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Internal Revenue Bulletin

Cumulative Bulletin 1940-2

JULY-DECEMBER, 1940

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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

Treasury Department : : : : : Bureau of Internal Revenue

Internal Revenue Bulletin

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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 : 1941

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The Internal Revenue Bulletin service for 1941 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 1940, inclusive, may do so at prices as follows:

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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 1940–2, 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. 27 to 53, inclusive) for the period July 1 to December 31, 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 December 31, 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 Acts of 1939 and 1940) 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 or 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 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.

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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 DECEMBER 31, 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 December 31, 1940, inclusive.]

[a] 1940-53-10541

The Commissioner acquiesces 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 [1]	91958	41	228
Affiliated Enterprises, Inc.[2]	96603	42	390
Allen, Laura, estate of [3]	89703	40	721
American Society of Cinematographers, Inc	96411	42	675
Anderson, John, transferee of estate of Frank O. Burridge	93334	40	944
Apex Brewing Co., Inc	91977	40	1109
Appleby, John S.[4]	94080	41	18
Augustus, Elizabeth G	96061	40	1200
B.			
Baker, Inc., Emerit E	92366 94401	40	554
Belcher, Harriet Holbrook	94879	42	633
Benaglia et ux., Arthur [5]	87638	36	838
Black Motor Co., Inc	97232	41	300
Bondholders Committee [6]	90452 90486 90487	40	881
Briggs-Killian Co	92562	40	894
Brookman, Murray	95871	41	557

[1] Acquiescence relates only to the Board's mathematical formula for apportionment of the dividend credit between the estate and the distributees.

[2] Acquiescence relates only to the issue, What amounts constitute reasonable allowance for services performed in 1935 and 1936 by the wives of the two principal officers of the corporation?

[3] Estate tax decision.

[4] Acquiescence relates only to the issue, Was the sum of $150 which was added by the Commissioner to John S. Appleby's income, taxable to him?

[5] Nonacquiescence published in Cumulative Bulletin 1938-1, page 35, withdrawn.

[6] Acquiescence does not relate to issue respecting bases for depreciation of petitioners' assets.

[a] Ruling No. 10541 includes all acquiescence and nonacquiescence notices published in the Internal Revenue Bulletin service from Janu ary 1, 1940, to December 31, 1940.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
C.			
Canelo, Harry F	66150, 90641	41	713
Carey Trust (Second)	93611	41	800
Carter, Shirley, estate of	93917	40	749
Cavett et al., K., executors of estate of W. T. Hales [1]	93208	40	1244
Cherokee Co	93962	41	1212
Claiborne et al., Austin Leigh, executors of the estate of Laura Allen [2]	89703	40	721
Cohen Testamentary Trust, Joel C	96231	42	1074
Columbia Oil & Gas Co.[3]	90624	41	38
Combs Lumber Co	91543	41	339
Cook Drilling Co.[4]	82231	38	291
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
Cooperative Insurance	95292	41	1151
Cooperative Power Plant	95291	41	1143
Crabb, Dolores	95002	41	686
Crawford Music Corporation	85389, 88290	40	284
D.			
Dallas Title & Guaranty Co. [5]	90466	40	1021
Dashiell, C. R.[6]	75056	36	313
Davison-Joseph Campau Realty Co., Inc	97366	41	675
Dean, Mason L.[7]	61205, 69832	35	839
Dearing, Roy E., estate of [8]	84195	36	843
Dearing, R. H. estate of, and trust estate [8]	84193, 84194	36	843
Dearing, Mrs. R. H.[8]	84196	36	843
Dearing et ux., Willis R. [8]	84192, 84197	36	843
Dearing, Willis R., executor of estate of Roy E. Dearing [8]	84195	36	843
Dearing, Willis R., executor of estate and trust estate, of R. H. Dearing [8]	84193, 84194	36	843
Deuble, George H	92055, 95044	42	277
Dolenz, Anton	93311	41	1091

[1] 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?

[2] Estate tax decision.

[3] Acquiescence does not relate to issue pertaining to allocation of cost of equipment on the property in question.

[4] Acquiescence relates only to the issue, whether the fair market value of future oil payments, under the drilling and sale of lease contracts, should be included in gross income of petitioner for the year 1932. Previous acquiescence published in Cumulative Bulletin 1939-2, page 8, affirmed as to this issue only.

[5] 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.

[6] Nonacquiescence published in Cumulative Bulletin 1937-2, page 36, withdrawn.

[7] Prior nonacquiescence published in Cumulative Bulletin 1937-2, page 36, withdrawn.

[8] Prior nonacquiescence published in Cumulative Bulletin 1938-1, page 39, withdrawn.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
Dollar, Agnes Barr	97283 98728	41	869
Dollar, J. Harold, estate of	97282 98727	41	869
Dollar, Robert II, et al., executors of estate of J. Harold Dollar	97282 98727	41	869
E.			
Elverson Corporation [1]	93281	40	615
Eustis, Augustus H.[2]	71637	30	820
Evans, Mary E.[3]	95527	42	246
F.			
Ferree, C. B.[4]	61542	32	725
First Mortgage Bonds [5]	90452 90486 90487	40	881
Fish, Isaac, estate of	96527	42	260
Fleischmann, Raoul H	90305	40	671
Fleming, Mrs. Anna Maud [6]	92958 94690	41	940
Fleming-Kimbell Corporation [6]	92959	41	940
Fleming, William [6]	92957 94689	41	940
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 [7 8]	92115	41	679
Gaylord, Inc., Robert [9]	96953	41	1119
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
Gump, Alfred S., estate of [10]	90656	42	197
Gump et al., Camille R., executors of estate of Alfred S. Gump [10]	90656	42	197

[1] Acquiescence relates only to the issue involving the fair market value of certain pledged collateral on the date of its surrender.
[2] Prior nonacquiescence published in Cumulative Bulletin XIV–2, page 30 (1935), withdrawn.
[3] Acquiescence relates to all issues except as to the deductibility of attorney's fees and abstract fees incurred incidental to the establishment of forfeiture of a lease and obtaining repossession of the leased premises.
[4] Nonacquiescence published in Cumulative Bulletin XIV–2, page 30 (1935), withdrawn.
[5] Acquiescence does not relate to issue respecting bases for depreciation of petitioners' assets.
[6] Acquiescence relates only to the following issues: (*a*) Did each of the communities of Kay Kimbell and wife and William Fleming and wife constructively receive oil payments of $60,848.65 and $53,401.35, respectively, for 1934 and 1935 from the Fleming-Kimbell Corporation, and (*b*) was a certain $4,000 reservation in connection with the transfer by William Fleming in 1936 of a leasehold interest in the Richter "A" lease, etc., taxable to the petitioners?
[7] Gift tax decision.
[8] 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?
[9] Acquiescence is as to result only.
[10] Estate tax decision.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
H.			
Hales, George A.[1]	93210	40	1244
Hales, Mrs. Oneta [1]	93209	40	1244
Hales, Jr., W. T.[1]	93211	40	1244
Hales, W. T., estate of [1]	93208	40	1244
Harris Trust & Savings Bank et al., executors of estate of Isaac Fish	96527	42	260
Hawaiian Trust Co., Ltd., trustee of Joel Cohen Testamentary Trust	96231	42	1074
Heller, Edward H.[2]	94794 94795	41	1020
Higgins, Eugene	80052 85961	39	1005
Hirsch, L. B	95782	42	566
Hooper, James P., estate of [3] [4]	85776	41	114
Hooper, Mathilde B., administratrix of estate of James P. Hooper [3] [4]	85776	41	114
Hoover, Herbert W	90974	42	289
Hopkins, William R	91753	41	1292
Hotel Astoria, Inc. [5]	97230	42	759
Howard et al., George Adams, executors of estate of Grace Adams Howard	99851	42	449
Howard, Grace Adams, estate of	99851	42	449
Huey & Philp Hardware Co	92801	40	780
Hummel-Ross Fibre Corporation	93077	40	820
Humphreys, Murray	87899	42	857
Hyde, Mildred K., estate of	95182	42	738
Hyde, Suffolk & Berks, Marguerite [6]	81417 93257	40	1120
Hyde, Willis O., administrator of estate of Mildred K. Hyde	95182	42	738
J.			
Joell Co	96535	41	825
Johnston, J. Edward	93768	41	550
Jones, Carrie L., estate of [3]	91831	41	1279
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
Kiesau Petroleum Corporation	95760	42	69

[1] 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?

[2] Acquiescence relates to the issue pertaining to the trust for the petitioner's minor son Emanuel.

[3] Estate tax decision.

[4] Acquiescence relates only to the determination of the value of the stock of William E. Hooper & Sons Co. on August 3, 1933.

[5] Acquiescence is as to result only.

[6] 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?

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Kimbell, Kay [1]	92956 94674	41	940
Kimbell, Mrs. Velma [1]	92955 94673	41	940
Knowles, Edwin C. F	91495	40	860
L.			
Legg, Mildred Sheppard, estate of [2]	89942	40	1073
Letts, Jr., Arthur	92857	41	1172
Lyon, Incorporated	93858 96546 99832	42	1094
M.			
MacConaughey, Harry E	92052	41	408
Macon, Dublin & Savannah Railroad Co	90592	40	1265
Majestic Oil Corporation [3]	96380	42	659
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
McLean et ux., Marrs	77419 77420 81391 81392 86804 86805 94402 94403	41	565
Medical Diagnostic Association	96563	42	610
Milbank, Dunlevy [5]	93050	41	1014
Moloney Electric Co. [6]	96076	42	78
Moock Electric Supply Co., The	96284	41	1209
Morton, Arthur F	91494	41	742
Mott, Dee Furey [7]	71903	35	195
Myers, George R	94764	42	640

[1] Acquiescence relates only to the following issues: (*a*) Did each of the communities of Kay Kimbell and wife and William Fleming and wife constructively receive oil payments of $60,848.65 and $53,401.35, respectively, for 1934 and 1935 from the Fleming-Kimbell Corporation, and (*b*) was a certain $4,000 reservation in connection with the transfer by William Fleming in 1936 of a lease-hold interest in the Richter "A" lease, etc., taxable to the petitioners?

[2] Estate tax decision.

[3] Acquiescence relates to all issues except the issue, Is the petitioner entitled to a 1935 loss deduction for the undepreciated cost of certain casing and other lease equipment which could not be removed from a certain oil well which the petitioner ceased to operate, during that year, because such operation had beco me unprofitable?

[4] Acquiescence does not relate to issue respecting bases for depreciation of petitioners' assets.

[5] Acquiescence is only with respect to the taxability of the income from the wife's trust.

[6] Acquiescence relates only to the deductibility in 1936 of the amount paid to the First National Bank of St. Louis in connection with the liquidation of the Franklin American Trust Co., such acquiescence being only in the result.

[7] Nonacquiescence published in Cumulative Bulletin 1937-1, page 43, withdrawn.

ACQUIESCENCES—Continued.

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N.			
Nichols, J. C	89169	42	618
Norweb, Emery May Holden [1]	92575	41	179
O.			
Ortiz, Alice duPont [2]	93159	42	173
O'Sullivan Rubber Co., Inc. (in dissolution)	97399	42	721
P.			
Patton, T. B	93918	40	749
Peck & Peck (New York)	99288	42	651
Peck—Peck Corporation, The	99314	42	651
Perkins, Ralph [3]	96126	41	1225
Pierce, D. W	92278	41	1261
Pittsburg Canners, Inc	93560	41	467
Plunkett, Theodore R	94017	41	700
Porter et al., J. Howard, trustees, identified as Porter Properties Trustees, Ltd	95762	42	681
Porter Properties Trustees, Ltd	95762	42	681
Pupin, Michael I., estate of [4] [5]	92177	38	1218
R.			
Rosenstock, Anna, individually and as executrix of estate of Isaac M. Rosenstock [4]	91686	41	635
Rosenstock, Isaac M., estate of [4]	91686	41	635
Rossi, Andrew E. [6]	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 [4]	89942	40	1073
St. Louis Union Trust Co. et al., executors of estate of Carrie L. Jones [4]	91831	41	1279
Schley et ux., Julian Larcombe	99404	42	434
Seavey & Flarsheim Brokerage Co	91618	41	198
Second Carey Trust	93611	41	800
Shamrock Oil & Gas Co	98588	42	1016
Sharp et ux., H. Cecil	97425 97426	42	336
Shelden Land Co. [7]	93196	42	498
Shenandoah Valley National Bank (Shirley Carter estate)	93917	40	749

[1] Gift tax decision.
[2] Acquiescence relates only to the issue, whether the petitioner is entitled to any deduction as the result of the satisfaction of the deficit existing in her husband's brokerage accounts at the end of the year 1934.
[3] Acquiescence relates only to the issue, Was the petitioner entitled to a loss on an investment of $17,250 in the Fourteenth Carnegie Co. for the year 1926?
[4] Estate tax decision.
[5] Prior nonacquiescence published in Cumulative Bulletin 1939-1, (Part 1), page 60, withdrawn.
[6] Unjust enrichment tax decision.
[7] Acquiescence relates only to the issue, whether certain losses suffered by petitioner as the result of foreclosures of properties owned by the petitioner are deductible in the year of foreclosure or in the year in which the equity of redemption expired.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Sherman, Doris Bond [1] [2]	95300	41	898
Silver, Max	100186	42	461
Simon, Jose, estate of [3]	91840	40	650
Simon et al., Jose P., executors [3]	91840	40	650
Smith, Charles G	93914	40	749
Smith, Madeline Welder	95003	41	686
Smith, Varvara Pupin, administratrix of estate of Michael I. Pupin [3] [4]	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 [3]	92588	40	924
Springford, Herbert H	97247	41	1001
Staley, Augustus E.[1]	88772	41	752
Staley, Emma L.[1]	88773	41	752
Stanley, William H	96558	41	1233
Stern, Allison L. S.[5]	93134	40	756
Suffolk & Berks, Marguerite Hyde [6]	81417 93257	40	1120
Sultana Oil Corporation (Delaware)	90078 90079	40	1195
Sunset-Lucille Co	93964	42	246
Sutcliffe Co., The	94235	41	1009
Swastika Oil & Gas Co	90861	40	797
T.			
Talbott et al., Harold E., executors of estate of Katherine H. Talbott [3]	97128	42	1081
Talbott, Katherine H., estate of [3]	97128	42	1081
Terhune, Wesley V. E	93894	40	749
Thatcher, Lester A., transferee of estate of Frank O. Burridge	93335	40	944
Timmerman, Louis F	96317	42	188
Traiser, Richard E., estate of [7]	91958	41	228
Trevor, Emily [1]	89820	40	1240
U.			
Union Guardian Trust Co	94687	41	1306
United States Fidelity & Guaranty Co	91398	40	1010
Universal Winding Co	87354	39	962

[1] Gift tax decision.
[2] Acquiescence relates only to the year 1935.
[3] Estate tax decision.
[4] Prior nonacquiescence published in Cumulative Bulletin 1939-1 (Part 1), page 60, withdrawn.
[5] 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?
[6] 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?
[7] 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.
V.			
Valley Tractor & Equipment Co	95878	42	311
W.			
Walter, William E	97537 99162	42	941
Washington Railway & Electric Co	92435	40	1248
Wegeforth, Lillie S	94708	42	633
Welder, Jr., James F	95005	41	686
Wheeler, Helen Evans [1]	95528	42	246
Winston Bros. Co.[2]	59270	29	905
Winthrop, Beekman [3]	79850	36	314
Wolf, Edith A	92429	41	1231
Wood, Elizabeth	95004	41	686
Wood, Orrin G.[4 5]	92489	40	904
Word, Anna	93543	41	965
Word, T. T	93542	41	965
Word Supply Co., T. T	93544	41	965
Y.			
Young, Du Bois [6]	78345	34	648

[1] Acquiescence relates to all issues except as to the deductibility of attorney's fees and abstract fees incurred incidental to the establishment of forefeiture of a lease and obtaining repossession of the leased premises.
[2] Prior nonacquiescence published in Cumulative Bulletin XIII-2, page 38 (1934), withdrawn.
[3] Nonacquiescence published in Cumulative Bulletin 1937-2, page 56, withdrawn.
[4] Gift tax decision.
[5] 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.
[6] 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.

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 [1]	91958	41	228
Affiliated Enterprises, Inc.[2]	96603	42	390
Alabama Asphaltic Limestone Co	91793	41	324
Allen, Jr., et al., Bona	93809		
Allen, Jr., et al., Bona, executors	93811		
Allen, H. Wadleigh, estate of	93811	41	206
Allen, John Q	93812		
Allen et al., Victor H	93810		
Alling, Noyes E., estate of [3]	87136	41	191
Appleby, Edgar S., estate of	93886	41	18
Appleby et al., Edgar T., executors of estate of Edgar S. Appleby	93886	41	18
Appleby, John S.[4]	94080	41	18
Armour, Lolita S	88151 93150	41	777
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 [5]	90452 90486 90487	40	881
Bonfils, F. G., estate of [6]	91501	40	1079
Bonfils Trust, F. G.[6]	93148	40	1085
Bonfils et al., Helen G., executors of estate of F. G. Bonfils [6]	91501	40	1079
Branch, Claude R	94248	40	1043
Bridgeport City Trust Co. et al., The, executors of estate of Noyes E. Alling [3]	87136	41	191
Bristol, Bennet B.[7]	96289	42	263
Brown, Antoinette K	97743	42	693
Bruckner, Arnold	97507	42	3
Buck, Ellsworth B	93330	41	99
Burnett, O. L	90248	40	604
C			
Carling Holding Co	86776 87378 88616	41	493
Cartex Mills, Inc	97698	42	894
Caspersen, Freda R	92765	40	758

[1] 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.

[2] Nonacquiescence relates only to the issue, is the petitioner subject to surtax as a personal holding company under sections 351 of the Revenue Acts of 1934 and 1936?

[3] Estate tax decision.

[4] Nonacquiescence relates to all issues except the issue with respect to the $150 added by the Commissioner to the petitioner's taxable income.

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

[6] Previous acquiescence published in Internal Revenue Bulletin 1940-15, page 1, withdrawn.

[7] Gift tax decision.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Cavett et al., K., executors of estate of W. T. Hales [1]	93208	40	1244
Central Loan & Investment Co.[2]	82565	39	981
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
Columbia Oil & Gas Co.[3]	90624	41	38
Cook Drilling Co.[4]	82231	38	291
Corporate Investment Co	78363	40	1155
Corpus Christi Terminal Co	88103	38	944
Covington et ux., George W	98283	42	601
Credit Alliance Corporation	100561	42	1020
Crichton, Kate J	97025	42	490
Cushman, Louise C., transferee of estate of Mary W. Cushman [5]	92881	40	947
Cushman, Mary W., estate of [5]	92882 92883	40	947
D.			
Dallas Title & Guaranty Co.[6]	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 [7]	93148	40	1085
Dunning, Henry A. B	92629	41	1101
Durkheimer, S. F	95209	41	585
E.			
Edwards Drilling Co.[8]	75931	35	341
Elias, Edna B	90827	41	1109
Elmhirst, Dorothy Whitney	85040 85880 95298	41	348
Elston Co., Ltd	96604	42	208
Elverson Corporation [9]	93281	40	615
Erb et al., Arthur L., executors of estate of Giles W. Mead [10]	97566	41	424

[1] 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?

[2] Acquiescence published in Cumulative Bulletin 1939-2, page 6, withdrawn.

[3] Nonacquiescence relates to issue pertaining to allocation of cost of equipment on the property in question.

[4] Nonacquiescence relates only to the issue whether the petitioner is entitled to deduct the costs incurred in drilling wells. Prior acquiescence published in Cumulative Bulletin 1939-2, page 8, withdrawn as to this issue only.

[5] Estate tax decision.

[6] 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.

[7] Previous acquiescence published in Internal Revenue Bulletin 1940-15, page 1, withdrawn.

[8] Nonacquiescence relates only to the issue whether the petitioner is entitled to deduct the costs incurred in drilling oil wells. Prior acquiescence published in Cumulative Bulletin 1939-1, page 11, withdrawn as to this issue only.

[9] Nonacquiescence relates only to the issue was the income resulting from the receipt of surrendered collateral in extinguishment of a debt personal holding company income?

[10] Gift tax decision.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Estates Administration, Inc., administrator of estate of Zachary Smith Reynolds [1]	86395	42	145
Evans, Mary E.[2]	95527	42	246
Ewing, Sherman	93013	40	911
F.			
F. H. E. Oil Co	92960	41	130
Falcon Co	92001	41	1128
Farmers & Ginners Cotton Oil Co	93436	41	1083
First Mortgage Bonds [3]	90452, 90486, 90487	40	881
First Trust & Deposit Co. et al., guardians	90749, 90750, 90751	41	107
Fleming, Mrs. Anna Maud [4]	92958, 94690	41	940
Fleming-Kimbell Corporation [4]	92959	41	940
Fleming, William [4]	92957, 94689	41	940
Fowler et ux., John O	91162	40	1293
Frazier, Frederic H	91412	41	146
G.			
Gadian Co., Ltd	96605	42	208
Gardner, J. Willis [5 6]	92115	41	679
Gloss [Glos], Lucy M.[5]	90391	41	1239
Goodman, Edwin	87799	41	472
Greene, A. Crawford, guardian of estate of Alice H. Lester [5]	93404, 96315	41	515
Greve, William M	97522	42	142
Grote et ux., Ben	94442, 94443	41	247
H.			
Hales, George A.[7]	93210	40	1244
Hales, Mrs. Oneta [7]	93209		
Hales, Jr., W. T.[7]	93211		
Hales, W. T., estate of [7]	93208		
Halsey, Lilian Johnson, executrix of estate of Richard Hemmons Halsey [1]	96404	42	607
Halsey, Richard Hemmons, estate of [1]	96404	42	607
Hartford-Connecticut Trust Co., The, extr. of estate of Mary W. Cushman [1]	92882	40	947
Heller, Edward H.[8]	94794, 94795	41	1020
Hercules Motor Corporation	92225	40	998

[1] Estate tax decision.

[2] Nonacquiescence relates only to the deductibility of attorney's fees and abstract fees incurred incidental to the establishment of forfeiture of a lease and obtaining repossession of the leased premises.

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

[4] Nonacquiescence is only with respect to the holding that the petitioners would realize no taxable income from the exchange of their oil, equipment, and personal property interest for contingent oil payments until they recovered the cost of the exchanged property from the oil payments received.

[5] Gift tax decision.

[6] 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?

[7] 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?

[8] Nonacquiescence relates to the issue whether petitioner was taxable on the income derived from certain securities placed in certain agency accounts with a bank in petitioner's name as trustee for his minor children.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
Hoffman, Katherine M	96741	40	459
Hoffman, W. W	96742		
Hoffman et ux., W. W	92414		
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
Hughes Tool Co	90002	40	962
J.			
Johnson et al., Thomas M., trustees	86776, 87378, 88616	41	493
Johnston, Katherine S., estate of [1]	86395	42	145
Jonas, Louise B	91010	40	970
K.			
Kellogg, Cornelia V. W., executrix of estate of Frederick R. Kellogg [1]	89143	40	915
Kellogg, F. W	95135	42	64
Kellogg, Frederick R., estate of [1]	89143	40	915
Kenan et al., William R., Jr., trustees u/w Mary Lily (Flagler) Bingham	94985	40	823
Kimbell, Kay [3]	92956, 94674	41	940
Kimbell, Mrs. Velma [3]	92955, 94673	41	940
Klyce, A. S., estate of	90174	41	194
Klyce, M. P., administrator	90174	41	194
Knapp, George O	91699	40	1144
L.			
Lester, Alice H., an incompetent, estate of [4]	93404, 96315	41	515
Lipe, Gordon C	90750	41	107
Lipe, Suzanne H	90751		
Lipe, Jr., Willard C	90749		
M.			
Majestic Oil Corporation [5]	96380	42	659
Marlborough House, Inc., et al. [6]	90452, 90486, 90487	40	881
Marlborough Investment Co. [6]	90452, 90486, 90487	40	881
Marshall, Herbert	99559	41	1064
McGlue, G. Percy, estate of	98446	41	1186

[1] Estate tax decision.

[2] 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?

[3] Nonacquiescence is only with respect to the holding that the petitioners would realize no taxable income from the exchange of their oil, equipment, and personal property interest for contingent oil payments until they recovered the cost of the exchanged property from the oil payments received.

[4] Gift tax decision.

[5] Nonacquiescence relates only to the issue, Is the petitioner entitled to a 1935 loss deduction for the undepreciated cost of certain casing and other lease equipment which could not be removed from a certain oil well which the petitioner ceased to operate during that year, because such operation had become unprofitable?

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

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
McGlue, M. Edith, executrix of estate of G. Percy McGlue	98446	41	1186
McGovern, Inc., Patrick	91846	40	705
McLean et ux., Marrs [1]	91170 91171	41	1266
Mead, Giles W., estate of [1]	97566	41	424
Michigan Silica Co	96786	41	511
Milbank, Dunlevy [2]	93050	41	1014
Moloney Electric Co.[3]	96072	42	78
Mueller Co., C. F	85964 96331	40	195
N.			
National Bank of Commerce of San Antonio, Tex	93164	40	470
National Bank of Commerce of Seattle [4]	89720	40	72
Nebraska Bridge Supply & Lumber Co	90846	40	40
Newport Industries, Inc	92331	40	977
Newton, Jr., James Q	97325	42	473
Newton Trust, James Q	97324	42	473
O.			
Ortiz, Alice duPont [5]	93159	42	173
P.			
Page Oil Co	90515 95674 96186	41	952
Palmer, Carleton H	89854	40	1001
Perkins, Ralph [6]	96126	41	1225
Phoenix State Bank & Trust Co., trustee under deed of trust from Mary W. Cushman, as trustee and transferee [7]	92883	40	947
Prouty, Olive H. [1]	96164	41	274
R.			
Realty Operators, Inc	92387	40	1051
Reynolds, R. J., estate of [7]	86394	42	145
Reynolds, Zachary Smith, estate of [7]	86395	42	145
Rhodes et al., Hugh D., administrators of estate of Mamie D. Rhodes [7]	91284	41	62
Rhodes, Mamie D., estate of [7]	91284	41	62
Richardson, Lunsford [1]	85905	39	927
Rubinstein, Wilton [1]	95922	41	220
Rust, Jr., et al., H. L., executors of estate of H. L. Rust	95880	41	832
Rust, H. L., estate of	95880	41	832

[1] Gift tax decision.
[2] Nonacquiescence is only with respect to the taxability of the income from the so-called short term trusts.
[3] Nonacquiescence relates only to the issue, Is the petitioner entitled to a credit under section 26(c)2 of the Revenue Act of 1936 in the amount of $13,810, representing 2 per cent of the largest amount of bonds at any one time outstanding during 1936?
[4] Acquiescence as to one issue published in Cumulative Bulletin 1939–2, page 26, withdrawn.
[5] Nonacquiescence relates to all issues except the issue, whether the petitioner is entitled to any deduction as the result of the satisfaction of the deficit existing in her husband's brokerage accounts at the end of the year 1934.
[6] Nonacquiescence relates only to the issue, Did the petitioner sustain a loss in the amount of $13,963.50 on the sale of second preferred and common stock of the Hill Clutch Machine & Foundry Co.?
[7] Estate tax decision.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
S.			
Safe Deposit & Trust Co. of Baltimore, trustee under wills of R. J. Reynolds, and Katherine S. Johnston, and deed of Katherine S. Johnston [1]	86394	42	145
Sanford Cotton Mills, Inc.[2]	95218	42	190
Shelden Land Co.[3]	93196	42	498
Sherman, Doris Bond [4 5]	95300	41	898
Sobel, Inc., N	93822	40	1262
Sporl & Co., Inc., C. A	90354	40	828
Spreckels, Adolph B	94621 95639	41	1204
Stanart Co., Ltd	96606	42	208
Stein, Nathan	83178	40	847
Stern, Allison L. S.[6]	93134	40	756
Straus, Friedrich A	83181		
Straus, Meier A	83180	40	847
Straus, Moritz	83179		
Strong Manufacturing Co., The	95626	41	1273
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
Traiser, Richard E., estate of [7]	91958	41	228
Trico Securities Corporation	85176	41	306
W.			
Walker, William T.[4]	92600	40	762
Watson, Archibald R	87873 88048 89650	42	52
Wenger, Mary E	92245	42	225
West Production Co	88997	41	1043
Wheeler, Helen Evans [8]	95528	42	246
White, Ida A., estate of	93575	41	525
Wood, Orrin G.[4 9]	92489	40	904

[1] Estate tax decision.
[2] See G. C. M. 22404 (page 204, this Bulletin).
[3] Nonacquiescence relates only to the issue whether petitioner is entitled to a deduction for an asserted loss on an alleged sale of certain land to another corporation.
[4] Gift tax decision.
[5] Nonacquiescence relates only to the year 1936.
[6] 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?
[7] 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.
[8] Nonacquiescence relates only to the deductibility of attorney's fees and abstract fees incurred incidental to the establishment of forfeiture of a lease and obtaining repossession of the leased premises.
[9] 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 ACTS OF 1939 AND 1940.

CHAPTER I.—INCOME TAX.

SUBCHAPTER A.—INTRODUCTORY PROVISIONS.

SECTION 1.—APPLICATION OF CHAPTER.

SECTION 19.1–1: Scope of regulations. 1940–41–10446
(Also Section 11, Section 19.11–1; Section 12, Sections 19.12–1 and 19.12–2; Section 13, Sections 19.13–1, 19.13–5, 19.13–6, and 19.13–7; Section 14, Sections 19.14–1 and 19.14–2; Section 15, Section 19.15–1; Section 25, Sections 19.25–1, 19.25–3, and 19.25–7; Section 47, Section 19.47–1; Section 51, Sections 19.51–1, 19.51–2, and 19.51–3; Section 102, Section 19.102–1; Section 104, Section 19.104–1; Section 131, Section 19.131–8; Section 142, Sections 19.142–1, 19.142–2, and 19.142–5; Section 147, Sections 19.147–1, 19.147–2, 19.147–3, 19.147–7, and 19.147–8; Section 163, Section 19.163–1; Section 201(b), Section 19.201(b)–1; Section 204(a), Section 19.204(a)–1; Section 207, Section 19.207–1; Section 211, Sections 19.211–1 and 19.211–7; Section 213, Section 19.213–1; Section 214, Section 19.214–1; Section 215, Section 19.215–1; Section 217, Section 19.217–2; Section 219, Section 19.219–1; Section 231, Section 19.231–1; Section 251, Section 19.251–1; Section 262, Section 19.262–2; Section 362, Section 19.362–1; Section 500, Section 19.500–1.) T. D. 5011

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

Regulations 103 amended to conform to the Revenue Act of 1940.

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

To Collectors of Internal Revenue and Others Concerned:

In order to conform Regulations 103 (Part 19, Title 26, Code of Federal Regulations, 1940 Sup.) to the Revenue Act of 1940 (Public,

No. 656, Seventy-sixth Congress, third session), approved June 25, 1940, such regulations are amended as follows:

PARAGRAPH 1. Section 19.1–1 is amended by inserting at the end thereof a new paragraph reading as follows:

As used in these regulations to describe a section of the Internal Revenue Code, the term "prior to its amendment" has reference only to amendment by the Revenue Act of 1939, and the term "as amended" has reference to amendment by any Act.

PAR. 2. The first sentence of section 19.11–1 is amended to read as follows:

Chapter 1 of the Internal Revenue Code, which applies only to taxable years beginning after December 31, 1938 (see section 1), imposes an income tax on individuals, including a normal tax (section 11), a surtax (section 12), and a defense tax for taxable years beginning after December 31, 1939, and before January 1, 1945 (section 15 added by section 201 of the Revenue Act of 1940).

PAR. 3. The following is inserted immediately preceding section 19.12–1:

SEC. 2 SURTAX ON INDIVIDUALS. (REVENUE ACT OF 1940, TITLE I.)

Section 12(b) of the Internal Revenue Code is amended to read as follows:

"(b) RATES OF SURTAX.—There shall be levied, collected, and paid for each taxable year upon the surtax net income of every individual a surtax as follows:

"Upon a surtax net income of $4,000 there shall be no surtax; upon surtax net incomes in excess of $4,000 and not in excess of $6,000, 4 per centum of such excess.

"$80 upon surtax net incomes of $6,000; and upon surtax net incomes in excess of $6,000 and not in excess of $8,000, 6 per centum in addition of such excess.

"$200 upon surtax net incomes of $8,000; and upon surtax net incomes in excess of $8,000 and not in excess of $10,000, 8 per centum in addition of such excess.

"$360 upon surtax net incomes of $10,000; and upon surtax net incomes in excess of $10,000 and not in excess of $12,000, 10 per centum in addition of such excess.

"$560 upon surtax net incomes of $12,000; and upon surtax net incomes in excess of $12,000 and not in excess of $14,000, 12 per centum in addition of such excess.

"$800 upon surtax net incomes of $14,000; and upon surtax net incomes in excess of $14,000 and not in excess of $16,000, 15 per centum in addition of such excess.

"$1,100 upon surtax net incomes of $16,000; and upon surtax net incomes in excess of $16,000 and not in excess of $18,000, 18 per centum in addition of such excess.

"$1,460 upon surtax net incomes of $18,000; and upon surtax net incomes in excess of $18,000 and not in excess of $20,000, 21 per centum in addition of such excess.

"$1,880 upon surtax net incomes of $20,000; and upon surtax net incomes in excess of $20,000 and not in excess of $22,000, 24 per centum in addition of such excess.

"$2,360 upon surtax net incomes of $22,000; and upon surtax net incomes in excess of $22,000 and not in excess of $26,000, 27 per centum in addition of such excess.

"$3,440 upon surtax net incomes of $26,000; and upon surtax net incomes in excess of $26,000 and not in excess of $32,000, 30 per centum in addition of such excess.

"$5,240 upon surtax net incomes of $32,000; and upon surtax net incomes in excess of $32,000 and not in excess of $38,000, 33 per centum in addition of such excess.

"$7,220 upon surtax net incomes of $38,000; and upon surtax net incomes in excess of $38,000 and not in excess of $44,000, 36 per centum in addition of such excess.

"$9,380 upon surtax net incomes of $44,000; and upon surtax net incomes in excess of $44,000 and not in excess of $50,000, 40 per centum in addition of such excess.

"$11,780 upon surtax net incomes of $50,000; and upon surtax net incomes in excess of $50,000 and not in excess of $60,000, 44 per centum in addition of such excess.

"$16,180 upon surtax net incomes of $60,000; and upon surtax net incomes in excess of $60,000 and not in excess of $70,000, 47 per centum in addition of such excess.

"$20,880 upon surtax net incomes of $70,000; and upon surtax net incomes in excess of $70,000 and not in excess of $80,000, 50 per centum in addition of such excess.

"$25,880 upon surtax net incomes of $80,000; and upon surtax net incomes in excess of $80,000 and not in excess of $90,000, 53 per centum in addition of such excess.

"$31,180 upon surtax net incomes of $90,000; and upon surtax net incomes in excess of $90,000 and not in excess of $100,000, 56 per centum in addition of such excess.

"$36,780 upon surtax net incomes of $100,000; and upon surtax net incomes in excess of $100,000 and not in excess of $150,000, 58 per centum in addition of such excess.

"$65,780 upon surtax net incomes of $150,000; and upon surtax net incomes in excess of $150,000 and not in excess of $200,000, 60 per centum in addition of such excess.

"$95,780 upon surtax net incomes of $200,000; and upon surtax net incomes in excess of $200,000 and not in excess of $250,000, 62 per centum in addition of such excess.

"$126,780 upon surtax net incomes of $250,000; and upon surtax net incomes in excess of $250,000 and not in excess of $300,000, 64 per centum in addition of such excess.

"$158,780 upon surtax net incomes of $300,000; and upon surtax net incomes in excess of $300,000 and not in excess of $400,000, 66 per centum in addition of such excess.

"$224,780 upon surtax net incomes of $400,000; and upon surtax net incomes in excess of $400,000 and not in excess of $500,000, 68 per centum in addition of such excess.

"$292,780 upon surtax net incomes of $500,000; and upon surtax net incomes in excess of $500,000 and not in excess of $750,000, 70 per centum in addition of such excess.

"$467,780 upon surtax net incomes of $750,000; and upon surtax net incomes in excess of $750,000 and not in excess of $1,000,000, 72 per centum in addition of such excess.

"$647,780 upon surtax net incomes of $1,000,000; and upon surtax net incomes in excess of $1,000,000 and not in excess of $2,000,000, 73 per centum in addition of such excess.

"$1,377,780 upon surtax net incomes of $2,000,000; and upon surtax net incomes in excess of $2,000,000 and not in excess of $5,000,000, 74 per centum in addition of such excess.

"$3,597,780 upon surtax net incomes of $5,000,000; and upon surtax net incomes in excess of $5,000,000, 75 per centum in addition of such excess."

SEC. 9. TAXABLE YEARS TO WHICH APPLICABLE. (REVENUE ACT OF 1940, TITLE I.)

The amendments made by this title, except the amendments made by section 5, shall be applicable only with respect to taxable years beginning after December 31, 1939.

PAR. 4. Section 19.12–1 is amended by inserting at the end thereof the following: "For the defense tax imposed for taxable years beginning after December 31, 1939, and before January 1, 1945, see section 19.15–1."

PAR. 5. Section 19.12–2 is amended as follows:

(A) The first sentence is amended to read: "The following tables show the surtax (1) for taxable years beginning after December 31,

1938, and before January 1, 1940, and (2) for taxable years beginning after December 31, 1939, upon certain specified amounts of surtax net income."

(B) The heading of the surtax table following the fourth sentence is changed to read:

TABLE I.—*Taxable years beginning after December 31, 1938, and before January 1, 1940.*

(C) There is inserted immediately after the existing table the following additional table:

TABLE II.—*Taxable years beginning after December 31, 1939.*

Surtax net income.	Per cent.	Total surtax.
$0 to $4,000		
$4,000 to $6,000	4	$80
$6,000 to $8,000	6	200
$8,000 to $10,000	8	360
$10,000 to $12,000	10	560
$12,000 to $14,000	12	800
$14,000 to $16,000	15	1,100
$16,000 to $18,000	18	1,460
$18,000 to $20,000	21	1,880
$20,000 to $22,000	24	2,360
$22,000 to $26,000	27	3,440
$26,000 to $32,000	30	5,240
$32,000 to $38,000	33	7,220
$38,000 to $44,000	36	9,380
$44,000 to $50,000	40	11,780
$50,000 to $60,000	44	16,180
$60,000 to $70,000	47	20,880
$70,000 to $80,000	50	25,880
$80,000 to $90,000	53	31,180
$90,000 to $100,000	56	36,780
$100,000 to $150,000	58	65,780
$150,000 to $200,000	60	95,780
$200,000 to $250,000	62	126,780
$250,000 to $300,000	64	158,780
$300,000 to $400,000	66	224,780
$400,000 to $500,000	68	292,780
$500,000 to $750,000	70	467,780
$750,000 to $1,000,000	72	647,780
$1,000,000 to $2,000,000	73	1,377,780
$2,000,000 to $5,000,000	74	8,597,780
$5,000,000 up	75	

(D) The last sentence of the last paragraph is amended to read as follows:

Accordingly, the surtax due for taxable years beginning after December 31, 1939, upon a surtax net income of $63,128 would be $17,650.16, computed as follows:

Surtax on $60,000 from table	$16,180.00
Surtax on $3,128 at 47 per cent	1,470.16
Total	17,650.16

PAR. 6. The following is inserted immediately preceding section 19.13–1:

SEC. 3. CORPORATION TAX. (REVENUE ACT OF 1940, TITLE I.)

(a) TAX ON CORPORATIONS IN GENERAL.—Section 13(b) of the Internal Revenue Code is amended to read as follows:

"(b) IMPOSITION OF TAX.—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation

the normal-tax net income of which is more than $25,000 (except a corporation subject to the tax imposed by section 14, section 231(a), Supplement G, or Supplement Q) whichever of the following taxes is the lesser:

"(1) GENERAL RULE.—A tax of 19 per centum of the normal-tax net income; or

"(2) ALTERNATIVE TAX (CORPORATIONS WITH NORMAL-TAX NET INCOME SLIGHTLY MORE THAN $25,000).—A tax of $3,775, plus 33 per centum of the amount of the normal-tax net income in excess of $25,000."

* * * * * * *

SEC. 9. TAXABLE YEARS TO WHICH APPLICABLE. (REVENUE ACT OF 1940, TITLE I.)

The amendments made by this title, except the amendments made by section 5, shall be applicable only with respect to taxable years beginning after December 31, 1939.

PAR. 7. Section 19.13–5 is amended by adding at the end thereof the following: "For the defense tax imposed for taxable years beginning after December 31, 1939, and before January 1, 1945, see section 19.15–1."

PAR. 8. Section 19.13–6 is amended by striking out "18 per cent," "$16,470," and "16,470," wherever they appear, and inserting in lieu thereof "19 per cent," "$17,385," and "17,385," respectively.

PAR. 9. Section 19.13–7 is amended by striking out "$3,525," "32 per cent," "$3,893," "3,893," "18 per cent," and "4,707," wherever they appear, and inserting in lieu thereof "$3,775," "33 per cent," "$4,154.50," "4,154.50," "19 per cent," and "4,968.50," respectively.

PAR. 10. The following is inserted immediately preceding section 19.14–1:

SEC. 3. CORPORATION TAX. (REVENUE ACT OF 1940, TITLE I.)

* * * * * * *

(b) TAX ON SPECIAL CLASSES OF CORPORATIONS.—Sections 14 (b) and (c) (1) of the Internal Revenue Code are amended to read as follows:

"(b) CORPORATIONS WITH NORMAL-TAX NET INCOMES OF NOT MORE THAN $25,000.—If the normal-tax net income of the corporation is not more than $25,000, and if the corporation does not come within one of the classes specified in subsection (c), (d), or (e) of this section, the tax shall be as follows:

"Upon normal-tax net incomes not in excess of $5,000, 13½ per centum.

"$675 upon normal-tax net incomes of $5,000, and upon normal-tax net incomes in excess of $5,000 and not in excess of $20,000, 15 per centum in addition of such excess.

"$2,925 upon normal-tax net incomes of $20,000, and upon normal-tax net incomes in excess of $20,000, 17 per centum in addition of such excess.

"(c) FOREIGN CORPORATIONS.—

"(1) In the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, the tax shall be an amount equal to 19 per centum of the normal-tax net income, regardless of the amount thereof."

* * * * *

SEC. 9. TAXABLE YEARS TO WHICH APPLICABLE. (REVENUE ACT OF 1940, TITLE I.)

The amendments made by this title, except the amendments made by section 5, shall be applicable only with respect to taxable years beginning after December 31, 1939.

PAR. 11. Section 19.14–2 is amended as follows:

(A) By striking out in the table following the fifth paragraph: "12½," "14," "16," "$625," "2,725," and "3,525," and by inserting in lieu thereof: "13½," "15," "17," "$675," "2,925," and "3,755," respectively.

(B) By striking out in the example "$1,430," "625," "805," "1,430," "12½ per cent," and "14 per cent," wherever they appear, and inserting in lieu thereof "$1,537.50," "675," "862.50," "1,537.50," "13½ per cent," and "15 per cent," respectively.

(C) By striking out in the first sentence of the last paragraph "18 per cent" and inserting in lieu thereof "19 per cent."

PAR. 12. Section 19.15–1 is stricken out and there is inserted in lieu thereof the following:

SEC. 201. INCOME TAX. (REVENUE ACT OF 1940, TITLE II.)

Chapter 1 of the Internal Revenue Code is amended by inserting after section 14 the following new section:

"SEC. 15. DEFENSE TAX FOR FIVE YEARS.

"In the case of any taxpayer, the amount of tax under this chapter for any taxable year beginning after December 31, 1939, and before January 1, 1945, shall be 10 per centum greater than the amount of tax computed without regard to this section. In no case shall the effect of this section be to increase the tax computed without regard to this section by more than 10 per centum of the amount by which the net income exceeds such tax. For the purposes of this section, the tax computed without regard to this section shall be such tax before the application of the credit provided in section 31 ('foreign tax credit'), and the credit provided in section 32 (taxes withheld at the source)."

SEC. 19.15–1. *Defense tax.*—For taxable years beginning after December 31, 1939, and before January 1, 1945, the tax computed in accordance with Chapter 1 of the Internal Revenue Code as amended without regard to section 15 (added by section 201 of the Revenue Act of 1940[1]) is increased by 10 per cent thereof. For the purposes of this 10 per cent increase, the tax which is to be increased is computed before the application of the foreign tax credit and the credit for taxes withheld at the source.

Section 15 also provides that in no case shall its effect be to increase the tax by more than 10 per cent of the amount by which the net income exceeds the tax computed without regard to section 15. This limitation applies to taxpayers whose income tax, computed without regard to the defense tax provisions, amounts to more than 50 per cent of their net income. It is provided that such taxpayers shall pay a defense tax of not more than 10 per cent of their income remaining after deduction of income tax computed without regard to the defense tax provisions. This limitation may be illustrated by the following example:

Example: The net income of an individual entitled to the maximum earned income credit and having no capital gains or losses is $752,800. He is entitled to credits for personal exemption and dependents amounting to $2,800. His tax liability computed without regard to section 15 is $497,724. The difference between the net income and the tax liability is $255,076. The tax after applying section 15 is $497,724 plus 10 per cent of $255,076, or $523,231.60. If such a limitation had not been provided for, the tax after the application of section 15 would have been $547,496.40.

A further effect of the limitation on the 10 per cent increase is to prevent any increase in the tax of a taxpayer who under existing law, as amended by Title I of the Revenue Act of 1940, has no net income because he has a net long-term capital loss, but is subject to tax under section 117(c)2 of the Internal Revenue Code.

[1] Section 201 of the Revenue Act of 1939 amended sections 13, 14, and 15 by enacting new sections 13 and 14 imposing taxes on the income of corporations for taxable years beginning after December 31, 1939, and eliminating section 15. A new section 15, providing for a defense tax, was added by section 201 of the Revenue Act of 1940.

PAR. 13. The following is inserted immediately preceding section 19.25–1, relating to credits of individuals against net income:

SEC. 6. PERSONAL EXEMPTION. (REVENUE ACT OF 1940, TITLE I.)

(a) Section 25(b)(1) of the Internal Revenue Code is amended to read as follows:

"(1) PERSONAL EXEMPTION.—In the case of a single person or a married person not living with husband or wife, a personal exemption of $800; or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $2,000. A husband and wife living together shall receive but one personal exemption. The amount of such personal exemption shall be $2,000. If such husband and wife make separate returns, the personal exemption may be taken by either or divided between them."

* * * * * * *

SEC. 9. TAXABLE YEARS TO WHICH APPLICABLE. (REVENUE ACT OF 1940, TITLE I.)

The amendments made by this title, except the amendments made by section 5, shall be applicable only with respect to taxable years beginning after December 31, 1939.

PAR. 14. The first two sentences of section 19.25–3 are amended to read as follows:

A single person or a married person not living with husband or wife is entitled to a personal exemption of $800 ($1,000 for a taxable year beginning before January 1, 1940) and the head of a family or a married person living with husband or wife, to $2,000 ($2,500 for a taxable year beginning before January 1, 1940). A husband and wife living together have but one personal exemption, which is $2,000 ($2,500 for a taxable year beginning before January 1, 1940).

PAR. 15. Section 19.25–7 is amended by adding at the end thereof the following paragraph:

If the change of status shown by the preceding examples occurs in any taxable year beginning after December 31, 1939, the apportionment of the personal exemptions will be based upon an allowance of $800 instead of $1,000 to a single person or a married person not living with husband or wife, and $2,000 instead of $2,500 in the case of a head of a family or a married person living with husband or wife.

PAR. 16. The first sentence of the example in section 19.47–1 is amended to read as follows: "A citizen of the United States made a return for a 10-month period ended October 31, 1939, by reason of a change in accounting period."

PAR. 17. The following is inserted immediately preceding section 19.51–1, relating to individual returns:

SEC. 7. RETURNS OF INCOME TAX. (REVENUE ACT OF 1940, TITLE I.)

(a) INDIVIDUAL RETURNS.—Section 51(a) of the Internal Revenue Code is amended to read as follows:

"(a) REQUIREMENT.—The following individuals shall each make under oath a return stating specifically the items of his gross income and the deductions and credits allowed under this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe.—

"(1) Every individual who is single or who is married but not living with husband or wife, if having a gross income for the taxable year of $800 or over.

"(2) Every individual who is married and living with husband or wife, if no joint return is made under subsection (b) and if—

"(A) Such individual has for the taxable year a gross income of $2,000 or over, and the other spouse has no gross income; or

"(B) Such individual and his spouse each has for the taxable year a gross income and the aggregate gross income is $2,000 or over."

* * * * *

SEC. 9. TAXABLE YEARS TO WHICH APPLICABLE. (REVENUE ACT OF 1940, TITLE I.)

The amendments made by this title, except the amendments made by section 5, shall be applicable only with respect to taxable years beginning after December 31, 1939.

Par. 18. Section 19.51–1 is amended as follows:

(A) The heading of the paragraph designated as "(*a*) *In general.*—" is changed to read as follows: "(*a*) *In general.—For taxable years beginning before January 1, 1940.*—"

(B) Immediately preceding the paragraph designated as "(*b*) *Joint returns.*—" the following is inserted:

(*b*) *In general.—For taxable years beginning after December 31, 1939.*—For taxable years beginning after December 31, 1939, such individuals shall make a return of income—

(1) If single or married but not living with husband or wife for any part of the taxable year, and if having for the taxable year a gross income (as defined in sections 22 and 116) of $800 or over.

(2) If married and living with husband or wife for the entire taxable year, if no joint return is made, and if—

(*a*) having for the taxable year a gross income of $2,000 or over, and the other spouse has no gross income; or

(*b*) such individual and his or her spouse each has for the taxable year a gross income and the aggregate gross income of the two is $2,000 or over.

(3) If married and living with husband or wife for any part of the taxable year but not at the close thereof, or if married and living with husband or wife at the close of the taxable year, but not during the entire taxable year, if no joint return is made, and if—

(*a*) having for the taxable year a gross income equal to, or in excess of, the credit allowed him or her by section 25(b) (1) and (3) (computed without regard to any credit to which he or she may be entitled as the head of a family (see section 19.25–7)), and the other spouse has no gross income; or

(*b*) such individual and his or her spouse each has for the taxable year a gross income, and their aggregate gross income is $2,000 or over, or is equal to, or in excess of, the credit allowed them by section 25(b) (1) and (3) (computed without regard to any credit to which either or both may be entitled as the head of a family (see section 19.25–7)).

(C) The paragraph now designated as "(*b*) *Joint returns.*" is changed to "(*c*) *Joint returns.*"

PAR. 19. Section 19.51–2 is amended by inserting in the first sentence after "$5,000," the following: "or, for taxable years beginning after December 31, 1939, if the gross income does not exceed $5,000,".

PAR. 20. Section 19.51–3 is amended as follows:

(A) There are stricken out of the first sentence the words "the taxable year," and inserted in lieu thereof the following: "a taxable year beginning before January 1, 1940, and for a taxable year beginning after December 31, 1939, if he has a gross income of $800 or over, regardless of the amount of his net income."

(B) There is inserted in the second sentence after "$5,000," the following: "or $800 or over, regardless of the amount of his net income, for a taxable year beginning after December 31, 1939,".

PAR. 21. Section 19.102–1 is amended by adding at the end thereof the following: "For the defense tax imposed for taxable years begin-

ning after December 31, 1939, and before January 1, 1945, see section 19.15–1."

PAR. 22. Section 19.104–1 is amended by adding at the end thereof the following: " For the defense tax imposed for taxable years beginning after December 31, 1939, and before January 1, 1945, see section 19.15–1."

PAR. 23. Section 19.131–8 is amended by substituting for Example (2) (with respect to corporations), the following example:

Example (2): The net income for the calendar year 1940 and the income and profits taxes paid or accrued to foreign countries and possessions of the United States in the case of a domestic corporation were as follows:

Country.	Net income.	Loss.	Income and profits taxes (paid or accrued).
United States	$200,000		
Great Britain	30,000		$7,500
Canada	20,000		1,800
Brazil	40,000		2,400
Argentine Republic	60,000		None.
Mexico		$100,000	None.
Puerto Rico	10,000		1,250
France (dividend)	50,000		[1]9,000
France (branch)	20,000		3,000

[1] Withheld.

Net income		$330,000.00
Less:		
85 per cent on dividends received from domestic corporations ($50,000)	$42,500.00	
Interest on obligations of the United States	25,000.00	
		67,500.00
Normal-tax net income		262,500.00
Total foreign net income		130,000.00
United States tax (not including tax imposed under section 102) before allowance of credit for foreign taxes		54,862.50

The income and losses from all foreign countries and possessions of the United States, except the dividend from sources within France, were derived from branch operations. Dividends of $50,000 were received from a French corporation, a majority of the voting stock of which was owned by the domestic corporation. The French corporation paid to France income and profits taxes on income earned by it and in addition a dividend tax for the account of its shareholders on income distributed to them, the latter tax being withheld and paid at the source.

The computation of the credit is as follows:

Great Britain.

Income and profits tax paid or accrued	$7,500
Limitation under section 131(b)(1) $\left(\frac{30,000}{262,500} \text{ of } \$54,862.50\right)$	6,270
Tentative credit	6,270

Canada.

Income and profits tax paid or accrued	$1,800
Limitation under section 131(b)(1) $\left(\frac{20,000}{262,500} \text{ of } \$54,862.50\right)$	4,180
Tentative credit	1,800

Brazil.

Income and profits tax paid or accrued	$2,400
Limitation under section 131(b)(1) $\left(\frac{40,000}{262,500}\text{ of }\$54,862.50\right)$	8,360
Tentative credit	2,400

Argentine Republic.

Tentative credit	None.

Mexico.

Tentative credit	None.

Puerto Rico.

Income and profits taxes paid or accrued	$1,250
Limitation under section 131(b)(1) $\left(\frac{10,000}{262,500}\text{ of }\$54,862.50\right)$	2,090
Tentative credit	1,250

France.

Dividend tax paid at source		$9,000
Income and profits taxes paid or accrued on branch operations		3,000
Income and profits taxes deemed under section 131(f) to have been paid, computed as follows:		
Dividend received on December 31 of the taxable year	$50,000	
Income of French corporation earned during taxable year	200,000	
Income and profits taxes paid to France on $200,000	30,000	
Accumulated profits ($200,000 minus $30,000)	170,000	
French taxes applicable to accumulated profits distributed $\left(\frac{50,000}{170,000}\text{ of }\left(\frac{170,000}{200,000}\text{ of }\$30,000\right)\right)$		7,500
Limitation under section 131(f) $\left(\frac{50,000}{262,500}\text{ of }\$54,862.50\right)$		10,450
Income and profits taxes deemed to have been paid (French taxes applicable to accumulated profits distributed to domestic corporation, reduced in accordance with the limitation under section 131(f))		7,500
Total income and profits taxes paid or accrued and deemed to have been paid to France		19,500
Limitation under section 131(b)(1) $\left(\frac{70,000}{262,500}\text{ of }\$54,862.50\right)$		14,630
Tentative credit		14,630

Sum of tentative credits.

Great Britain	$6,270
Canada	1,800
Brazil	2,400
Puerto Rico	1,250
France	14,630
	26,350
Limitation on sum of tentative credits under section 131(b)(2) to determine credit $\left(\frac{130,000}{262,500}\text{ of }\$54,862.50\right)$	27,170
Total amount of credit allowable (sum of tentative credits or the limitation under section 131(b)(2), whichever is the lesser)	26,350

PAR. 24. The following is inserted immediately preceding section 19.142-1, relating to fiduciary returns:

SEC. 7. RETURNS OF INCOME TAX. (REVENUE ACT OF 1940, TITLE I.)

* * * * * * *

(b) FIDUCIARY RETURNS.—Section 142(a) of the Internal Revenue Code is amended to read as follows:

"(a) REQUIREMENT OF RETURN.—Every fiduciary (except a receiver appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for any of the following individuals, estates, or trusts for which he acts, stating specifically the items of gross income thereof and the deductions and credits allowed under this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe—

"(1) Every individual having a gross income for the taxable year of $800 or over, if single, or if married and not living with husband or wife;

"(2) Every individual having a gross income for the taxable year of $2,000 or over, if married and living with husband or wife;

"(3) Every estate the gross income of which for the taxable year is $800 or over;

"(4) Every trust the net income of which for the taxable year is $100 or over, or the gross income of which for the taxable year is $800 or over, regardless of the amount of the net income; and

"(5) Every estate or trust of which any beneficiary is a nonresident alien."

* * * * *

SEC. 9. TAXABLE YEARS TO WHICH APPLICABLE. (REVENUE ACT OF 1940, TITLE I.)

The amendments made by this title, except the amendments made by section 5, shall be applicable only with respect to taxable years beginning after December 31, 1939.

PAR. 25. Section 19.142–1 is amended as follows:

(A) There is stricken out immediately after "(*a*)" in the paragraph so designated the word "For," and there is inserted in lieu thereof the following: "*For taxable years beginning before January 1, 1940—Returns for individuals.*—For a taxable year beginning before January 1, 1940, for."

(B) There is stricken out immediately after "(*b*)" in the paragraph so designated the word "For," and there is inserted in lieu thereof the following: "*For taxable years beginning before January 1, 1940—Returns for estates and trusts.*—For a taxable year beginning before January 1, 1940, for."

(C) There is inserted immediately after the paragraph designated as "(*b*)" the following:

(c) *For taxable years beginning after December 31, 1939—Returns for individuals.*—For a taxable year beginning after December 31, 1939, for the individual whose income is in his charge, if the gross income of such individual is $800 or over, if single, or if married and not living with husband or wife for any part of the taxable year; or if such individual is married and was living with husband or wife for any part of the taxable year but not at the close of the taxable year and his gross income for the taxable year is equal to, or in excess of, the credit allowed him by section 25(b) (1) and (3) (computed without regard to his status as head of a family); or if such individual is married and was living with husband or wife for the entire taxable year and the aggregate gross income of both husband and wife is $2,000 or over; or if such individual is married and was living with husband or wife at the close of the taxable year but not during the entire taxable year and the aggregate gross income of both husband and wife is $2,000 or over, or the aggregate

gross income of both husband and wife is equal to, or in excess of, the credit allowed them by section 25(b) (1) and (3) (computed without regard to the status of either of them as head of a family), or

(*d*) *For taxable years beginning after December 31, 1939—Returns for estates and trusts.*—For a taxable year beginning after December 31, 1939, for the estate for which he acts if the gross income of such estate is $800 or over, and for the trust for which he acts if the gross income of such trust is $800 or over, or the net income of such trust, as computed under section 162, is $100 or over, or if any beneficiary of such estate or trust is a nonresident alien.

(D) The first and second sentences in the second from the last paragraph are changed to read as follows: "The return in case (*a*) or (*c*) shall be on Form 1040 or 1040A. In case (*b*) or (*d*) a return is required on Form 1041."

(E) The next to the last sentence in the second from the last paragraph is stricken out and there is inserted in lieu thereof the following: "For a taxable year beginning before January 1, 1940, if the net income of a decedent from the beginning of the taxable year to the date of his death was equal to, or in excess of, the credit allowed him by section 25(b) (1) and (3) (computed without regard to his status as head of a family), or if his gross income for the same period was $5,000 or over, the executor or administrator shall make a return for such decedent. For a taxable year beginning after December 31, 1939, if the gross income of the decedent from the beginning of the taxable year to the date of his death was equal to, or in excess of, the credit allowed him by section 25(b) (1) and (3) (computed without regard to his status as head of a family), the administrator shall make a return for such decedent."

