 1120. The participants in the fund, who were required to make individual returns for the year 1932, included in their respective returns, filed on or before March 15, 1933, their shares of income.

September 17, 1936, pursuant to the recommendation of a Treasury agent that the fund be taxed as a corporation,[1] the respondent prepared from the Form 1041 return, a substitute corporation return on Form 1120, covering the year 1932, and, on February 27, 1937, gave notice of a consequent deficiency of tax.

The petitioner carried the matter to the Board of Tax Appeals for redetermination, asserting that it was taxable as a trust and not as an association and that assessment and collection of the asserted deficiency was barred by the expiration of two years from the date its return was filed. The Board held the assessment barred.

The respondent petitioned the United States Court of Appeals for the Third Circuit to review the Board's decision. That court held that the venue provision of section 1002(a) of the Revenue Act of 1926, as amended by section 519 of the Revenue Act of 1934,[2] empowered it to entertain the petition, and that the assessment of a deficiency was not barred by sections 275 and 276 of the Revenue Act of 1932,[3] the applicable section, in its view, being 275(c).[4]

The petitioner sought certiorari on the ground that the circuit court of appeals' decision that the fiduciary return it had filed was a return which governed venue under section 1002, as amended, but no return within the meaning of section 275(c), conflicts with a decision of the Circuit Court of Appeals for the Second Circuit.[5] Because of the conflict we granted certiorari.

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[1] Section 1111(a)2 of the Revenue Act of 1932 (47 Stat., 169, 289): "The term 'corporation' includes associations" * * *. (See *Morrissey* v. *Commissioner*, 296 U. S., 344 [Ct. D. 1064, C. B. XV–1, 264 (1935)].)

[2] Section 1002(a): "Except as provided in subdivision (b) [relating to venue by stipulation], such decision may be reviewed by the circuit court of appeals for the circuit in which is located the collector's office to which was made *the return of the tax in respect of which the liability arises* or, if no return was made, then by the Court of Appeals of the District of Columbia." [Italics supplied.] (44 Stat., 9, 110; 48 Stat., 680, 760; 26 U. S. C., 641(b).)

[3] SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) GENERAL RULE.—The amount of income taxes imposed by this title shall be assessed within two years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * * * *

(c) CORPORATION AND SHAREHOLDER.—*If a corporation makes no return of the tax imposed by this title,* but each of the shareholders includes in his return his distributive share of the net income of the corporation, then the tax of the corporation shall be assessed within four years after the last date on which any such shareholder's return was filed. [Italics supplied.]

SEC. 276. SAME—EXCEPTIONS.

(a) FALSE RETURN OR NO RETURN.—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time. (Revenue Act of 1932, 47 Stat., 169, 237.)

[4] *Commissioner* v. *Germantown Trust Co., Trustee* (106 F. (2d), 139).

[5] *Commissioner* v. *Roosevelt & Son Inv. Fund* (89 F. (2d), 706).

Petitioner and respondent agree that the court below was right in holding the return in question was such a return as fixed the venue of the petition for review in the Third Circuit, where the return was filed. We concur in this view.

The petitioner contends that the fiduciary return filed on Form 1041 was a return within the meaning of section 275(a), which limits the time for assessment to two years after the filing of the return. The respondent insists that the return was "no return of the tax" within the meaning of section 275(c), and, therefore, the 4-year limitation specified in that section applies.

As the notice of deficiency was given more than two years after the filing of the fiduciary return, and within four years of the filing of the last return by any participant in the fund, decision turns upon which subsection governs.

We hold that the return was a return within the meaning of section 275(a) and that the petitioner can not be held to have made no return so as to bring the case within section 275(c).

First. We are of opinion that if the return filed by the petitioner was such as to create venue of the proceeding for review in the court below, it was also a return under the terms of section 275(a), so that the 2-year period of limitations imposed by that section is applicable.

The return was a fiduciary return. It is admitted that the petitioner in respect of the fund was a fiduciary and was bound to file such a return.[6] It contained all of the data from which a tax could be computed and assessed although it did not purport to state any amount due as tax. Section 1002(a), as amended, supra, confers venue upon the circuit court for the circuit in which was made "the return of the tax in respect of which the liability arises." Section 275(a) provides that the amount of tax must be assessed within two years after "the return was filed." Section 275(c) fixes a period of four years for assessment "if a corporation makes no return of the tax imposed by this title," but each shareholder returns his distributive share of the net income.

We think the language of the sections is such that it can not be said the fiduciary return filed by the petitioner was a return of the tax in respect of which the liability arises but was no return of the tax imposed by the statute.

The respondent urges that the two sections have separate aims; that the venue provision was inserted for the convenience of taxpayers, so that they should not be compelled to litigate in courts far from their domicile, whereas the limitation sections have nothing to do with the designation of a forum. Conceding that this is true, it remains that, if the return in question complies with the one description, it equally complies with the other. We find no adequate reason for attributing a different meaning to the two phrases.

Second. Section 275(c) is inapplicable. Sections 275 and 276 set up a complete scheme of limitations on assessment of income taxes. Section 275(a) imposes a limitation of two years after the filing of the return. Section 276(a) provides that there shall be no period of limitations if a false return, or no return, be filed. If the statute went no further, and if the respondent's position is correct that, in this case, the taxpayer was a corporation and filed no return as such, then there would be no period of limitations whatever. This was the situation under the Revenue Act of 1924.[7]

The legislative history demonstrates that section 275(c) was adopted to set a period of limitations where no return is filed by the association but returns are filed only by the members. In other words, subsection (c) was adopted to limit, rather than to enlarge, the time for assessment in such a case.[8]

The respondent's contention is that where a fiduciary, in good faith, makes what it deems the appropriate return, which discloses all of the data from which the tax, treated as one imposed upon an association (classified as a corporation under the statute), can be computed, such a return is to be deemed no return. We think this view inadmissible.

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[6] Revenue Act of 1932 (47 Stat., 169, 214).

[7] Revenue Act of 1924, sections 227(a)1 and 278(a) (43 Stat., 253, 299).

[8] The provision was first inserted as section 277(a)5 of the Revenue Act of 1926 (44 Stat., 9, 58). The committee reports on the section, construed in connection with the course of the bill in Congress, sustain, rather than negative, the view that the section was intended to impose a period of limitation where one had not theretofore existed. (See H. Rept. No. 1, Sixty-ninth Congress, first session, page 11; S. Rept. No. 52, Sixty-ninth Congress, first session, page 28. Compare Hearings, Committee on Ways and Means of the House, Seventy-third Congress, first session, page 146.)

It can not be said that the petitioner, whether treated as a corporation or not, made no return of the tax imposed by the statute. Its return may have been incomplete in that it failed to compute a tax, but this defect falls short of rendering it no return whatever.[9]

The judgment is reversed.

SUPPLEMENT M.—INTEREST AND ADDITIONS TO THE TAX.

SECTION 292.—INTEREST ON DEFICIENCIES.

(Also Section 298.)

1940–18–10246
G. C. M. 21860

REVENUE ACT OF 1932.

Interest assessable on deficiencies in cases of bankruptcy and receivership.

An opinion is requested as to the amount of interest to be collected from the trustee in bankruptcy of the M Company in connection with the Government's claim for unpaid excess profits taxes filed in the bankruptcy case.

The facts, so far as pertinent, are that a petition for reorganization of the M Company was filed under section 77B of the National Bankruptcy Act on September —, 1935, and the court, after reciting the approval of the petition, appointed a trustee of all the assets of the M Company. Thereafter, a deficiency for 1933 excess profits taxes with interest was assessed. On December —, 1939, the trustee in bankruptcy was prepared to pay the claim in full and the question arose as to the correct amount of interest to be included. The question particularly involved is whether interest accrued on the interest assessed with the deficiency.

Before answering this specific question, it seems advisable to consider the general question as to the amount of interest due on taxes in a case where there is an adjudication of bankruptcy of a taxpayer in a bankruptcy proceeding or the appointment of a receiver for a taxpayer in a receivership proceeding before any court of the United States or of any State or Territory or of the District of Columbia. This memorandum is limited to two classes of such cases—(1) where the adjudication of bankruptcy or appointment of a receiver occurs *before* the assessment in ordinary course of the amount of the deficiency and interest, and (2) where the adjudication of bankruptcy or appointment of a receiver occurs *after* the assessment of the amount of the deficiency and interest. Class (2) must be further subdivided into cases (*a*) where the adjudication of bankruptcy or appointment of a receiver occurs *before* the date of notice and demand by the collector, and (*b*) where the adjudication of bankruptcy or appointment of a receiver occurs *after* the date of notice and demand by the

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[9] *Zellerbach Paper Co.* v. *Helvering* (293 U. S., 172, 180 [Ct. D. 889, C. B. XIII–2, 341 (1934)]); *Commissioner* v. *Stetson Co.* (43 F. (2d), 553); *United States* v. *Tillinghast* (69 F. (2d), 718); *Mabel Elevator Co.* (2 B. T. A., 517); *Abraham Werbelovsky* (8 B. T. A., 442, 446); *F. M. Stearns* (16 B. T. A., 889); *J. R. Brewer* (17 B. T. A., 704).

collector. The applicable provisions of the Revenue Act of 1932 which control this case (see section 216(b) of the National Industrial Recovery Act, 48 Stat., 195), the corresponding provisions of subsequent Revenue Acts, and the Internal Revenue Code will be considered. Wherever reference is made in this memorandum to interest, it means interest at the rate of 6 per cent per annum, since that is the rate applicable to income, estate, and gift taxes after October 24, 1933. (See section 404 of the Revenue Act of 1935, section 821 of the Revenue Act of 1938, and section 3794 of the Internal Revenue Code.) These provisions, as well as those later to be cited, are made applicable to excess profits taxes by virtue of section 216(b), supra, section 702(b) of the Revenue Act of 1934, section 106(c) of the Revenue Act of 1935, section 602(c) of the Revenue Act of 1938, and section 603 of the Internal Revenue Code.

Class (1)—Where the adjudication of bankruptcy or appointment of a receiver occurs *before* the assessment in the ordinary course (see section 272(a) of the Revenue Acts of 1932, 1934, 1936, 1938, and the Internal Revenue Code) of the amount of the deficiency and interest.

Section 274(a) of the Revenue Acts of 1932, 1934, 1936, 1938, and the Internal Revenue Code provides in part as follows:

Immediate assessment.—Upon the adjudication of bankruptcy of any taxpayer in any bankruptcy proceeding or the appointment of a receiver for any taxpayer in any receivership proceeding * * * any deficiency (together with all interest, additional amounts, or additions to the tax provided for by law) determined by the Commissioner in respect to a tax imposed by this title [chapter in the Code] upon such taxpayer shall, despite the restrictions imposed by section 272(a) upon assessments be immediately assessed if such deficiency has not theretofore been assessed in accordance with law. * * * Claims for the deficiency and such interest, additional amounts and additions to the tax may be presented, for adjudication in accordance with law, to the court before which the bankruptcy or receivership proceeding is pending, despite the pendency of proceedings for the redetermination of the deficiency in pursuance of a petition to the Board; but no petition for any such redetermination shall be filed with the Board after the adjudication in bankruptcy or the appointment of the receiver.

Prior to assessment interest accrues on the amount of the deficiency "at the rate of 6 per centum per annum from the date prescribed for the payment of the tax (or, if the tax is paid in installments, from the date prescribed for the payment of the first installment) to the date the deficiency is assessed, or, in the case of a waiver under section 272(d), to the thirtieth day after the filing of such waiver or to the date the deficiency is assessed whichever is the earlier." (Section 292 of the Revenue Acts of 1932, 1934, 1936, 1938, and the Internal Revenue Code.)

In the ordinary case (omitting those involving bankruptcy or receivership for the time being) it is provided in part in section 294(b) of the Revenue Acts of 1932, 1934, 1936, and 1938 and the Internal Revenue Code that:

Deficiency.—Where a deficiency, or any interest * * * assessed in connection therewith under section 292 * * * is not paid in full within 10 days from the date of notice and demand from the collector, there shall be collected as part of the tax, interest upon the unpaid amount * * * from the date of such notice and demand until it is paid * * *.

The term "unpaid amount" in section 294(b), supra, clearly refers to the amount of the assessment (which includes tax and interest) which is not paid in full within 10 days from the date of the notice and the demand. (See section 292, supra, which provides that the "Interest upon the amount determined as a deficiency shall be assessed at the same time as the deficiency, shall be paid upon notice and demand from the collector, and shall be collected as a part of the tax * * *.") Thus, section 294(b), supra, requires that interest be collected on the amount of the unpaid assessed tax and interest from the date of the notice and demand until paid.

It is important to note at this point that, ordinarily, an assessment of the amount of the deficiency and interest thereon can not be made "until such notice [of deficiency] has been mailed to the taxpayer, nor until the expiration of such 90-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final." (Section 272(a), supra.) One of the exceptions made to this rule is in cases relating to bankruptcy and receivership where an assessment must be made immediately. (Section 274(a), supra.) This exception to the rule was enacted in 1926 because of the fact that during the pendency of a bankruptcy or receivership proceeding the assets of the debtor-taxpayer could not be distrained upon even if the Commissioner succeeded before the Board of Tax Appeals in a petition for redetermination of the amount of the deficiency filed before the adjudication of bankruptcy or the appointment of a receiver. (Senate Report No. 52, Sixty-ninth Congress, first session, Revenue Act of 1926.) In any event, the statute provides that in such cases a claim for the deficiency and interest may be presented to and allowed by the court in which the proceeding is pending, and that no petition for a redetermination of the deficiency shall be filed with the Board after adjudication of bankruptcy or the appointment of a receiver.

It thus appears that with respect to assessments made in accordance with section 274(a), supra, the statute does not contemplate the issuance of a notice and demand for payment pursuant to section 294(b), supra. This is made clear not only by consideration of the purpose of section 274(a), supra, but by the particular wording of that section. The first part of section 274(a) requires that an assessment be immediately made of "any deficiency (together with all interest * * * provided for by law) determined by the Commissioner * * *." In the latter part of the section it is provided not that claims for the *assessment* be presented to the court but that "claims for the *deficiency* and such interest * * * may be presented." [Italics supplied.] The term "such interest" refers back to the phrase "all interest * * * provided for by law," which interest, where assessment was not made against the taxpayer prior to his adjudication, represented the interest accruing against the taxpayer in accordance with the provision of law applicable prior to assessment. (See section 292, supra.) It is believed, therefore, that the Government's claim in such cases should not only include the amount of the deficiency, but the amount of interest accruing thereon (as provided for by law) as of the date of the taxpayer's adjudication, and that the subsequent assessment of the tax, although required for administrative purposes, should not be regarded as terminating the running of such interest, since, in accordance with the statute, the amount of the deficiency and the amount of interest due thereon are left to the court "for adjudication in accordance with law."

After termination of the proceeding, however, a different rule applies by virtue of section 298 of the Revenue Acts of 1932, 1934, 1936, 1938, and the Internal Revenue Code, which provides:

If the unpaid portion of the claim allowed in a bankruptcy or receivership proceeding, as provided in section 274, is not paid in full within 10 days from the date of notice and demand from the collector, then there shall be collected as a part of such amount interest upon the unpaid portion thereof * * * from the date of such notice and demand until payment.

The term "unpaid portion," as used in section 298, supra, clearly includes the entire amount (both tax and interest) of the claim allowed by the court which is not paid in full within 10 days from the date of notice and demand.

It is the opinion of this office, therefore, that where there is an adjudication of bankruptcy or appointment of a receiver for a taxpayer *before* an assessment of the amount of the deficiency and interest is made in ordinary course, the interest which accrues is at the rate of 6 per cent per annum only on the principal amount of the tax during the pendency of the bankruptcy or receivership proceeding, and that the statute does not authorize the collection of interest on interest until after the issuance of notice and demand following the termination of such proceeding, and then only to the extent of any portion of the Government's claim (including interest) allowed in such proceeding which is unpaid, and with respect to which the taxpayer fails to make payment, within 10 days after the issuance of such notice.

Class (2)—Where the adjudication of bankruptcy or appointment of a receiver occurs *after* the assessment in due course of the amount of the deficiency and interest.

As can be seen from the discussion in the first part of this memorandum, in the ordinary case (omitting those involving bankruptcy or receivership for the time being) interest accrues on the amount of the unpaid assessed tax and interest from the date of notice and demand until paid. (Section 294(b), supra.) That this rule (although at a different rate of interest) was applicable to estates in bankruptcy or receivership, among others, is shown by section 294(c) of the Revenue Acts of 1932, 1934, and 1936, which reads as follows:

Fiduciaries.—For any period an estate is held by a fiduciary appointed by order of any court of competent jurisdiction or by will, there shall be collected interest at the rate of 6 per centum per annum in lieu of the interest provided in subsections (a) and (b) of this section.

Section 1111(a)6 of the Revenue Act of 1932, section 801(a)6 of the Revenue Act of 1934, and section 1001(a)6 of the Revenue Act of 1936 define the term "fiduciary" to mean, among others, trustee, receiver, or any person acting in any fiduciary capacity for any person. (See also Mim. 4496, C. B. XV-2, 530 (1936).)

Section 294(c) referred to above was omitted from the Revenue Act of 1938. This action is explained as follows by the report of the Committee on Ways and Means:

Section 294(c) of the Revenue Act of 1936 is not retained in this bill, since it is clearly surplusage. Prior to the enactment of section 404 of the Revenue Act of 1935, reducing the rates of interest on unpaid taxes from 1 per cent per month to 6 per cent per annum, the matter eliminated provided a special rule in the case of estates held by fiduciaries appointed by courts of competent jurisdiction or by will. Now that all unpaid taxes bear interest at the rate of 6 per cent per annum, there is no further need for continuing the matter eliminated, and the interest rate in such cases is governed by other provisions of section 294. (H. R. Report No. 1860, Seventy-fifth Congress, third session.)

As in class (1) discussed above, a different rule applies after termination of the proceeding by virtue of section 298, supra, which provides for interest on the unpaid portion of the claim allowed by the court which is not paid in full within 10 days from the date of notice and demand.

It is, therefore, the opinion of this office that where there is an adjudication of bankruptcy or appointment of a receiver for a taxpayer *after* an assessment of the amount of the deficiency and interest, the interest which accrues is at the rate of 6 per cent per annum on the amount of the unpaid assessed tax and interest from the date of the notice and demand until the termination of the bankruptcy or receivership proceeding. After the termination of the proceeding, that portion of the Government's claim allowed in such proceeding which is unpaid, and with respect to which the taxpayer fails to make payment within 10 days after the issuance of notice and demand, draws interest from the date of such notice and demand until payment.

With reference to subdivisions (*a*) and (*b*) of class (2) mentioned in the first part of this memorandum, it is believed to be immaterial whether the date of the notice and demand for the assessment (tax plus interest) precedes or follows the date of the adjudication of bankruptcy or appointment of a receiver. As heretofore pointed out, where an assessment has been made prior to an adjudication in bankruptcy or appointment of a receiver, section 294, subdivisions (b) and (c), of the Revenue Acts of 1932, 1934, and 1936, and section 294(b) of the Revenue Act of 1938 continue to govern the accrual of interest and the rate thereof, except as altered by section 298, supra, after the termination of the proceeding.

The instant case falls within class (1) above discussed, since the adjudication of bankruptcy occurred *before* the assessment in ordinary course of the amount of the deficiency and interest.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

SECTION 298.—BANKRUPTCY AND RECEIVERSHIPS.

REVENUE ACT OF 1932.

Interest assessable on deficiencies in cases of bankruptcy and receivership. (See G. C. M. 21860, page 181.)

SUPPLEMENT O.—OVERPAYMENTS.

SECTION 322.—REFUNDS AND CREDITS.

ARTICLE 322-7: Limitations upon the crediting and refunding of taxes paid. 1940-5-10157 Ct. D. 1436

INCOME TAX—REVENUE ACT OF 1934—DECISION OF COURT.

1. BOARD OF TAX APPEALS—AMENDMENT OF PETITION—SUBSTITUTION OF NEW CAUSE OF ACTION FOR ORIGINAL CLAIM—STATUTE OF LIMITATIONS.

A timely petition to the Board of Tax Appeals, based upon a specific ground, can not be amended after the expiration of two years from the date of payment of the tax by substituting for such ground an entirely different claim. The amendment constitutes a new cause of action which, by itself, would have been barred by the statute of limitations, and can not relate back to the filing of the original petition so as to bring it within the statutory period.

2. DECISIONS APPLICABLE.

United States v. *Andrews* (1938) (302 U. S., 517 [Ct. D. 1390, C. B. 1938-1, 322]) and *United States* v. *Garbutt Oil Co.* (1938) (302 U. S., 528 [Ct. D. 1301, C. B. 1938-1, 370]) are applicable to appeals filed with the Board of Tax Appeals.

3. DECISION REVERSED.

Decision of the United States Board of Tax Appeals (1937) (35 B. T. A., 1178) reversed.

4. CERTIORARI DENIED.

Petition for certiorari denied November 6, 1939.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

Commissioner of Internal Revenue, petitioner, v. *Edward E. Rieck, respondent.*
[104 Fed. (2d), 294.]

On petition for review of the decision of the United States Board of Tax Appeals.

Before BUFFINGTON and BIGGS, Circuit Judges, and DICKINSON, District Judge.

[January 17, 1939.]

OPINION.

DICKINSON, District Judge: The Commissioner of Internal Revenue levied a tax for the year 1932 upon the respondent taxpayer, based upon income received during that year. The Commissioner on a deficiency assessment included in the taxpayer's taxable income what the taxpayer claimed to be the income of what is known to this record as an insurance trust. The taxpayer paid the assessed tax on March 15, 1933, and the deficiency assessment on September 5, 1934. He then appealed to the Board of Tax Appeals, complaining of an over-assessment because of the inclusion of the insurance trust income in the tax-payer's taxable income and asked for a refund of the overpayment. This claim was filed April 19, 1935. The taxpayer had likewise included in his return of his 1933 income a deduction because of a loss suffered through the worthlessness of shares of stock in the Diamond National Bank. The Commissioner conceded the fact of the loss but refused the deduction because of his holding that the loss had been incurred in 1932 and hence could not be deducted from the 1933 income.

In the course of the appeal to the Board above mentioned, the taxpayer became convinced that his claim to a deduction because of the insurance trust income was baseless and would not be, as it was not, allowed by the Board. He accordingly asked and was granted by the Board leave to amend his claim by substituting for the insurance trust income deduction a deduction for the bank stock loss. This amendment was allowed September 28, 1936. The significance of this is that the original claim was filed April 19, 1935, within two years of the payment of the tax. The amended claim was not made until September 28, 1936, more than two years after the payment. If, however, the allowance of the amendment was proper, the bank loss claim would relate back to the insurance trust claim and both would be within the two years. The principle is too well settled to require the citation of authorities to support it, that an amendment will not be allowed if it introduces a new cause of action which as an independent proceeding would be barred by a statute of limitations. The real question thus becomes, as formulated in the opinion of the Board, "what constitutes a cause of action in cases involving the determination of the income tax liability of taxpayers."

The Board has favored us with a closely reasoned opinion in the discussion of the subject to which nothing could be profitably added. The Board however did not have the benefit of the ruling of the Supreme Court in the cases of *Andrews* v. *United States* (17 Fed. Supp., 980) and *Garbutt Oil Co.* v. *United States* (89 F. R. (2d), 749), since reported in 302 U. S., 517, and ibid., 528.

The review before us thus comes down to the question of whether these cases, or either of them, are decisive of the question ruled by the Board.

A distinction has been made, referred to in the opinion of the Board and stressed by appellee, between claims made to the Commissioner and appeals to the Board. Neither of the cited cases was of the Board of Appeals type. They nonetheless seem decisive of the question before us. The amended Act forbids an order of refund unless there is a finding by the Board that "the tax was paid within two years before the filing of the claim or the filing of the petition." The cited cases rule that an untimely claim can not be brought within the 2-year limitation by calling it an amendment of a claim filed in time unless the amendment was properly allowed and that it is not properly allowed if based "on a new and unrelated ground," which by itself alone would be barred by the statute.

It has likewise been urged upon us that no timely objection was made to the amendment and that the petitioner is thus in the position by an untimely objection, of seeking to raise the question of an untimely claim. There is in consequence said to have been a waiver of the delay in presenting the claim finally made. The cited cases however deal with this very point. Compliance with procedural regulations may be waived but a statutory limitation may not be. There is that in the situation of this taxpayer which has appealing force but there must be compliance with the statute.

The cited cases require us to hold that the petition to review the order of the Board of Tax Appeals be allowed and the order be reversed.

TITLE XI.—GENERAL ADMINISTRATIVE PROVISIONS.

SECTION 1106 (REVENUE ACT OF 1926).—FINAL DETERMINATIONS AND ASSESSMENTS.

ARTICLE 1341 (REGULATIONS 69): Final determination and assessment of tax or penalty. 1940–11–10202 Ct. D. 1447

INCOME TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

1. BOARD OF TAX APPEALS—FINDINGS OF FACT—EVIDENCE—BOARD'S FINDINGS TO BE ACCEPTED UPON REVIEW.

Where there was substantial evidence to support the conclusion of the Board of Tax Appeals that the Commissioner had adequately sustained the burden of showing fraud or malfeasance or misrepresentation of fact which affected a closing agreement and properly set aside that agreement, the court below should have accepted such finding and may not substitute its judgment of facts for that of the Board.

2. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Third Circuit (1939) (105 F. (2d), 552), vacating decision of the United States Board of Tax Appeals (1936) (34 B. T. A., 59), reversed.

SUPREME COURT OF THE UNITED STATES.

Guy T. Helvering, Commissioner of Internal Revenue, petitioner, v. *John Kehoe.*
[309 U. S., 277.]

On writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[February 26, 1940.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the Court.

Respondent Kehoe, in 1926, made an income tax return for 1925 and paid the amount computed thereon. In 1927, after inquiry concerning his affairs, the Commissioner assessed and collected an additional sum. Respondent waived appeal to the Board of Tax Appeals and became party to a closing agreement under section 1106(b), Revenue Act 1926,[1] approved by the Secretary of the Treasury January 27, 1928.

In 1932 the Commissioner undertook to set aside this agreement and made a deficiency assessment of more than $200,000, also a 50 per cent penalty. Respondent appealed to the Board of Tax Appeals where he maintained there was no adequate proof to support the assessment. The Board held the Commissioner had adequately sustained the burden of showing fraud or malfeasance or misrepresentation of fact, and did not err in setting the agreement aside.

The matter then went to the Circuit Court of Appeals, Third Circuit, which ruled there was no adequate evidence to support the conclusion and judgment of the Board. The facts are much discussed in a majority and dissenting opinion (105 Fed. (2d), 552). Another narration of them seems unnecessary.

Under the rule often announced, the function of the Board of Tax Appeals is to weigh the evidence and declare the result as to matters properly before it. Upon review the court may not substitute its judgment of the facts for that of the Board. When there is substantial evidence to support the conclusion of the latter this must be accepted. (*Helvering* v. *Rankin,* 295 U. S., 123, 131 [Ct. D. 966, C. B. XIV-1, 160 (1935)]; *General Utilities Co.* v. *Helvering,* 296 U. S., 200, 206 [Ct. D. 1055, C. B. XV-1, 214 (1936)]; *Elmhurst Cemetery Co.* v. *Commissioner,* 300 U. S., 37, 40 [Ct. D. 1202, C. B. 1937-1, 209].)

Here, upon evidence which we think is substantial (the dissenting member of the court below held the same view), the Board found fraud in fact which affected the closing agreement, and that the Commissioner properly set the contract aside. The court below should have accepted this finding of fact. As it failed so to do the challenged judgment must be reversed. The ruling of the Board is affirmed.

Reversed.

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[1] January 26, 1926 (ch. 27, 44 Stat., 9, 113)—

SEC. 1106. (b) If after a determination and assessment in any case the taxpayer has paid in whole any tax or penalty, or accepted any abatement, credit, or refund based on such determination and assessment, and an agreement is made in writing between the taxpayer and the Commissioner, with the approval of the Secretary, that such determination and assessment shall be final and conclusive, then (except upon a showing of fraud or malfeasance or misrepresentation of fact materially affecting the determination or assessment thus made) (1) the case shall not be reopened or the determination and assessment modified by any officer, employee, or agent of the United States, and (2) no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States.

EMPLOYMENT TAXES.

INTERNAL REVENUE CODE.

CHAPTER 9, SUBCHAPTER A.—EMPLOYMENT BY OTHERS THAN CARRIERS.

SECTION 1426: Definitions.
REGULATIONS 91, ARTICLE 4: Who are employers.

Change in status of employer under community property law of Texas (See S. S. T. 381, page 214.)

SECTION 1403: Receipts for employees. 1940–1–10129
REGULATIONS 106, SECTION 402.306: Statements for employees. Mim. 4992

Receipts for employees required by section 1403 of the Federal Insurance Contributions Act, as amended, with respect to wages paid after December 31, 1939.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., December 12, 1939.

Collectors of Internal Revenue and Others Concerned:

Section 1403 of the Federal Insurance Contributions Act (Subchapter A, Chapter 9, of the Internal Revenue Code), added by section 603 of the Social Security Act Amendments of 1939, provides as follows:

SEC. 1403. RECEIPTS FOR EMPLOYEES.

(a) REQUIREMENT.—Every employer shall furnish to each of his employees a written statement or statements, in a form suitable for retention by the employee, showing the wages paid by him to the employee after December 31, 1939. Each statement shall cover a calendar year, or one, two, three, or four calendar quarters, whether or not within the same calendar year, and shall show the name of the employer, the name of the employee, the period covered by the statement, the total amount of wages paid within such period, and the amount of the tax imposed by section 1400 with respect to such wages. Each statement shall be furnished to the employee not later than the last day of the second calendar month following the period covered by the statement, except that, if the employee leaves the employ of the employer, the final statement shall be furnished on the day on which the last payment of wages is made to the employee. The employer may, at his option, furnish such a statement to any employee at the time of each payment of wages to the employee during any calendar quarter, in lieu of a statement covering such quarter; and, in such case, the statement may show the date of payment of the wages, in lieu of the period covered by the statement.

(b) PENALTY FOR FAILURE TO FURNISH.—Any employer who willfully fails to furnish a statement to an employee in the manner, at the time, and showing the information, required under subsection (a), shall for each such failure be subject to a civil penalty of not more than $5.

The Bureau of Internal Revenue is receiving numerous inquiries relative to the form and content of the statements which are required by the above-quoted provisions to be furnished by employers to employees on and after January 1, 1940. The purpose of this mimeograph is to set forth the answers to certain questions which appear to be of general interest. Such questions, and the answers thereto, are as follows:

Question 1: In what form should the statement be made?

Answer: No particular form is prescribed for the statement required to be furnished by the employer to the employee. If a statement, in a form suitable for retention by the employee, is prepared by the employer to show clearly all the information called for by section 1403(a) and is furnished at the time or times specified therein, the statement may be in any form. Such statement may be furnished, for example, on the employee's pay envelope, on a detachable stub attached to the employee's pay check, or on a separate sheet of paper.

Question 2: May the employer omit the employee's name from the statement if the employee is required to write his name on the statement after it is furnished to him?

Answer: The statement must be complete when furnished to the employee, and the employee's name must be a part of the statement when it is so furnished.

Question 3: May the employee's account number or pay-roll number be shown on the statement, instead of the employee's name?

Answer: No. The employee's name must be shown on the statement. (See, however, the answer to question 8.)

Question 4: What amount of employee's tax should be shown on the statement if the employer—(*a*) collects as employees' tax more or less than 1 per cent of the total wages shown on the statement, because of the necessity of increasing or decreasing fractions of cents at the time of each collection of such tax; (*b*) erroneously collects more or less than the correct amount of employees' tax; or (*c*) pays the employees' tax to the collector without collecting the amount thereof from the employee?

Answer: The statement should show the amount collected from the employee by the employer as employees' tax during the period covered by the statement (including, with respect to the tax on each payment of wages, the increase of a fraction of a cent, if any, to 1 cent if the fraction is one-half or more, or excluding the fraction of a cent, if any, if the fraction is less than one-half). If, by reason of an error made during such period or prior thereto, the amount collected is greater or less than the amount of employees' tax which should have been collected with respect to the wages shown on the statement, the statement should also show the correct amount of employees' tax with respect to such wages. In any case, however, in which it is the practice of the employer to pay the employees' tax without collecting it from the employee, the statement should show the amount of employees' tax which, if such were not the practice of the employer, should have been deducted at the time the wages were paid.

Question 5: If an employee receives remuneration in excess of $3,000 for services performed during a calendar year, should the statement or statements furnished to the employee show the total amount of remuneration paid, or only the $3,000 which is taxable?

Answer: Only the taxable wages, in the amount of $3,000, should be shown on such statement or statements.

In preparing each statement required by section 1403(a), it will be necessary for the employer to show only that part of an employee's remuneration which constitutes "wages" for "employment," as those terms are defined in section 1426 of the Federal Insurance Contributions Act, as amended. The term "wages," as so defined, does not include remuneration in excess of the first $3,000 paid to an employee by an employer with respect to "employment" during any calendar year. Regulations relating in part to the meaning of the terms "wages" and "employment" are in preparation and may be obtained at a later date from collectors of internal revenue.

Question 6: May the amount of employees' tax shown on the statement be identified by some short designation, such as "F. I. C." (that is, Federal insurance contributions)?

Answer: The amount of employees' tax shown on the statement should be identified so that it will be clearly distinguishable from any other deductions from the employee's wages. If a short designation such as "F. I. C." is used, care should be taken that such designation is used to identify only the employees' tax.

Question 7: Is it permissible to show the last date covered by a pay roll, rather than the date of payment of the wages or the period covered by the statement?

Answer: This is not permissible unless the employer furnishes a statement at the time of each payment of wages to the employee and the wages are paid on the last date covered by the pay roll.

Section 1403(a) requires that the employer shall show the period covered by the statement unless a statement is furnished to the employee at the time of each payment of wages. If the statement is so furnished, the employer may, at his option, show the date of payment of the wages, rather than the period covered by the statement.

Question 8: May the employer include in the statement information in addition to that required by section 1403(a)?

Answer: If the statement otherwise meets the requirements of section 1403(a), there is no objection to the inclusion in the statement of additional information, such as the employee's account number or pay-roll number or amounts deducted other than as employees' tax, provided that such additional information is clearly distinguishable from the required information.

Correspondence relating to this mimeograph should refer to its number and to the symbols A&C:RR.

GUY T. HELVERING,
Commissioner.

Approved December 12, 1939.

HERBERT E. GASTON,
Acting Secretary of the Treasury.

SECTION 1426: Definitions. 1940-20-10259
REGULATIONS 106, SECTION 402.204: Who are employees. S. S. T. 387

Fishermen performing services on fishing schooners owned by the M Company, for which they receive a "lay" or share of the proceeds of the catch from the fishing voyage, are employees of the M Company within the meaning of Subchapter A, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

The question is presented whether fishermen performing services on fishing schooners owned by the M Company are employees of that company within the meaning of Subchapter A, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

The M Company owns several fishing schooners and operates them on a "lay" basis. The company engages an individual with proper qualifications as captain or master. The captain in turn engages a crew to operate the vessel. The members of the crew sign no agreements but the owner and the captain sign an agreement with the X Fishermen's Union which recognizes the "lay" basis upon which the voyage is conducted and places certain restrictions upon the conduct of the owner and captain in reference to the crew. The owner exercises no control over who shall be engaged as members of the crew, this matter and other details being left to the captain.

With the exception of the captain, engineer, and purser, the members of the crew are compensated on a straight share basis and receive no other remuneration for their services. The engineer receives $10x$ dollars per trip regardless of the financial outcome of the voyage, and the purser receives a "bonus" of $10x$ dollars per trip, which amount is contributed by the other members of the crew from their shares. The captain receives a commission, in addition to his share of the catch, based upon the owner's share of the income from the fishing voyage. The captain and members of the crew (other than the engineer) are jointly liable for any losses resulting from a voyage. In such a case it is customary for the loss to be deducted from the crew members' shares of the profits of the next voyage.

The catch of fish from a particular voyage is usually sold through the Y Fish Exchange, and after certain fees are deducted by the exchange, the captain receives the net proceeds or the "net stock." From the "net stock" are deducted certain specified expenses, such as fuel oil, lights, etc. One-fourth of the amount remaining after such expenses are deducted is turned over to the M Company (owner) as its share, less 5 per cent of such amount, which constitutes the captain's commission. From the remaining three-fourths of the proceeds of the voyage, the expenses of food, bait, etc., are deducted. The remainder is then divided equally among the members of the crew, including the captain.

Section 1426(b), Subchapter A, Chapter 9, of the Internal Revenue Code, as amended, provides in part as follows:

The term "employment" means any service * * * performed after December 31, 1939, by an employee for the person employing him * * * (B) on or in connection with an American vessel under a contract of service which is entered into within the United States or during the performance of which the vessel touches at a port in the United States, if the employee is employed on and in connection with such vessel when outside the United States, except—

* * * * * * *

(14) Service performed by an individual in (or as an officer or member of the crew of a vessel while it is engaged in) the catching, taking, harvesting, cultivating, or farming of any kind of fish, shellfish, crustacea, sponges, seaweeds, or other aquatic forms of animal and vegetable life (including service performed by any such individual as an ordinary incident to any such activity), except (A) service performed in connection with the catching or taking of salmon or halibut, for commercial purposes, and (B) service performed on or in connection with a vessel of more than 10 net tons (determined in the manner provided for determining the register tonnage of merchant vessels under the laws of the United States); * * *.

Section 1426(g), Subchapter A, Chapter 9, of the Code, as amended, provides as follows:

American vessel.—The term "American vessel" means any vessel documented or numbered under the laws of the United States; and includes any vessel which is neither documented or numbered under the laws of the United States nor documented under the laws of any foreign country, if its crew is employed solely by one or more citizens or residents of the United States or corporations organized under the laws of the United States or of any State.

The vessels operated by the M Company are "American vessels" within the meaning of section 1426(g), supra, and are more than 10 net tons each. The contracts for the services of the fishermen operating the M Company's vessels were entered into within the United States.

A common method of compensating a fisherman is to allow him a share of the profits of the voyage. It is well settled that agreements by which seamen engaged in a fishing voyage are to receive for their services such a share or "lay" are contracts of hiring, and the shares or "lays" so agreed upon are in the nature of wages, to recover which actions may be maintained at the end of the voyage. (*United States* v. *Laflin*, 24 F. (2d), 683; *United States* v. *Peterson*, 28 F. (2d), 29; *Lewis* v. *Chadbourne*, 92 Am. Dec., 558; *Bourne* v. *Smith*, 3 Fed. Cas., No. 1701, p. 1010.) Accordingly, it is held that the officers and members of the crews of the fishing schooners owned by the M Company are "employees" for purposes of the taxes imposed under Subchapter A, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939, with respect to their services performed subsequent to December 31, 1939.

The question remains whether the owner or the captain of each vessel is the employer of the fishermen for purposes of the taxes imposed by the Federal Insurance Contributions Act. The answer to this question depends on the facts of the particular case. (See *The Norland*, 101 Fed. (2d), 967.) In the absence of a direct contractual relationship between the owner of the vessel and the crew, the determining element is whether the captain or master of the ship is the agent of the owner of the vessel or whether he is the owner *pro hac vice* (for this occasion). In the former case, the crew, as well as the master or captain, would be the employees of the owner; in the latter case, the crew would be the employees of the master or captain and not of the owner of the vessel. (See *The Norland*, supra.)

Under the facts presented in the instant case, the captains or masters of the M Company's schooners are acting as agents of the owner in engaging the crews and conducting the voyages. Consequently, the members of the crews, together with the captains or masters, are employees of the M Company, the owner of the vessels, for the purposes of the taxes imposed by Subchapter A, Chapter 9, of the Internal Revenue Code, as amended. (See S. S. T. 336, C. B. 1938-2, 295, and *The Norland*, supra.)

The entire compensation of each officer and member of the crew, including the captain's commission, the 10x dollars paid to the engineer, the purser's " bonus " of 10x dollars, and each individual's " lay " or share received for services performed after December 31, 1939, is considered " wages " for the purposes of the taxes imposed under Subchapter A, Chapter 9, of the Internal Revenue Code, as amended. Furthermore, the fair cash value of the board deducted from the proceeds of the sale of the catch of fish and the lodging furnished the fishermen should be included as " wages." (See S. S. T. 386, page 211.)

SECTION 1426: Definitions. 1940-21-10266
REGULATIONS 106, SECTION 402.204: Who are employees. S. S. T. 388
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.204.)

B and the individuals whom he engages to assist him in the construction of houses for the M Company are employees of that company for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

The question is presented whether B and the individuals whom he engages to assist him in the construction of houses for the M Company are employees of that company for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

B, who operates as an individual and who does not maintain an office or place of business, enters into written contracts with the M Company to furnish the labor necessary for the construction of houses. Under the contracts, the company agrees to pay the costs of construction, including the costs of all labor, material and supplies, building permits, insurance, etc. However, B furnishes all tools and equipment used in the construction of the houses, performs personal services as a carpenter and mechanic for which he is paid a stipulated amount per hour, acts as superintendent and foreman, and engages other individuals to assist him. The company has the right to select, approve, or discharge any such individual. Upon the completion of a house, B is paid an amount equal to x per cent of the total cost thereof, such amount being in addition to the compensation which he receives for services performed as carpenter and mechanic.

B is not responsible for faults or defects of construction or for wasteful operations. A company representative frequently visits the house and keeps in touch with the progress of construction. At the end of each week, B presents a statement of the amount expended by him, including the pay roll, to the company for payment. B is given a check to cover such costs and pays the assistants, although he is not personally liable for their wages.

Upon a consideration of the above facts, it is held that B and the individuals engaged to assist him in the construction of the houses are employees of the M Company for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

SECTION 1426: Definitions. 1940-23-10282
REGULATIONS 106, SECTION 402.204: Who are employees. S. S. T. 390
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.204.)

A, who is engaged in selling burial lots and mausoleum space for the M Cemetery Co., and the individuals whom he engages to assist him are not employees of that company for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

The question is presented whether A, who is engaged under contract to sell burial lots and mausoleum space for the M Cemetery Co., and the individuals whom he engages to assist him are employees of that company for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

The contract provides that it shall be in effect for a definite period and that A shall devote his entire time and his best efforts to the sale of burial lots and mausoleum space for such sums of money and such prices as may from time to time be determined by the company. For his services A receives certain specified commissions. He is required to keep complete and accurate books of account and the company has the right to examine such records and have them audited or inspected at such times as its directors shall desire. Under the terms of the contract, the company pays the expenses of A for office rent and office supplies not to exceed $3x$ dollars per month. During the continuance of the contract, A must make diligent effort to collect any and all sums due and payable to the company for the sale and/or purchase of burial lots and mausoleum space.

A is not furnished with statements of rules, directions, or policies of the company. He is not required to conform to fixed hours of service, to canvass an assigned territory within any particular time or with specified frequency, to follow prescribed schedules, to call on particular customers or prospects whose names are furnished by the company, to submit reports, other than monthly reports of sales and collections, to perform services other than those specified in the contract, or to attend sales meetings or conferences. He is not subject to any instructions or restrictions of the company in the conduct of his selling activities. A does not have a drawing account nor are advances against unearned commissions made to him. His services may be terminated only upon a breach of contract. He engages other individuals to assist him, over whose activities the company has no control. The sales contracts signed by A are not subject to approval by the company and his decision is final as to the credit risks and terms of payment.

The term "employment" is defined in section 1426(b), Chapter 9, of the Internal Revenue Code, as amended, to mean "any service, of whatever nature, performed after December 31, 1939, by an employee for the person employing him * * *." Section 402.204, Regulations 106, promulgated under section 1426(b), supra, provides in part as follows:

Every individual is an employee if the relationship between him and the person for whom he performs services is the legal relationship of employer and employee.

Generally such relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to *what* shall be done but *how* it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work, to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is an independent contractor. An individual performing services as an independent contractor is not as to such services an employee.

* * * * * * *

Whether the relationship of employer and employee exists will in doubtful cases be determined upon an examination of the particular facts of each case.

In view of the above provisions of the regulations and under the particular facts in this case, it is held that the M Cemetery Co. does not exercise, or have the right to exercise, over the services of A and the individuals whom he engages to assist him the degree of control necessary to establish the legal relationship of employer and employee. Accordingly, A and the individuals whom he engages to assist him are not employees of the M Cemetery Co. for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

SECTION 1426: Definitions. 1940-24-10291
REGULATIONS 106, SECTION 402.204: Who are employees. S. S. T. 391
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.204.)

A, a tailor who performs services in his home in the manufacture of men's clothing for "merchant tailors" is an employee of such "merchant tailors" for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

The question is presented whether, for employment tax purposes, A is an employee of certain "merchant tailors" (wholesalers and retailers of clothing) for whom he performs services.

A visits the premises of certain "merchant tailors" for the purpose of securing orders for the manufacture of completed garments. When a "merchant tailor" has work for him to do, he is given the necessary material and an order for the garments, setting forth the price to be paid and the specifications therefor. A usually returns to his home, where he completes the garments. In some instances the "merchant tailor" maintains an equipped shop where A is privileged to perform his services and where other tailors in fact carry on similar manufacturing operations. Upon delivery of the completed articles to the "merchant tailor," A is paid a fixed price per piece (as agreed upon) if the garments do not vary from specifications in any major respect. Minor changes are made by the "merchant tailor" in his own shop. The "merchant tailor" furnishes the material for any major alterations which are made by A. A's equipment in his home consists of a sewing machine, an electric iron, shears, needles, etc. At times, when the amount of work justifies such action, he engages a member of his family to assist him. A does not maintain an equipped shop which is open to the general public.

In the instant case, it is evident that A is not engaged in an independent business. The "merchant tailor" either directs and controls, or has the right to direct and control, the manner in which such services are performed. On the basis of the above, it is held that A and any assistants engaged by him with the express or implied consent of the several "merchant tailors" are employees of such "merchant tailors" for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended. (See S. S. T. 137, C. B. 1937-1, 878.)

SECTION 1426: DEFINITIONS. 1940-24-10292
REGULATIONS 106, SECTION 402.204: Who are employees. S. S. T. 392
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.204.)

B, a tailor who operates a business establishment of his own, offering his services to the general public in the manufacture and repair of men's clothing, is not, with respect to manufacturing operations performed for various "merchant tailors," an employee for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

Advice is requested whether, for employment tax purposes, B is an employee of certain "merchant tailors" (wholesalers and retailers of clothing) with respect to operations performed by him in the manufacture of men's clothing.

B maintains a business establishment of his own where he engages in the manufacture and repair of clothing for the general public. The equipment owned by him and utilized in the operations includes sewing machines, cleaning and pressing equipment, etc. B employs several assistants for the manufacturing and repair work and a messenger who visits the premises of a number of "merchant tailors" for the purpose of securing orders for completed garments. If a particular "merchant tailor" has work for B, an order therefor is filled out showing the prices per piece which the "merchant tailor" is willing to pay and the specifications of the garments. The messenger collects the orders, together with the material for manufacture, and delivers them to B. After the garments are completed, the messenger delivers them to the "merchant tailors" and is paid therefor if the garments are according to the specifications. Garments not meeting specifications are returned to B for alteration at his own expense. B is at liberty to reject any order at his discretion.