PAR. 26. Section 19.142–2 is amended by striking out in the first sentence "A" and inserting in lieu thereof the following: "For a taxable year beginning prior to January 1, 1940, a," and by adding after the first sentence the following: "For a taxable year beginning after December 31, 1939, such a return must be made if the gross income of such person is equal to, or in excess of, the credit allowed him by section 25(b) (1) and (3), as so computed."

PAR. 27. Section 19.142–5 is amended as follows:

(A) In the second sentence of paragraph (*b*) there is inserted immediately after "$21,600" the following: ", or more than $24,000 for a taxable year beginning after December 31, 1939,".

(B) In the third sentence of paragraph (*b*) there is inserted immediately after "$21,600 or less," the following: "or $24,000 or less for a taxable year beginning after December 31, 1939,".

(C) In the next to the last sentence of paragraph (*b*) there is inserted immediately after "10 per cent" the following: ", or at 16½ per cent for a taxable year beginning after December 31, 1939, and before January 1, 1945, or at 15 per cent for a taxable year beginning after December 31, 1944,".

PAR. 28. The following is inserted immediately preceding section 19.147–1:

SEC. 7. RETURNS OF INCOME TAX. (REVENUE ACT OF 1940, TITLE I.)

* * * * * * *

(c) INFORMATION RETURNS.—Section 147(a) of the Internal Revenue Code (relating to information at the source) is amended by striking out "$1,000" wherever occurring therein and inserting in lieu thereof "$800."

SEC. 9. TAXABLE YEARS TO WHICH APPLICABLE. (REVENUE ACT OF 1940, TITLE I.)

The amendments made by this title, except the amendments made by section 5, shall be applicable only with respect to taxable years beginning after December 31, 1939.

PAR. 29. Section 19.147–1 is amended as follows:

(A) The heading of the section is amended to read as follows: "*Return of information as to payments of $1,000 for 1939, and $800 for years thereafter.*—"

(B) The first sentence is amended to read as follows:

All persons making payment to another person of fixed or determinable income of $1,000 or more in the calendar year 1939, or of $800 or more in any subsequent year, must render a return thereof to the Commissioner for such year on or before February 15 of the following year, except as specified in sections 19.147–3 to 19.147–5, inclusive.

PAR. 30. Section 19.147–2 is amended by inserting immediately after the words "are made" in the first sentence the following: "during the calendar year 1939, or of $800 or over during a subsequent calendar year."

PAR. 31. Section 19.147–3 is amended as follows:

(A) By inserting in the first sentence immediately after "over $1,000" the following: "during the calendar year 1939, or over $800 during a subsequent calendar year."

(B) The part designated as "(*e*)" is amended to read as follows: "(*e*) Payments of rent made to real estate agents (but the agent must report payments to the landlord if the amount paid during the calendar year 1939 was $1,000 or more, or $800 or more during a subsequent calendar year);".

(C) The part designated as "(*h*)" is amended to read as follows: "(*h*) Payments of salaries, or other compensation for personal services aggregating less than $2,500 for the calendar year 1939, or less than $2,000 for subsequent calendar years, made to a married individual (citizen or resident);".

PAR. 32. The first sentence of section 19.147–7 is amended by striking out "in any taxable year" and by inserting immediately after "$1,000 or more" the following: "within 1939, or $800 or more within a subsequent year."

PAR. 33. The second paragraph of section 19.147–8 is amended by striking out "10 per cent" immediately before the word "tax."

PAR. 34. Section 19.163–1 is amended by striking out "of $1,000" in the first sentence.

PAR. 35. Section 19.201(b)–1 is amended by adding at the end thereof the following: "For the defense tax imposed for taxable years beginning after December 31, 1939, and before January 1, 1945, see section 19.15–1."

PAR. 36. Section 19.204(a)–1 is amended by adding at the end thereof the following: "For the defense tax imposed for taxable years beginning after December 31, 1939, and before January 1, 1945, see section 19.15–1."

PAR. 37. Section 19.207–1 is amended by adding at the end thereof the following: "For the defense tax imposed for taxable years beginning after December 31, 1939, and before January 1, 1945, see section 19.15–1."

PAR. 38. The following is inserted immediately preceding section 19.211–1, relating to taxation of aliens in general:

SEC. 4. TAX ON NONRESIDENT ALIEN INDIVIDUALS. (REVENUE ACT OF 1940, TITLE I.)

(a) TAX IN GENERAL.—Section 211(a)(1)(A) of the Internal Revenue Code (relating to tax on nonresident alien individuals not engaged in trade or business within the United States and not having an office or place of business therein) is amended by striking out "10 per centum" and inserting in lieu thereof "15 per centum."

(b) AGGREGATE RECEIPTS MORE THAN $24,000.—Section 211(a)(2) of the Internal Revenue Code is amended to read as follows:

"(2) AGGREGATE MORE THAN $24,000.—The tax imposed by paragraph (1) shall not apply to any individual if the aggregate amount received during the taxable year from the sources therein specified is more than $24,000."

(c) TAX WHERE GROSS INCOME OF MORE THAN $24,000.—Section 211(c) of the Internal Revenue Code (relating to tax on certain nonresident alien individuals) is amended by striking out "$21,600" wherever occurring therein and inserting in lieu thereof "$24,000"; and by striking out "10 per centum" and inserting in lieu thereof "15 per centum."

SEC. 9. TAXABLE YEARS TO WHICH APPLICABLE. (REVENUE ACT OF 1940, TITLE I.)

The amendments made by this title, except the amendments made by section 5, shall be applicable only with respect to taxable years beginning after December 31, 1939.

PAR. 39. Section 19.211–7 is amended as follows:

(A) By inserting in the first and third paragraphs immediately after "$21,600" wherever it appears the following: "($24,000 during a taxable year beginning after December 31, 1939)."

(B) By inserting in the first sentence of the third paragraph immediately after the words "is taxable at the rate of 10 per cent" the following: "for a taxable year beginning prior to January 1, 1940, at the rate of 16½ per cent for a taxable year beginning after December 31, 1939, and before January 1, 1945 (see section 19.15–1), and at the rate of 15 per cent thereafter,".

(C) By inserting in the next to the last sentence in the third paragraph immediately after "at the rate of 10 per cent" the following: ", or 15 per cent, or 16½ per cent, as the case may be,".

(D) The heading of the paragraph designated as "(*b*)" is changed to read as follows: "(*b*) *No United States business or office—Aggregate more than $21,600 ($24,000 for a taxable year beginning after December 31, 1939).*—"

(E) By inserting in the third sentence of the paragraph designated as "(*b*)," and in the first sentence of the paragraph designated as "(*c*)," immediately after "10 percent," wherever it occurs, the following: ", or 15 per cent for a taxable year beginning after December 31, 1939,".

(F) By inserting immediately after the second sentence of the paragraph designated as "(*c*)" the following: "For the defense tax imposed for taxable years beginning after December 31, 1939, and before January 1, 1945, see section 19.15–1."

PAR. 40. Section 19.213–1 is amended as follows:

(A) By changing the heading of subparagraph (2) of the paragraph designated as "(*a*)" to read as follows: "*Aggregate more than $21,600 ($24,000 for a taxable year beginning after December 31, 1939).*"

(B) By inserting in the first sentence of subparagraph (2) of the paragraph designated as "(*a*)" immediately after "$21,600" the following: ", or more than $24,000 for a taxable year beginning after December 31, 1939,".

PAR. 41. The following is inserted immediately preceding section 19.214–1:

SEC. 6. PERSONAL EXEMPTION. (REVENUE ACT OF 1940, TITLE I.)

* * * * * * *

(b) Section 214 of the Internal Revenue Code (relating to personal exemption of nonresident alien individuals) is amended by striking out "$1,000" and inserting in lieu thereof "$800."

* * * * * * *

SEC. 9. TAXABLE YEARS TO WHICH APPLICABLE. (REVENUE ACT OF 1940, TITLE I.)

The amendments made by this title, except the amendments made by section 5, shall be applicable only with respect to taxable years beginning after December 31, 1939.

PAR. 42. Section 19.214–1 is amended as follows:

(A) By changing the heading in subparagraph (2) of the paragraph designated as "(*a*)" to read as follows: "*Aggregate more than $21,600 ($24,000 for a taxable year beginning after December 31, 1939)*."

(B) By inserting in the first sentence of subparagraph (2) of paragraph (*a*) immediately after "$21,600" the following: ", or more than $24,000 for a taxable year beginning after December 31, 1939,".

(C) By inserting in the first sentence in paragraph (*b*) immediately after "$1,000," the following: "or $800 for a taxable year beginning after December 31, 1939,".

PAR. 43. Section 19.215–1 is amended as follows:

(A) By changing the heading in subparagraph (2) of paragraph (*a*) to read as follows: "*Aggregate more than $21,600 ($24,000 for a taxable year beginning after December 31, 1939)*."

(B) By inserting immediately after "$21,600" wherever it occurs in subparagraph (2) of paragraph (*a*) the following: ", or more than $24,000 for a taxable year beginning after December 31, 1939,".

PAR. 44. Section 19.217–2 is amended as follows:

(A) By changing the heading in subparagraph (2) of paragraph (*a*) to read as follows: "*Aggregate more than $21,600 ($24,000 for a taxable year beginning after December 31, 1939)*."

(B) By inserting in the first sentence in subparagraph (2) of paragraph (*a*) immediately after "$21,600" the following: ", or more than $24,000 for a taxable year beginning after December 31, 1939,".

(C) By striking out in the second sentence in paragraph (*b*) the words "the taxable year" and by inserting in lieu thereof the following: "a taxable year beginning prior to January 1, 1940, or $800 during a taxable year beginning after December 31, 1939."

PAR. 45. The second sentence of section 19.219–1 is amended by inserting immediately after "$21,600," the following: "or more than $24,000 for a taxable year beginning after December 31, 1939,".

PAR. 46. The following is inserted immediately before section 19.231–1:

SEC. 3. CORPORATION TAX. (REVENUE ACT OF 1940, TITLE I.)

* * * * * * *

(c) TAX ON NONRESIDENT FOREIGN CORPORATIONS.—Section 231(a)(1) of the Internal Revenue Code is amended by striking out "except that in the case of dividends the rate shall be 10 per centum, and" and by striking out "of 10 per centum."

* * * * * * *

SEC. 9. TAXABLE YEARS TO WHICH APPLICABLE. (REVENUE ACT OF 1940, TITLE I.)

The amendments made by this title, except the amendments made by section 5, shall be applicable only with respect to taxable years beginning after December 31, 1939.

PAR. 47. Section 19.231–1 is amended as follows:

(A) The third paragraph is amended to read as follows:

The fixed or determinable annual or periodical income from sources within the United States, including royalties, of a nonresident foreign corporation is taxable at the rate of 15 per cent, except that for taxable years beginning after December 31, 1939, and before January 1, 1945, the rate is 16½ per cent (see section 19.15–1), and except further for a taxable year beginning before January 1, 1940, dividends are taxable at the rate of 10 per cent. In the case of dividends received by a nonresident foreign corporation organized under the laws of a contiguous country, the rate shall be reduced to such rate (not less than 5 per cent) as may be provided by treaty with such country.

(B) By striking out in the fourth sentence of the paragraph designated as "(*b*)," "18 per cent" and inserting in lieu thereof "19 per cent."

(C) By inserting at the end of the paragraph designated as "(*b*)" the following: "For the defense tax imposed for taxable years beginning after December 31, 1939, and before January 1, 1945, see section 19.15–1."

PAR. 48. The following is inserted immediately preceding section 19.251–1:

SEC. 6. PERSONAL EXEMPTION. (REVENUE ACT OF 1940, TITLE I.)

* * * * * * *

(c) Section 251(f) of the Internal Revenue Code (relating to personal exemption of citizens entitled to benefits of section 251) is amended by striking out "$1,000" and inserting in lieu thereof "$800."

SEC. 9. TAXABLE YEARS TO WHICH APPLICABLE. (REVENUE ACT OF 1940, TITLE I.)

The amendments made by this title, except the amendments made by section 5, shall be applicable only with respect to taxable years beginning after December 31, 1939.

PAR. 49. Section 19.262–2 is amended by substituting for Example (2) the following:

Example (2): Assume that for the calendar year 1940 the facts are the same as in example (1) except that a special dividend of $45,100 is distributed on February 15, 1941. Since, under section 13, as amended, the rate of income tax for 1940 is 19 per cent and (by section 15, added by section 201, Revenue Act of 1940) there is added to the tax thus computed 10 per cent thereof, the income tax for such year is $38,000 plus $3,800, or a total of $41,800. Since the special dividend ($45,100) exceeds the diminution of the income tax ($41,800) on account of the allowance of the special credit against net income, the entire amount of the special credit is allowable and the corporation has no income tax liability for 1940. Since the special dividend exceeds the amount of the income tax by the sum of $3,300, which sum equals the amount of the diminution of

the excess-profits tax ($3,000 plus 10 per cent thereof under section 204, Revenue Act of 1940) on account of the allowance of the special credit against net income, the entire amount of the special credit ($200,000) is allowable for excess-profits tax purposes for 1940 and hence the corporation has no excess-profits tax liability for that year.

PAR. 50. The following is inserted immediately preceding section 19.362–1:

SEC. 3. CORPORATION TAX. (REVENUE ACT OF 1940, TITLE I.)

* * * * * * *

(d) TAX ON MUTUAL INVESTMENT COMPANIES.—Section 362(b) of the Internal Revenue Code is amended to read as follows:

"(b) IMPOSITION OF TAX.—There shall be levied, collected, and paid for each taxable year upon the Supplement Q net income of every mutual investment company a tax equal to 19 per centum of the amount thereof."

SEC. 9. TAXABLE YEARS TO WHICH APPLICABLE. (REVENUE ACT OF 1940, TITLE I.)

The amendments made by this title, except the amendments made by section 5, shall be applicable only with respect to taxable years beginning after December 31, 1939.

PAR. 51. Section 19.362–1 is amended by striking out in the first sentence "18 per cent." and inserting in lieu thereof "19 per cent. (For the defense tax imposed for taxable years beginning after December 31, 1939, and before January 1, 1945, see section 19.15–1.)."

PAR. 52. The following is inserted immediately preceding section 19.500–1:

SEC. 203. PERSONAL HOLDING COMPANIES. (REVENUE ACT OF 1940, TITLE II.)

Section 500 of the Internal Revenue Code is amended by inserting "(a) GENERAL RULE.—" before the first paragraph and inserting at the end thereof the following new subsection:

"(b) DEFENSE TAX FOR FIVE YEARS.—In the case of every personal holding company, the amount of surtax under this subchapter for any taxable year beginning after December 31, 1939, and before January 1, 1945, shall be 10 per centum greater than the amount of surtax computed without regard to this subsection."

PAR. 53. The last sentence in the first paragraph of section 19.500–1 is amended by striking out the period at the end thereof and inserting in lieu thereof the following: ", except that for any taxable year beginning after December 31, 1939, and before January 1, 1945, such surtax is increased 10 per cent."

(This Treasury decision is issued under the authority contained in sections 1 to 4, inclusive, 6 to 9, inclusive, 201, and 203 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), and section 62 of the Internal Revenue Code (53 Stat., 32).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved September 24, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register September 26, 1940, 2.45 p. m.)

SUBCHAPTER B.—GENERAL PROVISIONS.

PART I.—RATES OF TAX.

SECTION 11.—NORMAL TAX ON INDIVIDUALS.

SECTION 19.11-1: Income tax on individuals.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.11-2: Citizens or residents of the United States liable to tax. (Also Section 211, Section 19.211-1.)

1940-44-10466
I. T. 3419

INTERNAL REVENUE CODE.

Foreign journalists and newspaper correspondents in the United States, who are nationals of the country of R, can not be granted exemption from the payment of the Federal income tax by reason of the fact that American newspaper correspondents in the country of R are not required to pay income tax to that country.

Advice is requested whether journalists and newspaper correspondents from the country of R, who are in the United States, may be granted exemption from the Federal income tax on the basis of reciprocity. It is stated that American newspaper correspondents in the country of R are not required to pay income tax to that country.

There is no provision in the Internal Revenue Code exempting foreign journalists or newspaper correspondents in the United States, who are nationals of the country of R, from the payment of Federal income tax on the basis of reciproctiy, and there is no treaty betweeen the United States and that country which contains a provision for that purpose. Journalists or newspaper correspondents from the country of R who are in the United States are, therefore, liable for the Federal income tax.

A foreign journalist or newspaper correspondent in the United States who is a resident of the United States is liable for the tax with respect to his income from sources within and without the United States. However, if such individual is a nonresident alien (1) who is temporarily present in the United States for a period or periods not exceeding 90 days during the taxable year, and (2) whose compensation does not exceed $3,000 in the aggregate for services performed within the United States as an employee of, or under contract with, a nonresident alien, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, he is not subject to United States income tax on such compensation. If, however, such tests are not met, income tax liability attaches to his income from United States sources, including his earned income from such sources. (Sections 119(a)3 and 211(a) of the Internal Revenue Code.)

SECTION 12.—SURTAX ON INDIVIDUALS.

SECTION 19.12–1: Surtax.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.12–2: Computation of surtax.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 13.—TAX ON CORPORATIONS IN GENERAL.

SECTION 19.13–1: Tax on corporations in general—Taxable years beginning in 1939.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.13–5: Tax on corporations in general—Taxable years beginning after December 31, 1939.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.13–6: Tax under general rule—Taxable years beginning after December 31, 1939.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.13–7: Alternative tax (corporations with normal-tax net incomes slightly more than $25,000)—Taxable years beginning after December 31, 1939.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 14.—TAX ON SPECIAL CLASSES OF CORPORATIONS.

SECTION 19.14–1: Tax on special corporations—Taxable years beginning in 1939.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.14–2: Tax on special corporations—Taxable years beginning after December 31, 1939.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 15.—DEFENSE TAX FOR FIVE YEARS.

(Also Section 500, Section 19.500–1.) 1940–36–10405
Mim. 5094

INCOME TAX.

Computation of defense tax provided by section 15 of the Internal Revenue Code, as added by section 201 of the Revenue Act of 1940, and section 500 of the Internal Revenue Code, as amended by section 203 of such Act—returns (final) covering taxable years beginning after December 31, 1939.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., August 19, 1940.

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

1. Attention is invited to section 201 of the Revenue Act of 1940, approved June 25, 1940 (Public, No. 656, Seventy-sixth Congress, third section), which amends Chapter 1 of the Internal Revenue Code by adding the following new section:

SEC. 15. DEFENSE TAX FOR FIVE YEARS.

In the case of any taxpayer, the amount of tax under this chapter for any taxable year beginning after December 31, 1939, and before January 1, 1945, shall be 10 per centum greater than the amount of tax computed without regard to this section. In no case shall the effect of this section be to increase the tax computed without regard to this section by more than 10 per centum of the amount by which the net income exceeds such tax. For the purposes of this section, the tax computed without regard to this section shall be such tax before the application of the credit provided in section 31 ("foreign tax credit"), and the credit provided in section 32 (taxes withheld at the source).

2. Section 203 of the Revenue Act of 1940 amends section 500 of the Internal Revenue Code by adding (in part) the following new subsection:

(b) DEFENSE TAX FOR FIVE YEARS.—In the case of every personal holding company, the amount of surtax under this subchapter for any taxable year beginning after December 31, 1939, and before January 1, 1945, shall be 10 per centum greater than the amount of surtax computed without regard to this subsection.

3. Income tax return forms (including personal holding company return forms) for the calendar year 1940 and for fiscal years ending in 1941 will be prepared and printed in due course. Until such forms are made available, in the case of taxable years beginning after December 31, 1939, return forms for 1939 will be utilized by adding the defense tax of 10 per cent to the income tax computed without regard to section 201 and section 203 of the Revenue Act of 1940. It should be noted that the defense tax is 10 per cent of the income tax *before* allowance of credit for foreign taxes or taxes withheld at the source. Appropriate notations should be inserted with a typewriter or pen and ink so that the amount of tax liability on each return will appear as follows:

Form 1040:
Line 31. Total tax (item 30, or if you had a net long-term capital gain or loss, enter line 16, Schedule F) (Defense tax, $_____) $_____

Form 1040A:
Line 17. Income tax (4 per cent of item 16) (Defense tax, $_____) _____

Form 1040B:
Line 34. Total tax (item 33, or if you had a net long-term capital gain or loss, enter line 16, Schedule F) (Defense tax, $_____) _____

Form 1040NB:
Line 2. Tax liability (10 per cent of item 1) (or 5 per cent of item 1 if resident of Canada) (Defense tax, if not resident of Canada, $_____) _____

Form 1040NB–a:
Line 27. Total tax (item 26 or 10 per cent of item 9, whichever is larger) (Defense tax, $_____) _____

Form 1040C:
Line 2. Tax liability (10 per cent of item 1) (5 per cent of item 1 if resident of Canada) (Defense tax, if not resident of Canada, $_____) _____
or
Line 16. Total tax (item 15, or 10 per cent of line 20, Schedule C, whichever is larger) (Defense tax, $_____) _____
or
Line 29. Total tax (items 27 and 28) (Defense tax, $_____) _____

Form 1040D:
Line 2. Estimated tax liability (10 per cent of item 1) (5 per cent of item 1 if resident of Canada) (Defense tax, if not resident of Canada, $_____) _____
or
Line 16. Estimated total tax (item 15, or 10 per cent of line 20, Schedule C, whichever is larger) (Defense tax, $_____) _____
or
Line 29. Estimated total tax (items 27 and 28) (Defense tax, $_____) _____

Form 1041:
Line 26. Total tax (item 25, or if you had a net long-term capital gain or loss, enter line 14, Schedule E) (Defense tax, $_____) _____

Form 1120:
Line 33. Total income tax (line 54, Schedule B) (Defense tax, $_____) _____

Form 1120A:
Line 47. Total income tax (total tax in column 3 of items 44, 45, and 46) (Defense tax, $_____) _____

Form 1120H:
Line 20. Total surtax in items 18 and 19 (Defense tax, $_____) _____

Form 1120L:
Line 20. Income tax (16½ per cent of item 19) (Defense tax, $_____) _____
or
Line 24. Income tax, foreign company (16½ per cent of item 23) (Defense tax, $_____) _____

Form 1120NB:

Line 3. Tax liability on item 1 (15 per cent of item 1) (Defense tax, $_____) _____ _____

Line 4. Tax liability on item 2 (10 per cent of item 2) (or, if corporation is organized under laws of Canada, 5 per cent of item 2) (Defense tax, if corporation is not organized under laws of Canada, $_____) _____ _____

4. The returns referred to in paragraph 3 above will be given a preliminary examination in the collectors' offices for the purpose of ascertaining whether the defense tax provided by sections 201 and 203 is correctly computed. The assessments will be made in the usual manner.

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

GUY T. HELVERING,
Commissioner.

SECTION 15.—CORPORATE TAXES EFFECTIVE FOR TWO TAXABLE YEARS.

SECTION 19.15–1: Purpose and effect of section 15.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

PART II.—COMPUTATION OF NET INCOME.

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

SECTION 19.22(a)–1: What included in gross income. 1940–38–10423
I. T. 3407

INTERNAL REVENUE CODE.

Certain land, buildings, machinery, equipment, and other facilities are being leased by the Y Corporation, which is wholly owned by the O Government, to the N Company for the purpose of manufacturing certain war material for that Government. All such property, subject to the lease, is to remain the property of the Y Corporation. No rental, except taxes and insurance, is to be paid by the lessee. The lease will terminate upon the one hundred and eightieth day after the N Company ceases to be obligated to deliver such war material to the O Government under a contract entered into between them, or upon the one hundred and eightieth day after the cessation of the national emergency declared by the President of the United States on September 8, 1939, to exist, whichever date is later.

Held, for Federal income tax purposes, no income will be realized by the N Company as the result of the mere execution of the lease or from the mere occupation and use of the leased property during the term of the lease.

Advice is requested whether the N Company will realize income, for Federal income tax purposes, as the result of the mere execution

of a lease or the mere occupation and use of leased property under the circumstances herein set forth.

The provisions of the lease constituting factors in a determination of the issue are as follows:

The Y Corporation, a domestic corporation which is wholly owned by the O Government, is leasing to the X Company for use by it in manufacturing war material certain land, buildings, machinery, equipment, and other facilities for a period to commence on the date of the execution of the lease and to terminate upon the one hundred and eightieth day after the X Company shall cease to be under obligation to deliver any such war material to the O Government under a contract entered into between them, or upon the one hundred and eightieth day after the cessation of the national emergency declared by the President of the United States on September 8, 1939, to exist, whichever date is later. As a consideration for the lease of said facilities (including land, buildings, machinery, and equipment), which facilities under the provisions of the contract are and shall be at all times the property of the Y Corporation subject only to the terms of the lease, the X Company agrees to pay as rent local direct property taxes when due and assessed against such facilities for the calendar year 1940 and succeeding calendar years, except for the calendar year in which such lease terminates, for which year of termination the X Company will pay an amount proportionate to that part of the year for which the term of the lease shall extend.

Further provisions of the lease are that the X Company will, at its expense, insure all of the facilities against fire and such other hazards as it normally carries with respect to its own property of similar nature, such insurance to be for the benefit of the Y Corporation and the X Company in proportion to their respective interests. Any insurance money thus received by the Y Corporation for loss or injury to any of the facilities will be paid over to the X Company to be expended by the latter for replacement of the injured or lost facilities, such new facilities to be the property of the Y Corporation and subject to the lease in the same manner as the lost or injured facilities so replaced. During the term of the lease, the X Company will have complete charge and control of all the facilities and the right to use them for the manufacture of certain specified war material, it being understood that such leased facilities, or facilities owned by the X Company of substantially equivalent productive capacity, will be devoted to performing the contract mentioned. With respect to any facilities which may not yet have been acquired by the Y Corporation at the effective date of the lease, it is provided that its terms shall become effective immediately as to such facilities upon their acquisition by that corporation.

Based upon the foregoing, it is held that no taxable income within the meaning of sections 21 and 22 of the Internal Revenue Code, will be realized by the X Company as a result of the mere execution of the lease or from the mere occupation and use of the leased property during the term of the lease.

SECTION 19.22(a)–1: What included in gross income. 1940–38–10426
I. T. 3409

INTERNAL REVENUE CODE.

For Federal income tax purposes, no income will be realized by the M Company as the result of the receipt of funds from the O Government to be used in expanding manufacturing and processing facilities and plant capacity to an extent not justified by present or otherwise anticipated business in order to complete a contract for the delivery of war material to that Government, all facilities to be acquired with such funds to be the property of the Y Corporation, which is wholly owned by the O Government.

Advice is requested whether, for Federal income tax purposes, income will be realized by the M Company as the result of the receipt of funds from the O Government to be used for plant expansion in connection with a contract for war material under the circumstances herein set forth.

The M Company (hereinafter referred to as the "seller"), organized under the laws of the State of R, and the O Government (hereinafter referred to as the "purchaser") are entering into a contract for the production and delivery of certain war material. The factors relevant in the determination of the present issue are as follows:

The "seller" agrees to cause to be manufactured by the N Company, a wholly-owned subsidiary of the "seller," and to be delivered to the "purchaser," and the "purchaser" agrees to accept and pay for, subject to the terms and conditions set forth in the contract, certain war material. In order to manufacture and deliver to the "purchaser" such material sold under the contract, it will be necessary to expand the manufacturing and processing facilities and plant capacity of the N Company to an extent not justified by the present or anticipated volume of the N Company. Such plant expansion must be effected in order to meet the delivery requirements under the contract. The "purchaser" has provided the funds, in an amount aggregating $26x$ dollars, for increasing the productive capacity to meet the productive requirements referred to above, and the "seller" agrees to expend the same as the agent of the "purchaser" in acquiring the necessary land, buildings, equipment, and machinery for such increased production, all of which shall belong to and be owned by the Y Corporation, a domestic corporation organized by the "purchaser," which shall issue all of its capital stock to the "purchaser" or its nominee in exchange therefor. Such properties are to be leased to the N Company by the Y Corporation by a lease in the form annexed to the contract. The total amount of $26x$ dollars shall be paid by the "purchaser" to the "seller" by depositing on specified dates to the credit of the "seller's" account in the Z Bank the amounts set out in the contract.

Further provisions of the contract are that in the event of termination by the "purchaser" in accordance with the provisions of the contract, the "seller" will discontinue as soon as practicable that portion of the program for expansion of manufacturing and processing facilities and plant capacity which is not then completed and which is not required by the "seller" to complete the manufacture of the war material designated by the "purchaser" to be completed in accordance with the contract. Upon such discontinuance, the "seller" shall be under no further obligation to continue the plant

expansion program. If the expenditures made for the "purchaser" by the "seller" for the items listed in the contract aggregate less than the total of all payments by the "purchaser" to the "seller" under the provisions of the contract, the excess of such aggregate payments over such aggregate expenditures shall be refunded by the "seller" to the "purchaser." All facilities, including land, buildings, machinery, and equipment purchased by the "seller" for the "purchaser" in accordance with the provisions of the contract are and shall be at all times the property of the Y Corporation, subject only to the terms of the lease to be executed and annexed to the contract.

Based upon the foregoing, it is held that under the contract in question, no taxable income, within the meaning of sections 21 and 22 of the Internal Revenue Code, will be realized by the M Company as a result of the receipt of the funds so advanced.

SECTION 19.22(a)-1: What included in gross income. 1940-46-10484
I. T. 3425

INTERNAL REVENUE CODE.

The 5 cents per gallon credit on certain fortified wine, provided for in Public, No. 655 (Seventy-sixth Congress, third session), is includible in gross income as of June 30, 1940, by taxpayers entitled to such credit who keep their books on the accrual basis. Taxpayers keeping their books on the cash receipts and disbursements basis who are entitled to the credit should include it in gross income as of the date of receipt of the Commissioner's certificate therefor.

Advice is requested as to the treatment, for Federal income tax purposes, of the credit of 5 cents per gallon on certain fortified wine, provided for in Public, No. 655 (Seventy-sixth Congress, third session), approved June 24, 1940.

The pertinent provisions of Public, No. 655, supra, read as follows:

SEC. 4. Upon the filing of a claim therefor by the proprietor of any bonded winery or bonded storeroom in which there was stored on June 30, 1940, or to which there was in transit on that date, wine lawfully fortified with brandy or wine spirits, and containing more than 14 per centum of absolute alcohol by volume, and not exceeding 24 per centum of absolute alcohol by volume, the Commissioner of Internal Revenue is authorized to issue to such proprietor suitable documents entitling such proprietor to a credit of 5 cents per gallon in respect of each gallon of such fortified wine which the Commissioner shall find was on such proprietor's bonded winery or bonded storeroom premises on June 30, 1940, or in transit thereto. The amount of such credit shall be allowed in whole or in part in the purchase of wine stamps. The claim shall be supported by an inventory, prepared, and filed by the proprietor in such form and manner as the Commissioner of Internal Revenue shall prescribe by regulations, approved by the Secretary of the Treasury, and by such other proof as the Commissioner may from time to time require. The aforesaid credit to the proprietor may be transferred by the proprietor to whom issued to the proprietor of any other bonded winery or bonded storeroom. All claims under this section must be filed on or before October 1, 1940.

It is held that the total amount of this credit is taxable income for Federal income tax purposes to the proprietor of the bonded winery or bonded storeroom entitled thereto and is includible in his gross income, upon the accrual basis, as of June 30, 1940, when his right to the credit became fixed, the amount thereof could be determined

approximately, and there was reasonable certainty that the right would be converted into money or its equivalent; or, upon the cash receipts and disbursements basis, as of the date he receives the Commissioner's certificate for the credit, such certificate being applicable by him to the purchase of wine stamps or transferable to another such proprietor for such use or transfer.

SECTION 19.22(a)-3: Compensation paid other than in cash. 1940-44-10467 I. T. 3420

INTERNAL REVENUE CODE.

The value of subsistence and quarters furnished female members of the Army Nurse Corps and Navy Nurse Corps does not constitute taxable income.

Advice is requested whether the value of subsistence and quarters, designated "allowances," furnished female members of the Army Nurse Corps and the Navy Nurse Corps constitutes taxable income under section 19.22(a)-3, Regulations 103, which provides in part as follows:

* * * The value of quarters furnished to the commissioned officers, chief warrant officers, warrant officers, and enlisted personnel of the Army, Navy, Coast Guard, Coast and Geodetic Survey, and Public Health Service, or amounts received by them as commutation of quarters, are to be excluded from gross income. * * *

Section 13 of the Act of June 10, 1922 (42 Stat., 625), is entitled "An Act to readjust the pay and allowances of the commissioned and enlisted personnel of the Army, Navy, Marine Corps, Coast Guard, Coast and Geodetic Survey, and Public Health Service," and provides:

SEC. 13. That, commencing July 1, 1922, the annual pay of female nurses of the Army and Navy shall be as follows: During the first three years of service, $840; from the beginning of the fourth year of service until the completion of the sixth year of service, $1,080; from the beginning of the seventh year of service until the completion of the ninth year of service, $1,380; from the beginning of the tenth year of service, $1,560. Superintendents of the Nurse Corps shall receive a money allowance at the rate of $2,500 a year, assistant superintendents, directors, and assistant directors at the rate of $1,500 a year, and chief nurses at the rate of $600 a year, in addition to their pay as nurses. Nurses shall be entitled to the same allowance for subsistence as is authorized in section 5 of this Act for officers receiving the pay of the first period, and to the same allowance for rental of quarters as is authorized in section 6 of this Act for officers receiving the pay of the first period.

It appears that female members of the Army Nurse Corps and the Navy Nurse Corps are accorded the relative rank of officers with respect to allowances for rental of quarters, subsistence, and travel, and that they are rated neither as civilian employees nor as enlisted personnel. (Sections 41 and 42 of Title 34, U. S. C. A., and sections 161, 164, 937, and 938 of Title 10, U. S. C. A.)

It is held, therefore, that the value of subsistence and quarters (allowances) furnished the female members of the Army Nurse Corps and the Navy Nurse Corps does not constitute taxable income for Federal income tax purposes. (*Clifford L. Jones* v. *United States*, 60 Ct. Cls., 552; T. D. 3724, C. B. IV-2, 136 (1925).)

SECTION 19.22(a)-8: Sale of stock and rights. 1940-47 10189
I. T. 3426

INTERNAL REVENUE CODE.

The M Company's proposed method of identification of securities sold, by entering each sale against an arbitrarily selected purchase as shown in the ledger account, does not constitute sufficient identification of the securities in determining, for Federal income tax purposes, the gain or loss resulting from their sale. Where the identity of securities can not be determined by their certificate numbers, the "first-in, first-out" rule of identification is applicable.

Advice is requested whether the identity of securities sold from lots purchased at different dates or at different prices may be determined, for Federal income tax purposes, by the method herein set forth.

The M Company is a large holder of securities, principally Government bonds, acquired for investment. It has been the practice of the M Company to determine gain or loss upon disposition of such securities through the application of the "first-in, first-out" rule. Effective January 1, 1940, the taxpayer desires to change this practice and thereafter to identify the securities sold with those acquired on specific purchases because of the enactment of section 212 of the Revenue Act of 1939, which amended section 117(d) of the Internal Revenue Code relating to limitation on capital losses. By reason of the change made in section 117(d) of the Internal Revenue Code, it will be necessary to make a distinction between "long-term" and "short-term" capital gains.

The method now proposed to be employed is outlined as follows:

All purchases will be posted in the investment ledger. This is an original record and part of the basic records of the M Company. Postings therein must be made concurrently with the transactions to which they relate, and once made can not be changed. The ledger will give description, date, par value, price, cost, and accrued interest of each separate purchase. Each sale will be posted in the ledger against a particular purchase or purchases, the sale being described by date, price, etc., and gain or loss will be calculated accordingly. In addition, each sale order and delivery ticket will be marked to show that the securities being sold were acquired on a particular date, and if more than one lot of the particular issue was purchased on that date at different prices, the sale order and delivery ticket will indicate the particular lot being sold. Such book entries and records will constitute a definite and irrevocable record of an intention to sell certain specific securities.

It is held that the above-described method does not constitute a sufficient identification of the securities in determining, for Federal income tax purposes, the gain or loss resulting from the sale thereof. This ruling is based primarily on the fact that, under the method proposed, there will be on hand unsold securities which, in so far as the investment ledger is concerned, were disposed of several months previously. It follows that where specific identification by certificate numbers can be made, the actual cost of such certificates should be used in determining gain or loss upon this sale. In cases where the identity of the securities by certificate numbers can not be determined, the "first-in, first-out" rule of identification is applicable.

SECTION 19.22(a)-13: Improvements by lessees. 1940-28-10323
T. D. 4980

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

Regulations 103 amended.—Improvements by lessee.

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

To Collectors of Internal Revenue and Others Concerned:

Section 19.22(a)-13 of Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.] is amended to read as follows:

Improvements by lessee.—If buildings are erected or other improvements are made by a lessee, the lessor shall include in gross income as of the date he acquires possession or control of the real estate with such improvements thereon, at the termination of the lease by forfeiture or otherwise, an amount equal to the excess of the value as of such date of the real estate with such improvements thereon over the value as of such date of the real estate without such improvements.

If for taxable years ending prior to January 1, 1940, other than the year in which the taxpayer acquired possession or control of the real estate with the improvements thereon, there has been included in gross income the value of such improvements or the several parts thereof fixed by reference to an option granted in any income tax regulations, then such inclusion shall not be disturbed and the taxpayer, for all taxable years subsequent to the one in which there was first so included any of such income, may continue to return income with respect to such property on such basis, if within 90 days after the approval of this Treasury decision, or within such later period as may be acceptable to the Commissioner, he files Form 968, in duplicate, with the Commissioner of Internal Revenue, Washington, D. C., Attention Income Tax Unit, Records Division, signifying his election to have income in respect of such property for all taxable years determined upon the basis heretofore employed, and expressly waiving any right which he might have had to claim or receive any refund, credit, or other tax advantage which would result from the exclusion of such items from income for the years for which included.

The rule stated in the first paragraph of section 19.22(a)-13 of Regulations 103, as amended by this Treasury decision, shall be applicable with respect to taxable years beginning prior to January 1, 1939, unless the taxpayer files Form 968 pursuant to section 19.22(a)-13 of Regulations 103, as amended by this Treasury decision, in which case the rule stated herein shall be disregarded and the rule stated in prior regulations shall be applicable.

(This Treasury decision is prescribed pursuant to sections 22(a), 62, and 3791(b) of the Internal Revenue Code (53 Stat., 9, 32, 467), and the corresponding provisions of prior internal revenue laws.)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved July 2, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 5, 1940, 12.52 p. m.)

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

1940-27-10313
T. D. 4975

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 25.—INCOME TAX.

Regulations affecting the taxation of nonresident alien individuals, residents of Sweden, and of Swedish corporations under the tax convention between the United States and Sweden, proclaimed by the President of the United States December 12, 1939, effective January 1, 1940.[1]

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

To Collectors of Internal Revenue and Others Concerned:

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SECTION 25.0. *Introductory.*—The tax convention and protocol between the United States and Sweden, hereinafter referred to as the convention, proclaimed by the President of the United States on December 12, 1939, and effective January 1, 1940, provides as follows:

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.

[1] Sections 25.0 to 25.18 issued under the authority contained in section 62 of the Internal Revenue Code (53 Stat., 32) and the tax convention between the United States and Sweden (54 Stat., —).

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 provisions 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 competenet 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:

SUMNER WELLES. (SEAL).

For His Majesty the King of Sweden:

W. BOSTRÖM. (SEAL.)

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 for vissa offentliga forestallningar) 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 deteremination 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.

SUMNER WELLES. (SEAL.)
W. BOSTRÖM. (SEAL.)

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.

The Internal Revenue Code provides in part as follows:

SEC. 22. GROSS INCOME.

* * * * * * *

(b) EXCLUSIONS FROM GROSS INCOME.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * * * *

(7) INCOME EXEMPT UNDER TREATY.—Income of any kind, to the extent required by any treaty obligation of the United States;

SEC. 62. RULES AND REGULATIONS.

The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this chapter.

Pursuant to section 62 of the Internal Revenue Code, Article XXI of the convention, and other provisions of the internal revenue laws, the following regulations are hereby prescribed and all regulations inconsistent herewith are modified accordingly.

SEC. 25.1. *Scope of regulations.*—The primary purposes of the convention, to be accomplished on a mutually reciprocal basis, are the avoidance of double taxation, exchange of fiscal information complementary to those provisions of the convention relating to avoidance of double taxation, and mutual assistance in the collection of the taxes to which the convention relates. These regulations deal primarily with the effect of the convention upon the determination of taxable income from sources within the United States of nonresident alien individuals resident in Sweden and of Swedish corporations and other Swedish entities, and with the information to be made available to the Finance Minister of Sweden.

The specific classes of income from sources within the United States exempt by reason of the convention from United States income tax are:

(*a*) Industrial and commercial profits of a Swedish enterprise having no permanent establishment in the United States (Article II);

(*b*) Income derived by a Swedish enterprise from the operation of ships or aircraft registered in Sweden (Article IV);

(*c*) Royalties and amounts derived by a nonresident alien individual resident in Sweden or by a Swedish corporation or other entity as consideration for the right to use copyrights, patents, secret processes and formulas, trade-marks and other analogous rights (Article VI);

(*d*) Gains derived from the sale or exchange of capital assets by a nonresident alien individual resident in Sweden, or by a Swedish corporation or other entity, having no permanent establishment in the United States (Article IX);

(*e*) Wages, salaries, and similar compensation and pensions paid by Sweden or by a political subdivision thereof to individuals (other than citizens of the United States) temporarily residing in the United States (Article X);

(*f*) Private pensions and life annuities paid to nonresident alien individuals residing in Sweden (Article X);

(*g*) Compensation for labor or personal services performed within the United States by a nonresident alien individual resident in Sweden, such exemption being, however, subject to the limitations set forth in Article XI of the convention and in section 25.12 of these regulations;

(*h*) Remittances from sources within Sweden (if and to the extent that they constitute gross income without regard to this convention) received in the United States by a nonresident alien individual resident of Sweden who is temporarily resident in the United States for the purposes of study or for acquiring business experience, such remittances being for the purposes of their maintenance or studies (Article XII).

The convention does not affect the liability to United States income tax of Swedish citizens resident in the United States except to the extent such citizens are entitled to the benefits of Article XIV of the convention. For the purposes of the convention, an individual resident in neither Sweden nor the United States and claiming the benefits of the convention as a citizen of Sweden shall be deemed to be a resident of Sweden if it is shown to the satisfaction of the Commissioner that he is such citizen. With respect to dividends and interest, see section 25.9 of these regulations.

Except as to those items of income expressly exempted by the convention, the income tax liability of a nonresident alien individual resident of Sweden and of a Swedish corporation or other entity is determined in accordance with the provisions of the internal revenue laws of the United States and the regulations thereunder applicable generally to the taxation of nonresident alien individuals and foreign corporations.

Except in so far as concerns dividends, the convention makes no reference to rates of taxation imposed by the United States.

SEC. 25.2. *Definitions.*—Any word or term used in these regulations which is defined in the convention shall be given the definition assigned to such word or term in such convention. Any word or term used in these regulations which is not defined in the convention but is defined in the Internal Revenue Code shall be given the definition contained therein.

As used in these regulations:

(*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 Swedish parent corporation having a subsidiary corporation which latter corporation has a permanent establishment in the United States will not be deemed, by reason of such fact, to have itself a permanent establishment in the United States. A Swedish enterprise as defined in the convention carrying on business in the United States through an employee or agent, established in the United States, who has general authority to contract for his employer or principal, shall be deemed to have a permanent establishment in the United States. However, business dealings in the United States by a Swedish enterprise through a bona fide commission agent, broker, or custodian do not constitute a permanent establishment in the United States.

(*b*) The term "enterprise" means any commercial or industrial undertaking whether conducted by an individual, partnership, corporation, or any other entity. It includes such activities as manufacturing, merchandising, mining, banking, and insurance. It does not include the operation of, or the trading in, real property located in the United States. It does not include the rendition of personal services. Hence, a nonresident alien individual, a resident of Sweden, rendering personal services within the United States, is not merely by reason of such services, engaged in an enterprise within the meaning of the convention and his liability to Federal income tax is unaffected by Article II of the convention.

(*c*) The term "Swedish enterprise" means an enterprise carried on in Sweden by a nonresident alien individual resident in Sweden or by a Swedish corporation or other entity. The term "Swedish corporation or other entity" means a partnership, corporation, or other entity created or organized in Sweden or under the laws of Sweden. For example, an enterprise carried on wholly without Sweden by a nonresident alien individual resident in Sweden is not a Swedish enterprise within the meaning of the convention.

(*d*) The term "industrial and commercial profits" means the profits arising from the industrial, mercantile, manufacturing, or like undertakings of a Swedish enterprise as defined in this section. Such term does not include dividends, interest, compensation for labor or personal services, or income derived from real property or from any interest in such property, including rentals and royalties therefrom and gain from the sale or disposition thereof. Such latter items of income are not governed by the provisions of Article II but are subject to the rules elsewhere set forth in the convention and in these regulations with respect to such specific items of income. As to gains from the sale or exchange of capital assets, see section 25.10.

SEC. 25.3. *Scope of convention with respect to determination of "industrial and commercial profits" of a nonresident alien individual resident of Sweden or of a Swedish corporation or other entity carrying on a Swedish enterprise in the United States.*—(*a*) *General.*—Article II of the convention adopts the principle that an enterprise of one of the contracting States shall not be taxable in the other contracting State in respect of its industrial and commercial profits unless it has a permanent establishment in the latter State. Hence, a Swedish enterprise is subject to tax upon its industrial and commercial profits from sources within the United States only if it has a permanent establishment within the United States. From the standpoint of Federal income taxation, the article has application only to a Swedish enterprise and to the industrial and commercial income thereof from sources within the United States. It has

no application, for example, to compensation for labor or personal services performed in the United States nor to income derived from real property located in the United States nor to any interest in such property, including rentals and royalties therefrom, nor to gains from the sale or disposition thereof nor to dividends and interest. Such latter items of income are treated separately elsewhere in these regulations and are subject to the rules laid down in the sections having specific reference to the respective items of income. As to what is a "Swedish enterprise," "a permanent establishment" and "industrial and commercial profits," see section 25.2.

(*b*) *No United States permanent establishment.*—A nonresident alien individual resident in Sweden or a Swedish corporation or other entity, carrying on a Swedish enterprise but having no permanent establishment in the United States is not subject to United States income tax upon industrial and commercial profits from sources within the United States. For example, if such Swedish corporation sells stock in trade such as iron ore or wood pulp through a bona fide commission agent or broker in the United States, the resulting profit is, under the terms of Article II of the convention, exempt from United States income tax. Such Swedish corporation, however, remains subject to tax upon all other items of income from sources within the United States and not expressly exempted from such tax under the convention. However, see sections 25.8, 25.10, 25.11, and 25.12 of these regulations.

(*c*) *United States permanent establishment.*—A nonresident alien individual resident in Sweden or a Swedish corporation or other entity, carrying on a Swedish enterprise having a permanent establishment in the United States is subject to tax upon his or its industrial and commercial profits from sources within the United States. In the determination of the income of such resident of Sweden or Swedish corporation or other entity from sources within the United States, all industrial and commercial profits from sources within the United States shall be deemed to be allocable to the permanent establishment within the United States. The net income from sources within the United States, including the industrial and commercial profits, shall be determined in accordance with the provisions of section 119, Internal Revenue Code, and regulations thereunder. In determining such income, no account shall be taken of the mere purchase of merchandise effected in the United States by such Swedish enterprise.

SEC. 25.4. *Control of a domestic enterprise by a Swedish enterprise.*—Article III of the convention provides that if a Swedish enterprise by reason of its control of a domestic business imposes conditions different from those which would result from normal bargaining between independent enterprises, the accounts between the enterprises will be adjusted so as to ascertain the true net income of the domestic enterprises. The purpose is to place the controlled domestic enterprise on a tax parity with an uncontrolled domestic enterprise by determining, according to the standard of an uncontrolled enterprise, the true net income from the property and business of the controlled enterprise. The convention contemplates that if the accounting records do not truly reflect the net income from the property and business of such domestic enterprise the Commissioner shall intervene and, by making such distributions, apportionments, or allocations as he may deem necessary of gross income or deductions or of any item of element affecting net income as between such domestic enterprise and the Swedish enterprise by which it is controlled or directed, determine the true net income of the domestic enterprise. The provisions of section 19.45–1, Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.], shall, in so far as applicable, be followed in the determination of the net income of the domestic business.

SEC. 25.5. *Income from operation of ships or aircraft.*—The income derived by a Swedish enterprise from the operation of ships or aircraft registered in Sweden is exempt from United States income tax. However, the profits derived by such enterprise from the operation of ships or aircraft not so registered are treated as are industrial and commercial profits generally. See Article II of the convention and section 25.3 of these regulations.

SEC. 25.6. *Income from real property.*—Income of whatever nature derived by a nonresident alien individual resident in Sweden or by a Swedish corporation or other entity from real property situated in the United States, including gains derived from the sale of such property, is not exempt from taxation by the convention. The treatment of such income for taxation purposes is governed by those provisions of the Internal Revenue Code applicable generally to the taxation of nonresident aliens and foreign corporations. Interest derived from

mortgages or bonds secured by real property does not constitute income from real property within the meaning of the convention but is subject to the provisions applicable to interest generally. See Article VIII of the convention and section 25.9 of these regulations

SEC. 25.7. *Mineral royalties.*—Royalties derived by a nonresident alien individual resident in Sweden or by a Swedish corporation or other entity from real property or in respect of the operation of mines, quarries, timber or other natural resources situated in the United States are not exempt from taxation under the convention. Such items of income are subject to taxation under the provisions of the Internal Revenue Code applicable generally to the taxation of nonresident aliens and foreign corporations.

SEC. 25.8. *Patent and copyright royalties.*—Royalties and amounts derived from sources within the United States by a nonresident alien individual resident in Sweden or by a Swedish corporation or other entity (if such corporation or entity is not a resident of the United States) as consideration for the right to use copyrights, patents, secret processes and formulas, trademarks and other analogous rights are exempt from Federal income taxation under the provisions of Article VI of the convention. Such items are therefore not subject to the withholding provisions of the Internal Revenue Code. Such exemption does not, however, apply in the case of a Swedish corporation engaged in trade or business within the United States or having an office or place of business therein. Such corporation is a resident Swedish corporation and hence the provisions of Article XIV(*a*) are applicable.

To obviate withholding of the tax at the source, the alien individual resident in Sweden or Swedish corporation or other entity should, by letter, notify the payor of the income that such income is exempt from Federal income taxation under the provisions of the convention. Such letter from such resident of Sweden shall contain his address and a statement that he is a resident of Sweden. The letter from such corporation or other entity shall contain the address of its office or place of business and a statement that it is a corporation or other entity organized under the laws of Sweden and shall be signed by an officer of the corporation or other entity giving his official title. The letter of notification or a copy thereof should be immediately forwarded by the recipient to the Commissioner of Internal Revenue, Withholding Returns Section, Washington, D. C., United States of America.

SEC. 25.9. *Dividends and interest.*—In general dividends derived from sources within the United States by a nonresident alien individual resident in Sweden or by a Swedish corporation or other entity remain subject to taxation under the provisions of the Internal Revenue Code applicable generally to the taxation of nonresident alien individuals and foreign corporations. See Article XIV(*a*) of the convention. However, for a period of at least two years beginning on January 1, 1940, the tax in the case of such alien individual resident in Sweden or such Swedish corporation or other entity (nonresident as to the United States) shall not exceed 10 per cent of the amount of such dividends. See Article VII of the convention. Hence, the higher rates applicable generally in the case of nonresident alien individuals subject to the provisions of section 211(c), Internal Revenue Code, are not applicable to dividends received by nonresident alien individuals who are residents of Sweden.

The taxation of interest derived from sources within the United States by a nonresident alien individual resident in Sweden or by a Swedish corporation or other entity is not affected by the convention except that in the case of such individual such interest is subject only to the rate of tax imposed by section 211(a), Internal Revenue Code. Hence, interest, like dividends, is excluded for the purposes of section 211(c), from the gross amount of fixed or determinable annual or periodical income of nonresident alien individuals who are residents of Sweden.

SEC. 25.10. *Capital gains.*—Under Article IX of the convention, gain derived from the sale or exchange of capital assets (other than real property) within the United States by a nonresident alien individual resident in Sweden or by a Swedish corporation or other entity is exempt from Federal income tax unless such individual, corporation, or other entity has a permanent establishment in the United States. With respect to real property, see section 25.6 of these regulations

SEC. 25.11. *Wages, salaries, and similar compensation, pensions and life annuities.*—Under Article X of the convention wages, salaries, and similar compensation and pensions paid by Sweden or by a political subdivision thereof to individuals temporarily residing in the United States are exempt from Federal

income tax. By reason, however, of the application of Article XIV(*a*) of the convention, such exemption does not apply to recipients of such income who are either citizens of the United States or aliens resident therein. As to who are resident aliens, see sections 19.211–2, 19.211–3 and 19.211–4, Regulations 103. As to the taxation generally of the compensation of employees of foreign governments, see section 116(h) of the Internal Revenue Code and section 19.116–1 of Regulations 103.

Under the provisions of the same article of the convention, private pensions and life annuities derived from sources within the United States by nonresident alien individuals residing in Sweden are exempt from the Federal income tax. Such items of income are, therefore, not subject to the withholding provisions of the Internal Revenue Code. See paragraph 5 of the protocol to the convention as to what constitutes life annuities. See also section 25.8 of these regulations with respect to patent and copyright royalties as to requirements necessary to avoid withholding of the tax at the source, which requirements are here also applicable.

SEC. 25.12. *Compensation for labor or personal services.*—Article XI of the convention adopts the principle that compensation for labor or personal services, including compensation realized in the practice of the liberal professions, is subject to tax only in the contracting State in which such services are rendered. Hence, in general such compensation derived by nonresident alien individuals residing in Sweden for services rendered in the United States is subject to Federal income tax. Such general rule is, however, subject to the following exceptions under the provisions of Article XI:

Such nonresident alien individual is not subject to Federal income tax upon compensation for labor or personal services performed within the United States if the following conditions prescribed by (*a*) or (*b*) are met:

He is temporarily present in the United States for a period or periods—

(*a*) (1) Not exceeding 180 days during the taxable year and

(2) his compensation is received for labor or personal services performed as an employee of, or under contract with, a resident of Sweden or a Swedish corporation or other entity; or

(*b*) (1) not exceeding 90 days during the taxable year and

(2) the compensation received for such services does not exceed $3,000 in the aggregate for such taxable year even though such compensation is paid by a United States resident or by a domestic corporation or other domestic entity.

If, therefore, such nonresident alien individual (1) is temporarily present in the United States for a period or periods in excess of 90 days during the taxable year, or (2) receives more than $3,000 in the aggregate during the taxable year for labor or personal services performed within the United States he is not exempt under clause (*b*), and his right to exemption under the convention will depend on his meeting both tests prescribed under clause (*a*), of the immediately preceding paragraph.

These exceptions, however, do not extend to the professional earnings of actors, artists, musicians, professional athletes, and those enaged in like activities. The professional earnings of such individuals resident in Sweden for services rendered within the United States are subject to the provisions of the Internal Revenue Code applicable generally to the taxation of nonresident alien individuals.

SEC. 25.13. *Remittances.*—Under Article XII nonresident alien individuals residents of Sweden who are temporarily residing in the United States exclusively for the purposes of study or acquiring business experience and receiving remittances from Sweden for the purposes of their maintenance and studies in the United States are exempt from Federal income tax upon such amounts if and to the extent that such amounts constitute gross income.

SEC. 25.14. *Scope of Article XIV.*—(*a*) *General.*—Article XIV(*a*) has an important bearing upon other articles of the convention. While many preceding articles provide in effect that items of income derived by citizens or residents of the United States or by domestic corporations from sources in Sweden are subject to tax only in Sweden, Article XIV(*a*) nevertheless permits the imposition of Federal income tax upon such income in the hands of such taxpayers. For example, Article V provides that income from real property, including gains derived from the sale or exchange of such property, shall be taxable only in the contracting State in which such property is situated. Hence, looking at such articles without reference to Article XIV a United States citizen realizing such income from real property situated within

Sweden would not be subject to Federal income tax upon such income. Article XIV(*a*), however, prescribes that, notwithstanding Article V or any other article of the convention, the Federal income tax may apply to all items of income without regard to other provisions of the convention and hence all items of income from sources within Sweden, regardless of their treatment in the articles dealing respectively with such items of income, must be included in gross income of United States citizens, residents and corporations for the purposes of the Federal income tax.

(*b*) *Credit for Swedish income taxes.*—Article XIV(*a*), for the purposes of avoidance of double taxation, further provides that a citizen or resident of the United States or a domestic corporation deriving income from sources within Sweden shall be entitled to a credit against the Federal income tax liability for the amount of Swedish national income and property tax, including surtax, and for the Swedish communal income tax. Such credit is, however, subject to the limitations prescribed in section 131, Internal Revenue Code (relating to the credit for foreign taxes), in that it can not exceed the same proportion of the tax against which the credit is taken which the taxpayer's net income from sources within Sweden bears to the entire net income, in the case of a taxpayer other than a corporation, or to the normal tax net income, in the case of a corporation, for the same taxable year.

In the application of Article XIV(*a*), the provisions of section 131, Internal Revenue Code, are in general applicable. See paragraph 6 of the protocol to the convention.

SEC. 25.15. *Reciprocal administrative assistance.*—By Article XV of the convention, United States and Sweden adopt the principle of exchange of information and assistance in the service of documents incident to the collection of taxes. It is agreed that such fiscal cooperation shall be carried out in accordance with the laws of the respective countries and hence only such information as is available to the Commissioner under the revenue laws may be used as a source from which to secure the information required to be submitted to the Finance Minister of Sweden.

Pursuant to such principle, withholding agents shall, in the preparation of withholding returns, Form 1042, report on such returns, in addition to the items of income upon which tax has been withheld at the source, those items of income paid to a nonresident alien individual resident in Sweden or to a Swedish corporation or other entity upon which tax has not been withheld at the source. See section 25.8 of these regulations. Such return shall show the same information with respect to such items of income upon which tax has not been withheld at the source as is shown with respect to items of income upon which the tax has been withheld at the source.

All information and correspondence relating to exchange of information and to service of documents may be transmitted by the Secretary directly to the Finance Minister of Sweden.

SEC. 25.16. *Information to be furnished in the ordinary course.*—In accordance with the provisions of Article XVI(1) (*a*) and (*b*) of the convention, the Secretary shall forward to the Finance Minister of Sweden, Stockholm, Sweden, as soon as practicable after the close of the calendar year 1940 and of each calendar year thereafter during which the convention is in effect the following information relating to such preceding calendar year:

(*a*) (1) The name and address of each person whose address as disclosed on Forms 1012 and 1042 is in Sweden deriving from sources within the United States dividends, interest, royalties, pensions, annuities, or other fixed or determinable annual or periodical income, showing the amount of such income with respect to such person.

(2) The name and address of each person whose address as disclosed by Forms 1000, 1087, and 1099 is in Sweden showing the amount of income set forth on such form with respect to each person.

(*b*) In accordance with the provisions of Article XVI(1) (*c*) of the convention, there shall likewise be forwarded any particulars which the Commissioner may obtain incident to the determination of estate tax liability of any decedent from inventories of assets of estates of decedents concerning debts contracted with individuals resident in Sweden or with Swedish corporations or other entities.

SEC. 25.17. *Information in specific cases.*—Under the provisions of Article XVIII of the convention and upon request of the Finance Minister of Sweden, made through diplomatic channels and subject to the provisions of Article XIX of the convention, the Secretary will furnish to the Finance Minister of Sweden particulars in case of any specific taxpayer who is a citizen of Sweden or a

Swedish corporation or other entity, relating to the application of Swedish national income and property tax and the Swedish communal income tax. In the case of other specific taxpayers, the Secretary will give consideration to requests of the Finance Minister of Sweden with a view to furnishing similar information concerning such taxpayers.

SEC. 25.18. *Mutual assistance in the collection of taxes.*—Under the provisions of Article XXI of the convention, the Secretary of the Treasury and the Finance Minister of Sweden are authorized to prescribe rules with respect to those provisions of the convention relating to the exchange of information, service of documents, and mutual assistance in the collection of the taxes to which the convention relates. Such rules concerning matters of procedure, forms of application and replies thereto, conversion of currency, disposition of amounts collected, and related matters will be made the subject matter of a common agreement between the competent authorities of the two contracting States concerned and when consummated will be published.

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved June 25, 1940.

HERBERT E. GASTON,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register June 27, 1940, 10 a. m.)

SECTION 19.22(b)(2)-2: Annuities. 1940-36-10406
I. T. 3402

INTERNAL REVENUE CODE, REVENUE ACT OF 1938, AND PRIOR REVENUE ACTS.

Taxable status for Federal income tax purposes of amounts received under a so-called endowment, income, and final sum policy which matured as an endowment in 1931, 20 years after date of issuance, the insured having survived the endowment period.

Advice is requested as to the proper treatment for Federal income tax purposes of amounts received by A under a so-called endowment, income, and final sum policy which matured as an endowment in 1931.

Under the terms of the policy, which was taken out in May, 1911, the insurance company, in consideration of annual premiums of $581.10 until 20 such premiums have been paid or until the prior death of A, the insured, promises to pay to the insured, if he be then living, on May —, 1931, " herein called the maturity of the endowment," a first yearly installment of $500 and a like yearly sum thereafter until 20 such payments have been made, and at the end of 20 years from the maturity of the endowment and 1 year after the last installment, a final sum of $10,000. In the event of the death of the insured prior to the maturity of the endowment, his beneficiary is to receive the amounts the insured would have received if living. When the policy becomes a claim, either by maturity of the endowment or prior death of the insured, the beneficiary entitled thereto may at that time, or upon any subsequent anniversary, receive instead of such payments the commuted value of the unpaid installments and final sum. Prior to maturity of the endowment, provided premiums have been fully paid, the insured is entitled to surrender the policy for a commuted value of $13,000.

The insured paid 20 annual premiums amounting to $11,622 and received so-called dividends in the amount of $1,953.51, thus making

the net cost of his policy $9,668.49. Having survived the endowment period, and having neither surrendered his policy nor entered into any supplementary contract for payment of the proceeds, A received in 1931 and subsequent years the annual payment of $500. The proper method of taxing such payments is the problem presented.

The policy is a 20-year endowment policy payable in 20 yearly installments of $500 each, and one year after the last installment a final sum of $10,000, such policy having a commuted value of $13,000 when all of the stipulated yearly premiums have been paid. The premiums or consideration paid for these benefits amounted to $9,668.49, as heretofore indicated. The commuted value of the policy, unless accepted by the beneficiary in lieu of the yearly installments and final sum of $10,000, has no bearing on the taxable status of the amounts received under the policy.

Under section 22(b)2 of the Revenue Act of 1928, which was in effect when the policy matured in 1931, amounts received under an endowment contract by an insured surviving the maturity of the endowment were not taxable until such amounts exceeded the premiums or consideration paid for the contract. The same rule was in effect under the Revenue Act of 1932. However, such exemption was inapplicable under the Revenue Act of 1934. Section 22(b)2 of the Revenue Act of 1934, with respect to annuities, 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 (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. * * *

Corresponding sections of subsequent Revenue Acts and the Internal Revenue Code contain provisions which are practically identical.

The payment of $500 for each of the years 1931, 1932, and 1933, or the total of $1,500 received in those years, was tax-free income to A, the insured. The consideration paid for the policy was $9,668.49. For 1934 and subsequent years, $290.05 ($9,668.49×0.03) of the $500 received by the insured is taxable income, and $209.95 ($500.00−$290.05) is excluded or returnable to him tax free. At the end of 1938, only $2,549.75 ($1,500+$1,049.75 ($209.95×5)) has been excluded. Therefore, for 1939, $290.05 of the $500 received is taxable income and $209.95 is tax-free.

SECTION 19.22(b)(2)-2: Annuities. 1940-40-10435
I. T. 3413

INTERNAL REVENUE CODE.

Treatment for Federal income tax purposes of certain payments made to an insured under the provisions of a life income, 25-year endowment policy issued by the M Company, which matured November 13, 1939.

Advice is requested as to the proper treatment for Federal income tax purposes of certain payments made to an insured under the provisions of a life income, 25-year endowment policy issued by the M Company, which matured November 13, 1939.

The policy was issued in 1914 and provided for the payment on maturity of a monthly income of $50 to the insured, if living, or to his wife as original beneficiary, for a period of 20 years and for life thereafter of the survivor, in consideration of the payment of a premium of $435.50 each year for 25 years. The insured surrendered the policy upon its maturity as an endowment November 13, 1939, in exchange for a supplementary contract income certificate, which provided for the payment of 240 installments of $50 each on the first of each month to the insured if living or, if not living, to his wife, the original beneficiary. Should either be living on November 1, 1959, the company agrees to continue such payment to the survivor for life. During the continuance of the payment of the 240 installments, excess interest at the rate declared by the company will be added to the payments. While the 240 payments are being made, the recipient is privileged upon notice to the company to receive, instead of the continued payments, the commuted value of any unpaid installments. Provision is made for the payment of such commuted value to others in the event of the death, prior to payment in full of the 240 installments, of the insured and his wife. During the term of the policy the insured elected to have the annual dividends, with the exception of the dividend for 1939, applied to the purchase of paid-up additional endowment insurance. Under the provisions of the policy, the insured was entitled to withdraw at any time the cash value of such paid-up additional endowment insurance. The amount of the dividends thus applied is $2,286.14. At the time the policy matured, the proceeds of this paid-up additional insurance, amounting to $3,017.54, and the 1939 dividend of $82.44 were paid in cash to the insured.

The questions presented are (1) the amount taxable, if any, at maturity of the policy, and (2) the amount taxable with respect to the installments payable thereunder during the year 1939 and thereafter. The following items are involved:

1. Total regular insurance premiums for endowment	$10,554.70
2. Amount paid to taxpayer in November, 1939, as surrender value of 1915-1938 dividend additions	3,017.54
3. 1939 cash dividend paid in November, 1939	82.44
4. Monthly installments of $50 each paid in November and December, 1939	100.00

As indicated, the cash premiums paid for the endowment aggregated $10,554.70. The dividends of $2,286.14, which at the insured's option were applied to the purchase of additional paid-up endowment insurance, constitute a return to the insured of premiums of a mutual insurance company, which is likewise true of the 1939 cash dividend of $82.44. (Section 19.22(a)-12 of Regulations 103.) Consequently, $8,186.12 ($10,554.70−($2,286.14+$82.44=) $2,368.58) is regarded as the consideration paid for the endowment contract.

On the maturity of the contract in 1939, it yielded an annuity of $50 a month for 20 years certain to the insured, or to his wife as successor annuitant within the period certain, and for the duration of the survivor's life thereafter; and the paid-up additional insurance yielded cash proceeds of $3,017.54, or $731.40 ($3,017.54−$2,286.14) in excess of its cost. The amount of $731.40, which is the excess of the amount received over the dividends used to purchase paid-up additional endowment insurance, such additional endowment insurance being paid

in cash at maturity, is taxable income to the insured in the year of receipt.

Section 22(b)2 of the Internal Revenue Code, with respect to annuities, provides in part as follows:

Annuities, etc. * * * Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income under this chapter or prior income tax laws in respect of such annuity equals the aggregate premiums or consideration paid for such annuity. * * *

Section 19.22(b)(2)-2 of Regulations 103 states in part:

Annuities.—* * * Such portion of each installment payment of an annuity shall be included in gross income as is not in excess of 3 per cent of the aggregate premiums or consideration paid for such annuity, whether or not paid during the taxable year, divided by 12 and multiplied by the number of months in respect of which the installment is paid. As soon as the aggregate of the amounts received and excluded from gross income equals the aggregate premiums or consideration paid for such annuity, the entire amount received thereafter in each taxable year must be included in gross income. * * *

Accordingly, $40.94 ($8,186.12×.03=$245.58÷12=$20.47×2) of the total annuity payments of $100 received by the taxpayer in 1939 is required to be included in the gross income of the recipient and $59.06 is excluded as tax-free income. Assuming that like provisions of the Internal Revenue Code will remain in effect for the calendar year 1940, $245.58 ($8,186.12×.03) would be includible in gross income in the annuitant's return for that year and the remainder of the $600 annuity, or $354.42, received in that year would be excluded from gross income.

During the period certain, excess interest is added annually to the annuity payments, the first such payment to be made in 1940. Any such excess interest is taxable in the year of its receipt.

SECTION 19.22(b)(2)-2: Annuities. 1940-48-10494
I. T. 3428

INTERNAL REVENUE CODE AND REVENUE ACT OF 1938.

Disability retirement pay received by a civil service employee pursuant to section 6 of the Civil Service Retirement Act of 1920, as amended, is includible in gross income, for Federal income tax purposes, to the extent and in the manner provided by section 22(b)2 of the Internal Revenue Code and the Revenue Act of 1938.

Advice is requested whether the disability retirement pay received by A from the United States Government is taxable under section 22(b)2 of the Internal Revenue Code, or is exempt from taxation under section 22(b)5 of the Code.

A was employed in the classified United States civil service until December, 1937, when she became ill. She was retired on account of disability in 1938 in accordance with the provisions of section 6 of the Act approved May 29, 1930 (chapter 349, 46 Stat., 468), entitled "An Act to amend the Act entitled 'An Act to amend the Act entitled "An Act for the retirement of employees in the classified civil service, and

for other purposes," approved May 22, 1920, and Acts in amendment thereof,' approved July 3, 1926, as amended." The pertinent provisions of section 6, supra, read as follows:

SEC. 6. Any employee to whom this Act applies who shall have served for a total period of not less than five years, and who, before becoming eligible for retirement under the conditions defined in the preceding sections hereof, becomes totally disabled for useful and efficient service in the grade or class of position occupied by the employee, by reason of disease or injury not due to vicious habits, intemperance, or willful misconduct on the part of the employee, shall upon his own application or upon the request or order of the head of the department, branch, or independent office concerned, be retired on an annuity computed in accordance with the provisions of section 4 hereof * * *.

Section 22(b)2 of the Internal Revenue Code, in so far as applicable, reads 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 (whether or not paid during such year), until the aggregate amount excluded from gross income under this chapter or prior income tax laws in respect of such annuity equals the aggregate premiums or consideration paid for such annuity. * * *

Section 22(b)5 of the Internal Revenue Code provides, among other things, that there shall be exempt from Federal income taxation:

* * * Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness * * *.

The Bureau holds that annuities paid to retired employees by the United States Government are subject to Federal income tax to the extent and in the manner provided by section 22(b)2 of the Internal Revenue Code and the corresponding sections of prior Revenue Acts. (See section 19.22(b)(2)-2 of Regulations 103; T. D. 3112, C. B. 4, 76 (1921); and I. T. 2984, C. B. XV-1, 87 (1936).)

The Federal Compensation Act of September 7, 1916 (39 Stat., 742), provides, among other things, that the United States shall pay compensation on account of death or disability of an employee of the Federal Government resulting from a personal injury sustained while in the performance of his duty. Section 5 of the Act approved May 22, 1920, supra, provides that no person shall be entitled to receive an annuity under that Act and compensation under the Act of September 7, 1916, supra, covering the same period of time, but that that provision shall not be so construed as to bar the right of any claimant to the greater benefit conferred by either Act for any part of the same period of time.

In I. T. 3281 (C. B. 1939-1 (Part 1), 97) it is held that compensation paid by the United States under the provisions of the Federal Compensation Act of September 7, 1916, supra, on account of disability or death of an employee of the Federal Government resulting from a personal injury sustained by the employee while in the performance of his duty comes within the provisions of section 22(b)5 of the Revenue Act of 1938 and is, therefore, not subject to Federal income tax. The provisions of section 22(b)5 of the Internal Revenue Code, supra, are the same as those of section 22(b)5 of the Revenue Act of 1938. It is stated in I. T. 3281, supra, that the pro-

visions of the Act of September 7, 1916, are similar in many respects to those of the so-called workmen's compensation acts of the various States.

It does not appear that the provisions of the Act approved May 22, 1920, as amended, usually referred to as the Civil Service Retirement Act, are similar to those of the so-called workmen's compensation acts of the various States or that the annuities paid thereunder represent compensation for personal injuries or sickness as contemplated in section 22(b)5 of the Code. It is, therefore, held that the disability retirement pay received by A from the United States Government is subject to Federal income tax to the extent and in the manner provided by section 22(b)2 of the Internal Revenue Code and the corresponding section of the Revenue Act of 1938.

SECTION 19.22(b)(4)–1: Interest upon State obligations.

INTERNAL REVENUE CODE.

Securities issued by limited dividend housing corporations organized under the Public Housing Law of New York, 1939. (See I. T. 3411, page 103.)

SECTION 22(c).—GROSS INCOME: INVENTORIES.

SECTION 19.22(c)–1: Need of inventories. 1940–29–10328
T. D. 4981

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

Amending section 19.22(c)–1 of Regulations 103 relative to need of inventories—Inventories of containers.

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

To Collectors of Internal Revenue and Others Concerned:

Section 19.22(c)–1 of Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.] is hereby amended to read as follows:

SEC. 19.22(c)–1. *Need of inventories.*—In order to reflect the net income correctly, inventories at the beginning and end of each taxable year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. The inventory should include all finished or partly finished goods and, in the case of raw materials and supplies, only those which have been acquired for sale or which will physically become a part of merchandise intended for sale, in which class fall containers, such as kegs, bottles, and cases, whether returnable or not, if title thereto will pass to the purchaser of the product to be sold therein. Merchandise should be included in the inventory only if title thereto is vested in the taxpayer. Accordingly, the seller should include in his inventory goods under contract for sale but not yet segregated and applied to the contract and goods out upon consignment, but should exclude from inventory goods sold (including containers), title to which

has passed to the purchaser. A purchaser should include in inventory merchandise purchased (including containers), title to which has passed to him, although such merchandise is in transit or for other reasons has not been reduced to physical possession, but should not include goods ordered for future delivery, transfer of title to which has not yet been effected. (But see section 19.22(d)-1.)

(This Treasury decision is issued under the authority contained in sections 22 and 62 of the Internal Revenue Code (53 Stat., 9, 32).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved July 3, 1940.

HERBERT E. GASTON,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 8, 1940, 10.03 a. m.)

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

SECTION 19.23(a)-1: Business expenses. 1940-37-10415
I. T. 3403

INTERNAL REVENUE CODE.

Deductibility of costs incident to the expense of training apprentices.

Advice is requested whether costs incident to the training of apprentices are deductible from gross income for Federal income tax purposes.

In the determination of taxable net income, the Bureau allows as ordinary and necessary expenses costs incident to the training of apprentices, including wages of apprentices and instructors, cost of related instruction, and the cost of materials used exclusively in the program. The allowance of these items as deductions for Federal income tax purposes is authorized by section 23(a) of the Internal Revenue Code, which reads in part as follows:

In computing net income there shall be allowed as deductions:
(a) EXPENSES.—
(1) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered * * *.

Small items of equipment having a life of not more than one year which are used exclusively in the program of training apprentices may be deducted in determining taxable income under the authority of the above-quoted provisions of the Internal Revenue Code. Items of equipment having a useful life in excess of one year should be capitalized and the cost thereof recovered through depreciation allowances in accordance with the provisions of section 23(l) of the Internal Revenue Code.

SECTION 19.23(a)-2: Traveling expenses. 1940-30-10341
I. T. 3395

INTERNAL REVENUE CODE.

Locomotive engineers and other railroad trainmen, who are required to remain at away-from-home terminals in order to obtain necessary rest prior to making a further run or beginning a return run to the home terminal, are entitled to deduct for Federal income tax purposes the cost of room rental and meals while away from home on such runs.

Advice is requested whether locomotive engineers and other railroad trainmen are entitled to deductions, for Federal income tax purposes, of their expenses for room and board while away from home.

It appears that many locomotive engineers and other railroad trainmen are assigned to runs extending over distances of several hundred miles. On arrival at away-from-home terminals on such runs, they are released from service for sufficient time to secure necessary rest. Thus, they are required to pay for room rental and meals from the time they leave their homes until they return. As they receive no allowances from their employers for such expenses, payment is made out of their personal funds.

Section 23(a)1 of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions—

* * * All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including * * * traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business * * *.

Section 19.23(a)-2 of Regulations 103, relating to traveling expenses, states in part:

* * * If the trip is solely on business, the reasonable and necessary traveling expenses, including * * * meals, and lodging, are business expenses.

(*a*) If, then, an individual, whose business requires him to travel, receives a salary as full compensation for his services, without reimbursement for traveling expenses * * * his traveling expenses, including the entire amount expended for meals and lodging, are deductible from gross income.

It is held that locomotive engineers and other railroad trainmen, who are required to remain at away-from-home terminals in order to obtain necessary rest prior to making a further run or beginning a return run to the home terminal, are entitled to deduct for Federal income tax purposes the cost of room rental and meals while away from home on such runs.

SECTION 19.23(a)-6: Compensation for personal services. 1940-42-10453
I. T. 3417

INTERNAL REVENUE CODE.

Salaries paid by employers during the present emergency to employees who are absent in the military or naval service, or who are serving the Government in other ways at a nominal compensation, but who intend to return at the conclusion of the emergency, are allowable deductions from gross income for Federal income tax purposes.

Advice is requested whether the M Company, which intends to make payments of salaries to employees who are called for military service, may deduct amounts so paid from gross income for Federal income tax purposes.

In 1917 and 1918 many employers adopted the practice of making such payments. At that time the question arose whether employers could deduct the amounts so paid from their gross income. It was held that salaries paid by employers to employees who were absent in the military or naval service or were serving the Government in other ways at a nominal compensation, but who intended to return at the conclusion of such service, were allowable deductions from gross income. (See article 108, Regulations 45 (1920 edition), promulgated under the Revenue Act of 1918.)

The same rule will apply to salaries paid during the present emergency.

SECTION 19.23(a)-10: Rentals. 1940-30-10350
I. T. 3396

INTERNAL REVENUE CODE.

For Federal income and excess profits tax purposes, the N Company may amortize over the 8-year period of a lease the cost of a building and permanent equipment to be used for manufacturing certain articles in connection with the national defense program.

Advice is requested whether, for Federal income and excess profits tax purposes, the N Company, a wholly owned subsidiary of the M Company, may amortize over an 8-year period the cost of erecting buildings and purchasing and installing permanent equipment for the manufacture of certain articles in connection with the national defense program.

With a view to enabling the N Company to increase its capacity for the production of certain articles and facilitating the delivery thereof at an accelerated rate of production, the Reconstruction Finance Corporation, or a subsidiary of the Reconstruction Finance Corporation, will acquire title in fee to a tract of land and will lease such tract to the N Company for a period of eight years with a right of renewal for a similar period. The N Company will construct upon said tract of land a manufacturing plant, including the erection of buildings and the purchase and installation of permanent equipment therein. In order to finance the construction of the plant, the Reconstruction Finance Corporation has agreed to lend to the N Company an amount equal to its cost, the loan to be repaid within eight years from the proceeds of the sale of the articles to be manufactured therein and to be secured by a mortgage on the buildings and equipment.

The existing facilities of the M Company are modern, efficient, and designed to produce articles of the character to be manufactured in the new plant of the N Company in sufficient quantities to meet the demand which existed for such articles prior to the emergency declared by the President of the United States on September 8, 1939, to exist. Notwithstanding the fact that the buildings and permanent equipment of the N Company placed upon the tract of land leased by that company, as lessee, would revert to the Reconstruction Finance Corporation, or its subsidiary, as lessor, upon the termination of the lease unless the option of renewal is exercised, the facts do not

show with reasonable certainty that the lease will be renewed since the present facilities of the M Company are sufficient to meet the demand for such articles which would probably exist if the emergency or the national defense program should end before the expiration of the original term of the lease.

Based upon the foregoing facts, it is held that for Federal income and excess profits tax purposes the N Company will be entitled to amortize the cost of the buildings and permanent equipment referred to above over the 8-year life of the lease from the Reconstruction Finance Corporation or its subsidiary. (Regulations 103, section 19.23(a)-10.)

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

SECTION 19.23(c)-1: Taxes. 1940-27-10306
I. T. 3388

INTERNAL REVENUE CODE.

Property taxes in North Carolina, beginning with taxes assessed as of January 1, 1940, should be accrued as of January 1 by taxpayers whose books are kept on the accrual basis. Taxes assessed as of April 1, 1939 (under the old law), should be accrued as of April 1, 1939, in accordance with G. C. M. 18929 (C. B. 1937-2, 91).

Advice is requested as to the proper taxable period in which accrual should be made, for Federal income tax purposes, of the property taxes imposed under the 1939 North Carolina Machinery Act.

Sections 302 and 1401 of the Machinery Act of 1939 (chapter 310 of the Public Laws of North Carolina, 1939), effective April 3, 1939, provide:

SEC. 302. *Date as of which assessment is to be made.*

All property, real and personal, shall be listed or listed and assessed, as the case may be, in accordance with ownership and value as of the 1st day of April, one thousand nine hundred thirty-nine, and thereafter all property shall be listed or listed and assessed in accordance with ownership and value as of the 1st day of January each year.

SEC. 1401. *Date as of which lien attaches.*

The lien of taxes levied on property and polls listed pursuant to this act shall attach to real estate as of the day as of which property is listed, regardless of the time at which liability for the tax may arise or the exact amount thereof be determined.

In G. C. M. 18929 (C. B. 1937-2, 91) it was held that under the North Carolina Machinery Act of 1937 ownership of property on April 1 was the event which determined the liability for taxes thereon and that North Carolina property taxes should be accrued as of April 1 by taxpayers whose books are kept on the accrual basis. In view of the changes made by the enactment of the North Carolina Machinery Act of 1939, it is held that, beginning with taxes which are assessed as of January 1, 1940, North Carolina property taxes should be accrued as of January 1 by taxpayers whose books are kept on an accrual basis. Taxes assessed as of April 1, 1939, should be accrued as of April 1, 1939, in accordance with G. C. M. 18929, supra.

SECTION 19.23(c)-1: Taxes. 1940-27-10307
I. T. 3389

INTERNAL REVENUE CODE.

The tax on motor fuel levied by the State of Texas under chapter 44 of the laws of 1933, as amended through the calendar year 1939, is deductible as a tax in the Federal income tax return of the consumer who pays it and to whom it is not refunded. However, the amount of the tax may not be deducted separately as a tax if it is added to or made a part of the business expenses of the consumer or is otherwise used to reduce his net income.

Advice is requested whether the motor fuel tax imposed by the State of Texas is deductible for Federal income tax purposes by a consumer in his return for the year 1939.

Reference is made to I. T. 2687 (C. B. XII-1, 32 (1933)), which held that the gasoline tax imposed under the provisions of an act of the Texas Legislature effective May 5, 1931, is deductible by the consumer in accordance with the provisions of section 23(c) of the Revenue Act of 1932.

Chapter 98, General Laws of Texas, 1931, which was the basis for the ruling in I. T. 2687, supra, was repealed by chapter 44 of the laws of 1933, effective March 21, 1933. The motor fuel law has since been amended by the Laws of Texas, 1935, effective May 11, 1935, and by the Laws of Texas, 1939. The law imposing a tax on motor fuel by the State of Texas is found in volume 20 of Vernon's Texas Civil Statutes, pages 117 to 142, articles 7065a-1 to 7065a-18. Pertinent provisions of the law read as follows:

ART. 7065a-2. *Occupation or excise tax; rate; reports by distributors to comptroller*—

(a) There is hereby imposed an occupation or excise tax of four (4) cents on each gallon of motor fuel or fractional part thereof. The said tax shall accrue and be paid as hereinafter provided upon the first sale in Texas.

(b) The tax shall accrue on the first sale so that a single tax only will be collected on the same gallon of motor fuel, it being intended to impose the tax at its source in Texas, or as soon thereafter as such motor fuel may be subject to being taxed. * * *

* * * * * * *

(d) Every distributor making first sale of motor fuel shall pay to the State of Texas an occupation or excise tax equal to four (4) cents per gallon or fractional part thereof, so sold, distributed or used, and such tax shall be due and payable at the office of the comptroller at Austin, Tex., on the 20th day of each month, the same to be based on such sales or use made during the calendar month next preceding * * *.

(e) Provided, however, that the tax on 1 per cent of the taxable gallonage shall be deducted by the distributor to cover losses and the expense of complying with the provisions hereof.

(f) If any distributor, or other person, shall export or lose by fire or other accident, any motor fuel, so that the same may never be made use of within this State, after the tax has been paid on such motor fuel, claim for refund may be made * * *. However, no claim shall be made for such loss due to any one accident or export of less than one hundred (100) gallons. Provided, however, that showing must be made that said tax was paid, and the comptroller shall deduct from such refund made under the provisions of this act, the 1 per cent allowed above.

* * * * * * *

ART. 7065a-13. *Exemptions and refunds; license to handle exempt fuel; payments into highway motor fuel tax fund*—

(a) Any person who purchases motor fuel in the State of Texas, and any distributor who appropriates motor fuel for use when such motor fuel purchased

by such person or used by such distributor for operating or propelling any stationary gas engine or tractor used for agricultural purposes, motor boats, aircraft, or for any purpose other than use in a motor vehicle operated or intended to be operated in whole or in part upon any of the public highways, roads, or streets of the State of Texas on which motor fuel tax has been paid, either directly or indirectly, shall be refunded the amount of such taxes so paid by the distributor, exclusive of the deduction for evaporation and loss * * *. The tax actually paid by any distributor or person shall be refunded as provided herein on motor fuel not subject to 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 states that in general taxes are deductible only by persons upon whom they are imposed.

It is clear from the State law that the distributor is the one to whom the State looks for actual payment of the motor fuel tax, but the tax is not imposed upon the distributor inasmuch as, under article 7065a-13(a), it is provided that a refund of the tax shall be made to the consumer who uses the motor fuel for purposes other than in motor vehicles on the public highways. The provisions for refund thus indicate the legislative intent that the tax is to be paid by the users of the motor fuel.

Accordingly, it is held that the tax on motor fuel levied by the State of Texas under chapter 44 of the laws of 1933, as amended through the calendar year 1939, is deductible as a tax in the Federal income tax return of the consumer who pays it and to whom it is not refunded. However, the amount of the tax may not be deducted separately as a tax if it is added to or made a part of the business expenses of the consumer or is otherwise used to reduce his net income.

SECTION 19.23(c)-1: Taxes. 1940-28-10325
(Also Section 42, Section 19.42-1.) I. T. 3390

INTERNAL REVENUE CODE AND REVENUE ACT OF 1938.

I. T. 3278 (C. B. 1939-1 (Part 1), 76), relating to amounts contributed by an employer to the New York unemployment insurance fund, is modified, with respect to the treatment as taxable income to the employer of the amount of credit or refund of such contributions, to accord with the views expressed in G. C. M. 22163. (See page 76, this Bulletin.) Since I. T. 3278 modified Mimeograph 4564 (C. B. 1937-1, 93), and Mimeograph 3958 (C. B. XI-2, 33 (1932)) as modified by Mimeograph 4564, this ruling has the effect of reinstating those mimeographs.

SECTION 19.23(c)-1: Taxes. 1940-29-10329
I. T. 3392

INTERNAL REVENUE CODE.

The tax imposed by section 2 of Act No. 142, Public Acts of Michigan, 1913, as amended, upon certain classes of intangible personal property, which property becomes exempt from further taxation, is deductible for Federal income tax purposes under section 23(c) of the Internal Revenue Code.

Advice is requested whether the specific tax of $5 per thousand face value imposed by section 2 of Act No. 142, Public Acts of Michigan,

1913, as amended, upon certain classes of intangible personal property is deductible for Federal income tax purposes.

Act No. 142, supra, is entitled "An act to provide for the assessment and the collection of a specific tax upon secured debts other than debts secured or evidenced by mortgages and liens upon real property, and which mortgages and liens are recorded in Michigan * * *." Section 4 of that act provides that secured debts upon which the specific tax has been paid shall be exempt from further general taxes under the laws of the State of Michigan. Act No. 142 was repealed by Act No. 301, Public and Local Acts of Michigan, 1939, imposing a tax on intangible personal property for the calendar year 1940 and each year thereafter. Section 3(b)2 of Act No. 301 provides for the exemption of certain intangible property on which the specific tax was paid, prior to the effective date of that act, under the provisions of Act No. 142, as amended. The tax here in question was paid in 1939 under the provisions of Act No. 142, and prior to the effective date of Act No. 301.

A tax is an enforced contribution, exacted pursuant to legislative authority in the exercise of taxing power and imposed and collected for the purpose of raising revenue to be used for public or governmental purposes. In the instant case, Act No. 142, supra, imposing the specific tax provides that one-half of the specific tax collected shall be credited to the general fund of the county and that the other one-half shall be credited to the general fund of the State for general State purposes. It is apparent that the specific tax imposed by Act No. 142 was for the purpose of raising revenue.

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, therefore, that the specific tax imposed by Act No. 142 of the Public Acts of Michigan, 1913, is an allowable deduction for Federal income tax purposes as a tax in the return of the owner of the intangible personal property upon whom the tax is imposed and who paid the tax prior to the effective date of Act No. 301 of the Public and Local Acts of Michigan, 1939. The amount may not, however, be deducted separately as a tax if it is included as a part of the business expense of the taxpayer or otherwise used to reduce his net income.

SECTION 19.23(c)-1: Taxes. 1940-31-10354
I. T. 3397

INTERNAL REVENUE CODE.

The taxes on alcoholic beverages imposed under the General Laws of Rhode Island, 1938, chapter 167, are deductible for Federal income tax purposes only by the manufacturers and importers upon whom such taxes are imposed.

Advice is requested as to the deductibility for Federal income tax purposes of the taxes imposed upon alcoholic beverages by the State of Rhode Island.

The law under which the taxes are imposed is contained in chapter 167 of the General Laws of Rhode Island for 1938. The pertinent provisions of law are contained in sections 1, 2, 3, 7, 9, 10, and 11 of that chapter.

An examination of the provisions of the law of the State of Rhode Island referred to above discloses that the legislature clearly intended to impose the taxes on the manufacturers and importers of alcoholic beverages in that 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.

For Federal income tax purposes, the taxes imposed on alcoholic beverages by the State of Rhode Island are deductible only in the return of the manufacturer or importer of the alcoholic beverages. The amount may not be deducted separately as a tax if it is included as a part of the business expenses of the taxpayer or is otherwise used to reduce his net income. If the one upon whom the tax is imposed passes it on to and collects the amount thereof from the retail dealer, such amount must be included in gross income. If the tax is passed on to the retail dealer, the amount is not deductible by him as a tax but forms a part of the cost of goods purchased. If the tax is passed on to the consumer, the amount thereof is merely additional cost of the article purchased.

SECTION 19.23(c)–1: Taxes. 1940–41–10447
I. T. 3414

INTERNAL REVENUE CODE.

Real property taxes levied by the city of Pittsburgh, and by Allegheny County, Pa., accrue for Federal income tax purposes on January 1 of the calendar year for which such taxes are imposed.

Advice is requested as to the accrual date for Federal income tax purposes of real property taxes levied by the city of Pittsburgh and by the county of Allegheny in the State of Pennsylvania.

Under the Pennsylvania statutes, there is no uniformly fixed date for the assessment of property. Pittsburgh is a city of the second class and Allegheny County is a county of the second class. In cities of the second class, property is subject to dual assessment—one assessment for county purposes and one for city and school purposes. Excerpts from Purdon's Pennsylvania Statutes, Annotated, Titles 53 and 72, containing provisions of law pertinent to the questions involved read as follows:

Title 53.

SEC. 10031. *Annual levy; reports of departments; determination of rates.*

Taxes and water-rents, or rates, in cities of the second class shall be levied and assessed annually * * * by general ordinances prior to the 1st day of December of each year, which shall fix and determine the same for the ensuing fiscal year commencing January 1st. * * * (1911, May 12, P. L. 295, section 1; 1915, June 15, P. L. 976, section 1.)

* * * * * * *

SEC. 10211. *Time of beginning and ending.*

Hereafter the fiscal year in cities of the second class shall begin on the 1st day of January, and end on the 31st day of December, of each and every year.

Title 72.

SEC. 5020-401. *Issuing of precepts and return of assessments in triennial years.*

(a) * * *

(b) In counties of the second class, the precepts to make triennial assessments shall be issued to the appointed assessors by the board for the assessment and revision of taxes at such time as the board may prescribe, and return thereof to be made on or before the first Monday of November as provided by existing law relating to the board for the assessment and revision of taxes in said counties * * *.

* * * * * * *

SEC. 5020-431. *Issuing of precepts and return of assessments in intertriennial years.*

(a) In counties of the second class, the precepts to make assessments in the years between triennial assessments shall be issued to the appointed assessors by the board for the assessment and revision of taxes at such time as the board may prescribe, and return thereof made on or before the first Monday of November as provided by existing law relating to the board for the assessment and revision of taxes in said counties.

From the foregoing provisions of law, it appears that the actual making of the assessments in Pittsburgh and in Allegheny County may be extended over the greater part of the year. While there is no statutory provision specifying the date as of which Pittsburgh or Allegheny County real property taxes accrue or are assessed, or specifically providing for personal liability for such taxes, the courts of the State have held that the owner of the property is personally liable for such taxes and that liability for the tax attaches to the person owning the property at the time the "assessment is levied and the tax is due." Whether that assessment is at the beginning or the middle of the year, the person charged at the time the taxes are assessed is liable for the whole tax. (*Theobald* v. *Sylvester*, 27 Pa. Super. Ct., 362.)

In *Pennsylvania Company for Insurances on Lives and Granting Annuities* v. *Bergson* (159 Atl., 32) the Superior Court of Pennsylvania said:

* * * It is clear from the principles in these cases and the legislative declarations that the owner of land is and should be personally liable for taxes assessed while he is the owner of the property. * * *

The tax year in Pittsburgh and in Allegheny County, Pa., is the calendar year. Inasmuch as it appears that the actual owner of the property at the time the "assessment is levied and the tax is due" is liable for the taxes covering the entire calendar year regardless of change of ownership, and that liability reverts back to the beginning of such year, it is held that real property taxes in Pittsburgh and in Allegheny County, Pa., accrue for Federal income tax purposes on January 1 of the calendar year for which such taxes are imposed.

SECTION 19.23(c)-1: Taxes.

INTERNAL REVENUE CODE.

Cuban taxes imposed upon sales, exchanges or assignments, and gross receipts. (See I. T. 3429, page 136.)

SECTION 19.23(c)–1: Taxes. 1940–50–10516
I. T. 3432

INTERNAL REVENUE CODE.

The gasoline tax imposed by the State of Alabama is deductible as a tax for Federal income tax purposes by the distributor, refiner, retail dealer, or storer of the gasoline, and the tax on lubricating oil is deductible by the distributor, manufacturer, retail dealer, or storer thereof. If, however, the taxes are added to or made a part of the business expenses of such persons, they are not deductible by them separately as taxes.

Advice is requested relative to the deductibility for Federal income tax purposes of the gasoline tax and the tax on lubricating oil imposed by the General Acts of Alabama for 1935.

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. Whether a gasoline tax or a tax on lubricating oil levied by a State may be deducted by an individual purchaser depends upon the terms of the State law imposing the tax.

The provisions of Alabama law imposing the tax on gasoline are contained in Article XIII, chapter 4, of the General Acts of Alabama for 1935, approved July 10, 1935, and effective August 1, 1935. The tax on lubricating oil is imposed under Article XIII, chapter 1, of that act. The tax on gasoline is imposed upon every distributor, refiner, retail dealer, or storer of gasoline, and the tax on lubricating oil is imposed upon every distributor, manufacturer, retail dealer, or storer of such oil. There is nothing in the statute, either by provision for a refund or otherwise, to indicate an intention or purpose to impose the taxes upon the consumer of the gasoline or lubricating oil.

It is held, therefore, that the gasoline tax imposed by the State of Alabama is deductible as a tax under section 23(c) of the Internal Revenue Code by the distributor, refiner, retail dealer, or storer of the gasoline, and the tax on lubricating oil is deductible by the distributor, manufacturer, retail dealer, or storer thereof. If, however, the taxes are added to or made a part of the business expenses of such persons, they are not deductible by them separately as taxes.

The conclusion relative to the deductibility of the gasoline tax is in accord with the conclusion reached in G. C. M 7527 (C. B. IX–1, 99 (1930)), relating to the gasoline tax imposed by the State of Alabama under the act approved February 10, 1923, as amended. The pertinent provisions of the 1935 act are not materially different from those of the earlier act.

SECTION 19.23(c)–1: Taxes.

INTERNAL REVENUE CODE.

Taxes imposed by the mineral fuel law of Cuba. (See I. T. 3433, page 137.)

SECTION 19.23(c)-1: Taxes. 1940-52-10530
I. T. 3435

INTERNAL REVENUE CODE.

Real estate taxes in Montgomery County, Md., accrue for Federal income tax purposes on January 1 of the calendar year for which they are levied.

Advice is requested as to the date of accrual of real estate taxes in Montgomery County, Md., for Federal income tax purposes.

Section 11 of article 81, volume 2, Annotated Code of Maryland (1939), reads as follows:

Except as hereinafter provided, all property directed in this article to be assessed, shall be assessed at the full cash value thereof on the date of finality. * * *

Section 1(20) of article 81 defines the phrase "date of finality" as the "date as of which taxes are to be levied for the taxable year in question and upon which assessments become final for such year * * *." Section 26 of article 81 reads in part as follows:

(a) All ordinary State taxes shall be levied for the calendar year.
(b) Except taxes required to be levied upon assessments made by the State tax commission, all ordinary county and city taxes shall be levied for the same period as now prescribed by local law, and all ordinary State, county and city taxes shall be levied as of the same date of finality as now prescribed by local law; provided * * * (5) that in any county or city in which the date of finality is not now specifically prescribed by statute, all State, county and city taxes shall be levied as of the 1st day of January of each year as the date of finality.

Since a date of finality is not specifically prescribed by statute for taxes on real estate in Montgomery County, they are generally assessed as of January 1.

The Bureau has held that ownership of property on the date as of which assessment is made is the event which determines the liability for taxes, and if the taxpayer's books are kept on the acrual basis, he should accrue property taxes as of that date. (See G. C. M. 15305, C. B. XIV-2, 80 (1935), and decisions cited therein.) That position is in accord with the principle laid down by the United States Supreme Court in *United States* v. *Anderson* (269 U. S., 422, T. D. 3839, C. B. V-1, 179 (1926)), wherein it was stated that in advance of the assessment of a tax all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it. It is held, therefore, that taxes on real property in Montgomery County, Md., should, generally, be accrued for Federal income tax purposes as of January 1 by taxpayers whose books are kept on the accrual basis.

SECTION 19.23(c)-1: Taxes.

INTERNAL REVENUE CODE.

Refunds or credits for State taxes previously deducted without tax benefit. (See I. T. 3438, page 446.)

SECTION 19.23(c)-3: Taxes for local benefits. 1940-45-10476
I. T. 3423

INTERNAL REVENUE CODE.

"Front foot benefit charges" assessed against property in Montgomery County, Md., by the Washington Suburban Sanitary Commission for water main and sewer improvements are "taxes assessed against local benefits of a kind tending to increase the value of the property assessed" within the meaning of section 23(c)4 of the Internal Revenue Code. Such charges are not deductible for Federal income tax purposes except to the extent that they are properly allocable to maintenance or interest charges.

Advice is requested whether "front foot benefit charges" assessed against property in Montgomery County, Md., by the Washington Suburban Sanitary Commission for water main and sewer improvements are deductible for Federal income tax purposes.

In the Code of Public Local Laws of Maryland, 1930, volume 2, article 16, provision is made for the incorporation of the Washington Suburban Sanitary District, consisting of certain parts of Montgomery and Prince Georges Counties, Md., adjacent to Washington, D. C. The sanitary district is under the jurisdiction of the Washington Suburban Sanitary Commission, which has charge of the construction and acquisition of water mains and sewers in those parts of the counties, and is authorized to assess "front foot benefit charges" against abutting property which is benefited. The amount assessed is added to the taxpayer's bill for State, county, and other taxes and is designated "Sanitary commission front foot benefit charge."

Section 23 of the Internal Revenue Code provides in part that in computing net income there shall be allowed as deductions:

(c) TAXES GENERALLY.—Taxes paid or accrued within the taxable year, except—

* * * * * * *

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

It is held that the "front foot benefit charges" assessed against a taxpayer's property in Montgomery County, Md., by the Washington Suburban Sanitary Commission for water mains and sewer improvements, which charges are assessed against only the property abutting upon the water mains and sewers, are "taxes assessed against local benefits of a kind tending to increase the value of the property assessed" within the meaning of the above-quoted provisions of section 23(c)4 of the Internal Revenue Code. They are, therefore, not deductible for Federal income tax purposes except to the extent that they are properly allocable to maintenance or interest charges.

SECTION 23(k).—DEDUCTIONS FROM GROSS INCOME: BAD DEBTS.

SECTION 19.23(k)-1: Bad debts. 1940-28-10317
T. D. 4978

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

Amending section 19.23(k)-1 of Regulations 103, article 23(k)-1 of Regulations 101 and 94, and article 23(k)-1 of Regulations 86, and article 191 of Regulations 77, both as amended by Treasury Decision 4633 [C. B. XV-1, 118 (1936)], relating to the deduction of bad debts by banks or other corporations which are subject to supervision by Federal authorities, or by State authorities maintaining substantially equivalent standards.

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

To Collectors of Internal Revenue and Others Concerned:

Paragraph (*c*) of section 19.23(k)-1 of Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.], paragraph (*c*) of article 23(k)-1 of Regulations 101 [section 9.23(k)-1, Title 26, Code of Federal Regulations, 1939 Sup.], the last paragraph of article 23(k)-1 of Regulations 94 [section 3.23(k)-1, Title 26, Code of Federal Regulations], and the last paragraph of article 23(k)-1 of Regulations 86 and of article 191 of Regulations 77, both as amended by Treasury Decision 4633, approved April 3, 1936 [C. B. XV-1, 118 (1936)], are each amended to read as follows [the paragraph designation of (*c*) not being included in the amendment of Regulations 94, 86, and 77]:

(*c*) Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders of such supervisory officers charge off debts in whole or in part, such debts shall be conclusively presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be, but in order that any amount of the charge-off may be allowed as a deduction for any taxable year it must be shown that the charge-off took place within such taxable year. But no such debt shall be so conclusively presumed to be worthless or recoverable only in part, as the case may be, if the amount so charged off is not claimed as a deduction for the taxable year in which such charge-off takes place. If a taxpayer does not claim a deduction in its return for such a totally or partially worthless debt for the year in which such charge-off takes place, but claims such a deduction for a later year, then such charge-off in the prior year will be deemed to have been involuntary and the deduction shall be allowed for the year for which claimed, if the taxpayer produces sufficient evidence to show (1) that the amount claimed in such later year was ascertained to be worthless or recoverable only in part, as the case may be, in such year, and (2) that, to the extent that the deduction claimed in the later year was not involuntarily charged off in prior years, it was charged off in the later year.

(This Treasury decision is issued under the authority contained in sections 23(k) and 62 of the Internal Revenue Code (53 Stat., 13, 32), and sections 23(k) and 62 of the Revenue Acts of 1938, 1936, 1934,

and 1932 (52 Stat., 460, 480, 26 U. S. C., Sup., 23(k), 62; 49 Stat., 1658, 1673, 26 U. S. C., Sup., 23(k), 62; 48 Stat., 688, 700, 26 U. S. C., 23(k), 62; and 47 Stat., 179, 191).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved June 27, 1940.

HERBERT E. GASTON,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register June 28, 1940, 4:10 p. m.)

SECTION 19.23(k)-1: Bad debts. 1940-28-10324
G. C. M. 22163

INTERNAL REVENUE CODE, REVENUE ACT OF 1938, AND PRIOR REVENUE ACTS.

An amount recovered upon a debt previously charged off and allowed as a deduction for Federal income tax purposes constitutes taxable income for the year of recovery regardless of whether the prior allowance of the deduction resulted in a tax benefit to the taxpayer.

G. C. M. 18525 (C. B. 1937-1, 80) modified; G. C. M. 20854 (C. B. 1939-1 (Part 1), 102) revoked; and S. R. 2940 (C. B. IV-1, 129 (1925)) modified. Recommended that I. T. 3172 (C. B. 1938-1, 150) and I. T. 3256 (C. B. 1939-1 (Part 1), 172) be revoked; that I. T. 3278 (C. B. 1939-1 (Part 1), 76) be modified; and that the acquiescence in *Central Loan & Investment Co.* v. *Commissioner* (39 B. T. A., 981, acquiescence, C. B. 1939-2, 6) and the acquiescence in *The National Bank of Commerce of Seattle* v. *Commissioner* (40 B. T. A., 72, acquiescence, C. B. 1939-2, 26) be withdrawn.

Reconsideration has been given to G. C. M. 18525 (C. B. 1937-1, 80) and G. C. M. 20854 (C. B. 1939-1 (Part 1), 102), both relating to bad debts, with particular attention to the question of the proper treatment for Federal income tax purposes of recoveries of debts charged off and claimed as deductions in prior years.

The last paragraph of G. C. M. 18525, supra, reads as follows:

The deductions for bad debts contemplated by the clause "allowed as a deduction for income tax purposes" (as used in (*f*), (*g*), (*h*), and (*i*) above) refer to deductions for bad debts which accomplished a reduction in tax liability and do not refer to deductions for bad debts in cases in which the taxpayer, on account of other allowable deductions, had no net income irrespective of the deduction for bad debts.

G. C. M. 18525, supra, was published to illustrate the application of the provisions of article 191 of Regulations 77 and article 23(k)-1 of Regulations 86, both as amended by Treasury Decision 4633 (C. B. XV-1, 118 (1936)), and the provisions of the last paragraph of article 23(k)-1 of Regulations 94, which read as follows:

Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders of such supervisory officers charge off debts in whole or in part, such debts shall be conclusively presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be, but in order that any amount of the charge-off may be allowed as a deduction for any taxable year it must be shown that the charge-off took place within such taxable year.

The last paragraph of G. C. M. 18525, supra, in effect provides that there shall be no adjustment of the basis of a debt as the result of the

prior deduction of such debt in whole or in part unless such prior deduction accomplished a reduction in tax liability. The primary purpose of the incorporation of that paragraph in G. C. M. 18525 was to set forth the rule that amounts recovered upon debts deducted in prior years do not constitute taxable income unless such deduction resulted in a reduction in tax liability. Thereafter, in I. T. 3172 (C. B. 1938–1, 150) there was set forth the method for determining the extent of the benefit derived by the deduction of bad debts. That ruling was later modified by I. T. 3256 (C. B. 1939–1 (Part 1), 172), in accordance with the recommendation contained in G. C. M. 20854, supra, which is discussed in the next paragraph of this memorandum.

G. C. M. 18525, supra, involved only bad debt deductions by banks or other corporations subject to supervision of Federal or State authorities as a result of the conclusive presumption of partial or total worthlessness established by orders of Federal or State supervisory officers. However, in G. C. M. 20854, supra, it was held that the principle stated in G. C. M. 18525, that recoveries of debts previously deducted do not constitute taxable income unless the deduction of the debts in prior years resulted in a reduction in tax liability, is equally applicable in cases of recoveries of debts voluntarily deducted by banks or other corporations subject to Federal or State supervision and to recoveries of debts deducted by other taxpayers. It was held that in any case in which a bad debt has been allowed as a deduction and has had the effect of offsetting taxable income, the taxpayer has, to that extent, in effect had the benefit of a recovery of capital for income tax purposes, but that amounts received in recovery of the debt should not be treated as taxable income until the taxpayer has fully recovered the capital represented by the debt either by such means or partly by such means and partly by repayment by the debtor.

In I. T. 3278 (C. B. 1939–1 (Part 1), 76) the principle of G. C. M. 20854, supra, was extended to amounts of State taxes refunded or credited, and it was held that the amount refunded or credited should be treated as taxable income only if and to the extent that it is in excess of the portion of the prior deduction which did not have the effect of offsetting taxable income. That ruling (I. T. 3278) modified Mimeograph 3958 (C. B. XI–2, 33 (1932)) and Mimeograph 4564 (C. B. 1937–1, 93), relating to the taxable status of refunds of customs duties and taxes.

In *Central Loan & Investment Co.* v. *Commissioner* (39 B. T. A., 981, acquiescence, C. B. 1939–2, 6), the Board of Tax Appeals applied the rule stated in I. T. 3278, supra, in reference to taxes, citing in its opinion G. C. M. 18525, supra, and G. C. M. 20854, supra. In *The National Bank of Commerce of Seattle* v. *Commissioner* (40 B. T. A., 72, acquiescence, C. B. 1939–2, 26, on recovery of bad debt issue), the Board applied the said rule to bad debts, again citing the above-mentioned General Counsel's memoranda. In neither of these Board of Tax Appeals decisions did the Board refer to its prior decision in *Lake View Trust & Savings Bank* v. *Commissioner* (27 B. T. A., 290), in which it was held that amounts received in recovery of debts allowed as deductions in prior years constitute taxable income irrespective of whether such prior deductions had the effect of reducing the taxpayer's taxable income.

Section 19.42–1 of Regulations 103, relating to the Internal Revenue Code, provides in part as follows:

* * * Bad debts or accounts charged off subsequent to March 1, 1913, because of the fact that they were determined to be worthless, which are subsequently recovered, whether or not by suit, constitute income for the year in which recovered, regardless of the date when the amounts were charged off. * * *

This regulation has been in effect in all of the income tax regulations of the Treasury Department to the present time.

Section 19.23(k)–1 of Regulations 103 provides in part as follows:

* * * Any amount subsequently received on account of a bad debt or on account of a part of such debt previously charged off and allowed as a deduction for income tax purposes, must be included in gross income for the taxable year in which received. * * *

This regulation has been in effect in all of the income tax regulations of the Treasury Department from article 151 of Regulations 62 to the present time.

Prior to the issuance of G. C. M. 18525, supra, the Bureau had consistently held that any amount subsequently recovered on account of a debt previously charged off and allowed as a deduction for income tax purposes must be included in gross income for the taxable year in which received, regardless of whether the prior allowance of the deduction resulted in a benefit to the taxpayer. As pointed out heretofore, in the case of Lake View Trust & Savings Bank, supra, decided prior to G. C. M. 18525, the Board of Tax Appeals sustained the Bureau practice.

Upon reconsideration, it is now the opinion of this office that the rule sustained in the case of Lake View Trust & Savings Bank, supra, is the correct rule to be followed. This conclusion is in accord with the decision of the Supreme Court of the United States in *Burnet* v. *Sanford & Brooks Co.* (282 U. S., 359, Ct. D. 277, C. B. X–1, 363 (1931)). The taxpayer in *Burnet* v. *Sanford & Brooks Co.* had entered into a dredging contract with the United States and, after having performed for three years at a large loss, abandoned operations and sued the Government for breach of warranty as to the character of the material to be dredged. Judgment was recovered for $192,577.59, of which $176,271.88 was the amount by which its expenses of operation under the contract exceeded receipts from it, and the balance, $16,305.71, represented accrued interest. During the years of operation the taxpayer had returned as gross income the receipts under the contract and had deducted its expenses paid in performing the contract. For all but one of such years the returns showed net losses. The taxpayer failed to return the amount of the judgment as income in the year of receipt, and the Commissioner, therefore, assessed a deficiency. In upholding the action of the Commissioner, the Supreme Court said in part:

All the Revenue Acts which have been enacted since the adoption of the sixteenth amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt. * * *

That the recovery made by respondent in 1920 was gross income for that year within the meaning of these sections can not, we think, be doubted. The money received was derived from a contract entered into in the course of respondent's

business operations for profit. While it equaled, and in a loose sense was a return of, expenditures made in performing the contract, *still*, as the Board of Tax Appeals found, *the expenditures were made in defraying the expenses incurred in the prosecution of the work under the contract, for the purpose of earning profits. They were not capital investments*, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income. * * * [Italics supplied.]

Under the principle of the Supreme Court's decision in the Sanford & Brooks Co. case, supra, items of expense incurred in carrying on a trade or business do not represent capital investment, the cost of which, if converted, must first be restored before there is a capital gain taxable as income. Bad debts charged off in any business are deductible under a specific provision of the Revenue Acts rather than as ordinary and necessary business expenses. They are, nevertheless, under well-established accounting practices, recognized as operating expenses of the business deductible as such in arriving at the net operating gain or loss for the periods involved. See Finney, Principles of Accounting, 1934 Edition, Volume I, page 37, and Kester, Principles of Accounting, Fourth Edition, pages 46, 116, and 554. Consequently, the amount represented by debts which become worthless and are charged off in the carrying on of a trade or business is not to be considered as an investment of capital which must first be returned in full before taxable income is derived. Under this principle, amounts recovered in any taxable year upon debts previously charged off and allowed as a deduction should be treated as taxable income regardless of whether the prior allowance of the deduction resulted in a tax benefit to the taxpayer.

It is the opinion of this office, furthermore, that in the case of a bad debt owing to a taxpayer which has not arisen in connection with the carrying on of a trade or business, the recovery of such a debt where it has been charged off and deducted in a prior year constitutes taxable income irrespective of whether the prior allowance of the deduction resulted in a tax benefit. In *United States* v. *Ludey* (274 U. S., 295, T. D. 4046, C. B. VI–2, 157 (1927)) it was held that in ascertaining the basis for computing gain or loss in the case of the sale of depreciable or depletable assets, the original basis thereof must be reduced by the amount of depreciation and depletion allowable as deductions in the years during which the property was held regardless of whether deductions had been claimed. It is to be observed that the Revenue Act involved in that case did not contain a specific provision requiring such a reduction of basis. It is believed that this case stands for the proposition that, under the broad purposes of the Revenue Acts, a taxpayer is to be charged with having recovered his capital to the extent that the statute permits deductions from gross income on account thereof, regardless of whether the taxpayer took advantage of the deduction privilege provided in the Revenue Acts. See also *Hardwick Realty Co., Inc.*, v. *Commissioner* (29 F. (2d), 498, certiorari dismissed on motion, 279 U. S., 876), in which it was held that depreciation must be deducted in ascertaining the adjusted basis of depreciable property even though deductions for depreciation in the years sustained conferred no tax benefit.

The case of *United States* v. *Ludey*, supra, would seem to indicate that amounts recovered upon a debt, whether or not incurred in business, constitute taxable income if in any prior year such debt con-

stituted an allowable deduction under the applicable Revenue Act, even though such deduction was not claimed and allowed. See S. R. 2940 (C. B. IV–1, 129 (1925)), modified in G. C. M. 20854, supra, in which it was held that under article 52 of Regulations 45, article 51 of Regulations 62, and article 50 of Regulations 65, the amount of a debt written off and *allowable* as a deduction should be treated as income for the year in which actually recovered. However, in view of the fact that all of the regulations beginning with article 151 of Regulations 62, promulgated under the Revenue Act of 1921, have contained the provision that any amount subsequently received on account of a bad debt or on account of a part of such debt "previously charged off, *and allowed as a deduction for income tax purposes*" [italics supplied] must be included in gross income for the taxable year in which received, taxpayers will not be required to return as income any amounts received in recovery of debts except to the extent that such debts have been previously claimed and allowed as deductions. As indicated above, however, if a debt was allowed as a deduction in whole or in part in a prior year, amounts recovered upon such debt constitute taxable income in the year of the recovery to the extent previously allowed as a deduction, *irrespective of whether the allowance of the deduction resulted in a tax benefit to the taxpayer.*

The foregoing is consistent with the manner in which the Bureau computes the gain or deductible expense to a corporation upon the retirement of its bonds. Section 19.22(a)–18 of Regulations 103 provides that if bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. It further provides that if the corporation purchases any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted is a deductible expense for the taxable year. It is provided, however, that if the corporation purchases any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the issuing price, plus any amount of discount already deducted, over the purchase price is gain or income for the taxable year. In computing the income or deductible expense under the regulations, the Bureau has adopted the view that it is immaterial whether the deductions on account of bond discount resulted in a tax benefit to the taxpayer.

In view of the foregoing, G. C. M. 18525, supra, is modified by eliminating the last paragraph thereof; G. C. M. 20854, supra, is revoked; and S. R. 2940, supra, is modified to accord with the views expressed herein. It is recommended that I. T. 3172, supra, and I. T. 3256, supra, be revoked; that I. T. 3278, supra, be modified; and that the acquiescence in *Central Loan & Investment Co.* v. *Commissioner*, supra, and the acquiescence in *The National Bank of Commerce of Seattle* v. *Commissioner*, supra, be withdrawn.

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

SECTION 19.23(k)-1: Bad debts. 1940-38-10421
G. C. M. 22204

INTERNAL REVENUE CODE.

Contributions were made to the M Corporation for financing the national convention of the N Organization. After the expenses of the convention and certain other obligations were met, the excess, if any, was to be refunded to the contributors, each to receive such proportion of the excess as his contribution bore to the total contributions, subject to certain limitations. The expenses of the convention exceeded the proceeds and the contributors received no refunds whatever. *Held*, the unrefunded contributions are not deductible as bad debts.

An opinion is requested whether amounts contributed to the M Corporation, which were to be refunded under certain conditions, constitute allowable deductions as bad debts upon failure of the contributor to receive a refund.

N is a Nation-wide organization which held its annual convention in the city of R in 1939. The M Corporation was formed to make arrangements for the financial obligations of the convention. In order to defray the operating expenses of the convention, requests were made for contributions to the M Corporation to be used for such purposes. At the time of contribution each contributor received a certificate entitled "Contributing Membership Certificate" which provided in part as follows:

THIS IS TO CERTIFY that _____ has contributed the sum of _____ dollars to the M Corporation to be used by it to assist in defraying the expenses in connection with the N Convention in the city of R on June _____, 1939, and grateful acknowledgment is hereby made of such contribution.

The board of directors of the M Corporation is vested with the sole power to determine the nature and extent of its expenses and its operations, the expenses of and incidental to the convention, and its decision shall be final. If, after such expenses and obligations have been fully paid or liquidated and a sum set aside to dissolve this corporation, there remains any excess, the M Corporation will refund to the holder of this certificate whose name appears thereon, upon surrender of this certificate, such proportion of the excess as the face amount of this certificate bears to the face amount of all like certificates; said refund not to exceed the amount of the contribution shown thereon.

This certificate is not negotiable and can not be assigned, and the refund, if any, payable hereunder, shall inure only to the holder whose name is set forth hereon.

The expenses of the convention were in excess of the receipts and the contributors to the corporation were not reimbursed in any amount. A number of contributors claimed the contributions as bad debts.

In *J. S. Cullinan* v. *Commissioner* (19 B. T. A., 930), the taxpayer made a contribution to a political campaign committee, and at or about the same time advanced funds to meet obligations of the campaign. It was understood and agreed that the taxpayer was to be reimbursed for this advance out of collections which the campaign committee expected to make from certain individuals whom the committee had listed as prospective contributors. The taxpayer received only a small amount in reimbursement. The Board held that the remainder did not constitute such a debt as the statute contemplates may be deducted. The Board stated in part:

* * * The word debts as used in the statute is to be taken in its usual and accepted meaning. A debt, according to Webster, is that which is due from one person to another whether money, goods or services; that which one person is bound to pay to another or to perform for his benefit; that of which payment is liable to be exacted; due, obligation, liability. Words and Phrases, First Series, volume 2, 1864, and cases there cited. A debt is defined to be in its general sense a specific sum of money, which is due or owing from one person to another, and denotes not only the obligation of the debtor to pay, but the right of the creditor to receive and enforce payment. (*Campbell* v. *City of Indianapolis*, 57 N. E., 920; 155 Ind., 187.)