In S. S. T. 391 (page 196, this Bulletin) it was held that A, a tailor who performs services in his home, in the manufacture of men's clothing for "merchant tailors," is an employee of such "merchant tailors" for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended. In the instant case, although B must follow the specifications furnished by the "merchant tailors" he has much wider independence of action. He is at liberty to reject any order tendered and means or methods of manufacture are vested entirely in him. Further, he maintains a place of business open to the general public, owns a substantial amount of equipment, and, in general, carries on extensive independent manufacturing operations, which factors were not present in S. S. T. 391.

On the basis of the presented facts, it is held that B is not an employee for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended, of the various "merchant tailors" for whom the manufacturing operations are performed. (See S. S. T. 153, C. B. 1937-1, 390.)

SECTION 1426: Definitions. 1940-14-10221
REGULATIONS 106, SECTION 402.206: Excepted services in general. Mim. 5019
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.206.)

Establishment of exemption of certain organizations under section 101 of the Internal Revenue Code for purposes of determining the extent of liability for the taxes imposed under Subchapters A and C, Chapter 9, Internal Revenue Code (Federal Insurance Contributions Act and Federal Unemployment Tax Act, respectively), as amended by the Social Security Act Amendments of 1939.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., March 16, 1940.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Others Concerned:

1. Certain of the provisions of section 101 of the Internal Revenue Code, as amended, relating to exemption from Federal income tax, correspond to provisions whereby certain services performed on or after January 1, 1940, are excepted from "employment" as defined in sections 1426(b) and 1607(c) of Subchapters A and C of Chapter 9 of the Internal Revenue Code (Federal Insurance Contributions Act and Federal Unemployment Tax Act, respectively), as amended by sections 606 and 614, respectively, of the Social Security Act Amendments of 1939. The Federal employment taxes are not applicable with respect to remuneration for such excepted services.

2. The pertinent provisions of sections 1426(b) and 1607(c), supra, are as follows:

The term "employment" means any service performed * * * after December 31, 1939, * * * except—

(8) Service performed in the employ of a corporation, community chest, fund, or foundation, 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; [This paragraph corresponds to section 101(6) of the Internal Revenue Code.]

* * * * * * *

(10)(A) Service performed in any calendar quarter in the employ of any organization exempt from income tax under section 101 [of the Internal Revenue Code], if—

(i) the remuneration for such service does not exceed $45, or

(ii) such service is in connection with the collection of dues or premiums for a fraternal beneficiary society, order, or association, and is performed away from the home office, or is ritualistic service in connection with any such society, order, or association, or [The societies, orders, or associations referred to in this subparagraph are the organizations described in section 101(3) of the Internal Revenue Code.]

(iii) such service is performed by a student who is enrolled and is regularly attending classes at a school, college, or university;

(B) Service performed in the employ of an agricultural or horticultural organization exempt from income tax under section 101(1) [of the Internal Revenue Code];

(C) Service performed in the employ of a voluntary employees' beneficiary association providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents, if (i) no part of its net earnings inures (other than through such payments) to the benefit of any private shareholder or individual, and (ii) 85 per centum or more of the income consists of amounts collected from members for the sole purpose of making such payments and meeting expenses; [This subparagraph corresponds to section 101(16) of the Internal Revenue Code.]

(D) Service performed in the employ of a voluntary employees' beneficiary association providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or their designated beneficiaries, if (i) admission to membership in such association is limited to individuals who are officers or employees of the United States Government, and (ii) no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual; [This subparagraph corresponds to section 101(19) of the Internal Revenue Code, added by section 217 of the Revenue Act of 1939.]

* * * * * * *

3. Whenever an employee performs any of the services indicated in the above-quoted provisions, the applicability of the employment taxes with respect to such services is wholly or partly dependent upon the status under such provisions of the organization employing him. Unless such organization has obtained or requested a ruling from the Bureau of Internal Revenue relative to its status under the above-quoted provisions, the corresponding provisions of section 101 of the Internal Revenue Code, or corresponding provisions of the several Revenue Acts, such organization should submit information sufficient to enable the Bureau to make such a ruling. It is the general practice of the Bureau to consider the status of any such organization for income tax purposes before determining its status for employment tax purposes. If the organization is exempt from income tax under provisions of law which correspond to exception provisions in sections 1426(b) and 1607(c), supra, such exception provisions are applicable with respect to services performed in the employ of the organization

Such an organization will not be further required to establish that such exception provisions are applicable unless, subsequent to the date its exempt status was determined for income tax purposes, it has changed its character, purposes, or methods of operation. Any change in the character, purposes, or methods of operation of such an organization should be reported immediately to the collector of internal revenue for the district in which the organization is located, in order that the effect of such change upon the status of the organization may be determined.

4. If the Bureau has not made a ruling relative to the status of an organization of a class contemplated in the above-quoted provisions, and such organization fails to submit information sufficient to enable the Bureau to make such a ruling, the above-quoted exception provisions will not be treated as applicable with respect to services performed in the employ of such organization. If such organization submits information sufficient to enable the Bureau to make a ruling relative to its status, however, such organization will ordinarily be permitted, during the period in which the Bureau is considering its status, to treat such exception provisions as applicable to services performed in its employ. If the Bureau determines that such provisions are not applicable, any underpayment of tax under Subchapter A or C of Chapter 9 of the Code must be corrected. Interest will be collectible with respect to such tax under Subchapter A unless the underpayment of such tax is adjusted in accordance with sections 402.701 to 402.703, inclusive, of Regulations 106, relating to the taxes imposed by Subchapter A. Interest will be collectible with respect to any such tax under Subchapter C.

5. An organization which has not submitted information to enable the Bureau to make a ruling relative to its status should furnish to the Bureau, or to the collector of internal revenue for the district in which the organization is located, an affidavit showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and the disposition of such income, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its status. To such affidavit should be attached a copy of the charter or articles of incorporation or a copy of any other instrument under which the organization was created and is operating, a copy of the by-laws of the organization, and the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the organization. The words "private shareholder or individual" as used in the above-quoted provisions refer to individuals having a personal and private interest in the activities of the organization. In the case of the particular classes of organizations listed below, the following additional information should be embodied in or attached to, and made a part of, the affidavit:

(*a*) Fraternal beneficiary societies, orders, or associations: (I) The number of subordinate lodges in active operation, (II) whether periodical meetings are actually held;

(*b*) Building and loan associations and cooperative banks: These associations and banks should submit the information required by questionnaire, Form 1027, copies of which may be obtained from any collector;

(*c*) Corporations, community chests, funds, or foundations: To what extent the activities of the organization involve carrying on propaganda, or otherwise attempting, to influence legislation;

(*d*) Educational organizations: In addition to the information called for in (*c*) above, whether any of the shareholders are paid by the organization, and if so, the reason for each such payment and the amount thereof;

(*e*) Hospitals: In addition to the information called for in (*c*) above, whether part-pay or non-pay patients are accepted and whether the amounts paid by part-pay patients are more than nominal;

(*f*) Business leagues: (I) A statement of the services performed for members, (II) a statement of the services performed for nonmembers;

(*g*) Clubs: The income received from the use of the facilities by the general public;

(*h*) Benevolent life insurance associations: (I) The number of counties in which the association accepts risks, (II) copies of the policies or certificates of membership;

(*i*) Mutual insurance companies: (I) Copies of the policies or certificates of membership, (II) if any substantial amount of income is claimed to be held for the payment of losses or expenses, a statement based upon a reliable table of loss experience demonstrating that the amount so held for the payment of losses is reasonably necessary; or in the case of expenses, a statement based upon reliable statistics showing that the expenses were incurred or that in all probability they will be incurred;

(*j*) Farmers' cooperative associations: These associations should submit the information required by questionnaire, Form 1028, copies of which may be obtained from any collector;

(*k*) Holding companies: (I) The name of the organization for which it holds title, (II) the information necessary to establish the exemption, under section 101 of the Internal Revenue Code, of the organization for which title is held.

6. In determining the status of local organizations, such as certain fraternal beneficiary societies, orders, or associations, which are identical to other local organizations chartered by and subordinate to a State, regional, or national organization, the Bureau will give consideration to the issuance of rulings covering all of the subordinate organizations upon a request made by the State, regional, or national organization. Such consideration will be given, however, only if the State, regional, or national organization establishes that the subordinate organizations are identical in character, purposes, and methods of operation. Any State, regional, or national organization which desires such rulings for its subordinate organizations should submit as a part of the information described in paragraph 5 of this mimeograph, a list showing the name and location of each subordinate organization for which a ruling is sought and a complete statement of the circumstances which establish that the subordinate organizations are identical in character, purposes, and methods of operation.

7. Inquiries relating to income tax liability should be addressed to the Bureau for the attention of IT:P:T. Inquiries relating to

employment tax liability should be addressed to the Bureau for the attention of A&C:RR. Correspondence otherwise relating to the contents of this mimeograph should refer to the number thereof and the symbols A&C:RR.

GUY T. HELVERING,
Commissioner.

SECTION 1426: Definitions.
REGULATIONS 106, SECTION 402.208: Agricultural labor.

Fermenting, grading, and baling of cigar leaf wrapper tobacco. S. S. T. 219 (C. B. 1937–2, 412) modified. (See S. S. T. 382, page 218.)

SECTION 1426: Definitions.
REGULATIONS 106, SECTION 402.213: United States and instrumentalities thereof.
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.213.)

1940–12–10209
S. S. T. 385

Army post exchanges are instrumentalities of, and wholly owned by, the United States within the meaning of Subchapters A and C of Chapter 9 of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939, and neither such exchanges nor their employees are subject to the taxes imposed under those subchapters.

Advice is requested whether Army post exchanges are instrumentalities of the United States within the meaning of Subchapters A and C of Chapter 9 of the Internal Revenue Code (Federal Insurance Contributions Act and Federal Unemployment Tax Act, respectively), as amended by the Social Security Act Amendments of 1939 (Public, No. 379, Seventy-sixth Congress, first session).

In S. S. T. 269 (C. B. 1938–1, 441) it was held that Army post exchanges are instrumentalities of the United States within the meaning of Titles VIII and IX of the Social Security Act. However, S. S. T. 269 is not conclusive as to the present status of Army post exchanges, since, under subparagraph (6) of sections 1426(b) and 1607(c) of the Internal Revenue Code, as amended, effective January 1, 1940, by sections 606 and 614, respectively, of the Social Security Act Amendments of 1939, service performed in the employ of an instrumentality of the United States is not excepted from "employment," as defined in the sections referred to, unless the instrumentality is (A) wholly owned by the United States, or (B) exempt from the taxes imposed by sections 1410 and 1600 of the Internal Revenue Code by virtue of any other provision of law. Since there is no provision of law exempting Army post exchanges from the taxes imposed by sections 1410 and 1600, it is necessary to determine whether such exchanges are wholly owned by the United States.

A partial description of the organization and activities of Army post exchanges is contained in S. S. T. 269, supra. Additional facts now submitted relative to the organization, ownership, and operation of such post exchanges show that they are wholly owned by the United States within the meaning of sections 1426(b)6 and 1607(c)6 of the Internal Revenue Code, as amended.

Accordingly, it is held that neither such exchanges nor their employees are subject to the taxes imposed by Subchapters A and C of Chapter 9 of the Internal Revenue Code, as amended.

SECTION 1426: Definitions. 1940-8-10181
REGULATIONS 106, SECTION 402.213: United States and instrumentalities thereof. Mim. 5003
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.213; and Social Security Act, Sections 811 and 907; Regulations 91 and 90, Articles 11 and 206(5)-(6).)

Applicability of the employment taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act with respect to services performed on or after January 1, 1940, in the employ of certain banks and related organizations.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., January 27, 1940.

Collectors of Internal Revenue and Others Concerned:

1. The employment taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act (formerly Titles VIII and IX, respectively, of the Social Security Act) are not applicable with respect to services performed prior to January 1, 1940, which were excepted from "employment" *as that term is defined with respect to services performed prior to January 1, 1940.* Section 1426(b)6 of the Federal Insurance Contributions Act and section 1607(c)5 of the Federal Unemployment Tax Act provide as follows *with respect to services performed prior to January 1, 1940:*

The term "employment" means any service * * * except—

* * * * * * *

Service performed in the employ of the United States Government or of an instrumentality of the United States; * * *.

2. Various rulings have been published in Internal Revenue Bulletins with respect to the applicability of the above-quoted provisions to services performed in the employ of all of the banks and related organizations, except Federal reserve banks,[1] which are hereinafter considered. Such banks and other organizations were held instrumentalities of the United States for purposes of such provisions.

3. Effective with respect to services performed on or after January 1, 1940, section 1426(b)6 of the Federal Insurance Contributions Act, as amended by section 606 of the Social Security Act Amendments of 1939, provides in part as follows:

The term "employment" means any service * * * except—

* * * * * * *

Service performed in the employ of the United States Government, or of an instrumentality of the United States which is (A) wholly owned by the United States, or (B) exempt from the tax imposed by section 1410 by virtue of any other provision of law; * * *.

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[1] Federal reserve banks are instrumentalities of the United States for employment tax purposes. See paragraphs 9 to 12, inclusive, of this mimeograph.

Section 1607(c)6 of the Federal Unemployment Tax Act, as amended by section 614 of the Social Security Act Amendments of 1939, contains similar provisions *with respect to services performed on or after January 1, 1940.*

4. The rulings stated hereinafter with respect to the status of banks and related organizations under the provisions of sections 1426(b)6 and 1607(c)6, as amended (paragraph 3, supra), are applicable *with respect to services performed on or after January 1, 1940.* Inasmuch as such banks and organizations are instrumentalities of the United States for employment tax purposes, consideration will be given principally to the question whether such organizations are wholly owned by the United States or are exempt from employment taxes "by virtue of any other provision of law." In deciding whether an instrumentality is wholly owned by the United States, primary consideration is given to statutory provisions regarding the capital shares of such instrumentality, for the proposition is axiomatic that the stockholders are the owners of a corporation. The determination that an instrumentality is exempt from employment taxes "by virtue of any other provision of law" depends upon specific language to that effect.

NATIONAL BANKS.

5. In S. S. T. 16 (C. B. XV–2, 386 (1936)), the Bureau of Internal Revenue ruled that national banks are instrumentalities of the United States for social security tax purposes, and that neither the banks nor their employees are subject to such taxes. This ruling, which is applicable with respect to services performed prior to January 1, 1940, is based primarily on the fact that such banks are required for the fiscal operations of the Government. It is necessary, for purposes of a ruling with respect to services performed on or after January 1, 1940, to determine whether such banks either are wholly owned by the United States or are exempt "by virtue of any other provision of law."

6. Section 5 of an Act approved June 3, 1864 (13 Stat., 100; U. S. C., Title 12, section 21), reads in part as follows:

> Associations for carrying on the business of banking under this chapter may be formed by any number of natural persons, not less in any case than five.

Section 6 of the Act approved June 3, 1864 (13 Stat., 101; U. S. C., Title 12, section 22), provides in part as follows:

> The persons uniting to form such an association shall, under their hands, make an organization certificate, which shall specifically state: * * * Third. The amount of capital stock and the number of shares into which the same is to be divided.

Section 12 of the Act approved June 3, 1864 (13 Stat., 102; U. S. C., Title 12, section 52), provides in part as follows:

> The capital stock of each association shall be divided into shares of $100 each, or into shares of such less amount as may be provided in the articles of association, and be deemed personal property, and transferable on the books of the association in such manner as may be prescribed in the by-laws or articles of association. Every person becoming a shareholder by such transfer shall, in proportion to his shares, succeed to all rights and liabilities of the prior holder of such shares; and no change shall be made in the articles of association by which the rights, remedies, or security of the existing creditors of the association shall be impaired.

Section 40 of the Act approved June 3, 1864 (13 Stat., 111; U. S. C., Title 12, section 62), provides in part as follows:

The president and cashier of every national banking association shall cause to be kept at all times a full and correct list of the names and residences of all the shareholders in the association, and the number of shares held by each, in the office where its business is transacted.

7. The above-quoted provisions of law and other provisions relating to the same subject matter indicate that Congress, in legislating with respect to national banks, did not contemplate that such banks should be owned by the United States. Furthermore, there is no specific provision of law providing for or authorizing the United States to acquire a proprietary interest in such banks, although there is a provision for the Reconstruction Finance Corporation to acquire preferred shares in certain instances. See section 401 of an Act approved March 9, 1933 (48 Stat., 1; U. S. C., Title 12, section 51d), amending the Federal Reserve Act (38 Stat., 251).

8. There is no specific provision of law which would serve to exempt national banks from the employment taxes. It is evident from the hearings before the Committee on Ways and Means, House of Representatives, and the Committee on Finance, United States Senate, that Congress, in enacting the Social Security Act Amendments of 1939, intended that employment taxes should be applicable with respect to services performed on or after January 1, 1940, in the employ of national banks. Accordingly, the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are applicable with respect to such services.

FEDERAL RESERVE BANKS.

9. Section 15 of the Federal Reserve Act (38 Stat., 251; U. S. C., Title 12, section 391), provides as follows:

The moneys held in the general fund of the Treasury, except the 5 per centum fund for the redemption of outstanding national-bank notes and the funds provided in this chapter for the redemption of Federal reserve notes may, upon the direction of the Secretary of the Treasury, be deposited in Federal reserve banks, which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States; and the revenues of the Government or any part thereof may be deposited in such banks, and disbursements may be made by checks drawn against such deposits.

Section 406 of the Agricultural Credit Act of 1923 (42 Stat., 1454; U. S. C., Title 12, section 393), provides as follows:

The Federal reserve banks are hereby authorized to act as depositories for and fiscal agents of any national agricultural credit corporation or Federal intermediate credit bank.

Section 8 of an Act approved April 27, 1934 (48 Stat., 643; U. S. C., Title 12, section 394), amending the Home Owners' Loan Act of 1933 (48 Stat., 128), provides as follows:

The Federal reserve banks are authorized, with the approval of the Secretary of the Treasury, to act as depositaries, custodians, and fiscal agents for the Home Owners' Loan Corporation.

10. In view of the foregoing provisions of law, it is held that Federal reserve banks are instrumentalities of the United States for employment tax purposes.

11. Section 7 of the Federal Reserve Act (38 Stat., 251; U. S. C., Title 12, section 531), provides as follows:

Federal reserve banks, including the capital stock and surplus therein and the income derived therefrom, shall be exempt from Federal, State, and local taxation, except taxes upon real estate.

12. Accordingly, the taxes imposed by Titles VIII and IX of the Social Security Act, the Federal Insurance Contributions Act, and the Federal Unemployment Tax Act are not applicable with respect to services performed either before or after January 1, 1940, in the employ of Federal reserve banks.

STATE BANKS MEMBERS OF THE FEDERAL RESERVE SYSTEM.

13. In S. S. T. 44 (C. B. XV-2, 388 (1936)), the Bureau ruled that State banks which are members of the Federal Reserve System are instrumentalities of the United States for social security tax purposes. Neither such banks nor their employees are subject to such taxes with respect to services performed prior to January 1, 1940. This ruling is based upon the Act of December 23, 1913 (38 Stat., 259), as amended by the Act of May 7, 1928 (45 Stat., 492), which provides that such banks, when designated for that purpose by the Secretary of the Treasury, shall be depositaries of public money and may be employed as fiscal agents of the Government.

14. State banks which are members of the Federal Reserve System are not wholly or partly owned by the United States, and there is no statutory authority for such ownership. There is no specific provision of law which would serve to exempt such banks from the employment taxes. Accordingly, the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are applicable with respect to services performed on or after January 1, 1940, in the employ of such banks.

FEDERAL LAND BANKS—NATIONAL FARM LOAN ASSOCIATIONS.

15. In S. S. T. 61 (C. B. 1937-1, 409), the Bureau ruled that Federal land banks and national farm loan associations are intrumentalities of the United States for social security tax purposes. Neither such organizations nor their employees are subject to such taxes.

16. Section 26 of the Federal Farm Loan Act (39 Stat., 360; U. S. C., Title 12, section 931), provides in part as follows:

Every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, * * *.

17. Accordingly, the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are not applicable with respect to services performed on or after January 1, 1940, in the employ of such organizations.

JOINT STOCK LAND BANKS.

18. In S. S. T. 61, supra, the Bureau ruled that joint stock land banks are instrumentalities of the United States for social security tax purposes. However, section 16 of the Federal Farm Loan Act (39 Stat., 360; U. S. C., Title 12, section 813), provides that "* * * the Government of the United States shall not purchase or subscribe

for any of the capital stock of any such bank; * * *." Further, there is no specific provision of law which would serve to exempt such banks from the employment taxes. Accordingly, the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are applicable with respect to services performed on or after January 1, 1940, in the employ of such banks. The employment taxes are also applicable with respect to services performed on or after January 1, 1940, in the employ of the estate of any joint stock land bank in liquidation for which a receiver has been appointed. The receiver is not an employee of such estate for employment tax purposes. (See S. S. T. 120, C. B. 1937-1, 375.)

FEDERAL FARM MORTGAGE CORPORATION.

19. In S. S. T. 61, supra, the Bureau ruled that the Federal Farm Mortgage Corporation is an instrumentality of the United States for social security tax purposes. Section 12(a) of the Federal Farm Mortgage Corporation Act (48 Stat., 344; U. S. C., Title 12, section 1020f), provides as follows:

The corporation, including its franchise, its capital, reserves, and surplus, and its income shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; * * *.

20. Accordingly, the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are not applicable with respect to services performed in the employ of the Federal Farm Mortgage Corporation.

FEDERAL INTERMEDIATE CREDIT BANKS.

21. In S. S. T. 61, supra, the Bureau ruled that Federal intermediate credit banks are instrumentalities of the United States for social security tax purposes. Section 205 of the Federal Farm Loan Act (42 Stat., 1454; U. S. C., Title 12, section 1061), provides that "For the purpose of exercising the powers conferred by this subchapter, each Federal intermediate credit bank shall have a subscribed capital stock of $5,000,000, which amount may be increased from time to time with the approval of the Governor of the Farm Credit Administration. Capital stock of such amount shall be divided into shares of $5 each and shall be subscribed, held, and paid by the Government of the United States." Further, section 210 of the Federal Farm Loan Act (42 Stat., 1454; U. S. C., Title 12, section 1111), provides as follows:

The privileges of tax exemption accorded under section 26 of this chapter shall apply also to each Federal intermediate credit bank, including its capital, reserve, or surplus, * * *.

22. Accordingly, the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are not applicable with respect to services performed in the employ of such banks.

PRODUCTION CREDIT CORPORATIONS—PRODUCTION CREDIT ASSOCIATIONS—REGIONAL BANKS FOR COOPERATIVES—CENTRAL BANK FOR COOPERATIVES.

23. In S. S. T. 61, supra, the Bureau ruled that production credit corporations, production credit associations, regional banks for cooperatives, and the Central Bank for Cooperatives are instrumentali-

ties of the United States for social security tax purposes. Section 62 of the Farm Credit Act of 1933 (48 Stat., 257; U. S. C., Title 12, section 1138c), provides in part as follows:

> The Central Bank for Cooperatives, and the production credit corporations, production credit associations, and banks for cooperatives, organized under this chapter, and their obligations, shall be deemed to be instrumentalities of the United States, * * *. Such banks, associations, and corporations, their property, their franchises, capital, reserves, surplus, and other funds, and their income shall be exempt from all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority; * * *.

24. Accordingly, the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are not applicable with respect to services performed in the employ of such banks, associations, and corporations.

REGIONAL AGRICULTURAL CREDIT CORPORATIONS.

25. In S. S. T. 61, supra, the Bureau ruled that regional agricultural credit corporations are instrumentalities of the United States for social security tax purposes. Section 201(e) of an Act approved July 21, 1932 (47 Stat., 711; U. S. C., Title 12, section 1148), as amended August 19, 1937 (50 Stat., 704), provides as follows:

> The Reconstruction Finance Corporation is authorized to create in any of the 12 farm credit districts where it may deem the same to be desirable a regional agricultural credit corporation with a paid-up capital of not less than $3,000,000, to be subscribed for by the Reconstruction Finance Corporation and paid for out of the unexpended balance of the amounts allocated and made available to the Secretary of Agriculture under section 602 of Title 15. Such corporations shall be managed by officers and agents to be appointed by the Farm Credit Administration under such rules and regulations as it may prescribe. * * * All expenses incurred in connection with the operation of such corporations shall be supervised and paid by the Reconstruction Finance Corporation under such rules and regulations as its board of directors may prescribe.

26. Accordingly, the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are not applicable with respect to services performed in the employ of such corporations.

FEDERAL HOME LOAN BANKS.

27. In S. S. T. 62 (C. B. 1937-1, 409), the Bureau held that Federal home loan banks are instrumentalities of the United States for social security tax purposes. Section 13 of the Federal Home Loan Bank Act (47 Stat., 725; U. S. C., Title 12, section 1433), provides in part as follows:

> * * * The bank, including its franchise, its capital, reserves, and surplus, its advances, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; * * *

28. Accordingly, the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are not applicable with respect to services performed in the employ of such banks.

MEMBERS OF THE FEDERAL HOME LOAN BANK SYSTEM.

29. In S. S. T. 109 (C. B. 1937-1, 421), the Bureau ruled that building and loan associations, savings and loan associations, cooperative banks, homestead associations, insurance companies, and savings

banks which are members of the Federal Home Loan Bank System are instrumentalities of the United States for social security tax purposes. Such organizations are not wholly or partly owned by the United States, and there is no specific provision of law providing for or authorizing the United States to acquire a proprietary interest in such organizations. There is no provision of law which would serve to exempt such organizations from the employment taxes.

30. Accordingly, the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are applicable with respect to services performed on or after January 1, 1940, in the employ of such organizations.

HOME OWNERS' LOAN CORPORATION.

31. In S. S. T. 62, supra, the Bureau ruled that the Home Owners' Loan Corporation is an instrumentality of the United States for social security tax purposes. Section 4(b) of the Home Owners' Loan Act of 1933 (48 Stat., 128; U. S. C., Title 12, section 1463b), provides that "The [Federal Home Loan Bank] board shall determine the minimum amount of capital stock of the [Home Owners' Loan] Corporation and is authorized to increase such capital stock from time to time in such amounts as may be necessary, but not to exceed in the aggregate $200,000,000. Such stock shall be subscribed for by the Secretary of the Treasury on behalf of the United States, * * *." Section 4(c) of the Home Owners' Loan Act of 1933 (48 Stat., 128; U. S. C., Title 12, section 1463c), provides in part as follows:

> * * * The Corporation, including its franchise, its capital, reserves and surplus, and its loans and income, shall likewise be exempt from such taxation; * * *.

32. Accordingly, the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are not applicable with respect to services performed in the employ of the Home Owners' Loan Corporation.

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION.

33. In S. S. T. 62, supra, the Bureau ruled that the Federal Savings and Loan Insurance Corporation is an instrumentality of the United States for social security tax purposes. Section 402(c) of the National Housing Act (48 Stat., 1246; U. S. C., Title 12, section 1725c), provides as follows:

> * * * The Corporation, including its franchise, capital, reserves, surplus, and income, shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; * * *.

34. Accordingly, the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are not applicable with respect to services performed in the employ of the Federal Savings and Loan Insurance Corporation.

FEDERAL CREDIT UNIONS.

35. In S. S. T. 140 (C. B. 1937-1, 428), the Bureau ruled that Federal credit unions organized pursuant to the Federal Credit Union Act of June 26, 1934 (48 Stat., 1216), are instrumentalities of

the United States for social security tax purposes. Section 18 of an Act approved December 6, 1937 (51 Stat., 4; U. S. C., Title 12, section 1768), amending the Federal Credit Union Act (48 Stat., 1216), provides as follows:

> The Federal credit unions organized hereunder, their property, their franchises, capital, reserves, surpluses, and other funds, and their income shall be exempt from all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority; * * *.

36. Accordingly, the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are not applicable with respect to services performed in the employ of such Federal credit unions.

37. The rulings published as S. S. T. 16, S. S. T. 44, S. S. T. 61, S. S. T. 62, S. S. T. 109, and S. S. T. 140, and all published rulings in which reference is made to any ruling so specified, are hereby modified to accord with the foregoing. Mimeograph 4621, dated June 30, 1937 (C. B. 1937-2, 434), is likewise modified.

38. Correspondence relating to this mimeograph should refer to its number and to the symbols A & C: RR.

GUY T. HELVERING,
Commissioner.

SECTION 1426: Definitions. 1940-5-10158
REGULATIONS 106, SECTION 402.227: Wages. S. S. T. 383
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.227; and Social Security Act, Sections 811 and 907; Regulations 91 and 90, Articles 16 and 209.)

> Amounts paid by the M Baseball Club to cover transportation, room, and board of its players while in training and while away from its home grounds do not constitute "wages" within the meaning of the Federal Insurance Contributions Act.

The question is presented whether certain amounts paid by the M Baseball Club to cover expenses of its players constitute "wages" within the meaning of the Federal Insurance Contributions Act.

During the period of approximately four weeks when the players of the M Baseball Club are at the training camp preparing for the regular baseball season, they receive no remuneration since their salaries are payable only for services performed during the actual playing season. The club furnishes the players railroad transportation from their homes to the training camp. While in training the players stay at a designated hotel and their meals are furnished by the hotel or by some restaurant where an account has been established by the club, which pays the expenses in question and carries them on its books as "training and travel expense." The club also pays such expenses of the players under contract during the season when the team is playing away from its home grounds, but otherwise the players pay their own living expenses.

It is held that the amounts paid by the M Baseball Club to cover transportation, room, and board of its players under the circumstances stated do not constitute "wages" within the meaning of the Federal Insurance Contributions Act. (See article 16(c), Regulations 91.)

The conclusion reached herein is applicable also under the Federal Unemployment Tax Act and under Titles VIII and IX of the Social Security Act.

SECTION 1426: Definitions. 1940-13-10215
REGULATIONS 106, SECTION 402.227: Wages. S. S. T. 356
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.227.)

The value of board and lodging furnished to the officers and members of the crews of vessels operated by the M Steamship Co. for services performed on and after January 1, 1940, in connection with the operation of its vessels constitutes "wages" within the meaning of Subchapter A, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

Advice is requested whether the value of board and lodging furnished to the officers and members of the crews of vessels operated by the M Steamship Co. for services performed on and after January 1, 1940, in connection with the operation of its vessels constitutes "wages" within the meaning of Subchapter A of Chapter 9 of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

The term "wages" is defined in section 1426(a), Chapter 9, of the Internal Revenue Code, as amended, subject to a limitation not here applicable, to mean "all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash." Section 402.227, Regulations 106, promulgated under section 1426(a), supra, contains the following provisions:

Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as remuneration for employment if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees. The term "facilities or privileges," however, does not ordinarily include the value of meals or lodging furnished, for example, to restaurant or hotel employees, or to seamen or other employees aboard vessels, since generally these items constitute an appreciable part of the total remuneration of such employees.

In the instant case the value of the board and lodging is not relatively small but constitutes a substantial part of the total remuneration of the officers and employees so that the board and lodging can not be said to constitute "facilities or privileges" which may be excluded from the term "wages." In S. S. T. 321 (C. B. 1938-2, 323) it was held that board and lodging furnished under the circumstances there set forth constitute "wages" and not "facilities or privileges" under article 207 of Regulations 90, promulgated under Title IX of the Social Security Act. The conclusion there reached is applicable in the present case.

It is held, therefore, that the fair value of the board and lodging furnished to the officers and members of the crews of vessels operated by the M Steamship Co. for services performed on and after January 1, 1940, constitute "wages" for purposes of the taxes imposed under Subchapter A, Chapter 9, of the Internal Revenue Code, as amended.

The Bureau has placed no specific value on board and lodging furnished to officers and members of crews for the purposes of the taxes imposed under Subchapter A, Chapter 9, of the Internal Revenue Code, as amended, but will recognize that amount which is the fair and reasonable value of those items. In computing the fair and reasonable value of board and lodging furnished to officers and members of crews, consideration should be given to all pertinent factors, including those factors set forth in S. S. T. 51 (C. B. XV-2, 421 (1936)), which may be applicable in the particular case.

The conclusion reached herein is also applicable under Subchapter C, Chapter 9, Internal Revenue Code, as amended.

SECTION 1426: Definitions. 1940-22-10271
REGULATIONS 106, SECTION 402.227: Wages. S. S. T. 389
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.227.)

Where the M Company pays an employee an amount equivalent to his regular salary during his absence on account of jury service, and the employee later reimburses the company to the extent of the pay received by him for such jury service, the amount received from the company by the employee in excess of that received by him for jury service constitutes "wages" for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

The question is presented relative to the amount to be reported as "wages" for employment tax purposes where an employer, pursuant to established practice, pays an employee an amount equivalent to his regular salary during his absence on account of jury service and the employee later reimburses the employer to the extent of the pay received for such jury service.

In S. S. T. 49 (C. B. XV-2, 420 (1936)) it was held that where a corporation voluntarily pays to its employees the difference between their normal earnings and the amount actually received by them from the State for the time they serve as members of the State National Guard, the payments equivalent to this difference constitute "wages" within the meaning of section 907(b) of Title IX of the Social Security Act and article 209 of Regulations 90. S. S. T. 49 is analogous in principle to the instant case. It is, therefore, held that the amount received from the M Company by the employee in excess of the amount received for jury service constitutes "wages" for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

SECTION 1426: Definitions. 1940-26-10304
REGULATIONS 106, SECTION 402.227: Wages. S. S. T. 393
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.227.)

Payments of unpaid minimum wages and unpaid overtime compensation made by the M Company to its employees, pursuant to section 16(b) of the Fair Labor Standards Act of 1938, constitute "wages" for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

Payments of liquidated damages made by the M Company to its employees, pursuant to section 16(b), supra, do not constitute "wages" for employment tax purposes.

Inquiry is made whether payments made by the M Company to its employees under section 16(b) of the Fair Labor Standards Act of 1938 (52 Stat., 1060) constitute "wages" as defined in Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

In compliance with section 16(b) of the Fair Labor Standards Act of 1938, the M Company restored to its employees certain amounts of unpaid minimum wages and unpaid overtime compensation. Subsequent to such restoration certain employees of the company filed claims for liquidated damages, as provided for in section 16(b), supra, and various amounts have been paid to the employees as a result thereof.

Section 16(b) of the Fair Labor Standards Act of 1938 provides:

Any employer who violates the provisions of section 6 or section 7 of this Act shall be liable to the employee or employees affected in the amount of their unpaid minimum wages, or their unpaid overtime compensation, as the case may be, and in an additional equal amount as liquidated damages. Action to recover such liability may be maintained in any court of competent jurisdiction * * *.

With certain exceptions not here material, sections 1426(a) and 1607(b) of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended, define the term "wages" as all remuneration for "employment," and sections 1426(b) and 1607(c) define the term "employment" as any service, of whatever nature, performed by an employee for the person employing him.

In view of the fact that the payments of unpaid minimum wages and unpaid overtime compensation made by the M Company to its employees under section 16(b), supra, were made with respect to services performed in an "employment" as above defined, it is held that such payments constitute "wages" for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended.

It is also held that the additional amounts paid by the M Company to its employees as "liquidated damages," pursuant to section 16(b), supra, are not "remuneration for employment" and, therefore, do not constitute "wages" for purposes of the above-mentioned subchapters of the Internal Revenue Code.

CHAPTER 9, SUBCHAPTER C.—TAX ON EMPLOYERS OF EIGHT OR MORE.

SECTION 1607: Definitions. 1940-1-10133
REGULATIONS 90, ARTICLE 204: Who are employers. S. S. T. 381
(Also Subchapter A (Federal Insurance Contributions Act), Section 1426; Regulations 91, Article 4.)

Where, in the community property State of Texas, one of the spouses dies and the survivor, without administration of the estate, acquires the property and operates the business previously conducted by the two spouses, a new employment begins for purposes of the Federal Unemployment Tax Act.

Prior to February —, 1939, A and his wife, B, owned and operated the M Store as community property. Upon the death of A, intestate, on February —, 1939, B took over and operated the business until it was sold on May —, 1939. There were no descendants of A and no administration of the estate was necessary under article 3662, Vernon's Civil Statutes of the State of Texas, which provides as follows:

Where the husband or wife dies intestate, or becomes insane, having no child or children, and no separate property, the common property passes to the survivor, charged with the debts of the community; and no administration thereon or guardianship of the estate shall be necessary.

The question arises whether the death of A and the taking over of the business by B effected a change in employment of the individuals performing services in connection with the business. If the period of operation by B is added to that of the operation by the community, liability for tax under the Federal Unemployment Tax Act would be incurred with respect to the wages of such individuals, since the period of their employment so computed would be of sufficient duration to bring the employing entity within the definition of "employer" as defined in section 1607(a) of the Act. If, on the other hand, there was a change of employment on February —, 1939, liability would not be incurred under the Federal Unemployment Tax Act by either the community or by B, since neither of the periods during which each person conducted the business was 20 weeks in duration.

Section 1607(a) of the Federal Unemployment Tax Act provides as follows:

(a) *Employer.*—The term "employer" does not include any person unless on each of some 20 days during the taxable year, each day being in a different calendar week, the total number of individuals who were employed by him in employment for some portion of the day (whether or not at the same moment of time) was 8 or more.

In the present case, the operation of the business by B following the death of A was solely on her own account and not in connection with the administration of the estate of the decedent or the winding up of the affairs of the community. It is held, therefore, that a new employment of the individuals performing services in carrying on the business began on February —, 1939, following the death of A, and that the period of operation by B should not be added to that of the operation of the business by the community for purposes of the Federal Unemployment Tax Act. Accordingly, neither the community nor B was an "employer" within the meaning of section

1607(a) of the Act during the year 1939 and liability for the tax imposed by that Act was not incurred during that year by either the community or the surviving spouse. (Cf. S. S. T. 354, C. B. 1939-1 (Part 1), 294.)

The conclusion reached herein is applicable also under the Federal Insurance Contributions Act and under Titles VIII and IX of the Social Security Act.

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.204: Who are employees.

Individuals performing services in the construction of houses. (See S. S. T. 388, page 194.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.204: Who are employees.

Individuals engaged in selling burial lots and mausoleum space for the M Cemetery Co. (See S. S. T. 390, page 195.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.204: Who are employees.

Individuals performing services in the manufacture of clothing for "merchant tailors." (See S. S. T. 391, page 196, and S. S. T. 392, page 197.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.206: Excepted services in general.

Status for employment tax purposes, on and after January 1, 1940, of certain organizations. (See Mim. 5019, page 198.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.208: Agricultural labor.

Fermenting, grading, and baling of cigar leaf wrapper tobacco. S. S. T. 219 (C. B. 1937-2, 412) modified. (See S. S. T. 382, page 218.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.213: United States and instrumentalities thereof.

Liability after January 1, 1940, for employment taxes of certain banks and related organizations. (See Mim. 5003, page 203.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.213: United States and instrumentalities thereof.

Army post exchange. (See S. S. T. 385, page 202.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.227: Wages.

Amounts paid by a baseball club to cover transportation, room, and board of its players. (See S. S. T. 383, page 210.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.227: Wages.

Board and lodging furnished to officers and members of crews of vessels. (See S. S. T. 386, page 211.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.227: Wages.

Amount paid by the M Company to an employee while performing jury service. (See S. S. T. 389, page 212.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.227: Wages.

Payments made by the M Company to its employees pursuant to section 16(b) of the Fair Labor Standards Act of 1938. (See S. S. T. 393, page 213.)

SECTION 1607: Definitions. 1940–6–10169
REGULATIONS 107, SECTION 403.401: Credit against tax for contributions paid. S. S. T. 384

Where, pursuant to an election or otherwise, an instrumentality of the United States referred to in section 1606(b) of the Federal Unemployment Tax Act, as amended, makes timely contributions into a State unemployment fund, which contributions are exacted pursuant to the provisions of State law, such payments constitute "payments required by a State law" within the meaning of section 1607(g) of the Federal Unemployment Tax Act, as amended, and, therefore, the basis for credit against the Federal unemployment tax, provided the State law is certified by the Social Security Board for the taxable year under the provisions of section 1603 of the Federal Act, as amended.

The opinion of the Bureau has been requested in the following cases:

(1) Under the unemployment compensation act of the State of R, an instrumentality of the United States referred to in section 1606(b) of the Federal Unemployment Tax Act, as amended by section 613 of

the Social Security Act Amendments of 1939 (Public, No. 379, Seventy-sixth Congress, first session), is not subject to tax in the absence of an election to come under the State act. The M Instrumentality filed an election to come under the State act for a period of at least two years, and pursuant thereto makes contributions into the State unemployment fund. The unemployment compensation act of the State of R has not been amended to comply with section 1606(b) of the Federal Unemployment Tax Act, as amended. Are such payments the basis for credit against the Federal unemployment tax?

(2) Under the unemployment compensation act of the State of S, an instrumentality of the United States referred to in section 1606(b) of the Federal Unemployment Tax Act, as amended, is subject to tax. Pursuant to such act, the N Instrumentality makes contributions into the State unemployment fund. The unemployment compensation act of the State of S has not been amended to comply with section 1606(b) of the Federal Unemployment Tax Act, as amended. Are such payments the basis for credit against the Federal unemployment tax?

Section 1601(a) of the Federal Unemployment Tax Act, as amended by section 609 of the Social Security Act Amendments of 1939, provides in part:

(1) The taxpayer may, to the extent provided in this subsection and subsection (c), credit against the tax imposed by section 1600 the amount of contributions paid by him into an unemployment fund maintained during the taxable year under the unemployment compensation law of a State which is certified for the taxable year as provided in section 1603.

Section 1607(g) of the Federal Unemployment Tax Act, as amended by section 614 of the Social Security Act Amendments of 1939, provides:

CONTRIBUTIONS.—The term "contributions" means payments required by a State law to be made into an unemployment fund by any person on account of having individuals in his employ, to the extent that such payments are made by him without being deducted or deductible from the remuneration of individuals in his employ.

Section 1606(b) of the Federal Unemployment Tax Act, as amended by section 613 of the Social Security Act Amendments of 1939, provides in part:

The legislature of any State may require any instrumentality of the United States (except such as are (A) wholly owned by the United States, or (B) exempt from the tax imposed by section 1600 by virtue of any other provision of law), and the individuals in its employ, to make contributions to an unemployment fund under a State unemployment compensation law approved by the Board under section 1603 * * *. The permission granted in this subsection shall apply * * * (2) only if such State law makes provision for the refund of any contributions required under such law from an instrumentality of the United States or its employees for any year in the event said State is not certified by the Board under section 1603 with respect to such year.

Under the provisions of section 1601(a) of the Federal Unemployment Tax Act, as amended, at least two things must exist in order to obtain credit against the Federal unemployment tax. There must be (1) "contributions" into a State unemployment fund, and (2) such "contributions" must be made under a State unemployment compensation law certified for the taxable year by the Social Security Board. In section 1607(g), supra, the term "contributions" is defined (in part) as "payments required by a State law."

In the opinion of this office, the question as to what constitutes "contributions" into an unemployment fund within the meaning of section 1607(g), supra, is not dependent upon compliance by the State with the conditions set forth in section 1606(b), supra.

It is held that where, pursuant to an election or otherwise, an instrumentality of the United States referred to in section 1606(b) of the Federal Unemployment Tax Act, as amended, makes timely contributions into a State unemployment fund, which contributions are exacted pursuant to the provisions of State law, such payments constitute "payments required by a State law" within the meaning of section 1607(g) of the Federal Act, as amended, and, therefore, the basis for credit against the Federal unemployment tax, provided the State law is certified by the Social Security Board for the taxable year under the provisions of section 1603 of the Federal Unemployment Tax Act, as amended. Accordingly, the payments made by the M Instrumentality and the N Instrumentality into the unemployment funds of the States of R and S, respectively, constitute the basis for credit against the Federal unemployment tax, provided the State law is certified by the Social Security Board for the taxable year under the provisions of section 1603 of the Federal Unemployment Tax Act, as amended.

TAXES UNDER SOCIAL SECURITY ACT.

SECTIONS 811 AND 907: Definitions.
REGULATIONS 91 AND 90, ARTICLES 4 AND 204: Who are employers.

Change in status of employer under community property law of Texas. (See S. S. T. 381, page 214.)

SECTIONS 811 AND 907: Definitions. 1940-4-10151
REGULATIONS 91 AND 90, ARTICLES 6 AND 206(1): S. S. T. 382
Agricultural labor.
(Also Internal Revenue Code, Chapter 9, Subchapter A (Federal Insurance Contributions Act), Section 1426; Regulations 106, Section 402.208; and Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.208.)

Services performed by employees of the M Company on farms owned by that company in connection with the fermenting, grading, and baling of cigar leaf wrapper tobacco grown on such farms do not constitute "agricultural labor" within the meaning of sections 811(b)1 and 907(c)1 of the Social Security Act. S. S. T. 219 (C. B. 1937-2, 412) modified.

The question is presented whether services performed by employees of the M Company in connection with the preparation of cigar leaf wrapper tobacco for market constitute "agricultural labor" within the meaning of sections 811(b)1 and 907(c)1 of the Social Security Act, which except "agricultural labor" from "employment."

In S. S. T. 219 (C. B. 1937-2, 412) it was held, *inter alia*, that services performed by employees of the M Company in its warehouses in connection with the fermenting, grading, and baling of cigar leaf wrapper tobacco grown on farms owned by that company constitute "agricultural labor" within the meaning of sections 811(b)1 and 907(c)1 of the Social Security Act. That ruling was based upon the statement of facts set forth therein. Since the issuance of that ruling additional information has been submitted which discloses that a considerable amount of machinery is used in the handling operations, that most of the operations are conducted under controlled temperatures or controlled humidities, or both, and that many of the individuals who work in the warehouses of the M Company are not the employees who perform services for the company in the fields in connection with the raising and harvesting of crops which activities constitute "agricultural labor." Although the products of the M Company are sold exclusively at wholesale, such disposition is not an isolated commercial transaction, as is usually the case in the wholesale disposition of crops by an ordinary farmer, but is a part of the extensive commercial activities engaged in by the M Company. Moreover, it appears that the customs and practices prevailing generally in the industry warrant the conclusion that the fermenting, grading, and baling of cigar leaf wrapper tobacco are not incident to ordinary farming operations as distinguished from manufacturing or commercial operations within the meaning of article 6 of Regulations 91, relating to Title VIII, and article 206(1) of Regulations 90, relating to Title IX of the Social Security Act.

In view of the foregoing, it is held that services performed by employees of the M Company in connection with the fermenting, grading, and baling of cigar leaf wrapper tobacco do not constitute "agricultural labor" within the meaning of sections 811(b)1 and 907(c)1 of the Social Security Act. Accordingly, S. S. T. 219, supra, is modified.

The conclusion reached above with respect to the status of the services in question under Titles VIII and IX of the Social Security Act is equally applicable to the status of such services under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

SECTIONS 811 AND 907: Definitions.
REGULATIONS 91 AND 90, ARTICLES 11 AND 206(5)-(6):
Government employees.

Liability after January 1, 1940, for employment taxes of certain banks and related organizations. (See Mim. 5003, page 203.)