Before a deduction can be allowed on account of a worthless debt it is essential that the existence of a valid debt be established. (*Missouri Valley Bridge & Iron Co.*, 14 B. T. A., 1162.) In the case of *Federal Fuel Co.* (3 B. T. A., 814), we said:

"If the debtor was not legally liable to the taxpayer, then there was no debt to become worthless. It can not become worthless because of inability to establish legally the liability for the debt, for in such a case there is not an ascertainment of worthlessness of an existing debt, but an ascertainment of the nonexistence of such a debt."

* * * The debts which the statute permits to be charged off when ascertained to be worthless are debts where there is an obligation of the debtor to pay and a right of the creditor to receive and enforce payment.

(See also section 19.23(k)-1(*d*) of Regulations 103, which provides that "the term 'debts' * * * means obligations to pay fixed or determinable sums of money * * *.")

In the instant case the M Corporation assumed no obligation to repay any of the contributions unless funds were available after payment of expenses and after the setting aside of a sum sufficient to dissolve the corporation. It does not appear that the contributors intended to make a loan to the corporation but to make a contribution of any amount which it should eventually be determined would not be refunded.

In view of the foregoing, it is the opinion of this office that the contributions described herein are not deductible as bad debts.

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

SECTION 19.23(k)-1: Bad debts. 1940-53-10542
(Also Section 23(c), Section 19.23(c)-1; I. T. 3438
Section 42, Section 19.42-1.)

INTERNAL REVENUE CODE AND REVENUE ACTS OF 1936 AND 1938.

Limited retroactive application of G. C. M. 22163 (page 76, this Bulletin), relating to the inclusion in gross income of recoveries upon debts previously charged off and allowed as a deduction for Federal income tax purposes where there was no tax benefit, and of I. T. 3390 (page 68, this Bulletin), relating to the inclusion in gross income of refunds or credits for State taxes previously deducted for Federal income tax purposes where there was no tax benefit.

Advice is requested relative to the retroactive application of G. C. M. 22163 (page 76, this Bulletin), promulgated July 8, 1940, in which it was held that an amount recovered upon a debt previously charged off and allowed as a deduction for Federal income tax purposes constitutes taxable income for the year of recovery even though the prior allowance of the deduction did not result in a tax benefit.

In the inquiry presented, reference is made to G. C. M. 18525 (C. B. 1937-1, 80), promulgated June 28, 1937, in which it was held that in the case of banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards), amounts received in recovery of debts deducted for a prior year as the result of charge-offs at the direction of Federal or State supervisory officers do not constitute taxable income unless such prior deduction accomplished a reduction in tax liability. It is pointed out that, in reliance upon the provisions of that ruling, many banks took deductions for bad debts in their income tax returns in accordance with the charge-offs made at the direction of bank examiners, even though the deductions did not result in tax benefits due to the fact that the banks had net losses without the benefit of such deductions. Under such circumstances, it is contended that the retroactive reversal of the ruling contained in G. C. M. 18525, supra, is inequitable, and the request is made that the ruling contained in G. C. M. 22163, supra, be not applied to recoveries on debts deducted during the time that G. C. M. 18525 was in effect, that is, from June 28, 1937, to July 8, 1940.

It is the opinion of the Bureau that amounts received in recovery of debts previously deducted should not be treated as taxable income where the deduction did not result in a tax benefit if the deduction was taken in an income tax return filed during the period when a published ruling of the Bureau was outstanding to the effect that amounts received in recovery of debts previously deducted do not constitute taxable income unless the prior deduction resulted in a tax benefit.

Accordingly, pursuant to authority contained in section 3791(b) of the Internal Revenue Code, the ruling in G. C. M. 22163, supra, will not be applied to recoveries upon debts charged off and deducted by banks or other corporations subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards), where such charge-offs were at the direction of Federal or State supervisory officers, if the deduction did not result in a reduction of Federal income tax liability, provided the deduction was taken in an income tax return filed during the period June 28, 1937, to July 8, 1940, during which period G. C. M. 18525, supra, remained unmodified.

Likewise, pursuant to authority contained in section 3791(b) of the Internal Revenue Code, the ruling in G. C. M. 22163, supra, will not be applied to recoveries upon debts voluntarily charged off and deducted by banks or other corporations subject to Federal or State supervision or by other taxpayers, if the deduction did not result in a reduction of Federal income tax liability, provided the deduction was taken in an income tax return filed during the period that G. C. M. 20854 (C. B. 1939-1 (Part 1), 102) was in effect, that is, February 27, 1939, to July 8, 1940. (G. C. M. 20854 extended the scope of G. C. M. 18525 to recoveries of debts voluntarily charged off and deducted by banks or other corporations subject to Federal or State supervision or by other taxpayers.)

In I. T. 3278 (C. B. 1939-1 (Part 1), 76), which was promulgated on May 15, 1939, the principle of G. C. M. 20854, supra, was extended to amounts of State taxes refunded or credited. It was held that if the deduction of such taxes did not result in offsetting taxable income, the amount refunded or credited in a subsequent year should not be treated

as taxable income. However, I. T. 3278 was modified by I. T. 3390 (page 68, this Bulletin), promulgated July 8, 1940, to accord with the views expressed in G. C. M. 22163, supra. Pursuant to authority contained in section 3791(b) of the Internal Revenue Code, the ruling in I. T. 3390 will not be applied to amounts of State taxes refunded or credited if the prior deduction of such taxes did not result in a reduction of Federal income tax liability, provided the deduction was taken in an income tax return filed during the period May 15, 1939, to July 8, 1940, during which period I. T. 3278 remained unmodified.

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved December 11, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

SECTION 24.—ITEMS NOT DEDUCTIBLE.

SECTION 19.24-4: Amounts allocable to exempt income, other than interest. 1940-38-10422 I. T. 3406

INTERNAL REVENUE CODE.

Method of determining what part of a State income tax paid by a State employee in 1939 for the year 1938 is attributable to his tax-exempt compensation received from the State in 1938 in order to determine the amount of the State income tax which may not be deducted in the Federal income tax return for 1939.

Advice is requested as to the method of determining the amount of State income tax paid in 1939 for the year 1938 which was attributable to the tax-exempt compensation received by a State employee in 1938.

The following items are involved in the State income tax return for 1938 and the total amount of State income tax paid in 1939 for the year 1938 was $130:

Compensation received from the State	$5,000	
Expenses in connection with such compensation	1,000	
		$4,000
Dividends		700
Interest on mortgages		300
Total income		5,000
Deductions:		
Contributions	$500	
Taxes on real estate	100	
		600
Net income		4,400
Personal exemption		1,000
Taxable income		3,400

In I. T. 3353 (C. B. 1940-1, 44) it was held (syllabus):

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.

Section 19.24–4 of Regulations 103 provides in part as follows:

If an item is indirectly attributable both to taxable income and exempt income, a reasonable proportion thereof, determined in the light of all the facts and circumstances in each case, shall be allocated to each. Apportionments must in all cases be reasonable.

In the above example the net income received by the taxpayer from the State during 1938, $4,000, which was exempt from Federal taxation, is four-fifths of his total income of $5,000. The deductions of $500 for contributions and $100 for taxes on real estate are not applicable to any particular item of reported income. Applying the above-quoted provisions of the regulations, it is held that the total tax is to be apportioned in the ratio that the net salary received from the State, $4,000, bears to the total income of $5,000. Accordingly, four-fifths of $130, or $104, is the part of the State income tax which may not be deducted in the individual's 1939 Federal income tax return.

SECTION 25.—CREDITS OF INDIVIDUAL AGAINST NET INCOME.

SECTION 19.25–1: Credits of individual against net income.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.25–3: Amount of personal exemption allowable.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.25–4: Personal exemption of head of family. 1940–39–10428 I. T. 3410

INTERNAL REVENUE CODE.

Certain relatives with whom a taxpayer may be said to be "closely connected" by blood or marriage within the meaning of section 19.25–4 of Regulations 103.

Advice is requested whether certain relatives of a taxpayer may be said to be "closely connected" with him by blood or marriage for the purpose of section 19.25–4 of Regulations 103, pertaining to personal exemption as head of a family. The relationships are:

BLOOD RELATIONSHIP.

Grandfather—	Grandmother.
Father—	Mother.
Son—	Daughter.
Brother—	Sister.
(whole or half blood)	
Uncle—	Aunt.
Nephew—	Niece.

Step-brother— Step-sister.
Father-in-law— Mother-in-law.
Brother-in-law—Sister-in-law.

Section 19.25–4 of Regulations 103 provides 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. * * *

A taxpayer is considered to be " closely connected " by blood with his progenitors and lineal descendants, his brothers and sisters, whether by the whole or half blood, and with his uncles, aunts, nephews, and nieces. Irrespective of any legal obligation of the taxpayer to support such dependent relatives, there is a moral obligation to do so.

The taxpayer is considered to be " closely connected " by marriage with his step-sisters and step-brothers. Whether the taxpayer's right to exercise family control and provide for such dependent individuals is based upon some moral or legal obligation must be decided upon the facts in the particular case.

With respect to the status of a taxpayer because of support furnished to his father-in-law, mother-in-law, brother-in-law, and sister-in-law, it is evident that he is " closely connected " with them by virtue of the relationship which arose out of his marriage. Likewise, whether the taxpayer's right to exercise family control and provide for such dependent individuals is based upon a moral or legal obligation is a question to be decided upon the facts in each particular case.

SECTION 19.25–6: Credit for dependents. 1940–43–10460
I. T. 3418

INTERNAL REVENUE CODE.

A, an American citizen, who, during the year 1940, supports a certain foreign refugee under 18 years of age in accordance with an obligation assumed by him for such support will be entitled to a credit for a dependent for Federal income tax purposes.

Advice is requested whether A, an American citizen, who has assumed an obligation to support a certain foreign refugee under 18 years of age during the year 1940, will be entitled to a credit for a dependent under section 25 of the Internal Revenue Code. A has furnished complete information relative to the existence of such obligation and other pertinent facts relating to the dependent.

Section 19.25–6 of Regulations 103 provides in part that the credit for dependents is based upon " actual financial dependency and not mere legal dependency. It may accrue to a taxpayer who is not the head of a family." For a person to be entitled to a credit, for income tax purposes, as head of a family, it is necessary that he actually support in one household one or more individuals " who are closely connected with him by blood relationship, relationship by marriage, or by adoption " (see section 19.25–4, Regulations 103). However, in order to be entitled to a credit for dependents, it is not necessary that

the person supported be a relative by blood, marriage, or adoption of the person claiming such credit. (See first paragraph of section 19.25–6, supra.)

In O. D. 139 (C. B. 1, 160 (1919)) it was held that "An American citizen may claim the credit for dependents irrespective of the nationality or place of residence of the dependents." In I. T. 2611 (C. B. XI–1, 36 (1932)) it was held that while a taxpayer is not entitled to credit as the head of a family by virtue of support and maintenance of a child who has not been legally adopted, he may nevertheless be entitled to the credit allowed on account of the support of a dependent. In I. T. 2808 (C. B. XIII–2, 137 (1934)) it was held that a naturalized citizen of the United States who was the sole support of his mother living in Germany may be entitled to a credit for a dependent if she was incapable of self-support because mentally or physically defective, even though he was not entitled to personal exemption as head of a family. The Board of Tax Appeals held in *Mamie S. Hammonds et al.* v. *Commissioner* (38 B. T. A., 4 (1938), acquiescence, C. B. 1938–2, 14) that "The statute giving a credit for the support of dependents does not require that they live in the same household as the taxpayer who contributes the support, nor does it require that those who are supported shall be legally dependent upon the taxpayer."

In view of the foregoing, it is held that A, an American citizen, who, under an obligation assumed by him, actually supports a certain foreign refugee under 18 years of age, is entitled to a credit for a dependent notwithstanding the absence of blood, marriage, or legal relationship, and notwithstanding such refugee is not actually housed in his home.

In such a case, it is necessary that the taxpayer shall have assumed an obligation for the support during the taxable year in question of the person with respect to whom the credit is claimed. He must furnish satisfactory evidence as to the existence of the obligation and other pertinent facts relating to the dependent. Credit will not be allowed in those cases where it appears that the support of one or more individuals in an institution is in substance merely a contribution to the institution and, therefore, together with other contributions of the taxpayer, subject to the statutory limitation on the amount of contributions deductible. (*Morrell* v. *Commissioner*, 107 Fed. (2d), 34.)

The conclusion reached herein is also applicable where the dependent, regardless of age, is incapable of self-support because mentally or physically defective. In order that the taxpayer may obtain the benefit of the credit, the dependent must receive more than one-half of his total support from the taxpayer.

This ruling is also applicable in the case of a resident alien.

SECTION 19.25–7: Personal exemption and credit for dependents where status changes.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 27(b).—CORPORATION DIVIDENDS PAID CREDIT: BASIC SURTAX CREDIT.

SECTION 19.27(b)-2: Dividends paid. 1940-41-10448
I. T. 3415

INTERNAL REVENUE CODE.

Dividends paid credit in cases where a dividend declared by a corporation can not be paid to foreign stockholders by reason of Executive Order No. 8389, dated April 10, 1940, as amended.

Advice is requested whether the M Company will be entitled to a dividends paid credit with respect to dividends declared and payable to foreign stockholders, even though the dividends can not actually be paid to them by reason of the "freezing" order known as Executive Order No. 8389, dated April 10, 1940, as amended, if the amount of such dividends is placed in a separate bank account pursuant to corporate resolution earmarking such account as a dividend, and proper credits to the stockholders' accounts are entered on the corporate books.

It is held that the crediting of the amount of a dividend to the account of a foreign stockholder, to whom actual transfer thereof is prohibited by Executive Order, and the placing of the amount of the dividend in a separate bank account pursuant to corporate resolution earmarking such account as a dividend will be regarded as payment of the dividend during the taxable year of such action within the meaning of section 19.27(b)-2(*a*) of Regulations 103, relating to when dividends are considered paid, provided such separate account is opened in the name of the stockholder and the corporation makes no restriction with respect to payment thereunder. The payment of such a dividend may only be made pursuant to a license issued under Executive Order No. 8389.

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

SECTION 42.—PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

SECTION 19.42-1: When included in gross income.

INTERNAL REVENUE CODE.

I. T. 3278 (C. B. 1939-1 (Part 1), 76) modified. (See I. T. 3390, page 68.)

SECTION 19.42-1: When included in gross income. 1940-44-10468
I. T. 3421

INTERNAL REVENUE CODE.

Treatment as taxable income to an employer of the amounts of refunds of social security taxes made pursuant to section 902(a)1 and 902(d) of the Social Security Act Amendments of 1939, where such taxes have been previously deducted for Federal income tax purposes.

Advice is requested relative to the proper treatment for Federal income tax purposes of refunds of social security taxes, received pursuant to the provisions of sections 902(a)1 and 902(d) of the Social Security Act Amendments of 1939, where such taxes have been previously deducted from gross income.

The taxes in question were imposed by the Social Security Act, approved August 14, 1935, the pertinent provisions of which read as follows:

TITLE IX.—TAX ON EMPLOYERS OF EIGHT OR MORE.

IMPOSITION OF TAX.

SEC. 901. On and after January 1, 1936, every employer (as defined in section 907) shall pay for each calendar year an excise tax, with respect to having individuals in his employ, equal to the following percentages of the total wages (as defined in section 907) payable by him (regardless of the time of payment) with respect to employment (as defined in section 907) during such calendar year:

(1) With respect to employment during the calendar year 1936 the rate shall be 1 per centum;

(2) With respect to employment during the calendar year 1937 the rate shall be 2 per centum;

(3) With respect to employment after December 31, 1937, the rate shall be 3 per centum.

CREDIT AGAINST TAX.

SEC. 902. The taxpayer may credit against the tax imposed by section 901 the amount of contributions, with respect to employment during the taxable year, paid by him (before the date of filing his return for the taxable year) into an unemployment fund under a State law. The total credit allowed to a taxpayer under this section for all contributions paid into unemployment funds with respect to employment during such taxable year shall not exceed 90 per centum of the tax against which it is credited, and credit shall be allowed only for contributions made under the laws of States certified for the taxable year as provided in section 903.

The Act entitled "Social Security Act Amendments of 1939" (C. B. 1939–2, 470), approved August 10, 1939, liberalized the conditions of allowance of the credit provided in section 902 of the Social Security Act, supra, against the tax imposed by section 901 of that Act. It also authorized refund of such tax in specified instances. The pertinent provisions of the amendments read as follows:

TITLE IX.—MISCELLANEOUS PROVISIONS.

SEC. 902. (a) Against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, any taxpayer shall be allowed credit for the amount of contributions, with respect to employment during such year, paid by him into an unemployment fund under a State law—

(1) Before the sixtieth day after the date of the enactment of this Act;

* * * * * * *

(d) Refund of the tax (including penalty and interest collected with respect thereto, if any), based on any credit allowable under subsections (a) * * * may be made in accordance with the provisions of law applicable in the case of erroneous or illegal collection of the tax. No interest shall be allowed or paid on the amount of any such refund.

Senate Report No. 734, submitted by the Committee on Finance, Seventy-sixth Congress, first session (C. B. 1939–2, 565, at pages 590 and 591), shows that the reason for enactment of the liberalizing amendment contained in section 902(a)1 of the Social Security Act Amendments of 1939, supra, was that some taxpayers paid their State unem-

ployment fund contributions too late for allowance of the credit provided by section 902 of the Social Security Act, supra. (See also House of Representatives Report No. 728, submitted by the Committee on Ways and Means, Seventy-sixth Congress, first session, C. B. 1939–2, 538, at page 564.)

It appears clear that the social security taxes for the calendar years 1936, 1937, and 1938 were legally collected under section 901 of the Social Security Act, supra, in the first instance; that they were proper deductions from gross income, for Federal income tax purposes, for the years in which the taxes were paid or accrued (I. T. 2960, C. B. XV–1, 98 (1936)); and that the subsequent refunds thereof resulted solely from the enactment of sections 902(a)1 and 902(d) of the Social Security Act Amendments of 1939, supra.

The general rule with respect to the taxability of amounts received as refunds of taxes legally collected and deducted in Federal income tax returns for prior years is set forth in Mimeograph 4564 (C. B. 1937–1, 93, modified by I. T. 3278. C. B. 1939–1 (Part 1), 76, but reinstated by I. T. 3390, page 68, this Bulletin), which reads in part as follows:

> Refunds of * * * taxes legally collected which have been taken as deductions in Federal income tax returns for a prior year should continue to be treated in all cases as income for the taxable year in which the refund is made.

In view of the foregoing, a taxpayer operating upon the cash receipts and disbursements basis of accounting should treat the refunds received pursuant to the provisions of sections 902(a)1 and 902(d) of the Social Security Act Amendments of 1939 as taxable income in the year in which such refunds are received. In the case of a taxpayer operating upon an accrual basis of accounting, who paid his contributions to the State on or before August 10, 1939 (the date of enactment of the amendments), any refunds of Federal social security taxes to which he became entitled pursuant to the provisions of sections 902(a)1 and 902(d) of the Social Security Act Amendments of 1939 should be accrued as taxable income as of August 10, 1939. If the contributions were paid to the State after August 10, 1939, the date of enactment of the amendments, and within the period prescribed by section 902(a)1, any refunds to which a taxpayer is entitled because of such payments should be accrued as taxable income as of the date on which the State contributions were paid.

SECTION 19.42–1: When included in gross income.

INTERNAL REVENUE CODE.

Refunds or credits for State taxes previously deducted without tax benefit. (See I. T. 3438, page 82.)

SECTION 19.42–4: Long-term contracts. 1940–51–10525
I. T. 3434

INTERNAL REVENUE CODE.

Social security taxes paid by the M Company with respect to salaries and wages which are properly allocable to a long-term contract should be allocated to the contract and treated as a part of the total deferred expenditures to be deducted from the gross income derived from the contract.

Advice is requested whether social security taxes paid by the M Company during the life of a long-term contract may be deferred along with the salaries and wages to which they pertain, under the provisions of section 19.42-4(*b*) of Regulations 103, where the completed contract basis is the taxpayer's regular method of accounting.

Section 19.42-4(*b*) of Regulations 103 provides that the gross income may be reported for the taxable year in which the contract is finally completed and accepted if the taxpayer elects as a consistent practice so to treat such income, provided such method clearly reflects the net income, and that if the method is adopted there should be deducted from gross income all expenditures during the life of the contract which are properly allocated thereto.

Regarding the time for the taking of deductions, section 43 of the Internal Revenue Code provides in part as follows:

> The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

Since the salaries and wages which are properly allocable to a long-term contract are clearly incurred in connection with the work of carrying out and completing such contract, it is held that in order clearly to reflect the income, social security taxes paid by the M Company with respect to salaries and wages which are properly allocable to a long-term contract should likewise be allocated to the contract and treated as a part of the total deferred expenditures to be deducted from the gross income derived from the contract. (Section 19.42-4(*b*), Regulations 103.)

SECTION 47.—RETURNS FOR A PERIOD OF LESS THAN TWELVE MONTHS.

SECTION 19.47-1: Returns for periods of less than twelve months.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

PART V.—RETURNS AND PAYMENT OF TAX.

SECTION 51.—INDIVIDUAL RETURNS.

SECTION 19.51-1: Individual returns.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.51-2: Form of return.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.51–3: Return of income of minor.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page —.)

SECTION 52.—CORPORATION RETURNS.

SECTION 19.52–1: Corporation returns.

INTERNAL REVENUE CODE.

Computation of defense tax prescribed by section 204 of the Revenue Act of 1940 amending section 600 of the Internal Revenue Code—corporation income and excess-profits tax returns for the fiscal years ending July 31, 1940, to November 30, 1940, inclusive. (See Mim. 5083, page 168.)

SECTION 55.—PUBLICITY OF RETURNS.

1940–31–10369
T. D. 4991

TITLE 26—INTERNAL REVENUE.—CHAPTER I, PART 463, SUBPART C; PART 458, SUBPART A.—INSPECTION OF RETURNS.

Amending section 463C.33 of Treasury Decision 4929 [C. B. 1939–2, 91], relating to the inspection of certain returns made under the Internal Revenue Code, and article 3, Part III, of Treasury Decision 4873 [C. B. 1938–2, 261], relating to the inspection of certain returns made pursuant to the requirements of the Revenue Act of 1938 and prior Revenue Acts, so as to provide a different method for such inspection by the District of Columbia, Alaska, Hawaii, the Philippine Islands, and Puerto Rico.

TREASURY DEPARTMENT,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

1. Section 463C.33 of Treasury Decision 4929 [C. B. 1939–2, 91] [Part 463C, Title 26, Code of Federal Regulations, 1939 Sup.] is amended by striking out "SEC. 463C.33." and inserting in lieu thereof "SEC. 463C.33. (*a*)" and adding at the end of the section the following:

(*b*) *Inspection by District of Columbia, Alaska, Hawaii, the Philippine Islands, and Puerto Rico.*—Any official, body, or commission, lawfully charged with the administration of any tax law of the District of Columbia, Alaska, Hawaii, the Philippine Islands, or Puerto Rico, or any representative or representatives of such official, body, or commission, may, in the discretion of the Commissioner of Internal Revenue, be permitted to inspect original income returns, for any taxable year ending on or after July 31, 1939, for the purpose of such administration.

Requests for permission to inspect original returns shall be in writing signed by the executive head of the government on whose behalf the inspection is to be made and shall be addressed to the Commissioner of Internal Revenue, Records Division, Washington, D. C. The request shall state (*a*) the kind of returns it is desired to inspect, (*b*) the taxable year or years covered by the returns it is desired to inspect, (*c*) the name of the official, body, or commission, by whom or which the inspection is to be made, (*d*) the name of the representative of such official, body, or commission, designated to make the inspec-

tion, (*e*) by specific reference, the tax law which such official, body, or commission, is charged with administering and the law under which he, she, or it is so charged, and (*f*) the purpose for which the inspection is to be made.

Within a reasonable time after the returns are filed the copies thereof (including photostats and photographs), under such procedure as may be prescribed by the Commissioner, shall be made available for inspection in the office of the collector of internal revenue in which the returns are filed, by any official, body, or commission, lawfully charged with the administration of any tax law of the District of Columbia, Alaska, Hawaii, the Philippine Islands, or Puerto Rico, or by the properly designated representatives of such official, body, or commission, for the purpose of such administration. The respective heads of the above-designated governments shall be notified by the Commissioner of the date the copies of the returns are available for inspection and inspection thereof shall not be permitted after one year from such date. Requests for inspection of copies of returns shall conform with the requirements relating to requests for permission to inspect original returns as prescribed by this subsection.

2. Article 3, Part III, of Treasury Decision 4873 [C. B. 1938-2, 261] [section 458.33, Subpart A, of Title 26, Code of Federal Regulations, 1938 Sup.] is amended by striking out "ART. 3." and inserting in lieu thereof "ART. 3. (*a*)" and adding at the end of the article the following:

(*b*) *Inspection by District of Columbia, Alaska, Hawaii, the Philippine Islands, and Puerto Rico.*—Any official, body, or commission, lawfully charged with the administration of any tax law of the District of Columbia, Alaska, Hawaii, the Philippine Islands, or Puerto Rico, or any representative or representatives of such official, body, or commission, may, in the discretion of the Commissioner of Internal Revenue, be permitted to inspect original income returns, for any taxable year, for the purpose of such administration.

Requests for permission to inspect original returns shall be in writing signed by the executive head of the government on whose behalf the inspection is to be made and shall be addressed to the Commissioner of Internal Revenue, Records Division, Washington, D. C. The request shall state (*a*) the kind of returns it is desired to inspect, (*b*) the taxable year or years covered by the returns it is desired to inspect, (*c*) the name of the official, body, or commission, by whom or which the inspection is to be made, (*d*) the name of the representative of such official, body, or commission, designated to make the inspection, (*e*) by specific references, the tax law which such official, body, or commission, is charged with administering and the law under which he, she, or it is so charged, and (*f*) the purpose for which the inspection is to be made.

(Part 1 of this Treasury decision is prescribed pursuant to sections 55(a), 508, 603, 702(a), 1204, and 1604(c) of the Internal Revenue Code (53 Stat., 29, 111, 111, 116, 171, 186).

(Part 2 of this Treasury decision is prescribed pursuant to section 257(a), 44 Stat., 51; section 55, 45 Stat., 809; section 55, 47 Stat., 189, as amended by section 218(h), 48 Stat., 209, 26 U. S. C., 55; section 215(e) and 216(b), 48 Stat., 207, 208; sections 55(a), 701(e), and 702(b), 48 Stat., 698, 769, 770, 26 U. S. C., 55, 1358, 341; sections 105(e) and 106(c), 49 Stat., 1017, 1019, 26 U. S. C., 1358a, 342; section 905, 49 Stat., 641, 42 U. S. C., 1105; sections 55(a), 351(c), and 503(a), 49 Stat., 1671, 1733, 1738, 26 U. S. C., Sup. IV, 55, 331, 345b; sections 55(a), 409, 601(c), and 602(c), 52 Stat., 478, 564, 565, 567, 26 U. S. C., Sup. IV, 55(a), 337a, 1358(e), 341(c).)

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

Approved July 20, 1940.

FRANKLIN D. ROOSEVELT,
The White House.

(Filed with the Division of the Federal Register July 22, 1940, 2.46 p. m.)

EXECUTIVE ORDER—AUTHORIZING THE INSPECTION BY THE DISTRICT OF COLUMBIA, ALASKA, HAWAII, THE PHILIPPINE ISLANDS, AND PUERTO RICO OF CERTAIN RETURNS MADE UNDER THE INTERNAL REVENUE CODE AND OF INCOME, EXCESS-PROFITS, AND CAPITAL STOCK TAX RETURNS FILED UNDER THE REVENUE ACT OF 1938 OR PRIOR REVENUE ACTS, ESTATE AND GIFT TAX RETURNS FILED AFTER JUNE 16, 1933, AND RETURNS UNDER TITLE IX OF THE SOCIAL SECURITY ACT.

By virtue of and pursuant to the authority vested in me by section 55(a) of the Internal Revenue Code (53 Stat., 29) and by section 257(a) of the Revenue Act of 1926 (44 Stat., 9, 51); section 55 of the Revenue Act of 1928 (45 Stat., 791, 809); section 55 of the Revenue Act of 1932 (47 Stat., 169, 189), as amended by section 218(h) of the National Industrial Recovery Act (48 Stat., 195, 209); sections 215(e) and 216(b) of the National Industrial Recovery Act (48 Stat., 195, 208); sections 55(a), 701(e), and 702(b) of the Revenue Act of 1934 (48 Stat., 680, 698, 770); sections 105(e) and 106(c) of the Revenue Act of 1935 (49 Stat., 1014, 1018, 1019); section 905 of the Social Security Act (49 Stat., 620, 641); sections 55(a), 351(c), and 503(a) of the Revenue Act of 1936 (49 Stat., 1648, 1671, 1733, 1738); and sections 55(a), 409, 601(e), and 602(c) of the Revenue Act of 1938 (52 Stat., 447, 564, 565, 567), it is hereby ordered that the following designated returns shall be open to inspection by the District of Columbia, Alaska, Hawaii, the Philippine Islands, and Puerto Rico 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 such returns approved by me on August 28, 1939, and the amendment thereto approved by me this date, and the rules and regulations prescribed by the Secretary of the Treasury in the Treasury decision relating to inspection of returns under Revenue Acts prior to the Internal Revenue Code approved by me on November 12, 1938, and the amendment thereto approved by me this date:

(1) Income (including income of personal holding companies and unjust enrichment income), excess-profits, capital stock, estate, and gift tax returns under the Internal Revenue Code and returns of employment tax on employers under Subchapter C of Chapter 9 of such Code.

(2) (*a*) Income, excess-profits, and capital stock tax returns made under the Revenue Act of 1938, the Revenue Act of 1936, the Revenue Act of 1935, the Revenue Act of 1934, the National Industrial Recovery Act, the Revenue Act of 1932, the Revenue Act of 1932, as amended by the National Industrial Recovery Act, and under the prior Revenue Acts, (*b*) estate and gift tax returns made under the Revenue Act of 1932 or the Revenue Act of 1932 as amended, and filed after June 16, 1933, (*c*) returns made under Title IX of the Social Security Act, and (*d*) returns made under any of such Acts as amended.

FRANKLIN D. ROOSEVELT.

THE WHITE HOUSE,
July 20, 1940.

(8490)

(Filed with the Division of the Federal Register July 22, 1940, 2.46 p. m.)

1940-47-10490
T. D. 5019

TITLE 26—INTERNAL REVENUE.—CHAPTER I, PART 458, SUBPART A; PART 458, SUBPART F.—INSPECTION OF RETURNS.

Amending sections 463C.2, 463C.4, and 463C.7 of Treasury Decision 4929 [C. B. 1939-2, 91], relating to the inspection of certain returns made under the Internal Revenue Code, and articles 5, 7, and 10, Part I, of Treasury Decision 4873 [C. B. 1938-2, 261], relating to the inspection of certain returns made pursuant to the requirements of the Revenue Act of 1938 and prior Revenue Acts, so as to permit inspection of certain returns by a receiver, or trustee in bankruptcy.

TREASURY DEPARTMENT,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

1. Section 463C.2 of Treasury Decision 4929 [C. B. 1939-2, 91] [section 458.302, Title 26, Code of Federal Regulations, 1939 Sup.] and article 5, Part I, of Treasury Decision 4873 [C. B. 1938-2, 261] [section 458.5, Title 26, Code of Federal Regulations, 1938 Sup.] are amended by inserting the following sentence immediately after the next to the last sentence of each:

If the property of the person who made the return is in the hands of a receiver, or trustee in bankruptcy, the return of such person shall be open to inspection by such receiver or trustee, or by the duly constituted attorney in fact of such receiver or trustee.

2. Section 463C.4 of Treasury Decision 4929 [section 458.304, Title 26, Code of Federal Regulations, 1939 Sup.] and article 7, Part I, of Treasury Decision 4873 [section 458.7, Title 26, Code of Federal Regulations, 1938 Sup.] are amended by inserting the following sentence immediately after the next to the last sentence of each:

If the property of the partnership is in the hands of a receiver, or trustee in bankruptcy, the return of the partnership shall be open to inspection by such receiver or trustee, or by the duly constituted attorney in fact of such receiver or trustee.

3. Section 463C.7 of Treasury Decision 4929 [section 458.307, Title 26, Code of Federal Regulations, 1939 Sup.] and article 10, Part I, of Treasury Decision 4873 [section 458.10, Title 26, Code of Federal Regulations, 1938 Sup.] are amended by inserting the following sentence immediately after the next to the last sentence of each:

If the property of the corporation is in the hands of a receiver, or trustee in bankruptcy, the return of such corporation shall be open to inspection by such receiver or trustee, or by the duly constituted attorney in fact of such receiver or trustee.

(This Treasury decision is prescribed pursuant to sections 55(a), 508, 603, 702(a), 1204, and 1604(c) of the Internal Revenue Code (53 Stat., 29, 111, 111, 116, 171, 186); section 257(a) of the Revenue Act of 1926 (44 Stat., 51); section 55 of the Revenue Act of 1928 (45 Stat., 809); section 55 of the Revenue Act of 1932 (47 Stat., 189), as amended by section 218(h) of the National Industrial Recovery Act (48 Stat., 209, 26 U. S. C., 55); sections 215(e) and 216(b) of the National Industrial Recovery Act (48 Stat., 207, 208); sections 55(a), 351, 701(e), and 702(b) of the Revenue Act of 1934 (48 Stat., 698, 751, 769, 770, 26 U. S. C., 55, 331, 1358, 341); sections 105(e) and 106(c) of the Revenue Act of 1935 (49 Stat., 1017, 1019, 26 U. S. C., 1358a, 342); section 905

of the Social Security Act (49 Stat., 641, 42 U. S. C., 1105); sections 55(a), 351(c), and 503(a) of the Revenue Act of 1936 (49 Stat., 1671, 1733, 1738, 26 U. S. C., Sup. IV, 55, 331, 345b); sections 55(a), 409, 601(c), and 602(c) of the Revenue Act of 1938 (52 Stat., 478, 564, 565, 567, 26 U. S. C., Sup. IV, 55(a), 337a, 1358(e), 341(c)).)

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

Approved November 7, 1940.

FRANKLIN D. ROOSEVELT,
The White House.

EXECUTIVE ORDER—AUTHORIZING THE INSPECTION BY RECEIVERS, AND TRUSTEES IN BANKRUPTCY, AND THEIR DULY CONSTITUTED ATTORNEYS IN FACT, OF CERTAIN RETURNS MADE UNDER THE INTERNAL REVENUE CODE AND OF INCOME, EXCESS-PROFITS, AND CAPITAL STOCK TAX RETURNS FILED UNDER THE REVENUE ACT OF 1938 OR PRIOR REVENUE ACTS, GIFT TAX RETURNS FILED AFTER JUNE 16, 1933, AND RETURNS UNDER TITLE IX OF THE SOCIAL SECURITY ACT.

By virtue of the authority vested in me by section 55(a) of the Internal Revenue Code (53 Stat., 29), section 257(a) of the Revenue Act of 1926 (44 Stat., 9, 51), section 55 of the Revenue Act of 1928 (45 Stat., 791, 809), section 55 of the Revenue Act of 1932 (47 Stat., 169, 189), as amended by section 218(h) of the National Industrial Recovery Act (48 Stat., 195, 209), sections 215(e) and 216(b) of the National Industrial Recovery Act (48 Stat., 195, 208), sections 55(a), 351, 701(e), and 702(b) of the Revenue Act of 1934 (48 Stat., 680, 698, 751, 769, 770), sections 105(e) and 106(c) of the Revenue Act of 1935 (49 Stat., 1014, 1018, 1019), section 905 of the Social Security Act (49 Stat., 620, 641), sections 55(a), 351(c), and 503(a) of the Revenue Act of 1936 (49 Stat., 1648, 1671, 1733, 1738), and sections 55(a), 409, 601(e), and 602(c) of the Revenue Act of 1938 (52 Stat., 447, 564, 565, 567), it is hereby ordered that the following-designated returns shall be open to inspection by a receiver, or trustee in bankruptcy, and by their duly constituted attorneys in fact, 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 such returns approved by me on August 28, 1939, and the amendments thereto approved by me on July 20, 1940, and this date, and the rules and regulations prescribed by the Secretary of the Treasury in the Treasury decision relating to inspection of returns under Revenue Acts prior to the Internal Revenue Code approved by me on November 12, 1938, and the amendments thereto approved by me on July 20, 1940, and this date:

(1) Income (including income of personal holding companies and unjust enrichment income), excess-profits, capital stock, and gift tax returns under the Internal Revenue Code and returns of employment tax on employers under Subchapter C of Chapter 9 of such Code.

(2) (*a*) Income, excess-profits, and capital stock tax returns made under the Revenue Act of 1938, the Revenue Act of 1936, the Revenue Act of 1935, the Revenue Act of 1934, the National Industrial Recovery Act, the Revenue Act of 1932, the Revenue Act of 1932 as

amended by the National Industrial Recovery Act, and under the prior Revenue Acts, (*b*) gift tax returns made under the Revenue Act of 1932 or the Revenue Act of 1932 as amended, and filed after June 16, 1933, (*c*) returns made under Title IX of the Social Security Act, and (*d*) returns made under any of such Acts as amended.

FRANKLIN D. ROOSEVELT.

THE WHITE HOUSE,
November 7, 1940.

(8586)

(Filed with the Division of the Federal Register November 8, 1940, 2.16 p. m.)

SECTION 19.55(b)-2: Copies of income returns. (Also Sections 19.55(b)-3, 19.55(b)-4, and 19.55(b)-5.)

1940-31-10355
T. D. 4989

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

Amending sections 19.55(b)-2, 19.55(b)-3, 19.55(b)-4, and 19.55(b)-5 of Regulations 103, relating to the filing of copies of income returns by taxpayers and the inspection of such copies by an official, body, or commission, lawfully charged with the administration of a State tax law.

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

To Collectors of Internal Revenue and Others Concerned:

PARAGRAPH 1. Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.] in so far as they prescribe rules relative to the filing of copies of income returns by taxpayers and the inspection of such copies by an official, body, or commission, lawfully charged with the administration of a State tax law, under section 55(b) of the Internal Revenue Code, are hereby amended as follows:

PAR. 2. Section 19.55(b)-2, section 19.55(b)-3, and section 19.55(b)-4 are amended by adding at the end of each of those sections a paragraph reading as follows:

The provisions of this section shall not apply to taxable years beginning after December 31, 1939.

PAR. 3. The last sentence of the first paragraph of section 19.55(b)-5 is amended to read as follows:

When permission to inspect original returns is requested, the application of the governor of the State shall conform to the requirements specified in section 19.55(b)-4 applying to copies of returns filed for taxable years beginning before January 1, 1940.

(This Treasury decision is issued under the authority contained in sections 55(b) and 62 of the Internal Revenue Code (53 Stat., 29, 32).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved July 15, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 22, 1940, 11.58 a. m.)

SECTION 19.55(b)-3: Inspection of copies of returns.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 4989, page 97.)

SECTION 19.55(b)-4: Request for permission to inspect copies.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 4989, page 97.)

SECTION 19.55(b)-5: Inspection of original returns.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 4989, page 97.)

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A.—RATES OF TAX.

SECTION 101.—EXEMPTIONS FROM TAX ON CORPORATIONS.

SECTION 19.101(6)-1: Religious, charitable, scientific, literary, and educational organizations and community chests. 1940-28-10318 G. C. M. 22120

INTERNAL REVENUE CODE AND REVENUE ACT OF 1938.

The M Teachers' Association, organized as a nonprofit, professional, educational corporation having neither capital stock nor surplus, its purpose being the promotion of educational interests of the State of R and its functions consisting of the conduct of educational research programs and those activities relating to the general professional welfare of its membership, is entitled to exemption from Federal income tax under section 101(6) of the Internal Revenue Code and section 101(6) of the Revenue Act of 1938.

An opinion is requested whether the M Teachers' Association is entitled to exemption from Federal income tax under the provisions of section 101(6) of the Internal Revenue Code and section 101(6) of the Revenue Act of 1938.

The M Teachers' Association was organized as a nonprofit, professional, educational corporation. It has neither capital stock nor surplus and it can not make any payments of interest or dividends. Its purpose, as stated in its constitution, "* * * shall be to promote the educational interests of the State of R." Its function is to conduct programs of educational research and those activities relating to the general professional welfare of its membership. The association publishes an educational journal, committee reports, research findings, and other educational reviews. It operates a reading

service, pursues educational research, conducts educational conventions, and attends to the ordinary business incidental to a State-wide organization.

Membership in the association is open to anyone. However, active membership is limited to persons engaged in teaching, or the supervision or administration of schools in the State of R, who have paid the annual dues. Persons otherwise engaged may become associate members on payment of a similar fee but such members are ineligible for office. Students preparing for professional teaching are eligible for membership as associate members.

The M Teachers' Association consists of a "general association" and a small number of "district associations." The district associations are authorized to adopt a constitution and by-laws consistent with the parent body's constitution, to require members to pay annual dues of a specified amount, a portion of which is forwarded to the parent body, and to elect delegates for representation at the delegate assembly. The secretary-treasurer is elected by the executive committee, which is composed of the president of the general association and one member from each district association.

The income of the association is derived from dues, the sale of advertising space in its journal, and the sale of research bulletins, reports, etc. Any profits derived by the association are used to extend its program of educational service and to purchase a home office building which is to be a permanent center of operation. No part of the association's net earnings inures to the benefit of any private shareholder or individual, and no substantial part of its activities consists of carrying on propaganda or otherwise attempting to influence legislation.

Section 101(6) of the Internal Revenue Code provides in part as follows:

> SEC. 101. * * * The following organizations shall be exempt from taxation under this chapter—
>
> (6) Corporations * * * 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;

Section 101(6) of the Revenue Act of 1938 contains almost identical language.

Section 19.101(6)–1 of Regulations 103, relating to the Internal Revenue Code, provides in part as follows:

> In order to be exempt under section 101(6), the organization must meet three tests:
>
> (1) It must be organized and operated exclusively for one or more of the specified purposes;
>
> (2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and
>
> (3) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

Article 101(6)–1 of Regulations 101, relating to the Revenue Act of 1938, contains identical language.

The Bureau has consistently held that an organization to be exempt as an educational corporation under section 101(6), supra, must, as therein provided, be organized and operated exclusively for educational purposes. (See I. T. 3182, C. B. 1938–1, 168; G. C. M. 19836,

C. B. 1938–2, 163; cf. I. T. 2334, C. B. VI–1, 82 (1927); G. C. M. 4805, C. B. VII–2, 58 (1928).) This position is supported by the decisions in *Appeals of George O. May* (1 B. T. A., 1220), *Alfred A. Cook* v. *Commissioner* (30 B. T. A., 292), and *Stanford University Book Store* v. *Helvering* (83 Fed. (2d), 710). Whether an association is organized and operated exclusively for educational purposes is largely a question of fact to be determined in each case.

An educational organization within the meaning of section 101(6), supra, is described in section 19.101(6)–1 of Regulations 103 as "* * * one designed primarily for the improvement or development of the capabilities of the individual, but, under exceptional circumstances, may include an association whose sole purpose is the instruction of the public, or an association whose primary purpose is to give lectures on subjects useful to the individual and beneficial to the community, even though an association of either class has incidental amusement features."

In the opinion of this office, the purposes, functions, and activities of the association in the instant case warrant the conclusion that it is an educational association. The corporate purposes and activities of the organization are aimed at the improvement of educational methods and administration in the schools of the State of R. Such purposes and activities are truly educational within the primary meaning of that word which, as stated in the regulations, is "the improvement or development of the capabilities of the individual."

In view of the foregoing, it is held that the M Teachers' Association is entitled to exemption from Federal income tax under the provisions of section 101(6) of the Internal Revenue Code and section 101(6) of the Revenue Act of 1938.

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

SECTION 19.101(6)–1: Religious, charitable, scientific, literary, and educational organizations and community chests.
(Also Section 101, Section 19.101(9)–1.)

1940–33–10382
G. C. M. 22116

INTERNAL REVENUE CODE.

The M Alumni Association, organized primarily to promote in every proper way the interests of the M College and to foster among its graduates a sentiment of regard for each other and attachment to their alma mater, which annually transfers to the M College the excess of its income (derived principally from annual contributions to an alumni fund) over its operating expenses, is not exempt from income taxation under section 101(6) of the Internal Revenue Code. *Roche's Beach, Inc.*, v. *Commissioner* (96 Fed. (2d), 776, Ct. D. 1359, C. B. 1938–2, 230) distinguished. However, the association is entitled to exemption under section 101(9) of the Internal Revenue Code.

An opinion is requested whether the M Alumni Association is entitled to exemption from Federal income taxation under the provisions of section 101(6) of the Internal Revenue Code.

The M Alumni Association has been held exempt from Federal income taxation under the provisions of section 231(9) of the Reve-

nue Act of 1918 (corresponding to section 101(9) of the Internal Revenue Code), which reads as follows:

SEC. 231. That the following organizations shall be exempt from taxation under this title—

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private stockholder or member;

The association now claims exemption from Federal income taxation under the provisions of section 101(6) of the Internal Revenue Code.

The M Alumni Association was incorporated under the general laws of the State of R in 1920. Its purposes and objects, as set forth in its articles of incorporation, are as follows:

(*a*) To promote in every proper way the interests of M College and to foster among its graduates a sentiment of regard for each other, and attachment to their alma mater.

(*b*) To purchase, take or lease, or otherwise acquire any lands, buildings, easements or property, real and personal, which may be requisite for the purpose of, or capable of being conveniently used in connection with, any of the objects of the corporation.

(*c*) To subscribe to, become a member of, and cooperate with any other association, whether incorporated or not, whose objects are altogether or in part similar to those of this corporation.

(*d*) To raise money by subscriptions, and to grant any rights and privileges to subscribers.

The association is managed by a board of directors, which elects the president, two vice presidents, corresponding and recording secretaries, and the treasurer of the association.

Membership in the association is of two classes, active and associate. To be eligible for active membership, the applicant must have received a degree from M College. Associate membership, however, is predicated on the applicant's connection with the college and is not dependent upon acquisition of a degree therefrom. Active members have the voting privilege, whereas associate members do not. Membership in the association for any current year is dependent upon a contribution to the alumni fund.

The income of the association is derived primarily from the annual contributions to the alumni fund. A contribution includes a membership fee, a subscription to a quarterly magazine, and a gift to the college. Other income is derived from the sale of advertising space in the magazine and a small amount of interest is received from a fund composed of paid life membership fees. The income is used to defray operating expenses of the association, and any balance over expenses is given annually to the college to be applied to some need.

The association has no capital stock, and no part of the net earnings of the association inures to the benefit of any private shareholder or individual. No substantial part of the association's activities consists of attempting to influence legislation by propaganda or otherwise.

Section 101(6) of the Internal Revenue Code provides in part as follows:

SEC. 101. * * * the following organizations shall be exempt from taxation under this chapter—

Corporations * * * 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;

Section 19.101(6)–1 of Regulations 103, relating to the Internal Revenue Code, provides in part as follows:

In order to be exempt under section 101(6), the organization must meet three tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes;

(2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and

(3) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

As stated in *Northwestern Municipal Association, Inc.*, v. *United States* (99 Fed. (2d), 460, Ct. D. 1419, C. B. 1939–2, 224), "The purpose of an organization must be determined from the purpose declared in the instrument creating it." This general rule is subject to the exception enunciated in *Roche's Beach, Inc.*, v. *Commissioner* (96 Fed. (2d), 776, Ct. D. 1359, C. B. 1938–2, 230), the facts of which, as well as the conclusion, are adequately set forth in G. C. M. 21610 (C. B. 1939–2, 103). The application of the rule in *Roche's Beach, Inc.*, v. *Commissioner*, supra, is, however, limited by G. C. M. 21610, which provides in part as follows:

* * * However, this rule is subject to the exception that where (as in Roche's Beach) the net income of an organization is required by some other binding instrument to be used for charitable purposes, its exemption will not be defeated by the fact that its charter or other instrument under which it exists does not indicate an exclusively charitable purpose. This exception to the general rule is required by the principle that statutes exempting income devoted to charity are not to be narrowly construed since they are begotten from motives of public policy. (Cf. *Helvering* v. *Bliss*, 293 U. S., 144, Ct. D. 884, C. B. XIII–2, 191 (1934), and *Lederer* v. *Stockton*, 260 U. S., 3.) *This exception to the general rule should not be extended to cases in which there is no such binding instrument requiring that the income be devoted to charity, even though the income is in fact devoted to charity. The exception to the general rule is also confined to cases in which* (as in Roche's Beach) *the intent which prompted the original organization was an intent to set up an organization to be operated exclusively for charitable purposes.* [Italics supplied.]

In the instant case there is no binding instrument requiring that the income of the association be transferred to the M College. The M Alumni Association was not created to provide funds for the M College, whereas Roche's Beach, Inc., was designed to provide funds for the charity set up by the will of Edward Roche. The college does not operate the association or depend on it for its sole support, which is in contrast with the facts in the case of *Roche's Beach, Inc.*, v. *Commissioner*, supra. Neither does it appear that the intent which prompted the creation of the M Alumni Association was to set up an organization to be operated exclusively for educational purposes. Under the circumstances, it is apparent that the instant case is clearly distinguishable from the case of *Roche's Beach, Inc.*, v. *Commissioner*, supra, and that the criteria set forth in G. C. M. 21610, supra, for the application of that case have not been satisfied.

Since the facts do not establish that the M Alumni Association is organized and operated exclusively for one or more of the purposes enumerated in section 101(6) of the Internal Revenue Code, it is not entitled to exemption from Federal income taxation under the pro-

visions of that section. However, the association is entitled to exemption under section 101(9) of the Internal Revenue Code.

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

SECTION 19.101(8)-1: Civic leagues and local associations of employees. (Also Section 22(b), Section 19.22(b)(4)-1.)

1940-39-10429
I. T. 3411

INTERNAL REVENUE CODE.

Limited dividend housing corporations organized under Article IX of the Public Housing Law of New York, 1939 (Laws of New York, 1939, ch. 808), are not exempt from Federal income tax. Interest on the securities issued by such corporations is not exempt from Federal income tax.

Advice is requested whether (1) limited dividend housing corporations formed pursuant to Article IX of the Public Housing Law of New York, 1939, effective June 8, 1939 (Laws of New York, 1939, ch. 808), are entitled to exemption from Federal income tax, and (2) whether the interest paid on the bonds and mortgages of such corporations is exempt from Federal income tax.

In *Amalgamated Housing Corporation* v. *Commissioner* and *Amalgamated Dwellings, Inc.*, v. *Commissioner* (37 B. T. A., 817, affirmed, 108 Fed. (2d), 1010), which cases arose under the New York State Housing Law of 1926 (Laws of New York, 1926, ch. 823), it was held that a private limited dividend housing corporation organized under that law was not exempt from Federal income tax either as an instrumentality of the State of New York engaged in an essential governmental function or as a civic league or organization not organized for profit but operated exclusively for the promotion of social welfare under sections 103(8) of the Revenue Acts of 1928 and 1932.

The present questions arise under the 1939 law. There are certain differences in the wording of that law and the earlier one.

Article 1, section 2, of the 1926 law provides:

* * * Therefore, there are created and authorized the agencies and instrumentalities hereinafter prescribed, which are declared to be the agencies and instrumentalities of the State for the purpose of attaining the ends herein recited, and their necessity in the public interest is hereby declared as a matter of legislative determination.

Article I, section 2, of the 1939 law provides:

* * * that these conditions require the creation of the agencies, instrumentalities and corporations hereinafter prescribed, which are declared to be agencies and instrumentalities of the State for the purpose of attaining the ends herein recited; and the necessity in the public interest for the provisions hereinafter enacted is hereby declared as a matter of legislative determination.

The differences between the declarations of policy set forth in the statutes do not result in a difference in the taxable status, for Federal income tax purposes, of the corporations organized under the 1926 law and corporations organized under the 1939 law.

Article IX, section 190(2), of the 1939 law provides:

Bonds and mortgages and the income debenture certificates of all housing companies are declared to be instrumentalities of the State, issued for public purposes and shall, together with interest thereon, be exempt from taxation. * * *

The New York State Housing Law of 1926 authorized the formation of public and private limited dividend housing companies, the principal difference between them being that the former could exercise the power of eminent domain and were restricted with respect to the disposition of their property, whereas the latter had no power of eminent domain but could dispose of their property with the consent of the State Board of Housing. The petitioner companies in the Amalgamated cases were incorporated as private limited dividend housing companies. The exemption provision for private limited dividend housing companies under the 1926 law, as amended by Laws of New York, 1931, ch. 557, provides:

> The securities of a private limited dividend housing company are not to be deemed instrumentalities of the State, but they and the interest on bonds or income debentures and the dividends on the stock of such companies shall nevertheless be exempt from any taxation by the State.

The corresponding provision for public limited dividend housing companies under the 1926 law was similar to section 190(2) of the 1939 law quoted above.

It is the opinion of the Bureau that the principle enunciated in the Amalgamated cases referred to herein is applicable to limited dividend housing corporations organized under Article IX of the Public Housing Law of New York, 1939, and that such corporations are not exempt from Federal income tax. It is believed that the securities issued by such corporations are not obligations of the State of New York or of a political subdivision thereof. Accordingly, the interest on such securities is not exempt from Federal income tax. (See section 22(b)4 of the Internal Revenue Code.)

SECTION 19.101(9)–1: Social clubs.

INTERNAL REVENUE CODE.

College alumni association. (See G. C. M. 22116, page 100.)

SECTION 102.—SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS.

SECTION 19.102–1: Taxation of corporation formed or utilized for avoidance of surtax.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 104.—BANKS AND TRUST COMPANIES.

SECTION 19.104–1: Tax on banks.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 113(b).—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS: ADJUSTED BASIS.

SECTION 19.113(b)(1)–1: Adjusted basis: General rule. 1940–35–10399 G. C. M. 22239

INTERNAL REVENUE CODE.

Where the original basis (March 1, 1913, value) of a developed oil property was completely recovered through depletion deductions in the taxable year 1934, the amount of percentage depletion deductions allowed the taxpayer in subsequent years in excess of such original basis should be applied against and used to reduce the cost of an additional well drilled on the property in 1938, for the purpose of ascertaining the adjusted basis under section 113(b)1(B) of the Internal Revenue Code for determining gain or loss upon the sale of the property in 1939.

An opinion has been requested whether, in ascertaining the adjusted basis for determining gain or loss as provided in section 113(a)1(B) of the Internal Revenue Code, the capital account of a developed oil property (which, in the year of sale, consisted only of the cost of drilling an additional oil well, after the previous exhaustion through depletion deductions of the original basis—March 1, 1913, value—of the property) should be reduced by the excess over the original basis of percentage depletion deductions allowed in years prior to the drilling of such additional well.

The taxpayer (the M Company) operated a small oil property for a number of years. The March 1, 1913, value of such property was $57x$ dollars. No further additions were made to the capital account until 1938. Prior to 1933, the depletion deduction was computed on the basis of the March 1, 1913, value. Beginning with 1933, the depletion deduction was computed on the percentage of income basis. In 1934, the deduction for depletion had the effect of reducing the remaining capital account to zero. As of January 1, 1938, excess depletion amounted to $5x$ dollars. In the year 1938, the taxpayer drilled an additional well at a cost of $4x$ dollars. In connection with the 1938 return, the taxpayer exercised the option of capitalizing the cost of this addition to the property. In January, 1939, all of the physical assets of the company were sold.

It has been contended that even though the aggregate of depletion deductions in prior years was a sum in excess of the cost or other basis of the property, the excess should not be offset against an addition to the property in a subsequent year, the theory being that an addition to the capital account can not be depleted before it is in existence and that each year's return stands by itself in that depletion allowances of a prior year are applicable only to the capital basis existing in such year.

On the other hand, it has been urged that the cost or other basis of all wells on a property must be taken as a whole in determining the adjusted basis of the property (*Witherspoon Oil Co.* v. *Commissioner*, 34 B. T. A., 1130); that while, under section 113(b)1(B) of the Internal Revenue Code, the adjustment of basis for taxable

years prior to 1932 on account of depletion allowed or allowable, whichever is greater, can not exceed depletion computed without reference to discovery value or to percentage depletion, the adjustment of basis for 1932 and subsequent taxable years under said section must be for the full depletion, whether allowed on discovery value or as percentage depletion; and that, therefore, the amount of percentage depletion allowed to the taxpayer in prior years after the exhaustion of the original basis of the property must be applied against and used to reduce any subsequent additions to the capital account of the property in determining the adjusted basis as of the year of the sale of the property.

Section 113(b)1(A) and (B) of the Internal Revenue Code, governing this case, provides as follows:

> (b) ADJUSTED BASIS.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a) [March 1, 1913, value in this case], adjusted as hereinafter provided.
>
> (1) GENERAL RULE.—Proper adjustment in respect of the property shall in all cases be made—
>
> (A) For expenditures, * * * or other items, properly chargeable to capital account * * *;
>
> (B) in respect of any period since February 28, 1913, for * * * depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws. Where for any taxable year prior to the taxable year 1932 the depletion allowance was based on discovery value or a percentage of income, then the adjustment for depletion for such year shall be based on the depletion which would have been allowable for such year if computed without reference to discovery value or a percentage of income;

It seems clear that subparagraph (A), above, requires the addition to the basis of the property of the expenditures made in 1938 by the taxpayer and which it elected to capitalize. (Section 19.113(b)(1)–1, Regulations 103.)

The purpose of subparagraph (B), above, regarding adjustment of basis on account of depletion, is set forth in Senate Report No. 665, Seventy-second Congress, first session, on H. R. 10236 (the revenue bill of 1932) (C. B. 1939–1 (Part 2), 496, at 517), as follows:

> The requirement in subparagraph (B) of the House bill that the adjustment for depletion should be computed without regard to discovery value or percentage depletion is eliminated in the bill as to all adjustments in respect of the taxable year 1932 and subsequent years. *Your committee believes it only fair that the basis of the property should be adjusted to the full extent of the depletion allowances, without regard to the method by which these allowances are determined.* In view of the substantial change from the existing law in this respect, your committee is of the opinion that it should not disturb the depletion adjustments in respect of years prior to 1932. [Italics supplied.]

In construing section 113(b)1(B) of the Revenue Act of 1936, the language of which is almost identical with the corresponding section of the Code, this office, in G. C. M. 17760 (C. B. 1937–1, 102), stated in part as follows:

> The provision requires that the basis of *depletable* property be reduced [beginning with the taxable year 1932] on account of the full depletion allowed, whether computed on the cost, discovery value, or percentage of income basis * * *.

Therefore, in the instant case, in ascertaining the adjusted basis for determining gain or loss as provided in section 113(b)1(B) of the Internal Revenue Code, the capital account of the oil property,

which in 1939, the year of sale, consisted entirely of the cost in 1938 of drilling the additional oil well, should be reduced by the excess, over the original basis, of depletion allowed in years prior to the drilling of such additional well.

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

SECTION 19.113(b)(1)-2: Adjusted basis: Cancellation of indebtedness. (Also Section 19.113(b)(1)-3.) 1940-35-10401 T. D. 5003

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

Regulations 103, 101, 94, and 86, amended. Cancellation of indebtedness and reduction of basis of debtor's property in proceedings under Bankruptcy Act of 1898, as amended.

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

To Collectors of Internal Revenue and Others Concerned:

The Act of July 1, 1940 (Public, No. 699, Seventy-sixth Congress, third session), amends sections 270, 396, and 522 of the Bankruptcy Act, as amended, to read as follows, effective June 22, 1938:

SEC. 270. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section.

SEC. 396. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income-tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the arrangement. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section.

SEC. 522. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor's basis in whole or

in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income-tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the arrangement. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section.

In conformity with the above-quoted provisions of law, Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.], 101 [Part 9, Title 26, Code of Federal Regulations, 1939 Sup.], 94 [Part 3, Title 26, Code of Federal Regulations], and 86 are amended as follows:

PARAGRAPH 1. Section 19.113(b)(1)-2 of Regulations 103 and article 113(b)-2 of Regulations 101 [section 9.113(b)-2] are amended by eliminating the first two sentences and substituting in lieu thereof the following:

In addition to the adjustments provided in section 113(b)(1) and section 19.113(b)(1)-1 ["article 113(b)-1" in Regulations 101] which are required to be made with respect to the cost or other basis of property, a further adjustment shall be made in any case in which there shall have been a cancellation or reduction of indebtedness in any proceeding under section 12, 74 (except in the case of a "wage earner" as defined in the Bankruptcy Act, as amended), or 77B or under Chapter X, XI, or XII of the Bankruptcy Act of 1898, as amended.

PAR. 2. Section 19.113(b)(1)-2 of Regulations 103, article 113(b)-2 of Regulations 101 [section 9.113(b)-2], both as amended by the preceding paragraph of this Treasury decision, article 113(b)-2 of Regulations 94, as amended by Treasury Decision 4871, approved November 9, 1938 [C. B. 1938-2, 130] [section 3.113(b)-2, Title 26, Code of Federal Regulations, 1938 Sup.], and article 113(b)-2 of Regulations 86, as amended by such Treasury Decision 4871, are each amended by substituting for the matter following the first sentence thereof the following:

Such further adjustment shall be made in the following manner and order:

(1) In the case of indebtedness incurred to purchase specific property (other than inventory or notes or accounts receivable) whether or not a lien is placed against such property securing the payment of all or part of such indebtedness, which indebtedness shall have been canceled or reduced in any such proceeding, the cost or other basis of such property shall be decreased (but not below its fair market value) by the amount by which the indebtedness so incurred with respect to such property shall have been canceled or reduced;

(2) In the case of specific property (other than inventory or notes or accounts receivable) against which, at the time of the cancellation or reduction of the indebtedness, there is a lien (other than a lien securing indebtedness incurred to purchase such property) the cost or other basis of such property shall be decreased (but not below its fair market value) by the amount by which the indebtedness secured by such lien shall have been canceled or reduced;

(3) Any excess of the total amount by which the indebtedness shall have been so canceled or reduced in such proceeding over the sum of the adjustments made under (1) and (2) shall next be applied to reduce the cost or other basis of the property of the debtor (other than inventory and notes and accounts receivable, but including property covered by (1) and (2)) as follows: The cost or other basis of each unit of property shall be decreased (but not below its fair market value) in an amount equal to such proportion of such excess as the adjusted basis (after adjustment under (1) and (2)) of

each such unit of property bears to the sum of the adjusted bases (after adjustment under (1) and (2)) of all the property of the debtor other than inventory and notes and accounts receivable;

(4) Any excess of the total amount by which such indebtedness shall have been so canceled or reduced over the sum of the adjustments made under (1), (2), and (3) shall next be applied to reduce the cost or other basis of any units of property covered by (1), (2), and (3) which have a remaining basis (after adjustment under (1), (2), and (3)) greater than their fair market value, as follows: The cost or other basis of each such unit of property shall be decreased (but not below its fair market value) in an amount equal to such proportion of such excess as the remaining basis of each such unit bears to the sum of the remaining bases of such units. The process shall be repeated until the cost or other basis of each unit of the property covered by (1), (2), and (3) is reduced to its fair market value or the amount by which the indebtedness shall have been canceled or reduced is exhausted, taking into account in the successive steps only those units of property having, after the preceding adjustment, a remaining basis greater than their fair market value; and

(5) Any excess of the total amount by which the indebtedness shall have been so canceled or reduced over the sum of the adjustments made under (1), (2), (3), and (4) shall next be applied to reduce the cost or other basis of inventory and notes and accounts receivable, as follows: The cost or other basis of inventory or notes or accounts receivable, as the case may be, shall be decreased (but not below its fair market value) in an amount equal to such proportion of such excess as the adjusted basis of inventory, notes receivable or accounts receivable, as the case may be, bears to the sum of the adjusted bases of such inventory and notes and accounts receivable. The process shall be repeated until the adjusted bases of inventory, notes receivable and accounts receivable are reduced to their fair market value or the amount by which the indebtedness shall have been canceled or reduced is exhausted, taking into account in the successive steps only those units of property having, after the preceding adjustment, a remaining basis greater than their fair market value.

For the purposes of this article ["section" in Regulations 103]—

(A) Basis shall be determined as of the date of entry of the order confirming the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced;

(B) Except where the context otherwise requires, property means all of the debtor's property, other than money;

(C) No adjustment shall be made by virtue of the cancellation or reduction of any accrued interest unpaid which shall not have resulted in a tax benefit in any income tax return;

(D) The phrase "indebtedness incurred to purchase" includes (i) indebtedness for money borrowed and applied in the purchase of property and (ii) an existing indebtedness secured by a lien against the property which the debtor, as purchaser of such property, has assumed to pay; and

(E) The term "fair market value" has reference to such value as of the date of entry of the order confirming the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced.

Any determination of value in a proceeding under the Bankruptcy Act, as amended, shall not constitute a determination of fair market value for the purposes of this article ["section" in Regulations 103].

The basis of any of the debtor's property which shall have been transferred to a person required to use the debtor's basis in whole or in part shall be determined in accordance with the provisions of this article ["section" in Regulations 103].

PAR. 3. Regulations 103 are amended by inserting after section 19.113(b)(1)-2 thereof the following new section:

SEC. 19.113(b)(1)-3. *Adjusted basis: Cancellation of indebtedness: Special cases.*—If the taxpayer and the Commissioner agree, the basis of the taxpayer's property may be adjusted in a manner different from that set forth in section 19.113(b)(1)-2. Variations from such rule may, for example, involve adjusting the basis of any part of the taxpayer's property or adjusting the basis of all the taxpayer's property, according to a fixed allocation. Agreement between the taxpayer and the Commissioner as to any variation from such general rule shall be effected only by a closing agreement entered into under the provisions of section 3760 (paragraph 46 of the Appendix to these regulations).

PAR. 4. Article 113(b)-3 [section 9.113(b)-3] of Regulations 101, and article 113(b)-3 of Regulations 94 [section 3.113(b)-3], and 86, as amended by Treasury Decision 4871, approved November 9, 1938, are each redesignated article 113(b)-4.

PAR. 5. Regulations 101, and Regulations 94 and 86 both as amended by Treasury Decision 4871, approved November 9, 1938, are each amended by inserting after article 113(b)-2 thereof the following new article:

ART. 113(b)-3. *Adjusted basis: Cancellation of indebtedness: Special cases.*— If the taxpayer and the Commissioner agree, the basis of the taxpayer's property may be adjusted in a manner different from that set forth in article 113(b)-2. Variations from such rule may, for example, involve adjusting the basis of any part of the taxpayer's property or adjusting the basis of all the taxpayer's property, according to a fixed allocation. Agreement between the taxpayer and the Commissioner as to any variation from such general rule shall be effected only by a closing agreement entered into under the provisions of section 3760 of the Internal Revenue Code.

(This Treasury decision is issued under the authority of the Bankruptcy Act of 1898, as amended, and as further amended by the Act of July 1, 1940 (Public, No. 699, Seventy-Sixth Congress, third session); sections 62 and 113(b) of the Internal Revenue Code (53 Stat., 32, 44); and sections 62 and 113(b) of the Revenue Acts of 1938, 1936, and 1934 (52 Stat., 480, 490, 26 U. S. C., Sup., 62, 113(b); 49 Stat., 1673, 1682, 26 U. S. C., Sup., 62, 113(b); 48 Stat., 700, 706, 26 U. S. C., 62, 113(b).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved August 16, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register August 19, 1940, 12.38 p. m.)

SECTION 19.113(b)(1)-3: Adjusted basis: Cancellation of indebtedness: Special cases.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5003, page 107.)

SECTION 115.—DISTRIBUTIONS BY CORPORATIONS.

SECTION 19.115-3: Earnings or profits. (Also Sections 19.115-12, 19.115-13, and 19.115-14.) 1940-52-10538 T. D. 5024

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

Regulations 103 amended to conform to section 501 of the Second Revenue Act of 1940 and made applicable to taxable years beginning prior to January 1, 1939.

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

To Collectors of Internal Revenue and Others Concerned:

PARAGRAPH 1. By reason of the enactment of section 501 of the Second Revenue Act of 1940 (Public, No. 801, Seventy-sixth Congress, third session), approved October 8, 1940, Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.] are amended as follows:

A. The following is inserted immediately preceding section 19.115–1:

SEC. 501. EARNINGS AND PROFITS OF CORPORATIONS. (Second Revenue Act of 1940, Title V.)

(a) UNDER INTERNAL REVENUE CODE.—Section 115 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsections:

"(l) EFFECT ON EARNINGS AND PROFITS OF GAIN OR LOSS AND OF RECEIPT OF TAX-FREE DISTRIBUTIONS.—The gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation—

"(1) for the purpose of the computation of earnings and profits of the corporation, shall be determined, except as provided in paragraph (2), by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, except that no regard shall be had to the value of the property as of March 1, 1913; but

"(2) for the purpose of the computation of earnings and profits of the corporation for any period beginning after February 28, 1913, shall be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain.

Gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent to which such a realized gain or loss was recognized in computing net income under the law applicable to the year in which such sale or disposition was made. Where in determining the adjusted basis used in computing such realized gain or loss the adjustment to the basis differs from the adjustment proper for the purpose of determining earnings or profits, then the latter adjustment shall be used in determining the increase or decrease above provided. Where a corporation receives (after February 28, 1913) a distribution from a second corporation which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, the amount of such distribution shall not increase the earnings and profits of the first corporation in the following cases:

"(1) No such increase shall be made in respect of the part of such distribution which (under such law) is directly applied in reduction of the basis of the stock in respect of which the distribution was made.

"(2) No such increase shall be made if (under such law) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received.

"(m) EARNINGS AND PROFITS—INCREASE IN VALUE ACCRUED BEFORE MARCH 1, 1913.—

"(1) If any increase or decrease in the earnings or profits for any period beginning after February 28, 1913, with respect to any matter would be different had the adjusted basis of the property involved been determined without regard to its March 1, 1913, value, then, except as provided in paragraph (2), an increase (properly reflecting such difference) shall be made in that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

"(2) If the application of subsection (1) to a sale or other disposition after February 28, 1913, results in a loss which is to be applied in decrease of earnings and profits for any period beginning after February 28, 1913, then, notwithstanding subsection (1) and in lieu of the rule provided in paragraph (1) of this subsection, the amount of such loss so to be applied shall be reduced by the amount, if any, by which the adjusted basis of the property used in determining the loss, exceeds the adjusted basis computed without regard to the value of the property on March 1, 1913, and if such amount so applied in reduction of the decrease exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913."

(b) EFFECTIVE DATE OF AMENDMENT.—The amendment made by subsection (a) shall be applicable to taxable years beginning after December 31, 1938.

(c) UNDER PRIOR ACTS.—For the purposes of the Revenue Act of 1938 or any prior Revenue Act the amendments made to the Internal Revenue Code by subsection (a) of this section shall be effective as if they were a part of each such Revenue Act on the date of its enactment. Nothing in this subsection shall affect the tax liability of any taxpayer for any year which, on September 20, 1940, was pending before, or was theretofore determined by, the Board of Tax Appeals, or any court of the United States.

B. Section 19.115–3 is amended as follows:

(*a*) By inserting before the period at the end of the third sentence of the first paragraph the following: "(see section 19.115–12)".

(*b*) By striking out the second paragraph and inserting in lieu thereof the following:

In the case of a corporation in which depletion or depreciation is a factor in the determination of income, the only depletion or depreciation deductions to be considered in the computation of the total earnings and profits are those based on cost or other basis without regard to March 1, 1913, value. In computing the earnings and profits for any period beginning after February 28, 1913, the only depletion or depreciation deductions to be considered are those based on (1) cost or other basis, if the depletable or depreciable asset was acquired subsequent to February 28, 1913, or (2) adjusted cost or March 1, 1913, value, whichever is higher, if acquired prior to March 1, 1913. Thus, discovery or percentage depletion under all Revenue Acts for mines and oil and gas wells is not to be taken into consideration in computing the earnings and profits of a corporation. Similarly, where the basis of property in the hands of a corporation is a substituted basis, such basis, and not the fair market value of the property at the time of the acquisition by the corporation, is the basis for computing depletion and depreciation for the purpose of determining earnings and profits of the corporation. The provisions of this paragraph may be illustrated by the following example:

Example: Oil producing property which A had acquired in 1936 at a cost of $28,000 was transferred to the Y Corporation in December, 1938, in exchange for all of its capital stock. The fair market value of the stock and of the property as of the date of the transfer was $247,000. The Y Corporation, after two years' operations, effected in 1940 a cash distribution to A in the amount of $165,000. In determining the extent to which the earnings and profits of the Y Corporation available for dividend distributions have been increased as the result of production and sale of oil, the depletion to be taken into account is to be computed upon the basis of $28,000 established in the nontaxable exchange in 1938 regardless of the fair market value of the property or of the stock issued in exchange therefor.

C. The following sections are inserted immediately following section 19.115–11:

SEC. 19.115–12. *Effect on earnings and profits of gain or loss realized after February 28, 1913.*—In order to determine the effect on earnings and profits of gain or loss realized from the sale or other disposition (after February 28, 1913) of prop-

erty by a corporation, section 115(l) prescribes certain rules for (1) the computation of the total earnings and profits of the corporation, of most frequent application in determining invested capital; and (2) the computation of earnings and profits of the corporation for any period beginning after February 28, 1913, of most frequent application in determining the source of dividend distributions. Such rules are applicable whenever under any provision of Chapter 1 or 2 it is necessary to compute either the total earnings and profits of the corporation or the earnings and profits for any period beginning after February 28, 1913. For example, since the earnings and profits accumulated after February 28, 1913, or the earnings and profits of the taxable year, are earnings and profits for a period beginning after February 28, 1913, the determination of either must be in accordance with the rules herein prescribed for the ascertainment of earnings and profits for any period beginning after February 28, 1913. Under (1) such gain or loss is determined by using the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, but disregarding value as of March 1, 1913. Under (2) there is used such adjusted basis for determining gain, giving effect to the value as of March 1, 1913, whenever applicable. In both cases the rules are the same as those governing depreciation and depletion in computing earnings and profits (see section 19.115–3). Under both (1) and (2) the adjusted basis is subject to the limitations of the third sentence of section 115(l) requiring the use of adjustments proper in determining earnings and profits. The proper adjustments may differ under (1) and (2) of section 115(l) depending upon the basis to which the adjustments are to be made. If the application of (2) of the first sentence of section 115(l) results in a loss and if the application of (1) of such sentence to the same transaction reaches a different result, then the loss under (2) will be subject to the adjustment thereto required by section 115(m)(2). (See section 19.115–14.)

The gain or loss so realized increases or decreases the earnings and profits to, but not beyond, the extent to which such gain or loss was *recognized* in computing net income under the law applicable to the year in which such sale or disposition was made. As used in this subsection the term "recognized" has reference to that kind of realized gain or loss which is recognized for income tax purposes by the statute applicable to the year in which the gain or loss was realized, for example, see section 112. A loss may be recognized though not allowed as a deduction (by reason, for example, of the operation of sections 24(b), 117, and 118 and corresponding provisions of prior revenue laws) but the mere fact that it is not allowed does not prevent decrease in earnings and profits by the amount of such disallowed loss. The "recognized" gain or loss for the purpose of computing earnings and profits is determined by applying the recognition provisions to the realized gain or loss computed under the provisions of section 115(l) as distinguished from the realized gain or loss used in computing net income. The application of this paragraph may be illustrated by the following examples:

Example (1): The X Corporation on January 1, 1939, owned stock in the Y Corporation which it had acquired from the Y Corporation in December, 1938, in an exchange transaction in which no gain or loss was recognized. The adjusted basis to the X Corporation of the property exchanged by it for the stock in the Y Corporation was $30,000. The fair market value of the stock in the Y Corporation when received by the X Corporation was $930,000. On April 9, 1939, the X Corporation made a cash distribution of $900,000 and, except for the possible effect of the transaction in 1938, had no earnings or profits accumulated after February 28, 1913, and had no earnings or profits for the taxable year. The amount of $900,000 representing the excess of the fair market value of the stock of the Y Corporation over the adjusted basis of the property exchanged therefor was not recognized gain to the X Corporation under the provisions of section 112 of the Revenue Act of 1938. Accordingly, the earnings and profits of the X Corporation are not increased by $900,000, the amount of the gain realized but not recognized in the exchange, and the distribution was not a taxable dividend. The basis in the hands of the Y Corporation of the property acquired by it from the X Corporation is $30,000. If such property is thereafter sold by the Y Corporation, gain or loss will be computed on such basis of $30,000, and earnings and profits will be increased or decreased accordingly.

Example (2): On January 2, 1910, the M Corporation acquired nondepreciable property at a cost of $1,000. On March 1, 1913, the fair market value of such property in the hands of the M Corporation was $2,200. On December 31, 1940, the M Corporation transfers such property to the N Corporation in exchange for $1,900 in cash and all the N Corporation stock, which has a fair market value of $1,100. For the purpose of computing the total earnings and profits of the M

Corporation the gain on such transaction is $2,000 (the sum of $1,900 in cash and stock worth $1,100 minus $1,000, the adjusted basis for computing gain, determined without regard to March 1, 1913, value), $1,900 of which is recognized under section 112(c), since this was the amount of money received, although for the purpose of computing net income the gain is only $800 (the sum of $1,900 in cash and stock worth $1,100, minus $2,200, the adjusted basis for computing gain determined by giving effect to March 1, 1913, value). Such earnings and profits will therefore be increased by $1,900. In computing the earnings and profits of the M Corporation for any period beginning after February 28, 1913, however, the gain arising from the transaction, like the taxable gain, is only $800, all of which is recognized under section 112(c), the money received being in excess of such amount. Such earnings and profits will therefore be increased by only $800 as a result of the transaction. For increase in that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after, March 1, 1913, see section 19.115-14.

Example (3): On July 31, 1940, the R Corporation owned oil producing property acquired after February 28, 1913, at a cost of $200,000, but having an adjusted basis (by reason of taking percentage depletion) of $100,000 for determining gain in computing net income. However, the adjusted basis of such property to be used in computing gain or loss for the purpose of earnings and profits is, because of the provisions of the third sentence of section 115(l), $150,000. On such day the R Corporation transferred such property to the S Corporation in exchange for $25,000 in cash and all of the S Corporation stock, which had a fair market value of $100,000. For the purpose of computing net income the R Corporation has realized a gain of $25,000 as a result of this transaction, all of which is recognized under section 112(c). For the purpose of computing earnings and profits, however, the R Corporation has realized a loss of $25,000, none of which is recognized owing to the provisions of section 112(e). The earnings and profits of the R Corporation are therefore neither increased nor decreased as a result of the transaction. The adjusted basis of the S Corporation stock in the hands of the R Corporation for purposes of computing earnings and profits, however, will be $125,000 (though only $100,000 for the purpose of computing net income), computed as follows:

Basis of property transferred	$200,000
Less money received on exchange	25,000
Plus gain or minus loss recognized on exchange	None
Basis of stock	175,000
Less adjustments (same as those used in determining adjusted basis of property transferred)	50,000
Adjusted basis of stock	125,000

If, therefore, the R Corporation should subsequently sell the S Corporation stock for $100,000, a loss of $25,000 will again be realized for the purpose of computing earnings and profits, all of which will be recognized and will be applied to decrease the earnings and profits of the R Corporation.

The third sentence of section 115(l) provides for cases in which the adjustments, prescribed in section 113, to the basis indicated in paragraph (1) or (2) of the first sentence, as the case may be, of section 115(l), differ from the adjustments to such basis proper for the purpose of determining earnings or profits. The adjustments provided by the third sentence of section 115(l) reflect the treatment provided by section 19.115-3 relative to cases where the deductions for depletion and depreciation in computing net income differ from the deductions proper for the purpose of computing earnings and profits. The effect of such third sentence may be illustrated by the following examples:

Example (1): The X Corporation purchased on January 2, 1931, an oil lease at a cost of $10,000. The lease was operated only for the years 1931 and 1932. The deduction for depletion in each of the years 1931 and 1932 amounted to $2,750, of which amount $1,750 represented percentage depletion in excess of depletion based on cost. The lease was sold in 1940 for $15,000. Under section 113(b)(1)(B), in determining the gain or loss from the sale of the property, the basis must be adjusted for cost depletion of $1,000 in 1931 and percentage depletion of $2,750 in 1932. However, the adjustment of such basis, proper for the determination of earnings and profits, is $1,000 for each year, or $2,000. Hence, the cost is to be adjusted only to the extent of $2,000, leaving an adjusted basis of $8,000 and the earnings and profits will be increased by $7,000, and not by $8,750. The difference of $1,750 is equal to the amount by which the

percentage depletion for the year 1932 ($2,750) exceeds the depletion on cost for that year ($1,000) and has already been applied in the computation of earnings and profits for the year 1932 by taking into account only $1,000 instead of $2,750 for depletion in the computation of such earnings and profits (see sections 19.115-3 and 19.115-6).

Example (2): If, in the preceding example, the property, instead of being sold, is exchanged in a transaction described in section 112(c) for like property having a fair market value of $7,750 and cash of $7,250, then the increase in earnings and profits amounts to $7,000, that is, $15,000 ($7,750 plus $7,250) minus the base of $8,000. However, in computing net income of the X Corporation, the gain is $8,750, that is, $15,000 minus $6,250 ($10,000 less depletion of $3,750), of which only $7,250 is recognized because the recognized gain can not exceed the sum of money received in the transaction. Section 112(c)(1), and corresponding provisions of prior revenue laws. If, however, the cash received was only $2,250 and the value of the property received was $12,750, then the increase in earnings and profits would be $2,250, that amount being the gain recognized under section 112.

For adjustment and allocation of the earnings and profits of the transferor as between the transferor and the transferee in cases where the transfer of property by one corporation to another corporation results in the nonrecognition, in whole or in part, of gain or loss, see section 19.115-11.

SEC. 19.115-13. *Effect on earnings and profits of receipt of tax-free distributions requiring adjustment or allocation of basis of stock.*—In order to determine the effect on earnings and profits, where a corporation receives (after February 28, 1913) from a second corporation a distribution which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, section 115(l) prescribes certain rules. It provides that the amount of such distribution shall not increase the earnings and profits of the first or receiving corporation in the following cases: (1) No such increase shall be made in respect of the part of such distribution which (under the law applicable to the year in which the distribution was made) is directly applied in reduction of the basis of the stock in respect of which the distribution was made and (2) no such increase shall be made if (under the law applicable to the year in which the distribution was made) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received. Where, therefore, the law (applicable to the year in which the distribution was made, as, for example, a distribution in 1934 from earnings and profits accumulated prior to March 1, 1913) requires that the amount of such distribution shall be applied against and reduce the basis of the stock with respect to which the distribution was made, there is no increase in the earnings and profits by reason of the receipt of such distribution. Similarly, where there is received by a corporation a distribution from another corporation in the form of a stock dividend and the law applicable to the year in which such distribution was made requires the allocation, as between the old stock and the stock received as a dividend, of the basis of the old stock, then there is no increase in the earnings and profits by reason of the receipt of such stock dividend even though such stock dividend constitutes income within the meaning of the sixteenth amendment to the Constitution. These principles may be illustrated by the following examples:

Example (1): The X Corporation in 1939 distributed to the Y Corporation, one of its shareholders, $10,000 which was out of earnings or profits accumulated before March 1, 1913, and did not exceed the adjusted basis of the stock in respect of which the distribution was made. This amount of $10,000 was, therefore, a tax-free distribution and under the provisions of section 115(b) must be applied against and reduce the adjusted basis of the stock in respect of which the distribution was made. The earnings and profits of the Y Corporation are not increased by reason of the receipt of this distribution.

Example (2): The Z Corporation in 1934 had outstanding common and preferred stock of which the Y Corporation held 100 shares of the common and no preferred. The stock had a cost basis to the Y Corporation of $100 per share, or a total cost of $10,000. In December of that year it received a dividend of 100 shares of the preferred stock of the Z Corporation. Such distribution is a stock dividend which, under section 115(f) of the Revenue Act of 1934, was not taxable and was accordingly not included in the gross income of the Y Corporation. The original cost of $10,000 is allocated to the 200 shares of the Z Corporation none of which has been sold or otherwise disposed of by the Y Corporation. See section 113(a)(19) and sections 19.113(a)(19)-1 and 19.113(a)(12)-1.

The earnings and profits of the Y Corporation are not increased by reason of the receipt of such stock dividend.

SEC. 19.115–14. *Adjustments to earnings and profits reflecting increase in value accrued prior to March 1, 1913.*—In order to determine, for the purpose of ascertaining the source of dividend distributions, that part of the earnings and profits which is represented by increase in value of property accrued before, but realized on or after, March 1, 1913, section 115(m) prescribes certain rules.

Paragraph (1) of section 115(m) sets forth the general rule with respect to computing the increase to be made in that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after, March 1, 1913. The effect of this paragraph may be illustrated by the following examples:

Example (1): The X Corporation acquired nondepreciable property prior to March 1, 1913, at a cost of $10,000. Its fair market value of March 1, 1913, was $12,000 and it was sold in 1940 for $15,000. The increase in earnings and profits based on the value as of March 1, 1913, representing earnings and profits accumulated since February 28, 1913, is $3,000. If the basis is determined without regard to the value as of March 1, 1913, there would be an increase in earnings and profits of $5,000. The difference of $2,000 ($5,000 minus $3,000) represents the increase to be made in that part of the earnings and profits of the X Corporation consisting of the increase in value of property accrued before, but realized on or after, March 1, 1913.

Example (2): The Y Corporation acquired depreciable property in 1908 at a cost of $100,000. Assuming no additions or betterments, and that the depreciation sustained prior to March 1, 1913, was $10,000, the adjusted cost as of that date was $90,000. Its fair market value as of March 1, 1913, was $94,000 and in 1939 it was sold for $60,000. For the purpose of determining gain from the sale, the basis of the property is the fair market value of $94,000 as of March 1, 1913, adjusted for depreciation for the period subsequent to February 28, 1913, computed on such fair market value. If the amount of the depreciation deduction allowed (not less than the amount allowable) after February 28, 1913, to the date of the sale in 1939 is the aggregate sum of $43,240, the adjusted basis for determining gain in 1939 ($94,000 less $43,240) is $50,760 and the gain would be $9,240 ($60,000 less $50,760). The increase in earnings and profits accumulated since February 28, 1913, by reason of the sale, based on the value as of March 1 1913, adjusted for depreciation, is $9,240. If the depreciation since February 28, 1913, had been based on the adjusted cost of $90,000 ($100,000 less $10,000) instead of the March 1, 1913, value of $94,000, the depreciation sustained from that date to the date of sale would have been $41,400 instead of $43,240 and the actual gain on the sale based on the cost of $100,000 adjusted by depreciation on such cost to $48,600 ($100,000 reduced by the sum of $10,000 and $41,400) would be $11,400 ($60,000 less $48,600). If the adjusted basis of the property was determined without regard to the value as of March 1, 1913, there would be an increase in earnings and profits of $11,400. The difference of $2,160 ($11,400 minus $9,240) represents the increase to be made in that part of the earnings and profits of the Y Corporation consisting of the increase in value of property accrued before, but realized on or after, March 1, 1913.

Paragraph (2) of section 115(m) is an exception to the general rule in paragraph (1) of such section and also operates as a limitation on the application of section 115(l). It provides that, if the application of (2) of the first sentence of section 115(l) to a sale or other disposition after February 28, 1913, results in a loss which is to be applied in decrease of earnings and profits for any period beginning after February 28, 1913, then, notwithstanding section 115(l) and in lieu of the rule provided in paragraph (1) of section 115(m), the amount of such loss so to be applied shall be reduced by the amount, if any, by which the adjusted basis of the property used in determining the loss, exceeds the adjusted basis computed without regard to the fair market value of the property on March 1, 1913. If the amount so applied in reduction of the loss exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after, March 1, 1913. The following examples will show the application of section 115(m)(2):

Example (1): The Y Corporation acquired nondepreciable property prior to March 1, 1913, at a cost of $8,000, its fair market value as of March 1, 1913, was $13,000, and it was sold in 1939 for $10,000. Under (2) of the first sentence of

section 115(1) the adjusted basis would be $13,000 and there would be a loss of $3,000. The application of (2) of the first sentence of section 115(1) would result in a loss from the sale in 1939 to be applied in decrease of earnings and profits for that year. Section 115(m)(2), however, applies and the loss of $3,000 is reduced by the amount by which the adjusted basis of $13,000 exceeds the cost of $8,000 (the adjusted basis computed without regard to the value on March 1, 1913), namely, $5,000. The amount of the loss is, accordingly, reduced from $3,000 to zero and there is no decrease in earnings and profits of the Y Corporation for the year 1939 as the result of the sale. The amount applied in reduction of the decrease, namely, $5,000, exceeds $3,000. Accordingly, as a result of the sale the excess of $2,000 increases that part of the earnings and profits of the Y Corporation consisting of increase in value of property accrued before, but realized on or after, March 1, 1913.

Example (2): The Z Corporation acquired nondepreciable property prior to March 1, 1913, at a cost of $10,000, its fair market value as of March 1, 1913, was $12,000, and it was sold in 1939 for $8,000. Under (2) of the first sentence of section 115(1) the adjusted basis would be $12,000 and there would be a loss of $4,000. The application of (2) of the first sentence of section 115(1) would result in a loss from the sale in 1939 to be applied in decrease of earnings and profits for that year. Section 115(m)(2), however, applies and the loss of $4,000 is reduced by the amount by which the adjusted basis of $12,000 exceeds the cost of $10,000 (the adjusted basis computed without regard to the value on March 1, 1913), namely, $2,000. The amount of the loss is, accordingly, reduced from $4,000 to $2,000 and the decrease in earnings and profits of the Z Corporation for the year 1939 as the result of the sale is $2,000 instead of $4,000. The amount applied in reduction of the decrease, namely, $2,000, does not exceed $4,000. Accordingly, as the result of the sale there is no increase in that part of the earnings and profits of the Z Corporation consisting of increase in value of property accrued before, but realized on or after, March 1, 1913.

PAR. 2. The above amendments to Regulations 103 (which regulations cover taxable years beginning after December 31, 1938) are hereby made applicable to taxable years beginning prior to January 1, 1939 (such years being covered by Regulations 101, 94, 86, 77, 74, 69, 65, 62, 45, and 33). Although under section 501(c) the final determination by the Board of Tax Appeals or any court of the United States of the tax liability of any taxpayer for any such taxable year which, on September 20, 1940, was pending before, or was theretofore determined by, the Board of Tax Appeals, or any court of the United States, is not affected by the enactment of section 501, the rules stated in the regulations are applicable to such cases inasmuch as such rules are a proper interpretation of the law as it existed prior to the enactment of section 501. The limitation in section 501(c) has application only to such taxpayer, and in the case of such taxpayer, only with respect to the tax liability for the specific year or years actually so pending on, or so determined prior to, September 20, 1940.

(This Treasury decision is prescribed pursuant to sections 62 and 3791(b) of the Internal Revenue Code (53 Stat., 32, 467), corresponding provisions of prior internal revenue laws, and section 501 of the Second Revenue Act of 1940 (Public, No. 801, Seventy-sixth Congress, third session).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved December 19, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 20, 1940, 3.11 p. m.)

SECTION 19.115-7: Stock dividends. 1940-48-10501
T. D. 5020

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

Regulations 103 amended.—Stock dividends and stock rights.

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

To Collectors of Internal Revenue and Others Concerned:

Section 19.115-7 of Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.] is amended by striking out all of the matter appearing after the first sentence thereof.

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

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved November 15, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register November 19, 1940, 3.27 p. m.)

SECTION 19.115-12: Effect on earnings and profits of gain or loss realized after February 28, 1913.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5024, page 110.)

SECTION 19.115-13: Effect on earnings and profits of receipt of tax-free distributions requiring adjustment or allocation of basis of stock.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5024, page 110.)

SECTION 19.115-14: Adjustments to earnings and profits reflecting increase in value accrued prior to March 1, 1913.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5024, page 110.)

SECTION 116.—EXCLUSIONS FROM GROSS INCOME.

1940–45–10477
I. T. 3424

INTERNAL REVENUE CODE.

B made two trips to Europe in the year 1939. The first trip extended from May 5 to June 8, and the second trip extended from June 16 to December 2. *Held*, B was a bona fide nonresident of the United States for more than six calendar months during the taxable year 1939, and is entitled to the exemption provided in section 116(a) of the Internal Revenue Code.

Advice is requested as to whether B was a bona fide nonresident of the United States " for more than six months " during the year 1939, within the meaning of section 116(a) of the Internal Revenue Code. B made two trips to Europe in that year. The first trip extended from May 5 to June 8, and the second trip extended from June 16 to December 2.

In G. C. M. 22065 (C. B. 1940–1, 100) it was held (syllabus):

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.

In accordance with G. C. M. 22065, supra, the first trip made by B, extending from May 5 to June 8, is to be treated as one calendar month. The second trip, extending from June 16 to December 2, constituted five full calendar months. Under the principle contained in G. C. M. 22065, supra, the fractional parts of months from the two trips, that is, from June 5 to June 8 and from November 16 to December 2, may not be recognized in the computation of calendar months' absence. However, in view of the fact that B was absent from the United States for six full calendar months in 1939, in addition to the fractional parts of months above mentioned, it is held that he was absent from the United States for *more* than six calendar months in that year. Accordingly, the taxpayer qualifies as a bona fide nonresident of the United States for more than six calendar months during the taxable year, and comes within the exemption provided by section 116(a) of the Internal Revenue Code.

SECTION 124.—AMORTIZATION DEDUCTION.

SECTION 19.124–1: Definitions. 1940–44–10474
T. D. 5016

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

Regulations 103 amended.—Amortization deductions under Title III of the Second Revenue Act of 1940 (Public, No. 801, Seventy-sixth Congress, third session), approved October 8, 1940.

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

To Collectors of Internal Revenue and Others Concerned:

Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.] are amended as follows:

PARAGRAPH 1. Section 19.23(l)-1 is amended by inserting at the end thereof a sentence reading as follows:

For deduction with respect to the amortization of emergency facilities, in lieu of the deduction for depreciation, see sections 23(t) and 124.

PAR. 2. The following is inserted immediately preceding section 24:

SEC. 301. ALLOWANCE OF AMORTIZATION DEDUCTION. (SECOND REVENUE ACT OF 1940.)

Section 23 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsection:

"(t) AMORTIZATION DEDUCTION.—The deduction for amortization provided in section 124."

PAR. 3. The following is inserted immediately following section 19.123-2:

SEC. 302. COMPUTATION OF AMORTIZATION DEDUCTION. (SECOND REVENUE ACT OF 1940.)

The Internal Revenue Code is amended by inserting after section 123 the following new section:

"SEC. 124. AMORTIZATION DEDUCTION.

"(a) GENERAL RULE.—Every corporation, at its election, shall be entitled to a deduction with respect to the amortization of the adjusted basis of any emergency facility (as defined in subsection (e)), based on a period of 60 months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the adjusted basis of the facility at the end of such month divided by the number of months (including the month for which the deduction is computed) remaining in the period. Such adjusted basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction above provided with respect to any month shall, except to the extent provided in subsection (g) of this section, be in lieu of the deduction with respect to such facility for such month provided by section 23(l), relating to exhaustion, wear and tear, and obsolescence. The 60-month period shall begin as to any emergency facility, at the election of the taxpayer, with the month following the month in which the facility was completed or acquired, or with the succeeding taxable year.

"(b) ELECTION OF AMORTIZATION.—The election of the taxpayer to take the amortization deduction and to begin the 60-month period with the month following the month in which the facility was completed or acquired shall (except as provided in subsection (d)(3)) be made only by a statement to that effect in its return for the taxable year in which the facility was completed or acquired. Its election to take the amortization deduction and to begin such period with the taxable year succeeding such year shall be made only by a statement to that effect in its return for such succeeding taxable year.

"(c) TERMINATION OF AMORTIZATION DEDUCTION.—A taxpayer which has elected under subsection (b) to take the amortization deduction provided in subsection (a) may, at any time after making such election, discontinue the amortization deductions with respect to the remainder of the amortization period, such discontinuance to begin as of the beginning of any month specified by the taxpayer in a notice in writing filed with the Commissioner before the beginning of such month. The deduction provided under section 23(l) shall be allowed, beginning with the first month as to which the amortization deduction is not applicable, and the taxpayer shall not (except as provided in subsection (d)) be entitled to any further amortization deductions with respect to such emergency facility.

"(d) TERMINATION OF AMORTIZATION PERIOD.—

"(1) If the President has proclaimed the ending of the emergency period (as defined in subsection (e)), or if the Secretary of War or the Secretary of the Navy has, in accordance with regulations prescribed by the President, certified to the Commissioner that an emergency facility ceased, on the date specified in the certificate, to be necessary in the interest of national defense during the emergency period, and if the date of such proclamation or the date specified in such certificate occurs within 60 months from the beginning of the amortization period with respect to such emergency facility, then the taxpayer may elect (in accordance with paragraph (4) of this subsection) to terminate the amortization period with respect to such emergency facility as of the end of the month in which such proclamation was issued or in which occurred the date specified in such certificate, whichever is the earlier. In such case the amortization period with respect to such facility shall end with the end of such month in lieu of the end of the 60-month period.

"(2) If the date of the proclamation or the date specified in the certificate referred to in paragraph (1) of this subsection occurs within 60 months from the beginning of the amortization period with respect to such emergency facility and after the beginning of the month which the taxpayer has previously fixed under subsection (c) for the taking, in lieu of the amortization deduction provided in this section, of the deduction allowed by section 23(l), the taxpayer may elect (in accordance with paragraph (4) of this subsection) to terminate the amortization period with respect to such emergency facility as of the end of the month in which such proclamation was issued or in which occurred the date specified in such certificate, whichever is the earlier. In such case the amortization period with respect to such facility shall end with the end of such month in lieu of the end of the 60-month period, and the termination of the amortization deduction under subsection (c) shall be disregarded.

"(3) In the case of a taxpayer which has not in either of its returns specified in subsection (b) elected to take an amortization deduction with respect to an emergency facility, if the date of the proclamation or the date specified in the certificate, referred to in paragraph (1) of this subsection, whichever is earlier, is before the expiration of 60 months from the last day of the month in which such emergency facility was completed or acquired, then the taxpayer may elect (in accordance with paragraph (4) of this subsection) the amortization deduction provided in subsection (a), using an amortization period beginning with the month following the month in which the emergency facility was completed or acquired and ending as of the end of the month within which such proclamation was issued or within which occurred the date specified in such certificate, whichever is the earlier.

"(4) The election provided in paragraph (1), (2), or (3) shall be made by filing with the Commissioner, in such manner, in such form, and within such time, as the Commissioner with the approval of the Secretary may by regulations prescribe, a statement of such election. When such election has been so made, then, under regulations prescribed by the Commissioner with the approval of the Secretary, the taxes for all taxable years, beginning with the taxable year in which the amortization period began, shall be computed in accordance with an amortization deduction computed in accordance with the method provided in subsection (a), but using (in lieu of the 60-month period provided in such subsection) the amortization period specified in paragraph (1), (2), or (3), as the case may be.

"(5) RECOMPUTATION OF TAX IN CASE OF ELECTION UNDER THIS SUBSECTION.—If the adjustment of the income or excess-profits tax liability for any taxable year necessary to give effect to paragraph (4) of this subsection is prevented (A) on the date of the certificate of the Secretary of War or the Secretary of the Navy or on the date of the President's proclamation, whichever is the basis of the taxpayer's election under this subsection, or (B) within one year from such date, by any provision of law (other than this paragraph and other than section 3761, relating to compromises), an adjustment of the tax liability shall nevertheless be made if in respect of such taxable year a notice of deficiency is mailed or a claim for refund is filed, as the case may be, within one year after the date of such certificate or such proclamation, whichever is the basis of the taxpayer's election under this subsection. If at the time of the mailing of such notice of deficiency or the filing of such claim for refund, the adjustment is so prevented, then

the amount of the adjustment authorized in this paragraph shall be limited to the increase or decrease in the tax previously determined for such taxable year which results solely from the effect of paragraph (4) of this subsection, and such amount shall be assessed and collected, or credited or refunded, in the same manner as if it were a deficiency or an overpayment, as the case may be, for such taxable year and as if on the date of such certificate or such proclamation, whichever is the basis of the taxpayer's election under this subsection, one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for the taxable year. The tax previously determined shall be ascertained in accordance with section 3801(d). The amount to be assessed and collected under this paragraph in the same manner as if it were a deficiency, or to be refunded or credited in the same manner as if it were an overpayment, shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of paragraph (4) of this subsection. Such amount, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of paragraph (4) of this subsection.

"(e) DEFINITIONS.—

"(1) EMERGENCY FACILITY.—As used in this section, the term 'emergency facility' means any facility, land, building, machinery, or equipment, or part thereof, the construction, reconstruction, erection, or installation of which was completed after June 10, 1940, or which was acquired after such date, and with respect to which a certificate under subsection (f) has been made.

"(2) EMERGENCY PERIOD.—As used in this section, the term 'emergency period' means the period beginning June 10, 1940, and ending on the date on which the President proclaims that the utilization of a substantial portion of the emergency facilities with respect to which certifications under subsection (f) have been made, is no longer required in the interest of national defense.

"(f) DETERMINATION OF ADJUSTED BASIS OF EMERGENCY FACILITY.—In determining, for the purposes of subsection (a) or subsection (h), the adjusted basis of an emergency facility—

"(1) There shall be included only so much of the amount otherwise constituting such adjusted basis as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after June 10, 1940, as the Advisory Commission to the Council of National Defense and either the Secretary of War or the Secretary of the Navy have certified, within the time specified in paragraph (3) of this subsection, and under such regulations as the President may prescribe, as necessary in the interest of national defense during the emergency period;

"(2) After the completion or acquisition of any emergency facility with respect to which a certificate under paragraph (1) has been made, any expenditure (attributable to such facility and to the period after such completion or acquisition) which does not represent construction, reconstruction, erection, installation, or acquisition included in such certificate, but with respect to which a separate certificate is made under paragraph (1), shall not be applied in adjustment of the basis of such facility and shall be considered as an expenditure with respect to a new emergency facility; and

"(3) The certificate provided for in paragraph (1) shall have no effect unless made before whichever of the following dates is the later: (A) The beginning of such construction, reconstruction, erection, or installation, or the date of such acquisition, or (B) the one hundred and twentieth day after the date of the enactment of the Second Revenue Act of 1940.

"(g) DEPRECIATION DEDUCTION.—If the adjusted basis of the emergency facility computed without regard to subsection (f) of this section is in excess of the adjusted basis computed under such subsection, the deduction provided by section 23(l) shall, despite the provisions of subsection (a) of this section, be allowed with respect to such emergency facility as if its adjusted basis were an amount equal to the amount of such excess.

"(h) PAYMENT BY UNITED STATES OF UNAMORTIZED COST OF FACILITY.—If an amount is properly includible in the gross income of the taxpayer on account of a payment with respect to an emergency facility and such payment is certified as provided in this paragraph, then, at the election of the taxpayer in its return for the taxable year in which such amount is so includible—

"(1) The amortization deduction for the month in which such amount is so includible shall (in lieu of the amount of the deduction for such month computed under subsection (a)) be the amount so includible, but such deduction shall not be in excess of the adjusted basis of the emergency facility as of the end of such month (computed without regard to any amortization deduction for such month). Payments referred to in this paragraph shall be payments the amounts of which are certified, under such regulations as the President may prescribe, by either the Secretary of War or the Secretary of the Navy as compensation to the taxpayer for the unamortized cost of the emergency facility made because—

"(A) A contract with the United States involving the use of the facility has been terminated by its terms or by cancellation, or

"(B) the taxpayer had reasonable grounds (either from provisions of a contract with the United States involving the use of the facility, or from written or oral representations made under authority of the United States) for anticipating future contracts involving the use of the facility, which future contracts have not been made.

"(2) In case the taxpayer is not entitled to any amortization deduction with respect to the emergency facility the deduction allowable under section 23(l) on account of the month in which such amount is so includible shall be increased by such amount, but such deduction on account of such month shall not be in excess of the adjusted basis of the emergency facility as of the end of such month (computed without regard to any amount allowable, on account of such month, under section 23(l) or this paragraph).

"(i) PROTECTION OF THE UNITED STATES.—If the taxpayer has been or will be reimbursed by the United States for all or a part of the cost of any emergency facility pursuant to any contract with the United States, either—

"(1) directly, by a provision therein dealing expressly with such reimbursement, or

"(2) indirectly, because the price paid by the United States (insofar as return of cost of the facility is used as a factor in the fixing of such price) is recognized by the contract as including a return of cost greater than the normal exhaustion, wear and tear,

no amortization deduction with respect to such emergency facility shall be allowed for any month after the end of the month in which such contract is made, unless, before the expiration of 90 days after the making of such contract or 120 days after the date of the enactment of the Second Revenue Act of 1940, whichever of such periods expires the later, the Advisory Commission to the Council of National Defense, and either the Secretary of War or the Secretary of the Navy certify to the Commissioner that such contract adequately protects the United States with reference to the future use and disposition of such emergency facility. A certificate by the Advisory Commission to the Council of National Defense and either the Secretary of War or the Secretary of the Navy, made to the Commissioner before the expiration of 90 days after the making of a contract or 120 days after the date of the enactment of the Second Revenue Act of 1940, whichever of such periods expires the later, to the effect that, under such contract, reimbursement for all or a part of the cost of any emergency facility is not provided for within the meaning of clause (1) or clause (2), shall be conclusive for the purposes of this subsection.

"The terms and conditions of contracts with reference to reimbursement of the cost of emergency facilities and the protecting of the United States with reference to the future use and disposition of such emergency facilities shall be made available to the public."

SEC. 19.124–1. *Definitions.*—As used in this section and sections 19.124–2 to 19.124–9, inclusive, the term—

(*a*) "*Advisory Commission*" means the Advisory Commission to the Council of National Defense.

(*b*) "*Secretary of the department concerned*" means the Secretary of War or the Secretary of the Navy, as the case may be.

(*c*) "*Emergency facility*" means any facility, land, building, machinery, or equipment, or any part thereof,—

(1) the acquisition of which occurred after June 10, 1940, or the construction, reconstruction, erection, or installation of which was completed after such date, and

(2) any part of the construction, reconstruction, erection, installation, or acquisition of which has, before (A) the date of such acquisition or the

beginning of such construction, reconstruction, erection, or installation, or (B) February 5, 1941, whichever date is the later, been certified by the Advisory Commission and the Secretary of the department concerned as necessary in the interest of national defense during the emergency period. The term "emergency facility," as so defined, may include, among other things, improvements of land, such as the construction of airports and the dredging of channels.

(*d*) "*Emergency period*" means the period beginning on June 10, 1940, and ending on the date on which the President proclaims that the utilization of a substantial portion of the emergency facilities is no longer required in the interest of national defense.

SEC. 19.124-2. *Amortization deduction—General rule.*—If the Advisory Commission and the Secretary of the department concerned have made the required certifications (including those required by section 124(i)), a corporation is entitled, at its election, to a deduction with respect to the amortization of the adjusted basis of an emergency facility, such amortization to be based generally on a period of 60 months. As to the adjusted basis of an emergency facility, see section 19.124-6. The taxpayer may, with respect to an emergency facility, elect to begin the 60-month amortization period with (1) the month following the month in which such facility was completed or acquired, or (2) the taxable year succeeding that in which such facility was completed or acquired (see section 19.124-3). The date on which, or the month within which, an emergency facility is completed or acquired is a question to be determined upon the facts in the particular case. Ordinarily the taxpayer is in possession of all the facts and, therefore, in a position to ascertain such date. A statement of the date ascertained by the taxpayer, together with a statement of the pertinent facts relied upon, should be filed with the taxpayer's election to take amortization deductions with respect to such facility.

In general, with respect to each month of the 60-month period which falls within the taxable year, the amortization deduction is an amount equal to the adjusted basis of the facility at the end of such month divided by the number of months (including the particular month for which the deduction is computed) remaining in the 60-month period. The adjusted basis of the facility at the end of any month shall be computed without regard to the amortization deduction with respect to such facility for such month. The total amortization deduction with respect to an emergency facility for a particular taxable year is the sum of the amortization deductions allowable with respect to such facility for each month of the 60-month period which falls within such taxable year. The amortization deduction with respect to an emergency facility taken for any month is in lieu of the deduction for depreciation which would otherwise be allowable under section 23(l) with respect to such facility for such month. See, however, section 19.124-7, relative to depreciation with respect to any amount not subject to amortization.

This section may be illustrated by the following examples:

Example (1): On July 1, 1940, the X Corporation, which makes its income tax returns on the calendar year basis, begins the construction of an emergency facility which is completed on September 30, 1940, at a cost of $240,000. The certificate of necessity covers the entire construction. The X Corporation elects to take amortization deductions with respect to the facility and to begin the 60-month amortization period with October, the month following its completion. The adjusted basis of the facility at the end of October is $240,000. The allowable amortization deduction with respect to such facility for the taxable year 1940 is $12,000, computed as follows:

Monthly amortization deductions:	
October ($240,000÷60)	$4,000
November ($236,000, or $240,000 minus $4,000, ÷59)	4,000
December ($232,000, or $236,000 minus $4,000, ÷58)	4,000
Total amortization deduction for 1940	12,000

Example (2): The Y Corporation, which makes its income tax returns on the basis of a fiscal year ending November 30, purchases an emergency facility (No. 1) on July 29, 1940. On June 15, 1940, it begins the construction of an emergency facility (No. 2) which is completed on August 2, 1940. The entire acquisition and construction of such facilities are certified as necessary in the interest of national defense. The Y Corporation elects to take amortization deductions with respect to both facilities and to begin the 60-month amortization period in each case with

the month following the month of acquisition or completion. The adjusted basis of facility No. 1 is $300,000 and the adjusted basis of facility No. 2 is $54,000 at the end of the first month of the amortization period. In September, 1940, facility No. 1 is damaged by fire, as a result of which its adjusted basis is properly reduced by $25,370. The allowable amortization deduction with respect to such facilities for the taxable year ending November 30, 1940, is $21,410, computed as follows:

FACILITY NO. 1.

Monthly amortization deductions:		
August ($300,000+60)	$5,000	
September ($269,630, or $300,000 minus $5,000 and $25,370, +59)	4,570	
October ($265,060, or $269,630 minus $4,570,+58)	4,570	
November ($260,490, or $265,060 minus $4,570,+57)	4,570	
Amortization deduction for 1940		$18,710

FACILITY NO. 2.

Monthly amortization deductions:		
September ($54,000+60)	$900	
October ($53,100+59)	900	
November ($52,200+58)	900	
Amortization deduction for 1940		2,700
Total amortization deduction for 1940		21,410

SEC. 19.124-3. *Election of amortization.*—An election by a taxpayer to take amortization deductions with respect to an emergency facility and to begin the 60-month amortization period with the month following the month in which such facility was completed or acquired shall be made only by a statement to that effect in its return for the taxable year in which such facility was completed or acquired. An election by a taxpayer to take amortization deductions with respect to an emergency facility and to begin the 60-month amortization period with the taxable year succeeding that in which such facility was completed or acquired shall be made only by a statement to that effect in its return for such succeeding taxable year. No other method of making such elections is permitted. If an emergency facility is completed or acquired in the last month of the taxpayer's taxable year, such statement should be made in the return for the taxable year succeeding the year during which such facility was completed or acquired. Any statement of election should contain a description clearly identifying each emergency facility for which an amortization deduction is claimed.

A taxpayer which does not elect, in the manner provided in section 124(b), to take amortization deductions with respect to an emergency facility shall not, except as provided in section 124(d)(3), be entitled to amortization deductions with respect to such facility (see section 19.124-5(*d*)).

SEC. 19.124-4. *Election to discontinue amortization.*—If a taxpayer has elected to take amortization deductions with respect to an emergency facility, it may, after such election and prior to the expiration of the 60-month amortization period, discontinue the amortization deductions with respect to such facility for the remainder of the 60-month period. An election to discontinue the amortization deductions shall be made by a notice in writing filed with the Commissioner specifying the month as of the beginning of which the taxpayer elects to discontinue the deductions. Such notice shall be filed before the beginning of the month specified therein, and should contain a description clearly identifying the emergency facility with respect to which the taxpayer elects to discontinue the amortization deductions. If the taxpayer so elects to discontinue the amortization deductions with respect to an emergency facility, it shall not, except as provided in section 124(d), be entitled to any further amortization deductions with respect to such facility (see section 19.124-5(*c*)).

A taxpayer which thus elects to discontinue amortization deductions with respect to an emergency facility is entitled, if such facility is depreciable property under section 23(l) and the regulations pertaining thereto, to a deduction for depreciation with respect to such facility. The deduction for depreciation shall begin with the first month as to which the amortization deduction is not applicable, and shall be computed on the adjusted basis of the property as of the beginning of such month (see section 113(b) and the regulations thereunder).

This section may be illustrated by the following example:

Example: On July 1, 1940, the X Corporation, which makes its income tax returns on the calendar year basis, purchases an emergency facility, consisting of land with a building thereon, at a cost of $306,000, of which $60,000 is allocable to the land and $246,000 to the building. The certificate of necessity covers the entire acquisition. The corporation elects to take amortization deductions with respect to the facility and to begin the 60-month amortization period with the taxable year 1941. Depreciation of the building in the amount of $6,000 is deducted and allowed for the taxable year 1940. On March 25, 1942, the corporation files notice with the Commissioner of its election to discontinue the amortization deductions beginning with the month of April, 1942. The adjusted basis of the facility on January 31, 1941, is $300,000, or the cost of the facility ($306,000) less the depreciation allowed for 1940 ($6,000). The amortization deduction for the taxable year 1941 and the months of January, February, and March, 1942, amounts to $75,000, or $5,000 per month for 15 months. Since, at the beginning of the amortization period (January 1, 1941), the adjusted basis of the land is one-fifth of the adjusted basis of the entire facility and since there are no adjustments to basis other than on account of amortization during the period, the adjusted basis of the land should be reduced by $15,000, or one-fifth of the entire amortization deduction, and the adjusted basis of the building should be reduced by $60,000, or four-fifths of the entire amortization deduction. Accordingly, the adjusted basis of the facility as of April 1, 1942, is $225,000, of which $180,000 is allocable to the building for the purpose of depreciation deductions under section 23(l), and $45,000 is allocable to the land.

SEC. 19.124-5. *Termination of amortization period.*—(*a*) *Date the emergency use ceases.*—As used in this section, the term "date the emergency use ceases" means whichever of the following is the earlier—

(1) the date of the proclamation by the President by reason of which the emergency period ends; or

(2) the date specified in a certificate with respect to an emergency facility made to the Commissioner by the Secretary of the department concerned (in accordance with regulations prescribed by the President) as the date on which such facility ceased to be necessary in the interest of national defense during the emergency period.

(*b*) *Taxpayer which has elected to amortize.*—A taxpayer which has elected to take amortization deductions with respect to an emergency facility may elect, in the manner provided in paragraph (*e*) of this section, to terminate the amortization period with respect to such facility as of the end of the month in which occurs the date the emergency use ceases, provided that such date occurs prior to the expiration of the original 60-month period. In such case there shall, with respect to such facility, be substituted, in lieu of the original 60-month period, a new amortization period beginning with the first month of the original 60-month period and ending with the end of the month in which occurs the date the emergency use ceases; and the taxpayer's taxes for all taxable years (beginning with the taxable year in which the original 60-month period began) shall be computed (or recomputed) so as to give effect to amortization deductions with respect to such facility computed in the manner provided in section 124(a) (see section 19.124-2) but on the basis of the new amortization period.

Example: On August 15, 1940, the X Corporation, which makes its income tax returns on the calendar year basis, acquires an emergency facility for the purpose of performing War Department contracts. The corporation elects to take amortization deductions with respect to such facility and to begin the 60-month amortization period with September, 1940, the month following the month of acquisition. The Secretary of War certifies to the Commissioner that such facility ceased, as of July 15, 1942, to be necessary in the interest of national defense. The X Corporation elects to terminate the amortization period and, accordingly, there is to be substituted, in lieu of the 60-month amortization period, a new amortization period of 23 months (4 months in 1940, 12 months in 1941, and 7 months in 1942). The X Corporation's taxes for the taxable years 1940, 1941, and 1942 shall be computed or recomputed so as to give effect to amortization deductions computed in the manner provided in section 124(a) but on the basis of the new 23-month amortization period.

(*c*) *Taxpayer which has elected to discontinue amortization.*—A taxpayer which has elected to take amortization deductions with respect to an emergency facility and has subsequently elected under section 124(c) (see section 19.124-4) to dis-

continue, as of the beginning of a specified month, the amortization deductions with respect to such facility may elect, in the manner provided in paragraph (*e*) of this section, to terminate the amortization period with respect to such facility as of the end of the month in which occurs the date the emergency use ceases, provided that such date occurs prior to the expiration of the original 60-month period and after the beginning of such specified month. In such case, with respect to such facility, the election to discontinue the amortization deductions shall be disregarded and there shall be substituted, in lieu of the original 60-month period, a new amortization period beginning with the first month of the original 60-month period and ending with the end of the month in which occurs the date the emergency uses ceases. The taxpayer's taxes for all taxable years (beginning with the taxable year in which the original 60-month period began) shall be computed (or recomputed) so as to give effect to amortization deductions with respect to such facility computed in the manner provided in section 124(a) (see section 19.124–2) but on the basis of the new amortization period.

Example: On November 1, 1940, the Y Corporation, which makes its income tax returns on the basis of a fiscal year ending June 30, begins the construction of an emergency facility which is completed on March 15, 1941. The corporation elects to take amortization deductions with respect to such facility and to begin the 60-month amortization period with April, 1941, the month following the completion. On January 15, 1942, the corporation files a notice with the Commissioner in which it elects to discontinue the amortization deductions with respect to such facility as of the beginning of February, 1942. The President issues a proclamation on August 16, 1942, by reason of which the emergency period ends. The Y Corporation then elects to terminate the amortization period and, accordingly, its election to discontinue the amortization deductions is to be disregarded. In such case, there is to be substituted, in lieu of the original 60-month amortization period, a new amortization period of 17 months (3 months in the taxable year ending June 30, 1941, 12 months in the taxable year ending June 30, 1942, and 2 months in the taxable year ending June 30, 1943). The corporation's taxes for the taxable years ending June 30, 1941, 1942, and 1943, are to be computed or recomputed so as to give effect to amortization deductions (in lieu of amortization and depreciation deductions previously taken during such 17-month period) computed in the manner provided in section 124(a) but on the basis of the new 17-month amortization period.

If the date the emergency use ceases should occur between the date of the notice of discontinuance and the beginning of the month specified in such notice, the provisions of section 124(d)(1) and paragraph (*b*) of this section are applicable.

(*d*) *Taxpayer which has not elected to amortize.*—A taxpayer which has obtained the required certifications but has not elected, as provided in section 124(b), to take amortization deductions with respect to the emergency facility to which such certifications relate may nevertheless take amortization deductions with respect to such facility, if (1) the date the emergency use ceases occurs before the expiration of 60 months from the last day of the month in which such facility was completed or acquired, and (2) an election to take such amortization deductions is made in the manner prescribed in paragraph (*e*) of this section. In such case, the taxes for all taxable years (beginning with the taxable year in which fell the month following the month in which such facility was completed or acquired) shall be computed (or recomputed) so as to give effect to amortization deductions with respect to such facility computed in the manner provided in section 124(a) (see section 19.124–2) but on the basis of an amortization period beginning with the month following the month in which such facility was completed or acquired, and ending with the last day of the month in which occurs the date the emergency use ceases.