SECTIONS 811 AND 907: Definitions.
REGULATIONS 91 AND 90, ARTICLES 16 AND 209: Items included as wages.

Amounts paid by a baseball club to cover transportation, room, and board of its players. (See S. S. T. 383, page 210.)

MISCELLANEOUS TAX RULINGS.

ESTATE TAX.

INTERNAL REVENUE CODE.

SECTION 811(c).—ESTATE TAX.

REGULATIONS 80 (1937), ARTICLE 16: Transfers in contemplation of death. 1940–11–10203 T. D. 4966

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 80.—ESTATE TAX.

Article 16, Regulations 80 (1937 Edition), amended.—Transfers in contemplation of death.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Article 16 of Regulations 80, 1937 edition [section 80.16, Title 26, Code of Federal Regulations], and that article as made applicable to the Internal Revenue Code by Treasury Decision 4885, approved February 11, 1939 [C. B. 1939–1 (Part 1), 396] (Part 465, Subpart B, of such Title 26), is hereby amended by striking out the second and third paragraphs thereof reading as follows:

A transfer in contemplation of death is a disposition of property prompted by the thought of death. The phrase "contemplation of death" as used in the statute is not limited to contemplation of imminent death or to an apprehension that death is near at hand. Death must be "contemplated," that is, the motive which induces the transfer must be such that leads to testamentary disposition. A gift inter vivos which springs from a motive essentially associated with life rather than with death is not made in contemplation of death.

As the phrase "transfer in contemplation of death" is applicable to many varying transactions, the circumstances of each case must be examined to ascertain the motive which induced the decedent to make the transfer. If the transfer results from mixed motives, one of which is the thought of death, the more compelling motive controls. A condition of the mind or body of the transferor (whether occasioned by old age or disease) which naturally prompts a testamentary disposition to a proper object of his bounty, will be considered a decisive test of contemplation of death in the absence of proof of the existence of purposes associated with life as the dominant motive for the transfer.—

and substituting in lieu thereof the following:

The phrase "contemplation of death," as used in the statute, does not mean, on the one hand, that general expectation of death such as all persons entertain, nor, on the other, is its meaning restricted to an apprehension that death is imminent or near. A transfer in contemplation of death is a disposition of property prompted by the thought of death (though it need not be solely so prompted). A transfer is prompted by the thought of death if it is made with the purpose of avoiding the tax, or as a substitute for a testamentary disposition of the property, or for any other motive associated with death. The bodily and mental condition of the decedent and all other attendant facts and circumstances are to be scrutinized to determine whether or not such thought prompted the disposition.

(This Treasury decision is issued under the authority contained in the following sections of law: Sections 811, 937, and 3791(a)1 of the Internal Revenue Code (53 Stat., Part 1); section 302 of the Revenue Act of 1926 (44 Stat., 70, 26 U. S. C., 411); section 1101 of the Revenue Act of 1926 (44 Stat., 111, 26 U. S. C., 1691); and section 403 of the Revenue Act of 1932 (47 Stat., 245, 26 U. S. C., 537).)

T. MOONEY,
Acting Commissioner of Internal Revenue.

Approved March 5, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 7, 1940, 11.03 a. m.)

TITLE III.—ESTATE TAX. (1926)

SECTION 302(j), AS ADDED BY SECTION 202(a) OF THE REVENUE ACT OF 1935.

REGULATIONS 80(1937), ARTICLE 11: Optional valuation date. 1940-3-10144
E. T. 14

The election to value property as of a date or dates subsequent to the decedent's death, as provided in section 302(j) of the Revenue Act of 1926, as added by section 202(a) of the Revenue Act of 1935, must be exercised by the executor in a return on Form 706 filed within 15 months after the decedent's death or prior to the expiration of any extension of time granted pursuant to Regulations 80 (1937).

Advice is requested whether the executor or administrator, as the case may be, in the three cases hereinafter described is entitled to value the property included in the decedent's gross estate as of a date or dates after the decedent's death, as provided in section 302(j) of the Revenue Act of 1926, as added by section 202(a) of the Revenue Act of 1935.

Section 302(j) of the Revenue Act of 1926, as added by section 202(a) of the Revenue Act of 1935, provides in part:

If the executor so elects upon his return (if filed within the time prescribed by law or prescribed by the Commissioner in pursuance of law), the value of the gross estate shall be determined by valuing all the property included therein on the date of the decedent's death as of the date one year after the decedent's death, except that (1) property included in the gross estate on the date of death and, within one year after the decedent's death, distributed by the executor (or, in the case of property included in the gross estate under subdivision (c), (d), or (f) of this section, distributed by the trustee under the instrument of transfer), or sold, exchanged, or otherwise disposed of, shall be included at its value as of the time of such distribution, sale, exchange, or other disposition, whichever first occurs, instead of its value as of the date one year after the decedent's death, * * *.

Article 11 of Regulations 80 (1937) reads in part as follows:

ART. 11. *Optional valuation date.*—In general, the object of subdivision (j) of section 302 is to make provision whereby the amount of tax otherwise payable may be lessened when, within the year following the decedent's death, the gross estate has suffered a shrinkage in its aggregate value.

If the decedent died after August 30, 1935, the executor may, by an election upon his return, Form 706, if filed within the time prescribed by law or prescribed by the Commissioner in pursuance of law, have the property which was included in the gross estate on the date of the decedent's death valued as of the applicable dates, as follows:

* * * * * * *

The election is available to the executor only at the time the return is filed, and only if the return is filed within 15 months from the decedent's death, or within the period of an extension of time for filing granted under the provisions of article 68 or 69 of these regulations. The election applies to all the property included in the gross estate on the date of the decedent's death. It can not be applied only to a portion of such property. The election, if exercised, can not be rescinded.

* * * * * * *

Under the provisions of section 304(a) of the Revenue Act of 1926, as amended, the executor is required to file an estate tax return under oath and in duplicate with the collector "at such times and in such manner as may be required by regulations made pursuant to law." Article 63 of Regulations 80 (1937) provides that the return on Form 706 must be filed in duplicate within 15 months after the date of death, if the decedent died on or after August 31, 1935. Under the conditions prescribed in articles 68 and 69 of Regulations 80 (1937), an extension of time for filing an estate tax return may be granted.

The following cases are involved:

1. A died on April 23, 1937. The executor was granted an extension of two months from July 23, 1938 (due date of return), or until September 23, 1938, within which to file the return. The return was not filed with the collector until September 26, 1938. It was thus three days late.

2. B died on April 13, 1937, and the return was thus due on July 13, 1938. However, the return was not filed until January 3, 1939, when the administrator claimed the right to have the property valued as of a date or dates subsequent to the decedent's death.

3. C died on April 20, 1937. The return was filed April 20, 1938, but the executor did not elect to have the property included in the return valued as provided in section 302(j) of the Revenue Act of 1926, as added by section 202(a) of the Revenue Act of 1935. However, on July 19, 1938, or one day prior to the due date for the filing of the return, the executor filed an amended return in which he elected to have the property included therein so valued.

The election provided in section 302(j) of the Revenue Act of 1926, as added by section 202(a) of the Revenue Act of 1935, and the applicable provisions of Regulations 80 (1937) is expressly conditioned upon the executor or administrator filing a return on Form 706 within 15 months after the decedent's death, or within such extension of time for filing the required return as may have been granted pursuant to the regulations. Inasmuch as the required returns in cases 1 and 2 (estates of A and B) were not filed within the prescribed time, it is held that neither the executor of A's estate nor the administrator of B's estate is entitled to have the property of such estates valued as provided in section 302(j) of the Revenue Act of 1926, as added by section 202(a) of the Revenue Act of 1935. Since both the original return and the amended return in case 3 (estate of C) were filed within the prescribed time, it is held that the executor of C's estate properly elected to have the property valued as provided in section 302(j) of the Revenue Act of 1926, as added by section 202(a) of the Revenue Act of 1935.

SECTION 302(c), AS AMENDED.

REGULATIONS 80, ARTICLE 17: Transfers conditional upon survivorship. 1940-7-10175 Ct. D. 1440

ESTATE TAX—REVENUE ACTS OF 1926 AND 1932—DECISION OF SUPREME COURT.

1. GROSS ESTATE—TRANSFER IN TRUST—PROVISION FOR RETURN OF CORPUS TO DONOR UPON CONTINGENCY TERMINABLE AT DEATH—INTENDED TO TAKE EFFECT IN POSSESSION OR ENJOYMENT AT OR AFTER DEATH.

An *inter vivos* transfer of property in trust, with provision for return or reversion of the corpus to the donor upon a contingency terminable at his death, comes within section 302(c) of the Revenue Act of 1926, and that section as amended by section 803 of the Revenue Act of 1932, relating to transfers intended to take effect in possession or enjoyment at or after death.

2. DECISION FOLLOWED.

Klein v. *United States* (1931) (283 U. S., 231 [Ct. D. 333, C. B. X-1, 462 (1931)]) followed.

3. DECISIONS OVERRULED.

Helvering v. *St. Louis Union Trust Co.* (1935) (296 U. S., 39 [Ct. D. 1047, C. B. XIV-2, 339 (1935)]) and *Becker* v. *St. Louis Union Trust Co.* (1935) (296 U. S., 48 [Ct. D. 1046, C. B. XIV-2, 337 (1935)]) overruled.

4. DECISIONS REVERSED.

Decisions of the United States Circuit Courts of Appeals, Sixth and Third Circuits (1939) (102 F. (2d), 1, and 103 F. (2d), 834), reversed.

5. DECISION AFFIRMED.

Decision of the United States Circuit Court of Appeals, Second Circuit (1939) (104 F. (2d), 1011), affirmed.

SUPREME COURT OF THE UNITED STATES.

No. 110. *Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *Mary Q. Hallock and Central United National Bank of Cleveland, Trustees.*

No. 111. *Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *Mary Q. Hallock, Executrix, Estate of Henry Hallock, Deceased.*

On writs of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

No. 112. *Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *S. H. Squire, Superintendent of Banks of the State of Ohio, etc.*

No. 183. *Walter J. Rothensies, Collector of Internal Revenue for the First District of Pennsylvania, petitioner,* v. *Craig Huston, Administrator d. b. n. c. t. a. of the Estate [of George F. Uber, Deceased].*

On writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

No. 399. *Waldo G. Bryant and Ida Bryant, Executors of the Estate of Waldo C. Bryant, Deceased, petitioners,* v. *Guy T. Helvering, Commissioner of Internal Revenue.*

[309 U. S., 106.]

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[January 29, 1940.]

OPINION.

Mr. Justice FRANKFURTER delivered the opinion of the Court.

These cases raise the same question, namely, whether transfers of property *inter vivos* made in trust, the particulars of which will later appear, are within the provisions of section 302(c) of the Revenue Act of 1926.[1] They were heard in succession and may be decided together. In each case the Commissioner of Internal Revenue included the trust property in the decedent's gross estate. In Nos. 110, 111, and 112—affecting three beneficiaries under the same instrument—his determination was reversed by the Board of Tax Appeals (34 B. T. A., 575) and the Board was affirmed by the Circuit Court of Appeals for the Sixth Circuit (102 F. (2d), 1). In No. 183, the taxpayer paid under protest, successfully sued for recovery in the District Court for the Eastern District of Pennsylvania, and his judgment was sustained by the Circuit Court of Appeals for the Third Circuit. (103 F. (2d), 834.) In No. 399, the Commissioner was in part successful before the Board of Tax Appeals (36 B. T. A., 669) and the Circuit Court of Appeals for the Second Circuit affirmed the Board (104 F. (2d), 1011).

Neither here nor below does the issue turn on the unglossed text of section 302(c). In its enforcement, Treasury and courts alike encounter three recent decisions of this Court, *Klein* v. *United States* (283 U. S., 231 [Ct. D. 333, C. B. X-1, 462 (1931)]), *Helvering* v. *St. Louis Trust Co.* (296 U. S., 39 [Ct. D. 1047, C. B. XIV-2, 339 (1935)]), and *Becker* v. *St. Louis Trust Co.* (ibid., 48 [Ct. D. 1046, C. B. XIV-2, 337 (1935)]). Because of the difficulties which lower courts have found in applying the distinctions made by these cases and the seeming disharmony of their results, when judged by the controlling purposes of the estate tax law, we brought the cases here. (308 U. S., —; ibid., —; ibid., —.) All involve dispositions of property by way of trust in which the settlement provides for return or reversion of the corpus to the donor upon a contingency terminable at his death. Whether the transfer made by the decedent in his lifetime is "intended to take effect in possession and [or] enjoyment at or after his death" by reason of that which he retained, is the crux of the problem. We must put to one side questions that arise under sections of the estate tax law other than section 302(c)—sections, that is, relating to transfers taking place at death. Section 302(c) deals with property not technically passing at death but with interests theretofore created. The taxable event is a transfer *inter vivos*. But the measure of the tax is the value of the transferred property at the time when death brings it into enjoyment.

We turn to the cases which beget the difficulties. In *Klein* v. *United States*, supra, decided in 1931, the decedent during his lifetime had conveyed land to his wife for her lifetime, "and if she shall die prior to the decease of said grantor then and in that event she shall by virtue hereof take no greater or other estate in said lands and the reversion in fee in and to the same shall in that event remain vested in said grantor * * *." The instrument further provided, "Upon condition and in the event that said grantee shall survive the said grantor, then and in that case only the said grantee shall by virtue of this conveyance take, have, and hold the said lands in fee simple, * * *." The taxpayer contended that the decedent had reserved a mere "possibility of reverter" and that such a "remote interest,"[2] extinguishable upon the grantor's death, was not sufficient to bring the conveyance within the reckoning of the taxable estate. This Court held otherwise. It rejected formal distinctions pertaining to the law of real property as irrelevant criteria in this field of taxation. "Nothing is to be gained," it was said, "by multiplying words in respect of the various niceties of the art of conveyancing or the law of contingent and vested remainders. It is perfectly plain that the death of the

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[1] Ch. 27, 44 Stat., 9, as amended by section 803 of the Revenue Act of 1932 (ch. 209, 47 Stat., 169, 279):

"The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

* * * * * * *

"(c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this title."

[2] Petitioner's brief, *Klein* v. *United States*, pages 11–13.

grantor was the indispensable and intended event which brought the larger estate into being for the grantee and effected its transmission from the dead to the living, thus satisfying the terms of the taxing Act and justifying the tax imposed." (*Klein* v. *United States*, supra, at 234.)

The inescapable rationale of this decision, rendered by a unanimous Court, was that the statute taxes not merely those interests which are deemed to pass at death according to refined technicalities of the law of property. It also taxes *inter vivos* transfers that are too much akin to testamentary dispositions not to be subjected to the same excise. By bringing into the gross estate at his death that which the settlor gave contingently upon it, this Court fastened on the vital factor. It refused to subordinate the plain purposes of a modern fiscal measure to the wholly unrelated origins of the recondite learning of ancient property law. Surely the Klein decision was not intended to encourage the belief that a change merely in the phrasing of a grant would serve to create a judicially cognizable difference in the scope of section 302(c), although the grantor retained in himself the possibility of regaining the transferred property upon precisely the same contingency. The teaching of the Klein case is exactly the opposite.[3]

In 1935 the St. Louis Trust cases came here. A rational application of the principles of the Klein case to the situations now before us calls for scrutiny of the particulars in the St. Louis cases in order to extract their relation to the doctrine of the earlier decision.

In *Helvering* v. *St. Louis Trust Co.*, supra, the decedent had conveyed property in trust, the income of which was to be paid to his daughter during her life, but at her death "If the grantor still be living, the trustee shall forthwith * * * transfer, pay, and deliver the entire estate to the grantor, to be his absolutely." But "If the grantor be then not living" then the income was to be devoted to the settlor's wife if she were living, and upon the death of both daughter and wife, if he were not living, the trust property was to go to the daughter's children, or if she left none, to the grantor's next of kin.

In *Becker* v. *St. Louis Trust Co.*, supra, the decedent had declared himself trustee of property with the income to be accumulated or, at his discretion, to be paid over to his daughter during her life. The instrument further provided that "If the said beneficiary should die before my death, then this trust estate shall thereupon revert to me and become mine immediately and absolutely, or * * * if I should die before her death, then this property shall thereupon become hers immediately and absolutely * * *."

On the authority of the Klein case the Commissioner had included in the taxable estates the gifts to which, in the St. Louis Trust cases, the grantor's death had given definitive measure. If the wife had predeceased the settlor in the Klein case, he would have been repossessed of his property. His wife's interests were freed from this contingency by the husband's prior death, and because of the effect of his death this Court swept the gift into the gross estate. So in *Helvering* v. *St. Louis Trust Co.*, the grantor would have become repossessed of the granted corpus had his daughter predeceased him. But he predeceased her and by that event her interest ripened to full dominion. The same analysis applies to the Becker case. In all three situations the result and effect were the same. The event which gave to the beneficiaries a dominion over property which they did not have prior to the donor's death was an act of nature outside the grantor's "control, design or volition." (296 U. S., 39, 43.) But it was no more and no less "fortuitous," so far as the grantor's "control, design or volition," was concerned, in the St. Louis Trust cases than it was in the Klein case. In none of the three cases did the dominion over property which finally came to the beneficiary fall by virtue of the grantor's will, except by his provision that his own death should establish such final and complete dominion. And yet a mere difference in phrasing the circumstance by which identic interests in property were brought into being—varying forms of words in the creation of the same wordly [worldly] interests—was found sufficient to exclude the St. Louis Trust settlements from the application of the Klein doctrine.

Four members of the Court saw no difference. They relied on the governing principle of section 302(c) that Congress meant to include in the gross estate

[3] Some indication of the influence of *Klein* v. *United States* upon the lower courts may be found in *Sargent* v. *White* (50 F. (2d), 410) and *Union Trust Co.* v. *United States* (54 F. (2d), 152, certiorari denied, 286 U. S., 547). Cf. *Commissioner* v. *Schwarz* (74 F. (2d), 712).

inter vivos gifts "which may be resorted to, as a substitute for a will, in making dispositions of property operative at death." (296 U. S., at 46.) To effectuate this purpose practical considerations applicable to taxation and not the "niceties of the art of conveyancing" were their touchstone. "Having in mind," said the dissenters, "the purpose of the statute and the breadth of its language it would seem to be of no consequence what particular conveyancers' device—what particular string—the decedent selected to hold in suspense the ultimate disposition of his property until the moment of his death. In determining whether a taxable transfer becomes complete only at death we look to substance, not to form * * *. However we label the device it is but a means by which the gift is rendered incomplete until the donor's death." (296 U. S., at 47.) For the majority in the St. Louis Trust Co. cases, these practicalities had less significance than the formal categories of property law. The grantor's death, the majority said, in *Helvering* v. *St. Louis Trust Co.*, "simply put an end to what, at best, was a mere possibility of a reverter by extinguishing it—that is to say, by converting what was merely possible into an utter impossibility." (296 U. S., 39, 43.) This was precisely the mode of argument which had been rejected in *Klein* v. *United States*, supra.

We are now asked to accept all three decisions as constituting a coherent body of law, and to apply their distinctions to the trusts before us.

In Nos. 110, 111 and 112 (*Helvering* v. *Hallock*) the decedent in 1919 created a trust under a separation agreement, giving the income to his wife for life, with this further provision:

"If and when Anne Lamson Hallock shall die and in such event * * * the within trust shall terminate and said trustee shall * * * pay party of the first part if he then be living any accrued income, then remaining in said trust fund and shall * * * deliver forthwith to party of the first part, the principal of the said trust fund. If and in the event said party of the first part shall not be living then and in such event payment and delivery over shall be made to Levitt Hallock and Helen Hallock, respectively son and daughter of the party of the first part, share and share alike * * *."

When the settlor died in 1932, his divorced wife, the life beneficiary, survived him. The circuit court of appeals held that the trust instrument had conveyed the "whole interest" of the decedent, subject only to a "condition subsequent," which left him nothing "except a mere possibility of reverter." (*Commissioner* v. *Hallock*, 102 F. (2d), 1, 3–4.)

In No. 183 (*Rothensies* v. *Cassell*) the decedent by an ante-nuptial agreement in 1925 conveyed property in trust, the income to be paid to his prospective wife during her life, subject to the following disposition of the principal:

"In trust if the said Rae Spektor shall die during the lifetime of said George F. Uber to pay over the principal and all accumulated income thereof unto the said George F. Uber in fee, free and clear of any trust.

"In trust if the said Rae Spektor after the marriage shall survive the said George F. Uber to pay over the principal and all accumulated income unto the said Rae Spektor—then Rae Uber—in fee, free and clear of any trust."

Mrs. Uber outlived her husband, who died in 1934. The circuit court of appeals deemed *Becker* v. *St. Louis Trust Co.* controlling against the inclusion of the trust corpus in the gross estate.

Finally, in No. 399 (*Bryant* v. *Helvering*), the testator provided for the payment of trust income to his wife during her life and upon her death to the settlor himself if he should survive her. The instrument, which was executed in 1917, continued:

"Upon the death of the survivor of said Ida Bryant and the party of the first part, unless this trust shall have been modified or revoked as hereinafter provided, to convey, transfer, and pay over the principal of the trust fund to the executors or administrators of the estate of the party hereto of the first part."

There was a further provision giving to the decedent and his wife jointly during their lives, and to either of them after the death of the other, power to modify, alter or revoke the instrument. The wife survived the husband, who died in 1930. The Board of Tax Appeals allowed the Commissioner to include in the decedent's gross estate only the value of a "vested reversionary interest" which the Board held the grantor had reserved to himself. On appeal by the taxpayer, the circuit court of appeals sustained this determination.

The terms of these grants differ in detail from one another, as all three differ from the formulas of conveyance used in the Klein and St. Louis Trust cases. It therefore becomes important to inquire whether the technical forms in which interests contingent upon death are cast should control our decision. If so, it becomes necessary to determine whether the differing terms of conveyance now in issue approximate more closely those used in the Klein case and are therefore governed by it, or have a greater verbal resemblance to those that saved the tax in the St. Louis Trust cases. Such an essay in linguistic refinement would still further embarrass existing intricacies. It might demonstrate verbal ingenuity, but it could hardly strengthen the rational foundations of law. The law of contingent and vested remainders is full of casuistries. There are great diversities among the several States as to the conveyancing significance of like grants; sometimes in the same State there are conflicting lines of decision, one series ignoring the other. Attempts by the Board of Tax Appeals and the circuit courts of appeal to administer section 302(c) by reference to these distinctions abundantly illustrate the inevitable confusion.[4] One of the cases at bar, No. 399, reveals vividly the snares which inevitably await an attempt to base estate tax law on the "niceties of the art of conveyancing." In connection with the ascertainment of its own death duties, the Supreme Court of Errors of Connecticut defined the nature of the interest which the decedent in that case retained after his *inter vivos* transfer. (*Bryant* v. *Hackett*, 118 Conn., 233.) And yet the nature of that interest under Connecticut law and the scope of the Connecticut court's adjudication of that interest were made the subject of lively controversy before us. The importation of these distinctions and controversies from the law of property into the administration of the estate tax precludes a fair and workable tax system. Essentially the same interests, judged from the point of view of wealth, will be taxable or not, depending upon elusive and subtle casuistries which may have their historic justification but possess no relevance for tax purposes.[5] These unwitty diversities of the law of property derive from medieval concepts as to the necessity of a continuous seisin.[6] Distinctions which originated under a feudal economy when land dominated social relations are peculiarly irrelevant in the application of tax measures now so largely directed toward intangible wealth.

Our real problem, therefore, is to determine whether we are to adhere to a harmonizing principle in the construction of section 302(c), or whether we are to multiply gossamer distinctions between the present cases and the three earlier ones. Freed from the distinctions introduced by the St. Louis Trust cases, the Klein case furnishes such a harmonizing principle. Does, then, the doctrine of *stare decisis* compel us to accept the distinctions made in the St. Louis Trust cases as starting points for still finer distinctions spun out of the tenuosities of surviving feudal law? We think not. We think the Klein case rejected the presupposition of such distinctions for the fiscal judgments which section 302(c) demands.

We recognize that *stare decisis* embodies an important social policy. It represents an element of continuity in law, and is rooted in the psychologic need to satisfy reasonable expectations. But *stare decisis* is a principle of policy and not a mechanical formula of adherence to the latest decision, however recent and questionable, when such adherence involves collision with a prior doctrine more embracing in its scope, intrinsically sounder, and verified by experience.

Nor have we in the St. Louis Trust cases rules of decision around which, by the accretion of time and the response of affairs, substantial interests have established themselves. No such conjunction of circumstances requires perpetuation of what we must regard as the deviations of the St. Louis Trust decisions from the Klein doctrine. We have not before us interests created or maintained in reliance on those cases. We do not mean to imply that the inevitably empiric process of construing tax legislation should give rise to an

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[4] See, for example, the attempts by the Board of Tax Appeals to deal with the peculiarities of New York law in the field of vested and contingent remainders. (*Elizabeth B. Wallace*, 27 B. T. A., 902; *Louis C. Raegner, Jr.*, 29 B. T. A., 1243.) In both of these cases limitations which would probably have been "contingent" at "common law" were held to be "vested" under the New York statutory rule. (Cf. *Commissioner* v. *Schwarz*, 74 F. (2d), 712; *Flora M. Bonney*, 29 B. T. A., 45.)

[5] Cf. *Lueth* v. *Hoey* (305 U. S., 188, 194). See Paul, The Effect on Federal Taxation of Local Rules of Property in Selected Studies in Federal Taxation (2d Series), pages 23–28; Developments in the Law—Taxation, 47 Harv. L. Rev., 1209, 1238–1241; Note, 49 Harv. L. Rev., 462.

[6] See, for example, Fearne, Contingent Remainders (4th Am. Ed.), pages 3–241; Gray, Rule Against Perpetuities (2d Ed.), pages 99–118; VII Holdsworth, History of English Law, 81 *et seq.*; 1 Simes, Future Interests, sections 64–96. The confusion apt to be engendered by judicial forays into this field is well illustrated by the use of the term "possibility of reverter" by the majority in *Helvering* v. *St. Louis Union Trust Co.* "A possibility of reverter" is traditionally defined as the interest remaining in a grantor who has conveyed a determinable fee. The definition has not been thought to have any relation to the reversionary interest of a grantor who has transferred either a vested or contingent remainder in fee. See Gray, Rule Against Perpetuities (2d Ed.), sections 13–51.

estoppel against the responsible exercise of the judicial process. But it is a fact that in all the cases before us the settlements were made and the settlors died before the St. Louis Trust decisions.

Nor does want of specific congressional repudiations of the St. Louis Trust cases serve as an implied instruction by Congress to us not to reconsider, in the light of new experience, whether those decisions, in conjunction with the Klein case, make for dissonance of doctrine. It would require very persuasive circumstances enveloping congressional silence to debar this Court from reexamining its own doctrines. To explain the cause of nonaction by Congress when Congress itself sheds no light is to venture into speculative unrealities.[7] Congress may not have had its attention directed to an undesirable decision; and there is no indication that as to the St. Louis Trust cases it had, even by any bill that found its way into a committee pigeonhole. Congress may not have had its attention so directed for any number of reasons that may have moved the Treasury to stay its hand. But certainly such inaction by the Treasury can hardly operate as a controlling administrative practice, through acquiescence, tantamount to an estoppel barring reexamination by this Court of distinctions which it had drawn.[8] Various considerations of parliamentary tactics and strategy might be suggested as reasons for the inaction of the Treasury and of Congress, but they would only be sufficient to indicate that we walk on quicksand when we try to find in the absence of corrective legislation a controlling legal principle.

This Court, unlike the House of Lords,[9] has from the beginning rejected a doctrine of disability at self-correction. Whatever else may be said about want of congressional action to modify by legislation the result in the St. Louis Trust cases, it will hardly be urged that the reason was congressional approval of those distinctions between the St. Louis Trust and the Klein cases to which four members of this Court could not give assent. By imputing to Congress a

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[7] We are not unmindful of amendments to the estate tax law to which other decisions of this Court gave rise. Thus by section 805 of the Revenue Act of 1936 (ch. 690, 49 Stat., 1648) Congress undid the construction which this Court gave the estate tax law in another connection by a decision rendered on the same day as were the St. Louis Trust cases. (Cf. *White* v. *Poor*, 296 U. S., 98.) This case arose under section 302(d) and not section 302(c). But, in any event, the fact of congressional action in dealing with one problem while silent on the different problems created by the St. Louis Trust cases, does not imply controlling acceptance by Congress of those cases.

By the joint resolution of March 3, 1931 (ch. 454, 46 Stat., 1516), Congress displaced the construction which this Court put upon section 302(c) in those cases wherein it was held that the reservation by a decedent of a life estate in property conveyed *inter vivos*, did not constitute a sufficient postponement of the remainder to bring it into the grantor's gross estate. (*May* v. *Heiner*, 281 U. S., 238 [Ct. D. 186, C. B. IX-1, 382 (1930)]; *Burnet* v. *Northern Trust Co.*, 283 U. S., 782; *Morsman* v. *Burnet*, 283 U. S., 783; *McCormick* v. *Burnet*, 283 U. S., 784.) The speculative arguments that may be drawn from *ad hoc* legislation affecting one set of decisions and the want of such legislation to modify another set of decisions dealing with a somewhat different though cognate problem are well illustrated by this remedial amendment. For it may be urged with considerable plausibilty that in 1931 Congress had in principle already rejected the general attitude underlying the St. Louis Trust cases, as illustrated by the fact that in those cases the majority, in part at least, relied upon the congressionally discarded *May* v. *Heiner* doctrine.

Whatever may be the scope of the doctrine that reenactment of a statute impliedly enacts a settled judicial construction placed upon the reenacted statute, that doctrine has no relevance to the present problem. Since the decisions in the St. Louis Trust cases, Congress has not reenacted section 302(c). The amendments that Congress made to other provisions of section 302 in connection with other situations than those now before the Court, were made without reenacting section 302(c). Nor has Congress, under any rational canons of legislative significance, by its compilation of internal revenue laws to form the Internal Revenue Code of 1939 (53 Stat., 1), impliedly enacted into law a particular decision which, in the light of later experience, is seen to create confusion and conflict in the application of a settled principle of internal revenue legislation.

Here, unlike the situation in such cases as *National Lead Co.* v. *United States* (252 U. S., 140, 146–147) and *Murphy Oil Co.* v. *Burnet* (287 U. S., 299, 302–303 [Ct. D. 619, C. B. XII-1, 231 (1933)]), we have no conjunction of long uniform administrative construction and subsequent reenactments of an ambiguous statute to give ground for implying legislative adoption of such construction. See Preface, Internal Revenue Code (53 Stat., III); compare *Smiley* v. *Holm* (285 U. S., 355, 373) and *Warner* v. *Goldtra* (293 U. S., 155, 161).

[8] Since the Treasury has amended its regulations in an effort to conform administrative practice to the compulsions of the St. Louis Trust cases, it can not be deemed to have bound itself by this change. (Article 17, Regulations 80 (1937 Ed.), page 42.) Cf. *Estate of Sanford* v. *Commissioner of Internal Revenue* (308 U. S., — (decided November 6, 1939)).

[9] *London Street Tramways Co., Ltd.*, v. *London County Council* [1898] (A. C., 375). But the rule is otherwise in the Privy Council. (*Read* v. *Bishop of Lincoln* [1892], A. C., 644, 655.) For the rôle of precedent in English law, see, *inter alia*, 2 Yorke, Life of Lord Chancellor Hardwicke, pages 425, 498; Goodhart, Precedent in English and Continental Law, 50 L. Q. Rev., 40; Holdsworth, Case Law, *ibid.*, 180; *Lord Wright in Westminster Council* v. *Southern Ry. Co.* [1936] (A. C., 511, 562–563); Allen, Law in the Making (3d ed.), pages 224 et seq.

hypothetical recognition of coherence between the Klein and the St. Louis Trust cases, we can not evade our own responsibility for reconsidering, in the light of further experience, the validity of distinctions which this Court has itself created. Our problem then is not that of rejecting a settled statutory construction. The real problem is whether a principle shall prevail over its later misapplications. Surely we are not bound by reason or by the considerations that underlie *stare decisis* to persevere in distinctions taken in the application of a statute which, on further examination, appear consonant neither with the purposes of the statute nor with this Court's own conception of it. We therefore reject as untenable the diversities taken in the St. Louis Trust cases in applying the Klein doctrine—untenable because they drastically eat into the principle which those cases professed to accept and to which we adhere.

In Nos. 110, 111, 112 and 183, the judgments are reversed.

In No. 399, the judgment is affirmed.

The Chief Justice concurs in the result upon the ground that each of these cases is controlled by our decision in *Klein* v. *United States* (283 U. S., 231).

SECTION 302(f), AS AMENDED.

Regulations 80, Article 24: Property passing under general power of appointment. 1940-7-10176 Ct. D. 1441

ESTATE TAX—REVENUE ACT OF 1926, AS AMENDED—DECISION OF SUPREME COURT.

1. Gross Estate—General Power of Appointment—Local Law—Federal Law.

A power of appointment exercisable by the donee thereof in favor of anyone, including her estate or creditors, is a general power of appointment within the intent of the Federal statute, though the property may be in trust with discretionary power in the trustees to withhold principal or income from any beneficiary under certain circumstances, and though under the State law such a power may be classified as special. Where the Federal Revenue Acts designate what interests or rights, created by State law, shall be taxed, the Federal law must prevail no matter what name is given to the interest or right by State law.

2. Decision Affirmed.

Decision of the United States Circuit Court of Appeals, Seventh Circuit (1939) (103 F. (2d), 636), affirming decision of the United States Board of Tax Appeals (1937) (36 B. T. A., 588), affirmed.

Supreme Court of the United States.

J. Earl Morgan, Executor of the Estate of Elizabeth S. Morgan, Deceased, petitioner, v. *Commissioner of Internal Revenue.*

[309 U. S., 78.]

On writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[January 29, 1940.]

OPINION.

Mr. Justice Roberts delivered the opinion of the Court.

We took this case because it raises an important question as to the construction of the Revenue Act of 1926, section 302(f), amended by the Revenue Act of 1932, section 803(b).[1]

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[1] 44 Stat., 9, 71; 47 Stat., 169, 279; 26 U. S. C., section 411.

Sec. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

* * * * * * *

(f) To the extent of any property passing under a general power of appointment exercised by the decedent (1) by will, or (2) by deed executed in contemplation of or intended to take effect in possession or enjoyment at or after his death, * * * except in case of a bona fide sale for an adequate and full consideration in money or money's worth; * * *.

The question is to what extent and in what sense the law of the decedent's domicile governs in determining whether a power of appointment exercised by him is a general power within the meaning of the statute.

The petitioner is the executor of Elizabeth S. Morgan who was the donee of two powers of appointment over property held in two trusts created by her father by will and by deed. The persons named are, or were, at death, citizens of Wisconsin. It is unnecessary to recite the terms of the trusts. Suffice it to say that under each, property remaining in the trustees' hands for Elizabeth S. Morgan was given at her death, to the appointee or appointees named in her will, with gifts over in case she failed to appoint. Under both trusts, if in the judgment of the trustees, property going to any beneficiary would be dissipated for any reason, or improvidently handled, the trustees were to withhold any part of such property; with directions for disposition, in such event, of what was withheld. The decedent appointed in favor of her husband.

The Commissioner ruled that the value of the appointed property should be included in the gross estate and determined a tax deficiency. The Board of Tax Appeals approved his action.[2] The circuit court of appeals affirmed the Board's decision.[3]

Under the law of Wisconsin, the decedent could have appointed anyone to receive the trust property, including her estate and her creditors, the petitioner urges that, by statute and decision, Wisconsin has defined as special a power such as she held.[4] The respondent urges that this is not a correct interpretation of the State law. We find it unnecessary to resolve the issue, since we hold that the powers are general within the intent of the Revenue Act, notwithstanding they may be classified as special by the law of Wisconsin.

State law creates legal interests and rights. The Federal Revenue Acts designate what interests or rights, so created, shall be taxed. Our duty is to ascertain the meaning of the words used to specify the thing taxed. If it is found in a given case that an interest or right created by local law was the object intended to be taxed, the Federal law must prevail no matter what name is given to the interest or right by State law.[5]

None of the Revenue Acts has defined the phrase "general power of appointment." The distinction usually made between a general and a special power lies in the circumstance that, under the former, the donee may appoint to anyone, including his own estate or his creditors, thus having as full dominion over the property as if he owned it; whereas, under the latter, the donee may appoint only amongst a restricted or designated class of persons other than himself.[6]

We should expect, therefore, that Congress had this distinction in mind when it used the adjective "general." The legislative history indicates that this is so.[7] The Treasury regulations have provided that a power is within the purview of the statute, if the donee may appoint to any person.[8]

With these regulations outstanding Congress has several times reenacted section 302(f), and has thus adopted the administrative construction. That construction is in accord with the opinion of several Federal courts.[9]

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[2] 36 B. T. A., 588.

[3] 103 F. (2d), 636.

[4] Section 232 05: *General power.*—A power is general when it authorizes the alienation in fee, by means of a conveyance, will, or charge of the lands embraced in the power, to any alienee whatever.

232.06 *Special power.*—A power is special: (1) When the person or class of persons to whom the disposition of the lands under the power to be made are designated. (2) When the power authorizes the alienation by means of a conveyance, will, or charge of a particular estate or interest less than a fee.

See *Will of Zweifel* (194 Wis., 428; 216 N. W., 840); *Cawker* v. *Dreutzer* (197 Wis., 98; 221 N. W., 401).

[5] *Burnet* v. *Harmel* (287 U. S., 103, 110 [Ct. D. 611, C. B. XI–2, 210 (1932)]); *Bankers Coal Co.* v. *Burnet* (287 U. S., 308, 310); *Palmer* v. *Bender* (287 U. S., 551, 555 [Ct. D. 641, C. B. XII–1, 235 (1933)]); *Thomas* v. *Perkins* (301 U. S., 655, 659 [Ct. D. 1237, C. B. 1937–1, 162]); *Heiner* v. *Mellon* (304 U. S., 271, 279 [Ct. D. 1345, C. B. 1938–1, 349]); *Lyeth* v. *Hoey* (305 U. S., 188, 193).

[6] Sugden on Powers (8th Ed.), page 394; Farwell on Powers (2d Ed.), page 7.

[7] House Rept. No. 767, Sixty-fifth Congress, second session, pages 21–22.

[8] Regulations 63 (1922 Ed.), article 25; Regulations 68 (1924 Ed.), article 24; Regulations 70 (1926 and 1929 Eds.), article 24; Regulations 80 (1934 Ed.), article 24.

[9] *Fidelity-Philadelphia Trust Co.* v. *McCaughn* (34 F. (2d), 600); *Stratton* v. *United States* (50 F. (2d), 48); *Old Colony Trust Co.* v. *Commissioner* (73 F. (2d), 970); *Johnstone* v. *Commissioner* (76 F. (2d), 55).

The petitioner claims, however, that the decision below is in conflict with two by other circuit courts of appeal.[10] The contention is based on certain phrases found in the opinions. We think it clear that, in both cases, the courts examined the local law to ascertain whether a power would be construed by the State court to permit the appointment of the donee, his estate or his creditors, and on the basis of the answer to that question determined whether the power was general within the intent of the Federal Act.

As the decedent in this case could have appointed to her estate, or to her creditors, we hold that she had a general power within the meaning of section 302(f). This conclusion is not inconsistent with authorities on which the petitioner relies,[11] holding that, in the application of a Federal Revenue Act, State law controls in determining the nature of the legal interest which the taxpayer had in the property or income sought to be reached by the statute.

The petitioner's second position is that, inasmuch as the trustees had an unfettered discretion to withhold principal or income from any beneficiary, they could exercise their discretion as respects any appointee of the decedent. This fact, they say, renders the power a special one. Assuming that the trustees could withhold the appointed property from an appointee, we think the power must still be held general. The quantum or character of the interest appointed, or the conditions imposed by the terms of the trust upon its enjoyment, do not render the powers in question special within the purport of section 302(f). The important consideration is the breadth of the control the decedent could exercise over the property, whatever the nature or extent of the appointee's interest.

The judgment is affirmed.

SECTION 303(a), AS AMENDED BY SECTION 807 OF THE REVENUE ACT OF 1932, AND SECTIONS 403(a) AND 406 OF THE REVENUE ACT OF 1934.

Regulations 80 (1937), Article 44: Transfers for public, charitable, religious, etc., uses. (Also Section 303(b)3, as amended, and Article 54.) 1940-22-10272 E. T. 17

The value of property bequeathed to a religious, charitable, scientific, literary, or educational organization which the legatee organization assigns or surrenders to the decedent's heirs pursuant to a compromise agreement approved by the court is not deductible under section 303(a)3 of the Revenue Act of 1926, as amended, in determining the value of the net estate of the decedent.

Advice is requested whether the value of property bequeathed to a religious, charitable, scientific, literary, or educational organization is deductible under section 303(a)3 of the Revenue Act of 1926, as amended, in determining the value of the net estate of a decedent, where the legatee organization assigns or surrenders a part of such property pursuant to a compromise agreement settling a controversy with the decedent's heirs, the agreement being approved by the court.

In the present case the decedent, after providing for annuities to his daughters, bequeathed the residue of his estate to a religious organization. The daughters contested the will and a compromise agreement, approved by the court, was entered into whereby the religious organization received a lesser amount than provided by the will.

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[10] *Whitlock-Rose* v. *McCaughn* (21 F. (2d), 164); *Leser* v. *Burnet* (46 F. (2d), 756).

[11] *Poe* v. *Seaborn* (282 U. S., 101 [Ct. D. 259, C. B. IX-2, 202 (1930)]); *Freuler* v. *Helvering* (291 U. S., 35 [Ct. D. 782, C. B. XIII-1, 242 (1934)]); *Blair* v. *Commissioner* (300 U. S., 5 [Ct. D. 1205, C. B. 1937-1, 175]); *Lang* v. *Commissioner* (304 U. S., 264 [Ct. D. 1342, C. B. 1938-1, 507]).

Section 303(a) of the Revenue Act of 1926, as amended by section 807 of the Revenue Act of 1932, and sections 403(a) and 406 of the Revenue Act of 1934, provides in part as follows:

* * * For the purpose of the tax the value of the net estate shall be determined—

(a) In the case of a citizen or resident of the United States, by deducting from the value of the gross estate—

* * * * * * *

(3) The amount of all bequests, legacies, devises, or transfers * * * to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes * * * no part of the net earnings of which inures to the benefit of any private stockholder or individual * * *.

The Supreme Court of the United States in *Lyeth* v. *Hoey* (305 U. S., 188; Ct. D. 1370, C. B. 1938-2, 208), in holding that the value of property received from the estate of a decedent by an heir in compromise of his claim as such heir is not taxable as income, but is within the statutory exemption allowed by section 22(b)3 of the Revenue Act of 1932, said in part as follows:

In exempting from the income tax the value of property acquired by "bequest, devise, or inheritance," Congress used comprehensive terms embracing all acquisitions in the devolution of a decedent's estate. * * * Thus, the acquisition by succession to a decedent's estate whether real or personal was embraced in the exemption. Further, by the "estate tax," Congress has imposed a tax upon the transfer of the entire net estate of every person dying after September 8, 1916, allowing such exemptions as it sees fit in arriving at the net estate. Congress has not indicated any intention to tax again the value of the property which legatees, devisees or heirs receive from the decedent's estate.

Where property is bequeathed to a religious, charitable, etc., organization and the legatee organization assigns or surrenders a part of the property pursuant to an agreement with the decedent's heirs settling a controversy affecting the amount of the bequest, the value of the property so assigned or surrendered in favor of the contesting heirs does not pass to the legatee organization under the decedent's will. Accordingly, the value of that part of the bequest which was so assigned or surrendered by the legatee organization is not deductible under section 303(a)3 of the Revenue Act of 1926, as amended, in determining the net estate of the decedent.

SECTION 303(a)3, AS AMENDED BY SECTION 807 OF THE REVENUE ACT OF 1932 AND SECTIONS 403 AND 406 OF THE REVENUE ACT OF 1934.

REGULATIONS 80(1937), ARTICLE 44: Tranfers for public, charitable, religious, etc., uses. 1940-17-10242 E. T. 16

Where insurance is receivable by beneficiaries other than the estate and some of the beneficiaries are public, charitable, religious, educational, etc., organizations, no part of the $40,000 specific exemption, provided for in section 302(g) of the Revenue Act of 1926, may be allocated to such organizations.

E. T. 2 (C. B. XII-2, 280 (1933)) revoked.

In E. T. 2 (C. B. XII-2, 280 (1933)) it was held (syllabus):

Where insurance is receivable by beneficiaries other than the estate and where some of the beneficiaries are charitable organizations, it is held that for the purpose of the charitable deduction to which the estate is entitled the

$40,000 statutory exemption should be prorated among the beneficiaries, and the amount of the insurance receivable by such organizations should be reduced by their proportionate shares in the exemption.

Section 302 of the Revenue Act of 1926, as amended by section 404 of the Revenue Act of 1934, provides in part as follows:

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside the United States— * * *

(g) To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life. * * *

The United States Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Pupin* (107 Fed. (2d), 745) held that where a decedent left life insurance in the amount of $101,122.20, of which $51,122.20 was payable to the decedent's daughter and $50,000 was payable to an exempt educational institution, the specific exemption of $40,000, provided for in section 302(g), supra, for insurance not payable to a decedent's estate, should be allocated to the insurance payable to the decedent's daughter, instead of being prorated between the daughter and the educational institution. The court further held that the $50,000 insurance paid to the educational institution constituted an allowable deduction under section 303(a)3 of the Revenue Act of 1926, as amended. The United States Circuit Court of Appeals for the Third Circuit in *McKelvy* v. *Commissioner* (82 Fed. (2d), 395) held to the same effect.

In view of the foregoing, E. T. 2 (C. B. XII-2, 280 (1933)) is revoked, and it is held that in such cases no part of the $40,000 specific exemption may be allocated to the public, charitable, religious, educational, etc., beneficiaries.

TITLE III.—GIFT TAX. (1932)

SECTION 505, AS AMENDED BY SECTION 517 OF THE REVENUE ACT OF 1934.—DEDUCTIONS.

REGULATIONS 79, ARTICLE 13: Charitable, etc., gifts. 1940–5–10159 E. T. 15

B created an irrevocable trust to which he transferred property upon the conditions (1) that the income therefrom be paid to B for life, and (2) that upon B's death the remainder interest in the trust fund be used by the trustees for the establishment and maintenance of the M Charitable Fund.

Held, the present worth of the remainder interest as of the time of the gift is deductible under section 505(a)2(B) of the Revenue Act of 1932, as amended.

Advice is requested whether a gift of a remainder interest made under the circumstances hereinafter stated comes within the scope of the deduction allowed for gift tax purposes by section 505(a)2(B) of the Revenue Act of 1932, as amended.

In 1937, B, a citizen of the United States, created an irrevocable trust to which he transferred $5x$ dollars upon the conditions (1) that the income therefrom be paid to him for life, and (2) that upon his death the remainder interest in the fund be used by the trustees to—

* * * formulate and carry out plans for the establishment of the M Charitable Fund. Said fund shall be conducted at all times as a nonprofit enterprise. For the purposes hereof, said trustees may organize a charitable corporation or association, provided such corporation or association be at all times a nonprofit enterprise. * * *

Section 505(a)2(B) of the Revenue Act of 1932, as amended, reads in part as follows:

In computing net gifts for any calendar year there shall be allowed as deductions:

(a) RESIDENTS.—In the case of a citizen or resident—

(2) *Charitable, etc., gifts.*—The amount of all gifts made during such year to or for the use of—

* * * * * * *

(B) a corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational 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 * * *.

Article 13 of Regulations 79 (1936 edition), which relates to the deduction for charitable, etc., gifts in determining the amount of net gifts for gift tax purposes, provides in part as follows:

If money or other property is so given that the income is, for the duration of a life or a term of years, to be paid to the donor or other individual, or is to be used for a purpose not described in section 505 (a)(2) or (b), and the property is then to be devoted exclusively to some one or more of the uses described in section 505 (a)(2) or (b), only the present worth of the remainder is deductible. To determine the present worth or value of such remainder (that is, its value as of the date of the gift), the amount of the money or the value of the property transferred should be multiplied by the appropriate factor in column 3 of Table A or B, a part of article 19.

The gift of the remainder interest in the trust fund created by B is unquestionably a "charitable gift." The question arises, however, whether the gift is within the deduction allowed by section

505(a)2(B) of the Revenue Act of 1932, as amended, because it was not made to an *existing* organization formed and operated exclusively for charitable purposes, since (1) the trust will be operated in part for a noncharitable purpose, namely, the payment of the income to B for life, and (2) the charitable corporation will not be established until after the death of B.

Among other things, the statute under consideration imposes the condition that the donee of a deductible gift must be " organized and operated exclusively " for one or more of the purposes specified therein. The phraseology " organized and operated exclusively " is descriptive and limits the deduction to gifts to institutions coming within that description. It does not impose a further condition that the institution which is to receive the gift must be in existence and operating exclusively for the specified purpose at the time the gift is made.

Since the gift of the remainder interest in the present trust fund is restricted to a corporation or association which will be organized and operated exclusively for a charitable purpose, it is held that the gift is properly deductible under section 505(a)2(B) of the Revenue Act of 1932, as amended. In accordance with the above-quoted provisions of article 13 of Regulations 79, the amount of the deduction, however, is limited to the present worth of the remainder interest as of the time of the gift.

CAPITAL STOCK TAX.

REGULATIONS 64 (1936), ARTICLE 21: Definitions. ARTICLE 44: Original declared value. (Also Article 24, Regulations 64 (1933), and Articles 41 and 42, Regulations 64 (1934).) 1940–22–10274 T. D. 4971

CAPITAL STOCK TAX.

Article 24 of Regulations 64 (1933), articles 41(*d*) and 42(*a*) of Regulations 64 (1934), and articles 21(*l*) and 44(*a*) of Regulations 64 (1936), as amended, amended.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

In order to make them conform to the decision of the United States Supreme Court in the case of *Haggar Company* v. *Helvering* (308 U. S., 389 (January 2, 1940) [Ct. D. 1433, page 237, this Bulletin]), Regulations 64 (Capital Stock Tax), approved August 15, 1933, Regulations 64 (Capital Stock Tax), approved August 27, 1934, and Regulations 64 (Capital Stock Tax), approved May 6, 1936, as amended by Treasury Decision 4667, approved July 18, 1936 [C. B. XV–2, 312 (1936)], are amended as follows:

1. The last sentence of the first paragraph of article 24 of Regulations 64 (Capital Stock Tax), approved August 15, 1933, is amended to read as follows:

This value once having been declared may not be changed either by the corporation or by the Commissioner after the expiration of the statutory period (or any extension thereof) within which the return is required to be filed.

2. Article 41(*d*) of Regulations 64 (Capital Stock Tax), approved August 27, 1934, is amended to read as follows:

(*d*) *First return* means the capital stock tax return filed by a corporation for its first taxable year.

3. The second sentence of article 42(*a*) of Regulations 64 (Capital Stock Tax), approved August 27, 1934, is amended to read as follows:

Extreme care should be exercised by the corporation in making this original declared value, for the reason that when the value has been declared such value can not be changed, amended, or corrected, either by the corporation or by the Commissioner after the expiration of the statutory period (or any extension thereof) within which the return is required to be filed.

4. Article 21(*l*) of Regulations 64 (Capital Stock Tax), approved May 6, 1936, is amended to read as follows:

(*l*) The term "first return" means the capital stock tax return filed by a corporation for its first taxable year under section 105.

5. Article 44(*a*) of Regulations 64 (Capital Stock Tax), approved May 6, 1936, as amended by Treasury Decision 4667, approved July 18, 1936, is amended to read as follows:

(*a*) In its first return a corporation must declare a definite and unqualified value for its capital stock. Extreme care should be exercised in making this original declared value, for the reason that if a return has been filed disclosing a declared value, such value can not be changed, amended, or corrected, either by the corporation or by the Commissioner after the expiration of the statutory period (or any extension thereof) within which the return is required to be filed. The importance of the original declared value may be seen from the fact that such original declared value forms the basis for the computation of the tax on capital stock in years subsequent to the first taxable year, and constitutes a prime factor in determining the amount of tax imposed on excess profits under section 106 of the Revenue Act of 1935.

This Treasury decision is prescribed pursuant to section 215 of the National Industrial Recovery Act, section 701 of the Revenue Act of 1934, and section 105 of the Revenue Act of 1935.

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved May 17, 1940.
JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register May 20, 1940, 3.40 p. m.)

NATIONAL INDUSTRIAL RECOVERY ACT (1933).—SECTION 215(f).

REGULATIONS 64 (1933), ARTICLE 24: Adjusted declared value. 1940-3-10145 Ct. D. 1433

CAPITAL STOCK TAX—NATIONAL INDUSTRIAL RECOVERY ACT OF 1933—DECISION OF SUPREME COURT.

1. AMENDMENT OF RETURN—MEANING OF TERM "FIRST RETURN."

The term "first return," as used in section 215(f) of the National Industrial Recovery Act of 1933, means a capital stock tax return for the first year in which the taxpayer exercises the privilege of fixing its capital stock value for tax purposes, and includes a timely amended return for that year. The term is used to distinguish the return made for the first year from the return "for any subsequent year," and does not mean the first paper filed as a return.

2. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Fifth Circuit (1939) (104 F. (2d), 24), affirming decision of the United States Board of Tax Appeals (1938) (38 B. T. A., 141), reversed.

SUPREME COURT OF THE UNITED STATES.

Haggar Company, petitioner, v. Guy T. Helvering, Commissioner of Internal Revenue.

[308 U. S., 389.]

On writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[January 2, 1940.]

OPINION.

Mr. Justice STONE delivered the opinion of the Court.

Decision in this case turns on the question whether a capital stock tax return filed pursuant to section 215 of the National Industrial Recovery Act of 1933 (48 Stat., 195, 207) may be amended within the time fixed for filing the return.

Sections 215 and 216 of the National Industrial Recovery Act impose interrelated taxes on domestic corporations, namely an annual capital stock tax and an annual tax on profits in excess of 12½ per cent of the capital stock, calculated on the basis of the value of the capital stock as fixed by the corporation's return for the first year in which the tax is imposed.

Section 215(a) imposes on domestic corporations an annual tax with respect to carrying on or doing business for any part of the taxable year at the rate of "$1 for each $1,000 of the adjusted declared value of its capital stock." Section 215(f) provides that "For the first year ending June 30 in respect of which a tax is imposed by this section upon any corporation, the adjusted declared value shall be the value, as declared by the corporation in its first return under this section (which declaration of value can not be amended), as of the close of its last income-tax taxable year ending at or prior to the close of the year for which the tax is imposed by this section. * * * For any subsequent year ending June 30, the adjusted declared value in the case of a domestic corporation shall be the original declared value" as changed by certain prescribed capital adjustments occasioned by increases and decreases of capital occurring after "the date as of which the original declared value was declared." Section 216(a) imposes an annual tax upon so much of the net income of a corporation taxable under section 215(a) as is in excess of 12½ per cent of the "adjusted declared value of its capital stock * * * as of the close of the preceding income-tax taxable year (or as of the date of organization if it had no preceding income-tax taxable year) * * *."

It will be observed that by section 215 (a) and (f) the declared value of capital stock which is made the basis of computation of both taxes is not required to conform either to the actual or to the nominal capital of the tax-paying corporation; and that the declared value for the first taxable year, with the addition or subtraction of specified items of subsequent capital gains or losses is made the basis of the computation of both taxes in later years. The taxpayer is thus left free to declare any value of capital stock for its first taxable year which it may elect, but since the declared value for the first year is a controlling factor for the computation of taxes for later years, the statute provides that the declaration once made can not be amended. Because of the method of computation, increase or decrease in the declared value of capital, and of the corresponding tax, produces, as the case may be, a decrease or an increase in the tax on excess profits.

In August, 1933, petitioner, a Texas corporation, mistakenly believing that it was required to state the par value of its issued capital stock in its tax return, filed a timely return for the year ending June 30, 1933, declaring the value of its entire capital stock to be $120,000 and paid the tax of $120. The date for filing returns for that year having been extended to September 29, 1933 (Treasury Decisions 4368 [C. B. XII-1, 473 (1933)], 4386 [C. B. XII-2, 404 (1933)]), petitioner before that date filed an amended return, declaring the value of its capital stock to be $250,000. On March 15, 1934, petitioner filed its income and excess profits tax return for the calendar year 1933. The Commissioner, having refused to accept the amended capital stock return, gave notice of a deficiency in the excess profits tax calculated upon the basis of the capital stock value of $120,000 as declared in petitioner's original return.

The Board of Tax Appeals determined that petitioner's capital stock and excess profits tax should be computed on the basis of $120,000 capital stock value as originally stated instead of $250,000 stock value declared in its amended return, found a deficiency, and entered its order accordingly. (38 B. T. A., 141.) The Circuit Court of Appeals for the Fifth Circuit affirmed, holding that section 215(f) by its terms precluded any amendment of the tax return for the first year even though made within the time allowed for filing the return. (104 F. (2d), 24.) We granted certiorari October 9, 1939, to resolve a conflict of the decision below with that of the Court of Appeals for the Sixth Circuit in *Glenn* v. *Oertel Co.* (97 F. (2d), 495), and that of the Court of Claims in *Philadelphia Brewing Co.* v. *United States* (27 Fed. Supp., 583).

The Commissioner founds his argument in support of the decision below upon a literal reading of the introductory sentence of section 215(f) already quoted, which, he argues, precludes even a timely amendment of the tax return for the first year, and upon the administrative and congressional interpretation of the statute. He insists that the phrase "first return" in the clause "declared value shall be the value as declared by the corporation in its first return under this section (which declaration of value can not be amended)," means the first paper filed by the taxpayer as a return, and that these words plainly forbid any amendment of the declared value of the capital stock, even though made within the time allowed for filing the return.

In making these contentions the Commissioner concedes that the amount of the declared value of capital fixed for the first year is a matter of indifference to the Government since the statute leaves the taxpayer free to declare any amount which its fancy may choose and that for any reduction in capital stock tax effected by the declaration of a low value of the capital stock there is an accompanying increase in excess profits taxes. He concedes that if petitioner had filed but a single return on the date of filing the amended return, stating the value of the capital stock as $250,000 instead of $120,000, the Government would have been concluded by the taxpayer's declaration and that it has long been the practice of the Department, in the cases of other types of tax to accept an amended return, filed within the period allowed for filing returns, as the return of the taxpayer for the taxable year. He concedes also, as he logically must, that the argument leads to the conclusion that a mistake in the declaration of value whether of law or of fact, however serious and excusable, can not be corrected by a timely amendment of the return.

All statutes must be construed in the light of their purpose. A literal reading of them which would lead to absurd results is to be avoided when they can be given a reasonable application consistent with their words and with the legislative purpose. (*Hawaii* v. *Mankichi*, 190 U. S., 197; *United States* v. *Katz*, 271 U. S., 354; *Sorrells* v. *United States*, 287 U. S., 435, 446; *Burnet* v. *Guggenheim*, 288 U. S., 280, 285 [Ct. D. 636, C. B. XII-1, 374 (1933)]: *Armstrong Co.* v. *Nu-Enamel Corporation*, 305 U. S., 315, 332–333.) Here the purpose of the statute is unmistakable. It is to allow the taxpayer to fix for itself the amount of the taxable base for purposes of computation of the capital stock tax, but with the proviso that the amount thus fixed for the first taxable year shall be accepted, with only such changes as the statute prescribes for the purpose of computing the capital stock and excess profits taxes in later years. Congress thus avoided the necessity of prescribing a formula for arriving at the actual value of capital for the purpose of computing excess profits taxes, which had been found productive of much litigation under earlier taxing Acts (see Senate Report 52, Sixty-ninth Congress, first session, pages 11–12: cf. *Ray Consolidated Copper Co.* v. *United States*, 268 U. S., 373, 376 [T. D. 3721, C. B. IV-1, 333 (1925)]). At the same time it guarded against loss of revenue to the Government through understatements of capital, by providing for an increase in excess profits tax under section 216 ensuing from such understatements.

It is plain that none of these purposes would have been thwarted and no interest of the Government would have been harmed had the Commissioner, in conformity to established departmental practice, accepted the petitioner's amended declaration. It is equally plain that by its rejection petitioner has been denied an opportunity to make a declaration of capital stock value which it was the obvious purpose of the statute to give, and that denial is for no other reason than that the declaration appeared in an amended instead of an unamended return. We think that the words of the statute, fairly read in the light of the purpose, disclosed by its own terms, require no such harsh and incongruous result.

Section 215 nowhere mentions amendment of returns or amended returns. It speaks of "declared value" for the first tax year and provides that the "declaration of value" can not be amended. The "declaration of value" is that of the corporation in its "first return under this section." The "first return" as the context shows is the return for the first tax year of the taxpayer and the characterization of the return as "first" is obviously used to distinguish the return made for the first year from the return "for any subsequent year" in which the "adjusted declared value" is required by the same section to conform to a formula based on the "declared value" for the first year and which, for that reason, "can not be amended."

"First return" thus means a return for the first year in which the taxpayer exercises the privilege of fixing its capital stock value for tax purposes, and includes a timely amended return for that year. A timely amended return is as much a "first return" for the purpose of fixing the capital stock value in contradistinction to returns for subsequent years, as is a single return filed by the taxpayer for the first tax year. (*Glenn* v. *Oertel Co.*, supra; *Philadelphia Brewing Co.* v. *United States*, supra; see also, similarly construing the phrase "first return" under section 114(b)4 of the Revenue Act of 1934 (48 Stat., 680, 710), *C. H. Mead Coal Co.* v. *Commissioner*, 106 F. (2d), 388, 390; cf. *Pacific National Co.* v. *Welch*, 304 U. S., 191, 194 [Ct. D. 1337, C. B. 1938-1, 274].) Thus read the statute gives full effect to its obvious purposes and to the evident meaning of its words. To construe "first return" as meaning the first paper filed as a return, as distinguished from the paper containing a timely amendment, which, when filed is commonly known as the return for the year for which it is filed, is to defeat the purposes of the statute by dissociating the phrase from its context and from the legislative purpose in violation of the most elementary principles of statutory construction.

Article 24 of Treasury Regulations 64 (1933 ed.), under section 215(f) of the National Industrial Recovery Act, in force when the petitioner filed its amended return, did not call for any different construction from that which we have indicated is the correct one. The article made no mention of the "first return." It pointed out merely that the original declared value would be the basis of the tax for the first and later years, and stated "This value once having been declared may not subsequently be changed either by the corporation or by the Commissioner." This evidently refers to the parenthetical clause of section 215(f) "which declaration can not be amended" which phrase concededly does not preclude an effective declaration of value in a timely amended return.[1]

Sections 215 and 216 of the National Industrial Recovery Act were reenacted as sections 701 and 702 of the 1934 Revenue Act (48 Stat., 680, 769, 770). That Act, section 703, amended the National Industrial Recovery Act so as to provide that the capital stock tax and excess profits tax imposed by sections 215 and 216 of the Act last mentioned should not apply respectively to any taxpayer in any year except the years ending June 30, 1933, and June 30, 1934. The amended Regulations 64 (1934 ed.), relating to sections 701 and 702 of the Revenue Act of 1934, are prefaced with the statement "It must constantly be borne in mind that these regulations relate only to the tax imposed by section 701 of the Revenue Act of 1934. With respect to the tax imposed by section 215 of the National Industrial Recovery Act consult Regulations 64, edition of 1933." This warning was repeated in Regulations 64, 1936 edition, under the corresponding sections 105 and 106 of the 1935 Revenue Act (49 Stat., 1014, 1017–1019).

Since the regulations under the Revenue Acts for 1934 and 1935 are thus made inapplicable to the taxpayer's stock return under the National Industrial Recovery Act for the year ending June 30, 1933, they are without force for present purposes except as they are persuasive commentaries on the meaning of the language of section 215(f) of the National Industrial Recovery Act which was carried forward into later Revenue Acts. Article 41(d) of Treasury Regulations 64, published under the 1934 Act, declared that "First return means the first capital stock tax return filed by a corporation for its first taxable year," a definition which was continued in article 44 of Regulations 64 (1936 ed.), under the corresponding section 105 of the Revenue Act of 1935. Article 44 of the latter regulations for the first time informed taxpayers that an effective declaration of value for the first tax year could not be made in a timely amended return, saying, "A subsequent return declaring a different value, even though filed before the expiration of the prescribed period, is therefore not acceptable under the statute."

On the argument the Commissioner admitted that this ruling served no administrative or governmental convenience or purpose apart from compliance with the supposed command of the statute. There is thus a complete absence of those reasons which ordinarily lead courts to give persuasive force to an administrative construction and which justify their acceptance of it in preference to their own. The regulations have not been consistent in their interpretation of the statute and do not embody the results of any specialized departmental knowledge or experience. (Cf. *Brewster* v. *Gage*, 280 U. S., 327, 336 [Ct. D. 148, C. B. IX–1, 274 (1930)]; *Sanford* v. *Commissioner of Internal Revenue*, No. 34, October term, 1939, decided November 6, 1939 [Ct. D. 1426, C. B. 1939–2, 340].) No one, not even the Government, will be prejudiced by its rejection, and as we have said the construction flies in the face of the purposes of the statute and the plain meaning of its words. Judicial obeisance to administrative action can not be pressed so far.

It is said that Congress, by the change of the language of the capital stock provisions adopted in the 1938 Revenue Act has attributed to the earlier statute the same meaning as that ascribed to it by the administrative construction. It is familiar doctrine that Congress, by reenacting a section of the Revenue Act without change, approves and adopts a consistent administrative construction of

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[1] The Government concedes in its brief that the parenthetical clause "which declaration can not be amended" continued in the capital stock tax section, section 601, of the 1938 Revenue Act (52 Stat., 447, 565), does not preclude an effective declaration of value in a timely amended return for the first tax year. If the phrase "first return" in section 215(f) had that effect, then the parenthetical phrase concededly prohibiting amendments in tax returns of later years would have been superfluous.

it. But here the argument is that by amendment of the statute, which would preclude such a construction in the future, Congress has also declared that the departmental construction was that intended by the earlier Congress which enacted the statute.

Section 601 of the 1938 Act (52 Stat., 447, 565), in addition to other changes in the capital stock and excess profits tax provisions, prescribed that the "adjusted declared value" should be determined with respect to 3-year periods, beginning with the year ending June 30, 1938, and denominated the first year of each period a "declaration year." Section 601(f)2 provided that the declared capital stock value for purposes of the tax shall be the value as declared by the corporation "in its return for such declaration year (which declaration of value can not be amended)." Since, under the new legislation, the return for the declaration year for each 3-year period and not that for the first tax year of the taxpayer is controlling, there was no occasion for repeating the phrases "first year" and "first return" which had appeared in the earlier legislation and the new section dropped from the statute the words which had given rise to the earlier administrative construction. This was pointed out by the House committee report recommending the amendment,[2] stating that the change would serve to permit the taxpayer to amend its declaration by timely amendment of the return for the declaration year and adding, "denial of all opportunity for correction appears unduly restrictive."

It must be assumed that Congress was aware through its committees of the change in the regulations which in 1936 had construed the statute as precluding an effective declaration in a timely amended return, and of the litigation then pending in this case and in *Glenn* v. *Oertel*, supra, in which the departmental construction had been challenged as "unduly restrictive." In the face of the legislative expression of dissatisfaction with the earlier statute as construed, congressional purpose to declare that such was the intended meaning is not to be inferred merely from the fact that the amendment providing for the future said nothing as to the past. If we are to draw inferences it would seem as probable that Congress was content to leave the problems of the past to be solved by the courts where they were then pending, rather than to preclude their solution there. Action so ambiguous in its implications as to the past is wanting in that certainty and evident purpose which would justify its acceptance as a legislative declaration of what an earlier Congress had intended rather than an effort to make clear that which had been rendered dubious by unwarranted administrative construction. (Cf. *Jordan* v. *Roche*, 228 U. S., 436, 445; *Helvering* v. *New York Trust Co.*, 292 U. S., 455 [Ct. D. 840, C. B. XIII-1, 188 (1934)]; *Noble* v. *Oklahoma City*, 297 U. S., 481, 492.) Retroactive declarations of legislative intent. prejudicial to those who have acted under an earlier statute whose construction seems clear, it would seem, ought not to be implied more than the legislative intention to give retroactive operation to a new statute. (See *Hassett* v. *Welch*, 303 U. S., 303, 314 [Ct. D. 1317, C. B. 1938-1, 490] and cases cited; cf. *Noble* v. *Oklahoma City*, supra.)

Reversed.

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[2] "The new section also alleviates the rigid provision of section 105(f) of the 1935 Act that the valuation shall be as declared by the corporation in its 'first' return. Errors of calculation or other errors sometimes occur in first returns, and denial of all opportunity for correction appears unduly restrictive. Accordingly, the word 'first' as it appears the second time in section 105(f) of the 1935 Act, as amended, is eliminated from the corresponding language appearing in subsection (f)(2) of the new section. This will serve to give a corporation the right, so long as it acts within the time allowed for filing its return (including the last day of any extension period) for the year for which a declaration of value is required, to file subsequent returns for that year showing a different valuation, the valuation shown by the last timely return being binding." (H. Rept. 1860, Committee on Ways and Means, Seventy-fifth Congress, third session, page 62.)

TITLE V.—CAPITAL STOCK AND EXCESS-PROFITS TAXES. (1934)

SECTION 701.—CAPITAL STOCK TAX.

REGULATIONS 64 (1934), ARTICLE 53: Carrying on or doing business. 1940–24–10293 G. C. M. 22069
(Also Section 215(b) of the National Industrial Recovery Act and Article 31 of Regulations 64 (1933).)

A foreign banking corporation whose activities consist merely of purchasing and selling securities in the United States through its correspondent in the United States is not carrying on or doing business in the United States within the meaning of the capital stock tax provisions of Revenue Acts prior to the Revenue Act of 1936. G. C. M. 17517 (C. B. XV–2, 321 (1936)), revoked.

An opinion is requested whether G. C. M. 17517 (C. B. XV–2, 321 (1936)) is affected by the decision of the United States Circuit Court of Appeals for the Second Circuit in *Union Internationale de Placements* v. *Hoey* (96 F. (2d), 591).

In G. C. M. 17517, supra, it was held that the M Company, a foreign banking corporation, in purchasing and selling securities in the United States through its correspondent in the United States, was carrying on or doing business in the United States within the meaning of section 215(b) of the National Industrial Recovery Act and section 701(b) of the Revenue Act of 1934, and was subject to the capital stock tax imposed by those Acts.

The United States Circuit Court of Appeals for the Second Circuit in *Union Internationale de Placements* v. *Hoey*, supra, held that the purchase and sale of securities in the United States by a foreign banking corporation through its New York correspondents did not constitute doing business by such corporation in the United States and that the corporation was not subject to the capital stock tax imposed by section 215(b) of the National Industrial Recovery Act and section 701(b) of the Revenue Act of 1934.

Inasmuch as the facts presented in G. C. M. 17517, supra, are not in any material respect different from those involved in the Union Internationale de Placements case, it is the opinion of this office that the decision in that case is controlling. Accordingly, it is held that the M Company (involved in G. C. M. 17517, supra) was not carrying on or doing business in the United States within the meaning of section 215(b) of the National Industrial Recovery Act and section 701(b) of the Revenue Act of 1934, and was, therefore, not liable for capital stock tax. Accordingly, G. C. M. 17517, supra, is revoked.

With respect to such liability under later Revenue Acts, it was held in G. C. M. 17014 (C. B. XV–2, 317 (1936)) that:

Where a foreign corporation has a capital stock tax taxable year ending within an income tax taxable year controlled by the Revenue Act of 1936, and such corporation has no office or place of business within the United States, and its only activities consist of effecting transactions in the United States in stocks, securities, or commodities through a resident broker, commission agent, or custodian, such corporation is exempt from the capital stock tax imposed by section 105(b) of the Revenue Act of 1935, as amended.

Where a foreign corporation has a capital stock tax taxable year ending within an income tax taxable year controlled by the Revenue Act of 1934, as amended, the provisions of section 211(b) of the Revenue Act of 1936 can not be used as a test to determine whether the foreign corporation is carrying on or doing business within the United States.

G. C. M. 17014, supra, should not be construed as holding that a foreign corporation which has a capital stock tax taxable year ending within an income tax taxable year controlled by any Revenue Act prior to the Revenue Act of 1936 is subject to the capital stock tax where its activities consist merely of effecting transactions in the United States in stocks, securities, or commodities through a resident broker, commission agent, or custodian.

The rule laid down in G. C. M. 17014, supra, as to capital stock tax liability in such a case under section 105(b) of the Revenue Act of 1935, as amended, is equally applicable under the Revenue Act of 1938 and the Internal Revenue Code.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

CORPORATION EXCISE TAX.

(CAPITAL STOCK TAX.)

SECTION 38, REVENUE ACT OF 1909. 1940-10-10193
Ct. D. 1443

EXCISE TAX—REVENUE ACT OF 1909—DECISION OF COURT.

CAPITAL STOCK TAX—FOREIGN CORPORATION—"ENGAGED IN BUSINESS" IN UNITED STATES.

A foreign banking corporation which continuously engaged in business activities on a large scale in this country through bankers, and brokerage and investment houses in New York City although it had no office or place of business or general agent in this country upon whom process could be served, was "engaged in business" in the United States within the meaning of section 38 of the Revenue Act of 1909 and therefore subject to the excise tax imposed by that section on the privilege of carrying on or doing business in the United States.

COURT OF CLAIMS OF THE UNITED STATES.

Berliner Handels-Gesellschaft v. *The United States.*
[30 F. Supp., 490.]

[December 4, 1939.]

OPINION.

WHALEY, Chief Justice, delivered the opinion of the court.

Plaintiff brings this action to recover excise taxes levied on this foreign corporation by the Commissioner of Internal Revenue on the income of plaintiff derived from engaging in business in the United States during the years 1909, 1910, 1911, 1912, and the first two months of 1913, under section 38 of the Revenue Act of 1909, which reads as follows:

"That every corporation, joint-stock company or association, organized for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States or of any State or Territory of the United States or under the Acts of Congress applicable to Alaska or the District of Columbia, or now or hereafter organized under the laws of any foreign country and engaged in business in any State or Territory of the United States or in Alaska or in the District of Columbia, shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint-stock company or association, or insurance company equivalent to 1 per centum upon the entire net income over and above $5,000 received by it from all sources during such year, exclusive of amounts received by it as dividends upon stock of other corporations, joint-stock companies or associations, or insurance companies, subject to the tax hereby imposed; or if organized under the laws of any foreign country, upon the amount of net income over and above $5,000 received by it from business transacted and capital invested within the United States and its Territories, Alaska, and the District of Columbia during such year, exclusive of amounts so received by it as dividends upon stock of other corporations, joint-stock companies or associations, or insurance companies, subject to the tax hereby imposed." (36 Stat., 112.)

This section levies a capital stock tax on domestic and foreign corporations of "1 per centum upon the entire net income over and above $5,000 received by it from all sources during such year * * *" and in the case of plaintiff corporation upon the "amount of net income over and above $5,000 received by it from business transacted *and capital invested* within the United States * * *." [Italics ours.]

The real question presented is, under the facts of this case: Was the plaintiff "engaged in business" within the meaning of the foregoing statute and therefore subject to the excise tax for engaging in business in this country? The Commissioner of Internal Revenue found that plaintiff was subject to the tax and denied the claim for refund.

A capital stock tax is a tax upon the privilege of doing business in a corporate capacity and is based on income derived from operating as a corporation whereas an income tax is based on the receipt of income however derived. (*Flint* v. *Stone Tracy Co.*, 220 U. S., 107.)

The phrase "engaged in business" is a most comprehensive term and embraces everything which a corporation may be engaged in for profit. When a corporation is organized for the purpose of profit-making activities, and engages in such activities, it is subject to the capital stock tax. It is not denied that plaintiff engaged in numerous and sundry activities in the pursuit of profit and gain and if it were a domestic corporation there could be no question that it was subject to the tax.

Plaintiff did not engage in a single activity nor did it engage in sporadic activities, but, on the contrary, during the years in question its activities were continuous and involved large sums of money and numerous and sundry transactions, all of which were for the purpose of gain and profit. Plaintiff did not maintain an office or place of business in the United States, its Territories, or possessions, and did not have a general agent in this country. All of its purchases and sales or other disposition of securities, its collections, and deposits of interest and dividends, and the safekeeping of securities were handled by bankers, and brokerage and investment houses in New York City. No purchases, sales, or other disposition of such securities were made without special instructions from the bank in Berlin. Plaintiff maintained accounts in various stock brokerage houses in the city of New York, several of which did a private banking business. Plaintiff loaned moneys to these firms and at times borrowed from or through them, paying and receiving interest. It maintained purchasing accounts and gave its orders for purchases and sales of securities. It purchased stock on joint account with another firm and in these transactions contributed over $2,000,000. Plaintiff entered into a joint account with another firm for the purpose of dealing in New York City bonds. It acted jointly with others in a banking group, as readjustment and syndicate managers, in the union of two Mexican railway companies, participating in the profits, losses, and commissions. It participated in syndicates underwriting the issuance of new securities upon the invitation of banking and investment houses which formed these syndicates. Plaintiff advertised in this country for business, giving its home address in Berlin. It purchased and paid for, out of its own funds, a limited partnership for one of its officers in Hallgarten & Co., but the profits earned by Hallgarten & Co., to which this limited partner was entitled, were not paid to the limited partner, but all of these profits were paid directly to plaintiff.

A corporation can not enter into a partnership and therefore it was necessary to name one of its officers as a partner but, as a matter of fact, and what actually occurred was, plaintiff provided the funds with which this partnership was purchased and received all the profits earned by this partner who was an officer of plaintiff. In substance, plaintiff was the real partner but, in form, the officer of plaintiff was named as the partner. Hallgarten & Co. received and paid interest, loaned money, entered into joint accounts for dealing in New York City bonds, acted jointly with other banking groups as readjustment and syndicate managers in the union of two Mexican railway companies and participated in the profits, losses, and commissions, in the proportions agreed upon, and kept on deposit securities for plaintiff's account.

It is apparent from these many profit-making activities through Hallgarten & Co. and the varied nature of these transactions that this company, in which plaintiff's officer held a limited partnership, was the one through which plaintiff chiefly conducted its business.

Plaintiff's sole contention is that, having no place of business in the United States and no office or agent in this country, it is immaterial what amount of business it may do through several bankers, brokerage and investment houses or otherwise, and it is not "engaged in business" because there is no one in this country on whom process may issue. An examination of the statute shows that there is no difference made between a domestic and a foreign corporation which would give the latter a distinct advantage over the former because of the fact it did not maintain an office or agent or have a place of business in this country.

We feel that the intention of Congress in levying this tax was to require a corporation engaged in business to pay for the privilege, irrespective of the fact of whether or not it maintained a place of business or had an office or agent in this country. It comes down to a question of the amount of business done. A single activity would not constitute "engaging in business." (*Emery, Bird, Thayer Realty Co.*, 237 U. S., 28, 35.)

But we have no such case here. It is admitted that during the four years and two months in question plaintiff was continuously engaged in business activities of various sorts involving millions of dollars and numerous and frequent transactions with many firms and banks.

Plaintiff mainly relies on the case of *Union Internationale de Placements* v. *Hoey* (96 Fed. (2d), 591). The opinion was written by Circuit Judge Martin Manton and although the term "engaged in business" is most comprehensive for taxation purposes, nevertheless, he holds it is essential that a foreign corporation have a place of business or a branch office or an agent or representative in this country on whom process can be served, no matter how numerous and continuous its activities in seeking gain and profit and how large and multifarious its investments, to subject it to an excise tax levied on foreign corporations for the privilege of doing business. We do not feel that this is *sine-qua-nonical.* The activities of the plaintiff in the instant case differ so widely from those in the case decided by Judge Manton that there is no parallel.

It has been held that each case should stand on its own facts. In *Von Baumbach* v. *Sargent Land Co.* (242 U. S., 503, 516), in dealing with former cases, the Supreme Court said:

"* * * The fair test to be derived from a consideration of all of them is between a corporation which has reduced its activities to the owning and holding of property and the distribution of its avails and doing only the acts necessary to continue that status, and one which is still active and is maintaining its organization for the purpose of continued efforts in the pursuit of profit and gain and such activities as are essential to those purposes."

Plaintiff was not engaged solely in banking business, but its transactions were more extensive and varied. (*Bank of America* v. *Whitney Bank*, 261 U. S., 171.)

There is not before us the question of service of process in order to gain jurisdiction over plaintiff, but the right to collect the excise tax based on the privilege to corporations to engage in business for the purpose of gain or profit.

We feel that the facts clearly show that the continuous and active participation in numerous and frequent transactions and various business undertakings constituted being "engaged in business," as defined by the statute, and, therefore, the plaintiff can not recover and its petition is dismissed. It is so ordered.

WHITAKER, Judge; WILLIAMS, Judge; LITTLETON, Judge; and GREEN, Judge, concur.

MANUFACTURERS' EXCISE AND IMPORT TAXES.

INTERNAL REVENUE CODE.

SECTION 3443.—CREDITS AND REFUNDS.

REGULATIONS 46(1940), SECTION 316.94: Credits and refunds. 1940-19-10255 S. T. 900

Where an overpayment of manufacturers' excise taxes was made prior to October 1, 1935, no interest is allowable on the refund of such overpayment for any period prior to October 1, 1935, even though the refund was not allowed until after the enactment of the Internal Revenue Code.

Advice is requested whether interest on an overpayment of manufacturers' excise taxes made prior to October 1, 1935, should be computed under section 3443(c) of the Internal Revenue Code or under section 621(c) of the Revenue Act of 1932, as amended by section 401(c) of the Revenue Act of 1935, where the claim for refund of the overpayment was not allowed by the Commissioner until after February 10, 1939, the date on which the Internal Revenue Code was enacted.

The enacting provisions of the Internal Revenue Code provide in part as follows:

SEC. 4. REPEAL AND SAVINGS PROVISIONS.—(a) The Internal Revenue Title, as hereinafter set forth, is intended to include all general laws of the United States and parts of such laws, relating exclusively to internal revenue, in force on the 2d day of January 1939 (1) of a permanent nature and (2) of a temporary nature if embraced in said Internal Revenue Title. In furtherance of that purpose, all such laws and parts of laws codified herein, to the extent they relate exclusively to internal revenue, are repealed, effective, except as provided in section 5, on the day following the date of the enactment of this Act.

(b) Such repeal shall not affect any act done or *any right accruing or accrued*, or any suit or proceeding had or commenced in any civil cause before the said repeal, but all rights and liabilities under said acts *shall continue, and may be enforced in the same manner*, as if said repeal had not been made * * * [Italics supplied.]

* * * * * * *

SEC. 5. CONTINUANCE OF EXISTING LAW.—Any provision of law in force on the 2d day of January 1939 corresponding to a provision contained in the Internal Revenue Title shall remain in force until the corresponding provision under such Title takes effect.

Section 3443(c) of the Internal Revenue Code provides as follows:

(c) Interest shall be allowed at the rate of 6 per centum per annum with respect to any amount of tax under this chapter credited or refunded, except that no interest shall be allowed with respect to any amount of tax credited or refunded under the provisions of subsection (a) hereof.

(Subsection (a) is not involved in this case.)

Section 621(c) of the Revenue Act of 1932 was amended by section 401(c) of the Revenue Act of 1935 to read as follows:

(c) Interest shall be allowed at the rate of 6 per centum per annum with respect to any amount of tax under this title credited or refunded, * * * except that no interest shall be allowed for any period prior to the 1st day of the second month following the date of the enactment of the Revenue Act of 1935.

The Revenue Act of 1935 was enacted on August 30, 1935. Consequently, under section 621(c) of the Revenue Act of 1932, as amended, no interest is allowable for any period prior to October 1, 1935. It is contended, however, that the right to interest did not accrue until the date on which the claim for refund was allowed, which was after the enactment of the Code, and that interest should be paid under section 3443 of the Code on the amount refunded.

The taxpayer's right to recover the overpayment of tax in question is a substantive right which arose when the overpayment of tax was made. Such right arose prior to February 10, 1939, the date of enactment of the Internal Revenue Code, and was a "right accruing or accrued" within the meaning of section 4(b), supra. By virtue of that section, the taxpayer's right to obtain a refund of the overpayment of tax was to continue and be enforced, after the effective date of the Code, in the same manner as if section 621(c) of the Revenue Act of 1932, as amended, had not been repealed. Accordingly, the interest to be allowed on such a refund is to be determined by the provisions of section 621(c) of the Revenue Act of 1932, as amended, which for that purpose continues to be current law.

In view of the foregoing, it is held that no interest is allowable on the refund of such overpayment for any period prior to October 1, 1935.

TITLE IV.—MANUFACTURERS' EXCISE TAXES. (1932)

SECTION 606.—AUTOMOBILES, ETC.

REGULATIONS 46, ARTICLE 41: Definition of parts or accessories. 1940-8-10182 Ct. D. 1442

MANUFACTURERS' EXCISE TAX—REVENUE ACT OF 1932—DECISION OF COURT.

MANUFACTURER OR PRODUCER—AUTOMOBILE PARTS OR ACCESSORIES—USE OF DISCARDED CONNECTING RODS IN PRODUCTION OF RODS FOR SALE.

A taxpayer who obtains used automobile connecting rods which have been worn out and discarded, dismantles the same, salvages the usable parts thereof, and by a series of mechanical operations and processes combines and assembles such usable parts with new materials to produce connecting rods for sale, is a manufacturer or producer of automobile parts and is therefore subject to the tax imposed by section 606(c) of the Revenue Act of 1932.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Clawson & Bals, Inc., a Corporation, plaintiff-appellant, v. *Carter H. Harrison, Collector of Internal Revenue in and for the First District of Illinois, defendant-appellee.*

[108 F. (2d), 991.)

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division.

[December 13, 1939.]

OPINION.

TREANOR, Circuit Judge: This is an appeal from the judgment of the district court dismissing plaintiff-appellant's action for the refund of $54,232.02, assessed and paid by plaintiff, as manufacturer's excise taxes and interest.

The sole question presented is whether sales of automobile connecting rods by plaintiff were taxable under the statute which imposes a tax upon automoble parts "sold by the manufacturer, producer or importer" thereof.[1]

(NOTE.—Subsections (a) and (b) refer to automobiles, automobile trucks, and motorcycles.)

The taxpayer is a corporation authorized under the laws of Illinois "to manufacture, buy, sell, export and import, deal in and deal with all kinds of automobiles and automobile accessories, and all other articles incident to automobiles * * *." It prepares connecting rods from steel forgings, for sale in the trade, and concedes that it is a manufacturer or producer within the taxing statute, of these connecting rods. It also prepares rods from used connecting rods which have been discarded and replaced by new rods, but contends that in respect to these rods it is a repairer and not a manufacturer or producer.

The rods in question connect the piston head to the crank shaft, and serve to transmit the power generated in the cylinder to the crank shaft, being attached to the crank pin of the latter. There is a ring bearing made of a babbitt metal, known as the crank shaft bearing, in the large end of the connecting rod, such bearing being included partly within the cap and partly within the shank of the rod. The cap and shank are held together by bolts

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[1] Revenue Act of 1932 (ch. 209, 47 Stat., 169):

SEC. 606. TAX ON AUTOMOBILES, ETC.

There is hereby imposed upon the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold:

* * * * * * *

(c) Parts or accessories (other than tires and inner tubes) for any of the articles enumerated in subsection (a) or (b), 2 per centum. * * *

and nuts. The smaller end of the rod is known as the wrist-pin end; and approximately half of the rods prepared by plaintiff during the taxable period had bronze bushings in the wrist-pin end. These bushings are ring bearings, and for the rods which have them they are "just as important and just as necessary as the babbitt bearing" at the larger, or crank shaft, end of the rod.

The taxpayer obtains its supply of used rods chiefly from jobbers or from persons known in the trade as "junkies." When plaintiff receives the second-hand rods they are unusable as connecting rods because the babbitt bearings and bronze bushings are worn; and in many of the discarded rods old shims between the cap and shank must be replaced and the rods realigned. The first operation is to separate the cap and shank by the removal of two bolts and nuts. Usable bolts and nuts are not replaced in the caps and shanks from which they are removed but are thrown into the general mass of nuts and bolts, new and old. The shank and cap are separately placed in a melting pot where all of the old babbitt metal bearing is removed.

This ends the dismantling process by which the original used rod is reduced, in form, to two pieces of steel which must be subjected to various operations, including machine work, in the process of being prepared for sale as connecting rods. According to taxpayer's witness the processes and operations consist of grinding operations, machining operations and assembling and combining of new with old materials, a combining of all materials, and the utilization of workmanship and skill.

When the taxpayer buys new forgings from which to prepare connecting rods a forging may consist of a single unit or of two units, one unit forming a cap and the other the shank. If the forging is in the form of a single unit, a portion of one end is sawed off to form the cap. Each new forging is designed for a connecting rod for the motor of a particular make and model of automobile and carries an identification mark and number. In the case of a new forging the necessary machine work required to convert it into a connecting rod includes boring out the big end and the small end, drilling the necessary bolt holes, performing of necessary milling work, cutting off the cap if the forging is in one piece, and drilling oil relief holes.

Taxpayer's witness testified that when the forging arrives at the babbitting stage it undergoes substantially the same process and operations as the used rods. These operations are performed by the same men and by the same machines.

The first step in assembling the parts of the connecting rod consists of fastening the cap and arm together; but before this is done some of the babbitting operations are performed. A flux is applied to the inner surfaces of the semicircular openings of the cap and shank to prepare the steel metal for a coating of tin, which in turn acts as a bond for the babbitt metal and the steel cap and shank. This is described by a witness as a bonding operation. A coating of flux is necessary to cause the tin to adhere to the steel and, in the words of the witness, "that acts as a bond and makes the babbitt metal stick so it becomes a part of the steel."

Following the application of the flux the arm and cap are separately dipped into a pot containing the molten tin; then the cap and arm are put into a machine with the proper size of mold and the molten babbitt metal is poured into the bearing openings. The cap and arm are then subjected to a lathing, or abraising operation for the purpose of removing the babbitt metal which protrudes from the respective portions of the bearing ring in the cap and arm. This latter operation leaves an even surface and the cap and arm are assembled and fastened together with the bolts and nuts, the bearing portions of the cap and arm which are thus brought together forming a perfect circle. An opening is then drilled through the babbitt metal, the opening being approximately 10/1000 of an inch smaller than the finished diameter of the bore, which is attained by a broaching operation. Oil grooves and channels are cut on the inside of the babbitt bearing for oiling purposes and oil holes are drilled through the babbitt to connect with oil holes in the steel cap or shank. The assembled rod if composed of parts of an old rod, is then placed on a pressing machine where the old worn bushing is forced out and a new bushing forced in, the bushing operation being required for about 50 per cent of the connecting rods prepared from used rods. In the case of connecting rods for Fords the bushing is grooved on the inside, the grove completely severing the bushing bearing into two parts. Twenty-one different operations are required in the preparation of a usable Ford rod from a used connecting rod. The assembled rod is next checked for alignment and twist, a jig machine being used for this operation; and any defect in alignment or twist is corrected.

In the course of announcing its decision the district court made the following statement:

"The court is of the opinion that what the plaintiff did and what it is doing is the manufacturing and producing of connecting rods from scrap. It is true that the scrap may have slightly greater value than some other kinds of scrap, but it is still scrap, and when it is manufactured or produced by the plaintiff it has relatively much greater value than in its scrap condition.

"The situation here seems to be much like the situation in the worn-out tire case. Those worn-out tires look like tires. These worn-out connecting rods undoubtedly look like connecting rods, and one can recognize that they have been connecting rods, just as one can by looking at a worn-out tire recognize the fact that it has been a tire. But in each case, the articles are worn out. A manufacturing process is, in the opinion of the court, required to make a serviceable product; and in the case of the connecting rod, the plaintiff carries on that manufacturing process."

We believe that the foregoing aptly sums up the merits of the case.

Plaintiff questions the application of the term "scrap" to used rods and states that there is nothing in the evidence from which it can be determined what the court meant by the term "scrap." But as revealed by the foregoing excerpt from its memorandum the district court meant by "scrap" simply "worn-out connecting rods," automobile parts which as a result of use were unfit to perform the function for which they had been designed, and which could not perform their original function until they had been remade in respect to certain essential and most characteristic parts. The district court concluded that the operations involved in this process constituted manufacturing or producing within the meaning of the pertinent statutory provision.

Defendant-appellee cites and relies strongly upon a decision of the Supreme Court of Canada in *Biltrite Tire Co.* v. *The King.*[2] The analysis of the facts and the reasoning of the court as revealed in the opinion are strongly persuasive that on the facts of the instant case the taxpayer is a manufacturer or producer of connecting rods. The legislative enactment imposed an excise duty on "tires in whole or in part of rubber" which were "manufactured or produced in Canada and sold." The business practice of the Canadian taxpayer was to purchase in bulk lots old and worn-out motor vehicle tires and put them through a process of repair, treatment and retreading, for sale in the trade. Throughout the process the side wall of the tire was not dismantled or destroyed, the numerical identification of the original tire was not destroyed, and the name of the manufacturer of the original tire was clearly marked upon its side walls, upon which the taxpayer also marked a serial number. In the course of treatment of the old tire the tread was removed and a new tread affixed; holes were patched, cement and plastic rubber preparation utilized. The final result of the treatment was that repairs to holes and blow-outs, the cementing inside and without, and the new tread, were firmly and permanently affixed to the fabric and side walls of the original tire. The Canadian court sums up the whole process as follows:

"What the appellant did was to remove part of the old or worn-out tire and add to the remnant the plastic rubber preparation. It would appear that the position is the same as if the appellant had purchased an old or worn-out tire which had already been treated by the vendor in the manner described above, down to and including the cutting off of the old tread. If then the appellant had purchased from a third party the rubber preparation and had applied the latter and continued with the subsequent steps, could it be suggested that the article in its final condition had not been produced or manufactured by the appellant? The definitions of words 'manufacture' and 'produce' as nouns or verbs, in the standard dictionaries, clearly indicate that such proceedings would constitute the appellant a manufacturer or producer. And the mere fact that the appellant has itself performed the defined operations on the old tire can not exclude it from the operation of the section.