Example: On September 25, 1940, the Z Corporation, which makes its income tax returns on the calendar year basis, acquires an emergency facility for the purpose of performing Navy Department contracts. The corporation does not elect to take amortization deductions with respect to such facility. The Secretary of the Navy certifies to the Commissioner that such facility ceased, as of July 20, 1942, to be necessary in the interest of national defense. The Z Corporation may elect, in the manner provided in paragraph (*e*) of this section, to take amortization deductions with respect to such facility and in such case its taxes for the taxable years 1940, 1941, and 1942 are to be computed or recomputed so as to give effect to amortization deductions computed in the manner provided in section 124(a) but on the basis of an amortization period of 22 months (3 months in 1940,

12 months in 1941, and 7 months in 1942), such amortization deductions to be in lieu of depreciation deductions previously taken during such 22-month period.

(*e*) *Manner of making election.*—The election described in paragraph (*b*), (*c*), or (*d*) of this section shall be made by filing with the Commissioner of Internal Revenue, Washington, D. C., a statement of such election. Such statement shall be filed within 90 days after the date of the President's proclamation or the date of the certificate of the Secretary of the department concerned, whichever is the basis of the taxpayer's election, and should contain a description clearly identifying the facility. A copy of such statement should be attached by the taxpayer to the income-tax return for the taxable year in which falls the date the emergency use ceases.

(*f*) *Recomputation of taxes in case of commuted amortization period.*—The recomputation of the tax liability authorized by section 124(d)(4) applies to any income or excess-profits tax imposed under Chapter 1 or Subchapter A, B, D, or E of Chapter 2, to the capital stock tax imposed by Chapter 6, and to any other tax of the corporation affected directly or indirectly by the recomputation of the amortization deduction.

Under section 124(d)(5), if the adjustment of any income or excess-profits tax for any taxable year to give effect to the revised amortization deduction is prevented (1) on the date of the certificate of the Secretary of the department concerned or the date of the President's proclamation, whichever forms the basis of the taxpayer's election, or (2) within one year after such date, by any provision of law (other than section 3761, relating to compromises, and other than section 124(d)(5) or by any rule of law, including the doctrine of res judicata, an adjustment shall nevertheless be made if a claim for refund or credit is filed or a notice of deficiency is mailed, as the case may be, within one year after the date of such certificate or proclamation. Section 124(d)(5) applies only if, at the time of the filing of the claim for refund or the mailing of the notice of deficiency, the adjustment would otherwise be prevented by the running of the statute of limitations, by the execution of a closing agreement, by the operation of the rule of res judicata or for other reasons. For reference to provisions which would prevent adjustment except for the provisions of section 124(d)(5), see section 19.3801(b)-0. Section 124(d)(5) is not applicable, however, if on the date of the filing of the claim for refund or the mailing of the notice of deficiency, adjustment of the tax liability is permissible without recourse to such section.

The amount of the adjustment authorized by section 124(d)(5) is limited to the increase or decrease in the tax previously determined for the taxable year which results solely from the revision of the amortization deduction and the collateral effects of such revision upon items of income, deductions, credits, invested capital, etc., already taken into account in ascertaining the tax previously determined. The tax previously determined for any taxable year is to be ascertained in accordance with the provisions of section 3801(d). See section 19.3801(d)-1. If the amount of the adjustment determined under section 124(d)(5) represents an increase in tax, it is to be treated in the same manner as a deficiency for the taxable year; if it represents a decrease in tax, it is to be treated in the same manner as an overpayment for the taxable year. The amount of the adjustment considered as a deficiency or as an overpayment, as the case may be, will bear interest to the extent provided by the internal revenue laws applicable to deficiencies and overpayments for the taxable year for which the adjustment is made.

The amount of any adjustment under the provisions of section 124(d)(5) which is refunded may not subsequently be recovered in a suit for erroneous refund based upon any adjustment other than one resulting from the revision of the amortization deductions. The amount of any adjustment under section 124(d)(5) which is assessed and collected as a deficiency may not thereafter be recovered by the taxpayer in any suit for refund based upon any adjustment other than one resulting from the revision of the amortization deductions. The application of the provisions of section 124(d)(5) may be illustrated by the following example:

Example: On August 31, 1940, the X Corporation, which makes its income tax returns on the calendar year basis, acquires an emergency facility at a cost of $300,000 and elects to take amortization deductions with respect to such facility over the 60-month period beginning with the month of September, 1940. For the taxable year 1940 the corporation files an income tax return disclosing a normal-tax net income of $68,500 and a tax liability of $16,440 which is assessed and paid. In making such computation, the corporation takes amortization deductions of $5,000 a month for four months, or $20,000, but in computing its gross income erroneously omits interest income amounting to $6,000, and in

computing its deductions erroneously omits a deduction for insurance expense of $2,000. The corporation includes in gross income dividends from a domestic corporation in the amount of $10,000 and takes a dividends received credit of $8,500. It also files an excess-profits tax return under Subchapter E of Chapter 2 disclosing an invested capital of $500,000, an excess-profits net income of $50,560, an excess-profits credit of $40,000 computed on the invested capital basis, and an excess-profits tax liability of $1,390.

On September 1, 1944, the Secretary of the department concerned certifies to the Commissioner that such emergency facility ceased as of August 15, 1944, to be necessary in the interest of national defense. The X Corporation elects to terminate the amortization period and to amortize the adjusted basis of such facility over the shortened period of 48 months beginning September 1, 1940, and ending August 31, 1944. The corporation is therefore entitled to compute or recompute its taxes for 1940, 1941, 1942, 1943, and 1944 on the basis of an amortization deduction of $6,250 in lieu of $5,000 for each month beginning with September, 1940, and ending with August, 1944. The allowable deduction for 1940 is therefore $25,000 in lieu of $20,000. Claims for refund for all years, except 1944, are filed on November 30, 1944. For the taxable year 1940 the period of limitations upon the filing of a claim for refund provided by section 322 expires on March 15, 1944. Since, however, the claim is filed within one year from the date of the certificate of the Secretary of the department concerned, an adjustment is authorized under section 124(d)(5). The amount of the adjustment of the income tax under section 13 and the excess-profits tax under Subchapter E of Chapter 2 for 1940 is $2,150 (income tax, $1,200; excess-profits tax, $950), computed as follows:

Income tax.

Normal-tax net income upon which tax previously determined was based		$68,500
Less: Additional deduction for amortization:		
Amount deductible	$25,000	
Amount deducted in return	20,000	
		5,000
Normal-tax net income as recomputed		63,500
Normal tax as recomputed		15,240
Tax previously determined and paid		16,440
Amount of adjustment under section 124(d)(5) to be refunded or credited		1,200

Excess-profits tax.

Excess-profits net income reported		$50,560
Less: Additional deduction for amortization		5,000
Balance		45,560
Add: Adjustment for normal taxes:		
Amount previously deducted	$16,440	
As recomputed	15,240	
		1,200
Excess-profits net income as recomputed		46,760
Less: Excess-profits credit	$40,000	
Specific exemption	5,000	
		45,000
Adjusted excess-profits net income		1,760
Excess-profits tax as recomputed		440
Tax previously determined and paid		1,390
Amount of adjustment under section 124(d)(5) to be refunded or credited		950

By reason of the limitations imposed by section 124(d)(5), the adjustment is limited to the decrease in the tax previously determined which results solely from the revision of the amortization deductions and the consequences flowing therefrom. Accordingly, the recomputation does not take into consideration the

item of $6,000, representing interest received, which was omitted from gross income, or the item of $2,000, representing insurance expense, for which no deduction was allowed.

Since the claims for refund for the taxable years 1941, 1942, and 1943 were filed within the period of limitations provided in section 322, the provisions of section 124(d)(5) are not applicable and the complete adjustment of the taxes for such taxable years may be made without regard to the limitations contained in section 124(d)(5).

SEC. 19.124–6. *Adjusted basis of emergency facility.*—(*a*) *In general.*—The adjusted basis of an emergency facility for purposes of computing the amortization deduction may differ from what would otherwise constitute the adjusted basis of such emergency facility, in that it may be only a portion of such other adjusted basis. It will be only a portion of such other adjusted basis if only a portion of the basis (unadjusted) is attributable to certified construction, reconstruction, erection, installation, or acquisition after June 10, 1940. It is therefore necessary first to determine the unadjusted basis of the emergency facility from which the adjusted basis for amortization purposes is derived.

The unadjusted basis for amortization purposes, in cases where the entire construction, reconstruction, erection, installation, or acquisition takes place after June 10, 1940, and such construction, reconstruction, erection, installation, or acquisition is certified in its entirety by the Advisory Commission and the Secretary of the department concerned as necessary in the interest of national defense during the emergency period, is the same as the unadjusted basis otherwise determined.

In cases where the Advisory Commission and the Secretary of the department concerned certify the entire construction, reconstruction, erection, installation, or acquisition after June 10, 1940, as necessary in the interest of national defense during the emergency period, but only a portion of the construction, reconstruction, erection, installation, or acquisition attributable to the facility takes place after June 10, 1940, the unadjusted basis for purposes of amortization is so much of the entire unadjusted basis of the emergency facility as is attributable to that portion of the construction, reconstruction, erection, installation, or acquisition which took place after June 10, 1940. For example, the X Corporation begins the construction of a facility on April 11, 1940, and such facility is completed on September 10, 1940, at a cost of $500,000. The certificate of necessity covers the entire construction after June 10, 1940, and all the construction is distributed uniformly throughout the 5-month construction period. The unadjusted basis of the emergency facility for amortization purposes is therefore three-fifths of $500,000, or $300,000, since only such amount is attributable to the construction in the three months following June 10. For depreciation of remaining portion ($200,000), see section 19.124–7.

If the Advisory Commission and the Secretary of the department concerned certify only a portion of the construction, reconstruction, erection, installation, or acquisition after June 10, 1940, then the unadjusted basis for amortization purposes is limited to the amount attributable to such portion of the construction, reconstruction, erection, installation, or acquisition after June 10, 1940. Assuming the same facts as in the example in the preceding paragraph, except that the certificate is to the effect that only 50 per cent of the construction after June 10, 1940, is necessary in the interest of national defense during the emergency period, the unadjusted basis for amortization purposes is 50 per cent of three-fifths of $500,000, or $150,000.

The adjusted basis of an emergency facility for amortization purposes is the unadjusted basis for amortization purposes less the adjustments properly applicable thereto. Such adjustments are those specified in section 113(b), except that no adjustments are to be taken into account which increase the adjusted basis. (See paragraph (*b*) of this section.) Amounts received by a taxpayer in connection with its agreement to supply articles for national defense, though denominated reimbursements for all or a part of the cost of an emergency facility, are not to be treated as capital receipts but are to be taken into account in computing income, and are therefore not to be applied in reduction of the basis of such facility. The following examples will illustrate the computation of the adjusted basis of an emergency facility for amortization purposes:

Example (1): The X Corporation completes an emergency facility on July 1, 1940, the entire unadjusted basis of which is $500,000, and the unadjusted basis of which for purposes of amortization is $300,000. The X Corporation elects to begin amortization on January 1, 1941. The only adjustment to basis for the period from July 1, 1940, to January 31, 1941, other than depreciation or

amortization for January 1941, is $5,000 for depreciation for the last six months of 1940. The adjusted basis for purposes of amortization is therefore $300,000 less $3,000 (300,000/500,000ths of $5,000), or $297,000.

Example (2): On July 31, 1944, the Y Corporation has an emergency facility (a building) completed on July 1, 1940, the entire unadjusted basis of which is $500,000, and the unadjusted basis of which for purposes of amortization is $300,000. The corporation elects to begin amortization on January 1, 1941, by which time it is entitled to $5,000 depreciation for the last six months of 1940. On July 1, 1944, the facility is damaged by fire, as the result of which its adjusted basis is properly reduced by $200,000. The adjusted bases of the emergency facility as of July, 1944, for purposes of amortization and depreciation, and the adjusted basis for other purposes, are $23,849.18, $49,250.82, and $73,100, respectively, computed as follows:

	For amortization.	For depreciation.	For other purposes.
Unadjusted basis	$300,000.00	$200,000.00	$500,000
Less depreciation to Jan. 1, 1941	3,000.00	2,000.00	5,000
Adjusted basis January, 1941	297,000.00	198,000.00	495,000
Less amortization for 42 months	207,900.00	None	207,900
Less depreciation for 42 months	None	14,000.00	14,000
Adjusted basis at time of fire loss	89,100.00	184,000.00	273,100
Less fire loss (apportioned as explained below)	65,250.82	134,749.18	200,000
Adjusted basis after fire loss	23,849.18	49,250.82	73,100

The $200,000 fire loss is applied against the adjusted basis for purposes of amortization and the adjusted basis for purposes of depreciation in the proportion that each such adjusted basis at the time of such fire loss bears to their sum, i. e., 89,100/273,100ths of $200,000 or $65,250.82, against the amortization basis, and 184,000/273,100ths of $200,000 or $134,749.18, against the depreciation basis.

(*b*) *Capital additions.*—If, after the completion or acquisition of an emergency facility with respect to which a certificate of necessity has been made, further expenditures are made for construction, reconstruction, erection, installation, or acquisition attributable to such facility but not included in such certificate of necessity, such expenditures shall not be added to the adjusted basis of the emergency facility for amortization purposes under such certificate. If such further expenditures are covered by a separate certificate of necessity made in accordance with the provisions of section 124(f), they are treated as certified expenditures in connection with a new emergency facility, and, if proper election is made, will be taken into account in computing the adjusted basis of such new emergency facility for purposes of amortization.

Example: On March 1, 1941, the Advisory Commission and the Secretary of the department concerned certify as an emergency facility a heating plant proposed to be constructed by the Z Corporation. Such facility is completed on July 1, 1941. The Z Corporation, on August 1, 1941, installs in the plant an additional boiler, which is not included in the certificate for the plant but is, prior to such installation, certified in a separate certificate as necessary in the interest of national defense. For amortization purposes, the adjusted basis of the heating plant is determined without including the cost of the additional boiler. Such cost is taken into account in computing the adjusted basis of the new emergency facility (the boiler), as to which the taxpayer has a separate election for amortization purposes and a separate amortization period.

SEC. 19.124-7. *Depreciation of portion of emergency facility not subject to amortization.*—The rule set forth in section 124(a) (see section 19.124-2), that an amortization deduction with respect to an emergency facility is in lieu of any deduction for depreciation which would otherwise be allowable with respect to such facility, is subject to the exception provided in section 124(g). Under this exception, if the property constituting such facility is depreciable property under section 23(l) and the regulations pertaining thereto and if the adjusted basis of such facility as computed under section 113(b) for purposes other than the amortization deductions (see section 19.113(b)(1)-1) is in excess of the adjusted basis computed under section 124(f) for purposes of the amortization deductions (see section 19.124-6), then the excess shall be charged off over the

useful life of the facility and recovered through depreciation deductions. Thus, if the construction of an emergency facility is begun on or before June 10, 1940, and completed after such date, no amortization deductions are allowable with respect to the amount attributable to such construction on or before such date (see section 19.124–6). However, if the property constituting such facility is depreciable property under section 23(l) and the regulations pertaining thereto, then the depreciation deduction provided by such section and regulations is allowable with respect to the amount attributable to such construction on or before June 10, 1940.

Similarly, if only a part of the construction, reconstruction, erection, installation, or acquisition after June 10, 1940, of an emergency facility has been certified by the Advisory Commission and the Secretary of the department concerned as necessary in the interest of national defense during the emergency period, and if such facility is depreciable property under section 23(l) and the regulations pertaining thereto, then the depreciation deduction provided by such section and regulations is allowable with respect to the part which has not been so certified.

For illustration of the treatment of a depreciable portion of an emergency facility, see Example (2) in section 19.124–6(*a*).

SEC. 19.124–8. *Payment by United States of unamortized cost of facility.*— Section 124(h) contemplates that certain payments may be made by the United States to a taxpayer as compensation for the unamortized cost of an emergency facility. If the amount of any such payment is properly includible in gross income and has been certified, as provided in section 124(h), as having been paid under the circumstances described therein, a taxpayer which is recovering the adjusted basis of an emergency facility through amortization rather than depreciation may elect to take such amount as an amortization deduction with respect to such facility for the month in which such amount is so includible. Such amortization deduction shall be in lieu of the amortization deduction otherwise allowable with respect to such facility for such month, and shall not in any case exceed the adjusted basis of such facility (see section 19.124–6) as of the end of such month (computed without regard to any amortization deduction for such month). The election referred to in this paragraph shall be made in the return for the taxable year in which the amount of such payment is includible in gross income.

If a taxpayer is recovering the adjusted basis of an emergency facility through depreciation rather than amortization, the depreciation deduction allowable under section 23(l) for the month in which the amount of any such payment is includible in gross income shall, at the taxpayer's election, be increased by such amount; but the total deduction with respect to the certified portion of such facility shall not in any case exceed the adjusted basis of such facility (computed as provided in section 124(f) and section 19.124–6 for amortization purposes) as of the end of such month (computed without regard to any amount allowable for such month under section 23(l) or 124(h)(2)). The election referred to in this paragraph shall be made in the return for the taxable year in which the amount of such payment is includible in gross income.

This section may be illustrated by the following examples:

Example (1): On January 31, 1941, the X Corporation purchases an emergency facility at a cost of $600,000. The certificate of necessity covers the entire acquisition. The X Corporation elects to take amortization deductions with respect to such facility and to begin the 60-month amortization period with February, 1941, the month following the month of acquisition. On July 15, 1942, as a result of the cancellation of certain contracts with the X Corporation, the United States makes a payment of $300,000 to the corporation as compensation for the unamortized cost of such facility. The $300,000 payment is includible in the X Corporation's gross income for July, 1942. The adjusted basis of such facility for amortization purposes as of the end of July, 1942, computed without regard to any amortization deduction for such month, is $430,000. Accordingly, the corporation is entitled to take an amortization deduction of $300,000 for such month, in lieu of the $10,000 amortization deduction which is otherwise allowable.

Example (2): On November 30, 1940, the Y Corporation purchases an emergency facility, consisting of land with a building thereon at a cost of $500,000, of which $200,000 is allocable to the land and $300,000 to the building. The certificate of necessity covers the entire acquisition. The Y Corporation does not elect to take amortization deductions with respect to such facility, but is entitled to a depreciation deduction with respect to the building at the rate of 3 per cent per annum, or $750 per month. On August 12, 1942, as a result of cancellation of certain contracts, the United States makes a payment of $400,000 to the corporation as compensation for the unamortized cost of such facility. The

$400,000 is includible in the Y Corporation's gross income for August, 1942. The adjusted basis of the facility as of the end of August, 1942, computed without regard to depreciation for such month, is $485,000, of which amount $200,000 is allocable to the land and $285,000 to the building. Accordingly, the corporation is entitled to increase the $750 depreciation deduction for August, 1942, by the full amount of the $400,000 payment.

SEC. 19.124-9. *Reimbursement by United States for cost of facility.*—If the taxpayer has been or will be reimbursed by the United States for all or a part States, no amortization deductions will be allowed with respect to such facility of the cost of any emergency facility pursuant to any contract with the United for any month after the end of the month in which such contract is made, unless (1) before the expiration of 90 days after the making of such contract or (2) before February 6, 1941, whichever date is the later, the Advisory Commission and the Secretary of the department concerned have certified to the Commissioner that the contract contains provisions adequately protecting the United States with reference to the future use and disposition of such facility. For treatment of reimbursements, see section 19.124-6. If the Advisory Commission and the Secretary of the department concerned have certified to the Commissioner before the date indicated above that under such contract no reimbursement is provided for within the meaning of section 124(i), such certification shall be conclusive of such fact.

(This Treasury decision is issued under the authority contained in sections 301 and 302 of the Second Revenue Act of 1940 (Public, No. 801, Seventy-sixth Congress, third session), and section 62 of the Internal Revenue Code (53 Stat., 32).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved October 23, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register October 24, 1940, 11.56 a. m.)

SECTION 19.124-2: Amortization deduction—General rule. 1940-47-10491

Notice of procedure for certification under section 124 of the Internal Revenue Code.

NOVEMBER 1, 1940.

Sections 23 and 124[1] of the Internal Revenue Code allow a deduction for income and excess-profits tax purposes for amortization, over a 60-month period, with respect to any emergency facility, the construction of which was completed, or which was acquired, after June 10, 1940, upon the issuance of the certificate or certificates, as hereinafter defined, provided for in the statute. Such certificates are to be issued to the Commissioner of Internal Revenue by the Secretary of War or the Secretary of the Navy and the Advisory Commission to the Council of National Defense.

In all cases a "Necessity Certificate" is required. A taxpayer who has been or will be reimbursed by the United States for all or a part of the cost of any emergency facility pursuant to any contract with the United States, is not allowed such amortization deduction unless a "Certificate of Government Protection" is also issued with respect

[1] Title III, section 302, Second Revenue Act of 1940.

to the facility covered by such contract. A "Certificate of Non-Reimbursement" with respect to any contract with the United States conclusively establishes that it does not provide for reimbursement to the applicant.

In the event that a taxpayer has no contract with the United States, it is not considered necessary for the taxpayer, in addition to a "Necessity Certificate," to obtain a "Certificate of Government Protection" or a "Certificate of Non-Reimbursement," unless the taxpayer is the real party in interest under a contract with the United States, as, for example, a case in which some other person is acting in a contract as agent for the taxpayer to secure payment of the cost of the emergency facilities by the United States.

The Secretary of the Treasury, the Secretary of War, the Secretary of the Navy, and the Advisory Commission to the Council of National Defense hereby give notice that the following will be the procedure for applying for such certificates:

I. *Applications.*—Applications for certificates shall be respectively entitled "Application for a Necessity Certificate," "Application for a Certificate of Government Protection," "Application for a Certificate of Non-Reimbursement." Instructions as to the information to be given in such applications may be obtained from the Office of the Assistant Secretary of War (Purchase and Contract Branch), Washington, D. C., or from the Office of the Judge Advocate General of the Navy, Navy Department (Certification Unit), Washington, D. C.

II. *Place of filing applications and copies required.*—The original and two unsigned copies of the application, addressed to either the Secretary of War or the Secretary of the Navy, as the case may be, and to the Advisory Commission to the Council of National Defense, shall be duly prepared in accordance with the applicable instructions and filed as follows:

The original and both copies of applications, addressed to the Secretary of War and the Advisory Commission, shall be filed with the contracting officer (or with the Office of the Assistant Secretary of War, Purchase and Contract Branch, Washington, D. C., in cases in which there is no particular contracting officer concerned).

The original and both copies of applications, addressed to the Secretary of the Navy and the Advisory Commission, shall be filed with the Office of the Judge Advocate General, Navy Department (Certification Unit), Washington, D. C.

One copy of any application will be promptly transmitted by the office in which the application has been filed to the Office of the Coordinator of National Defense Purchases, Washington, D. C., acting on behalf of the Advisory Commission.

III. *Time of filing applications.*—Section 124 of the Internal Revenue Code provides that the "Necessity Certificate" must be made before February 5, 1941, or before the beginning of the construction or the date of acquisition of the emergency facility, whichever is later, and that the "Certificate of Government Protection" and "Certificate of Non-Reimbursement" must be made before February 6, 1941, or within 90 days after the execution of the contract, whichever is later.

In order that the applications may be acted upon and certificates made within the prescribed time, applications for such certificates should be filed at the earliest possible date. Unless filed in sufficient time, it will not be possible to act upon the applications within the statutory periods referred to above.

IV. *Notification.*—The Office of the Assistant Secretary of War (Purchase and Contract Branch) or the Office of the Judge Advocate General of the Navy, as the case may be, will notify the applicant of the action taken upon its application by the Secretary of War or Secretary of the Navy and the Advisory Commission to the Council of National Defense.

V. *Definition of terms.*—(1) The term "Necessity Certificate" as used herein means a certification, issued pursuant to section 124(f) of the Internal Revenue Code, that the construction or acquisition of the facilities, referred to in the certificate, is necessary in the interest of national defense during the emergency period.

(2) The term "Certificate of Government Protection" as used herein means a certification, issued pursuant to section 124(i) of the Internal Revenue Code, that a contract in which the taxpayer has been or will be reimbursed by the United States, directly or indirectly, for all or a part of the cost of the emergency facility, referred to in the certificate, adequately protects the United States with reference to the future use and disposition of such facility.

(3) The term "Certificate of Non-Reimbursement" as used herein means a certification, issued pursuant to section 124(i) of the Internal Revenue Code, that reimbursement to the taxpayer for all or a part of the cost of any emergency facility is not provided for under a contract with the United States.

(4) The term "reimbursement" as used herein means reimbursement to the taxpayer pursuant to any contract with the United States either (1) directly, by a provision therein dealing expressly with such reimbursement, or (2) indirectly, because the price paid by the United States (in so far as return of cost of the facility is used as a factor in the fixing of such price) is recognized by the contract as including a return of cost greater than the normal exhaustion, wear, and tear.

(5) The term "emergency facility" as used herein means any facility, land, building, machinery, or equipment, or part thereof, the construction, reconstruction, erection, or installation of which was completed after June 10, 1940, or which was acquired after such date, and with respect to which a "Necessity Certificate" has been made.

Approved:

HERBERT E. GASTON,
Acting Secretary of the Treasury.
JAMES FORRESTAL,
Acting Secretary of the Navy.
G. C. MARSHALL,
Acting Secretary of War.
WM. H. MCREYNOLDS,
Secretary of Advisory Commission to the Council of National Defense.

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

SECTION 19.131-1: Analysis of credit for taxes. 1940-49-10504 I. T. 3429
(Also Section 23(c), Section 19.23(c)-1.)

INTERNAL REVENUE CODE.

The tax imposed by the Cuban law of October 9, 1922, as amended by law of July 15, 1925, and by law of January 27, 1927, and decree law No. 393, dated November 8, 1935, equal to a certain percentage on sales, exchanges or assignments, and gross receipts, which tax was extended by the law of January 27, 1927, to the purchase of merchandise coming from abroad, is not an income tax and may not be claimed as a credit under section 131 of the Internal Revenue Code. Such tax may, however, be taken as a deduction under section 23(c) of the Code.

This ruling is also applicable to taxes imposed by decree No. 695, dated March 3, 1940.

Advice is requested whether the taxes imposed by certain Cuban laws constitute foreign income taxes which may be taken as credits under section 131 of the Internal Revenue Code.

The law of October 9, 1922, enacted by the Cuban Government, established a tax of 1 per cent on sales, exchanges or assignments, and gross receipts, which tax was increased by one-half of 1 per cent by the law of July 15, 1925. Those laws were extended on January 27, 1927, to include the purchase of merchandise coming from abroad (outside Cuba). Decree law No. 393, dated November 8, 1935, made no material change in the original provisions of the law of October 9, 1922, in so far as the nature of the tax is concerned.

It is the opinion of the Bureau that the tax in question is a tax on gross sales and gross receipts and not a tax imposed on net profits.

The general rule is that a tax based on gross receipts constitutes a tax on business and is an excise tax. Cooley on Taxation, 4th Edition, sections 844 and 892, contains numerous citations to the effect that a tax on gross revenues or gross receipts is an excise tax. (See also *Maine* v. *Grand Trunk Railway Co.*, 142 U. S., 217; *Security Savings & Commercial Bank* v. *District of Columbia*, 279 Fed., 185; *Ohio River & W. Railway Co.* v. *Dittey*, 203 Fed., 537.)

It is accordingly held that the amount of tax paid under the law of October 9, 1922, as amended by law of July 15, 1925, and by law of January 27, 1927, and decree law No. 393, supra, to the Cuban Government is not an income tax and may not be claimed as a credit under section 131 of the Internal Revenue Code. The amount of such tax may be claimed, however, as a deduction under section 23(c) of the Internal Revenue Code for the year in which paid or accrued, dependent upon whether a taxpayer's books of account are kept on the cash receipts and disbursements basis or on the accrual basis.

This ruling is also applicable to taxes paid under decree No. 695, dated March 3, 1940, which increased the rate of tax from 1½ to 2 per cent.

SECTION 19.131-1: Analysis of credit for taxes. 1940-50-10517
(Also Section 23(c), Section 19.23(c)-1.) I. T. 3433

INTERNAL REVENUE CODE.

The taxes imposed by Articles XXII and XXIII of Chapter VI of the mineral fuel law of Cuba, effective January 1, 1939, which taxes are based upon the value of the product at the mouth of the well, are not income taxes and may not be taken as credits against the Federal income tax under section 131 of the Internal Revenue Code. Payments of such taxes, however, constitute allowable deductions from gross income for Federal income tax purposes by the person who is actually liable for such taxes.

Advice is requested whether the taxes imposed by the mineral fuel law of Cuba may be taken as credits against the Federal income tax under section 131 of the Internal Revenue Code.

The pertinent provisions of the Cuban law, which relate to the imposition of the tax and the various rates of tax upon explorers and exploiters of petroleum and its natural associates, are contained in Articles XXII and XXIII of Chapter VI of the mineral fuel law of Cuba.

From an examination of the provisions of that law, it is apparent that the tax is based on the commercial value of the product at the mouth of the well, computed at the average price of the product of the same quality during the preceding month in the regulating market, minus cost of transportation to such regulating markets, regardless of whether there is any income from the sale of the product. In other words, the tax is upon the value of the product rather than on income derived from the operation of the wells. Accordingly, amounts paid under Articles XXII and XXIII of Chapter VI of the mineral fuel law of Cuba, effective January 1, 1939, do not constitute payments of income tax and, therefore, no credit is allowable under the provisions of section 131 of the Internal Revenue Code with respect to such payments. However, such payments by the person upon whom the tax is imposed under the Cuban law constitute allowable deductions from gross income as provided by section 23(c) of the Internal Revenue Code.

SECTION 19.131-8: Limitations on credit for foreign taxes.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX.

SECTION 142.—FIDUCIARY RETURNS.

SECTION 19.142-1: Fiduciary returns.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.142–2: Return by guardian or committee.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.142–5: Return for nonresident alien beneficiary.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 143.—WITHHOLDING OF TAX AT SOURCE.

SECTION 19.143–1: Withholding tax at source. 1940–28–10322
(Also Section 143, Sections 19.143–3 and 19.143–7; T. D. 4979
Section 144, Sections 19.144–1 and 19.144–2;
Section 262, Section 19.262–4.)

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

Withholding under sections 143 and 144 of the Internal Revenue Code as amended by the Revenue Act of 1940—Regulations 103 amended.

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

To Collectors of Internal Revenue and Others Concerned:

In order to conform Regulations 103 (Part 19, Title 26, Code of Federal Regulations, 1940 Sup.), relating to the income tax under the Internal Revenue Code, to section 5 and section 202 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), amending section 143 and section 144 of the Internal Revenue Code, such regulations are amended as follows:

(1) The following is inserted immediately preceding section 19.143–1:

SEC. 5. WITHHOLDING OF TAX AT SOURCE.

(a) Section 143 of the Internal Revenue Code is amended by striking out "10 per centum" wherever occurring therein and inserting in lieu thereof "15 per centum".

* * * * * * *

(c) The amendments made by this section shall take effect on June 26, 1940.

SEC. 202. RATES OF WITHHOLDING.

Section 143 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsection:

"(h) RATES UNTIL JANUARY 1945.—For the period after June 25, 1940, and before January 1, 1945, the rate provided in this section and section 144, of 15 per centum shall be 16½ per centum. This subsection or section 15 shall not apply in any case where its operation would be contrary to any treaty obligation of the United States, nor to a resident of, or a corporation organized under the laws of, a contiguous country so long as there is in effect with such country a treaty, ratified prior to August 26, 1937, relating to rates of income tax."

(2) Section 19.143–1 is amended as follows:

(*a*) By inserting after the words "10 per cent" wherever appearing therein the words, "(15 per cent on and after June 26, 1940, except as otherwise provided herein)."

(*b*) By inserting at the end of the first paragraph of subsection (*a*) the following sentence:

However, in accord with Article VII of the tax convention and protocol between the United States and Sweden, effective January 1, 1940, the rate of withholding shall, for a period of at least two years beginning with such date, be 10 per cent with respect to dividends paid to residents of Sweden.

(*c*) By striking out the words "Sorting Section" in the eighth paragraph of subsection (*a*) and inserting in lieu thereof the words, "Withholding Returns Section."

(*d*) By adding at the end of subsection (*b*) the following new subsection:

(*c*) *Withholding on and after June 26, 1940, and prior to January 1, 1945.*— With respect to income paid on or after June 26, 1940, and prior to January 1, 1945, the rate of withholding (except with respect to income paid to residents of Canada and dividends paid to residents of Sweden) is 16½ per cent instead of 15 per cent.

(3) Section 19.143–3 is amended as follows:

(*a*) By striking out the words "Sorting Section" wherever occurring therein and inserting in lieu thereof the words, "Withholding Returns Section."

(*b*) By inserting in the last paragraph thereof immediately after "$1,000" the following words: ", or $800 for taxable years beginning after December 31, 1939,".

(4) Section 19.143–7 is amended by inserting in lieu of the last sentence of the first paragraph thereof the following sentence:

If Form 1000 is modified to show the name and address of a fiscal or paying agent in the United States (see section 19.143–5), Forms 1012 and 1013 should be likewise modified.

(5) The following is inserted immediately preceding section 19.144–1:

SEC. 5. WITHHOLDING OF TAX AT SOURCE.

* * * * * * *

(b) Section 144 of the Internal Revenue Code is amended by striking out "except that in the case of dividends the rate shall be 10 per centum, and" and by striking out "of 10 per centum."

(c) The amendments made by this section shall take effect on June 26, 1940.

SEC. 202. RATES OF WITHHOLDING.

Section 143 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsection:

"(h) RATES UNTIL JANUARY 1945.—For the period after June 25, 1940, and before January 1, 1945, the rate provided in this section and section 144, of 15 per centum shall be 16½ per centum. This subsection or section 15 shall not apply in any case where its operation would be contrary to any treaty obligation of the United States, nor to a resident of, or a corporation organized under the laws of, a contiguous country so long as there is in effect with such country a treaty, ratified prior to August 26, 1937, relating to rates of income tax."

(6) Section 19.144–1 is amended as follows:

(*a*) By inserting in the first paragraph thereof the word "and" immediately preceding "(2)," by striking out, "and (3) dividends" and by inserting at the end of such paragraph the following sentence:

However, in accord with Article VII of the tax convention and protocol between the United States and Sweden, effective January 1, 1940, the rate of withholding shall, for a period of at least two years beginning with such date, be 10 per cent with respect to dividends paid to a corporation or other entity created or organized under the laws of Sweden.

(*b*) By inserting in the third paragraph after the words "10 per cent" whenever occurring therein the words, "(15 per cent on and after June 26, 1940, except as otherwise provided herein)."

(*c*) By adding at the end thereof the following new paragraph:

With respect to income paid on or after June 26, 1940, and prior to January 1, 1945, the rate of withholding (except with respect to dividends paid to corporations organized under the laws of Canada and to corporations or other entities created or organized under the laws of Sweden) is 16½ per cent instead of 15 per cent.

(7) Section 19.144–2 is amended as follows:

(*a*) By striking out the words "Sorting Section" in the first paragraph and inserting in lieu thereof the words, "Withholding Returns Section."

(*b*) By inserting, immediately preceding the table in the last paragraph thereof, the following heading:

For the period prior to June 26, 1940.

(*c*) By inserting in the last column of line numbered 7 of the table the symbol "(2)" and adding a footnote to such table as follows:

[2] Interest on any noncorporate security the owner of which is unknown to the withholding agent is subject to withholding at the rate of 10 per cent.

(*d*) By inserting at the end thereof the following new paragraph:

The following table of withholding rates under the Internal Revenue Code as amended and the tax conventions between the United States and Canada and United States and Sweden has been prepared for the purpose of making a summary of such rates readily available to withholding agents:

For the period on and after June 26, 1940, and prior to January 1, 1945.

Classes of taxpayers.	Corporate bond interest.			Salary or other compensation for personal services.	Other fixed or determinable annual or periodical income, including dividends, from sources within the United States.
	With tax-free covenant and issued before Jan. 1, 1934.		Without tax-free covenant or issued on or after Jan. 1, 1934, with tax-free covenant.		
	If corporation assumes over 2 per cent of the tax.	If corporation assumes not over 2 per cent of the tax.			
1. Citizen or resident individual, fiduciary, or partnership	*Per cent.* 2	*Per cent.* 2	*Per cent.*	*Per cent.*	*Per cent.*
2. Nonresident individual, fiduciary, or partnership (except as stated in item 5 below)	2	16½	16½	[1] 16½	[3] 16½
3. Domestic corporation or resident foreign corporation					
4. Nonresident foreign corporation (except as stated in item 6 below)	2	16½	16½	16½	[3] 16½
5. Individual, fiduciary, or partnership, resident of Canada	2	5	5	(4)	5
6. Nonresident corporation organized under laws of Canada	2	16½	16½	16½	[2] 16½
7. Unknown owner	2	16½	16½		(4)

[1] Salary or compensation for personal services rendered in the United States is not subject to withholding in the case of nonresident aliens, residents of Canada or Mexico, who enter and leave the United States at frequent intervals.

[2] In the case of dividends paid to a corporation organized under the laws of Canada, the rate is 5 per cent.

[3] In the case of a resident of Sweden or a corporation or other entity organized under the laws of Sweden the rate with respect to dividends is 10 per cent for at least two years beginning January 1, 1940.

[4] Interest on any noncorporate security the owner of which is unknown to the withholding agent is subject to withholding at the rate of 16½ per cent.

(8) Section 19.262-4 is amended as follows:

(*a*) By inserting after the words "10 per cent" wherever appearing therein the words, "(15 per cent on and after June 26, 1940, except as otherwise provided herein)."

(*b*) By striking out the last sentence thereof and inserting in lieu thereof the following:

As to reduction in rate of withholding (*a*) in the case of nonresident alien individuals who are residents of Canada or of Sweden, see section 19.143-1; (*b*) in the case of nonresident foreign corporations organized under the laws of Canada, or corporations or other entities created or organized under the laws of Sweden, see section 19.144-1.

With respect to income paid on or after June 26, 1940, and prior to January 1, 1945, the rate of withholding (except with respect to dividends paid to residents of, or corporations organized under the laws of, Canada or to residents of, or to corporations or other entities created or organized under the laws of, Sweden) is 16½ per cent instead of 15 per cent.

(This Treasury decision is issued under the authority of sections 143 and 144 of the Internal Revenue Code (53 Stat., 60, 62), as amended by section 5 and section 202 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session); and section 62 of the said Internal Revenue Code (53 Stat., 32).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved July 1, 1940.

HERBERT E. GASTON,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 2, 1940, 3.22 p. m.)

SECTION 19.143-1: Withholding tax at source. 1940-31-10356
(Also Section 144, Section 19.144-1.) Mim. 5075

Withholding of tax from income derived by persons in certain foreign countries.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., July 8, 1940.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Other Persons Concerned:

Certain Executive Orders have been issued by the United States Government restricting the transfer of funds from the United States to persons in Norway, Denmark, the Netherlands, Belgium, Luxembourg, and France.

Banks, corporations, and other persons in the United States have the control, receipt, custody, disposal, and payment of fixed or determinable annual or periodical income from sources within the United States of persons in those foreign countries, which is subject to the provisions of sections 143 and 144 of the Internal Revenue Code, as amended by sections 5 and 202 of the Revenue Act of 1940. Such income is credited to the accounts of the foreign persons to whom actual transfer thereof is prohibited. The tax should be withheld in such cases in the same manner and to the same extent as if the restriction on the transfer of the income did not exist.

If a custodian account is maintained in the name of a foreign bank or other foreign person in any of the foreign countries referred to,

and the United States custodian has reason to believe that the actual owner of the securities is another person, the name of the foreign bank or other foreign person should be entered on the ownership certificate, Form 1001, as the owner of the securities until such time as the name of the actual owner is disclosed to the custodian. In such a case an amended ownership certificate showing the name of the actual owner should be secured as soon as possible.

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

TIMOTHY C. MOONEY,
Acting Commissioner.

SECTION 19.143-1: Withholding tax at source. 1940-37-10416
I. T. 3404

INTERNAL REVENUE CODE.

Withholding agents in the United States are authorized to return directly to the British Government, or to the M Bank as the agent of the British Government, the amount of tax withheld during 1940 from interest on bonds and dividends on stock of American corporations, title to which was taken by the British Government under the Acquisition of Securities Order, 1940, provided the securities belonged to the British Government when the tax was withheld.

Advice is requested relative to the release to the British Government by withholding agents in the United States of the amount of tax withheld during 1940 from interest on bonds and dividends on stock.

On February 17 and April 13, 1940, the British Government, under the Acquisition of Securities Order, 1940, took title to the stocks owned by its subjects in a number of American corporations, and under the same authority also took title to certain bonds issued by American corporations. The M Bank is acting on behalf of the British Government as custodian for those securities. There has been delay in getting physical possession of some of the securities and in having stocks transferred to the names of nominees. During that interval, the record owners of the securities so taken over have collected dividends and interest thereon from which 10 per cent or 15 per cent income tax has been withheld. The British Government has reclaimed such dividends and interest from the recipients, and contends that the tax should not have been withheld therefrom.

As income of foreign governments from sources within the United States is exempt from Federal income tax under section 116(c) of the Internal Revenue Code, no tax is required to be withheld from the income of the British Government consisting of interest on bonds and dividends on stock owned by that Government. The amount of tax withheld during 1940 is not required to be paid to the Federal Government until June 15, 1941. Withholding agents in the United States are, therefore, authorized to release the amount of tax withheld from such securities during 1940 to the British Government direct, or to the M Bank as the agent of the British Government, provided the withholding agents are satisfied that the securities belonged to the British Government at the time the tax was withheld, and that the interest and dividends forming the basis for the tax withheld were turned over to the British Government by the former owners of the securities.

SECTION 19.143–1: Withholding tax at source.

INTERNAL REVENUE CODE.

Withholding with respect to nonresident alien individuals under the Internal Revenue Code, as amended by the Revenue Act of 1940. (See Mim. 5140, page 151.)

SECTION 19.143–3: Exemption from withholding.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 4979, page 138.)

SECTION 19.143–3: Exemption from withholding. 1940–47–10192
(Also Section 165, Section 19.165–1.) I. T. 3427

INTERNAL REVENUE CODE.

Under the tax convention with Sweden, a citizen of Sweden not residing in either Sweden or the United States is considered a resident of Sweden.

The term "private pensions," as used in Article X of the convention, means pensions paid by private persons as distinguished from pensions paid by one of the contracting States or by the political subdivisions, territories, or possessions thereof. Private pensions paid by trusts which qualify under section 165 of the Internal Revenue Code are exempt under Article X of the convention only to the extent that they represent additional compensation for past services.

Dividends received as income by a domestic trust and distributed by a fiduciary to Swedish beneficiaries retain their character as dividends under Article VII of the convention.

Advice is requested in connection with the tax convention and protocol with Sweden (C. B. 1940–1, 288), in view of the Revenue Act of 1940 and Treasury Decision 4979 (page 138, this Bulletin).

The questions submitted relate to the following:

(*a*) Definition of the term "resident" as used in the convention with respect to residents of Sweden.

(*b*) Definition of the term "private pensions" as used in Article X of the convention.

(*c*) Status of dividends received as income by domestic trusts and paid by such trusts to alien beneficiaries thereof resident in Sweden.

With respect to the persons to whom the benefits of the convention accrue (Article I of the convention) and the definition of the term "resident" (paragraph 3 of the protocol), it has been suggested that the language used in Treasury Decision 4979, supra, promulgated under the Revenue Act of 1940, seems to confine the effect of the convention to residents. It is also pointed out that the term "private pensions" mentioned in Article X of the convention is not defined. If all payments made to beneficiaries of trusts which qualify under section 165 of the Internal Revenue Code are not exempt as private pensions, a list of the payments which are exempt is requested. The question is also presented as to whether dividends, which are received as income of a domestic trust and then remitted as a distribution of trust income to a Swedish beneficiary, retain their character as dividends under Article VII of the convention.

The last paragraph of Article I of the convention provides:

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.

Paragraph 3 of the protocol reads in part as follows:

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.

The third paragraph of section 25.1 of the regulations prescribed in connection with the treaty (T. D. 4975, page 43, this Bulletin) reads as follows:

The convention does not affect the liability to United States income tax of Swedish citizens resident in the United States except to the extent such citizens are entitled to the benefits of Article XIV of the convention. For the purposes of the convention, an individual resident in neither Sweden nor the United States and claiming the benefits of the convention as a citizen of Sweden shall be deemed to be a resident of Sweden if it is shown to the satisfaction of the Commissioner that he is such citizen. With respect to dividends and interest, see section 25.9 of these regulations.

The first paragraph of section 25.2 of Treasury Decision 4975, supra, reads:

Definitions.—Any word or term used in these regulations which is defined in the convention shall be given the definition assigned to such word or term in such convention. Any word or term used in these regulations which is not defined in the convention but is defined in the Internal Revenue Code shall be given the definition contained therein.

Treasury Decision 4979, supra, relates to the increase in the withholding rates of sections 143 and 144 of the Internal Revenue Code as effected by the Revenue Act of 1940. That Treasury decision does not and could not have any limiting effect on the provisions of Article I of the convention. The provisions of sections 143 and 144 of the Code are applicable in general to nonresident alien individuals, nonresident foreign partnerships, and nonresident foreign corporations. The increased rates of the Revenue Act of 1940 affect their Federal income tax liability except in cases where the rates of tax are fixed by treaties. (Section 22(b)7, Internal Revenue Code.) The only item of income specified in the convention which remains unaffected by the increased rate of withholding is dividends paid to a resident of Sweden or a corporation or other entity organized under the laws of Sweden. Inasmuch as the term "resident" as used in the treaty, includes citizens of Sweden resident in countries other than the United States and Sweden, it was deemed unnecessary to add to the terms "resident of Sweden" or "residents of Sweden" in Treasury Decision 4979, the clause, "as defined in paragraph 3 of the protocol to the tax convention between the United States and Sweden."

Article X of the convention provides as follows:

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.

The term "private pensions," as used in the second paragraph of Article X of the convention, means pensions paid by private persons as distinguished from "pensions paid by one of the contracting States or by the political subdivisions or territories or possessions thereof," referred to in the first paragraph of Article X. A similar distinction is made in section 19.22(a)–2 of Regulations 103, pertaining to the income tax provisions of the Internal Revenue Code, and the corresponding article in income tax regulations promulgated under prior Revenue Acts, which provide in part that "* * * pensions or retiring allowances paid by private persons or by the United States are income to the recipients."

In general, private pensions paid either directly or through the medium of a trust come within the meaning of the term "private pensions" in Article X of the convention. No broad ruling can be made, however, that all payments made to beneficiaries of trusts which qualify under section 165 of the Internal Revenue Code are exempt under Article X. Such exemption is applicable only to those payments made under trusts qualifying under section 165 which represent additional compensation for past services rendered.

Paragraph 1 of Article VII of the tax convention provides as follows:

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.

Dividends received as income of a domestic trust which are to be distributed currently by a fiduciary to a Swedish beneficiary retain their character as dividends under paragraph 1 of Article VII of the convention when distributed to the beneficiary.

SECTION 19.143–7: Return and payment of tax withheld.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 4979, page 138.)

SECTION 144.—PAYMENT OF CORPORATION INCOME TAX AT SOURCE.

SECTION 19.144–1: Withholding in the case of nonresident foreign corporations.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 4979, page 138.)

SECTION 19.144-1: Withholding in the case of nonresident foreign corporations.

INTERNAL REVENUE CODE.

Withholding of tax from income derived by persons in Norway, Denmark, the Netherlands, Belgium, Luxembourg, and France. (See Mim. 5075, page 141.)

SECTION 19.144-1: Withholding in the case of nonresident foreign corporations.

INTERNAL REVENUE CODE.

Withholding with respect to foreign corporations under the Internal Revenue Code, as amended by the Revenue Act of 1940. (See Mim. 5140, page 151.)

SECTION 19.144-2: Aids to withholding agents in determining liability for withholding of tax.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 4979, page 138.)

SECTION 147.—INFORMATION AT SOURCE.

SECTION 19.147-1: Return of information as to payments of $1,000.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.147-2: Return of information as to payments to employees.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.147-3: Cases where no return of information required.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.147-7: Return of information as to foreign items.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.147-8: Information as to actual owner.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 148.—INFORMATION BY CORPORATIONS.

SECTION 19.148–3: Return of information respecting distributions in liquidation. 1940–44–10473 T. D. 5015

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART 19.—INCOME TAX.

Regulations 103 amended with respect to certain information returns.

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

To Collectors of Internal Revenue and Others Concerned:

Effective for taxable years beginning after December 31, 1939, Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.] are amended as follows:

PARAGRAPH 1. Section 19.148–3 is amended as follows:

(*a*) By amending the first sentence to read as follows:

Unless the distribution is one in respect of which information is required to be filed pursuant to section 19.112(b) (6)–5(*b*), 19.112(g)–6(*a*), or 19.371–10, every corporation making any distribution of $800 or more during a calendar year to any shareholder in liquidation of the whole or any part of its capital stock shall file a return of information on Forms 1096 and 1099L, giving all the information required by such forms and by these regulations.

(*b*) By striking out "in duplicate" in the second sentence.

(*c*) By striking out "duplicate" in the last sentence.

PAR. 2. Section 19.148–4 is amended by striking out "Schedule H–1" in the first sentence and inserting in lieu thereof "a schedule on the form prescribed by the Commissioner."

PAR 3. Section 19.149–1 is amended as follows:

(*a*) By striking out "either" and "purchases or" in the first sentence.

(*b*) By striking out "the total of the purchases," in the second sentence.

(*c*) By inserting at the end of the first paragraph the following:

Banks and trust companies will not be required to show the dollar totals of the sales and exchanges.

(*d*) By striking out the second paragraph.

(*e*) By striking out "purchases," and "purchases and" wherever occurring in the third paragraph.

(*f*) By striking out "purchases and" and "purchases or" in the first sentence of the fourth paragraph.

(This Treasury decision is issued under the authority contained in sections 62, 148, and 149 of the Internal Revenue Code (53 Stat., 32, 64, 65).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved October 22, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register October 24, 1940, 10.56 a. m.)

SECTION 19.148–4: Information respecting compensation of officers and employees in excess of $75,000.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5015, page 147.)

SECTION 149.—RETURNS OF BROKERS.

SECTION 19.149–1: Return of information by brokers.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5015, page 147.)

SUPPLEMENT E.—ESTATES AND TRUSTS.

SECTION 163.—CREDITS AGAINST NET INCOME.

SECTION 19.163–1: Credits to estate, trust, or beneficiary.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 165.—EMPLOYEES' TRUSTS.

SECTION 19.165–1: Employees' trusts.

INTERNAL REVENUE CODE.

Exemption of pensions paid under Article X of tax convention with Sweden. (See I. T. 3427, page 143.)

SECTION 19.165–1: Employees' trusts. 1940–52–10531
I. T. 3436

INTERNAL REVENUE CODE AND REVENUE ACT OF 1938.

The pension plan maintained by the M Railway Co. qualifies as an employees' trust under section 165 of the Internal Revenue Code and the Revenue Act of 1938, even though there is no formal trust instrument, since the M Railway Co. has parted with title to the fund and the participants have the right to demand that it be administered according to the terms and conditions of the pension plan.

Advice is requested whether the supplemental pension plan of the M Railway Co. meets the requirements of section 165 of the Internal Revenue Code, as amended, and the corresponding provisions of the Revenue Act of 1938 for classification as an employees' trust.

The supplemental pension plan, effective December —, 1938, provides for pensions to those employees of the company receiving compensation in excess of $300 a month, which pensions will be in addition to those to which such employees become entitled under the Railroad Retirement Act of 1937. Contributions are made to the pension trust fund by the employee and the railway company. The employee contributes the same percentage of his compensation above $300 a month as is required to be paid by him on his compensation below $300 a month under the Carriers Taxing Act of 1937. The railway company contributes an amount equal to the employee's contribution on his compensation above $300 a month. The railway company will make an additional contribution to the pension for each employee in the year in which he retires to cover services rendered by the retired employee prior to the effective date of the plan. All contributions made by the railway company and employees under the supplemental pension plan are turned over to a trust company in accordance with a custodial agreement entered into between the board of managers and the trust company. The board of directors of the railway company reserves the right upon written notice of not less than —— days to amend or discontinue the plan, but in either case all liabilities with respect to the employees under the plan must be satisfied before any moneys remaining can be returned to the railway company. No formal trust indenture appears to have been executed, but this omission is immaterial if the facts and circumstances connected with the creation and operation of the fund show that it is a valid, existing trust.

It is well established that there is no specific formula required for the creation of trusts. If the intention of the creator is clear, the trustee and beneficiaries designated, and the subject of the trust indicated, the simplest of words will be sufficient to sustain the trust. As stated in 39 Cyc., page 80, under " Trusts ":

> An express trust may be proved not only by express declarations but also by circumstances from which its existence may be inferred, and to this end evidence of the acts and declarations, either oral or written, of the parties, as well as the surrounding circumstances, may be admitted and considered.

The elements required to create a trust are set forth in 26 R. C. L., 1179, as follows:

> The several elements which must concur in the creation of a trust are, a person competent to create it, sufficient words to create it, a person capable of holding as trustee a specified or ascertainable object, a definite subject, and declaration of the terms of the trust.

(To the same general effect see the citations in *Hibbard, Spencer, Bartlett & Co.* v. *Commissioner*, 5 B. T. A., 464, acquiescence, C. B. VI–2, 3 (1927).)

It is, therefore, the opinion of the Bureau that the guiding rules applicable in cases such as here involved should be whether the employer has placed the fund absolutely in the hands of the trustees and beyond his power to recall it, and whether the employees have such a vested right in the fund that they may demand it be administered for and in their behalf. If these conditions obtain, there would appear to be a true trust relationship between the trustees and beneficiaries, and the organization should be dealt with as a trust separate and distinct from the employer who created it, even though the employer may have

some supervisory power over the investment of the fund and may terminate it on notice. The essential thing is whether the employer has absolutely contributed his portion of the fund to the trustees and the employees hold the complete vested equitable interest in it.

Applying these tests to the supplemental pension fund of the M Railway Co., it is the opinion of the Bureau that the fund should be treated as a valid, enforceable trust. It appears that the M Railway Co. has effectively parted with title to the fund; that it has no right thereto except a possibility of reversion upon liquidation of the fund, provided all liabilities to the employees under the plan have been met; and that the participants therein have the right to demand that the fund be administered according to the terms and conditions of the pension plan and the above-mentioned agreement.

Based on the foregoing, it is held that the supplemental pension plan of the M Railway Co. qualifies as an employees' trust under section 165 of the Internal Revenue Code, as amended, and the corresponding provisions of the Revenue Act of 1938.

SUPPLEMENT G.—INSURANCE COMPANIES.

SECTION 201(b).—TAX ON LIFE INSURANCE COMPANIES: IMPOSITION OF TAX.

SECTION 19.201(b)–1: Tax on life insurance companies.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 204(a).—INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL: IMPOSITION OF TAX.

SECTION 19.204(a)–1: Tax on insurance companies other than life or mutual.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 207.—MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

SECTION 19.207–1: Tax on mutual insurance companies other than life.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 211.—TAX ON NONRESIDENT ALIEN INDIVIDUALS.

SECTION 19.211–1: Taxation of aliens in general.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.211–1: Taxation of aliens in general.

INTERNAL REVENUE CODE.

Foreign journalists and newspaper correspondents in the United States. (See I. T. 3419, page 32.)

SECTION 19.211–7: Taxation of nonresident alien individuals.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.211–7: Taxation of nonresident alien individuals. 1940–53–10543 Mim. 5140

Taxation of nonresident alien individuals and foreign corporations not engaged in trade or business within the United States and not having an office or place of business therein, under the Internal Revenue Code, as amended by the Revenue Act of 1940, approved June 25, 1940.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., December 12, 1940.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Other Persons Concerned.

In order to avoid unnecessary repetition, nonresident alien individuals and foreign corporations of the type covered by the caption of this mimeograph will be designated as nonresident alien individuals and nonresident foreign corporations, respectively, without any reference to United States business or office.

Bulletin "N" (revised) contains the basic principles of the taxation of nonresident alien individuals and foreign corporations under the Internal Revenue Code and the provisions of Regulations 103 concerning the items of gross income, the deductions and credits, and the conditions under which they may be claimed, and under which income tax returns are required to be filed, the method of their preparation, the time and place for filing such returns, and the time for the payment of the tax due thereon.

CHANGES.

The computation of the Federal income tax liability of nonresident alien individuals and nonresident foreign corporations for taxable years beginning after December 31, 1939, was affected by the Revenue Act of 1940. These changes are:

(1) The rate of 10 per cent imposed upon the fixed or determinable annual or periodical income from sources within the United States of nonresident alien individuals was increased to 15 per cent (section 211(a)1(A) of the Code, as amended), excepting dividends received by nonresident aliens residing in Sweden, such exception being due to the existing tax convention between the United States and Sweden (section 8, Revenue Act of 1940);

(2) The substitution of $24,000 for $21,600 (section 211(a)2 of the Code, as amended);

(3) The reduction of the personal exemption of $1,000 to $800 (section 214, as amended), affecting only nonresident aliens who are entitled to such credit;

(4) The increased surtax rates (section 12(b) of the Code, as amended), affecting only nonresident aliens who are liable to surtax; and

(5) The imposition of the 10 per cent defense tax for taxable years beginning after December 31, 1939, and before January 1, 1945 (Chapter 1 of the Code, as amended by the insertion of section 15).

The changes affecting the computation of the Federal income tax liability of nonresident foreign corporations under the Revenue Act of 1940 are:

(1) The rate of 10 per cent applicable to dividends was increased to 15 per cent (section 231(a) of the Code, as amended) except dividends paid to corporations and other entities organized under the laws of Sweden, such exception being due to the existing tax convention between the United States and Sweden (section 8, Revenue Act of 1940); and

(2) The imposition of the 10 per cent defense tax for taxable years beginning after December 31, 1939, and before January 1, 1945 (Chapter 1 of the Code, as amended by the insertion of section 15).

All the amendments referred to are applicable to taxable years beginning after December 31, 1939. Section 15 is applicable to taxable years beginning after December 31, 1939, and before January 1, 1945.

No change was made in the rate of tax (5 per cent) applicable to nonresident aliens residing in Canada with respect to their fixed or determinable annual or periodical income from sources within the United States, and the rate of tax (5 per cent) applicable to dividends received by nonresident foreign corporations organized under the laws of Canada (section 8, Revenue Act of 1940).

WITHHOLDING.

The withholding rate of 10 per cent has been increased to 15 per cent (sections 143 and 144 of the Code, as amended), and for the period after June 25, 1940, and before January 1, 1945, such 15 per cent rate is increased to 16½ per cent (section 143 of the Code, as amended by the insertion of subsection (h)).

The increased rate of 16½ per cent does not apply to the fixed or determinable annual or periodical income from sources within the United States of nonresident alien individuals residing in Canada, to dividends received by nonresident foreign corporations organized under the laws of Canada, or to dividends received by nonresident alien individuals residing in Sweden and nonresident foreign corporations and other entities organized under the laws of Sweden.

SUMMARY OF THE CHANGES IN TAXATION.

Summarizing the foregoing, in general, nonresident alien individuals and nonresident foreign corporations are subject to tax at the rate of 16½ per cent upon their fixed or determinable annual or periodical income from sources within the United States for taxable years beginning after December 31, 1939, and before January 1, 1945.