"* * * It is suggested that the old or worn-out tire did not lose its identity *qua* tire and that, therefore, the appellant could not be said to have manu-

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[2] 1937 Canada Law Rep., 364.

factured or produced a tire. However, when one bears in mind the various steps taken by appellant and particularly the state of the article when the tread was removed, it would appear that appellant can not be any less the manufacturer of a tire because it started with something that had once been a usable tire than if, as suggested in the preceding paragraph, it had commenced with two substances purchased from different sources."

As disclosed by the evidence in the instant case the taxpayer purchases the discarded connecting rods and by a dismantling or disassembling operation reduces them to substantially the same physical condition as that of the new forgings when the holes have been bored in them, preparatory to rebabbitting and bushing operations and to the combining of the cap and arm. At that stage the used connecting rod has been reduced in form to some of the parts of the original connecting rod; and in order to transform it into a connecting rod there must be an assembling of these parts with other materials which are just as essential as the parts salvaged from the old connecting rod; and it is only by an assembling and combining of the old and new parts and the addition of new materials by a series of mechanical operations that a connecting rod is produced. Furthermore, the mechanical operations and the processes of combining old with new material required to make a salable connecting rod out of the usable parts of an old connecting rod do not differ substantially from those required to produce a salable connecting rod from a fresh forging, and the taxpayer concedes that this process is manufacturing or producing within the Revenue Act.

There is obvious difficulty in treating the taxpayer as a repairer in view of the normal concept of the relation of a repairer to the repaired article. Ordinarily a repairer furnishes labor and material to the owner of some article for the purpose of restoring the article to its normal condition. The article remains the property of the one for whom the service is performed. If this taxpayer is a repairer it is a repairer of its own property, not for the purpose of restoring its own property for efficient use in the ordinary operations of the taxpayer's business, but for the purpose of preparing the property for sale in the trade. In the transactions between the taxpayer and its vendees the connecting rods, whether prepared from new forgings or from old connecting rods, are treated as newly and freshly produced automobile accessories. Neither taxpayer nor the trade recognizes that the finished connecting rods are repaired rods. Looked at from the standpoint of production and distribution in the trade the taxpayer is performing the function of a manufacturer rather than a repairer. The taxpayer is producing connecting rods for the trade in a very true sense and not repairing old connecting rods for owners or users. The fact that the taxpayer could perform for the owner of used connecting rods all of the mechanical operations which it does perform under the facts of this case, and still properly be classified as a repairer, does not require a holding that the taxpayer is a repairer when it purchases discarded rods to be used as materials for combination with other materials of the taxpayer, and by means of mechanical operations prepares what are, for all practical purposes, new connecting rods for sale in the trade.

We conclude that the district court did not err in holding that the taxpayer was a manufacturer or producer of the connecting rods and subject to the tax imposed by section 606 of the Revenue Act.

Judgment affirmed.

Regulations 46, Article 41: Definition of parts or accessories. (Also Section 602 and Article 19.)

1940-8-10183
S. T. 896

Persons who manufacture or produce automobile connecting rods from used or worn-out connecting rods and new material are manufacturers or producers within the meaning of section 606 of the Revenue Act of 1932, and are subject to tax under that section upon the sales of such connecting rods.

S. T. 606 (C. B. XI-2, 476, (1932)), S. T. 648 (C. B. XII-1, 384 (1933)), and S. T. 812 (C. B. XIV-1, 406 (1935)) modified.

The United States Circuit Court of Appeals for the Seventh Circuit on December 13, 1939, in *Clawson & Bals, Inc.*, v. *Harrison* (page 249, this Bulletin), held that the corporation was taxable as a manufacturer or producer under section 606 of the Revenue Act of 1932, with respect to sales of automobile connecting rods manufactured or produced by it from used automobile connecting rod forgings and new material.

The tests applied by the court in reaching the conclusion that the corporation was the manufacturer or producer of the connecting rods involved are not wholly in accord with the principles announced in S. T. 606 (C. B. XI-2, 476 (1932)), relating to rebuilt taximeters, and S. T. 648 (C. B. XII-1, 384 (1933)) and S. T. 812 (C. B. XIV-1, 406 (1935)), relating to retreaded and rebuilt tires. Accordingly, the foregoing rulings are modified to accord with the principles laid down by the court in the above-entitled case.

STAMP TAXES.

INTERNAL REVENUE CODE.

SECTION 1802, AS AMENDED BY SECTION 1 OF THE REVENUE ACT OF 1939.—CAPITAL STOCK (AND SIMILAR INTERESTS).

REGULATIONS 71 (1932), ARTICLE 28: Issues subject to tax. 1940–15–10231 S. T. 899

The entire issue of new stock to carry out the recapitalization of the M Corporation is subject to stamp tax under section 1802(a) of the Internal Revenue Code, as amended.

Advice is requested whether, under the circumstances hereinafter stated, the entire issue of new stock by the M Corporation is subject to the stamp tax imposed by section 1802(a) of the Internal Revenue Code, as amended by section 1 of the Revenue Act of 1939.

Section 1802(a) of the Internal Revenue Code, as amended, imposes a stamp tax on each original issue of "shares or certificates of stock, or of profits, or of interest in property or accumulations, by any corporation * * *."

Article 29(i) of Regulations 71, made applicable to the provisions of the Internal Revenue Code by Treasury Decision 4885 (C. B. 1939–1 (Part 1), 396), provides that "The issue by a corporation of certificates of stock in exchange for outstanding certificates of its own stock where such exchange is effected without the capital of the corporation being increased, either by transfer of surplus to capital account or otherwise," is not subject to stamp tax.

In the present case, the M Corporation, immediately prior to its recapitalization, had outstanding 500 shares of capital stock having a par value of $100 a share or a total par value of $50,000. In carrying out the recapitalization, the corporation issued 500 shares of new stock having a par value of $75 a share in exchange for the 500 shares of the $100 par value stock outstanding, and transferred $12,500 from the capital account to capital surplus by reason of the reduction in par value indicated; and the corporation also issued 500 shares of new stock having a par value of $75 which it sold at $100 a share, thereby resulting in an addition of $12,500 to the capital surplus account. The recapitalization effected an increase in the outstanding capital stock from $50,000 to $75,000 and a capital surplus of $25,000.

In this case it is clear that each stockholder received an interest in the new capital of the M Corporation measured by the number of shares held. Thus, each certificate of the new stock issued constituted a new certificate of interest in the newly adjusted capital structure of the corporation and, consequently, was of a kind never before issued. Under the circumstances, the entire issue of 1,000 shares of new stock by the M Corporation constitutes an original issue subject to the stamp tax imposed by section 1802(a) of the Internal Revenue Code, as amended.

SECTION 1804.—INSURANCE POLICIES.

REGULATIONS 71 (1932), ARTICLE 62: Definitions. 1940–10–10192
S. T. 898

An insurance policy issued by the M Company, a foreign corporation, covering some of the risks specified in section 1804 of the Internal Revenue Code, which is in force from the time the goods leave the warehouse in a foreign country and continues in force after the goods are unloaded from the vessel at the final port until the goods are delivered at the destination in the United States named in the policy, is subject to stamp tax.

Advice is requested whether the insurance policy hereinafter described is subject to the stamp tax imposed by section 1804 of the Internal Revenue Code, which provides for the imposition of a tax as follows:

On each policy of insurance, or certificate, binder, covering note, memorandum, cablegram, letter, or other instrument by whatever name called whereby insurance is made or renewed upon property within the United States (including rents and profits) against peril by sea or on inland waters or in transit on land (including transshipments and storage at termini or way points) or by fire, lightning, tornado, windstorm, bombardment, invasion, insurrection or riot, issued to or for or in the name of a domestic corporation or partnership or an individual resident of the United States by any foreign corporation or partnership or any individual not a resident of the United States, when such policy or other instrument is not signed or countersigned by an officer or agent of the insurer in a State, Territory, or District of the United States within which such insurer is authorized to do business, a tax of 3 cents on each dollar, or fractional part thereof of the premium charged * * *.

The policy was issued by the M Company, a foreign insurance company, with respect to a cargo shipped by a domestic corporation from a foreign port to a specified destination in the United States. The policy was not signed or countersigned by an officer or agent of the insurer in a State, Territory, or District of the United States within which such insurer is authorized to do business. Among other risks, it insures against insurrection, bombardment, and riot. One of the clauses of the policy provides in part as follows:

This insurance attaches from the time the goods leave the warehouse and/or store at the place named in the policy for the commencement of the transit and continues during the ordinary course of transit, including customary transshipment if any, until the goods are discharged overside from the overseas vessel at the final port. Thereafter the insurance continues whilst the goods are in transit and/or awaiting transit until delivered to final warehouse at the destination named in the policy * * *.

Since (1) the policy covers some of the risks enumerated in section 1804 of the Internal Revenue Code, namely, insurrection, bombardment, and riot, (2) the insurance continues in force until the delivery of the insured goods at the destination in the United States named in the policy so that the insurance is "made or renewed upon property within the United States," and (3) the policy is not signed or countersigned by an officer or agent of the insurer in a State, Territory, or District of the United States within which such insurer is authorized to do business (see section 1804 of the Code, supra), it is subject to the tax imposed under that section.

The decision of the United States Circuit Court of Appeals for the Second Circuit in *Amtorg Trading Corporation* v. *United States*

(103 Fed. (2d), 339) does not apply to the insurance here under consideration. The decision in that case is limited to insurance which does not extend beyond the time the vessel is within the 3-mile limit and is being unloaded. That condition is not present in the instant case.

SECTION 3482, AS AMENDED BY SECTION 1 OF THE REVENUE ACT OF 1939.—CONVEYANCES.

REGULATIONS 71, ARTICLE 94: Deeds to a State. 1940–9–10188
S. T. 897

A conveyance of realty to a local housing authority, which is an instrumentality of either a State or a political subdivision thereof, is not subject to stamp tax.

Advice is requested whether conveyances of realty to local housing authorities are subject to stamp tax under section 3482 of the Internal Revenue Code, as amended by section 1 of the Revenue Act of 1939.

Section 3482, as amended, imposes a stamp tax on any "Deed, instrument, or writing * * * whereby any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers * * * when the consideration or value of the interest or property conveyed, exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, exceeds $100 * * *."

Public housing authorities are public corporate bodies, separate and distinct from the State or political subdivisions thereof. They are created pursuant to State law and are authorized to acquire land by eminent domain, and to undertake and operate projects for the clearance of slums and the construction of dwelling accommodations for persons of low income.

Article 94 of Regulations 71 reads as follows:

Deeds to a State.—Deeds conveying to a State real estate purchased by it are not subject to tax.

Although article 94 refers to conveyances to a *State*, it is held that the scope of the article is not limited to a conveyance to the State itself but also includes conveyances to a corporate instrumentality of a State or a political subdivision thereof.

It is held that a conveyance of realty to a local housing authority, *which is an instrumentality of either a State or a political subdivision thereof*, is not subject to stamp tax under section 3482 of the Internal Revenue Code, as amended.

TITLE 18 OF THE UNITED STATES CODE.

SECTION 261 (CRIMINAL CODE, SECTION 147).—"OBLIGATION OR OTHER SECURITY OF THE UNITED STATES" DEFINED. ALSO SECTION 264 (CRIMINAL CODE, SECTION 150).

1940–7–10174
S. T. 895

Black and white reproductions of canceled United States internal revenue stamps may be made, held, and disposed of, provided that such reproductions are made, held, and disposed of as a part of and in connection with the making, holding, and disposition, for lawful purposes, of the reproductions of the documents to which such stamps are attached.

S. T. 882 (C. B. 1939–1 (Part 1), 362) modified.

In S. T. 882 (C. B. 1939-1 (Part 1), 362) it was held (syllabus):

The reproduction of canceled or uncanceled United States revenue stamps, in whole or in part, by photographic or photostatic process is prohibited by section 150 of the Criminal Code, and is not permissible under the provisions of the Act of January 27, 1938 (52 Stat., 6).

The Acting Secretary of the Treasury on January 15, 1940, authorized the reproduction of canceled United States internal revenue stamps under certain specified conditions. (Title 31, Chapter IV, Part 402, section 402.2, Code of Federal Regulations, published in the Federal Register on January 18, 1940, page 220.) Section 402.2 reads as follows:

SEC. 402.2. *Reproductions authorized.*—Authority is hereby given to make, hold and dispose of black and white reproductions of canceled United States internal revenue stamps, provided that such reproductions are made, held and disposed of as a part of and in connection with the making, holding, and disposition, for lawful purposes, of the reproductions of the documents to which such stamps are attached.

In view of the provisions of the authorization above quoted, black and white reproductions of canceled United States internal revenue stamps may be made, held, and disposed of, provided that such reproductions are made, held, and disposed of as a part of and in connection with the making, holding, and disposition, for lawful purposes, of the reproductions of the documents to which such stamps are attached.

S. T. 882, supra, is modified to the extent that it is inconsistent with the foregoing.

BITUMINOUS COAL ACT OF 1937.

SECTION 3.

Regulations 98, Article 42: Application of tax. (Also Article 22.) 1940–23–10283 Ct. D. 1457

EXCISE TAX—BITUMINOUS COAL ACT OF 1937—DECISION OF SUPREME COURT.

1. Liability to Tax—Non-Code Members.

Section 3(b) of the Bituminous Coal Act of 1937, imposing a tax of 19½ per cent on the sale or other disposal of bituminous coal, applies to producers who are not members of the Bituminous Coal Code but whose sales or other disposals would be subject to the application of the conditions and provisions of such code.

2. Constitutionality.

The Bituminous Coal Act of 1937, providing for the regulation of the sale and distribution of bituminous coal by the National Bituminous Coal Commission, its purpose being the stabilization of the industry and the elimination of unfair competition, is constitutional. Section 3 (a) and (b) of the Act, imposing excise taxes upon the sale or other disposition by the producer of bituminous coal, is not invalid because of the purpose and effect of the tax. The regulatory provisions of the Act are clearly within the power of Congress under the commerce clause of the Constitution, and Congress may single out for separate treatment a particular industry and thereby remove the penalties of the Sherman Act as respects it; the Act does not violate the fifth amendment; nor does it contain an invalid delegation of legislative power in fixing prices or of judicial power in delegating to an administrative agency the determination of the question whether a particular coal producer fell within the terms of the Act.

3. Authority of the National Bituminous Coal Commission to Determine Status of Coal—Res Judicata.

The National Bituminous Coal Commission has authority to determine the status of coal, and its determination that appellant's coal was "bituminous" as defined in section 17(b) of the Act, which determination was affirmed in a suit brought against the Commission, is *res judicata* in a subsequent suit against the collector to enjoin collection of the tax; the issues in the separate suits being the same and there being privity between the parties defendant, officers of the same government.

Supreme Court of the United States.

The Sunshine Anthracite Coal Co., appellant, v. Homer M. Adkins, as Collector of Internal Revenue for the District of Arkansas.

[60 S. Ct., 907.]

Appeal from the District Court of the United States for the Eastern District of Arkansas.

[May 20, 1940.]

OPINION.

Mr. Justice Douglas delivered the opinion of the Court.

The labor provisions of the Bituminous Coal Conservation Act of 1935 (49 Stat., 991) were held unconstitutional by this Court in *Carter* v. *Carter Coal Co.* (298 U. S., 238). The Bituminous Coal Act of 1937 (50 Stat., 72) was thereupon enacted. It eliminated those provisions of the earlier Act and made other substantive and structural changes.[1] The basic problem here involved is the constitutionality of the 1937 Act.

[1] H. Report No. 294, Seventy-fifth Congress, first session, pages 2–3.

That Act provides for the regulation of the sale and distribution of bituminous coal by the National Bituminous Coal Commission[2] with the cooperation of the bituminous coal industry. Its aim is the stabilization of the industry primarily through price-fixing and the elimination of unfair competition. It is provided in section 4 that the coal producers, accepting membership, shall be organized under the Bituminous Coal Code. Some 20 district boards of code members are provided for, which are to operate as an aid to the Commission but subject to its pervasive surveillance and authority. The statute specifies in detail the methods of their organization and operation, the scope of their functions, and the jurisdiction of the Commission over them. The Commission is empowered to fix minimum prices for code members in accordance with stated standards. Under section 4, II(a) each board shall "on its own motion or when directed by the Commission" propose minimum prices pursuant to prescribed statutory standards. These may be approved, disapproved, or modified by the Commission as the basis for the coordination of minimum prices. Somewhat comparable machinery is provided for such coordination of minimum prices "in common consuming market areas upon a fair competitive basis" (section 4, II(b)), and for establishment of rules and regulations incidental to the sale and distribution of coal by code members. (Section 4, II(a).) The Commission is also given power by section 4, II(c) to establish maximum prices for code members pursuant to standards prescribed therein. The sale, delivery, or offer for sale of coal below the minimum or above the maximum prices established by the Commission is made a violation of the code. (Section 4, II(e).) So are numerous practices, specified in section 4, II(i) as unfair methods of competition. And contracts for the sale of coal at prices below the prescribed minimum or above the maximum are invalid and unenforceable. (Section 4, II(e).) The Commission may, after hearing, revoke the code membership of any coal producer for willful violation of the code or of any regulation made thereunder. (Section 5(b).)

Section 3(a) imposes an excise tax of 1 cent per ton of 2,000 pounds upon the sale or other disposition by the producer of bituminous coal produced in the United States.[3] Section 3(b) imposes an additional 19½ per cent tax (based on sale price or in certain cases on fair market value) on sales of bituminous coal by producers "which would be subject to the application of the conditions and provisions of the code provided for in section 4, or of the provisions of section 4–A."[4] Producers who are members of the code are exempt from that tax. As we shall see, the interpretation of section 3(b) is a subject of controversy. But if, as the Government contends, the 19½ per cent tax is applicable to sales by nonmembers, there are strong inducements for joining the code.

Machinery is provided in section 4–A for obtaining exemptions. A producer who believes that any commerce in coal is not, or may not be made, subject to the provisions of section 4 may file an application for exemption with the Commission. Subject to qualifications not material here, the filing of such application "in good faith" exempts the applicant from any "obligation, duty or liability" imposed by section 4 pending action by the Commission on the application. The Commission shall grant the application or, after notice and opportunity for hearing, shall deny or otherwise dispose of it. An applicant aggrieved by such denial or other disposition may obtain a review of the order in the Court of Appeals for the District of Columbia or in the Court of Appeals in the circuit where he resides or has his principal place of business. (Section 6(b).) The findings of the Commission as to the facts, if supported by substantial evidence, are conclusive.

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[2] Though we refer throughout to the Commission, it should be noted that its functions have been administered since July 1, 1939, by the Bituminous Coal Division of the Department of the Interior. (Reorganization Plan No. II, section 4 (a) and (b), submitted by the President to the Congress May 9, 1939. Public Resolution No. 20, Seventy-sixth Congress, first session, chapter 193, approved June 7, 1939.)

[3] These provisions are now found in section 3520 of the Internal Revenue Code. (53 Stat., 430.) The 1 cent tax was apparently designed to cover the administrative costs of the Act. See H. Report No. 294, supra note 1, pages 2–3, recommending a one-half per cent tax which in conference was changed to 1 cent per ton. (H. Report No. 578, Seventy-fifth Congress, first session, page 5.)

[4] Section 4, as we have seen, governs the constitution and operation of the code. Section 4–A provides, *inter alia*, that the Commission shall subject coal in intrastate commerce to the provisions of section 4 if it finds after hearing that transactions in that coal "cause any undue or unreasonable advantage, preference, or prejudice as between persons and localities in such commerce on the one hand and interstate coal on the other hand, or any undue, unreasonable, or unjust discrimination against interstate commerce in coal, or in any manner directly affect interstate commerce in coal."

Appellant is lessee of coal lands in Arkansas and is engaged in the business of mining and shipping coal. It has not subscribed to or accepted the provisions of the Bituminous Coal Code provided for in section 4 of the Act. In August, 1937, it filed an application for exemption on the grounds that its coal was not bituminous coal as defined in section 17(b) of the Act.[5] The Commission held a public hearing on that application in October, 1937.[6] Appellant appeared, introduced evidence, and was heard on oral argument before the Commission.[7] In August, 1938, the Commission handed down an opinion with findings of fact and conclusions of law and entered an order denying appellant's application for exemption on the grounds that its coal was bituminous within the meaning of section 17(b). Appellant obtained a review of this order in the circuit court of appeals. That court held that the Commission had jurisdiction to determine the status of coal claimed to be exempt and that the Commission's decision was based on substantial evidence. It accordingly affirmed the order. (*Sunshine Anthracite Coal Co.* v. *National Bituminous Coal Commission*, 105 F. (2d), 559). We denied certiorari. (308 U. S., 604.)

In May, 1938, while the above proceeding was pending before the Commission, appellee demanded that appellant pay the taxes, penalties and interest accruing under section 3(b) of the Act for the period ending February, 1938; and filed a notice of tax lien against appellant's property. Thereupon appellant filed its complaint in this suit to enjoin the collection of the tax. A three-judge court was convened, which issued a temporary injunction. Apparently no further action was taken in this case until after the decision of the circuit court of appeals in *Sunshine Anthracite Coal Co.* v. *National Bituminous Coal Commission*, supra, when appellee filed a supplemental answer stating that the decision in that case was *res judicata* as to the status of appellant's coal under the Act and that the district court had no jurisdiction over that subject matter. The court below denied appellant's motion to strike that portion of the answer. (31 F. Supp., 125.) The case was tried. The court held the Act to be constitutional and dismissed the bill on the merits.[8] The case is here on appeal (50 Stat., 752; 28 U. S. C. A., section 380(a)).

I. Appellant argues that it is not subject to the 19½ per cent tax imposed by section 3(b) because that section does not apply to producers who are not members of the code. Its argument rests on the construction of section 3(b) and section 4. As we have seen, the former places the 19½ per cent tax on the sale or other disposition of coal "which would be subject to the application of the conditions and provisions of the code provided for in section 4, or of the provisions of section 4–A." Section 4 provides that the "provisions of such code shall apply only to such code members." Appellant therefore contends that the tax is not applicable to its coal, since the coal produced by a non-code producer such as appellant is not subject to the provisions of the code.

But if the 19½ per cent tax is not applicable to non-code members, it is not applicable to anyone since section 3(b) exempts code members from that tax. That construction would read the 19½ per cent tax out of the Act. The essential sanction of the Act would then disappear and its effectiveness would be seriously impaired. That alternative will not be taken where a construction is possible which will preserve the vitality of the Act and the utility of the langauge in question. (See *Armstrong Paint & Varnish Works* v. *Nu-Enamel Corporation*, 305 U. S., 315, 333, and cases cited.) Only a highly strained construction of section 3(b) would lead to the conclusion that non-code members are exempt from the 19½ per cent tax. It seems that Congress made a de-

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[5] Section 17(b) provides: "The term 'bituminous coal' includes all bituminous, semibituminous, and subbituminous coal and shall exclude lignite, which is defined as a lignitic coal having calorific value in British thermal units of less than 7,600 per pound and having a natural moisture content in place in the mine of 30 per centum or more."

[6] This hearing was not restricted to appellant's application. Other producers in the same field intervened.

[7] The liberal notice and opportunity to be heard afforded appellant are illustrated by the following: In January, 1938, the report of the examiner was served on appellant. In May, 1938, a proposed report of the Commission was issued giving appellant 30 days to file exceptions and briefs and in that event to apply for oral argument. Appellant filed exceptions and asked for oral argument. Notice of oral argument was issued and oral argument was had. Thereafter the Commission issued its order denying the application.

[8] It granted, however, a permanent injunction against collection of taxes prior to December 4, 1939, the date on which this Court denied a petition for rehearing on the petition for certiorari. (308 U. S. 638.) Appellee has not appealed from that part of the decree. The Court also granted a stay with respect to collection of taxes accruing after December 4, 1939, pending final disposition of this appeal.

liberate choice of words when it said that the tax applied to the sale or other disposition of coal which "would be" subject to section 4 and section 4–A. Section 4 is made expressly applicable "only to matters and transactions in or directly affecting interstate commerce in bituminous coal." Hence it seems plain that the tax was intended to apply only to those *sales* by non-code members which "would be" subject to *regulation* under section 4. Appellant's coal plainly falls in that class since practically its entire output is sold to purchasers outside the State of Arkansas. To sustain appellant's position we would not only have to substitute "is" for "would be"; we would have to override the express Congressional plan to make the 19½ per cent tax "in aid of the regulation of interstate commerce" in bituminous coal.[9] That would be not only to rewrite section 3(b) but to remake the whole statutory scheme. Obviously such a task is not for the courts.

II. Appellant challenges the constitutionality of the Act on the grounds that the 19½ per cent tax is not a tax but a penalty, that Congress lacks the power to fix minimum prices for bituminous coal sold in interstate commerce, that there has been an invalid delegation of legislative and judicial power, and that the division of bituminous coal into code and non-code classes is improper.

Clearly this tax is not designed merely for revenue purposes. In purpose and effect it is primarily a sanction to enforce the regulatory provisions of the Act. But that does not mean that the statute is invalid and the tax unenforceable. Congress may impose penalties in aid of the exercise of any of its enumerated powers. The power of taxation, granted to Congress by the Constitution, may be utilized as a sanction for the exercise of another power which is granted it. (*Head Money Cases*, 112 U. S., 580, 596. And see *Sonzinsky* v. *United States*, 300 U. S., 506 [Ct. D. 1217, C. B. 1937–1, 351].) It is so utilized here.

The regulatory provisions are clearly within the power of Congress under the commerce clause of the Constitution. These provisions are applicable only to sales or transactions in, or directly or intimately affecting, interstate commerce. The fixing of prices, the proscription of unfair trade practices, the establishment of marketing rules respecting such sales of bituminous coal constitute regulations within the competence of Congress under the commerce clause. As stated by Mr. Justice Cardozo in his dissent in *Carter* v. *Carter Coal Co.*, supra, page 326, "To regulate the price for such transactions is to regulate commerce itself, and not alone its antecedent conditions or its ultimate consequences." (See *Tagg Bros. & Moorhead* v. *United States*, 280 U. S., 420.) What is true of prices is true of the attachment of other conditions to the flow of a commodity in interstate channels. (*Mulford* v. *Smith*, 307 U. S., 38 and cases cited.) Since this power when it exists is complete in itself (*Gibbons* v. *Ogden*, 9 Wheat., 1, 196), there can be no question but that the provisions of this Act are an exertion of the paramount Federal power over interstate commerce. (See *United States* v. *Rock Royal Co-operative, Inc.*, 307 U. S., 533.)

Nor does the Act violate the fifth amendment. Price control is one of the means available to the States (*Nebbia* v. *New York*, 291 U. S., 502) and to the Congress (*United States* v. *Rock Royal Co-operative, Inc.*, supra) in their respective domains (*Baldwin* v. *G. A. F. Seelig, Inc.*, 294 U. S., 511) for the protection and promotion of the welfare of the economy. But appellant claims that this Act is not an appropriate exercise of the Congressional power. It urges that the nature and use of bituminous coal in nowise endanger the health and morals of the populace; that no question of conservation is involved; that the ills of the industry are attributable to overproduction; that the increase of prices will cause a further loss of markets and add to the afflictions which beset the industry; and that the consuming public will be deprived of the wholesome restriction of the anti-trust laws. Those matters, however, relate to questions of policy, to the wisdom of the legislation, and to the appropriateness of the remedy chosen—matters which are not our concern. If we endeavored to appraise them we would be trespassing on the legislative domain. And if we undertook to narrow the scope of Federal intervention in this field, as suggested by appellant, we would be blind to at least 30 years of history. For a generation there have been various manifestations of incessant demand

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[9] H. Report, No. 294, supra, note 1, states concerning this tax (page 4): "Under subsection (b) a tax of 19½ per cent is applied to coal which would be subject to the provisions in section 4 or the provisions of section 4A. Producers who are code members are exempt from this tax. This tax is intended to be in aid of the regulation of interstate commerce in coal provided for in sections 4 and 4A."

for Federal intervention in the coal industry.[10] The investigations preceding the 1935 and 1937 Acts are replete with an exposition of the conditions which have beset that industry.[11] Official[12] and private[13] records give eloquent testimony to the statement of Mr. Justice Cardozo in the *Carter case* (page 330) that free competition had been "degraded into anarchy" in the bituminous coal industry. Overproduction and savage, competitive warfare wasted the industry. Labor and capital alike were the victims. Financial distress among operators and acute poverty among miners prevailed even during periods of general prosperity. This history of the bituminous coal industry is written in blood as well as in ink.

It was the judgment of Congress that price fixing and the elimination of unfair competitive practices were appropriate methods for prevention of the financial ruin, low wages, poor working conditions, strikes, and disruption of the channels of trade which followed in the wake of the demoralized price structures in this industry. If the strategic character of this industry in our economy and the chaotic conditions which have prevailed in it do not justify legislation, it is difficult to imagine what would. To invalidate this Act we would have to deny the existence of power on the part of Congress under the commerce clause to deal directly and specifically with those forces which in its judgment should not be permitted to dislocate an important segment of our economy and to disrupt and burden interstate channels of trade. That step could not be taken without plain disregard of the Constitution. There are limits on the powers of the States to act as respects these interstate industries. (*Baldwin* v. *G. A. F. Seelig, Inc.*, supra.) If the industry acting on its own had endeavored to stabilize the markets through price-fixing agreements, it would have run afoul of the Sherman Act. (*United States* v. *Socony-Vacuum Oil Co., Inc.*, 309 U. S., —.) But that does not mean that there is a no man's land between the State and Federal domains. Certainly what Congress has forbidden by the Sherman Act it can modify. It may do so, by placing the machinery of price fixing in the hands of public agencies. It may single out for separate treatment, as it has done on various occasions,[14] a particular industry and thereby remove the penalties of the Sherman Act as respects it. Congress under the commerce clause is not impotent to deal with what it may consider to be dire consequences of laissez faire. It is not powerless to take steps in mitigation of what in its judgment are abuses of cutthroat competition. And it is not limited in its choice between unrestrained self-regulation on the one hand and rigid prohibitions on the other. The commerce clause empowers it to undertake stabilization of an interstate industry through a process of price fixing which safeguards the public interest by placing price control in the hands of its administrative representative. (*United States* v. *Rock Royal Co-operative, Inc.*, supra.) That was the choice which Congress made here. There is nothing in the Carter case which stands in the way. The majority of the Court in that case did not pass on the price-fixing features of the earlier Act. The Chief Justice and Mr. Justice Cardozo in separate minority opinions expressed the view that the price-fixing features of the earlier Act were constitutional. We rest on their conclusions for sustaining the present Act.

Nor does the Act contain an invalid delegation of legislative power. Under section 4, II(c) the Commission may fix maximum prices when in the public interest it deems it necessary in order to protect the consumer against unreasonably high prices. These maximum prices must be fixed at a uniform increase above minimum prices so that in the aggregate they will yield a reasonable return above the weighted average total cost of the district. And no maximum price shall be established for any mine which will not yield a fair return on the fair value of the property. The minimum prices to be fixed must conform to the following standards: the weighted average cost for each minimum price area must be computed, the elements of cost being defined;

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[10] National Resources Committee, Energy Resources and National Policy (1939), pages 11–123, 338–346, 405–423.

[11] Hearings on H. R. 8479, Seventy-fourth Congress, first session.

[12] National Resources Committee, Energy Resources and National Policy, supra, note 10; H. Report No. 1800, Seventy-fourth Congress, first session, covering the 1935 Act; S. Report No. 252, H Report No. 294, Seventy-fifth Congress, first session, covering the 1937 Act: *Appalachian Coals, Inc.*, v. *United States* (288 U. S., 344); Third Annual Report Under the Bituminous Coal Act of 1937 (1940), pages 4–5.

[13] Hamilton & Wright, The Case of Bituminous Coal (1926); Report of the Fifteenth Annual Meeting of the National Coal Association, October, 1934, pages 9–11, 96–97.

[14] See *United States* v. *Socony-Vacuum Oil Co., Inc.*, supra, page —.

a classification of the various sizes and grades of coal shall be made which reflects as nearly as possible the relative market value of the various kinds, qualities, and sizes of coal, which is just and equitable as between producers within the district and which has due regard to the interests of the consuming public; and coordinated minimum prices shall be established for such coal (*a*) which reflect as nearly as possible the relative market values at points of delivery taking into account specifically enumerated factors, (*b*) which preserve as nearly as may be existing fair competitive opportunities, (*c*) which are just and equitable as between the districts, and (*d*) which, consistently with the process of coordination, yield a return to each area approximating its weighted average cost per ton.

The problem of fixing reasonable prices for bituminous coal can not be differentiated legally from the task of fixing rates under the Interstate Commerce Act (41 Stat., 484, 49 U. S. C. A., section 15) and the Packers and Stockyards Act (42 Stat., 166, 7 U. S. C. A., section 211). The latter provide the standard of "just and reasonable" to guide the administrative body in the rate-making process. The validity of that standard (*Tagg Bros. & Moorhead* v. *United States*, supra), the appropriateness of the criterion of the "public interest" in various contexts (*New York Central Securities Corporation* v. *United States*, 287 U. S., 12, 24; *United States* v. *Chemical Foundation, Inc.*, 272 U. S., 1; *Avent* v. *United States*, 266 U. S., 127), the legality of the standard of "unreasonable obstruction" to navigation (*Union Bridge Co.* v. *United States*, 204 U. S., 364) all make it clear that there is a valid delegation of authority in this case. The standards which Congress has provided here far exceed in specificity others which have been sustained. Certainly in the hands of experts the criteria which Congress has supplied are wholly adequate for carrying out the general policy and purpose of the Act. To require more would be to insist on a degree of exactitude which not only lacks legal necessity but which does not comport with the requirements of the administrative process. Delegation by Congress has long been recognized as necessary in order that the exertion of legislative power does not become a futility. (*Currin* v. *Wallace*, 306 U. S., 1, 15, and cases cited.) But the effectiveness of both the legislative and administrative processes would become endangered if Congress were under the constitutional compulsion of filling in the details beyond the liberal prescription here. Then the burdens of minutiae would be apt to clog the administration of the law and deprive the agency of that flexibility and dispatch which are its salient virtues. For these reasons we hold that the standards with which Congress has supplied the Commission are plainly valid. (*United States* v. *Rock Royal Co-operative, Inc.*, supra.)

Nor has Congress delegated its legislative authority to the industry. The members of the code function subordinately to the Commission. It, not the code authorities, determines the prices. And it has authority and surveillance over the activities of these authorities. Since lawmaking is not entrusted to the industry, this statutory scheme is unquestionably valid. (*Currin* v. *Wallace*, supra, and cases cited.)

But appellant maintains that the delegation of authority to the Commission to determine what coal is subject to the Act is unlawful because of uncertainty in the statutory definition of bituminous coal. Section 17(b) defines the term "bituminous coal" as follows:

"The term 'bituminous coal' includes all bituminous, semibituminous, and subbituminous coal and shall exclude lignite, which is defined as a lignitic coal having calorific value in British thermal units of less than 7,600 per pound and having a natural moisture content in place in the mine of 30 per centum or more."

As in the case of the term "interurban" electric railway in the Railway labor Act (*Shields* v. *Utah Idaho Central Railroad Co.*, 305 U. S. 177) we think the definition of bituminous coal is wholly adequate as a standard for administrative action. The fact that it is not a chemist's or an engineer's definition is not fatal. The definition is not devoid of meaning. We are unable to say that it can not be applied so as to delineate the areas in which Congress intended to make this system of control effective. The fact that many instances may occur where its application may be difficult is merely to emphasize the nature of the administrative problem and the reason for the grant of latitude by the Congress. The difficulty or impossibility of drawing a statutory line is one of the reasons for supplying merely a statutory guide. (Cf. *Piedmont & Northern Railway Co.* v. *Interstate Commerce Commission*, 286 U. S., 299, 312.)

That guide is sufficiently precise for an intelligent determination of the ultimate questions of fact by experts.

Nor is there an invalid delegation of judicial power. To hold that there was would be to turn back the clock on at least a half century of administrative law. The question of whether or not appellant should be subjected to the regulatory provisions of the Bituminous Coal Act was one which the Congress could decide in the exercise of its powers under the commerce clause. In lieu of making that decision itself, it could bring to its aid the services of an administrative agency. And it could delegate to that agency the determination of the question of fact whether a particular coal producer fell within the Act. (*Shields* v. *Utah Idaho Central Railroad Co.*, supra, page 180.) The fact that such determination involved an interpretation of the term "bituminous coal" is of no more significance here than was the fact that in the Shields case a decision by the Interstate Commerce Commission of what constituted an "interurban" electric railway was necessary for the ultimate finding as to the applicability of the Railway Labor Act to carriers. That problem involves no more than the adequacy of the standard governing the exercise of the delegated authority. Furthermore, on this phase of the case, appellant has received all the judicial review to which it is entitled. As we have seen, it obtained a review under section 6(b) of the Commission's denial of its application for exemption. The functions of the courts cease when it is ascertained that the findings of the Commission meet the statutory test. (*Rochester Telephone Corporation* v. *United States*, 307 U. S., 125, 146.)

Appellant contends that the statutory classification of coal into code and non-code classes and the application of the 19½ per cent tax to the latter are improper under the fifth amendment. Its objection is not premised on lack of due process. Nor could it be in view of the elaborate machinery and procedure for the Act's enforcement which the Congress has provided. Rather appellant's objection is founded on its claim of discrimination. But the fifth amendment, unlike the fourteenth, has no equal protection clause. (*Steward Machine Co.* v. *Davis*, 301 U. S., 548, 584, and cases cited.) And there is "no requirement of uniformity in connection with the commerce power." (*Currin* v. *Wallace*, supra, page 14.) The lack of similarity in treatment of the two classes of coal is an integral and essential feature of this Act. As we have said, it is through that device that Congress sought to obtain an effective sanction for the Act's enforcement. Coercion is the very essence of any penalty exacted for failure of submission. "It is of the essence of the plenary power conferred" by the commerce clause "that Congress may exercise its discretion in the use of the power." (*Currin* v. *Wallace*, supra, page 14.) A part of that discretion is the selection of the sanction for the law's enforcement. Discrimination constitutionally may be the price of noncompliance. "Inquiry into the hidden motives which may move Congress to exercise a power constitutionally conferred upon it is beyond the competency of courts." (*Sonzinsky* v. *United States*, supra, pages 513–514. And see *Mulford* v. *Smith*, supra, page 48.)

III. Appellant contends here, as it did below, that *Sunshine Anthracite Coal Co.* v. *National Bituminous Coal Commission*, supra, is not determinative of the present issues since that case did not involve the assessment of taxes and since the Commission had no authority to determine the status of appellant's coal.

These contentions are untenable. In the first place, the Commissioner of Internal Revenue is merely the agency to collect taxes levied under the Act; he is not the administrative agent whom Congress has designated to determine what coal is exempt from the 19½ per cent tax. That function is intrusted to the Commission. By the terms of section 4–A it is the Commission which determines whether an application for exemption should be granted or denied. By the provisions of section 3(b) it is the Commission which certifies to the Commissioner those who are code members and consequently exempt from the 19½ per cent tax. Hence the Commission determines the scope of the provisions of the Act and their applicability to various producers. The Commissioner is given no administrative functions whatsoever except tax collection. In the second place, the underlying issue in each of these two suits is the same. In *Sunshine Anthracite Coal Co.* v. *National Bituminous Coal Commission*, supra, the question was whether or not appellant's coal was "bituminous" within the meaning of section 17(b). When that issue was decided adversely to appellant, liability for the 19½ per cent tax followed unless appellant joined the code, in which event it would be entitled to a certificate from the Commission evidencing its tax exemption. In the present suit, appellant is seeking to raise the identical issue, since its purpose is to enjoin collection of the self-same tax.

The result is clear. Where the issues in separate suits are the same, the fact that the parties are not precisely identical is not necessarily fatal. As stated in *Chicago, Rock Island & Pacific Railway Co.* v. *Schendel* (270 U. S., 611, 620), "Identity of parties is not a mere matter of form, but of substance. Parties nominally the same may be, in legal effect, different, * * * and parties nominally different may be, in legal effect, the same." A judgment is *res judicata* in a second action upon the same claim between the same parties or those in privity with them. (*Cromwell* v. *County of Sac*, 94 U. S., 351.) There is privity between officers of the same government so that a judgment in a suit between a party and a representative of the United States is *res judicata* in relitigation of the same issue between that party and another officer of the Government. (See *Tait* v. *Western Maryland Railway Co.*, 289 U. S., 620 [Ct. D. 683, C. B. XII-1, 351 (1933)].) The crucial point is whether or not in the earlier litigation the representative of the United States had authority to represent its interests in a final adjudication of the issue in controversy. (Cf. *Gunter* v. *Atlantic Coast Line Railroad Co.*, 200 U. S., 273, 284–289.) Cases holding that a judgment in a suit against a collector for unlawful exaction is not a bar to a subsequent suit by or against the Commissioner or the United States (*Sage* v. *United States*, 250 U. S., 33; *Bankers Pocahontas Coal Co.* v. *Burnet*, 287 U. S., 308) are not in point, since the suit against the collector is "personal and its incidents, such as the nature of the defenses open and the allowance of interest, are different." (*Sage* v. *United States*, supra, page 37.) But here the authority of the Commission is clear. There can be no question that it was authorized to make the determination of the status of appellant's coal under the Act. It represented the United States in that determination and the delegation of that power to the Commission was valid, as we have said. That suit therefore bound the United States, as well as the appellant. Where a suit binds the United States, it binds its subordinate officials. (*Tait* v. *Western Maryland Railway Co.*, supra.) The suggestion that the doctrine of *res judicata* does not apply unless the court rendering the judgment had jurisdiction of the cause is sufficiently answered by *Stoll* v. *Gottlieb* (305 U. S., 165) and *Treinies* v. *Sunshine Mining Co.* (308 U. S., 66). As held in those cases, in general the principles of *res judicata* apply to questions of jurisdiction as well as to other matters—whether it be jurisdiction of the subject matter or of the parties. Accordingly the lower court correctly held that it had no jurisdiction to determine whether appellant's coal was "bituminous" as defined in the Act. Furthermore where, as here, Congress has created a special administrative procedure for the determination of the status of persons or companies under a regulatory Act and has prescribed a procedure which meets all requirements of due process, that remedy is exclusive. (See *Anniston Manufacturing Co.* v. *Davis*, 301 U. S., 337 [Ct. D. 1234, C. B. 1937-1, 485].)

The decree below subjected appellant to payment of taxes accrued or assessed against it under section 3(b) after December 4, 1939. To relieve against payment of taxes until final termination of the litigation would be to put a premium on dilatory tactics in a situation where under the authority of *Currin* v. *Wallace*, *Mulford* v. *Smith*, and *United States* v. *Rock Royal Co-operative, Inc.*, supra, the subject of the Act was clearly one over which the jurisdiction of Congress was complete.

Affirmed.

Mr. Justice McReynolds is of opinion that the Act under review is beyond any power granted to Congress and that the judgment below should be reversed.

TITLE VII.—REFUNDS OF AMOUNTS COLLECTED UNDER THE AGRICULTURAL ADJUSTMENT ACT. (1936)

SECTION 902.—CONDITIONS ON ALLOWANCE OF REFUNDS.

REGULATIONS 96, ARTICLE 204: Conditions as to tax burden with respect to amounts of refund allowable. 1940–20–10258 Ct. D. 1455

PROCESSING TAX—AGRICULTURAL ADJUSTMENT ACT—REVENUE ACT OF 1936—DECISION OF COURT.

1. CLAIM FOR REFUND—TAX PAID BY VENDEE AS PART OF PURCHASE PRICE—CONDITIONS ON ALLOWANCE OF REFUNDS—CONSENT OF SOVEREIGN TO SUIT.

A vendee who, under the terms of contracts made with processor-vendors, purchased processed products at prices which included the amount of processing taxes paid by the vendors under the Agricultural Adjustment Act, is not entitled to recover from the United States an amount equivalent to the taxes. Nor is a vendee entitled to recover such equivalent amount, when it was added to the contract price, where the contract was entered into before the effective date of the tax and delivery of the processed article was made after such date and where such contract, by its terms, required the addition of an amount equal to the tax which was payable by the vendor to the United States. In either case, the amounts so paid by the vendee represented only increased amounts which it was required by contract, not by the taxing statute, to pay, and were to obtain goods from the processor and not to satisfy any obligation which it owed to the United States. Such vendee is not recognized by the refunding statute, and as to it the sovereign has not consented to suit.

2. CERTIORARI DENIED.

Petition for certiorari denied April 1, 1940.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Oswald Jaeger Baking Co., petitioner, v. *Commissioner of Internal Revenue, respondent.*

[108 F. (2d), 375.]

Petition for review of order of United States Processing Tax Board of Review.

Before EVANS, MAJOR, and KERNER, Circuit Judges.

[December 7, 1939.]

OPINION.

KERNER, Circuit Judge: In 1937 the Oswald Jaeger Baking Co. (petitioner) filed a refund claim for sums alleged to have been paid as processing taxes under the Agricultural Adjustment Act. (48 Stat., 31, 35, 40.) In 1938 the Commissioner of Internal Revenue rejected the claim on the ground that petitioner was not the taxpayer. Petitioner then sought review of the disallowance in the United States Processing Tax Board of Review, the Commissioner moved to dismiss the petition, and the Board granted the motion. (Title VII of the Revenue Act of 1936, sections 901–917; 49 Stat., 1747.) The case is now before us on petition to review the decision of the Board. (7 U. S. C., section 648.)

The facts, shown in the pleadings and exhibits attached thereto and admitted by the motion to dismiss, are as follows: Petitioner was not a processor, but its baking activities required many purchases of flour, corn and hog products, and sugar from various millers, packers and manufacturers (the processors). According to the purchase contracts the wheat, corn, hog and sugar beet taxes (the processing taxes) were included in the price paid for the processed products.

In other words, in this case the taxing statute made the processor liable for processing taxes. The processor paid the tax. He then passed the burden of the tax on to his vendee by contract. The vendee, however, did not shift the burden but instead absorbed it. On January 6, 1936, the Supreme Court declared the taxing statute invalid. (*United States* v. *Butler*, 297 U. S., 1 [Ct. D. 1070, C. B. XV-1, 421 (1936)].) Congress then provided for a refund "of any amount paid by or collected from any claimant as tax under the Agricultural Adjustment Act" if the claimant could show that he bore the burden of such amount. (Title VII, supra, section 902.)

On our record the processor can not recover the amounts paid as processing taxes, for he passed on the incidence thereof. So his vendee, bearer of the tax burden, seeks the refund in his place. As expressed in the words of counsel for petitioner, the theory of recovery advanced states that "the real party in interest is the petitioner. It bought the flour; it paid for the flour; it paid the processing tax on the wheat from which the flour was milled; and, it, and it alone, has suffered from the imposition of the processing taxes. * * * Regardless of whether the petitioner paid these taxes * * * through the instrumentality of the flour milling companies, * * * the fact is that the petitioner is * * * the only sufferer if it is denied the return of the taxes so paid by it."

The claim for refund involved processing taxes amounting to $103,333.92. These taxes pertained to a period of time between July 9, 1933 (the effective date of the taxing statute), and January 6, 1936 (the date the statute was invalidated). According to the purchase contracts between the various processors and petitioner, the vendee (petitioner) promised to put the processor in funds for the payment of the processing taxes in addition to the stated contract price, and so the vendee did.

Of the sum of $103,333.92, the amount of $81,359.49 was paid with respect to the purchase of processed products under contracts made and executed during the taxing period in question (hereafter these contracts are referred to as the "new contracts"). On the other hand, the amount of $21,974.43 was paid with respect to the purchase of flour under contracts made prior to July 9, 1933, but executed thereafter (hereafter these contracts are referred to as "old contracts").

The invoices relating to the new contracts provided for one quoted price, and this price included the contract price and the amount of the processing tax. The invoices relating to the old contracts showed that the vendee was billed separately for the amount of the tax. Under the terms of the contracts, old and new, the amount of the tax was added to the contract price, and petitioner paid a sum equivalent to the contract price and the tax amount.

In connection with the old contracts, it is necessary to study section 18 of the taxing statute. (7 U. S. C., section 618: 48 Stat., 41.) Section 18(a) provides that if an old contract "does not permit the addition" of the tax to the contract price, "the vendee shall pay so much of the tax as is not permitted to be added to the contract price." Section 18(b) provides that "taxes payable by the vendee shall be paid to the vendor," who shall pay the United States. With this exception, the taxing statute makes the processor liable for the tax, and expressly states that the processor shall pay the tax. (7 U. S. C., section 609.)

In this case the old contracts not only permitted the addition of the tax to the contract price; the old contracts required the addition of the tax thereto, and the amount of $21,974.43 was added and consequently paid as part of the purchase price. Therefore, section 18 supra was not operative, and hence the amount of $21 974.43 was not paid by the petitioner as "taxes payable by the vendee." The amount of $21,974.43 was paid by the petitioner, just as the amount of $81,359.49 was paid, as part of the cost of the processed goods purchased.

And so we come to the real question in this case. The taxing statute makes the processor liable for the processing taxes. The vendee of the processor bears the burden of the tax. The taxing statute is consequently declared invalid. Is the vendee entitled to the refund? Petitioner advances the contention, fully expressed earlier in this opinion, that he is entitled to recover the tax money according to what is just and good.

It is elementary that the sovereign may not be sued except upon its consent, and then only upon the conditions under which it has consented to be sued. The sovereign consented here, but prescribed certain conditions. (Title VII of the Revenue Act of 1936, section 902; 7 U. S. C., section 644.) The refund statute makes no provision for making a refund to particular persons to whom the burden of the invalid exaction may be found to have been shifted. (*F. & F. Laboratories, Inc.*, v. *Commissioner*, 104 F. (2d), 563 [Ct. D. 1418, C. B. 1939-2, 396]; *Anniston Mfg. Co.* v. *Davis*, 301 U. S., 337, 350 [Ct. D. 1234, C. B. 1937-1, 485].)

In the Laboratories case, wherein we discussed fully the refund statute in question, we held that the statute restricted refunds to persons who had been liable for and had paid directly to the United States amounts imposed as tax under the Agricultural Adjustment Act. The vendee of the processor in the instant case, that is, the petitioner, is not recognized by the refunding statute, and as to it the sovereign has not consented to suit.

The record in this case clearly shows that petitioner did not pay any amount to the United States as processing tax under the taxing statute. At most, the amounts paid by petitioner represented only increased amounts which it was required by contract, not by the taxing statute, to pay. Furthermore, the amounts were paid by petitioner to obtain goods from the processor, not to satisfy any obligation which it owed the United States.

We conclude, therefore, that petitioner's contentions lack merit, and consequently the decision of the United States Processing Tax Board of Review is affirmed.

Affirmed.

MISCELLANEOUS RULINGS.

ALCOHOL TAX.

1940-25-10299
T. D. 4974

Treasury Department Order No. 30.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, June 12, 1940.

SECTION 1. By virtue of and pursuant to the authority conferred upon me by sections 2 and 8 of Reorganization Plan No. III (House Document No. 681, Seventy-sixth Congress) prepared in accordance with the provisions of the Reorganization Act of 1939, and transmitted to the Congress by the President on April 2, 1940, by the joint resolution of June 4, 1940 (Public Resolution No. 75, Seventy-sixth Congress), by section 3170 of the Internal Revenue Code, and by section 161 of the Revised Statutes (U. S. C., Title 5, section 22), Subpart A of Part 171 (Miscellaneous Regulations Related to Liquor) of Title 26 of the Code of Federal Regulations is hereby amended by adding the following new sections at the end thereof to read as follows:

171.1a. *Basic Permit and Trade Practice Division created.*—There is hereby established in the Alcohol Tax Unit in the Bureau of Internal Revenue a division to be known as the Basic Permit and Trade Practice Division, at the head of which shall be an Assistant Deputy Commissioner who shall be appointed by the Secretary of the Treasury under the provisions of section 2(c) of the Federal Alcohol Administration Act (49 Stat., 977), and shall perform his duties under the immediate direction and supervision of the Deputy Commissioner of Internal Revenue in Charge of the Alcohol Tax Unit, and under the general direction and supervision of the Commissioner of Internal Revenue and the Secretary of the Treasury.

171.1b. *Transfer of Federal Alcohol Administration personnel and property.*—Except as provided in Treasury Department Order No. 31 of June 12, 1940 (uncodified),[1] relating to the transfer of certain legal personnel and property,

[1] Treasury Department Order No. 31.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, June 12, 1940.

By virtue of and pursuant to the authority conferred upon me by sections 2 and 8 of Reorganization Plan No. III (House Document No. 681, Seventy-sixth Congress) prepared in accordance with the provisions of the Reorganization Act of 1939, and transmitted to the Congress by the President on April 2, 1940, by the joint resolution of June 4, 1940 (Public Resolution No. 75, Seventy-sixth Congress), by section 3170 of the Internal Revenue Code, by section 3930 of the Internal Revenue Code, and by section 161 of the Revised Statutes (U. S. C., Title 5, section 22), the following order is issued:

SECTION 1. There are hereby transferred to the Legal Division of the Treasury Department all of the personnel, records, books, furniture, and supplies connected with the legal activities of the Federal Alcohol Administration. The transfer of personnel under this section shall be in accordance with the provisions of section 10(b) of the Reorganization Act of 1939 (53 Stat., 563), and shall be subject to the provisions of section 8 of Reorganthere are hereby transferred to the Basic Permit and Trade Practice Division of the Alcohol Tax Unit all of the personnel, records, books, furniture, and supplies of the Federal Alcohol Administration and of the office of the Administrator thereof (other than the Administrator) which Administration and office were abolished by section 2 of Reorganization Plan No. III: *Provided, however*, That such transfer shall be in accordance with the provisions of section 10(b) of the Reorganization Act of 1939 (53 Stat., 563), and shall be subject to the provisions of section 8 of Reorganization Plan No. III.

SEC. 2. By virtue of and pursuant to the authority set out in section 1 of this order, Part 171 of Title 26 of the Code of Federal Regulations is hereby further amended by inserting between Subpart B and Subpart C thereof a new Subpart B(A) to read as follows:

SUBPART B(A)—ADDITIONAL DUTIES OF ALCOHOL TAX UNIT.

171.4a. *Delegation of Federal Alcohol Administration functions.*—Except as provided in paragraph 171.1a, relating to the appointment of an Assistant Deputy Commissioner, and except as provided in Treasury Department Order No. 31 of June 12, 1940 (uncodified), relating to certain legal and personnel functions, all functions of the Federal Alcohol Administration, and the office of the Administrator and the offices of the members thereof, are hereby delegated to the Deputy Commissioner of the Bureau of Internal Revenue in Charge of the Alcohol Tax Unit, to be exercised by him under the direction and supervision of the Commissioner of Internal Revenue and the Secretary of the Treasury through the Basic Permit and Trade Practice Division, and the officers and employees thereof: *Provided, however*, That with the approval of the Commissioner of Internal Revenue and the Secretary of the Treasury, said Deputy Commissioner may exercise any of such functions through any other division of the Alcohol Tax Unit, and the officers and employees thereof.

171.4b. *Prior regulations adopted.*—Except as herein, or as may be hereafter, otherwise provided, all regulations prescribed, all orders and instructions issued, and all forms adopted for the enforcement of the laws heretofore administered by the Administrator of the Federal Alcohol Administration, the Federal Alcohol Administration, and the officers and employees thereof, will continue in effect as regulations, orders, instructions, and forms of the Alcohol Tax Unit of the Bureau of Internal Revenue. The term "Administrator" wherever used in such regulations, orders, instructions, and forms, shall be held to mean "Deputy Commissioner of Internal Revenue."

SEC. 3. This order shall take effect on the date that section 2 of Reorganization Plan No. III becomes effective.

H. MORGENTHAU, Jr.,
Secretary of the Treasury.

(Filed with the Division of the Federal Register June 12, 1940, 11.39 a. m., as Treasury Order No. 30.)

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ization Plan No. III. The provisions of Department Circular No. 519 of June 20, 1934, are hereby made applicable to all duties and functions incident to the administration of the legal activities of the Federal Alcohol Administration, and to all of the personnel, records, books, furniture, and supplies hereby transferred.

SEC. 2. All appointment and other personnel functions of the Administrator and members of the Federal Alcohol Administration, which functions are within the purview of section 404 of Reorganization Plan No. II (53 Stat., 1436) are vested in the Secretary of the Treasury. The provisions of Treasury Department Order No. 22 of June 30, 1939, issued under such section 404 of Reorganization Plan No. II and relating to submission to the Administrative Assistant to the Secretary of the Treasury of certain personnel actions enumerated therein for final approval, are hereby made applicable to all such personnel actions in connection with all personnel transferred to the Alcohol Tax Unit of the Bureau of Internal Revenue by Treasury Department Order No. 30 of this date, and to all such personnel actions in connection with the personnel transferred to the Legal Division by section 1 of this order.

SEC. 3. This order shall take effect on the date that section 2 of Reorganization Plan No. III becomes effective.

H. MORGENTHAU, Jr.,
Secretary of the Treasury.

INDUSTRIAL ALCOHOL.

1940–12–10210
T. D. 4967

Revising specially denatured alcohol formula No. 42 in Appendix to Regulations No. 3.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To District Supervisors, Chemists in Charge, Authorized Chemists, and Others Concerned:

Pursuant to authority contained in sections 3105(a) and 3124(a)6 of the Internal Revenue Code, the formula for specially denatured alcohol formula No. 42 in Appendix to Regulations No. 3, approved December 29, 1938, is revised to read as follows:

To every 100 gallons of ethyl alcohol of not less than 190° proof add

(*a*) 80 grams potassium iodide U. S. P. and 109 grams red mercuric iodide U. S. P.; or

(*b*) 76 grams of any one of the following:

Phenyl mercuric nitrate, C. P.
Phenyl mercuric chloride, C. P.
Phenyl mercuric benzoate, C. P.; or

(*c*) 95 grams sodium ethyl mercuric thiosalicylate, C. P.

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved March 8, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 11, 1940, 11.31 a. m.)

REGULATIONS 3 (Alcohol), ARTICLE 146: General provisions governing the use of specially denatured alcohol.

1940–5–10160
T. D. 4963

Labeling and sale of rubbing alcohol compound—(Amendment of Regulations No. 3).

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To District Supervisors and Others Concerned:

In order further to protect the revenue, and pursuant to the authority contained in sections 3105(a), 3124(a)6, and 3111, Internal Revenue Code, the second paragraph of article 146 of Regulations No. 3, as amended, is hereby amended to read as follows:

Rubbing alcohol compound, as referred to in these regulations, shall mean any product manufactured with specially denatured alcohol and represented to be a rubbing alcohol compound. The sale of this product by the manufacturer, or wholesale druggist, must be made directly, or through his employees, only to wholesale or retail druggists, and to purchasers who acquire the product for legitimate external use and not for resale, such as hospitals, sanatoriums, clinics, turkish baths, athletic associations, physicians, dentists, veterinarians, et cetera. This product may also be sold by retail druggists to any of the foregoing or in retail quantities only to other persons for external use. Sales to such other persons by retail druggists must be made through a registered pharmacist who will, at the time of sale, write or stamp across the brand label in contrasting colors the words "Sold by" followed by his (the pharmacist) name and the address of the retail drug store where the sale is made.

A manufacturer, wholesale druggist, retail druggist, or any other person shall not sell rubbing alcohol compound for use, or for sale for use, for beverage purposes, nor shall he sell such product under circumstances from which it might reasonably appear that it is the intention of the purchaser to procure the product for use, or for sale for use, for beverage purposes. Any person who shall sell rubbing alcohol compound in violation of these regulations shall be subject to all provisions of law pertaining to alcohol that is not denatured, including those requiring the payment of tax thereon, and the person so selling the rubbing alcohol compound shall be required to pay such tax and special tax as a dealer in liquors.

The manufacturer shall package rubbing alcohol compound in the bottles in which it is to be sold to the ultimate consumer. Such bottles shall not exceed 1 pint in capacity and shall bear a brand label and a caution notice placed thereon by the manufacturer. No other person shall place a label or notice thereon. The brand label must contain the following information:

1. The brand or trade name of the product, if any.
2. The legend "Rubbing Alcohol Compound" which shall be in letters of the same color and size as the brand or trade name.
3. The name and address of the manufacturer. (Where rubbing alcohol compound is manufactured and bottled under the name of a dealer for resale, the manufacturer may place his symbol and permit number on the label in lieu of his name and address, provided the name and address of the person for whom manufactured is shown.)
4. The legend "Contains 70 per cent absolute alcohol by volume."
5. The legend "*For external use only.* If taken internally serious gastric disturbances will result."

The caution notice, which shall appear on the back of the bottle, shall be printed in plain and legible type of not less than 6 point, and must read as follows:

"CAUTION NOTICE:

"The sale of this product by the manufacturer, or wholesale druggist, must be made directly, or through his employees, only to wholesale or retail druggists, and to purchasers who acquire the product for legitimate external use and not for resale, such as hospitals, sanatoriums, clinics, turkish baths, athletic associations, physicians, dentists, veterinarians, et cetera. This product may also be sold by retail druggists to any of the foregoing, or in retail quantities only to other persons for external use. Sales to such other persons must be made by a retail druggist through a registered pharmacist, who will write or stamp across the brand label in contrasting colors the words 'Sold by' followed by his (the pharmacist) name and the address of the retail drug store where the sale is made. Sales for other than external use will subject the dealer to special tax as a dealer in liquors and to the internal revenue tax on the alcohol contained in this compound."

The manufacturer may incorporate in the brand label, or in a separate label appearing in conjunction with the brand label, any other desired statement, but such statement shall not obscure or contradict the labeling required hereby. No labeling, other than the caution notice, shall be placed on the back of the bottle.

These regulations shall be effective as to transactions occurring subsequent to the date hereof, except that:

(*a*) The requirements as to pharmacists shall not take effect until 30 days after the effective date of these regulations.

(*b*) Each district supervisor will notify all permittees in his district that they may use present supply of approved labels until exhausted, provided that within 30 days after the effective date of these regulations such labels are supplemented by the caution notice prescribed in these regulations.

(*c*) The district supervisor will also notify all permittees that, prior to the exhaustion of their present supply of approved labels, they must file with him Form 1479–A, in quadruplicate, showing formulae, brand labels, and caution notices, or facsimiles thereof, for their rubbing alcohol compounds. The district supervisor will (1) examine the formulae to ascertain that they are identical with approved formulae now used and (2) examine the brand labels and caution notices, or facsimiles thereof, to determine that they conform with these regulations. If all requirements have been complied with, the district supervisor will note his approval on each copy of Form 1479–A, return one copy to the permittee, forward one copy to the Commissioner, furnish one copy to the chemist in charge, and retain the remaining copy for his files. If the formulae on Form 1479–A are not identical with approved formulae now used, the forms will be forwarded to the Commissioner for consideration. If the brand labels and caution notices, or facsimiles thereof, are disapproved, all copies of Form 1479–A, with attachments, will be returned to the permittee with a statement of the reason for disapproval.

(*d*) Stocks of rubbing alcohol compound now bottled and labeled need not be relabeled in accordance with these regulations; and

(*e*) Stocks of rubbing alcohol compound now in the possession of persons other than those entitled to sell the same under the foregoing regulations may be sold for external uses only.

Nothing in the foregoing regulations shall in any manner alter or affect the provisions of article 146–A of Regulations No. 3, as amended.

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved January 18, 1940.

H. MORGENTHAU, Jr.,
Secretary of the Treasury.

(Filed with the Division of the Federal Register January 20, 1940, 10.18 a. m.)

TRAFFIC IN CONTAINERS OF DISTILLED SPIRITS.

REGULATIONS 13 (1940), SECTION 175.3: Definitions. 1940-21-10267
SECTION 175.9: Labels. T. D. 4970
SECTION 175.14: Reuse of containers.

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, PART 175—TRAFFIC IN CONTAINERS OF DISTILLED SPIRITS.

Labeling and reuse of containers of distilled spirits.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, D. C., May 11, 1940.

To District Supervisors and Others Concerned:

Section 175.3(*m*) of Regulations 13 (Part 175, Title 26, Code of Federal Regulations, 1940 Sup.) is amended to read as follows:

(*m*) The term "age" shall have the meaning given to such term by definition (*j*) of Article I of Regulations 5 (27 CFR, Part 5), relating to labeling and advertising of distilled spirits, issued under the Federal Alcohol Administration Act, in effect as of July 1, 1938, and shall be stated in the manner provided in section 39 of Article III of said regulations: *Provided, however,* That the actual age may be stated as to whisky withdrawn prior to April 1, 1937, from cisterns at distilleries registered under the internal revenue laws, and as to such whisky which, when blended or rectified, does not contain spirits other than those withdrawn prior to April 1, 1937, from distilleries registered under the internal revenue laws.

Section 175.3(*n*) of Regulations 13 (Part 175, Title 26, Code of Federal Regulations, 1940 Sup.) is amended to read as follows:

(*n*) The term "kind" shall have the respective meanings given to such term by the "Standards of identity for distilled spirits" set forth in Article II of Regulations 5 (27 CFR, Part 5), relating to labeling and advertising of distilled spirits, issued under the Federal Alcohol Administration Act, in effect as of July 1, 1938, and theretofore, as to spirits produced in the respective periods covered by such regulations, and shall be stated as to spirits produced in each such period in the manner provided in section 34 of Article III of said regulations: *Provided, however,* That the actual kind may be stated as to distilled spirits withdrawn prior to April 1, 1937, from cisterns at distilleries registered under the internal revenue laws, and as to all blends thereof, and as to all such spirits rectified without the addition of spirits other than those withdrawn prior to April 1, 1937, from cisterns at distilleries registered under the internal revenue laws.

Section 175.9(*d*) of Regulations 13 (Part 175, Title 26, Code of Federal Regulations, 1940 Sup.) is amended to read as follows:

(*d*) If whisky, not blended or rectified, the age thereof, but this statement shall not be required as to Scotch, Irish, or Canadian whisky, or whisky bottled in bond. As to whisky withdrawn on or after April 1, 1937, from cisterns at distilleries registered under the internal revenue laws, and stored in reused cooperage, the period of such storage shall be stated in the form heretofore prescribed for such statements by Regulations 5 (27 CFR, Part 5), relating to labeling and advertising of distilled spirits, issued under the Federal Alcohol Administration Act.

Section 175.9(*e*) of Regulations 13 (Part 175, Title 26, Code of Federal Regulations, 1940 Sup.) is amended to read as follows:

(*e*) If blended or rectified whisky, the age of the youngest whisky therein, but this statement shall not be required as to Scotch, Irish, or Canadian whisky; and the respective percentage, by volume, of whisky or whiskies, and neutral spirits. As to whisky withdrawn on or after April 1, 1937, from cisterns at distilleries registered under the internal revenue laws, and stored in reused cooperage, and used in blending or rectification, the period of such storage shall be stated in the form heretofore prescribed for such statements by Regulations 5 (27 CFR, Part 5), relating to labeling and advertising of distilled spirits, issued under the Federal Alcohol Administration Act.

Section 175.14 of Regulations 13 (Part 175, Title 26, Code of Federal Regulations, 1940 Sup.) is amended to read as follows:

Reuse of containers.—The reuse for packaging distilled spirits for sale at retail of liquor bottles or other authorized marked containers, as defined herein, is prohibited: *Provided*, That bottles or other authorized containers of distilled spirits, which have not been sold to the consumer or opened, may be returned to the bottler filling the same for reuse, pursuant to authorization by the district supervisor of the district in which the bottler is located, upon the filing by the bottler of an application (Form 98).

(This Treasury decision is prescribed pursuant to the authority conferred by section 2871 of the Internal Revenue Code.)

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register May 13, 1940, 2.46 p. m.)

DISTILLED SPIRITS.

INTERNAL REVENUE CODE.

1940–8–10184
T. D. 4964

Mutilated or missing strip stamps.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue, District Supervisors, and Others Concerned:

Pursuant to the authority contained in section 2803(d) of the Internal Revenue Code, the following regulations are hereby prescribed:

1. Unopened bottles containing tax-paid distilled spirits required to be stamped under section 2803(d) of the Internal Revenue Code, from which the strip stamps are missing, or on which the strip stamp is mutilated to the extent that the contents of the bottle are accessible without further destruction of the stamp, or on which the strip stamp is so mutilated that the genuineness thereof can not be determined, may be restamped pursuant to the following procedure:

2. The bottle should be set aside by the dealer and proper remittance (1 cent for each stamp of one-half pint or greater, or one-quarter cent for each stamp of less than one-half pint) and application under oath for the necessary stamps submitted with Form 428, "Order for stamps—Distilled spirits bottle strips," in triplicate, to the district supervisor, Alcohol Tax Unit. Copies of Form 428 may be obtained from the district supervisor, Alcohol Tax Unit. The applicant in every case will state the cause of mutilation or absence of the stamps and submit evidence that the spirits are tax-paid. Such evidence may consist of the invoices covering the purchase of the spirits, in addition to other available documents. The district supervisor will approve the requisition, Form 428, if he is satisfied from the evidence submitted that the tax has been paid on the spirits, and that the mutilation or absence of the stamps has been explained. He will forward the original Form 428 and one copy with the remittance to the proper collector of internal revenue. The collector will enter the serial numbers of the stamps issued and stamp the date of sale on both copies of Form 428. He will send the stamps and the copy of Form 428 to the district supervisor, who will deliver the stamps to the applicant, either by mail or by a representative of his office, together with instructions in regard to affixing them to the containers.

3. When an internal revenue officer discovers an unopened bottle containing distilled spirits, to which no strip stamp is affixed, or on which the strip stamp is mutilated to the extent that the contents of the bottle are accessible without further destruction of the stamp, or on which the strip stamp is so mutilated that the genuineness thereof can not be determined, the officer will direct that the bottle be set aside. If the officer is satisfied that the spirits in the bottle have been tax-paid, and the original contents of the bottle have not been replaced or increased by the addition of any substance, he shall

secure an affidavit from the proper person setting forth the reason for the absence or mutilation of the stamp, accompanied by documentary evidence, if any, in support thereof. The officer shall assist the person in executing an application on Form 428 in order to procure a strip stamp to be affixed to the bottle, pursuant to the procedure outlined in paragraph 2 hereof. No offer in compromise will be suggested in such cases.

When the inspector has good reason to believe that the distilled spirits have not been tax-paid, or that the original contents of the bottle have been replaced or increased by the addition of a substance, he will seize the spirits for forfeiture.

4. It will not be necessary to require the replacement of strip stamps where an immaterial portion of the stamp is missing, or where the strip stamp has dropped off a bottle and may be reaffixed thereto by the dealer. No offer in compromise will be suggested in such cases.

5. In the case of an opened bottle of distilled spirits from which all portions of the strip stamp have been removed, there will be no necessity to require the restamping of the bottle or to suggest an offer in compromise if the internal revenue officer is satisfied the bottle contains all or a part of its original tax-paid contents only.

6. Nothing contained in these regulations shall supersede or otherwise affect the authority granted and the procedure established by Treasury Decision 4744, approved June 24, 1937 [C. B. 1937-2, 573], for obtaining stamps to replace those which have been lost or destroyed.

7. Treasury Decision 4776, approved November 12, 1937 [C. B. 1937-2, 548], is hereby revoked.

GUY T. HELVERING,
Commissioner.

Approved February 15, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 15, 1940, 4.07 p. m.)

PUBLIC SALARY TAX ACT OF 1939.

1940-1-10130
I. T. 3341

Employees of Federal land banks are employees of agencies or instrumentalities of the United States within the meaning of sections 207 and 208 of the Public Salary Tax Act of 1939 (Public, No. 32, Seventy-sixth Congress, first session, C. B. 1939-1 (Part 1), 428).

Advice is requested whether employees of the Federal land banks are employees of agencies or instrumentalities of the United States within the meaning of sections 207 and 208 of the Public Salary Tax Act of 1939 (Public, No. 32, Seventy-sixth Congress, first session, C. B. 1939-1 (Part 1), 428).

Sections 207 and 208 of that Act read as follows:

SEC. 207. No collection of any tax (including interest, additions to tax, and penalties) imposed by any State, Territory, possession, or local taxing authority on the compensation, received before January 1, 1939, for personal service as an officer or employee of the United States or any agency or instrumentality thereof which is exempt from Federal income taxation and, if a corporate agency or instrumentality, is one (a) a majority of the stock of which is owned by or on behalf of the United States, or (b) the power to appoint or select a majority of the board of directors of which is exercisable by or on behalf of the United States, shall be made after the date of the enactment of this Act.

SEC. 208. This title shall not apply with respect to any officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, after the Secretary of the Treasury has determined and proclaimed that it is the policy of such State to collect from any individual any tax, interest, additions to tax, or penalties, on account of compensation received by such individual prior to January 1, 1939, for personal service as an officer or employee of the United States or any agency or instrumentality thereof. In making such determination the Secretary of the Treasury shall disregard the taxation of officers and employees of any corporate agency or instrumentality which is not exempt from Federal income taxation, or which if so exempt is one (a) a majority of the stock of which is not owned by or on behalf of the United States and (b) the power to appoint or select a majority of the board of directors of which is not exercisable by or on behalf of the United States.

In order for Federal land banks, which are corporate agencies or instrumentalities, to fall within the above-quoted provisions of law, it is necessary that they be exempt from Federal income taxation, and (*a*) a majority of the stock must be owned by or on behalf of the United States, or (*b*) the power to appoint or select a majority of the board of directors must be exercisable by or on behalf of the United States. Federal land banks are exempt from Federal income taxation. (39 Stat., 380, section 26.) The question remains as to whether they meet the requirements of either (*a*) or (*b*) above.

Under the provisions of section 5(a) of the Farm Credit Act of 1937 (50 Stat., 703), the 12 districts theretofore designated Federal land bank districts were designated farm credit districts. Section 5(b) of that Act provides for 12 farm credit boards to function respectively in the 12 farm credit districts. Each board is composed of seven members. Three of the members are known as elected directors, no one of whom is designated by or on behalf of the United States. Three of the remaining four members are known as district directors and the fourth member is known as director at large. Two of the district directors and the director at large are appointed by the Governor of the Farm Credit Administration, an official of the United States Government. The third district director is chosen in accordance with the provisions of section 5(d). That section provides that each third district director shall be selected from the three persons having the greatest number of votes of national farm loan associations and borrowers through agencies in the district. The Governor of the Farm Credit Administration, however, has the power of appointing from this selected group. He, therefore, appoints a majority of the members of each board. Section 7(b) of that Act provides that the members of the farm credit board of each farm credit district provided for in section 5(a) shall be ex officio the directors of the Federal land bank located in that district. The Federal land bank located in each farm credit district has seven directors who are identical with the members of the farm credit board of the district in which the bank is located. Since the Governor of the Farm Credit Administration appoints a majority of the members of the farm credit board of each farm credit district, he appoints a majority of the directors of the Federal land bank of each district. Federal land banks, therefore, are corporate agencies or instrumentalities of the United States in which the power to appoint or select a majority of the board of directors is exercisable on behalf of the United States.

In view of the foregoing, it is held that the employees of Federal land banks are employees of agencies or instrumentalities of the United States within the meaning of sections 207 and 208 of the Public Salary Tax Act of 1939.

SECTION 3 OF THE VINSON ACT (48 STAT., 503, 505), AS AMENDED BY ACT OF JUNE 25, 1936 (49 STAT., 1926), AND BY ACT OF APRIL 3, 1939 (53 STAT., 555, 560).

1940–22–10273
I. T. 3377

A deficiency in profit sustained in the performance of a contract for aircraft instruments awarded by the Navy Department under the Vinson Act, as amended, is not allowable as a credit in computing the excess profit realized in the performance of a contract for aircraft instruments awarded by the War Department under the Act of April 3, 1939.

Advice is requested whether a deficiency in profit sustained upon completion of a contract for aircraft instruments awarded by the Navy Department under the Vinson Act, as amended, is allowable as a credit in computing the excess profit on a completed contract for aircraft instruments awarded by the War Department under the Act of April 3, 1939.

Section 17.10 of the regulations promulgated in Treasury Decision 4906 (C. B. 1939–2, 404) under section 3 of the Vinson Act, as amended, relating to excess profits on Navy contracts and subcontracts for naval vessels and naval aircraft, provides in part as follows:

(*e*) *Deficiency in profit.*—The term "deficiency in profit" as used in the Act and in these regulations relates only to contracts and subcontracts coming within the scope of the Act which are for the construction or manufacture of any complete naval aircraft or any portion thereof and are completed within an income-taxable year ending after April 3, 1939. As so used, the term "deficiency in profit" means the amount by which 12 per cent of the total contract prices of such contracts and subcontracts which are completed by a particular contracting party within the income-taxable year exceeds the net profit upon such contracts and subcontracts. A deficiency in profit sustained by a contracting party with respect to such contracts and subcontracts for the construction or manufacture of complete naval aircraft or any portion thereof and completed within any income-taxable year ending after April 3, 1939, is allowable as a credit in computing the contracting party's excess profit on contracts and subcontracts for the construction or manufacture of complete naval aircraft or any portion thereof which are completed within the four next succeeding income-taxable years.

Section 16.9 of the regulations promulgated in Treasury Decision 4909 (C. B. 1939–2, 422) under section 14 of the Act of April 3, 1939, relating to excess profits on Army contracts for Army aircraft provides in part as follows:

The term "deficiency in profit" as used in the Act and as applied to contracts and subcontracts coming within these regulations means the amount by which 12 per cent of the total contract prices of all such contracts and subcontracts entered into after April 3, 1939, and completed by a particular contracting party within the income-taxable year exceeds the net profit upon all such contracts and subcontracts.

A net loss or a deficiency in profit sustained by a contracting party for an income-taxable year is allowable as a credit in computing the contracting party's excess profit on contracts and subcontracts coming within these regulations and completed during the four next succeeding income-taxable years. Credit for such a net loss or deficiency in profit may be claimed in the contracting party's annual report of profit filed with the collector of internal revenue (see section 16.15 of these regulations), but it shall be supported by separate schedules for each contract or subcontract involved showing total contract prices, costs of performance and pertinent facts relative thereto, together with a summarized computation of the net loss or deficiency in profit. * * *

Section 16.1(*c*) of the regulations promulgated under section 14 of the Act of April 3, 1939 (T. D. 4909, supra), provides that—

As used in these regulations the term "contract" means an agreement made by authority of the Secretary of War for the construction or manufacture of any complete aircraft or any portion thereof for the Army.

Under section 14 of the Act of April 3, 1939, and the regulations promulgated thereunder, the deficiency in profit sustained on a completed contract for aircraft instruments awarded by the Navy Department under the Vinson Act, as amended, is not allowable as a credit in computing the excess profit realized upon completion of a contract for aircraft instruments awarded by the War Department under the Act of April 3, 1939.

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MISCELLANEOUS.

1940–3–10142
T. D. 4961

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER E, PART 468.

Regulations relating to seizures of vessels, vehicles, and aircraft in connection with contraband firearms covered by section 1(b)2, Act of August 9, 1939.[1]

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., January 5, 1940.

To Collectors of Internal Revenue and Others Concerned:

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SECTION 468.0. *Introductory.*—The Act approved August 9, 1939 (53 Stat., 1291), providing for the seizure and forfeiture of vessels, vehicles, and aircraft used to transport narcotic drugs, firearms, and counterfeit coins, obligations, securities, and paraphernalia, and for other purposes, reads as follows:

> * * * That (a) it shall be unlawful (1) to transport, carry, or convey any contraband article in, upon, or by means of any vessel, vehicle, or aircraft; (2) to conceal or possess any contraband article in or upon any vessel, vehicle, or aircraft, or upon the person of anyone in or upon any vessel, vehicle, or aircraft; or (3) to use any vessel, vehicle, or aircraft to facilitate the transportation, carriage, conveyance, concealment, receipt, possession, purchase, sale, barter, exchange, or giving away of any contraband article.
>
> (b) As used in this section, the term "contraband article" means—
>
> (1) Any narcotic drug which has been or is possessed with intent to sell or offer for sale in violation of any laws or regulations of the United States dealing therewith, or which is sold or offered for sale in violation thereof, or which does not bear appropriate tax-paid internal-revenue stamps as required by law or regulations;
>
> (2) Any firearm, with respect to which there has been committed any violation of any provision of the National Firearms Act, as now or hereafter amended, or any regulation issued pursuant thereto; or
>
> (3) Any falsely made, forged, altered, or counterfeit coin or obligation or other security of the United States or of any foreign government; or any material or apparatus, or paraphernalia fitted or intended

[1] Sections 468.0 to 468.16 are issued under the authority contained in the Act of August 9, 1939 (53 Stat., 1291).

to be used, or which shall have been used, in the making of any such falsely made, forged, altered, or counterfeit coin or obligation or other security.

SEC. 2. Any vessel, vehicle, or aircraft which has been or is being used in violation of any provision of section 1, or in, upon, or by means of which any violation of section 1 has taken or is taking place, shall be seized and forfeited: *Provided*, That no vessel, vehicle, or aircraft used by any person as a common carrier in the transaction of business as such common carrier shall be forfeited under the provisions of this Act unless it shall appear that (1) in the case of a railway car or engine, the owner, or (2) in the case of any other such vessel, vehicle, or aircraft, the owner or the master of such vessel or the owner or conductor, driver, pilot, or other person in charge of such vehicle or aircraft was at the time of the alleged illegal act a consenting party or privy thereto: *Provided further*, That no vessel, vehicle, or aircraft shall be forfeited under the provisions of this Act by reason of any act or omission established by the owner thereof to have been committed or omitted by any person other than such owner while such vessel, vehicle, or aircraft was unlawfully in the possession of a person who acquired possession thereof in violation of the criminal laws of the United States, or of any State.

SEC. 3. The Secretary of the Treasury is empowered to authorize, or designate, officers, agents, or other persons to carry out the provisions of this Act. It shall be the duty of any officer, agent, or other person so authorized or designated, or authorized by law, whenever he shall discover any vessel, vehicle, or aircraft which has been or is being used in violation of any of the provisions of this Act, or in, upon, or by means of which any violation of this Act has taken or is taking place, to seize such vessel, vehicle, or aircraft and to place it in the custody of such person as may be authorized or designated for that purpose by the Secretary of the Treasury, to await disposition pursuant to the provisions of this Act and any regulations issued hereunder.

SEC. 4. All provisions of law relating to the seizure, summary and judicial forfeiture, and condemnation of vessels and vehicles for violation of the customs laws; the disposition of such vessels and vehicles or the proceeds from the sale thereof; the remission or mitigation of such forfeitures; and the compromise of claims and the award of compensation to informers in respect of such forfeitures shall apply to seizures and forfeitures incurred, or alleged to have been incurred, under the provisions of this Act, insofar as applicable and not inconsistent with the provisions hereof: *Provided*, That such duties as are imposed upon the collector of customs or any other person with respect to the seizure and forfeiture of vessels and vehicles under the customs laws shall be performed with respect to seizures and forfeitures of vessels, vehicles, and aircraft under this Act by such officers, agents, or other persons as may be authorized or designated for that purpose by the Secretary of the Treasury.

SEC. 5. Any appropriation which has been or shall hereafter be made for the enforcement of the customs, narcotics, counterfeiting, or internal-revenue laws, and the provisions of the National Firearms Act shall be available for the defraying of expenses of carrying out the provisions of this Act.

SEC. 6. The provisions of this Act shall be construed to be supplemental to, and not to impair in any way, existing provisions of law imposing fines, penalties, or forfeitures; or providing for the seizure, condemnation, or disposition of forfeited property or the proceeds thereof; or authorizing the remission or mitigation of fines, penalties, or forfeitures.

SEC. 7. When used in this Act—

(a) The term "vessel" includes every description of watercraft or other contrivance used, or capable of being used, as means of transportation in water, but does not include aircraft;

(b) The term "vehicle" includes every description of carriage or other contrivance used, or capable of being used, as means of transportation on, below, or above the land, but does not include aircraft;

(c) The term "aircraft" includes every description of craft or carriage or other contrivance used, or capable of being used, as means of transportation through the air;

(d) The term "narcotic drug" means any narcotic drug, as now or hereafter defined by the Narcotic Drugs Import and Export Act, the internal-revenue laws or any amendments thereof, or the regulations issued thereunder; or marihuana as now or hereafter defined by the Marihuana Tax Act of 1937 or the regulations issued thereunder;

(e) The term "firearm" means any firearm, as now or hereafter defined by the National Firearms Act, or any amendments thereof, or the regulations issued thereunder; and

(f) The words "obligation or other security of the United States" are used as now or hereafter defined in section 147 of the Criminal Code, as amended (U. S. C., title 18, section 261).

SEC. 8. The Secretary of the Treasury shall prescribe such rules and regulations as may be necessary to carry out the provisions of this Act.

The following regulations are hereby prescribed under the Act of August 9, 1939, relative to the seizure and disposition of vessels, vehicles, and aircraft when engaged in the transportation, etc., of contraband firearms within the meaning of the National Firearms Act.

SECTION 468.1. *Definitions.*—As used in these regulations, except as otherwise indicated by the context:

(*a*) The term "Act" means the Act of August 9, 1939 (53 Stat., 1291).

(*b*) The term "conveyance" means a vessel, vehicle, or aircraft within the scope of the Act and these regulations.

(*c*) The terms "seizing officer," "officer seizing," etc., mean the Commissioner of Internal Revenue, the collector or deputy collector of the proper district, or such other collector, deputy collector or other officer of internal revenue as may be specially authorized by the Commissioner pursuant to section 3720 of the Internal Revenue Code to seize property legally subject to seizure and who has made seizure of a conveyance or adopted a seizure within the scope of these regulations.

(*d*) The term "Secretary" means the Secretary of the Treasury.

(*e*) The term "Commissioner" means the Commissioner of Internal Revenue.

(*f*) The term "collector" means the collector of internal revenue.

(*g*) The term "Director" means the Director of the Procurement Division of the Treasury Department.

(*h*) The term "Manual" means the Manual of Procedure for Forfeiture and Disposition of Personal Property Seized by the Alcohol Tax Unit, issued June, 1937.

(*i*) The terms defined in the Act shall have the meanings thereby ascribed to them.

SEC. 468.2. *Reports of seizure.*—An officer seizing or adopting the seizure of a conveyance shall promptly make a complete written report, in quadruplicate, to the collector. The report shall show, in so far as feasible, the following data: The date and place of seizure, the name and address of the person from whom seized, a specific description of the conveyance, including the make, type, model, and year of manufacture, the registration and motor and serial numbers, if any, and the general condition; the name and address of the owner, the names and addresses of witnesses, the reasons for and circumstances of the seizure, a description of the contraband articles, the disposition made of the contraband articles, and any other pertinent information. So far as practicable the description of the conveyance shall be in the form of, and include the details indicated by, Form 181. (See Manual.)

The collector shall forward two copies of the report to the Commissioner, and shall advise of later developments as they occur.

SEC. 468.3. *Custody and storage.*—Any conveyance seized under the provisions of these regulations shall be in the custody of the collector for the district in which the seizure is made. The seizing officer shall store the conveyance in a place designated, either generally or in the particular case, by the collector. The place of storage shall be in the judicial district in which the seizure occurred. Government storage facilities shall be utilized if practicable. If the conveyance is stored on private premises there shall be secured from the proprietor thereof and forwarded with the report to the collector a receipt for the conveyance coinciding with the description in the report to the collector. Conveyances may not be used prior to forfeiture and award for official use.

SEC. 468.4. *Appraisement.*—The collector shall appraise the conveyance to determine the value at the time and place of appraisement, or if there is no market for the conveyance at the place of appraisement, the value in the principal market nearest the place of appraisement. The appraisal may be based upon the report of the seizing officer and any other information which may be acquired.

SEC. 468.5. *Advertisement.*—If the appraised value does not exceed $1,000, the collector shall cause a notice of the seizure and of the intention to forfeit and sell or otherwise dispose of the property to be published once a week for at least three successive weeks in a newspaper of general circulation in the judicial district in which the seizure occurred. The notice shall not be inserted oftener than three times, unless the collector is of the opinion that, because of circumstances peculiar to the particular case, a greater number of insertions will be to the advantage of the Government. The notice shall—

(1) describe the conveyance seized and show the registration and motor and serial numbers, if any;

(2) show the reason for, and time and place of, seizure; and

(3) state that any person desiring to claim the conveyance may, within 20 days from the date of first publication of the notice, file with the collector a claim for the conveyance and a bond for costs of judicial condemnation with satisfactory sureties in the sum of $250; and that unless such claim and bond are filed within the stated time the conveyance will be disposed of in accordance with law. See form of advertisement on page 8 of Manual which may be adapted to the purposes of these regulations.

SEC. 468.6. *Requirements as to claim and bond.*—The bond and claim shall be in triplicate. The bond shall sufficiently identify the conveyance, shall run to the United States of America, have sureties approved by the collector, and be conditioned that in case of condemnation of the conveyance the obligor shall pay all the costs and expenses of the proceeding to obtain the condemnation. Bond, Form 175, may be adapted for the purposes of these regulations. When a claim and bond are received by the collector, he shall, if he finds the documents in proper form and the sureties satisfactory, proceed in accordance with section 468.8 of these regulations. If the documents are not in satisfactory form when first received by the collector, a reasonable time for correction may be allowed. If correction is not made within a reasonable time the documents may be treated as nugatory, and the case may proceed as though they had not been tendered. The filing in proper form of the claim and bond does not entitle the claimant to possession of the conveyance but stops the summary proceedings.

SEC. 468.7. *Summary forfeiture.*—If the appraised value does not exceed $1,000, and the claim and bond mentioned in section 468.6 are not filed within 20 days, the collector shall execute, in duplicate, a declaration of forfeiture, and forward one copy thereof to the Commissioner. The declaration should state that it is made in accordance with the provisions of section 609 of the Tariff Act of 1930 and should follow, with necessary modifications, Form 1570. (See Manual.) Thereafter the conveyance shall be disposed of in accordance with official instructions duly received by the collector.

SEC. 468.8. *Presentation for judicial action.*—If the appraised value is greater than $1,000, or if the appraised value is not more than $1,000 but a claim and satisfactory bond have been received (see section 468.6 of these regulations), the collector shall transmit a copy of the report of the seizing officer, and a supplemental report of any pertinent facts and circumstances additional to those disclosed by the seizing officer's report (see section 468.2 of these regulations), to the United States attorney for the judicial district in which the seizure was made for institution of condemnation proceedings. If the seizure has been advertised the report shall include copies of the newspapers containing the advertisements. Immediately upon reference of a case to the United States attorney, the collector shall notify the Commissioner. The Commissioner will, if he deems such action appropriate, request the Director of Procurement to petition the court for delivery of the vehicle for official use. See Treasury Decision 4625 (section 3), Cumulative Bulletin XV-1 (1936), page 492.

SEC. 468.9. *Petitions for remission or mitigation of forfeiture.*—Any person interested in any conveyance within the scope of these regulations which has been forfeited, either summarily or by court proceedings, or which is held for forfeiture, may within the time prescribed (see section 468.10 of these regulations) file a petition for remission or mitigation of the forfeiture. Such petition shall be filed in duplicate with the collector.

The petition shall be addressed to the Secretary and shall be executed and sworn to by the petitioner. The petition shall state in clear and concise terms the following:

(1) A complete description of the conveyance, including registration number and motor and serial numbers, if any, the name of the owner, and of the person from whom seized, as well as the date and place of seizure.

(2) The interest of the petitioner in the conveyance, which shall be established by bills of sale, contracts, mortgages, or other satisfactory documentary evidence filed with the petition.

(3) The circumstances, to be established by satisfactory proof, relied upon by the petitioner to justify remission or mitigation.

Where the forfeiture and sale has already occurred (see section 468.10 of these regulations) it must be established by satisfactory proof that the petitioner did not know of the seizure prior to the forfeiture, and was in such circumstances as prevented him from knowing thereof.

If the conveyance, when seized, was in possession of a third person whose conduct was responsible for the forfeiture, there shall be included evidence showing how the conveyance came into the possession of such person, and evidence of any investigation made by the petitioner prior to parting with the conveyance. If such investigation was not made, the reason for not making it shall be stated.

SEC. 468.10. *Time for filing petition.*—A petition for remission or mitigation of a forfeiture must be seasonably filed. Where the petition is for restoration of the proceeds of sale, it must be filed within three months after the date of sale. In the case of a conveyance which is retained or awarded for official use, the retention or delivery shall be regarded as a sale for the purposes of these regulations.

SEC. 468.11. *Handling of petition.*—Upon receipt of a petition in a case which has been reported to the United States attorney for institution of judicial forfeiture proceedings, the collector shall forward both copies of the petition to the United States attorney who shall be furnished with all information that may be requested, or that may seem of assistance in the disposition of the case. The collector shall notify the petitioner that the petition has been referred to the United States attorney, and advise that the matter is within the jurisdiction of the Department of Justice. If the case has not been reported to the United States attorney, the collector shall forward to the Commissioner the original of the petition with a report of any additional investigation made, and a statement of the expenses and costs incurred, the taxes, if any, owing by the petitioner on the conveyance, and the collector's recommendation.

SEC. 468.12. *Expenses: Disposition of proceeds.*—Expenses in connection with a seizure and forfeiture within the scope of these regulations shall be paid from the internal revenue appropriation. If the conveyance is sold, the net proceeds, after reimbursing the appropriation for all expenses in connection with the seizure and forfeiture, shall be deposited as other internal revenue receipts. In the event that the conveyance is transferred to another Federal agency, such agency shall reimburse the internal revenue appropriation for all expenses incurred.

If the forfeiture and sale be by court proceedings, the sum recovered after deducting all appropriate charges for marshal's fees, court costs, etc., is payable to the collector. When such sum is received by the collector he shall distribute it without delay.

SEC. 468.13. *Release on payment of appraised value.*—If any person claiming an interest in any conveyance within the scope of these regulations offers to pay the appraised value thereof (see section 468.4 of these regulations), and it appears that the claimant has in fact a substantial interest in the conveyance, the collector may, subject to the approval of the Secretary, accept the offer and release the conveyance upon payment of the money, which shall be distributed in accordance with section 468.12 of these regulations.