In general, the tax at the rate of 16½ per cent due from nonresident alien individuals and nonresident foreign corporations is collectible at the source, as their taxable income is limited to the items of income which are subject to withholding at the source.

If, however, a nonresident alien individual (not a resident of Canada) receives during the taxable year fixed or determinable annual or periodical income from sources within the United States exceeding $24,000 he will be liable to tax (1) at the normal rate of 4 per cent imposed by section 11, the graduated surtax imposed by section 12 of the Code, as amended, and the 10 per cent defense tax, or (2) to tax at the rate of 16½ per cent, whichever method of calculation results in the larger tax. In computing the normal tax and surtax, such alien is entitled to the statutory deductions from gross income allowable to a nonresident alien individual provided by sections 23 and 213, and also to the credits against net income allowable to an individual by section 25, as amended, subject to the limitation provisions of section 214. Should a nonresident alien residing in Sweden receive fixed or determinable annual or periodical income from sources within the United States in excess of $24,000, that portion of such income consisting of dividends is taxable at the rate of 10 per cent only.

RETURNS.

Every nonresident alien individual must file a return on Form 1040NB and pay the tax shown to be due thereon unless the tax has been fully paid at the source.

Every nonresident foreign corporation must file a return on Form 1120NB and pay the tax shown to be due thereon unless the tax has been fully paid at the source.

Some of the items upon which the tax liability will not have been fully satisfied at the source are interest received during the year upon so-called tax-free covenant bonds upon which a tax of 2 per cent only was withheld at the source and dividends received from a foreign corporation which are treated as income from sources within the United States under section 119(a)2(B).

If a nonresident alien (other than a resident of Canada) receives more than $24,000 gross amount of fixed or determinable annual or periodical income from sources within the United States, a return on Form 1040NB–a of such income is required to be filed by or in behalf of such nonresident alien.

The withholding provisions of the Internal Revenue Code, as amended, increasing the withholding rates of 10 and 15 per cent to 16½ per cent apply only to income payments made on and after June 26, 1940. Nonresident alien individuals and nonresident foreign corporations receiving income which was subject to withholding during 1940 prior to June 26, 1940, are liable to tax in addition to the amount of tax withheld at the rate of 10 per cent or 15 per cent during that period, if their taxable year 1940 began after December 31, 1939. Such taxpayers will, therefore, be required to file Forms 1040NB, Forms 1040NB–a, or Forms 1120NB for the year 1940.

The items of fixed or determinable annual or periodical income from sources within the United States which are excluded from the gross income of citizens of France residing therein, French corporations, nonresident alien individuals residing in Sweden, and corporations and other entities organized under the laws of Sweden, under existing tax conventions between the United States and France and the United States and Sweden, are not covered by this mimeograph, as this subject is fully explained in the income tax returns required to be filed by nonresident alien individuals and nonresident foreign corporations.

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

GUY T. HELVERING,
Commissioner.

SECTION 213.—DEDUCTIONS.

SECTION 19.213–1: Deductions allowed nonresident alien individuals.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 214.—CREDITS AGAINST NET INCOME.

SECTION 19.214–1: Credits to nonresident alien individuals.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 215.—ALLOWANCE OF DEDUCTIONS AND CREDITS.

SECTION 19.215–1: Allowance of deductions and credits to nonresident alien individuals.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 217.—RETURNS.

SECTION 19.217–2: Return of income.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 219.—PARTNERSHIPS.

SECTION 19.219–1: Partnerships.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SUPPLEMENT I.—FOREIGN CORPORATIONS.

SECTION 231.—TAX ON FOREIGN CORPORATIONS.

SECTION 19.231–1: Taxation of foreign corporations.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.231–1: Taxation of foreign corporations.

INTERNAL REVENUE CODE.

Taxation of foreign corporations not engaged in trade or business within the United States and not having an office or place of business therein under the Internal Revenue Code, as amended by the Revenue Act of 1940. (See Mim. 5140, page 151.)

SECTION 19.231–3: Exclusion of earnings of foreign ships from gross income. 1940–32–10373 I. T. 3399

INTERNAL REVENUE CODE, REVENUE ACT OF 1938, AND PRIOR REVENUE ACTS.

The term "ship or ships," as used in section 231(d) of the Internal Revenue Code and corresponding sections of prior Revenue Acts, does not include the terms "airship or airships" or "airplane or airplanes."

Advice is requested whether the term "ship or ships," as used in section 231(d) of the Internal Revenue Code and section 19.231–3 of Regulations 103, includes the terms "airship or airships" or "airplane or airplanes."

Section 231(d) of the Internal Revenue Code provides as follows:

(d) *Ships under foreign flag.*—The income of a foreign corporation, which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States, shall not be included in gross income and shall be exempt from taxation under this chapter.

The provisions of section 231(d) of the Internal Revenue Code first appeared in the Revenue Act of 1921 as section 213(b)8, and they have been reenacted substantially unchanged in each subsequent Revenue Act. The legislative history of section 213(b)8 of the Revenue Act of 1921 clearly indicates that it was not intended to include aircraft within the meaning of the term "ship or ships."

In G. C. M. 11539 (C. B. XII–1, 456 (1933)) it was held that seaplanes, amphibians, airplanes, and land planes are not vessels within the meaning of Schedule A–5 of Title VIII of the Revenue Act of 1926, as amended by section 442 of the Revenue Act of 1928 relating to stamp taxes. That memorandum was based upon the decision of the United States Supreme Court in *McBoyle* v. *United States* (283 U. S., 25), which involved the conviction of McBoyle for theft of an airplane, alleged to be in violation of the provisions of the Federal Motor Vehicle Theft Act (41 Stat., 324). The Act prohibited the transportation in interstate or foreign commerce of stolen motor vehicles. It defined the term motor vehicle and provided that it should include an automobile, automobile truck, automobile wagon, motorcycle, or any other self-propelled vehicle not designed for running on rails. The Court stated in part that:

* * * No doubt etymologically it is possible to use the word [vehicle] to signify a conveyance working on land, water or air, and sometimes legislation extends the use in that direction, e. g., land and air, water being separately provided for, in the Tariff Act, September 22, 1922 (ch. 356, section 401(b), 42 Stat., 858, 948). But in everyday speech "vehicle" calls up the picture of a thing moving on land. * * * So here, the phrase under discussion calls up the popular picture. For after including automobile truck, automobile wagon and motor cycle, the words "any other self-propelled vehicle not designed for running on rails" still indicate that a vehicle in the popular sense, that is a vehicle running on land, is the theme. It is a vehicle that runs, not something, not commonly called a vehicle, that flies. * * *

* * * When a rule of conduct is laid down in words that evoke in the common mind only the picture of vehicles moving on land, the statute should not be extended to aircraft, simply because it may seem to us that a similar policy applies, or upon the speculation that, if the legislature had thought of it, very likely broader words would have been used. * * *

In G. C. M. 11539, supra, it is stated:

> Passage tickets for transportation by air involve the primary function of seaplanes and amphibians, as well as land planes. They involve transportation by air, not by water. Water transportation is purely incidental and occurs only when the landing facilities available are water and not land.
>
> The decision in the McBoyle case, supra, seems entirely to the point. The term "vessel" etymologically is broad enough to signify any container or conveyance, irrespective of the medium in which it operates. But in its limited and everyday meaning, when used with respect to transportation, the term vessel calls up a picture of a thing moving on water. When the Congress, in a statute, lays down words evoking in the common mind only the picture of craft moving on water, the statute should not, in the words of Mr. Justice Holmes, "be extended to aircraft, simply because it may seem * * * that a similar policy applies."

The reasoning employed in G. C. M. 11539, supra, is applicable to the present inquiry. It is held, therefore, that the term "ship or ships," as used in section 231(d) of the Internal Revenue Code and corresponding sections of prior Revenue Acts, does not include the terms "airship or airships" or "airplane or airplanes."

SUPPLEMENT J.—POSSESSIONS OF THE UNITED STATES.

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

SECTION 19.251–1: Citizens of the United States and domestic corporations deriving income from sources within a possession of the United States.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.251–2: Income received within the United States. 1940–46–10485 G. C. M. 22314

INTERNAL REVENUE CODE.

> Income of A, a professional man practicing in the Philippine Islands and entitled to the benefits of section 251 of the Internal Revenue Code, which was actually received by A's agents in the Philippine Islands and deposited by them in A's bank account in Manila while he was on a vacation in the United States, is held to have been received by A in the Philippine Islands.

An opinion is requested whether certain income of A, a taxpayer entitled to the benefits of section 251 of the Internal Revenue Code, was received by him in the Philippine Islands or in the United States.

A, an American citizen engaged in the practice of his profession in the Philippine Islands and entitled to the benefits of section 251 of the Internal Revenue Code, came to the United States on a vacation in December, 1939, which vacation extended into 1940. During his absence from the Philippine Islands, professional fees due him were received by A's agents in the Philippine Islands and deposited by them in his bank account in Manila. The question is presented

whether the fees which accrued to the taxpayer while he was in the United States are taxable to him under section 251(b) as income *constructively received* in the United States.

Section 251 of the Internal Revenue Code provides in part as follows:

SEC. 251. INCOME FROM SOURCES WITHIN POSSESSIONS OF UNITED STATES.

(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.

(b) AMOUNTS RECEIVED IN UNITED STATES.—Notwithstanding the provisions of subsection (a) there shall be included in gross income all amounts received by such citizens or corporations within the United States, whether derived from sources within or without the United States.

This office is of the opinion that the mere temporary presence of the taxpayer in the United States is in itself insufficient to warrant the conclusion that he constructively received income in the United States when such income was actually received by his agents in the Philippines, the place of his residence. This office disapproves any inference to the contrary which might arise from the statement in S. M. 5488 (C. B. V-1, 51 (1926)) to the effect that certain payments made to a taxpayer's wife and to his attorney-in-fact were constructively received by the taxpayer at whatever place he happened to be at the time of payment.

It is the opinion of this office that in the instant case reliance should be placed primarily on the fact that agents of the taxpayer actually received the funds in the Philippines. Such receipt by his agents in the Philippines is equivalent to receipt there by the taxpayer.

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

SUPPLEMENT K.—CHINA TRADE ACT CORPORATIONS.

SECTION 262.—CREDIT AGAINST NET INCOME.

SECTION 19.262-2: Credits allowed China Trade Act corporations.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 19.262-4: Withholding by a China Trade Act corporation.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 4979, page 138.)

SECTION 293.—ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

1940–46–10486
G. C. M. 22326

INTERNAL REVENUE CODE, REVENUE ACT OF 1938, AND PRIOR REVENUE ACTS.

The 50 per centum addition to tax for fraud imposed by section 293(b) of the Revenue Acts of 1936 and 1938 does not abate upon the death of the taxpayer but is collectible from his estate and should be asserted in the notice of deficiency.

The same principle applies to identical or similar provisions of prior Revenue Acts and of the Internal Revenue Code; also to the other additions to tax included in Supplement M of the Revenue Act of 1928, corresponding sections of other Revenue Acts and of the Internal Revenue Code, and to the additions to tax provided by section 3176, Revised Statutes, as amended, and section 3612, Internal Revenue Code.

G. C. M. 9162 (C. B. X–1, 263 (1931)) revoked, and G. C. M. 15736 (C. B. XIV–2, 325 (1935)) modified.

An opinion is requested whether the 50 per cent addition to tax provided by section 293(b) of the Revenue Acts of 1936 and 1938, assessed as a part of jeopardy assessments made against A, are collectible from his estate.

On July —, 1940, jeopardy assessments were made against A for the years 1937 and 1938 of additional income taxes totaling $284x$ dollars, 50 per cent additional taxes for fraud totaling $142x$ dollars, and interest in the amount of $32x$ dollars, making total assessments for the two years of $458x$ dollars. To stay collection of the tax pending appeal, A gave to the collector of internal revenue a bond secured by United States Treasury bonds in the aggregate principal sum of $550x$ dollars, with power of attorney to the collector to dispose of this collateral, subject to the conditions of the bond. A died on August —, 1940, prior to the issuance of the 90-day notice of deficiency covering the jeopardy assessments. The question is presented whether the 50 per cent addition to tax abated upon the death of A.

Section 293 of the Revenue Act of 1938 is entitled "Additions to the tax in case of deficiency," and paragraph (b) provides as follows:

(b) FRAUD.—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be *so* assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

The foregoing provision appears as section 293(b) in each of the Revenue Acts of 1936, 1934, 1932, and 1928, and as section 275(b) in the Revenue Acts of 1926 and 1924. Similar provisions are contained in section 250(b) of the Revenue Acts of 1921 and 1918, prior to which time section 3176 of the Revised Statutes was applied to income taxes. The same provision also appears as section 520(b) of the Revenue Act of 1932 with respect to gift taxes. All of these sections derive from section 3176 of the Revised Statutes.

Section 3176 of the Revised Statutes, as amended, is general in terms and applies to all internal revenue taxes for which returns are required, unless specifically excepted therefrom by special provisions similar to

the above with respect to particular types of taxes. Section 3176, as amended, provides in part as follows:

> In case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax 50 per centum of its amount.
>
> The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax.

There is no provision or exception in any of the Acts to the effect that this penalty shall not be assessed against, or collected from, the estate of a deceased taxpayer. The question whether such addition to tax is collectible from a deceased taxpayer's estate, therefore, depends upon whether the cause of action for such additional amount survives the death of the taxpayer. The addition to tax is based upon or results from a wrongful act (or tort) committed by the deceased taxpayer. There is no Federal statute defining what causes of action survive. Section 955 of the Revised Statutes provides merely that where either party to a suit in a Federal court dies before final judgment, the executor or administrator of such deceased party may prosecute or defend the suit "in case the cause of action survives by law." State statutes providing for the survival of causes of action have no application where the cause of action arises under a Federal statute. (*Schreiber* v. *Sharpless*, 110 U. S., 76.) In *Van Choate* v. *General Electric Co.* (245 Fed., 120) the court stated:

> * * * In causes of action which arise solely under the laws of the United States, survivorship is determined according to the principles of the common law. (*Schreiber* v. *Sharpless*, 110 U. S., 76, 3 Sup. Ct., 423, 28 L. Ed., 65.) At common law, actions ex delicto did not survive, except in a few instances, in which the injured party had the right to waive the tort and sue in assumpsit. (*Patton* v. *Brady, Ex'x.*, 184 U. S., 608, 614, 22 Sup. Ct., 493, 46 L. Ed., 713; *Phillips* v. *Homfray*, 24 Ch. D., 439; *United States* v. *Daniels*, 6 How., 11, 12 L. Ed., 323.) Actions for mere injuries not resulting in profit to the wrongdoer did not survive either his death or that of the injured party. (*Henshaw* v. *Miller*, 17 How., 212, 219, 222, 15 L. Ed., 222.) Penal actions, for obvious reasons, come within the class which are abated by death. (*Schreiber* v. *Sharpless*, supra.)

Whether the cause of action for the addition to tax (or penalty) here in question is one which survives under the common law depends, in the first instance, upon whether the addition to tax is, in substance, a personal punishment to be imposed upon the wrongdoer. If so, the cause of action abates upon the death of the tort-feasor under the common law rule that personal actions die with the person. (*Schreiber* v. *Sharpless*, supra; *Sullivan* v. *Associated Billposters and Distributors*, 6 Fed. (2d), 1000.)

In Law Opinion 1091 (C. B. I–1, 422 (1922)) it was held that the 5 per cent penalty imposed by section 502 of the Revenue Act of 1918 was a personal punishment and did not survive the death of the taxpayer so as to be collectible from his estate. In reaching that conclusion, reference was made to the similarity of penalties imposed by section 3176 of the Revised Statutes to the penalty imposed by section 502, and Law Opinion 926 (C. B. 1, 241 (1919)) was cited, in which it was held that the additions to tax authorized by section 3176, Revised Statutes, were to be considered as penalties and not taxes, except for purposes of collection. The holding in Law Opinion 926 was in turn based largely upon an opinion of the Attorney General (17 Op. Atty. Gen., 433, 435). On the strength of the ruling in Law

Opinion 1091, supra, and its reference to section 3176, Revised Statutes, this office held in G. C. M. 9162 (C. B. X–1, 263 (1931)) and in G. C. M. 15736 (C. B. XIV–2, 325 (1935)) that the 25 per cent penalty imposed by section 3176, Revised Statutes, for delinquency in filing a return was a personal punishment and, therefore, was not collectible from the taxpayer's estate or from transferees of the taxpayer's estate.

The opinion of the Attorney General (17 Op. Atty. Gen., 433, 435), referred to in Law Opinion 926, supra, and in Law Opinion 1091, supra, was rendered under date of July 28, 1882, in response to an inquiry from the Secretary of the Treasury as to whether the 50 per centum addition to tax authorized by section 3176, Revised Statutes, to be imposed upon any person who neglects or refuses to make a list or return was a *penalty* within the meaning of section 5292 of the Revised Statutes, which authorized the Secretary of the Treasury to remit fines, penalties, and forfeitures imposed under any revenue law. The Attorney General held that the addition to tax was a penalty *within the meaning of that statute*, and in the course of his opinion stated—

> It is in the nature of punishment, and was intended, by fear of its exaction, to induce all persons holding taxable property to make out lists thereof and return the same within the time prescribed by law.

In Law Opinion 926, supra, the question was whether the addition to tax for delinquency authorized by section 3176, Revised Statutes, as amended, when imposed in connection with an excess profits tax return, should be disallowed as a deduction from gross income in determining net income subject to normal income tax. On the strength of the Attorney General's opinion above cited, it was held that the addition to tax should be considered a penalty for such purpose, but it was not held that the penalty was a "punishment," that question not being pertinent to the issue there involved.

Reference is also made in Law Opinion 1091, supra, to a portion of the opinion of the Supreme Court in *Helwig* v. *United States* (188 U. S., 605), in which the Court held that the additional sums imposed upon importers by section 7 of the Customs Administrative Act of 1890 (26 Stat., 131), which were more than five times as much as the normal duties, were punitive and "without doubt a punishment upon the importer." The transactions involved in the Helwig case arose before the passage of the Act of July 29, 1897, which cut the additional duties in half and by section 32 directed that the additional duty should not be construed as a penalty. The question before the Supreme Court in the Helwig case was whether the additional duties imposed by section 7 of the 1890 Act were "penal" within the meaning of "penalties" in sections 563 and 629 of the Revised Statutes, the first of which conferred jurisdiction upon the district courts "of all suits for penalties" and the latter conferred jurisdiction upon the circuit courts "of all suits at common law * * * except suits for penalties * * *." The Court, therefore, was examining the statute in question from a jurisdictional point of view.

As stated above, Law Opinion 1091, supra, dealt with the 5 per cent penalty imposed by section 502 of the Revenue Act of 1918. Section 500 of that Act imposed certain taxes upon amounts paid for transportation, which taxes were payable by the person paying for the

transportation (section 501). Section 502 required the person receiving such payments to collect the taxes, make monthly returns thereof, and pay the taxes so collected to the collector of internal revenue at the time fixed for filing the returns, and provided further that:

* * * If the tax is not paid when due, there shall be added as part of the tax a penalty of 5 per centum, together with interest at the rate of 1 per centum for each full month, from the time when the tax became due.

That penalty was not one to be imposed upon the taxpayers but was applicable to persons in unofficial capacities who were required to collect the taxes from the taxpayers and pay them over to the collector of internal revenue. In this respect the penalty under consideration in Law Opinion 1091, supra, was not necessarily similar to the additions to tax authorized by section 3176 of the Revised Statutes.

The nature of the 50 per cent addition to tax provided by section 293(b) of the Revenue Act of 1928 (identical with section 293(b) of the Revenue Acts of 1936 and 1938) was squarely before the Supreme Court in *Helvering* v. *Mitchell*, decided March 7, 1938 (303 U. S., 391, C. B. 1938–1, 317). In that case Mitchell had been indicted under section 146(b) of the Revenue Act of 1928 for willfully attempting to defeat and evade income tax upon his net income for 1929. He was tried and acquitted. Thereafter, the Commissioner issued a notice of deficiency to Mitchell for 1929 and asserted the 50 per cent addition to tax provided by section 293(b) of the Revenue Act of 1928. Mitchell appealed to the Board of Tax Appeals, which sustained the Commissioner's determination (*Charles E. Mitchell* v. *Commissioner*, 32 B. T. A., 1093). Upon petition for review the Circuit Court of Appeals for the Second Circuit sustained the finding of the Board that Mitchell had fraudulently claimed a certain deduction and had fraudulently failed to return other income received by him. The circuit court affirmed the Board's decision with respect to the deficiency in tax, but reversed the Board's approval of the assessment of the addition to tax under section 293(b). The circuit court based its reversal of this portion of the Board's decision upon the acquittal of Mitchell in the criminal proceeding, holding that under the decisions of the Supreme Court in *Coffey* v. *United States* (116 U. S., 436) and *United States* v. *La Franca* (282 U. S., 568), it was required to treat the imposition of the 50 per cent addition to tax as barred by the prior acquittal in the criminal action. (*Mitchell* v. *Commissioner*, 89 Fed. (2d), 873.)

At the instance of the United States, the Supreme Court granted certiorari to review that part of the decision of the circuit court of appeals which reversed the decision of the Board. The Government contended before the Supreme Court that section 293(b) operates not as a punitive but as a compensatory measure; and that it represents a remedial provision enacted by Congress to fix the damages resulting to the Government in fraud cases, and to impose those damages on the persons responsible. Mitchell contended that the addition to tax provided by section 293(b) was a penalty and punishment; that the facts and intents requisite to the imposition of this penalty were put in issue and determined against the Government in the criminal trial; and that the acquittal in that case barred the Government from obtaining a second judgment based upon the same facts and

intents. The question whether section 293(b) of the Revenue Act of 1928 was punitive, therefore, was directly in issue in the Mitchell case.

In its opinion in that case the Supreme Court stated in part as follows:

* * * That acquittal on a criminal charge is not a bar to a civil action by the Government, remedial in its nature, arising out of the same facts on which the criminal proceeding was based has long been settled. (*Stone* v. *United States*, 167 U. S., 178, 188; *Murphy* v. *United States*, 272 U. S., 630, 631, 632. Compare *Cantangco* v. *Abaroa*, 218 U. S., 476, 481, 482.) Where the objective of the subsequent action likewise is punishment, the acquittal is a bar, because to entertain the second proceeding for punishment would subject the defendant to double jeopardy; and double jeopardy is precluded by the fifth amendment whether the verdict was an acquittal or a conviction. (*Murphy* v. *United States*, 272 U. S., 630, 632.)

The necessary implication from the foregoing statement of the Court is that if the addition to tax were a punishment, it could not be imposed in any case in which, on the same facts, the taxpayer has been criminally prosecuted, whether such prosecution resulted in acquittal or conviction, but would be merely an alternative punishment. The Court distinguishes between penalties which are intended as punishments and are, therefore, essentially criminal, and penalties which are remedial in character, providing compensation or indemnity, and which, therefore, may be imposed administratively without the necessity of invoking the judicial power. In this connection, the opinion of the Court reads in part as follows:

Mitchell contends that this proceeding is barred under the doctrine of double jeopardy because the 50 per centum addition of $364,354.92 is not a tax, but a criminal penalty intended as punishment for allegedly fraudulent acts. Unless this sanction was intended as punishment, so that the proceeding is essentially criminal, the double jeopardy clause provided for the defendant in criminal prosecutions is not applicable.

1. In assessing income taxes the Government relies primarily upon the disclosure by the taxpayer of the relevant facts. This disclosure it requires him to make in his annual return. To insure full and honest disclosure, to discourage fraudulent attempts to evade the tax, Congress imposes sanctions. Such sanctions may confessedly be either criminal or civil. As stated in *Oceanic Steam Navigation Co.* v. *Stranahan* (214 U. S., 320, 339):

"In accord with this settled judicial construction, the legislation of Congress from the beginning, not only as to tariff but as to internal revenue, taxation and other subjects, has proceeded on the conception that it was within the competency of Congress, when legislating as to matters exclusively within its control, to impose appropriate obligations and sanction their enforcement by reasonable money penalties, giving to executive officers the power to enforce such penalties without the necessity of invoking the judicial power."

Congress may impose both a criminal and a civil sanction in respect to the same act or omission; for the double jeopardy clause prohibits merely punishing twice, or attempting a second time to punish criminally, for the same offense. The question for decision is thus whether section 293(b) imposes a criminal sanction. That question is one of statutory construction. (Compare *Murphy* v. *United States*, 272 U. S., 630, 632.)

Remedial sanctions may be of varying types. One which is characteristically free of the punitive criminal element is revocation of a privilege voluntarily granted.

Forfeiture of goods or their value and the payment of fixed or variable sums of money are other sanctions which have been recognized as enforceable by civil proceedings since the original revenue law of 1789. (Act of July 31, 1789, chap. 5, section 36, 1 Stat., 29, 47.) In spite of their comparative severity, such sanctions have been upheld against the contention that they are essentially criminal and subject to the procedural rules governing criminal prosecutions. * * * (Citing numerous Supreme Court cases.)

2. The remedial character of sanctions imposing additions to a tax has been made clear by this Court in passing upon similar legislation. They are provided primarily as a safeguard for the protection of the revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud. In *Stockwell* v. *United States* (13 Wall., 531, 547, 551), the Court said of a provision which added double the value of the goods:

"It must therefore be considered as remedial, as providing indemnity for loss. And it is not the less so because the liability of the wrongdoer is measured by double the value of the goods received, concealed, or purchased, instead of their single value. The act of abstracting goods illegally imported, receiving, concealing or buying them, interposes difficulties in the way of a Government seizure, and impairs, therefore, the value of the Government right. It is, then, hardly accurate to say that the only loss the Government can sustain from concealing the goods liable to seizure is their single value, or to assert that the liability imposed by the statute of double the value is arbitrary and without reference to indemnification. Double the value may not be more than complete indemnity * * *.

"The Act of 1823 was, as we have seen, remedial in its nature. Its purpose was to secure full compensation for interference with the rights of the United States * * *."

In sections 276 and 293 it is provided that collection of the 50 per centum addition, like that of the primary tax itself, may be made "by distraint" as well as "by a proceeding in court." If the section provided a criminal sanction, the provision for collection by distraint would make it unconstitutional. (Compare *Lipke* v. *Lederer*, 259 U. S., 557; *Regal Drug Corporation* v. *Wardell*, 260 U. S., 386. See also *United States* v. *Choutcau*, 102 U. S., 603, 611; *Boyd* v. *United States*, 116 U. S., 616; *Lees* v. *United States*, 150 U. S., 476; *United States* v. *La Franca*, 282 U. S., 568.) That Congress provided a distinctly civil procedure for the collection of the additional 50 per centum indicates clearly that it intended a civil, not a criminal, sanction. Civil procedure is incompatible with the accepted rules and constitutional guaranties governing the trial of criminal prosecutions, and where civil procedure is prescribed for the enforcement of remedial sanctions, those rules and guaranties do not apply. Thus the determination of the facts upon which liability is based may be by an administrative agency instead of a jury, or if the prescribed proceeding is in the form of a civil suit, a verdict may be directed against the defendant; there is no burden upon the Government to prove its case beyond a reasonable doubt, and it may appeal from an adverse decision; furthermore, the defendant has no constitutional right to be confronted with witnesses against him, or to refuse to testify; and finally, in the civil enforcement of a remedial sanction there can be no double jeopardy.

4. The fact that the Revenue Act of 1928 contains two separate and distinct provisions imposing sanctions, and that these appear in different parts of the statute, helps to make clear the character of that here invoked. The sanction of fine and imprisonment prescribed by section 146(b) for willful attempts "in any manner to evade or defeat any [income] tax," introduced into the Act under the heading "Penalties," is obviously a criminal one. The sanction of 50 per centum addition "if any part of any deficiency is due to fraud with intent to evade tax," prescribed by section 293(b), introduced into the Act under the heading "Additions to the Tax," was clearly intended as a civil one. This sanction, and other additions to the tax, are set forth in Supplement M, entitled "Interest and Additions to the Tax." The supplement includes, besides section 293(b), sections 291, 292, 293(a), and 294. Section 291 prescribes a 25 per centum addition for failure to make and file a return; section 292 prescribes interest at the rate of 6 per centum per annum upon the deficiency from the date prescribed for payment of the tax; section 293(a), an addition of 5 per centum if the deficiency "is due to negligence, or intentional disregard of rules and regulations but without intent to defraud"; and section 294 prescribes an addition to the tax of 1 per centum per month in case of nonpayment. Obviously all of these "additions to the tax" were intended by Congress as civil incidents of the assessment and collection of the income tax.

In view of the decision of the Supreme Court that section 293(b) is remedial and provides compensation and indemnity, it seems obvious that the cause of action for this penalty does not abate upon the death of the taxpayer as a cause of action for a personal punishment.

It is the opinion of this office that the question as to whether this 50 per centum addition to tax is collectible from the estate of the deceased taxpayer is not to be determined by the common law rule with respect to actions *ex delicto*.

Section 3744 of the Internal Revenue Code (section 3213, R. S., as modified by section 289, Act of March 3, 1911) provides as follows:

SEC. 3744. SUITS FOR TAXES.

Taxes may be sued for and recovered in the name of the United States in any proper form of action, before any district court of the United States, for the district within which the liability to such tax is incurred, or where the party from whom such tax is due resides at the time of the commencement of the said action.

In *Dollar Savings Bank* v. *United States* (19 Wall., 227) the Supreme Court held that the action of debt was a proper form of action for the recovery of taxes.

In every instance where provision has been made for a 50 per cent addition to tax due to fraud, Congress has provided that it shall be collected "as a part of the tax," or "in the same manner as the tax," or "in the same manner as if it were a deficiency." (R. S., 3176, as amended; section 293(b) of the Revenue Act of 1938 and corresponding provisions of prior Revenue Acts; section 520(b) of the Revenue Act of 1932 and corresponding provisions of the Internal Revenue Code.)

In an opinion of the Attorney General dated October 24, 1933 (38 Op. Atty. Gen., 94, 97), it was held that tax, interest, and penalty constitute a single liability. To the same effect is the decision of the Circuit Court of Appeals, Eighth Circuit, in *Ely & Walker Dry Goods Co.* v. *United States* (34 Fed. (2d), 429, 432), wherein the court stated:

We accordingly conclude that the deficiency tax included the penalty and constituted an entire, single liability, that this single liability, treated as such by the parties, was duly compromised, and that such compromise is a bar to this action.

Summarizing with respect to the nature of this addition to tax, it has been held that the statute is remedial, providing compensation or indemnity for loss; that the addition to tax is to be added to the tax and collected in the same manner as the tax, or the deficiency ("and as a part of the tax" R. S., 3176); and that the tax and penalty make a single liability, which, under common law forms of action, was recoverable in the contract action for debt.

It is, therefore, the opinion of this office that the addition to tax provided by section 293(b) of the Revenue Acts of 1936 and 1938 is collectible from the estate of the deceased taxpayer, A, and should be asserted in the notice of deficiency. This conclusion also applies to the 50 per cent addition to tax for fraud imposed by identical or similar provisions of prior Revenue Acts and the Internal Revenue Code.

The other additions to tax included in Supplement M of the Revenue Act of 1928, as discussed by the Supreme Court in the Mitchell case, corresponding sections of other Revenue Acts and of the Internal Revenue Code, the additions to tax provided by section 3176, Revised Statutes, as amended, and the same section in the Code (section 3612, I. R. C.), fall within the same classification and principle.

In view of the foregoing, G. C. M. 9162, supra, is revoked, and G. C. M. 15736, supra, is modified to the extent that it is inconsistent with this opinion. Law Opinion 1091, supra, should be applied only to section 502 of the Revenue Act of 1918 and, as that statute has been repealed, it is not necessary to determine the nature of that penalty.

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

SUPPLEMENT Q.—MUTUAL INVESTMENT COMPANIES.

SECTION 362.—TAX ON MUTUAL INVESTMENT COMPANIES.

SECTION 19.362–1: Tax on mutual investment companies.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

CHAPTER 2.—ADDITIONAL INCOME TAXES.

SUBCHAPTER A.—PERSONAL HOLDING COMPANIES.

SECTION 500.—SURTAX ON PERSONAL HOLDING COMPANIES.

SECTION 19.500–1: Surtax on personal holding companies.

INTERNAL REVENUE CODE.

Computation of defense tax. (See Mim. 5094, page 34.)

SECTION 19.500–1: Surtax on personal holding companies.

INTERNAL REVENUE CODE.

Regulations 103, amended. (See T. D. 5011, page 15.)

SECTION 502.—PERSONAL HOLDING COMPANY INCOME.

SECTION 19.502–1: Personal holding company income. 1940–34–10393
I. T. 3401

INTERNAL REVENUE CODE.

The M Corporation complies with the gross income requirements for classification as a personal holding company inasmuch as an item of income designated "receipts under oil and gas leases" constitutes "rents" within the purview of section 502(g) of the Internal Revenue Code, and not "royalties" within the meaning of section 502(h) of the Code, such item amounting to less than 50 per cent of the corporation's gross income.

Advice is requested whether the M Corporation complies with the gross income requirements for classification as a personal holding company under the provisions of the Internal Revenue Code.

The underlying question is whether an item of income designated "receipts under oil and gas leases" in the amount of x dollars, such item amounting to less than 50 per cent of the corporation's gross income, constitutes "rents" within the purview of section 502(g) of the Internal Revenue Code. The reference to this item, which is contained in a lease, reads, "The lessee shall pay to the lessor as a *rental* herefor, the sum of one dollar ($1) per acre per year, commencing on date of execution hereof and payable semiannually in advance * * *." [Italics supplied.] This gross payment is subject to diminution or abatement per unit of a stated number of acres upon the bringing in of either a producing or nonproducing oil or gas well. It is argued on behalf of the taxpayer that this disputed item constitutes either "royalties" within the purview of section 502(h) of the Internal Revenue Code or some type of income which is not classified as personal holding company income by any of the subdivisions of section 502 of the Code.

Section 502 of the Internal Revenue Code reads in part as follows:

SEC. 502. * * * For the purposes of this subchapter the term "personal holding company income" means the portion of the gross income which consists of:

* * * * * * *

(g) *Rents.*—Rents, unless constituting 50 per centum or more of the gross income. For the purposes of this subsection the term "rents" means compensation, however designated, for the use of, or right to use, property, and the interest on debts owed to the corporation, to the extent such debts represent the price for which real property held primarily for sale to customers in the ordinary course of its trade or business was sold or exchanged by the corporation; but does not include amounts constituting personal holding company income under subsection (f).

(h) *Mineral, oil, or gas royalties.*—Mineral, oil, or gas royalties, unless (1) constituting 50 per centum or more of the gross income, and (2) the deductions allowable under section 23(a) (relating to expenses) other than compensation for personal services rendered by shareholders, constitute 15 per centum or more of the gross income.

The word "royalty" as used in a gas lease generally refers to "a share of the product or profit reserved by the owner for permitting another to use the property." (*J. T. Sneed, Jr.*, v. *Commissioner*, 33 B. T. A., 478, acquiescence, C. B. XV–1, 21 (1936); *Continental Oil Co.* v. *Commissioner*, 36 B. T. A., 693; *Hill* v. *Roberts*, 284 S. W., 246; 3 Sumners Oil and Gas (1938 edition), section 571, page 348). It is compensation for the privilege of drilling and producing oil and gas and consists of a share in the product. (*Bellport* v. *Harrison*, 123 Kan., 310, 255 Pac., 52.) No oil or other minerals were removed from the lands of the M Corporation. Moreover, the item of income in question is not the result of production and does not represent a portion of oil or other minerals produced. Accordingly, it is clear that the moneys in question can not be classified as "royalties."

The agreement of lease denominates this payment "rental" and requires the payment thereof in advance semiannually. As stated in 54 C. J., at page 382, "The word [rent] has a well defined significance and may be generally defined as a compensation or return." In 40 C. J., at page 742 (Mines and Minerals), it is stated that, "'Dead' or 'sleeping' rent is rent which must be paid under a

mining lease whether the mine is worked or not * * *," citing *McIntyre* v. *McIntyre Coal Co.* (105 N. Y., 264, 273, 11 N. E., 645). (See also *Indianapolis Gas Co.* v. *Pierce*, 36 Ind. App., 573, 76 N. E., 173; *Same* v. *Rayle*, 36 Ind. App., 706, 76 N. E., 176; *Commissioner* v. *Wilson*, 76 Fed. (2d), 766; *J. T. Sneed, Jr.*, v. *Commissioner*, supra.)

While the question of whether "delay rentals" constitute "rents," as that term is used in section 502(g) of the Internal Revenue Code, does not appear to have received the consideration of the courts, the Bureau has held that for Federal income tax purposes "there is no distinction between the term 'rent,' in the sense in which that term ordinarily is used, and 'delay rentals.'" (G. C. M. 11197, C. B. XII–1, 238 (1933).) In the consideration of this question, it is further stated in G. C. M. 11197 that:

> * * * Rent is a fixed compensation paid for the use, possession, or interest in land or other property. Delay rental is a sum paid under the terms of a lease for the privilege of continuing the lessee's interest without developing the property. In the case of *Aldridge* v. *Houston Oil Co. et al.* (244 Pac., 782) * * *. The court * * * quoted as follows from Thornton's Law of Oil and Gas, page 668, section 253:
>
> "* * * Care must be taken to distinguish between rent and royalty in connection with gas and oil leases. Rent is the term applied to the privilege given to bore for gas and oil and for delay in beginning operation; while royalty is a certain percentage of the oil after it is found, or so much per gas well developed."
>
> In that case [*Aldridge* v. *Houston Oil Co. et al.*] the court was concerned only with the annual rentals and/or delay rentals which were to be paid under the terms of the lease. The court made no distinction between the term "rent" and "delay rentals." * * *

It is, accordingly, held that the item "receipts under oil and gas leases" in the sum of x dollars constitutes "rents" within the purview of section 502(g) of the Internal Revenue Code, and that the M Corporation complies with the gross income requirements for classification as a personal holding company, such item amounting to less than 50 per cent of the corporation's gross income.

SUBCHAPTER B.—EXCESS-PROFITS TAX.

SECTION 600.—RATE OF TAX.

(Also Section 52, Section 19.52–1.) 1940–31–10367
Mim. 5083

EXCESS-PROFITS TAX.

Computation of defense tax prescribed by section 204 of the Revenue Act of 1940 amending section 600 of the Internal Revenue Code—corporation income and excess-profits tax returns for the fiscal years ending July 31, 1940, to November 30, 1940, inclusive.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., July 17, 1940.

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

1. Attention is invited to section 204 of the Revenue Act of 1940, approved June 25, 1940 (Public, No. 656, Seventy-sixth Congress,

third session), which amends section 600 of the Internal Revenue Code (53 Stat., Part 1) to read as follows:

SEC. 600. RATE OF TAX.

(a) GENERAL RULE.—If any corporation is taxable under section 1200 with respect to any year ending June 30, there shall be imposed upon its net income for the income-tax taxable year ending after the close of such year, an excess-profits tax equal to the sum of the following:

6 per centum of such portion of its net income for such income-tax taxable year as is in excess of 10 per centum and not in excess of 15 per centum of the adjusted declared value;

12 per centum of such portion of its net income for such income-tax taxable year as is in excess of 15 per centum of the adjusted declared value.

(b) DEFENSE TAX FOR FIVE YEARS.—In the case of any taxpayer, the amount of tax payable under this section for any income-tax taxable year ending after June 30, 1940, and before July 1, 1945, shall be 10 per centum greater than the amount of tax which would be payable if computed without regard to this subsection.

2. Corporation income and excess-profits tax return forms for the calendar year 1940 and for fiscal years ending in 1941 will be prepared and printed in due course. New return forms will not be printed for excess-profits tax purposes with respect to the fiscal years ending July 31, 1940, to November 30, 1940, inclusive. In the case of such fiscal years, Form 1120 and Form 1120A for 1939 will be utilized for excess-profits tax purposes in accordance with the following procedure:

(*a*) If the return is made on Form 1120, the excess-profits tax computation (Schedule A) will be made without regard to section 204 of the Revenue Act of 1940 and the amount of line 8 of that schedule will be inserted on line 36 (page 1 of the return) immediately following the parenthesis. The defense tax will be computed by taking 10 per cent of such amount and, with the notation "defense tax, $------," will be inserted with a typewriter or pen and ink on line 36, after which the total excess-profits tax will be inserted in the money column. Such total excess-profits tax will also be inserted on line 29 of the return form, except that if the return is made on the cash receipts and disbursements basis, line 29 will include only the excess-profits tax actually paid within the taxable year. If, for example, a corporation's excess-profits tax, computed without regard to section 204, amounts to $100, line 36 will appear as follows:

36. Excess-profits tax (line 8, Schedule A), $100 (Defense tax, $10)---- $110.00

(*b*) If the return is made on Form 1120A, the excess-profits tax computation (page 1 of the return) will be made without regard to section 204 of the Revenue Act of 1940 and the amount so computed will be inserted in column 3 of line 40. The defense tax will be computed by taking 10 per cent of such amount and, with appropriate notations, inserted with a typewriter or pen and ink, the amount so computed will be added to the excess-profits tax as determined without regard to section 204. The total excess-profits tax will also be inserted on lines 29 and 50 of the return form, except that if the return is made on the cash receipts and disbursements basis, line 29 will include only the excess-profits tax actually paid within the taxable year. If, for example, a corporation's excess-profits tax, computed without regard to section 204, amounts to $100, line 40, with notations referred to above, will appear as follows:

40. Total excess-profits tax (total of item 38, column 3, and item 39, column 3)	$100.00
Defense tax, 10 per cent of item 40	10.00
Total excess-profits tax	110.00

3. The return on Form 1120 and Form 1120A for the fiscal years ending July 31, 1940, to November 30, 1940, inclusive, will be given a preliminary examination in the collectors' offices for the purpose of ascertaining whether the defense tax prescribed by section 204 is correctly computed and care will be taken to see that such tax is included in the excess-profits tax assessments. The excess-profits tax assessments for such fiscal years will be made in the usual manner and identified by the letters "E. P. and D."

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

TIMOTHY C. MOONEY,
Acting Commissioner.

(Also Section 601.)

1940-33-10389
T. D. 4999

TITLE 26—INTERNAL REVENUE.—CHAPTER I. SUBCHAPTER A, PART 21.—EXCESS-PROFITS TAX.

Amending Treasury Decision 4927 [C. B. 1939-2, 143] to conform to the Revenue Act of 1940.

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

To Collectors of Internal Revenue and Others Concerned:

In order to make the provisions of Treasury Decision 4927, approved August 23, 1939 [C. B. 1939-2, 143] [Part 21, Title 26, Code of Federal Regulations, 1939 Sup.], relative to the excess-profits tax, conform to the provisions of sections 204 and 205 of the Revenue Act of 1940, such Treasury decision is amended as follows:

PARAGRAPH 1. That part of section 21.0 preceding the quotation of section 1200 of the Internal Revenue Code is amended to read as follows:

SECTION 21.0. *Introductory.*—(*a*) Chapter 6 (Capital Stock Tax) of the Internal Revenue Code (53 Stat., Part 1), as amended by section 301 of the Revenue Act of 1939 (53 Stat., 882) and by section 205 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), approved June 25, 1940, provides in part:

PAR. 2. Section 21.0 is amended by inserting after the quotation of section 1200(b) of the Internal Revenue Code, the following:

SEC. 205. CAPITAL STOCK TAX. (REVENUE ACT OF 1940.)

Section 1200 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsection:

"(c) DEFENSE TAX FOR FIVE YEARS.—For the year ending June 30, 1940, and for the four succeeding years ending June 30, the rates provided in subsections (a) and (b) shall be $1.10 in lieu of $1."

PAR. 3. Section 21.0 is amended by inserting after the quotation of section 600 of the Internal Revenue Code the following:

SEC. 204. EXCESS-PROFITS TAX. (REVENUE ACT OF 1940.)

Section 600 of the Internal Revenue Code is amended by inserting "(a) GENERAL RULE.—" before the first paragraph and by inserting at the end of such section the following new subsection:

"(b) DEFENSE TAX FOR FIVE YEARS.—In the case of any taxpayer, the amount of tax payable under this section for any income-tax taxable year ending after June 30, 1940, and before July 1, 1945, shall be 10 per centum greater than the amount of tax which would be payable if computed without regard to this subsection."

PAR. 4. Section 21.1(*a*) is amended to read as follows:

(a) "*Adjusted declared value*" means in the case of a domestic corporation the adjusted declared value of its capital stock as determined under section 1202 of the Internal Revenue Code and the regulations issued respecting the capital stock tax imposed by section 1200 of such Code, and in the case of a foreign corporation the adjusted declared value of capital employed in the transaction of its business in the United States as determined under such section 1202 and the regulations issued in reference thereto.

PAR. 5. Section 21.3 is amended by substituting a comma in lieu of the period at the end of paragraph (*a*) and by adding the following:

plus (3) for any income-tax taxable year ending after June 30, 1940, and before July 1, 1945, 10 per cent of the sum of (1) and (2).

PAR. 6. Section 21.4 is amended by adding after the "*Example*" the following:

For any income-tax taxable year ending after June 30, 1940, and before July 1, 1945, the excess-profits tax shall be computed in the manner set forth in the above example. To the result thus obtained shall be added 10 per cent thereof as defense tax. Thus, if the income of the M Corporation for the calendar year 1940 is the same as that for the year 1939, its total excess-profits tax would be $1,089 ($990 plus $99).

(This Treasury decision is issued pursuant to sections 204 and 205 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session) and section 62 of the Internal Revenue Code (53 Stat., 32).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved August 1, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register August 6, 1940, 10.55 a. m.)

SECTION 601.—ADJUSTED DECLARED VALUE.

INTERNAL REVENUE CODE.

Amending Treasury Decision 4927 [C. B. 1939–2, 143] to conform to the Revenue Act of 1940. (See T. D. 4999, page 170.)

SECTION 729(b).—LAWS APPLICABLE: RETURNS.

1940–53–10547
T. D. 5025

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 30.—EXCESS PROFITS TAX.

Regulations relating to time for filing returns and payment of tax under the Excess Profits Tax Act of 1940.

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

To Collectors of Internal Revenue and Others Concerned:

SEC. 30.729–1. *Time and place for filing returns.*—Excess profits tax returns under the Excess Profits Tax Act of 1940 shall be filed at the same time and place as the time and place prescribed in sections 53 and 235 of the Internal Revenue Code and the income tax regulations under such sections (sections 19.53–1 to 19.53–5 and 19.235–1 of Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.]) for the filing of income tax returns under Chapter 1, except that such excess profits tax returns for taxable years ending before December 31, 1940, which, if filed within the time prescribed in Regulations 103, would be filed before March 15, 1941, shall be filed on or before March 15, 1941. (Section 62, 53 Stat., 32; 26 U. S. C., Sup. 62; section 729, Excess Profits Tax Act of 1940, Public, No. 801, Seventy-sixth Congress, third session.)

SEC. 30.729–2. *Time for payment of tax.*—The excess profits tax imposed by the Excess Profits Tax Act of 1940 shall be paid at the same time as the time prescribed in sections 56 and 236 of the Internal Revenue Code and the income tax regulations under such sections (sections 19.56–1, 19.56–2, and 19.236–1 of Regulations 103) for the payment of the income tax imposed by Chapter 1, except that such excess profits tax for taxable years ending before December 31, 1940, which, if paid within the time so prescribed, would be paid before March 15, 1941, shall be paid on or before March 15, 1941. In case an election is made to pay in installments such excess profits tax for a taxable year ending before December 31, 1940, and the first installment, if paid within the time prescribed in section 19.56–1, 19.56–2, or 19.236–1 of Regulations 103, would be paid before March 15, 1941, then the first installment of such tax shall be paid on March 15, 1941, and the second, third, and fourth installments thereof shall be paid on or before the 15th day of the third, sixth, and ninth months, respectively, after March 15, 1941. (Section 62, 53 Stat., 32, 26 U. S. C., Sup., 62; section 729, Excess Profits Tax Act of 1940, Public, No. 801, Seventy-sixth Congress, third session.)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved December 21, 1940.

HERBERT E. GASTON,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 26, 1940, 10.10 a. m.)

CHAPTER 38.—MISCELLANEOUS PROVISIONS.

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

1940-45-10482
T. D. 5018

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

Treasury Decision 4958 [C. B. 1940-1, 74] amended.

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

To Collectors of Internal Revenue and Others Concerned:

Section 464A.5(*b*) of Treasury Decision 4958[C. B. 1940-1, 74] [Part 464A, Title 26, Code of Federal Regulations, 1939 Sup.] is amended by striking out the second paragraph thereof.

(This Treasury decision is prescribed pursuant to sections 3791 and 3798 of the Internal Revenue Code as amended by section 406 of the Revenue Act of 1939 (53 Stat., 467, 470, 884).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved October 26, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register October 30, 1940, 10.21 a. m.)

B. REVENUE ACT OF 1938.

SUBTITLE B.—GENERAL PROVISIONS.

PART II.—COMPUTATION OF NET INCOME.

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

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

REVENUE ACT OF 1938.

Amounts received under so-called endowment, income, and final sum policy. (See I. T. 3402, page 57.)

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

REVENUE ACT OF 1938.

Disability retirement pay under section 6 of the Civil Service Retirement Act of 1920, as amended. (See I. T. 3428, page 60.)

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

ARTICLE 23(a)–1: Business expenses. 1940–39–10430
I. T. 3412

REVENUE ACT OF 1938.

Awards made by the National Labor Relations Board in favor of the employees of the M Company represent compensatory damages and are deductible by the M Company as ordinary and necessary business expenses for Federal income tax purposes. Counsel fees incurred by the company in defending its position before that Board are also deductible as ordinary and necessary business expenses.

Advice is requested relative to the deductibility by the M Company for Federal income tax purposes of awards required to be paid to certain employees as the result of a decision of the National Labor Relations Board. The question is also presented as to the deductibility of counsel fees in connection therewith.

Prior to the year 1938 the M Company was involved in labor difficulties in its plant and jurisdiction over the situation was taken by the National Labor Relations Board. A decision was rendered in 1938 under which the M Company paid to its employees a sum of money approximating $32x$ dollars. The company also incurred counsel fees approximating $5x$ dollars in defending its position. The awards of the National Labor Relations Board represented what the employees would have earned had they not been absent from work as a result of the labor difficulties, after subtracting therefrom the amount of wages, if any, which such employees earned elsewhere during such absence. No appeal from the decision was filed by the M Company.

It is held that the awards here in question represent compensatory damages and are deductible under the provisions of section 23(a) of the Revenue Act of 1938 as ordinary and necessary expenses incurred in connection with the operation of the taxpayer's business. Counsel fees incurred in defending its position before the National Labor Relations Board are also considered to have been incurred in connection with the taxpayer's business and constitute ordinary and necessary business expenses. (See generally O. D. 974, C. B. 5, 129 (1921); O. D. 1117, C. B. 5, 121 (1921); I. T. 1853, C. B. II–2, 124 (1923); S. M. 4078, C. B. V–1, 226 (1926); *Kornhauser* v. *United States*, 276 U. S., 145; *Welch* v. *Helvering*, 290 U. S., 111.)

With respect to the year in which the amounts in question are deductible, under section 43 of the Revenue Act of 1938, deductions for Federal income tax purposes shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order clearly to reflect the income the deductions should be taken as of a different period. Article 43–1 of Regulations 101 provides that a taxpayer shall take the deduction only for the taxable period in which actually "paid or incurred" or "paid or accrued," as the case may be.

Inasmuch as the M Company has adopted the accrual method of reporting its income, it is entitled to deduct the amount of the awards for the taxable year 1938, that is, the year in which the decision of the National Labor Relations Board was rendered (no appeal having been taken) and the liability became fixed and determined. If the legal fees also became a fixed and determined liability during the year 1938, the taxpayer likewise is entitled to deduct such fees as a business expense for that year.

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

ARTICLE 23(c)-1: Taxes.

REVENUE ACT OF 1938.

Refunds or credits for State taxes previously deducted without tax benefits. (See I. T. 3438, page 446.)

ARTICLE 23(c)-1: Taxes.

REVENUE ACT OF 1938.

I. T. 3278 (C. B. 1939-1 (Part 1), 76) modified. (See I. T. 3390, page 68.)

SECTION 23(k).—DEDUCTIONS FROM GROSS INCOME: BAD DEBTS.

ARTICLE 23(k)-1: Bad debts.

REVENUE ACT OF 1938.

Regulations 101, amended. (See T. D. 4978, page 75.)

ARTICLE 23 (k)-1: Bad debts.

REVENUE ACT OF 1938.

Recoveries of bad debts charged off in prior years. (See G. C. M. 22163, page 76.)

ARTICLE 23(k)-1: Bad debts.

REVENUE ACT OF 1938.

Recoveries upon bad debts previously deducted without tax benefit. (See I. T. 3438, page 446.)

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

SECTION 42.—PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

ARTICLE 42-1: When included in gross income.

REVENUE ACT OF 1938.

I. T. 3278 (C. B. 1939-1 (Part 1), 76) modified. (See I. T. 3390, page 68.)

ARTICLE 42-1: When included in gross income.

REVENUE ACT OF 1938.

Refunds or credits for State taxes previously deducted without tax benefit. (See I. T. 3438, page 446.)

PART V.—RETURNS AND PAYMENT OF TAX.

SECTION 55.—PUBLICITY OF RETURNS.

REVENUE ACT OF 1938.

Treasury Decision 4873 (C. B. 1938-2, 261), relating to the inspection of certain returns, amended. (See T. D. 4991, page 92.)

REVENUE ACT OF 1938.

Treasury Decision 4873 (C. B. 1938-2, 261), relating to the inspection of certain returns, amended. (See T. D. 5019, page 95.)

SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A.—RATES OF TAX.

SECTION 101.—EXEMPTIONS FROM TAX ON CORPORATIONS.

ARTICLE 101(6)-1: Religious, charitable, scientific, literary, and educational organizations and community chests.

REVENUE ACT OF 1938.

State teachers' association organized and operated for the improvement of educational methods and administration. (See G. C. M. 22120, page 98.)

SUPPLEMENT B.—COMPUTATION OF NET INCOME.

SECTION 113(b).—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS: ADJUSTED BASIS.

ARTICLE 113(b)-2: Adjusted basis: Cancellation of indebtedness.

REVENUE ACT OF 1938.

Regulations 101, amended. (See T. D. 5003, page 107.)

ARTICLE 113(b)-3: Adjusted basis: Cancellation of indebtedness: Special cases.

REVENUE ACT OF 1938.

Regulations 101, amended. (See T. D. 5003, page 107.)

ARTICLE 113(b)-4: Substituted basis.

REVENUE ACT OF 1938.

Regulations 101, amended. (See T. D. 5003, page 107.)

SUPPLEMENT E.—ESTATES AND TRUSTS.

SECTION 165.—EMPLOYEES' TRUSTS.

ARTICLE 165-1: Employees' trusts.

REVENUE ACT OF 1938.

Pension plan not evidenced by trust instrument. (See I. T. 3436, page 148.)

SUPPLEMENT I.—FOREIGN CORPORATIONS.

SECTION 231.—TAX ON FOREIGN CORPORATIONS.

ARTICLE 231-3: Exclusion of earnings of foreign ships from gross income.

REVENUE ACT OF 1938.

Inclusion of terms "airship or airships" or "airplane or airplanes" in term "ship or ships." (See I. T. 3399, page 156.)

SUPPLEMENT M.—INTEREST AND ADDITIONS TO THE TAX.

SECTION 293.—ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

REVENUE ACT OF 1938.

Collectibility, after death of the taxpayer, of 50 per centum addition to tax for fraud. (See G. C. M. 22326, page 159.)

INCOME TAX RULINGS.—PART II.

REVENUE ACTS OF 1937 AND 1936.

SUBTITLE B.—GENERAL PROVISIONS.

PART II.—COMPUTATION OF NET INCOME.

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

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

REVENUE ACT OF 1936.

Amounts received under so-called endowment, income, and final sum policy. (See I. T. 3402, page 157.)

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

ARTICLE 23(a)-9: Pensions—Compensation for injuries. 1940-38-10424 I. T. 3408

(Also Section 23(p), Article 23(p)-1; Section 113(a), Article 113(a)-1.)

REVENUE ACT OF 1936.

The M Company may take as deductions for Federal income tax purposes reasonable amounts paid for sick or accident benefits or into its pension trust even though the regulations of the Federal Communications Commission require the allocation of a pro rata share of such expenditures to the cost of new construction. The cost or other basis of assets as shown on the books under the regulations of the Commission must be adjusted, for Federal income tax purposes, by eliminating such items which have been allowed as deductions from gross income as business expenses.

Advice is requested whether sick and accident benefits and pension accruals are deductible by the M Company for the year 1937, even though the provisions of the Federal Communications Commission's regulations require that a pro rata portion of such items shall be capitalized and charged to new construction.

Under section 23(a) of the Revenue Act of 1936 and regulations issued thereunder, reasonable amounts paid by the taxpayer into the pension trust fund in 1937, which were not in excess of the company's pension liability for such year, and reasonable amounts paid for sick or accident benefits, were proper deductions by the company in computing its income subject to tax for such year. Payments to the pension trust fund in excess of the company's pension liability for the year in question are deductible over a 10-year period as provided in section 23(p) of the Revenue Act of 1936.

Notwithstanding the provisions of the Federal Communications Commission's regulations relative to the allocation of a pro rata share of the expenditures for sick and accident benefits and pension accruals to the cost of new construction, for Federal income tax purposes the taxpayer is entitled to deduct as ordinary and necessary business

expenses for the year 1937 reasonable amounts paid for sick and accident benefits and reasonable amounts paid to the pension trust fund covering the taxpayer's pension liability for such year.

The above-mentioned items, if taken as deductions from gross income, should not be added to the base of depreciable property either as "overhead" or otherwise. (As to "overhead" see G. C. M. 9357, C. B. X-1, 385 (1931).) In computing gain or loss upon the sale or other disposition of such property, the cost or other basis thereof as shown on the books under the provisions of the Federal Communications Commission's regulations should be adjusted by eliminating therefrom such items previously allowed as deductions from gross income as ordinary and necessary business expenses.

SECTION 23(k).—DEDUCTIONS FROM GROSS INCOME: BAD DEBTS.

ARTICLE 23(k)-1: Bad debts.

REVENUE ACT OF 1936.

Regulations 94, amended. (See T. D. 4978, page 75.)

ARTICLE 23(k)-1: Bad debts. 1940-28-10326
I. T. 3391

REVENUE ACT OF 1936.

I. T. 3172 (C. B. 1938-1, 150) and I. T. 3256 (C. B. 1939-1 (Part 1), 172), concerning taxability of amounts recovered on debts deducted by banks in a prior year pursuant to charge-offs at the specific direction of Federal or State supervisory officers, are revoked in view of G. C. M. 22163 (page 76, this Bulletin.)

ARTICLE 23(k)-1: Bad debts.

REVENUE ACT OF 1936.

Recoveries of bad debts charged off in prior years. (See G. C. M. 22163, page 76.)

ARTICLE 23(k)-1: Bad debts.

REVENUE ACT OF 1936.

Recoveries upon bad debts previously deducted without tax benefit. (See I. T. 3438, page 446.)

SECTION 23(p).—DEDUCTIONS FROM GROSS INCOME: PENSION TRUSTS.

ARTICLE 23(p)-1: Payments to employees' pension trusts.

REVENUE ACT OF 1936.

Deductibility of payments to pension trusts required under regulations of Federal Communications Commission to be capitalized in part. (See I. T. 3408, page 178.)

SECTION 26.—CREDITS OF CORPORATIONS.

ARTICLE 26-2: Credit in connection with contracts restricting payment of dividends. 1940-48-10496 Ct. D. 1467

INCOME TAX—REVENUE ACT OF 1936—DECISION OF SUPREME COURT.