The offer must be in writing, addressed to the Secretary, signed by the claimant, and submitted in duplicate to the collector. It must express assent to forfeiture of the conveyance and waive further proceedings. The offer shall be supported by such proof of ownership as in the opinion of the collector is necessary. The collector shall forward the offer to the Commissioner and retain custody of the conveyance, pending action on the offer and payment of the amount of the offer if it is approved.

SEC. 468.14. *Awards.*—Any person not an officer of the United States who takes and seizes any conveyance within the scope of these regulations, and reports the matter to an officer of internal revenue or who furnishes information leading to the forfeiture of such a conveyance, may be awarded compensation of 25 per cent of the net amount realized, but not exceeding $50,000 in any case which shall be paid out of the internal revenue appropriation. If a forfeited conveyance is destroyed in lieu of sale, or devoted to official use, compensation of 25 per cent of the appraised value, not to exceed $50,000 in any case, may be awarded and paid. Awards may not be paid out of the proceeds of sale.

When information of the existence of legal basis for seizure is furnished to an internal revenue officer in writing, the original will be forwarded immediately to the Commissioner. The officer shall retain a copy. If the information is furnished orally, a memorandum thereof will be made and likewise forwarded. However, appropriate action shall be taken in the case without awaiting instructions from the Commissioner.

The claim of an informer, or of a detector and seizor, shall be executed in triplicate on Form No. 211, appropriately amended. The original of a claim for compensation shall contain the signatures of the respective parties to the claim. Any number of additional copies necessary to complete the collector's files may be required. The claim must show the date when, and the circumstances under which, the information was furnished or the conveyance was detected and seized, and fairly state all the pertinent facts of the case.

The collector of the district in which the claim originated will attach a statement showing the following facts:

(1) The place of seizure; (2) the date of seizure; (3) the statutes on the violation of which the seizure was based; (4) a full description of the conveyance and any other property seized; (5) the names of the persons involved in the violation; (6) the net amount realized from the forfeitures; (7) the date when the amount realized was deposited, and the amount of the certificate of deposit; (8) the amount paid in compromise, if any, and the date of payment; (9) the amount of expenses payable from the internal revenue appropriation; and (10) if the conveyance was released upon payment of the appraised value, or the conveyance was devoted to official use, the appraised value, as well as costs and expenses incurred, or that would properly have been incurred had the ordinary procedure been followed.

The collector shall indicate his approval or disapproval of the claim and shall certify whether or not the claimant was an officer of the United States, and if an informer, whether he furnished the original information in the case, and if a detector and seizor, whether the claimant actually detected and seized the conveyance, and in either case whether any person other than the claimant gave original information in the case.

Claims will be transmitted by the collector to the Commissioner in duplicate. Where there is a decree or order of court designating the informer a copy thereof shall also be forwarded. In a contested case the collector shall forward the applications of all claimants and furnish a statement of the facts bearing on the merits of the several claims together with his recommendation.

SEC. 468.15. *Payments to officers prohibited.*—If any officer of the United States directly or indirectly receives, accepts, or contracts for the receipt of, any portion of any award which may accrue to any person detecting and seizing, or furnishing information in a case within the scope of these regulations, he will be guilty of a felony, and upon conviction will be liable to a fine of not more than $10,000, or imprisonment for not more than two years, or both fine and imprisonment, and shall be thereafter ineligible to any office. Any money or property so paid may be recovered.

SEC. 468.16. *Application of Manual.*—With respect to procedural details not expressly covered by these regulations, collectors and other officers may follow the procedure established by the Manual (see section 468.1(*h*) of these regulations) in so far as applicable and not inconsistent with these or any other regulations or any statutory provision, with such variations as may be appropriate in the circumstances.

HERBERT E. GASTON,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 8, 1940, 12.46 p. m.)

1940–15–10233

Double taxation—Convention and protocol between the United States of America and Sweden—Signed at Washington March 23, 1939; ratification advised by the Senate of the United States August 2, 1939; ratified by the President of the United States September 8, 1939; ratified by Sweden August 21, 1939; ratifications exchanged at Stockholm November 14, 1939; proclaimed by the President of the United States December 12, 1939.

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA—A PROCLAMATION.

Whereas a convention between the United States of America and Sweden for the avoidance of double taxation and the establishment of rules of reciprocal administrative assistance in the case of income and other taxes, and a protocol forming an integral part of the said convention, were concluded and signed by their respective Plenipotentiaries at Washington on the twenty-third day of March, one thousand nine hundred and thirty-nine, the original of which convention and protocol being in the English and Swedish languages, are word for word as follows:

The President of the United States of America and His Majesty the King of Sweden, being desirous of avoiding double taxation and of establishing rules of reciprocal administrative assistance in the case of income and other taxes, have decided to conclude a convention and for that purpose have appointed as their respective Plenipotentiaries:—

The President of the United States of America:

Sumner Welles, Acting Secretary of State of the United States of America; and

His Majesty the King of Sweden:

W. Boström, Envoy Extraordinary and Minister Plenipotentiary at Washington;

who, having communicated to one another their full powers found in good and due form, have agreed upon the following articles:

ARTICLE I.

The taxes referred to in this convention are:

(*a*) In the case of the United States of America:

(1) The Federal income taxes, including surtaxes and excess-profits taxes.

(2) The Federal capital stock tax.

(*b*) In the case of Sweden:

(1) The National income and property tax, including surtax.

(2) The National special property tax.

(3) The communal income tax.

It is mutually agreed that the present convention shall also apply to any other or additional taxes imposed by either contracting State, subsequent to the date of signature of this convention, upon substantially the same bases as the taxes enumerated herein.

The benefits of this convention shall accrue only to citizens and residents of the United States of America, to citizens and residents of Sweden and to United States or Swedish corporations and other entities.

ARTICLE II.

An enterprise of one of the contracting States is not subject to taxation by the other contracting State in respect of its industrial and commercial profits except in respect of such profits allocable to its permanent establishment in the latter State. The income thus taxed in the latter State shall be exempt from taxation in the former State.

No account shall be taken, in determining the tax in one of the contracting States, of the mere purchase of merchandise effected therein by an enterprise of the other State.

The competent authorities of the two contracting States may lay down rules by agreement for the apportionment of industrial and commercial profits.

ARTICLE III.

When an enterprise of one of the contracting States, by reason of its participation in the management or capital of an enterprise of the other contracting State, makes or imposes on the latter in their commercial or financial relations conditions different from those which would be made with an independent enterprise, any profits which should normally have appeared in the balance sheet of the latter enterprise but which have been in this manner diverted to the former enterprise may, subject to applicable measures of appeal, be incorporated in the taxable profits of the latter enterprise. In such case consequent rectifications may be made in the accounts of the former enterprise.

ARTICLE IV.

Income which an enterprise of one of the contracting States derives from the operation of ships or aircraft registered in that State is taxable only in the State in which registered. Income derived by such an enterprise from the operation of ships or aircraft not so registered shall be subject to the provisions of Article II.

ARTICLE V.

Income of whatever nature derived from real property, including gains derived from the sale of such property, but not including interest from mortgages or bonds secured by real property, shall be taxable only in the contracting State in which the real property is situated.

ARTICLE VI.

Royalties from real property or in respect of the operation of mines, quarries, or other natural resources shall be taxable only in the contracting State in which such property, mines, quarries, or other natural resources are situated.

Other royalties and amounts derived from within one of the contracting States by a resident or by a corporation or other entity of the other contracting State as consideration for the right to use copyrights, patents, secret processes and formulas, trade-marks and other analogous rights, shall be exempt from taxation in the former State.

ARTICLE VII.

1. Dividends shall be taxable only in the contracting State in which the shareholder is resident or, if the shareholder is a corporation or other entity, in the contracting State in which such corporation or other entity is created or organized; provided, however, that each contracting State reserves the right to collect and retain (subject to applicable provisions of its revenue laws) the taxes which, under its revenue laws, are deductible at the source, but not in excess of 10 per centum of the amount of such dividends. For the purposes of this article the national income and property tax imposed by Sweden shall be deemed to be a tax deducted at the source.

2. Notwithstanding the provisions of Article XXII of this convention, the provisions of this article may be terminated by either of the contracting States at the end of two years from the date upon which this convention enters into force or at any time thereafter, provided at least six months' prior notice of termination is given, such termination to become effective on the 1st day of January following the expiration of such 6-month period. In the event the provisions of this article are terminated, the provisions of—

(1) Article XIII(2), in so far as they relate to the special property tax imposed by Sweden upon shares in a corporation;

(2) Article XIV(b)(2), relating to the allowance of an additional deduction from taxes on dividends; and

(3) Article XVI, in so far as they relate to exchange of information with respect to dividends,

will likewise terminate.

ARTICLE VIII.

Interest on bonds, notes, or loans shall be taxable only in the contracting State in which the recipient of such interest is a resident or, in the case of a corporation or other entity, in the State in which the corporation or other entity is created or organized; provided, however, that each contracting State reserves the right to collect and retain (subject to applicable provisions of its revenue laws) the taxes which, under its revenue laws, are deductible at the source.

Article IX.

Gains derived in one of the contracting States from the sale or exchange of capital assets by a resident or a corporation or other entity of the other contracting State shall be exempt from taxation in the former State, provided such resident or corporation or other entity has no permanent establishment in the former State.

Article X.

Wages, salaries and similar compensation and pensions paid by one of the contracting States or by the political subdivisions or territories or possessions thereof to individuals residing in the other State shall be exempt from taxation in the latter State.

Private pensions and life annuities derived from within one of the contracting States and paid to individuals residing in the other contracting State shall be exempt from taxation in the former State.

Article XI.

(*a*) Compensation for labor or personal services, including the practice of the liberal professions, shall be taxable only in the contracting State in which such services are rendered.

(*b*) The provisions of paragraph (*a*) are, however, subject to the following exceptions:

A resident of Sweden shall be exempt from United States tax upon compensation for labor or personal services performed within the United States of America if he falls within either of the following classifications:

1. He is temporarily present within the United States of America for a period or periods not exceeding a total of 180 days during the taxable year and his compensation is received for labor or personal services performed as an employee of, or under contract with, a resident or corporation or other entity of Sweden; or
2. He is temporarily present in the United States of America for a period or periods not exceeding a total of 90 days during the taxable year and the compensation received for such services does not exceed $3,000 in the aggregate.

In such cases Sweden reserves the right to the taxation of such income.

(*c*) The provisions of paragraph (*b*) of this article shall apply, mutatis mutandis, to a resident of the United States of America deriving compensation for personal services performed within Sweden.

(*d*) The provisions of paragraphs (*b*) and (*c*) of this article shall have no application to the professional earnings of such individuals as actors, artists, musicians and professional athletes.

(*e*) The provisions of this article shall have no application to the income to which Article X relates.

Article XII.

Students or business apprentices from one contracting State residing in the other contracting State exclusively for purposes of study or for acquiring business experience shall not be taxable by the latter State in respect of remittances received by them from within the former State for the purposes of their maintenance or studies.

Article XIII.

In the case of taxes on property or increment of property the following provisions shall be applicable:

(1) If the property consists of:

(*a*) Immovable property and accessories appertaining thereto;

(*b*) Commercial or industrial enterprises, including maritime shipping and air transport undertakings;

the tax may be levied only in that contracting State which is entitled under the preceding articles to tax the income from such property.

(2) In the case of all other forms of property, the tax may be levied only in that contracting State where the taxpayer has his residence or, in the case of a corporation or other entity, in the contracting State where the corporation or other entity has been created or organized.

The same principles shall apply to the United States capital stock tax with respect to corporations of Sweden having capital or other property in the United States of America.

ARTICLE XIV.

It is agreed that double taxation shall be avoided in the following manner:

(*a*) Notwithstanding any other provision of this convention, the United States of America in determining the income and excess-profits taxes, including all surtaxes, of its citizens or residents or corporations, may include in the basis upon which such taxes are imposed all items of income taxable under the revenue laws of the United States of America as though this convention had not come into effect. The United States of America shall, however, deduct the amount of the taxes specified in Article I(*b*) (1) and (3) of this convention or other like taxes from the income tax thus computed but not in excess of that portion of the income tax liability which the taxpayer's net income taxable in Sweden bears to his entire net income.

(*b*) (1) Notwithstanding any other provision of this convention, Sweden, in determining the graduated tax on income and property of its residents or corporations or other entities, may include in the basis upon which such tax is imposed all items of income and property subject to such tax under the taxation laws of Sweden. Sweden shall, however, deduct from the tax so calculated that portion of such tax liability which the taxpayer's income and property exempt from taxation in Sweden under the provisions of this convention bears to his entire income and property.

(2) There shall also be allowed by Sweden from its national income and property tax a deduction offsetting the tax deducted at the source in the United States of America, amounting to not less than 5 per centum of the dividends from within the United States of America and subject to such tax in Sweden. It is agreed that the United States of America shall allow a similar credit against the United States income tax liability of citizens of Sweden residing in the United States of America.

ARTICLE XV.

With a view to the more effective imposition of the taxes to which the present convention relates, each of the contracting States undertakes, subject to reciprocity, to furnish such information in the matter of taxation, which the authorities of the State concerned have at their disposal or are in a position to obtain under their own law, as may be of use to the authorities of the other State in the assessment of the taxes in question and to lend assistance in the service of documents in connection therewith. Such information and correspondence relating to the subject matter of this article shall be exchanged between the competent authorities of the contracting States in the ordinary course or on demand.

ARTICLE XVI.

1. In accordance with the preceding article, the competent authorities of the United States of America shall forward to the competent authorities of Sweden as soon as practicable after the close of each calendar year the following information relating to such calendar year:

(*a*) The names and addresses of all addressees within Sweden deriving from sources within the United States of America dividends, interest, royalties, pensions, annuities, or other fixed or determinable annual or periodical income, showing the amount of such income with respect to each addressee;

(*b*) Any particulars which the competent United States authorities may obtain from banks, savings banks or other similar institutions concerning assets belonging to individuals resident in Sweden or to Swedish corporations or other entities;

(*c*) Any particulars which the competent United States authorities may obtain from inventories in the case of property passing on death concerning debts contracted with individuals resident in Sweden or Swedish corporations or other entities.

2. The competent authorities of Sweden shall forward to the competent authorities of the United States of America as soon as practicable after the close of each calendar year the following information relating to such calendar year:

(*a*) The particulars contained in the forms delivered to the Swedish authorities in connection with the payment to individuals or corporations or other entities whose addresses are within the United States of America of dividends on shares in a corporation or participation certificates in cooperative societies, and interest on bonds or other similar securities;

(*b*) The particulars contained in permits accorded to individuals resident in the United States of America or to United States corporations or other entities to enable them to acquire for business purposes immovable property situated in Sweden;

(*c*) Any particulars which the central Swedish authorities may obtain from banks, savings banks or other similar institutions concerning assets belonging to individuals resident in the United States of America or to United States corporations or other entities;

(*d*) Any particulars which the central Swedish authorities may obtain from inventories in the case of property passing on death, concerning debts contracted with individuals resident in the United States of America, or United States corporations or other entities;

(*e*) A list of the names and addresses of all United States citizens resident in the United States of America who have made declarations to the Central Committee in Stockholm in charge of the taxation of taxpayers not resident in Sweden for purposes of the Swedish tax on income and property;

(*f*) Particulars concerning annuities and pensions, public or private, paid to individuals resident in the United States of America.

ARTICLE XVII.

Each contracting State undertakes, in the case of citizens or corporations or other entities of the other contracting State, to lend assistance and support in the collection of the taxes to which the present convention relates, together with interest, costs, and additions to the taxes and fines not being of a penal character. The contracting State making such collection shall be responsible to the other contracting State for the sums thus collected.

In the case of applications for enforcement of taxes, revenue claims of each of the contracting States which have been finally determined shall be accepted for enforcement by the other contracting State and collected in that State in accordance with the laws applicable to the enforcement and collection of its own taxes. The State to which application is made shall not be required to enforce executory measures for which there is no provision in the law of the State making the application.

The applications shall be accompanied by such documents as are required by the laws of the State making the application to establish that the taxes have been finally determined.

If the revenue claim has not been finally determined the State to which application is made may, at the request of the other contracting State, take such measures of conservancy as are authorized by the revenue laws of the former State.

ARTICLE XVIII.

The competent authority of each of the contracting States shall be entitled to obtain, through diplomatic channels, from the competent authority of the other contracting State, particulars in concrete cases relative to the application to citizens or to corporations or other entities of the former State, of the taxes to which the present convention relates. With respect to particulars in other cases, the competent authority of each of the contracting States will give consideration to requests from the competent authority of the other contracting State.

ARTICLE XIX.

In no case shall the provisions of Article XVII, relating to mutual assistance in the collection of taxes, or of Article XVIII, relating to particulars in concrete cases, be construed so as to impose upon either of the contracting States the obligation

(1) to carry out administrative measures at variance with the regulations and practice of either contracting State, or

(2) to supply particulars which are not procurable under its own legislation or that of the State making application.

The State to which application is made for information or assistance shall comply as soon as possible with the request addressed to it. Nevertheless, such State may refuse to comply with the request for reasons of public policy or if compliance would involve violation of a business, industrial or trade secret or practice. In such case it shall inform, as soon as possible, the State making the application.

ARTICLE XX.

Where a taxpayer shows proof that the action of the revenue authorities of the contracting States has resulted in double taxation in his case in respect of any of the taxes to which the present convention relates, he shall be entitled to lodge a claim with the State of which he is a citizen or, if he is not a citizen of either of the contracting States, with the State of which he is a resident, or, if the taxpayer is a corporation or other entity, with the State in which it is created or organized. Should the claim be upheld, the competent authority of such State may come to an agreement with the competent authority of the other State with a view to equitable avoidance of the double taxation in question.

ARTICLE XXI.

The competent authorities of the two contracting States may prescribe regulations necessary to interpret and carry out the provisions of this convention. With respect to the provisions of this convention relating to exchange of information, service of documents and mutual assistance in the collection of taxes, such authorities may, by common agreement, prescribe rules concerning matters of procedure, forms of application and replies thereto, conversion of currency, disposition of amounts collected, minimum amounts subject to collection and related matters.

ARTICLE XXII.

The present convention shall be ratified, in the case of the United States of America, by the President, by and with the advice and consent of the Senate, and in the case of Sweden, by His Majesty the King, with the consent of the Riksdag. The ratifications shall be exchanged at Stockholm.

This convention shall become effective on the 1st day of January following the exchange of the instruments of ratification and shall apply to income realized and property held on or after that date. The convention shall remain in force for a period of five years and indefinitely thereafter but may be terminated by either contracting State at the end of the 5-year period or at any time thereafter, provided at least six months' prior notice of termination has been given, the termination to become effective on the 1st day of January following the expiration of the 6-month period.

In witness whereof the respective plenipotentiaries have signed this convention and have affixed their seals hereto.

Done in duplicate, in the English and Swedish languages, both authentic, at Washington, this 23d day of March, 1939.

For the President of the United States of America:

[SEAL] SUMNER WELLES.

For His Majesty the King of Sweden:

[SEAL] W. BOSTRÖM.

PROTOCOL.

At the moment of signing the convention for the avoidance of double taxation, and the establishment of rules of reciprocal administrative assistance in the case of income and other taxes, this day concluded between the United States of America and Sweden, the undersigned plenipotentiaries have agreed that the following provisions shall form an integral part of the convention:

1. As used in this convention:

(a) The term "permanent establishment" includes branches, mines and oil wells, plantations, factories, workshops, warehouses, offices, agencies, installations, and other fixed places of business of an enterprise but does not include the casual or temporary use of merely storage facilities. A permanent establishment of a subsidiary corporation shall not be deemed to be a permanent establishment of the parent corporation. When an enterprise of one of the contracting States carries on business in the other State through an employee or agent, established there, who has general authority to contract for his employer or principal, it shall be deemed to have a permanent establishment in the latter State. But the fact that an enterprise of one of the contracting States has business dealings in the other State through a bona fide commission agent, broker or custodian shall not be held to mean that such enterprise has a permanent establishment in the latter State.

(*b*) The term "enterprise" includes every form of undertaking whether carried on by an individual, partnership, corporation, or any other entity.

(*c*) The term "enterprise of one of the contracting States" means, as the case may be, "United States enterprise" or "Swedish enterprise."

(*d*) The term "United States enterprise" means an enterprise carried on in the United States of America by a resident of the United States of America or by a United States corporation or other entity; the term "United States corporation or other entity" means a partnership, corporation or other entity created or organized in the United States of America or under the law of the United States of America or of any State or Territory of the United States of America.

(*e*) The term "Swedish enterprise" is defined in the same manner, mutatis mutandis, as the term "United States enterprise."

2. The term "corporation" includes associations, joint-stock companies, and insurance companies.

3. A citizen of one of the contracting States not residing in either shall be deemed, for the purpose of this convention, to be a resident of the contracting State of which he is a citizen.

When doubt arises with respect to residence or with respect to the taxable status of corporations or other entities, the competent authorities of the two contracting States may settle the question by mutual agreement.

4. The provisions of Swedish law concerning the taxation of the undivided estates of deceased persons shall not apply where the beneficiaries are directly liable to taxation in the United States of America.

5. The term "life annuities" referred to in Article X of this convention means a stated sum payable periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in consideration of a gross sum paid for such obligation.

6. The Swedish so-called "fees tax" (bevillningsavgift för vissa offentliga föreställningar) based on gross income in so far as it affects such individuals as actors, artists, musicians and professional athletes shall be deemed to be an income tax for the purposes of Article XIV(*a*).

The credit for taxes provided in Article XIV shall have no application to taxes deducted at the source from dividends and interest except to the extent provided in paragraph (*b*), (2) of that article.

In the application of the provisions of this convention the benefits of section 131 of the United States Revenue Act of 1938, relating to credits for foreign taxes, shall be accorded, but the credit provided for in Article XIV(*a*) shall not extend to United States excess-profits taxes nor to the surtax imposed on personal holding companies.

7. Citizens of each of the contracting States residing within the other contracting State shall not be subjected in the latter State to other or higher taxes than are imposed upon the citizens of such latter State.

8. The provisions of this convention shall not be construed to deny or affect in any manner the right of diplomatic and consular officers to other or additional exemptions now enjoyed or which may hereafter be granted to such officers, nor to deny to either of the contracting States the right to subject to taxation its own diplomatic and consular officers.

9. The provisions of the present convention shall not be construed to restrict in any manner any exemption, deduction, credit or other allowance accorded by the laws of one of the contracting States in the determination of the tax imposed by such State.

10. In the administration of the provisions of this convention relating to exchange of information, service of documents, and mutual assistance in collection of taxes, fees and costs incurred in the ordinary course shall be borne by the State to which application is made but extraordinary costs incident to special forms of procedure shall be borne by the applying State.

11. Documents and other communications or information contained therein, transmitted under the provisions of this convention by one of the contracting States to the other contracting State shall not be published, revealed or disclosed to any person except to the extent permitted under the laws of the latter State with respect to similar documents, communications or information.

12. As used with respect to revenue claims in Article XVII of this convention the term "finally determined" shall be deemed to mean:

(*a*) In the case of Sweden, claims which have been finally established, even though still open to revision by exceptional procedure;

(*b*) In the case of the United States of America, claims which are no longer appealable, or which have been determined by decision of a competent tribunal, which decision has become final.

13. As used in this convention the term "competent authority" or "competent authorities" means, in the case of the United States of America, the Secretary of the Treasury and in the case of Sweden, the Finance Ministry.

14. The term "United States of America" as used in this convention in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

15. Should any difficulty or doubt arise as to the interpretation or application of the present convention, or its relationship to conventions between one of the contracting States and any other State, the competent authorities of the contracting States may settle the question by mutual agreement.

16. The present convention and protocol shall not be deemed to affect the exchange of notes between the United States of America and Sweden providing relief from double income taxation on shipping profits, signed March 31, 1938.

Done at Washington, this 23d day of March, 1939.

[SEAL] SUMNER WELLES.
[SEAL] W. BOSTRÖM.

And whereas the said convention and the said protocol have been duly ratified on both parts and the ratifications of the two Governments were exchanged at Stockholm on the 14th day of November, one thousand nine hundred and thirty-nine;

And whereas, as is provided in Article XXII, the said convention shall become effective on the 1st day of January following the exchange of the instruments of ratification;

Now, therefore, be it known that I, Franklin D. Roosevelt, President of the United States of America, have caused the said convention and the said protocol to be made public to the end that the same and every article, clause and part thereof may be observed and fulfilled with good faith by the United States of America and the citizens thereof on and from the 1st day of January, one thousand nine hundred and forty.

In testimony whereof, I have hereunder set my hand and caused the Seal of the United States of America to be affixed.

Done at the city of Washington this 12th day of December, in the year of our Lord one thousand nine hundred and thirty-nine, and of the Independence of the United States of America the one hundred and sixty-fourth.

[SEAL]

FRANKLIN D ROOSEVELT.

By the President:

CORDELL HULL,
Secretary of State.

MISCELLANEOUS.

1940-15-10232
Mim. 4298 (Rev.)

Symbols for use in correspondence.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., March 25, 1940.

Collectors of Internal Revenue; Internal Revenue Agents in Charge; District Supervisors; Heads of Field Divisions, Technical Staff; Special Agents in Charge; Deputy Commissioners; and Other Officers and Employees of the Bureau of Internal Revenue Concerned:

The following directions supersede those contained in Mimeograph 4298 (revised), dated November 28, 1938 [C. B. 1938-2, 508], and all other instructions in conflict therewith. Section 63(6), Part I, of the Internal Revenue Manual is, also, amended to conform to the following:

Every letter prepared in the Bureau in Washington will bear in the upper left-hand corner of the first page, and immediately below the wording "Address reply to," etc., a symbol that will indicate the office of origin; provided, that this practice will not apply to congressional correspondence, or to letters prepared for the signatures of others than officials of the Bureau.

Every letter addressed to the Bureau by a field office, if it is in reply to a communication from the Bureau, will bear, immediately above the body of the letter and near the center of the first page, the symbol that appears in the communication that is being answered; thus "Attention: Ad:PB." If the letter is not in reply to a Bureau communication, the symbol of the unit, division, or section of the Bureau concerned will be indicated in the same manner, provided there is no question as to the proper symbol; *if any doubt exists, no symbol whatever will be used.*

Where a field office uses a system of symbols in conducting its correspondence, the appropriate symbol will be placed in the upper left-hand corner of the first sheet, just below the wording "In replying refer to," of each letter addressed to the Bureau. The Bureau letter, if any, replying to such communication will show the field office symbol above the body of the letter in the same manner as is prescribed in the next preceding paragraph.

Closed, and not window, envelopes with printed or typewritten address will be used by field offices in transmitting mail to the Bureau. Every such envelope, or other wrapper, will bear in the lower left-hand corner of the face thereof the same symbol that is quoted in the communication which it incloses. There is no objection to forwarding in one envelope a number of communications intended for the same unit or division of the Bureau; in fact, this is desirable, except that instructions contained in A&C-Circular 1248, dated May 28, 1938, regarding the separation of social security from other mail for the Accounts and Collections Unit should be complied with. Under no circumstances, however, should correspondence pertaining to the work of one unit be inclosed in an envelope addressed to another unit.

Information which will assist field officers in determining the destination of correspondence that is not in reply to Bureau letters may be obtained by directing an inquiry to the Administrative Division, attention Communication Section.

Only one subject will be treated in any one letter.

The following represents the organization and symbols used:

OFFICE OF THE COMMISSIONER.

Ad—Administrative Division.
Ad: C—Communication Section.
Ad: PB—Printing and Binding Section.
Ad: SL—Space and Lease Section.
Ad: SE—Supplies and Equipment Section.
P—Personnel Division.
Pub. Rel.—Public Relations Division.
SD—Special Deputy Commissioner.
SD: Tn—Training Division.
TS—Technical Staff.

ACCOUNTS AND COLLECTIONS UNIT.

A&C: DC—Deputy Commissioner.
A&C: AD—Assistant Deputy Commissioner.
A&C: EA—Executive Assistant.
A&C: ET—Chief Employment Tax Activities.
A&C: TA—Technical Assistants.
A&C: D—Disbursement Accounting Division.
A&C: Col—Collection Accounting Division.
A&C: PES—Collectors' Personnel, Equipment, and Space Division.

AUDIT DIVISION.

A&C: A—Head of Division.
A&C: A: AA—Audit and Adjustment Section.
A&C: A: E—Examining Section.
A&C: A: F—Files Section.
A&C: A: F: RB&R—Bankruptcy Unit.

RULES AND REGULATIONS DIVISION.

A&C: RR—Head of Division.
A&C: RR: 1—Section 1.
A&C: RR: 2—Section 2.
A&C: RR: 3—Section 3.

SERVICE DIVISION.

A&C: S—Head of Division.
A&C: S: F—Files Section.
A&C: S: S—Stenographic Section.

CONTROL DIVISION.

A&C: C—Head of Division.
A&C: C: A—Assessment Section.
A&C: C: CC—Claims Control Section.

ALCOHOL TAX UNIT.

AT: DC—Deputy Commissioner.
AT: L—Legal Division.

ENFORCEMENT DIVISION

AT: E—Assistant Deputy Commissioner.
AT: EX—Examining Section.
AT: PP—Pardon and Parole Section.
AT: EF—Enforcement Files Section.
AT: RM—Raw Materials Section.

PERMISSIVE AND ADMINISTRATIVE.

AT: P—Assistant Deputy Commissioner.
AT: FI—Field Inspection Division.
AT: PS—Personnel and Supply Division.
AT: PR—Procedure Division.
AT: S—Statistical Section.
AT: A—Audit Division.
AT: BA—Bonded Accounts Section.
AT: T—Tax Section.
AT: LB—Laboratory Division.

OFFICE OF THE CHIEF COUNSEL.

GC: A—Appeals Division.
GC: C—Civil Division.
GC: C: C—Compromise Section.
GC: I—Interpretative Division.
Manuscript Section.
GC: L&R—Legislation and Regulations Division.
GC: P—Penal Division.
GC: R—Review Division.
GC: RBR—Reorganization Section.
GC: Ad—Administrative Division.
Mail and Records Section.
Engineers and Auditors Section.

INCOME TAX UNIT.

IT—Deputy Commissioner.
Assistant Deputy Commissioner.
IT: R: A—Audit Review Division A (New York).
IT: R: B—Audit Review Division B (Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, Pennsylvania, Rhode Island, Vermont).
IT: R: C—Audit Review Division C (Alabama, Delaware, District of Columbia, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, Missouri, North Carolina, Ohio, South Carolina, Tennessee, Virginia, West Virginia).
IT: R: D—Audit Review Division D (Illinois, Indiana, Iowa, Michigan, Minnesota, Nebraska, North Dakota, South Dakota, Wisconsin).
IT: R: E—Audit Review Division E (Alaska, Arizona, Arkansas, California, Colorado, Hawaii, Idaho, Kansas, Montana, Nevada, New Mexico, Oklahoma, Oregon, Texas, Utah, Washington, Wyoming).
IT: R: E: Aj—Special Adjustment.

CLEARING DIVISION.

IT: Cl—Head of Division.
IT: Cl: CC—Claims Control Section.
IT: Cl: D—Returns Distribution Section.
IT: Cl: P—Proving Section.
IT: Cl: St—Statistical Section.

ENGINEERING AND VALUATION DIVISION.

IT: EV—Head of Division.
IT: EV: Ap—Appraisal Section.
IT: EV: NR—Natural Resources Section.
IT: EV: PU—Public Utilities Section.
IT: EV: Se—Securities Section.

FIELD PROCEDURE DIVISION.

IT: F—Field Procedure Division.

PRACTICE AND PROCEDURE DIVISION.

IT : P—Head of Division.
IT : P : IR—Bureau Information and Rulings Section.
IT : P : CA—Coordinating and Advisory Section.
IT : P : T—Taxpayers' Rulings Section.
IT : P : T : 1—Group 1.
IT : P : T : 2—Group 2.
IT : P : T : 3—Group 3.

RECORDS DIVISION.

IT : Rec—Head of Division.
IT : Rec : F—Files Section.
IT : Rec : W—Withholding Returns Section.

SERVICE DIVISION.

IT : S—Service Division.

UNJUST ENRICHMENT DIVISION.

IT : UE—Head of Division.
IT : UE : AR—Audit and Review Section.
IT : UE : Conf—Conference Section.
IT : UE : I—Invalidity Claims Section.

INTELLIGENCE UNIT.

SI—Chief, Intelligence Unit.

MISCELLANEOUS TAX UNIT.

MT : DC—Deputy Commissioner.
MT : CST—Capital Stock Tax Division.
MT : ET—Estate Tax Division.
MT : PT—Processing Tax Division.
MT : ST—Sales Tax Division.
MT : T—Tobacco Division.

GUY T. HELVERING,
Commissioner.

OLEOMARGARINE.

1940-1-10132
MS. 221

Schedule of oleomargarine produced and materials used during the month of November, 1939, as compared with November, 1938.

	November, 1939.	November, 1938.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 27, 743, 186	[2] 30, 098, 029
Total withdrawn tax-paid	27, 689, 512	29, 778, 769
Ingredient schedule of uncolored oleomargarine:		
Babassu oil	1, 057, 357	642, 668
Coconut oil	2, 108, 369	6, 976, 189
Corn oil	34, 171	113, 313
Cottonseed oil	9, 683, 122	10, 793, 497
Derivative of glycerine	71, 858	73, 790
Lecithin	7, 097	8, 782
Milk	5, 307, 196	5, 809, 056
Neutral lard	115, 957	108, 282
Oleo oil	730, 704	922, 302
Oleo stearine	227, 795	260, 927
Oleo stock	84, 130	107, 983
Palm kernel oil		18, 234
Peanut oil	200, 828	245, 562
Salt	1, 201, 100	1, 261, 551
Soda (benzoate of)	10, 503	11, 616
Soya bean oil	8, 039, 038	4, 284, 522
Soya bean stearine		7, 349
Vitamin concentrate	1, 690	1, 215
Total	28, 880, 915	31, 649, 868
Total production of colored oleomargarine	[3] 142, 724	[4] 122, 850
Total withdrawn tax-paid	29, 248	32, 948
Ingredient schedule of colored oleomargarine:		
Coconut oil	45, 243	46, 929
Color	164	141
Corn oil	25	136
Cottonseed oil	17, 602	18, 356
Cottonseed stearine	855	
Derivative of glycerine	354	261
Lecithin	55	6
Milk	29, 503	29, 131
Neutral lard	8, 752	3, 962
Oleo oil	14, 241	17, 959
Oleo stearine	450	490
Oleo stock	1, 310	1, 164
Palm kernel oil		66
Peanut oil	301	85
Salt	8, 456	6, 131
Soda (benzoate of)	47	49
Soya bean oil	35, 037	18, 557
Soya bean stearine		27
Vitamin concentrate	3	1
Total	157, 398	138, 451

[1] Of the amount produced, 27,029 pounds were reworked.
[2] Of the amount produced, 24,163 pounds were reworked.
[3] Of the amount produced, 128 pounds were reworked.
[4] Of the amount produced, 77 pounds were reworked.

1940-5-10163
MS. 222

Schedule of oleomargarine produced and materials used during the month of December, 1939, as compared with December, 1938.

	December, 1939.	December, 1938.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 25, 438, 984	[2] 30, 252, 565
Total withdrawn tax-paid	25, 711, 698	29, 956, 607
Ingredient schedule of uncolored oleomargarine:		
Babassu oil	659, 111	614, 791
Coconut oil	1, 912, 842	7, 160, 309
Corn oil	53, 493	134, 763
Cottonseed oil	8, 765, 590	10, 563, 896
Derivative of glycerine	60, 257	74, 890
Lecithin	7, 142	9, 714
Milk	4, 958, 870	5, 804, 222
Neutral lard	201, 718	100, 962
Oleo oil	860, 384	994, 400
Oleo stearine	236, 008	236, 979
Oleo stock	78, 427	116, 609
Palm kernel oil		98, 472
Peanut oil	193, 650	231, 826
Salt	1, 050, 755	1, 238, 503
Soda (benzoate of)	9, 116	12, 488
Soya bean oil	7, 546, 246	4, 174, 633
Vitamin concentrate	1, 342	1, 282
Total	26, 594, 951	31, 568, 739
Total production of colored oleomargarine	[3] 148, 126	[4] 120, 858
Total withdrawn tax-paid	25, 499	34, 358
Ingredient schedule of colored oleomargarine:		
Coconut oil	58, 769	43, 663
Color	115	153
Corn oil	54	54
Cotton seed oil	13, 181	12, 856
Cottonseed stearine	210	
Derivative of glycerine	285	380
Lecithin	77	3
Milk	29, 443	25, 978
Neutral lard	4, 200	3, 624
Oleo oil	15, 526	14, 936
Oleo stock	956	719
Palm kernel oil		218
Peanut oil	200	37
Salt	7, 702	6, 921
Soda (benzoate of)	35	55
Soya bean oil	29, 108	23, 785
Vitamin concentrate	1	3
Total	159, 862	133, 385

[1] Of the amount produced, 10,425 pounds were reworked.
[2] Of the amount produced, 40,316 pounds were reworked.
[3] Of the amount produced, 1,475 pounds were reworked.
[4] Of the amount produced, 1,696 pounds were reworked.

1940-10-10194
MS. 223

Schedule of oleomargarine produced and materials used during the month of January, 1940, as compared with January, 1939.

	January, 1940.	January, 1939.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 29,204,468	[2] 30,199,609
Total withdrawn tax-paid	29,379,265	30,315,940
Ingredient schedule of uncolored oleomargarine:		
Babassu oil	692,201	712,285
Butter	64	
Coconut oil	2,001,649	7,207,087
Corn oil	83,545	118,864
Cottonseed oil	10,055,129	9,871,469
Derivative of glycerine	72,406	75,562
Lecithin	7,165	8,438
Milk	5,666,278	5,828,765
Neutral lard	238,029	102,766
Oleo oil	1,131,517	1,166,224
Oleo stearine	261,934	232,079
Oleo stock	119,617	128,869
Palm kernel oil		121,434
Peanut oil	165,727	218,940
Salt	1,206,030	1,289,047
Soda (benzoate of)	11,639	13,082
Soya bean oil	8,939,392	4,793,826
Vitamin concentrate	1,481	1,173
Total	30,653,803	31,689,910
Total production of colored oleomargarine	[3] 149,578	[4] 119,563
Total withdrawn tax-paid	30,011	34,058
Ingredient schedule of colored oleomargarine:		
Babassu oil		2
Coconut oil	49,779	87,205
Color	106	118
Corn oil	261	63
Cottonseed oil	21,968	13,008
Cottonseed stearine	60	
Derivative of glycerine	316	320
Lecithin	83	9
Milk	29,591	27,634
Neutral lard	2,871	3,852
Oleo oil	12,690	21,042
Oleo stearine	2,687	125
Oleo stock	661	1,999
Palm kernel oil		626
Peanut oil	138	38
Salt	7,564	6,199
Soda (benzoate of)	36	61
Soya bean oil	33,837	17,257
Vitamin concentrate	3	3
Total	162,651	129,561

[1] Of the amount produced, 20,735 pounds were reworked.
[2] Of the amount produced, 29,307 pounds were reworked.
[3] Of the amount produced, 610 pounds were reworked.
[4] Of the amount produced, 320 pounds were reworked.

1940-14-10223
MS. 224

Schedule of oleomargarine produced and materials used during the month of February, 1940, as compared with February, 1939.

	February, 1940.	February, 1939.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 29, 308, 517	[2] 27, 574, 196
Total withdrawn tax-paid	28, 444, 023	27, 744, 210
Ingredient schedule of uncolored oleomargarine:		
Babassu oil	769, 597	1, 164, 916
Butter	64	
Coconut oil	1, 785, 788	5, 262, 189
Corn oil	88, 514	61, 505
Cottonseed oil	10, 187, 859	9, 397, 515
Derivative of glycerine	79, 062	77, 635
Lecithin	8, 015	7, 059
Milk	5, 723, 102	5, 395, 467
Neutral lard	330, 750	110, 218
Oleo oil	1, 311, 582	1, 270, 172
Oleo stearine	259, 362	228, 563
Oleo stock	103, 092	130, 691
Palm kernel oil		43, 980
Peanut oil	152, 830	193, 885
Salt	1, 221, 719	1, 150, 819
Soda (benzoate of)	10, 323	11, 133
Soya bean oil	8, 611, 381	4, 365, 905
Vitamin concentrate	1, 701	1, 724
Vegetable gum	583	
Total	30, 645, 357	28, 873, 366
Total production of colored oleomargarine	[3] 168, 729	126, 602
Total withdrawn tax-paid	29, 729	30, 230
Ingredient schedule of colored oleomargarine:		
Babassu oil		2, 622
Coconut oil	55, 328	32, 705
Color	147	132
Corn oil	54	69
Cottonseed oil	12, 503	14, 490
Cottonseed stearine	360	
Derivative of glycerine	640	349
Lecithin	78	6
Milk	38, 145	26, 983
Neutral lard	2, 176	4, 379
Oleo oil	25, 664	18, 752
Oleo stearine	1, 475	
Oleo stock	2, 362	1, 409
Palm kernel oil		178
Peanut oil	13	77
Salt	10, 008	6, 691
Soda (benzoate of)	39	69
Soya bean oil	46, 098	29, 255
Vitamin concentrate	2	2
Total	195, 092	138, 173

[1] Of the amount produced, 21,741 pounds were reworked.
[2] Of the amount produced, 14,747 pounds were reworked.
[3] Of the amount produced, 30 pounds were reworked.

1940-18-10248
MS. 225

Schedule of oleomargarine produced and materials used during the month of March, 1940, as compared with March, 1939.

	March, 1940.	March, 1939.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 26,503,406	[2] 29,279,377
Total withdrawn tax-paid	26,798,988	28,999,585
Ingredient schedule of uncolored oleomargarine:		
Babassu oil	525,197	1,589,377
Butter	60	
Coconut oil	2,421,474	4,702,759
Corn oil	86,219	51,431
Cottonseed oil	9,013,808	9,663,677
Derivative of glycerine	62,607	73,385
Lecithin	7,554	7,274
Milk	5,045,721	5,827,131
Neutral lard	297,738	108,615
Oleo oil	1,302,816	1,307,170
Oleo stearine	242,077	270,334
Oleo stock	94,095	93,787
Palm oil	1,050	
Palm kernel oil		171,522
Peanut oil	146,144	202,511
Salt	1,076,929	1,213,216
Soda (benzoate of)	10,100	11,603
Soya bean oil	7,125,375	5,411,040
Vegetable gum	1,179	
Vitamin concentrate	1,287	1,289
Total	27,461,430	30,706,121
Total production of colored oleomargarine	137,958	[3] 137,202
Total withdrawn tax-paid	29,269	32,693
Ingredient schedule of colored oleomargarine:		
Babassu oil	498	7,103
Coconut oil	42,930	25,881
Color	110	137
Corn oil	62	98
Cottonseed oil	7,495	14,541
Cottonseed stearine	270	60
Derivative of glycerine	282	303
Lecithin	54	7
Milk	28,619	33,465
Neutral lard	2,965	3,638
Oleo oil	14,396	18,431
Oleo stearine	400	1,100
Oleo stock	1,810	1,287
Palm kernel oil		1,123
Peanut oil	11	107
Salt	6,692	8,612
Soda (benzoate of)	40	63
Soya bean oil	43,804	40,956
Vitamin concentrate	2	3
Total	150,440	156,915

[1] Of the amount produced, 16,706 pounds were reworked.
[2] Of the amount produced, 19,106 pounds were reworked.
[3] Of the amount produced, 64 pounds were reworked.

1940-23-10284
MS. 226

Schedule of oleomargarine produced and materials used during the month of April, 1940, as compared with April, 1939.

	April, 1940.	April, 1939.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 27,230,978	[2] 23,229,375
Total withdrawn tax-paid	27,550,016	23,595,417
Ingredient schedule of uncolored oleomargarine:		
Babassu oil	935,954	1,246,331
Coconut oil	3,016,302	3,407,487
Corn oil	32,364	27,239
Cottonseed oil	8,173,118	7,472,545
Derivative of glycerine	77,947	59,774
Lecithin	6,948	5,911
Milk	5,208,285	4,541,279
Neutral lard	633,964	90,965
Oleo oil	1,216,693	1,017,622
Oleo stearine	312,881	235,979
Oleo stock	117,440	80,149
Palm kernel oil		125,756
Peanut oil	113,514	177,709
Salt	1,129,257	995,007
Soda (benzoate of)	9,615	9,323
Soya bean oil	7,103,705	4,895,876
Soya bean stearine	500	
Vitamin concentrate	1,294	1,311
Total	28,088,781	24,390,263
Total production of colored oleomargarine	[3] 177,184	95,670
Total withdrawn tax-paid	29,955	27,051
Ingredient schedule of colored oleomargarine:		
Babassu oil	831	473
Coconut oil	68,050	20,260
Color	120	90
Corn oil	3	4
Cottonseed oil	14,881	10,992
Derivative of glycerine	403	291
Lecithin	86	3
Milk	36,212	19,346
Neutral lard	3,958	3,554
Oleo oil	18,275	14,204
Oleo stearine	820	900
Oleo stock	2,120	806
Palm kernel oil		468
Peanut oil	38	34
Salt	8,032	6,616
Soda (benzoate of)	73	33
Soya bean oil	36,785	28,961
Vitamin concentrate	3	1
Total	190,690	107,036

[1] Of the amount produced, 24,432 pounds were reworked.
[2] Of the amount produced, 32,112 pounds were reworked.
[3] Of the amount produced, 12 pounds were reworked.

TOBACCO.

1940-1-10131
T. 66

Statement of manufactured tobacco produced, by classes, during the month of October, 1939, as compared with October, 1938.

	October, 1939.	October, 1938.
	Pounds.	*Pounds.*
Plug	4,369,593	4,344,306
Twist	518,382	444,336
Fine-cut chewing	373,467	358,365
Scrap chewing	3,827,380	2,151,438
Smoking	19,659,708	17,670,745
Total	28,748,530	24,969,190

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

1940-5-10161
T. 67

Statement of manufactured tobacco produced, by classes, during the month of November, 1939, as compared with November, 1938.

	November, 1939.	November, 1938.
	Pounds.	*Pounds.*
Plug	3,851,324	4,266,312
Twist	515,243	414,774
Fine-cut chewing	365,549	362,835
Scrap chewing	3,415,282	4,563,403
Smoking	17,466,579	18,503,408
Total	25,613,977	28,110,732

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

1940-9-10189
T. 68

Statement of manufactured tobacco produced, by classes, during the month of December, 1939, as compared with December, 1938.

	December, 1939.	December, 1938.
	Pounds.	*Pounds.*
Plug	3,763,223	4,289,930
Twist	448,759	440,335
Fine-cut chewing	323,309	382,042
Scrap chewing	3,195,678	4,132,533
Smoking	14,420,982	15,580,293
Total	22,151,951	24,825,133

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

1940–14–10222
T. 69

Statement of manufactured tobacco produced, by classes, during the month of January, 1940, as compared with January, 1939.

	January, 1940.	January, 1939.
	Pounds.	*Pounds.*
Plug	3, 484, 165	3, 418, 751
Twist	399, 495	399, 664
Fine-cut chewing	330, 480	371, 902
Scrap chewing	3, 590, 964	3, 419, 480
Smoking	15, 165, 040	15, 650, 411
Total	22, 970, 144	23, 260, 208

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

1940–18–10249
T. 70

Statement of manufactured tobacco produced, by classes, during the month of February, 1940, as compared with February, 1939.

	February, 1940.	February, 1939.
	Pounds.	*Pounds.*
Plug	4, 035, 409	4, 145, 496
Twist	481, 224	470, 912
Fine-cut chewing	299, 909	319, 040
Scrap chewing	3, 396, 970	2, 923, 992
Smoking	15, 835, 734	14, 711, 479
Total	24, 049, 246	22, 570, 919

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

1940–22–10275
T. 71

Statement of manufactured tobacco produced, by classes, during the month of March, 1940, as compared with March, 1939.

	March, 1940.	March, 1939.
	Pounds.	*Pounds.*
Plug	3, 805, 804	4, 321, 519
Twist	453, 734	491, 139
Fine-cut chewing	335, 070	423, 113
Scrap chewing	3, 363, 062	3, 365, 273
Smoking	16, 086, 939	17, 451, 168
Total	24, 044, 609	26, 052, 212

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

BOARD OF TAX APPEALS.

1940–12–10211

RULES OF PRACTICE BEFORE THE UNITED STATES BOARD OF TAX APPEALS.

INTRODUCTION.

These revised rules are promulgated pursuant to authority of section 907(a) of the Revenue Act of 1924, as amended by section 601 of the Revenue Act of 1928, which provides in part that "The proceedings of the Board and its divisions shall be conducted in accordance with such rules of practice and procedure (other than rules of evidence) as the Board may prescribe and in accordance with the rules of evidence applicable in courts of equity of the District of Columbia."

Congress in the Revenue Acts has enacted provisions relating to the organization, jurisdiction, and procedure of the Board of Tax Appeals, and to the action of the Bureau of Internal Revenue with respect to the assessment and collection of deficiencies when a petition has been filed with the Board. Reference is made to those statutory provisions in the Revenue Acts for procedural requirements other than those relating to the conduct of proceedings before the Board and its divisions to which these rules of practice are limited. Attention is called to Title 26 of the United States Code for convenient reference to the Revenue Acts as amended and particularly to sections 271, 272, 273, 600, and 645 of Title 26.

This edition of the rules of practice * * * becomes effective on March 1, 1940, and takes the place of the last revision which became effective on July 1, 1938. * * *

Attention is called to the following: Many petitions filed with this Board are dismissed for lack of jurisdiction and for failure to comply with the rules of practice. It is therefore of great importance to petitioners that petitions be prepared and filed properly in accordance with statutory requirements and the provisions of the rules of practice.

RULE 1. BUSINESS HOURS.

The office of the Board at Washington, D. C., will be open each business day from 9 o'clock a. m. to 4.30 o'clock p. m.

RULE 2. ADMISSION TO PRACTICE.

Persons of the following classes who are found by the Board, upon consideration of their applications, to be citizens of the United States, of good moral character, and to possess the requisite qualifications to represent others, may be admitted to practice before the Board:

(*a*) Attorneys at law who are admitted to practice before the Supreme Court of the United States or the highest court of any State or Territory or of the District of Columbia.

(*b*) Certified public accountants duly qualified under the laws of any State or Territory or of the District of Columbia.

Corporations and firms will not be admitted or recognized.

An applicant for admission must file his application with the Board on the form provided. Forms will be furnished upon request to the secretary of the Board. Such application shall be accompanied by a current certificate of the clerk of the court in which the applicant is admitted to practice to the effect that he has been so admitted and is in good standing; or a current certificate by the proper State, Territorial, or District authority to the effect that the applicant is a certified public accountant in good standing, duly qualified and entitled to practice in such State or Territory or the District of Columbia.

The Board may deny admission to, suspend, or disbar any person who in its judgment does not possess the requisite qualifications to represent others, or who is lacking in character, integrity, or proper professional conduct. No person shall be suspended for more than 60 days or disbarred until he has been afforded an opportunity to be heard. A division may immediately suspend any person for not more than 60 days for contempt or misconduct during the course of any proceeding.

The Board may require any practitioner before it to furnish a statement under oath of the terms and circumstances of his employment in any proceeding.

RULE 3. PERSONAL REPRESENTATION IN LIEU OF COUNSEL.

Any individual taxpayer or member of a taxpayer partnership may appear for himself or such partnership upon adequate identification to the Board. A taxpayer corporation may be represented by a bona fide officer of the corporation upon permission granted, in its discretion, by the Board or the division sitting.

RULE 4. FORM AND STYLE OF PAPERS.

All papers filed with the Board shall be either printed or typewritten, and if typewritten, shall be on only one side of plain white paper. This paper shall be not more than 8½ inches wide and 11 inches long, and shall weigh not less than 16 pounds to the ream. The papers shall be fastened on the left side and at no other place. They shall not be bound with stiff covers or backs. Copies shall be legible but may be on any weight paper. If printed, they shall be in 10 or 12 point type, on good unglazed paper, 5⅞ inches wide by 9 inches long, with inside margin not less than 1 inch wide, and with double-leaded text and single-leaded quotations. Citations shall be in italics when printed, and underscored when typewritten.

The proper caption shall be placed upon all papers filed. If the petitioner is an individual, the full given name and surname shall be set forth in the caption. If the petitioner is a married woman, her given name shall be used, not the name of her husband preceded by "Mrs." If the petitioner is a fiduciary, the name of the estate, trust, or other person for whom he acts, shall be given first, followed by the name of the fiduciary. (See rules 5 and 6(*a*), and Appendix I, Form No. 2.)

Except as otherwise provided in these rules, a signed original and four conformed copies of all papers shall be filed. Whenever any paper is filed in more than one proceeding (as a motion to consolidate proceedings or in proceedings already consolidated), one additional copy shall be filed for each additional proceeding.

The written signature, whether of counsel or of the petitioner, shall be in individual and not in firm name, except that where the petitioner is a corporation the written signature shall be by an active officer of the corporation. The name and mailing address of the petitioner or of counsel shall be typed or printed immediately following the written signature.

RULE 5. PROPER PARTIES.

The proceeding shall be brought by and in the name of the person against whom the Commissioner determined the deficiency [or liability, as the case may be], or by and in the full descriptive name of the fiduciary legally entitled to institute a proceeding on behalf of such person.

In the event of a variance between the name set forth in the notice of deficiency or liability and the correct name, a statement of the reasons for such variance shall be set forth in the petition. (See rules 4, 6, and 23.)

RULE 6. INITIATION OF A PROCEEDING—PETITION.

A proceeding shall be initiated by filing with the Board a petition, as provided in rules 4, 5, and 8, and substantially in accordance with Form 2, shown in Appendix I. The petition shall be complete in itself so as fully to state the issues. It shall contain:

(*a*) A caption in the following form:

UNITED STATES BOARD OF TAX APPEALS

____________________________________, *petitioner,* v. *Commissioner of Internal Revenue, respondent.*	Docket No.

PETITION.

(*b*) Proper allegations showing jurisdiction in the Board.

(*c*) A statement of the amount of the deficiency [or liability, as the case may be], determined by the Commissioner, the nature of the tax, the period for which determined, and the amount thereof (as nearly as may be computed) in controversy.

(*d*) Clear and concise assignments of each and every error which the petitioner alleges to have been committed by the Commissioner in the determination of the deficiency. Issues in respect of which the burden of proof is by statute placed upon the Commissioner will not be deemed to be raised by the petitioner in the absence of assignments of error in respect thereof. Each assignment of error shall be numbered.

(*e*) Clear and concise numbered statements of the facts upon which the petitioner relies as sustaining the assignments of error, except those assignments of error in respect of which the burden of proof is by statute placed upon the Commissioner.

(*f*) A prayer, setting forth relief sought by the petitioner.

(*g*) The signature of the petitioner or that of his counsel. (See rule 4.)

(*h*) A verification by the petitioner; provided that where the petitioner is sojourning outside the United States or is a nonresident alien, the petition may be verified by a duly appointed attorney in fact, who shall attach to the petition a copy of the power of attorney under which he acts and who shall state in his verification that he acts pursuant to such power, that such power has not been revoked; that petitioner is absent from the United States, and the grounds of his knowledge of the facts alleged in the petition. As used herein the term "United States" includes only the States and the District of Columbia. A notary public is not authorized to administer oaths, etc., in matters in which he is employed as counsel. (See Title 4, ch. 2, D. C. Code, and 26 Op. A. G., 236.)

The verification shall contain a statement that the fiduciaries signing and verifying have authority to act for the taxpayer.

Where the petitioner is a corporation, the person verifying shall state in his verification that he has authority to act for the corporation.

The signature and the verification to the petition shall be considered the certificate of those performing these acts that there is good ground for the petition, the proceeding has not been instituted merely for delay, and it is not frivolous.

(*i*) A copy of the notice of deficiency [or liability, as the case may be], shall be appended to the petition. If a statement has accompanied the notice of deficiency, so much thereof as is material to the issues set out in the assignments of error likewise shall be appended. If the notice of deficiency refers to prior notices from the Bureau, which are necessary to elucidate the determination, such parts thereof as are material to the issues set out in the assignments of error shall likewise be appended. (See Appendix I, Form No. 2.)

Rule 7. Filing of Petition.

An original and four clear copies of the petition, either printed or typewritten as provided by rule 4, shall be filed with the Board. (See rule 9.) The copies of the petition shall be conformed to the original by the petitioner.

Failure to file a sufficient number of copies, as provided in this rule, or to conform to the requirements of rules 4, 5, and 8, shall be ground for the dismissal of the proceeding.

Rule 8. Fee for Filing Petition.

The fee for filing a petition with the Board shall be $10, payable at the time of filing.

Rule 9. Filing.

Any document to be filed with the Board, must be filed at the office of the Board in Washington, D. C., during business hours; provided, that a division hearing a proceeding may permit documents pertaining thereto to be filed at the hearing.

Rule 11. Docket.

Upon receipt of the petition, the proceeding will be docketed and assigned a number and the parties notified thereof. This number shall be placed by the parties on all papers thereafter filed in the proceeding.

Rule 12. Service of the Petition.

Upon filing of a petition and the copies, as prescribed in rule 7, the clerk will serve a copy upon the Commissioner.

RULE 14. ANSWER.

After service upon him of a copy of the petition, the Commissioner shall have 60 days within which to file an answer or 45 days within which to move in respect of the petition. The answer shall be so drawn as fully and completely to advise the petitioner and the Board of the nature of the defense. It shall contain a specific admission or denial of each material allegation of fact contained in the petition and a statement of any facts upon which the Commissioner relies for defense or for affirmative relief or to sustain any issue raised in the petition in respect of which issue the burden of proof is, by statute, placed upon the Commissioner. Each paragraph contained in the answer shall be numbered to correspond with the paragraphs of the petition. An original and four copies of the answer shall be filed, of which the original shall be signed by the Commissioner or his counsel and the copies conformed by him.

The clerk will serve one copy of the answer upon the petitioner or his counsel of record by registered mail.

RULE 15. REPLY.

If the answer of the Commissioner sets forth facts upon which he relies for affirmative relief, or contains a statement of the facts upon which he relies to sustain an issue in respect of which the burden of proof is placed upon him by statute, the petitioner shall, within 45 days after a copy of such answer is mailed to him or his counsel of record by registered mail, file a reply which shall contain a specific admission or denial of each material allegation of fact contained in the answer and shall set forth any facts upon which he relies for defense. Each paragraph contained in the reply shall be numbered to correspond with the paragraphs of the answer. An original and four copies of the reply shall be filed, of which the original shall be signed by the petitioner or his counsel and the copies conformed by him.

The Board upon motion of the respondent in which good cause is shown, or upon its own motion, may require the verification of any reply.

The clerk will serve one copy of the reply upon the Commissioner.

RULE 16. JOINDER OF ISSUE.

A proceeding shall be deemed at issue upon the filing of the answer unless a reply is required under rule 15, in which event the proceeding shall be deemed at issue upon the filing of the reply.

RULE 17. AMENDED AND SUPPLEMENTAL PLEADINGS.

The petitioner may, as of course, amend his petition at any time before answer is filed. After answer is filed, a petition may be amended only by consent of the Commissioner or on leave of the Board.

All motions to amend, made prior to the hearing, must be accompanied by the proposed amendments or amended pleading.

Upon motion made, the Board may, in its discretion, at any time before the conclusion of the hearing, permit a party to a proceeding to amend the pleadings to conform to the proof.

When motions to amend are granted at the hearing, the amendment or amended pleading shall be filed at the hearing or with the Board within such time as the division may fix.

See rules 4 and 19.

RULE 18. PLEADINGS—GENERAL.

The Board, upon motion of either party in which good cause is shown, or upon its own motion, may order a further and better statement of the nature of the claim or defense, or of any matter stated in any pleading. Such a motion filed by a party shall point out the defects complained of and the details desired. If such order of the Board is not obeyed within 15 days or within such other time as the Board may fix, the Board may strike the pleading to which the motion was directed or may make such other order as it deems just.

If no reply is required by these rules, each and every material allegation of fact set out in the answer shall be deemed to be denied. Any new or affirmative matter contained in the reply shall be deemed to be denied.

Where an answer has been filed, each and every material allegation of fact set out in the petition and not expressly admitted or denied in the answer, shall be deemed to be admitted. Where a reply is required by these rules and a reply has been filed, each and every material allegation of fact set out in the answer and not expressly admitted or denied in the reply shall be deemed to be admitted.

Where no answer is filed or where a reply is required by these rules, but no reply is filed, the adverse party, within 45 days after the expiration of the time fixed by these rules for filing the answer or the reply, as the case may be (or within 45 days after the promulgation of these rules, whichever shall allow the greater time), may file a motion with the Board calling attention to the fact that the pleading has not been filed within the specified time and certain material allegations of fact have not been denied, and requesting the Board to enter its order that those particular undenied allegations shall be deemed to be admitted. The Board will serve a copy of this motion upon the other party and issue an order to show cause, returnable on or before a day certain. If the above described motion is not filed within the prescribed time, the allegations of the pleading to which there was no response shall be deemed to be denied.

Rule 19. Motions.

Motions must be timely. If a motion, other than one relating to the receipt of evidence during trial, is made orally during trial, the maker thereof shall promptly reduce it to writing and file it with the Board unless the division directs otherwise. Motions shall be prepared in the form and style prescribed by rule 4. The clerk will serve a copy of each motion upon the opposite party. Motions will be acted upon as justice may require and may, in the discretion of the Board, be placed upon the calendar for argument. (See also rule 30(*b*).) The filing of a motion shall not constitute cause for postponement of a hearing from the date set.

Motions for rehearing, reconsideration, further hearing, and the like, to be considered timely, shall be made within 30 days after promulgation or entry of the report.

Motions to vacate, correct, or revise a decision of the Board, to be considered timely, shall be made within 30 days after entry of the decision.

Rule 20. Extensions of Time.

Continuances, extensions of time (except for the filing of the petition and except as otherwise provided in these rules), and adjournments may be ordered by the Board on its own motion or may be granted by it in its discretion on motion of either party filed in writing and showing good and sufficient cause therefor.

Rule 21. Dismissal.

A proceeding may be dismissed for cause upon motion of either party or of the Board.

Rule 22. Service.

When at any time there are two or more counsel of record for a petitioner, service will be made upon the one whose appearance was first entered of record, unless he has otherwise requested by writing filed with the Board, in which event service will be upon such other counsel of record as may be designated by him. However, service upon any counsel of record shall be deemed service upon the party. If there is no counsel of record, service will be made upon the petitioner.

Service may be made upon the Commissioner in person, upon deputies designated by him for the purpose of accepting service, or upon counsel appearing for the respondent in the proceeding. (See rules 12, 14, and 15.)

Rule 23. Substitution of Parties.

In the event of the death of a petitioner or for other cause, the Board may order the substitution of the proper parties. In the event of mistake in the name or title of a proper party, the Board may order substitution of the proper name or title. (See rule 5.)

Motions for substitution should be accompanied by a proper certificate of the court or official having custody of the record showing the interest of the party substituted. In the event of a change in the name of a corporation or other party petitioner, a motion to amend the pleadings to show such change should be filed, accompanied by a copy of the certificate, decree, or other document, effecting such change, certified by the official having custody of such document, unless the parties have agreed to the change and have so indicated in the record.

RULE 24. SUBSTITUTION OR WITHDRAWAL OF COUNSEL—NOTICE OF APPEARANCE.

Counsel of record in any proceeding desiring to withdraw must give prompt notice of his withdrawal to the Board and to his client. The Board may, in its discretion, withhold permission to counsel of record to withdraw.

Where the petition is not subscribed by counsel, or counsel of record has withdrawn, counsel subsequently appearing for the petitioner shall immediately file a notice of appearance, which shall include statements of his admission to practice before the Board and of his mailing address.

Notice of a change in the mailing address of counsel or petitioner shall be filed promptly with the Board, and a separate notice shall be filed for each docket number involved.

RULE 25. CALENDARS.

(*a*) *Washington and circuit calendars.*—Each proceeding when at issue will be placed either upon the Washington calendar or upon a circuit calendar, in accordance with rule 26. (See Appendix II.)

(*b*) *Hearing calendars.*—The clerk, as directed from time to time by the chairman, will prepare hearing calendars.

(*c*) *Reserve calendar.*—A proceeding which is at issue may be placed upon the reserve calendar for good cause shown, as, for example, to await the decision of the Supreme Court in a pending case.

RULE 26. PLACE OF HEARING—REQUESTS AND DESIGNATION.

The petitioner at the time of filing the petition shall also file a request showing the name of the place where he would prefer the hearing on the merits to be held. A copy of this request will be served upon the Commissioner by the clerk of the Board.

If the petitioner has filed no request, or if the respondent desires that the hearing on the merits be held at some place other than the place requested by the petitioner, the respondent shall file at the time he files his answer, a request showing the name of the place preferred by him. A copy will be served upon the petitioner by the clerk of the Board.

These requests shall not be bound as a part of the petition or answer but shall be separate therefrom and shall consist of an original and four copies.

The Board will determine the place of hearing, with due regard to any request properly filed in the proceeding and in accordance with the statutory provision that the time and place of trial shall be fixed "with as little inconvenience and expense to taxpayers as is practicable," and, in all cases, will notify the parties of the place at which or in the vicinity of which the hearing on the merits will be held.

Motions for change in designation of the place of hearing, made after the notice of the time of the hearing has been mailed, will not be deemed to have been timely filed.

In case it is necessary for the Board to hear the parties on matters other than the merits, such hearing will be held in Washington unless good cause is shown for holding it elsewhere.

(See Appendix II for further information to assist in making requests as to place of hearing.)

RULE 27. NOTICE OF HEARING.

When a proceeding has been placed upon the hearing calendar the clerk will, not less than 15 days in advance, notify the parties of the place where and the date when it will be called.

RULE 28. CALL OF CALENDAR AND ASSIGNMENT FOR HEARING.

The hearing calendar of proceedings to be heard at Washington will be called at 9.30 a. m. The hearing calendar of proceedings to be heard elsewhere will be called at the time indicated in the notice of hearing. Proceedings will be assigned therefrom for hearing in due course.

RULE 29. FAILURE TO APPEAR.

The unexcused absence of a party or his counsel on the day set for the hearing of any proceeding, will not be the occasion for delay. The hearing will proceed and the case will be regarded as submitted on the part of the absent party or parties.

The Board may require appearance for argument or it may accept briefs in lieu of personal appearance.

Rule 30. Submission Without Hearing or Appearance.

(*a*) *Submission of cases without hearing where facts are uncontested.*—Any proceeding not requiring a hearing for the submission of evidence (as, for example, where sufficient facts have been admitted, stipulated, or included in the record in some other way), may be submitted at any time by notice of the parties filed with the Board. The parties need not wait for the proceeding to be calendared and need not appear in person. The chairman will then assign the proceeding to a division for report, which division, upon request of the parties, will fix a time for filing briefs or for oral argument.

(*b*) A contested motion, not predicated upon an issue of fact, may be submitted in the same way.

See, however, rule 31.

Rule 31. Evidence and the Submission of Evidence.

(*a*) *Rules applicable.*—The rules of evidence applicable in courts of equity of the District of Columbia shall govern the admission or exclusion of evidence.

(*b*) *Stipulations.*—The parties by stipulation in writing filed with the Board or presented at the hearing, may agree upon any facts involved in a proceeding. A complete duplicate of the stipulation, including all exhibits, shall be filed at the same time. Stipulations filed need not be formally offered to be considered in evidence.

(*c*) *Depositions must be offered.*—Testimony taken by deposition will not be considered until offered and received in evidence.

(*d*) *Documentary evidence.*—(1) When books, records, papers, or documents have been received in evidence, a copy thereof or of so much thereof as may be material or relevant may, in the discretion of the division holding the hearing, be substituted therefor.

(2) After the decision of the Board in any proceeding has become final, the Board may, upon motion, permit the withdrawal by the party entitled thereto of original exhibits, or the Board may, on its own motion, make such other disposition thereof as it deems advisable.

(*e*) *Not evidence.*—Statements in the petition, ex parte affidavits and briefs do not constitute evidence.

(*f*) *Failure of proof.*—Failure to adduce evidence in support of the material facts alleged in the petition and denied by the Commissioner in his answer will be ground for dismissal. Where there is a joinder of issue on questions of fact, the provisions of rule 30 do not relieve the party upon whom rests the burden of proof from properly producing evidence to support the issues.

Rule 32. Burden of Proof.

The burden of proof shall be upon the petitioner, except as otherwise provided by statute and except that in respect of any new matter pleaded in his answer, it shall be upon the respondent.

Rule 35. Briefs.

The parties should be prepared to make oral arguments at the conclusion of the hearing or to file written citations of authorities at that time if the division so directs. The filing of briefs and the making of oral arguments shall be in accordance with the directions of the member presiding at the hearing. If the division does not direct otherwise, each party shall have 45 days after the day on which the hearing was concluded within which to file a brief and either party may file a reply brief within 15 days after the filing of the original brief by his opponent. After a brief has been filed, the clerk will serve a copy upon the opposite party, unless the brief bears a notation that a copy has already been served.

If briefs are typewritten, an original and four copies shall be filed; if printed, 20 copies. Each brief shall contain on its front flyleaf a table of contents with page references, supplemented by a list of all citations, alphabetically arranged as to cases cited, together with references to pages. Citations shall be in italics, when printed, and underscored, when typewritten.

The form of all briefs shall be as follows:

(*a*) A statement of the nature of the tax and how the proceeding comes before the Board.

(*b*) The party having the burden of proof shall set forth complete statements of the facts based upon the evidence. Each statement shall be numbered, shall be complete in itself, and shall consist of a concise statement of the essential fact and not a discussion or argument relating to the evidence or the law. Reference to the pages of the transcript or the exhibits relied upon in support thereof shall be inserted after each separate statement.

If the other party disagrees with any or all of the statements of fact, he shall set forth each correction which he believes the evidence requires and shall give the same numbers to his statements of fact as appear in his opponent's brief. His statement of fact shall be set forth in accordance with the requirements above designated.

(*c*) A concise statement of the points upon which the party relies.

(*d*) *The argument.*—The argument shall set forth the points of law relied upon and any discussion of the evidence deemed necessary to support the statement of fact.

RULE 40. TRANSCRIPTS OF PROCEEDINGS.

Hearings before the Board or its divisions shall be stenographically reported and a transcript therof shall be made if, in the opinion of the Board or of the division holding the hearing, a permanent record of the hearing is deemed necessary. Transcripts shall be supplied to the parties and to the public by the official reporter at such rates as may be fixed by contract between the Board and the reporter.

RULE 44. SUBPENAS.

(*a*) *How issued.*—The party desiring a subpena must make a timely application therefor, in writing.

(*b*) *Application for.*—The application shall state the name and address of each witness required, the time and place at which and the officer before whom he is to appear, and whether he may designate some one to appear in his place. An original and two conformed copies shall be filed. (See Appendix I, Form No. 3.)

(*c*) *For production of documents.*—If evidence other than oral testimony is required, such as documents or written data, the application shall set forth the specific matter to be produced and sufficient facts to indicate that such matter is reasonably necessary to establish the cause of action or defense of the applicant.

(*d*) *Service and proof.*—The Board will not serve subpenas, but will leave service to be procured by the party making the application. Service may be made by any citizen of the United States over the age of 21 years and competent to be a witness, and not a party to or in any way interested in the proceeding. Proof of service may be made by affidavit.

RULE 45. DEPOSITIONS.

(*a*) *Application to take.*—When either party desires to take a deposition, he shall file with the Board a verified application and two conformed copies, together with an additional copy for each additional docket number involved. The Board upon request will furnish forms for this purpose. If the space in the form furnished by the Board is inadequate for setting forth the reasons in support of the application in any particular case, a substitute form may be used, but the substitute must contain all of the information called for on the Board's form. (See Appendix I, Form No. 5.)

(*b*) *Limitation on time for application to take.*—Applications to take depositions must be filed at least 30 days prior to the date set for the hearing of the proceeding, and such depositions must be completed and filed with the Board at least 10 days prior to the hearing: *Provided*, Such applications will not be regarded as sufficient ground for the granting of a continuance from the date or place of the hearing theretofore set, unless the proceeding shall have been at issue less than 60 days and the motion for continuance shall have been filed not less than 20 days prior to said date of hearing: *Provided further*, That under special circumstances, and for good cause shown, the Board may otherwise order.

(*c*) *Qualification of officer.*—The officer before whom depositions are taken must be one authorized to administer oaths under the Revenue Act of 1924. (See section 908 of the Revenue Act of 1924, as amended by section 1000 of the Revenue Act of 1926; section 1002(d), Revenue Act of 1924; and section 1102(d), Revenue Act of 1926.) In no case shall a deposition be taken before any person who has any office connection or business employment with either party or his counsel except by consent of the parties and when no other officer is available, and in his certificate of return to such deposition such officer shall so certify.

(*d*) *Order for taking.*—Upon receipt of such application, the clerk will serve a copy thereof on the opposite party, and allow a reasonable time for objection thereto. Thereafter, the Board will, in its discretion, make an order, a copy of which will be mailed or delivered to the parties or their counsel, wherein the Board will name the witness whose deposition is to be taken and specify the time when, the place where, and the officer before whom the witness is to testify, but such time, place, and officer specified in the Board's order may or may not be the same as set forth in the application. The applicant shall thereupon make all necessary arrangements for the taking of each deposition and shall furnish the officer before whom it is to be taken with a copy of the order above mentioned.

(*e*) *By stipulation.*—At any time after issue is joined, the parties or their counsel may, by stipulation duly signed and filed, take depositions. In such cases, the stipulation shall state the name and address of each witness, the time when and the place where such depositions will be taken and the name, address, and official title of the officer before whom it is proposed to take the depositions. In such cases, no order to take depositions will be issued, but they shall be taken and returned by the officer in accordance with the rules of the board.

(*f*) *Manner of taking.*—Each witness must first take the oath or affirm. The questions propounded to him and his answers must be recorded verbatim.

Objections to questions or answers shall be explicitly but briefly and concisely stated, but no comment, explanation, or argument of any kind shall be recorded; neither shall there be recorded any comment, explanation, or argument by examining counsel. Any matter reported in violation of this rule may be sufficient cause for the suppression of the deposition.

(*g*) *Other witnesses to be excluded.*—At the request of either party, a person whom either expects or intends to call as a witness in the same or any related proceeding shall be excluded from the room where the testimony of a witness is being taken. If such person remains in the room or within hearing of the examination after such request has been made, he shall not thereafter be permitted to testify except by the consent of the party who requested his exclusion.

(*h*) *Depositions to be signed.*—The testimony of the witness when transcribed shall be read to or by him and shall be signed by him. (See Appendix I, Form No. 6.)

(*i*) *Form in which depositions must be returned to the Board.*—When a deposition is returned to the Board it must show the docket number and the caption (the names of the parties) of the proceeding as appears in the Board's records, the place and date of taking, the name of the witness, the party by whom called, the names of counsel present, indicating which party each counsel represents, and (in the body of the deposition) the name of counsel examining or cross-examining the witness.

The officer must so fasten the sheets of the deposition that they can not be tampered with. He must spare no pains to return to the Board the exact testimony he has taken. All exhibits must be carefully marked so as to be capable of identification, and when practicable must be attached to the deposition.

The officer must properly execute and attach to the deposition a certificate of return in the form prescribed. (See Appendix I, Form No. 6.)

(*j*) *Return of.*—The officer must inclose the original depositions and exhibits, together with two copies of the depositions, in a sealed packet, with postage or other transportation charges prepaid, and direct and forward the same to the United States Board of Tax Appeals, Washington, D. C. In each case, the original of the depositions must be directed and forwarded to the Board. The officer may, however, upon written request, deliver a copy of the depositions to either or to both of the parties, or to their representatives, in lieu of sending such copies to the Board as above provided. If one or both of the required copies are delivered by the officer taking the depositions, he shall attach to his return the written request of the party or parties, or of their counsel to whom such copy or copies were delivered, and shall state in his certificate of return the fact of delivery by him of such copy or copies. If copies of the depositions are delivered by the officer taking the same, no service of copies of such depositions upon the party or his counsel of record will be made by the Board.

(*k*) The deposition of any witness shall not constitute a part of the record until received in evidence. (See rule 31.)

RULE 46. DEPOSITIONS UPON WRITTEN INTERROGATORIES.

Depositions may be taken in the discretion of the Board upon written interrogatories in substantially the same manner as provided in rule 45 for depositions upon oral examination. An original and five copies of the interrogatories must be filed with the application. The clerk will serve one copy of the application and of the interrogatories upon the opposite party. If the opposite party desires to file objections or cross-interrogatories, he must do so within 10 days after the application and interrogatories have been served upon him. Cross-interrogatories must consist of an original and five copies. The clerk will serve one copy thereof upon the opposite party who, if he has any objection thereto, must file his objections within 10 days thereafter. No objections to the interrogatories or cross-interrogatories will be considered at the hearing unless timely filed in accordance with this rule.

No person other than the witness, a stenographic reporter, and the officer taking the deposition upon written interrogatories and cross-interrogatories shall be present at the examination of the witness. This fact shall be certified by the officer taking the deposition. That officer shall propound the interrogatories and cross-interrogatories to the witness in their order and cause the testimony to be reduced to writing in the witness's own words.

Depositions obtained in foreign countries must be taken upon written interrogatories, except as otherwise directed by the Board for cause shown.

RULE 50. COMPUTATIONS BY PARTIES FOR ENTRY OF DECISION.

Where the Board has promulgated or entered its opinion determining the issues in a proceeding, it may withhold entry of its decision for the purpose of permitting the parties to submit computations pursuant to the Board's determination of the issues, showing the correct amount of the deficiency or overpayment to be entered as the decision. If the parties are in agreement as to the amount of the deficiency or overpayment to be entered as the decision pursuant to the report of the Board, they or either of them shall file promptly with the Board an original and two copies of a computation showing the amount of the deficiency or overpayment and that there is no disagreement that the figures shown are in accordance with the decision of the Board. The Board will then enter its decision. If, however, the parties are not in agreement as to the amount of the deficiency or overpayment to be entered as the decision, in accordance with the report of the Board, either of them may file with the Board a computation of the deficiency or overpayment believed by him to be in accordance with the report of the Board. The clerk will serve a copy thereof upon the opposite party, will place the matter upon the hearing calendar for argument in due course, and will serve notice of the argument upon both parties. If the opposite party fails to file objection, accompanied by an alternative computation, at least five days prior to the date of such argument, or any continuance thereof, the Board may enter decision in accordance with the computation already submitted. If in accordance with this rule computations are submitted by the parties which differ as to the amount to be entered as the decision of the Board, the parties will be afforded an opportunity to be heard in argument thereon on the date fixed, and the Board will determine the correct deficiency or overpayment and enter its decision.

Any argument under this rule will be confined strictly to the consideration of the correct computation of the deficiency or overpayment resulting from the report already made, and no argument will be heard upon or consideration given to the issues or matters already disposed of by such report or of any new issues. This rule is not to be regarded as affording an opportunity for rehearing or reconsideration.

RULE 51. COSTS—PREPARATIONS OF RECORD ON REVIEW.

Immediately after the contents of a record on review have been settled or agreed to, the clerk will notify the petitioner of the costs and charges for the preparation, comparison, and certification of said records; such charges to be determined in accordance with the provisions of an Act of Congress entitled "An Act to provide fees to be charged by clerks of the district courts of the United States," approved February 11, 1925 (43 Stat., 857–858; U. S. C., Title 28, sections 548–554).

No transcript will be certified and transmitted to the appellate court until the costs and charges therefor have been paid.

A petitioner for review who requests the clerk to certify but not to prepare documents for transmission to a United States Circuit Court of Appeals or to the United States Court of Appeals for the District of Columbia shall furnish the clerk with the copies of the documents to be certified.

RULE 52. COSTS—PRINTING OF RECORD ON REVIEW.

In each proceeding for review of a decision of the Board by the United States Circuit Court of Appeals for the Second Circuit when review is sought by the Commissioner of Internal Revenue, the clerk of the Board shall, immediately after the contents of the record on review, as required by rule 35 of the court, have been settled or agreed upon, make available to the Commissioner, or his counsel, the record of the Board in the proceeding. The Commissioner shall cause the record to be printed. Twenty-five copies of the printed record shall be delivered to the clerk of this Board for certification and for filing with the clerk of the circuit court of appeals. The clerk of the Board shall serve three copies of the printed record upon counsel for the taxpayer.

RULE 53. COPIES OF BOARD RECORD—FEES FOR FURNISHING.

A plain or a certified copy of any document, record, entry, or other paper may be had upon application to the Board, the fee to be charged and collected therefor to be determined in accordance with the provisions of the Act of Congress entitled "An Act to provide fees to be charged by clerks of the district courts of the United States," approved February 11, 1925 (43 Stat., 857–858; U. S. C., Title 28, sections 548–554).

RULE 60. FEES AND MILEAGE.

Title X of the Revenue Act of 1926 provides in part:

" SEC. 909. (a) Any witness summoned or whose deposition is taken under section 908 shall receive the same fees and mileage as witnesses in courts of the United States. Such fees and mileage and the expenses of taking any such deposition shall be paid as follows:

"(1) In the case of witnesses for the Commissioner, such payments shall be made by the Secretary out of any moneys appropriated for the collection of internal-revenue taxes, and may be made in advance.

"(2) In the case of any other witnesses, such payments shall be made, subject to rules prescribed by the Board, by the party at whose instance the witness appears or the deposition is taken."

No witness, other than one for the Commissioner, shall be required to testify in any proceeding before the Board until he shall have been tendered the fees and mileage to which he is entitled in accordance with the above provision of law.

RULE 61. COMPUTATION OF TIME—SUNDAYS AND HOLIDAYS.

Whenever these rules prescribe a time for the performance of any act, Sundays and legal holidays in the District of Columbia shall count just as any other days, except that when the time prescribed for the performance of an act expires on a Sunday or a legal holiday in the District of Columbia, such time shall extend to and include the next succeeding day that is not a Sunday or such a legal holiday: *Provided*, That when the time for performing any act is prescribed by statute nothing in these rules shall be deemed to be a limitation or extension of the statutory time period.

The following-named days are legal holidays within the District of Columbia:

New Year's Day, January 1 (U. S. C., Title 5, section 87).

Inauguration Day, every fourth year (48 Stat., 879; D. C. Code, Title 22, section 126).

Washington's Birthday, February 22 (U. S. C., Title 5, section 87).

Decoration Day, May 30 (U. S. C., Title 5, section 87).

Fourth of July (U. S. C., Title 5, section 87).

Labor Day, first Monday in September (U. S. C., Title 5, section 87).

Armistice Day, November 11 (52 Stat., 351).

Thanksgiving Day, day proclaimed by the President (section 993, R. S., relating to D. C.; D. C. Code, Title 22, section 126).

Christmas Day, December 25 (U. S. C., Title 5, section 87).

When legal holidays fall on Sunday the next day shall be a holiday (22 Stat., 1; D. C. Code, Title 22, section 126).

RULE 62. SPECIAL ASSESSMENT.

(*a*) If some of the issues raised by the petition involve section 327 or section 328 of the Revenue Act of 1918 or of 1921 [or section 210 of the Revenue Act of 1917, as the case may be], and some do not involve such sections, the hearing may, in the discretion of the Board, on motion, be limited in the first instance to trial of the issues which do not involve such sections.

(*b*) A hearing may be had in the discretion of the Board, on motion, limited to the trial of the issue whether the petitioner is entitled to have its tax determined as provided in section 328 [or section 210, as the case may be].

(*c*) If the Board decides that the petitioner is entitled to have its tax determined as provided in section 328 [or section 210, as the case may be], the respondent shall within 60 days after such decision file with the Board an original and two copies of a proposed redetermination showing the method of the computation. If, within 20 days after service by the clerk upon the petitioner of a copy of such proposed redetermination, the parties are unable to agree upon the amount of tax, either party may move, or the Board may upon its own motion order, that the proceeding be placed upon the calendar for further hearing, at which either party may submit proof of the correct amount of tax and deficiency or overpayment.

(*d*) If from the pleadings or otherwise it appears of record before the Board that the parties agree that petitioner is entitled to have its tax determined as provided in section 328 [or section 210, as the case may be], and the only issue is as to the correct amount of the tax so determined, the proceeding will be placed upon the calendar in due course for hearing, at which either party may submit proof of the correct amount of the tax and deficiency or overpayment.

RULE 70. EFFECTIVE DATE.

These rules shall become effective March 1, 1940, superseding all prior editions and amendments.

APPENDIX.

I. FORMS.

These forms are subject to amendment as circumstances may render necessary.

No. 2. Petition.
No. 3. Application for subpena.
No. 5. Application for order to take depositions.
No. 6. Certificate on return of depositions.

(NOTE.—Read rule 4 of the rules of practice of the Board and carefully observe the requirements thereof as to form, size, and style of papers.)

No. 2.—PETITION.

(See rules 4, 5, 6, 7, and 8.)

UNITED STATES BOARD OF TAX APPEALS.

_____________________________________, *petitioner,*
v. } Docket No.
Commissioner of Internal Revenue, respondent.

PETITION.

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols) dated ____________________, 19___, and as a basis of his proceeding alleges as follows:

1. The petitioner is (set forth whether individual, corporation, fiduciary, etc., as provided in rule 6) with principal office (or residence) at _______________ (Street.) ___________________ (City.), ____________________ (State.). The return for the period here involved was filed with the collector for the ______ district of _______________

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on ______________________, 19___.

3. The taxes in controversy are (income, profits, estate, or gift) taxes for the (calendar or fiscal year) year 19___ and in the amount of ___________ dollars (state as exactly as possible the amount in dispute).

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors: (Enumerate specifically the assignments of error in a concise manner and avoid pleading facts which properly belong in the succeeding paragraph.)

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows: (Here set forth allegations of the facts relied upon—but not the evidence—in orderly and logical sequence, with subparagraphs lettered, so as fully to inform the Board of the issues to be presented and to enable the Commissioner to admit or deny each specific allegation.)

Wherefore, the petitioner prays that this Board may hear the proceeding and (Here state the relief desired).

(Signed) ______________________________
(Petitioner or counsel.)

____
(Post-office address.)

STATE OF ________________________ }
County of ____________________ } *ss:*

______________________________, being duly sworn, says that he is the petitioner (if a corporation, or fiduciary, state title of office or trust of person verifying and that he is duly authorized to verify the foregoing petition) above named; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

(Signed) ______________________________

Subscribed and sworn to before me this __________ day of ___________, 19__.

(Signed) ______________________________
(Official title.)

[SEAL.]

No. 3.—APPLICATION FOR SUBPENA.

__________________________________, *petitioner,*
v.
Commissioner of Internal Revenue, respondent.
} Docket No.

To the United States Board of Tax Appeals:

Application is hereby made for the issuance of a subpena for the attendance before ____
(The United States Board of Tax Appeals or the name and official title of the person authorized to take depositions.)

at ______________________________ on ______________________________
at ___________ o'clock ______ m. of the following persons whose oral testimony is desired on behalf of the ______________________________ in the above-
(Petitioner or respondent.)
entitled proceeding:

NAME.	ADDRESS.
__________________________________	__________________________________
__________________________________	__________________________________
__________________________________	__________________________________
__________________________________	__________________________________
__________________________________	__________________________________
__________________________________	__________________________________
__________________________________	__________________________________
__________________________________	__________________________________
__________________________________	__________________________________
__________________________________	__________________________________

Dated _______________, 19___.

(Signed) __________________________________
(Post-office address) ________________________
____

No. 5.—APPLICATION FOR ORDER TO TAKE DEPOSITIONS.

(See rules 45 and 46.)

UNITED STATES BOARD OF TAX APPEALS.

____________________________________, *petitioner,*
v.
Commissioner of Internal Revenue, respondent.
} Docket No.

APPLICATION FOR ORDER TO TAKE DEPOSITIONS.

To the United States Board of Tax Appeals:

1. Application is hereby made by the above-named ________________________
(Petitioner or respondent.)
for an order to take the deposition__ of the following-named person__:

NAME OF WITNESS.	POST-OFFICE ADDRESS.
(a) ________________________________	_________________________________
(b) ________________________________	_________________________________
(c) ________________________________	_________________________________
(d) ________________________________	_________________________________

2. It is desired to take the depositions of the persons above named and each of them for the following reasons:

(a) __________________ will testify to the following material matters:
____
____
(Set forth briefly the matter upon which said witness will be called to testify.)

(b) __________________________ will testify to the following material matters:
____
____

(c) __________________________ will testify to the following material matters:
____
____

(d) __________________________ will testify to the following material matters:
____
____

3. The reasons why ____________________________________ desires to take the
(Petitioner or respondent.)
testimony of the above-named persons rather than have them appear personally and testify before the Board are as follows: (State specifically reasons for each witness.)

4. It is desired to take the testimony of ___________________________________
(Names of witnesses.)
____
on the ____________ day of ________, 19____, at the hour of ______ o'clock ____ m.
(A date sufficiently in advance of the day set for hearing of the proceedings to enable the deposition to be completed and filed with the Board at least 10 days prior to the hearing.)
before ___________________________ in the City of ___________________________
(State name and title of official.)
State of _______________________ at room ______________________________________
(Give number of room, street
____
number, and name of building.)

5. That ____ is a
(Name of official before whom depositions are to be taken.)
______________________________, who has no office connection or business employ-
(Give official title.)
ment with the petitioner or his counsel.

Dated ________________, 19____.

(Signed) ______________________________
(Petitioner or counsel.)

____
(Post-office address.)

STATE OF ________________________ } ss:
County of ________________________ }

________________________________, being duly sworn, says that the fore-
(Petitioner or counsel.)
going application for order to take depositions is made in good faith and for the reasons therein stated and that the same is not made for purposes of delay.

(Signed) ____________________________

Subscribed and sworn to before me this _____ day of __________, 19___.

(Signed) ____________________________
(Official title.)

[SEAL.]

No. 6.—CERTIFICATE ON RETURN.

To the United States Board of Tax Appeals:

I, ______________________________, the person named in the foregoing order to take depositions, hereby certify:

1. That I proceeded, on the ______ day of __________________, A. D. 19___, at the office of __________________, in the City of _________________________, State of __________________________, at ______ o'clock, __ m., under the said order and in the presence of ____________________________ and ____________ ________________ the counsel of the respective parties, to take the following depositions, viz:

______________________________________, a witness produced on behalf of the ________________________________;
(Petitioner or respondent.)

______________________________________, a witness produced on behalf of the ________________________________;
(Petitioner or respondent.)

______________________________________, a witness produced on behalf of the ________________________________.
(Petitioner or respondent.)

2. That each witness was examined under oath at such times and places as conditions of adjournment required, and that the testimony of each witness (or his answers to the interrogatories filed) was taken stenographically and reduced to typewriting by me or under my direction.

3. That after the testimony of each witness had been reduced to writing the transcript of that testimony was read and signed by the witness in my presence and that each witness acknowledged before me that his testimony was in all respects truly and correctly transcribed.

4. That, after the signing of the deposition in my presence, no alterations or changes were made therein.

5. That I have no office connection or business employment with the petitioner or his attorney except that of ________________, objection to which was
(State connection.)
waived by both parties to the proceeding.

[SEAL]

____
(Signature of person taking deposition.)

____
(Official title.)

____
(Post-office address.)

NOTE.—This form when properly executed should be attached to and bound with the transcript preceding the first page thereof. It should then be inclosed in a sealed envelop and addressed to United States Board of Tax Appeals, Washington, D. C.

II. REQUESTS FOR PLACE OF HEARING.

The Board will fix the times and places for its hearings in order to secure reasonable opportunity to taxpayers to be heard with as little inconvenience and expense to taxpayers as is practicable. (Section 1000, Revenue Act of 1926, amending section 907(e), Revenue Act of 1924.) Hearings may be held at any place requested if suitable accommodations are available and a sufficient number of cases are ready for hearing there. A partial list of cities where a combination of these circumstances has justified a calendar of hearings recently appears below. It is published here merely to assist parties in making requests under rule 26. The grouping of certain cities in the list indicates that if one of those cities is requested, it may be necessary to hold the hearing at the other city in order to make up a sufficient calendar of hearings. Likewise, if sufficient cases are not ready for hearing in any particular city requested by taxpayers, or if suitable quarters are not available there, the Board may find it necessary to combine the hearings requested for that city and hold them along with the hearings requested for some other city in the vicinity.

LIST.

Alabama:
- Birmingham.
- Mobile.

Arkansas: Little Rock (alternative, Memphis, Tenn.).

California:
- Los Angeles.
- San Francisco.

Colorado: Denver.

District of Columbia: Washington.

Florida:
- Jacksonville.
- Miami.
- Tampa (alternative, Miami).

Georgia: Atlanta.

Hawaii: Honolulu (alternative, Los Angeles or San Francisco, Calif.).

Illinois: Chicago.

Indiana: Indianapolis.

Iowa: Des Moines.

Kentucky: Louisville.

Louisiana:
- New Orleans.
- Shreveport.

Maine: Portland (alternative, Boston, Mass.).

Massachusetts: Boston.

Michigan:
- Detroit.
- Grand Rapids.

Minnesota: St. Paul.

Missouri:
- Kansas City.
- St. Louis.

Montana: Helena.

Nebraska: Omaha.

New York:
- Buffalo.
- New York City.

Ohio:
- Cincinnati (alternative, Columbus).
- Cleveland.
- Columbus (alternative, Cincinnati).

Oklahoma:
- Oklahoma City (alternative, Tulsa).
- Tulsa (alternative, Oklahoma City).

Oregon: Portland.

Pennsylvania:
- Philadelphia (alternative, Washington, D. C., or New York, N. Y.).
- Pittsburgh.

Tennessee:
- Knoxville (alternative, Atlanta, Ga.).
- Memphis.
- Nashville.

Texas:
- Dallas.
- Houston.

Utah: Salt Lake City.

Washington:
- Seattle.
- Spokane.

West Virginia: Charleston.

Wisconsin:
- Madison (alternative, Milwaukee).
- Milwaukee.

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