1. SURTAX ON UNDISTRIBUTED PROFITS—CREDIT OF CORPORATION—CONTRACT RESTRICTING PAYMENT OF DIVIDENDS—PROHIBITION ON PAYMENT OF DIVIDENDS—CORPORATE CHARTER AND STATE LAW NOT A WRITTEN CONTRACT EXECUTED BY CORPORATION.

A corporate charter granted by a State together with a State law prohibiting a corporation having a previously existing deficit from distributing dividends do not constitute a "written contract executed by the corporation" within the meaning of section 26(c)1 of the Revenue Act of 1936, which allows credit to a corporation which can not distribute dividends without violating an express provision of a written contract executed by it, dealing with the payment of dividends. Therefore such a corporation, not being entitled to the credit allowed by that section, is liable for surtax on its undistributed profits for the year 1936.

2. CASE FOLLOWED.

Helvering v. *Northwest Steel Rolling Mills, Inc.*, decided by the Supreme Court on November 12, 1940 [Ct. D. 1468, page 181, this Bulletin], followed.

3. DECISION AFFIRMED.

Decision of the United States Circuit Court of Appeals, Eighth Circuit (105 Fed. (2d), 740), affirming decision of the United States Board of Tax Appeals (38 B. T. A., 1355), affirmed.

SUPREME COURT OF THE UNITED STATES.

Crane-Johnson Co., a Corporation of North Dakota, petitioner, v. Guy T. Helvering, Commissioner of Internal Revenue.

[61 S. Ct., 114.]

On writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[November 12, 1940.]

OPINION.

Mr. Justice BLACK delivered the opinion of the Court.

Because of a previously existing deficit, petitioner corporation was prohibited by State law [1] from distributing as dividends its profits earned in 1936. Notwithstanding this State prohibition, the Commissioner held respondent liable under the 1936 Revenue Act [2] for surtax on undistributed profits. The Board of Tax Appeals sustained the Commissioner,[3] and the circuit court of appeals affirmed.[4] On a similar state of facts the Court of Appeals for the Ninth Circuit held undistributed profits exempt from surtax.[5] We granted certiorari in both cases to resolve this conflict.[6] The legal questions here presented are in all respects the same as those presented in *Helvering* v. *Northwest Steel Rolling Mills*, this day decided [Ct. D. 1468, page 181, this Bulletin], and on the authority of that case the decision below is affirmed.

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[1] "The directors of corporations must not make dividends except from the surplus profits arising from the business thereof * * *." (N. D. Comp. Laws (Supp. 1925), section 4543.)

[2] 49 Stat., 1648, 1655.

[3] 38 B. T. A., 1355.

[4] 105 Fed. (2d), 740.

[5] *Northwest Steel Rolling Mills* v. *Commissioner* (110 Fed. (2d), 286).

[6] 309 U. S., 692; 311 U. S., —.

ARTICLE 26–2: Credit in connection with contracts restricting payment of dividends. 1940–48–10497 Ct. D. 1468

INCOME TAX—REVENUE ACT OF 1936—DECISION OF SUPREME COURT.

1. SURTAX ON UNDISTRIBUTED PROFITS—CREDIT OF CORPORATION—CONTRACT RESTRICTING PAYMENT OF DIVIDENDS—PROHIBITION ON PAYMENT OF DIVIDENDS—CORPORATE CHARTER AND STATE LAW NOT A WRITTEN CONTRACT EXECUTED BY CORPORATION.

A corporate charter granted by a State together with a State law prohibiting a corporation having a previously existing deficit from distributing dividends do not constitute a "written contract executed by the corporation" within the meaning of section 26(c)1 of the Revenue Act of 1936, which allows credit to a corporation which can not distribute dividends without violating an express provision of a written contract executed by it, dealing with the payment of dividends. Therefore, such a corporation, not being entitled to the credit allowed by that section, is liable for surtax on its undistributed profits for the year 1936.

2. CONSTITUTIONALITY OF STATUTE.

Section 26(c)1 of the Revenue Act of 1936, construed as denying credit to corporations prohibited by State law from distributing dividends, does not offend the fifth, tenth, and sixteenth amendments to the Constitution.

3. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Ninth Circuit (110 Fed. (2d), 286), reversing unreported decision of the United States Board of Tax Appeals, reversed.

SUPREME COURT OF THE UNITED STATES.

Guy T. Helvering, Commissioner of Internal Revenue, petitioner, v. *Northwest Steel Rolling Mills, Inc.*

[61 S. Ct., 109.]

On writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[November 12, 1940.]

OPINION.

Mr. Justice BLACK delivered the opinion of the Court.

Respondent corporation, because of a previously existing deficit, was prohibited by State law[1] from distributing as dividends its profits earned in 1936. Notwithstanding this State prohibition, the Commissioner held respondent liable under the 1936 Revenue Act[2] for surtax on undistributed profits. The Board of Tax Appeals sustained the Commissioner;[3] the circuit court of appeals reversed.[4] On a similar state of facts the Court of Appeals for the Eighth Circuit held undistributed profits taxable.[5] We granted certiorari in both cases to resolve this conflict.[6]

Section 14 of the 1936 Act imposed a general surtax on corporate profits earned but not distributed as dividends during the tax year. Section 26(c)1 of the Act relieved from such surtax all undistributed profits which the corporation could not distribute as dividends "without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends."

The only "written contract executed by the corporation" upon which respondent relies for its claimed exemption is its corporate charter, granted by the State of Washington. Upon the premises that respondent's Washington

[1] "No corporation shall pay dividends * * * except from the surplus of the aggregate of its assets over the aggregate of its liabilities. * * *" (Wash. Rev. Stat. Ann. (Remington, 1932), title 25, section 3803–24.)

[2] 49 Stat., 1648, 1655.

[3] The memorandum opinion of the Board is not officially reported; the Board relied on its earlier opinion in *Crane-Johnson Co.* v. *Commissioner* (38 B. T. A., 1355).

[4] 110 Fed. (2d), 286.

[5] *Crane-Johnson Co.* v. *Commissioner* (105 Fed. (2d), 740).

[6] 309 U. S., 692; 311 U. S., —.

charter was a written contract, and that the Washington laws prohibiting dividend payments were by operation of law a part of that contract, the court below concluded that the taxpayer had satisfied the requirements of section 26(c)1.

We must therefore decide whether section 26(c)1 authorized a credit or deduction to corporations prohibited by State law from distributing dividends. And respondent strongly urges that the Act, if construed to deny such credit, is unconstitutional.

First. It is material that we are dealing here with a generally imposed surtax upon the undistributed net income of corporations, and that respondent's claim is for a credit in the nature of a specially permitted deduction. It has been said many times that provisions granting special tax exemptions are to be strictly construed.[7]

Measured by this sound standard it is probably not necessary to go beyond the plain words of section 26(c)1 in search of the legislative meaning. Certainly, at first blush, few would suppose that when Congress granted a special exemption to corporations whose dividend payments were prohibited by executed written contracts, it thereby intended to grant an exemption to corporations whose dividend payments were prohibited by State law. The natural impression conveyed by the words "written contract executed by the corporation" is that an explicit understanding has been reached, reduced to writing, signed and delivered. True, obligations not set out at length in a written contract may be incorporated by specific reference, or even by implication. But Congress indicated that any exempted prohibition against dividend payments must be expressly written in the executed contract. It did this by adding a precautionary clause that the granted credit can only result from a provision which "expressly deals with the payment of dividends."

That the language used in section 26(c)1 does not authorize a credit for statutorily prohibited dividends is further supported by a consideration of section 26(c)2. By this section, a credit is allowed to corporations contractually obligated to set earnings aside for the payment of debts.[8] That this section referred to routine contracts dealing with ordinary debts and not to statutory obligations is obvious—yet the words used to indicate that the section had reference only to a "written contract executed by the corporation" are identical with those used in section 26(c)1. There is no reason to believe that Congress intended that a broader meaning be attached to these words as used in section 26(c)1 than attached to them under the necessary limitations of 26(c)2.

Respondent urges that the legislative history of section 26(c)1 supports its contention. But, on the contrary, that history points in the other direction. The original House bill contained separate relief provisions (1) for deficit corporations such as respondent; (2) for corporations contractually obligated to pay debts; and (3) for corporations contractually prohibited from paying dividends.[9] The Senate Finance Committee struck out all three of these House provisions, but substituted an equivalent for the third.[10] An amendment from the Senate floor restored an equivalent of the second.[11] But the bill as finally passed contained no express relief provision relating to deficit corporations.

It is true, as respondent contends, that a charter has been judicially considered to be a contract in so far as it grants rights, properties, privileges and franchises.[12] To this extent it has been said that an act of incorporation is a contract between the State and the stockholders.[13] But it does not follow that Congress intended to include corporate charters and related State laws in the cautiously limited area permissible for tax credits and deductions under this section. Nor have the courts considered that all the provisions of laws providing for the grant of corporate franchises are necessarily contractual in their nature. The same legislative Act is a law as well as a grant, and

[7] E. g., *Deputy* v. *du Pont* (308 U. S., 488, 493); *White* v. *United States* (305 U. S., 281, 292 [Ct. D. 1372, C. B. 1938–2, 238]; *New Colonial Ice Co.* v. *Helvering* (292 U. S., 435, 440 [Ct. D. 841, C. B. XII–1, 194 (1933)]).

[8] 49 Stat., 1664. The credit allowed is "An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside."

[9] H. R. 12395, Seventy-fourth Congress, second session, sections 14, 15, and 16; see H. Rept. No. 2475, Seventh-fourth Congress, second session, pages 8–9.

[10] See S. Rept. No. 2156, Seventy-fourth Congress, second session, pages 12–13, 15–16.

[11] 80 Cong. Rec., 9071, Seventy-fourth Congress, second session.

[12] *Trustees of Dartmouth College* v. *Woodward* (4 Wheat., 518); *Home Building and Loan Ass'n* v. *Blaisdell* (290 U. S., 398, 429).

[13] *Chenango Bridge Co.* v. *Binghamton Bridge Co.* (3 Wall., 51, 73).

this Court has held that the same legislative enactment may be both a contract—which can not be impaired—and a law, subject to repeal, modification, alteration, or amendment within the general legislative powers.[14] Respondent's chief reliance is upon that charter provision which required that it conform to the existing and future laws of Washington. But that provision is not a grant and is not a contract. With or without such a charter provision, it was the duty of the corporation to conform to valid Washington statutes. The corporation was subject to the law of Washington; it could not rise above it. A corporate charter to operate a particular business in a particular manner does not deprive the State of its inherent power of legislation touching corporate activities. And the grant of a franchise does not exempt the corporation from the requirement that it obey State legislation validly adopted in the interests of the public welfare.[15] It can not be said, therefore, that the charter provision that the corporation should obey Washington law, including the statutory prohibition against distributing dividends, was a provision of a written contract executed by respondent. More, the Constitution of the State of Washington under which the general corporation laws were enacted provides that "All laws relating to corporations may be altered, amended, or repealed by the legislature at any time, and all corporations doing business in this State may, as to such business, be regulated, limited, or restrained by law."[16] It is clear, therefore, that what prohibited respondent from distributing dividends was not the provision of an executed written contract expressly dealing with the payment of dividends. On the contrary, what prohibited respondent from paying dividends was a valid law of the State of Washington.[17]

Second. Respondent contends that the tax statute, as construed, offends the fifth, tenth and sixteenth amendments. None of those contentions is valid.[18]

It is argued that the Act offends the due process clause of the fifth amendment because it permits credits or deductions in the case of corporations restrained from a distribution of dividends under a given type of written contract, while not permitting any credit or deduction to corporations restrained from distribution by oral contracts or by the laws of a State. This contention is without merit. It is not necessary to point out the many obvious reasons that might underlie the distinctions here drawn in granting special deductions from a generally imposed tax.

Respondent also urges that the tax as applied to it amounts to a confiscation of its property without due process of law because the tax is imposed, not on income, but only on undistributed income, and that there can be no undistributed income so long as the corporation has an existing deficit. But the surtax here is imposed upon the undistributed net income of the corporation "for each taxable year." It is true that the surtax is imposed upon the annual income only if it is not distributed, but this does not serve to make it anything other than a true tax on income within the meaning of the sixteenth amendment. Nor is it true, as respondent urges, that because there might be an impairment of the capital stock, the tax on the current annual profit would be the equivalent of a tax upon capital. Whether there was an impairment of the capital stock or not, the tax here under consideration was imposed on profits earned during a definite period—a tax year—and therefore on profits constituting income within the meaning of the sixteenth amendment.

It is contended that the statute as here applied violates the tenth amendment because it interferes with the authority of the States to prescribe the powers of corporations and the conditions under which their powers may be exercised. But the statute in no way limits the powers of the corporation. It imposes a tax as authorized by the sixteenth amendment and does not infringe upon the powers reserved to the State by the tenth amendment.[19] The court below was in error; its judgment is reversed and the cause is remanded with directions to affirm the judgment of the Board of Tax Appeals.

Reversed.

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[14] *Oregon & California Railroad Co.* v. *United States* (238 U. S., 393, 427).

[15] *Hammond Packing Co.* v. *Arkansas* (212 U. S., 322, 345).

[16] Washington Constitution, article 12, section 1.

[17] Respondent contended that the stock certificates satisfied the statutory requisites even if the charter did not; but what we have here said with respect to the charter applies equally to the certificates.

[18] Cf. *Helvering* v. *National Grocery Co.* (304 U. S., 282 [Ct. D. 1341, C. B. 1938–1, 279]).

[19] *Helvering* v. *National Grocery Co.*, supra, at 286–287. And cf. *Florida* v. *Mellon* (273 U. S., 12, 17): "Congress can not accommodate its legislation to the conflicting or dissimilar laws of the several States nor control the diverse conditions to be found in the various States which necessarily work unlike results from the enforcement of the same tax."

PART V.—RETURNS AND PAYMENT OF TAX.

SECTION 55.—PUBLICITY OF RETURNS.

REVENUE ACT OF 1936.

Treasury Decision 4873 (C. B. 1938-2, 261), relating to the inspection of certain returns, amended. (See T. D. 4991, page 92.)

REVENUE ACT OF 1936.

Treasury Decision 4873 (C. B. 1938-2, 261), relating to the inspection of certain returns, amended. (See T. D. 5019, page 95.)

SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A.—RATES OF TAX.

SECTION 101.—EXEMPTIONS FROM TAX ON CORPORATIONS.

ARTICLE 101(11)-1: Farmers' or other mutual hail, cyclone, casualty, or fire insurance companies or associations. 1940-51-10526 Ct. D. 1474

INCOME TAX—REVENUE ACTS OF 1928, 1932, 1934, AND 1936—DECISION OF COURT.

1. CORPORATION—FIRE INSURANCE COMPANY—EXEMPTION AS MUTUAL COMPANY DETERMINED BY CHARACTER OF BUSINESS ACTUALLY DONE.

A fire insurance company is not exempt from payment of income taxes as a mutual insurance company within the meaning of sections 103(11) of the Revenue Acts of 1928 and 1932 and sections 101(11) of the Revenue Acts of 1934 and 1936, where it appears that less than 1 per cent of its policyholders qualified for membership and voting privileges by executing the deposit notes required from members, and that no refunds to policyholders of the excess of premiums over actual cost were ever made. While name, charter powers, and subjection to State insurance laws have significance as to the business which a corporation is authorized and intends to carry on, the character of the business actually done in the taxable years determines whether it is entitled to exemption as a mutual insurance company.

2. DECISION REVERSED.

Decision of the District Court of the United States for the Western District of Pennsylvania (28 F. Supp., 224) reversed.

3. CERTIORARI DENIED.

Petition for certiorari denied October 14, 1940.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

William Driscoll, Collector of Internal Revenue, Twenty-third District of Pennsylvania, Pittsburgh, Pa., defendant-appellant, v. Washington County Fire Insurance Co., Washington, Pa., plaintiff-appellee.

[110 Fed. (2d), 485.]

On appeal from the District Court of the United States for the Western District of Pennsylvania.

[February 27, 1940.]

OPINION.

BIGGS, Circuit Judge: Upon December 8, 1873, the appellee, Washington County Fire Insurance Co., was incorporated pursuant to the provisions of Act No. 236,[1] page 211, Laws of Pennsylvania, Session of 1856, in conjunction with the provisions of Act No. 27, page 44, Laws of Pennsylvania, Session of 1867. The charter of the company (section 2), issued by the Court of Common Pleas of Washington County, provided, "The business of the said company shall be transacted upon the mutual principle, exclusively, and the said company is allowed to insure on the cash or annual premium system, the sum so received to be paid into the common treasury of the company, and in consideration thereof the said company to be responsible for all losses occurring to property thus insured according to the terms of their policies. Insurance thus effected shall not entitle the insured to membership in said company, nor subject them to the payment of assessments." Paragraph IX of the by-laws of the appellee provides, "Every person wishing to become a member of this company, shall previous to being insured, deposit his application and premium note with the secretary of said company, and if approved, the policy shall bear date on that day, and take effect at noon, unless directed by the applicant to be dated on a future date. A sum equal to at least 5 per cent of the premium note shall be paid at the time of making the application."

It appears from the agreed statement of facts that beginning in 1873, when the appellee was incorporated, all insurance policies were issued by it in consideration of a cash premium and a contingent liability represented by a deposit note. This course was continued until July, 1911, when the by-laws were amended to provide that an insured should execute a deposit note only when the property insured was not rated. Beginning in January, 1914, and until the present time (with the exception set forth in the next paragraph) insurance has been issued upon rated property and unrated property alike for an annual cash premium payable in advance without the execution of deposit notes.

The exception referred to is as follows: During the period involved in this litigation (1928 to 1936, inclusive) the 16 persons who were or are in charge of the management of the company did execute deposit notes in accordance with the practice which prevailed prior to 1911. During this period the average number of policyholders was 3,000. The agreed statement of facts (paragraph 12) states, "Only those persons executing deposit notes are members. The use of the deposit notes has been continued since 1914 for the purpose of providing for the membership entitled to elect the managing officers of the corporation. The personnel of the deposit note makers since 1914 has been determined by the directors of the plaintiff company. Every deposit note maker is a policyholder." No refunds or returns whether by way of the payment of redundancy or otherwise have ever been made to anyone. The corporation has prospered and no assessments have ever been made.

If the charter provisions alone constitute the contract between the appellee and its members, putting to one side for the time being the provisions of the act under which the appellee was incorporated, only deposit note makers are members. It is clear that throughout the taxable period only the 16 deposit note makers voted to elect directors, thereby fulfilling one of the functions of membership in a mutual association. All the other policyholders performed none of the duties of members. If the provisions of section 2 of the charter are to be deemed valid they are not subject to assessment for losses, and policies of insurance were issued to them precisely similar to those issued by

[1] This act was repealed by 1921 P. L., 682, Article XI, section 1101, 40 P. S., 991.

stock companies to those whom they insured. These policyholders, as distinguished from the deposit note makers, merely paid a fixed premium for which they obtained a contract of insurance.

The question presented for our determination is whether the appellee was exempt from the payment of income taxes during the years 1928 to 1936 inclusive. The Federal Acts[2] provide:

"The following organizations shall be exempt from taxation under this title—

* * * * * * *

"(11) Farmers' or other mutual hail, cyclone, casualty, or fire insurance companies or associations * * * the income of which is used or held for the purpose of paying losses or expenses;"

Was the appellee a mutual company? The court below held that it was, believing that its membership could not be limited to the deposit note makers despite the provision of the charter to such effect. The argument in favor of this conclusion may be stated as follows: Section 11 of the Pennsylvania act of 1856[3] provides that membership in the company may be obtained by payment of a premium or contracting to pay it and that the extent of the liability of the insured for assessment should be limited to the amount of such premium. Therefore by the payment of a premium, the insured becomes a member of a mutual company, but is not liable for assessment beyond the amount of the premium paid. The Supreme Court of Pennsylvania has construed the act of 1856 to such effect in the case of *Schimpf & Son* v. *Lehigh Valley Mutual Insurance Co.* (86 Pa. St., 373, 376). The terms of a statute under which a corporation is created may be read into and become a part of the contract between the corporation and its members. Therefore, runs the argument, all policyholders are members of the corporation. All policyholders, whether they have given deposit notes or not, possess the right to vote for directors for such a right is given to policyholders by section 11[4] of the act of 1856. The policyholders are the only persons interested in the appellee and they are all treated upon an identical basis. Therefore, says the appellee, it is a mutual company.

The exempting statutes, however, require that the appellee meet a twofold test if it is to gain exemption. Not only must it be a mutual company but its income must be used or held solely for the payment of losses or expenses. (*MacLaughlin* v. *Philadelphia Contributionship*, 73 Fed. (2d), 582; *Baltimore Equitable Society* v. *United States*, 3 Fed. Supp., 427 [Ct. D. 709, C. B. XII–2, 121 (1933)], certiorari denied, 290 U. S., 662.) The appellee contends that it meets the second requirement as well as the first, that not only is it a mutual company but all of its income is held for the purpose of paying losses and expenses. The district court so held. Assuming *arguendo*, that the appellee must be deemed to be a mutual company within the purview of the statutes conferring exemption, let us test first the last contention of the appellee.

It is clear that the income upon which the appellee was taxed in the taxable years in question was net income computed after deducting payments for losses and expenses. The income taxed was not used for the payment of losses or expenses. Was it held for such purposes? It will be observed that the company's surplus increased from $280,000 in 1929 to $446,000 in 1936. Throughout

[2] Revenue Act of 1928 (ch. 852, 45 Stat., 791, 813), section 103(11); Revenue Act of 1932 (ch. 209, 47 Stat., 169, 193), section 103(11); Revenue Act of 1934 (ch. 277, 48 Stat., 680, 700, 701), section 101(11); and Revenue Act of 1936 (ch. 690, 49 Stat., 1648, 1674), section 101(11) (U. S. C., Title 26, section 103).

The pertinent provisions of the respective Acts are identical.

[3] Section 11 of the act of 1856 provides in part:

"That whenever any company may be incorporated under this law, and may intend to transact its business upon the mutual principle exclusively, or in connection with a joint stock capital, it shall be so designated in its charter; and if upon the mutual principle exclusively, then the parties named in said special act, and their associates, shall be made and constituted a body corporate, directly, and without the grant of letters patent, as hereinbefore provided in reference to joint stock companies; and in that case all persons insuring with, and continuing to be insured therein, shall thereby become members during the period they shall remain so insured, and no longer, and shall pay such rates as shall be determined by the board of directors, and be liable for all losses and expenses of said company, to the amount of the premiums paid, or agreed to be paid by said members respectively."

[4] The pertinent language of section 11 of the act of 1856 is as follows:

"At the elections for directors, each member insured by any sum not less than $1, paid in as a premium of insurance to said company during the year previous to said election, and on policy then existing, shall have one vote; and for every additional $25 so paid, one other vote. In other respects, the management of said mutual companies shall be as hereinbefore provided in reference to joint stock insurance companies: * * *."

the taxable years in question the appellee has had insurance in force averaging more than $10,000,000. The amount of surplus is far in excess of unearned premium reserve required by the law of Pennsylvania.[5] These facts require a further consideration of the terms of the act of 1856.

The act of 1856 was a general incorporation act for insurance companies. It provided for the incorporation of joint stock insurance companies, for mutual companies, and for hybrid companies authorized to issue insurance both as joint stock companies and upon the mutual principle at the same time. It prescribed the terms upon which such companies might do business. Section 12 of the act provides for the payment of dividends by joint stock companies, and in respect to companies "* * * organized upon the mutual principle exclusively (the section states that), each member shall be entitled to such a proportion of the said surplus, as the cash premium paid by such members respectively may bear to the aggregate surplus so declared; and for the proportionate share of each member so ascertained, a certificate shall be issued, declaring him or them to be entitled to such a portion of the accumulated capital of the company; said certificate to be construed and governed as hereinafter mentioned; but no certificate shall be issued for a less sum than $25, nor for any fractional part of $5, and shall, at the discretion of the directors bear, and be paid interest at a rate not exceeding 6 per centum per annum."

Section 14 of the act provides, "That within 30 days after the yearly balance of the affairs of said company shall be struck, the directors shall cause to be paid, in cash, to the stockholders of any such joint stock insurance company, the amount of dividends they may respectively be entitled to; and where any such company may be chartered upon the stock and mutual principle combined, they shall cause to be paid to the stockholders, in cash, not exceeding 6 per centum on their stock respectively; and shall issue the company's certificates to such insured members and stockholders respectively, agreeably to the provisions of the twelfth section; in which case, and where said company shall be chartered on the mutual principle exclusively, the certificates issued to the members as aforesaid shall not be paid until the net profits or surplus shall exceed the sum of $250,000, when the said excess may be applied for the redemption of the said certificates, and any arrears of interest that may have been allowed thereon."

The law pursuant to which appellee was incorporated thus declares that each member is entitled to an aliquot share or the appellee's surplus and the directors are required to issue to them certificates to such effect. The payment of interest upon the certificates is discretionary as is the ultimate payment of the shares represented by the certificates subject to the qualification that the surplus of the company must exceed $250,000 before that discretion may be exercised. As noted, the surplus of the appellee far exceeds this sum and has done so throughout the whole of the taxable period. We think that the discretion of the directors of mutual fire insurance companies incorporated under the act of 1856 is a legal discretion and may not be abused. (*White* v. *Provident L. & Tr. Co.*, 237 Pa., 375, 384; *Grange* v. *Penn Mutual Life Insurance Co.*, 235 Pa., 320, 329, 330; *Fraternal Guardians Est. Sheeler's Ap.*, 159 Pa., 594. See also *McKean* v. *Biddle et al.*, 181 Pa., 361.) If the financial condition and surplus of a mutual fire insurance company incorporated under the act of 1856 are such as those of the appellee and interest bearing certificates representing redundancy have not been issued, we entertain no doubt that directors may not be heard to say that the surplus is not held for the benefit of the members.

How much a distribution of surplus including earnings could be made is not the question before us. We are concerned with a question of taxation and not with corporate management, but it does appear from the record that the appellee has invested profitably its accumulated capital from time to time and received income from such investments throughout the taxable period. Payments of redundancy must be treated as elements of expense deductible from gross income for income tax purposes (see paragraph 3 of section 208 of the Revenue Act of 1928 (ch. 852, section 208, 45 Stat., 846)), but payments of corporate earnings to members of a company are not so deductible. It follows that surplus held even in part for the payment of interest upon redundancy certificates is not held for the payment of losses and expenses, treating expenses as including redundancy. For analogy see *MacLaughlin* v. *Philadelphia Contributionship*, supra, page 584.

[5] Purdon's Pa. Stat., Title 40, section 91.

The appellee contends, however, that following the passage of the act of May 25, 1921 (P. L., 1124, 40 P. S., 677), by the legislature of Pennsylvania it could not hold its surplus for any other purposes than the payment of losses and expenses. Section 3 of the act of May 25, 1921, provides that "The surplus of any domestic fire insurance companies issuing policies in accordance with the provisions of section 1 or 2 of this act shall be held as a reserve for the payment of losses and expenses; and, in the event of dissolution of the company, shall be divided pro rata among the policyholders whose policies are in force at the time of dissolution, but no policyholder, other than loss claimants, shall receive more than the amount of the unearned cash premium last paid to the company for the current term of such policy. Any balance remaining shall escheat to the Commonwealth of Pennsylvania." Section 2 of the act need not be discussed here. Section 1, however, provides that "Any domestic mutual fire insurance company, organized prior to May first, one thousand eight hundred and seventy-six, having a surplus not less than the minimum capital required for the organization of a domestic stock fire insurance company and an unearned premium reserve computed upon the same basis as that required of domestic stock fire insurance companies, may issue policies for a cash premium without any contingent liability for assessment." The appellee's accumulated capital and unearned premium reserve is sufficient to meet the requirements of this section if it be applicable. We think that the amendment of 1857 to the constitution of Pennsylvania of 1838, providing that the legislature shall have the power to alter the provisions of any charter thereafter conferred by general or special law, is applicable to the charter of the appellee. It follows, says the appellee, that the legislature by passing the act of May 25, 1921, has amended its charter and has set forth in the act itself the purposes for which the appellee must hold its surplus if it operates upon the basis set forth in section 1. The provisions of section 3 of the 1921 act may be held to constitute a valid exercise of police power by the Commonwealth.[6] It is not necessary for us to pass upon this question, however, for it is our opinion that the appellee is not a mutual company.

The essential of mutuality is membership. In Cooley's Briefs on Insurance (2d Ed., 1927), volume 1, page 68, it is stated that "* * * the fundamental principle of a mutual insurance company is that the company in no case can insure property not owned by one of its members." (See *Penn Mutual Co.* v. *Lederer*, 252 U. S., 523, 533–534 [T. D. 3046, C. B. 3, 249 (1920)]; *Atlantic Life Insurance Co.* v. *Moncure*, 35 Fed. (2d), 360, 362; *Hays* v. *Lycoming Fire Insurance Co.*, 98 Pa., 184, 191; *Given* v. *Rettew*, 162 Pa., 638, 640–641; *McKean* v. *Biddle*, supra, page 362.) Incident to membership is the right to redundancy and the burden of assessment. As was stated by the Supreme Court in *Penn Mutual Co.* v. *Lederer*, supra, 525, it is the essence of mutual insurance that the excess in the premium over the actual cost as ascertained shall be returned to the policyholders.

Without regard to the purposes for which the appellee holds its surplus, it is the case that by the terms of its own charter, by the conditions of its own by-laws and by the very stipulation of the agreed statement of facts, those policyholders who have not executed deposit notes are not members. The appellee can not refuse membership to those whose property it insures for a cash premium and grant it to those whose property it insures for the consideration of a deposit note and be deemed to be a mutual company. Even if those whose property is insured solely for a cash premium be deemed to be members as well as the deposit note makers, those members are treated upon different bases, for each class receives insurance under different conditions. From either viewpoint, the appellee carried on a nonmutual business.

Looking to the actual conduct of the appellee from the time of its incorporation through the period embraced by this suit, we find the following: From the time of its incorporation in 1873 to 1911, the appellee operated on a strictly mutual basis, all policyholders making deposit notes and delivering them to the appellee, thereby becoming members of the corporation. From 1911 until the end of the taxable period the appellee did not operate as a mutual company or upon a mutual basis. Specifically, throughout the taxable period deposit notes have been given by less than 1 per cent of the persons to whom policies have been issued. It therefore conducted its business upon a dual basis with membership for the 16 deposit note makers and nonmembership for the other 3,000 or more policyholders. Even treating all those whose property was insured as

[6] So far as we can ascertain, the validity of section 3 of the act of May 25, 1921, has been passed upon but once; namely, by the court below in the case at bar.

members, the status of the two groups was essentially different and such as to destroy mutuality. The note makers voted for directors and managed the company; the nonnote makers did not do these things. We think it is fruitless to argue that perhaps the nonnote makers could have gone into a court of equity and compelled the appellee to recognize them as members. The determination of that question involves the internal management of a Pennsylvania corporation and is one which would have to be determined by the courts of that State. Our problem is the determination of the applicability of Federal exempting Acts. In determining such applicability we must look not to what the appellee should have done or what it could have been compelled to do by premium-paying policyholders in search of membership status. Upon the contrary, we must find what it actually did do and judge it accordingly. In *Bowers* v. *Lawyers Mortgage Co.* (285 U. S., 182, 188 [Ct. D. 481, C. B. XI-1, 364 (1932)]), the Supreme Court in holding that a company incorporated, *inter alia* to do business as an insurance company, was not taxable as such, the Supreme Court by Mr. Justice Butler stated, "While name, charter powers, and subjection to State insurance laws have significance as to the business which a corporation is authorized and intends to carry on, the character of the business actually done in the taxable years determines whether it was taxable as an insurance company." So in the case at bar, what the appellee actually did in the taxable years determines whether it is entitled to exemption as a mutual insurance company. We conclude for the reasons stated that the appellee is not entitled to exemption.

The judgment of the court below is reversed and the cause is remanded with directions to enter judgment for the appellant.

SUPPLEMENT B.—COMPUTATION OF NET INCOME.

SECTION 112(a).—RECOGNITION OF GAIN OR LOSS: GENERAL RULE.

ARTICLE 112(a)-1: Sales or exchanges. 1940-27-10308
G. C. M. 22056

REVENUE ACT OF 1936.

The extension of the maturity date of notes issued by the M Company was not, under the facts of this case, an exchange of one obligation for another and was not a transaction which resulted in gain or loss for Federal income tax purposes.

An opinion is requested whether the extension of the maturity date of certain notes issued by the M Company was a taxable transaction resulting in gain or loss for Federal income tax purposes.

The terms of the extension are contained in an agreement hereinafter referred to as "the plan," which provided that if the noteholders would deposit their notes with certain depositaries such notes would be returned to the notcholders with an agreement extending the maturity to a certain date. Interest coupons providing for payment of the same rate of interest as in the original notes were also to be attached. The plan further provided that the notes were to continue to be secured by the trust indenture under which mortgage bonds of the M Company were held as security and were to be guaranteed by the original guarantor, the N Company. The N Company, which owned $43x$ dollars out of $92x$ dollars of the outstanding notes, agreed that none of the notes owned by it would, during the period of extension, be redeemed by the N Company until all notes other than those owned by it were retired or their retirement provided for.

The N Company also agreed that the lien of the notes owned by it upon the collateral security would be subordinated to the lien of the other notes until such other notes were retired or provision made for the retirement thereof.

The question presented is whether there was, in effect, an exchange of the old obligation of the M Company for a new obligation of that company which resulted in gain or loss for Federal income tax purposes.

In I. T. 1365 (C. B. I-1, 151 (1922)) it was held that second 4¼ per cent Liberty bonds and fourth 4¼ per cent Liberty bonds are not "substantially identical property" within the meaning of section 214(a)5 of the Revenue Act of 1921 which precludes the allowance of a loss sustained upon the sale or other disposition of stock or securities if, within 30 days before or after the date of such sale or other disposition, the taxpayer has acquired "substantially identical property." In I. T. 2672 (C. B. XII-1, 72 (1933)) it was held, under the corresponding provisions of the Revenue Act of 1932, that two bonds of the same face value issued by the same municipality at the same rate of interest but of different dates of issue, of interest payments, and of maturity, are not "substantially identical" securities. In I. T. 2734 (C. B. XII-2, 73 (1933)) Liberty bonds were exchanged for a new issue of Treasury bonds and it was held that the transaction was one in which gain or loss is recognized. In I. T. 2896 (C. B. XIV-1, 96 (1935)) it was held that an exchange of one issue of municipal bonds for another issue of bonds of the same municipality was a transaction from which gain or loss resulted. In I. T. 2778 (C. B. XIII-1, 79 (1934)) the Series "A" debentures of the "M Corporation" were issued in the amount of $8x$ dollars under an indenture dated in 1929. In 1930 an additional issue of $6x$ dollars, designated as "Series B," was made under a supplemental indenture. The only differences between the two issues were the dates of issue and the amounts to be redeemed annually. It was held that an exchange of "Series A" debentures for "Series B" debentures is a transaction from which gain or loss may result.

In all of those cases one issue of securities was exchanged for an entirely new and distinct issue, or securities of one issue were sold and those of an entirely new and distinct issue were purchased. In the present case there was not an exchange of one security for another. All that occurred was that the maturity date of an existing series of notes was extended and the holder of a part thereof agreed that none of the notes owned by it would be redeemed during the period of extension until all the other notes were retired or their retirement provided for, and that the lien of the notes owned by it upon the collateral security should be subordinated to the lien of the other notes. Under the facts of this case, it is the opinion of this office that no gain or loss resulted from the above described transaction.

The foregoing does not mean that the income tax liability resulting from a particular transaction involving change in the terms of outstanding securities is controlled entirely by the mechanical means used for the accomplishment of such change. It is realized that there may be cases where material changes in the terms of an outstanding bond are made by indorsement of such changes on the existing bond rather than by the issuance of a new one. Where the

changes are so material as to amount virtually to the issuance of a new security, the same income tax consequences should follow as if the new security were actually issued. Each case of this nature must be governed by its own facts. In the present case it is, as stated above, the opinion of this office that a mere extension of maturity of outstanding notes, accompanied by the agreement of some of the holders of the notes not to resort to the underlying security until other noteholders have been paid, does not constitute in substance the exchange of the outstanding note for a new and materially different note, or a closed and completed transaction upon which gain or loss may be determined.

It is, therefore, the opinion of this office that neither gain nor loss to any of the holders of these notes resulted from the above-described transaction.

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

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

ARTICLE 113(a)-1: Scope of basis for determining gain or loss.

REVENUE ACT OF 1936.

Adjustment of basis by elimination of items allowed as business expenses. (See I. T. 3408, page 178.)

SECTION 113(b).—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS: ADJUSTED BASIS.

ARTICLE 113(b)-2: Adjusted basis: Cancellation of indebtedness.

REVENUE ACT OF 1936.

Regulations 94, amended. (See T. D. 5003, page 107.)

ARTICLE 113(b)-3: Adjusted basis: Cancellation of indebtedness: Special cases.

REVENUE ACT OF 1936.

Regulations 94, amended. (See T. D. 5003, page 107.)

ARTICLE 113(b)-4. Substituted basis.

REVENUE ACT OF 1936.

Regulations 94, amended. (See T. D. 5003, page 107.)

SUPPLEMENT I.—FOREIGN CORPORATIONS.

SECTION 231.—TAX ON FOREIGN CORPORATIONS.

ARTICLE 231–4: Exclusion of earnings of foreign ships from gross income.

REVENUE ACT OF 1936.

Inclusion of terms "airship or airships" or "airplane or airplanes" in term "ship or ships." (See I. T. 3399, page 156.)

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.

1940–36–10407
G. C. M. 22248

REVENUE ACT OF 1936.

Where a decedent's Federal income tax return for the calendar year 1936 was closed and an assessment made under section 275(b) of the Revenue Act of 1936 and, after the 18-month limitation period for assessment provided in that section had expired, it was discovered that additional income in excess of 25 per centum of the amount of gross income stated in the return for 1936 was includible in the return for that year, section 275(c) of the Revenue Act of 1936, permitting assessment within five years after the return was filed, is applicable.

An opinion is requested whether section 275(c) of the Revenue Act of 1936 may be applied to a Federal income tax return for the year 1936 which was closed and the tax assessed under section 275(b) of that Act.

A Federal income tax return for the calendar year 1936 was filed in behalf of A, deceased, on March 15, 1937, and the return was closed under the applicable provisions of section 275(b) of the Revenue Act of 1936, relating to requests for prompt assessments in certain cases. A recent examination of the Federal income tax return of the estate of the decedent for the year 1938 revealed additional income which was includible in the return of the decedent for the year 1936. This additional income is in excess of 25 per centum of the amount of gross income stated in the 1936 income tax return filed for the decedent.

Section 275 of the Revenue Act of 1936 reads in part as follows:

Except as provided in section 276—

(a) GENERAL RULE.—The amount of income taxes imposed by this title shall be assessed within three 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.

(b) REQUEST FOR PROMPT ASSESSMENT.—In the case of income received during the lifetime of a decedent, or by his estate during the period of administration, * * * the tax shall be assessed, and any proceeding in court without assessment for the collection of such tax shall be begun, within eighteen months after written request therefor (filed after the return is made) by the executor, administrator, or other fiduciary representing the estate of such decedent, * * * but not after the expiration of three years after the return was filed. * * *

(c) OMISSION FROM GROSS INCOME.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the 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 within five years after the return was filed.

Under the general rule set forth in section 275(a), supra, a tax may not be assessed against a taxpayer by the Government after the expiration of three years from the date upon which the return is filed. In order to facilitate prompt settlement of estates and to aid in the collection of taxes, section 275(b), supra, provides that if certain conditions are complied with in the case of income received during the lifetime of a decedent, the tax shall be assessed within 18 months after such compliance. If, however, the conditions mentioned in section 275(b), supra, are not complied with, then, in the case of income received during the lifetime of a decedent, the general 3-year limitation period is applicable. In section 275(c), supra, Congress has provided that in an extraordinary case, i. e., a case in which the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed at any time within five years after the return was filed. It seems clear that, although Congress shortened the period of limitation upon assessment, for reasons which have been stated, in certain cases covered by section 275(b), Congress nevertheless intended section 275(c) to supersede section 275(b) in the extraordinary case covered by section 275(c). Moreover, the provision relating to request for prompt assessment in cases involving income received during the lifetime of a decedent, or by his estate during the period of administration, was in the Revenue Acts long before section 275(c) was enacted in the Revenue Act of 1934. Therefore, Congress was aware of section 275(b) when it enacted section 275(c) and gave no indication that it intended that section 275(c) should not apply to cases of the type referred to in section 275(b) where there was an omission of income in excess of 25 per centum of the amount of gross income stated in the return.

The report of the Senate Finance Committee on section 275 of the revenue bill of 1934, Senate Report No. 558, Seventy-third Congress, second session (C. B. 1939–1 (Part 2), 585, at page 619), reads in part as follows:

The present law permits the Government to assess the tax without regard to the statute of limitations in case of failure to file a return or in case of a fraudulent return. [Section 276(a), Revenue Act of 1934.] The House bill continues this policy, but enlarges the scope of this provision to include cases wherein the taxpayer understates gross income on his return by an amount which is in excess of 25 per cent of the gross income stated in the return. Your committee is in general accord with the policy expressed in this section of the House bill. However, it is believed that in the case of a taxpayer who makes an honest mistake, it would be unfair to keep the statute open indefinitely. For instance, a case might arise where a taxpayer failed to report a dividend because he was erroneously advised by the officers of the corporation that it was paid out of capital or he might report as income for one year an item of income which properly belonged in another year. Accordingly, your committee has provided for a 5-year statute in such cases. * * *.

The legislative history of section 275(c), supra, shows that Congress first considered that the "Omission from gross income" provision should be a part of section 276(a) of the Revenue Act of 1934. However, when it was concluded that there should be a 5-year statute

in such cases, and not an unlimited statute, it was decided that the new provision should appear as section 275(c) of the Revenue Act of 1934. That is the position of the provision in subsequent Revenue Acts and in the Internal Revenue Code. In *The National City Bank of New York, Executor (Estate of James E. O'Neil)*, v. *Commissioner* (35 B. T. A., 975, affirmed, 98 Fed. (2d), 93), it was held that, under section 250(d) of the Revenue Act of 1921, the provision relating to the period of limitation upon assessment in the case of a false or fraudulent return with intent to evade tax limited the provision pertaining to a request for prompt assessment and that, although the executor had requested in writing a prompt assessment, the Commissioner would not be barred by any statute of limitations because the income tax returns involved were fraudulent with intent to evade taxes. Had the provision in the Revenue Act of 1934 concerning understatement of gross income by an amount in excess of 25 per cent been included in section 276(a) of that Act and had the limitation period been kept open indefinitely, the provision pertaining to omissions from gross income would without doubt have limited the provision relating to requests for prompt assessments. (Cf. *The National City Bank of New York, Executor (Estate of James E. O'Neil)*, v. *Commissioner*, supra.) That Congress finally enacted the provision concerning omissions from gross income as section 275(c), supra, and fixed the limitation period upon assessments at five years in such cases, does not alter the conclusion that section 275(c) modifies or limits section 275(b). In other words, such section (275(c)) is applicable where the conditions prescribed therein are present even though a request for assessment under section 275(b) has been made and the 18-month period for assessment prescribed by that section has expired.

In view of the foregoing, it is the opinion of this office that in the instant case section 275(c) of the Revenue Act of 1936 is applicable notwithstanding that an assessment was made under the provisions of section 275(b) of the Revenue Act of 1936 and the 18-month limitation period provided for therein has expired.

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

SUPPLEMENT M.—INTEREST AND ADDITIONS TO THE TAX.

SECTION 293.—ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

REVENUE ACT OF 1936.

Collectibility, after death of the taxpayer, of 50 per centum addition to tax for fraud. (See G. C. M. 22326, page 159.)

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. 1940-36-10408
(Also Section 322, Article 322-3.) Ct. D. 1464

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. SUIT—RECOVERY OF TAXES—ACCOUNT STATED.

A determination by the Commissioner that the taxpayer was entitled to a refund of taxes paid, a telegram advising her to file claim therefor, and the preparation of a certificate of overassessment, do not constitute an "account stated" in her favor, where, upon further consideration by the Bureau, the certificate was canceled without having been forwarded to the collector or delivered to the taxpayer.

2. CALIFORNIA COMMUNITY PROPERTY—INCOME TAXED IN ACCORDANCE WITH AGREEMENT BETWEEN HUSBAND AND WIFE AS TO SEPARATE OWNERSHIP OF EARNINGS.

Where husband and wife, citizens of California, entered into an agreement in 1927, providing that all property thereafter acquired by either should be the sole and separate property of the party so acquiring it, free and clear of any and all claims of the other, either community or otherwise, earnings of the wife were properly reported in her income tax return for 1930 on the basis of such agreement rather than in accordance with the community property laws of California. Under the law of that State, as construed by her courts, and under applicable decisions of the United States courts, the earnings of the wife do not become community property if husband and wife have entered into a valid agreement providing that the earnings of each shall be the separate property of the earner.

3. DECISION FOLLOWED.

Helvering v. *Hickman* (C. C. A. 9th, 1934) (70 Fed. (2d), 985 [Ct. D. 866, C. B. XIII-2, 274 (1934)]) followed.

4. CERTIORARI DENIED.

Petition for certiorari denied October 23, 1939.

COURT OF CLAIMS OF THE UNITED STATES.

Corinne Griffith Marshall v. *The United States.*

[26 F. Supp., 474.]

[March 6, 1939.]

OPINION.

GREEN, Judge, delivered the opinion of the court.

This is a suit to recover an alleged overpayment of income taxes for the year 1930.

It appears from the findings that in 1927 plaintiff and her husband, being then, and at all times involved in the suit, citizens of the State of California, entered into an agreement with reference to existing property rights between

them providing in substance that all property acquired by either of the parties after that date should be the sole and separate property of the party so acquiring the same, free and clear of any and all claims of the other, either community or otherwise.

In filing a return for her income tax for the year 1930, the plaintiff appears to have assumed that this agreement was in force and reported that her personal net income was $283,821.44 and her tax liability $55,442.91, which was duly paid. Her husband also filed a return of his personal income and tax liability for the same year in accordance with the agreement. The Commissioner of Internal Revenue, however, after examining these returns, disregarded the agreement and determined that the income of plaintiff and her husband for Federal tax purposes should be allocated according to the community property laws of the State of California, that is, one-half the income earned by each spouse should be attributed to the other. Accordingly, an overassessment was computed in favor of the plaintiff and a deficiency found against her husband. Notice and demand for the payment of this deficiency was made upon the husband but no part of the amount so assessed has ever been paid. The Bureau, instead of following its original determination with reference to the taxes of the plaintiff, canceled the overassessment and has collected from plaintiff the amount of tax liability shown by her return.

The plaintiff contends that the action of the Commissioner together with subsequent proceedings on the part of the Bureau of Internal Revenue constituted an account stated in her favor upon the basis of the original determination of plaintiff's tax by the Commissioner. A claim for refund of the sum collected was duly filed and this suit begun to recover the amount thereof.

The plaintiff also insists that her income tax was correctly determined by the Commissioner in the first instance and that a refund is due her in the amount of the overassessment as computed.

In support of her contention that an account stated was rendered the plaintiff relies on a number of facts and circumstances. Those which have been specially urged as important will be considered.

On June 13, 1933, the Bureau, pursuant to the determination that the income of plaintiff and her husband should be allocated according to the community property laws of the State of California, telegraphed the plaintiff to "file claim immediately with collector" for $23,275.58 year 1930 "basis transfer one-half community income to husband's return." In accordance with this direction, the plaintiff filed a claim for refund for the year 1930 in the amount above stated and later the Commissioner prepared a certificate of overassessment in favor of the plaintiff for $23,275.58, but this certificate was subsequently canceled by the Commissioner without having been forwarded to the collector or delivered to the plaintiff. The record does not show the date of preparation or the date of cancellation.

Still later and on May 14, 1934, the Bureau wrote to plaintiff in substance that it had under consideration her income tax return for the year 1930 and that "on the basis of the information now on file with your return, it is the opinion of this office that your taxable income as reported should be adjusted in accordance with the recommendations contained in the revenue agent's report," that is, one-half of the income earned by each spouse should be attributed to the other. The communication further stated that a case involving a similar issue was pending in the United States Circuit Court of Appeals and that it was deemed advisable to defer action until a decision had been rendered by the court on the question. The attention of the taxpayer was called to the fact that the statutory period within which final notice of deficiency might be issued would expire in the near future and the taxpayer was advised that she had the right to make a written application for the execution of a consent extending the period of limitation for assessment. This resulted in a consent to extension of the period of limitation being executed by the plaintiff and the Bureau of Internal Revenue. The same kind of a notice was sent to the plaintiff's husband and the same action taken. Later and on May 25, 1934, the representative of the plaintiff telegraphed the Deputy Commissioner of Internal Revenue that plaintiff and her husband would be willing to close cases by allowing returns to remain as filed disallowing wife's claim for refund, or on a community basis allowing wife's refund to pay husband's deficiency provided entire deficiency was eliminated by such procedure. The Bureau replied that the closing of the cases must be deferred pending action of the Bureau in regard to a case in the circuit court of appeals. On August 24, 1934, the representative of the plaintiff wrote the Commissioner of Internal Revenue with reference to the refund claim of

the plaintiff asking that he be advised when he might expect some action on the claim.

There was further correspondence between the plaintiff's representative and the Bureau with reference to the claim of the plaintiff for refund which the plaintiff sought to have allowed and paid, the Bureau on its part giving various reasons for not complying with the plaintiff's request. Finally, on January 3, 1936, the Commissioner sent a communication to plaintiff's attorney stating that the overassessment would not be released as the deficiency assessed against Mr. Morosco had not been paid, and that—

"It is the position of this office that in cases involving the transfer of income from the return of one taxpayer to that of another, the amount of the overassessment disclosed may not be refunded to the detriment of the Government."

In the view of the court, there is nothing in this correspondence material to the determination of the case except that the final communication was in effect a refusal to allow the claim for refund.

We think the evidence fails to disclose the necessary elements of an account stated. An "account stated" must be or contain a statement of the balance of the account, that is, a balance must be struck and an account rendered to the other party for that balance. (1 C. J. S., section 22, page 703.) No account of any kind was ever rendered to the plaintiff. Under a misapprehension of the law, the Commissioner originally held that there had been an overassessment of plaintiff's taxes and prepared a certificate to that effect. This certificate, however, was withheld in the Bureau and subsequently canceled. There was nothing in this action that shows that plaintiff was presented with an account showing a balance due her. On the contrary, the withholding of the certificate and its subsequent cancellation showed that the Bureau had not definitely determined what should be done with reference to plaintiff's taxes. The Commissioner also sent a telegram to plaintiff directing her to "file immediately a claim for refund." But this was not a promise to pay the claim, it was merely advice with reference to the protection of her rights in case it should eventually be found she was entitled to the refund. The action was commendable on the part of the Commissioner as taxpayers often fail to file their claims in time and by reason thereof find themselves barred by the statute of limitations. A promise to refund a definite sum or a statement that a definite sum is due the other party has sometimes been held to constitute an account stated, but here there was no promise either of allowance or payment or even an admission that a definite sum was due. The Commissioner's action in making a preliminary examination of the account, his erroneous conclusion as to the amount of taxes due, and his direction to file a refund claim taken singly or considered together, did not bind the defendant to allow and pay plaintiff's claim.

In the brief of counsel for plaintiff many cases are cited, none of which in our opinion support the contention made. In *Wood* v. *United States* (84 C. Cls., 367), the Commissioner not only determined an overpayment but sent a certificate of overassessment to the taxpayer in which a balance of the account was struck and shown to be due plaintiff. The Commissioner, however, determined that this amount acknowledged to be due could not be paid for the reason that a claim for it was barred by the statute of limitations. Here a complete account was rendered, a balance struck and agreed upon by the parties. The court held that the error of the Commissioner with reference to the effect of the statute of limitations did not prevent the plaintiff from claiming an account stated. In the case of *Shipley Construction Co.* v. *United States* (79 C. Cls., 736), the plaintiff was not only advised that an audit of its income tax showed an overassessment and the amount thereof but other statements in the letter of advice were such in the opinion of the court as to imply a promise to pay the same and make it an account stated. In the case before us, there is nothing from which such a promise can be implied. On the contrary, the defendant was continually giving reasons why it would not pay the claim.

The case of *Daube* v. *United States* (75 C. Cls., 633, affirmed 289 U. S., 367 [Ct. D. 677, C. B. XII–1, 346 (1933)]), was similar in many respects to the one at bar. In that case the Commissioner prepared a certificate of overassessment and went so far as to enter this certificate on a schedule of refunds and credits which was signed by him and issued a check in favor of the taxpayer; after which the Commissioner prepared a letter stating the amount of the overassessment which, with the check for the amount thereof, was sent to the collector. The collector, perceiving that an error had been made, did not forward

the check or the letter to plaintiff but returned the check to the Commissioner. The taxpayer claimed that this action of the Commissioner constituted an account stated. The Supreme Court said "there had been messages back and forth between the officers and branches of an administrative bureau," as there had been in the instant case, but by none of these acts had the Commissioner divested himself of control of the matter and the court held in effect that he had the right to rescind his original action. In stating the elements of an account stated this court said in the Daube case, supra, that the rule is absolute that "unless some kind of an account or statement is presented or communicated by one party to the other which shows the balance due on the accounts between the parties, there is no foundation for a claim upon an account stated." In the case before us there was no such statement or communication. It is true the Bureau did direct the plaintiff to file a claim for a certain amount, but the plaintiff was not told that this amount was due her or that it would be paid. We have stated above the reasons for this direction being given. In the argument on behalf of plaintiff it is said that what was "done by the Commissioner has never been undone." The cancellation of the certificate of overassessment was sufficient abrogation of the prior action of the Commissioner if anything was necessary to set aside what had originally been done. We think, however, nothing was necessary as the defendant still retained control of the whole matter and the refusal or failure of the Bureau to pay the claim for refund was a sufficient denial of the claim. It is immaterial that the reasons given by the Commissioner for his action were neither logical nor a correct statement of legal principles. As will be shown further on, the Commissioner erred in his construction of the California statute and he was equally unfortunate in giving the reasons for his final conclusion. But this does not affect the determination of the case which must be decided in accordance with legal principles.

In this connection the plaintiff argues that the original action of the Commissioner was presumptively correct and that in the absence of affirmative pleading the plaintiff is entitled to recover.

We know of no such rule. The final determination of the Commissioner when disputed by the taxpayer is presumed to be correct in the absence of evidence showing the contrary but that rule has no application here. The Commissioner was not bound to adhere to his original ruling if he subsequently found it was not in accordance with the law as applied to the facts in the case.

It is also argued on behalf of the plaintiff that the Commissioner was right when in the first instance he disregarded the property agreement between the plaintiff and her husband and held that for Federal income tax purposes the income of both was community property under the laws of California and that the plaintiff was only liable for taxes computed accordingly; in other words, that the overassessment of the plaintiff as originally computed by the Commissioner was correct and that plaintiff should have the amount thereof refunded. In support of this contention, counsel for plaintiff presents an elaborate discussion of both Federal and State cases in which was involved either directly or indirectly the question of the effect of agreements between husband and wife, citizens of California, providing that all property acquired by either party subsequent to the date of the agreement should be the sole and separate property of the party acquiring the same. The plaintiff takes the position that neither the California cases nor the decisions of the United States courts show that the original determination of the Commissioner was erroneous.

That this last contention on the part of plaintiff is not well founded is settled by so many and well reasoned cases it does not seem necessary to add anything to the conclusions reached therein. Moreover, an attempt to review all of the cases cited on behalf of plaintiff would unduly extend the limits of this opinion. The precise issue now raised by plaintiff was presented to the Board of Tax Appeals in the case of *Howard C. Hickman* v. *Commissioner* (27 B. T. A., 807). In that case the Commissioner held that such agreements could not operate to prevent the allocation of one-half of the community income to each spouse for income tax purposes in a community property State. The Board of Tax Appeals reversed the holding of the Commissioner, and an appeal was taken to the Circuit Court of Appeals for the Ninth District under the title of *Helvering, Commissioner*, v. *Hickman* (70 Fed. (2d), 985 [Ct. D. 866, C. B. XIII–2, 274 (1934)]). The decision of the Board of Tax Appeals was affirmed, following an elaborate opinion in which all of the principal cases bearing on the subject were considered, including most of those cited by plaintiff. The decisions bearing on the effect of the validity of agreements made by citizens of California with reference to community property were carefully analyzed and the opinion stated positively that—

"By the law of California, as construed by her courts, the earnings of the wife never became community property if the husband and wife have agreed that they shall be and remain her separate property."

The case of *Poe* v. *Seaborn* (282 U. S., 101 [Ct. D. 259, C. B. IX-2, 202 (1930)]) was examined in connection with *Goodell, Collector*, v. *Koch* (282 U. S., 118 [Ct. D. 262, C. B. IX-2, 199 (1930)]); *Hopkins, Collector*, v. *Bacon* (282 U. S., 122 [Ct. D. 260, C. B. IX-2, 201 (1930)]); and *Bender, Collector*, v. *Pfaff* (282 U. S., 127). All were found to hold in effect that the earnings of either husband or wife were to be taxed according to the ownership of the earnings under the laws of the State of which they were residents, and *Lucas* v. *Earl* (281 U. S., 111) was distinguished. We think nothing needs to be added to the reasoning of this well considered opinion which disposes of the question now before us.

After this decision was rendered, the Bureau, having further considered the construction placed by the California courts on agreements made by husband and wife under the community property laws, announced that the Hickman case would be followed in determining the tax liability of husband and wife residing in California who have entered into a valid agreement providing that the earnings of each should be the separate property of the earner. Proceeding accordingly, the tax against the plaintiff was reaudited, assessed, and collected from plaintiff in accordance with her return. Under the rule laid down in *Lewis* v. *Reynolds* (284 U. S., 281 [Ct. D. 443, C. B. XI-1, 130 (1932)]), the ultimate question is whether the taxpayer has overpaid her tax. Our conclusion is that she has not.

It follows that the plaintiff's petition must be dismissed and it is so ordered.

WHALEY, Judge; and BOOTH, Chief Justice, concur.

WILLIAMS, Judge, took no part in this decision.

ARTICLE 22(a)-1: What included in gross income. 1940-48-10498 Ct. D. 1466

INCOME TAX—REVENUE ACT OF 1928—FEDERAL FARM LOAN ACT OF 1916—DECISION OF SUPREME COURT.

1. GROSS INCOME—EXEMPTION—GAINS REALIZED UPON DEALINGS IN FARM LOAN BONDS—INTEREST.

Gains realized by a taxpayer upon his dealings in farm loan bonds issued by joint-stock land banks under the Federal Farm Loan Act of 1916 are not exempt from Federal taxation as "income derived" from the bonds within the meaning of section 26 of that Act. Under such section only interest on farm loan bonds is exempt from Federal taxation.[a]

2. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Ninth Circuit (106 Fed. (2d), 405), reversing decision of the District Court, N. D. Calif., S. D. (24 F. Supp., 145), reversed.

SUPREME COURT OF THE UNITED STATES.

The United States of America, petitioner, v. *Ashby Oliver Stewart.*

[61 S. Ct., 102.]

On writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[November 12, 1940.]

OPINION.

MR. JUSTICE DOUGLAS delivered the opinion of the Court.

This case is here on certiorari to resolve a conflict of the decision below (106 Fed. (2d), 405) with *Stern Bros. & Co.* v. *Commissioner* (108 Fed. (2d), 309).

During the year 1930 respondent purchased farm loan bonds issued by joint-stock land banks under the Federal Farm Loan Act of 1916 (39 Stat., 360). The

[a] No. 37. *Stern Bros. & Co.* v. *Helvering, Commissioner.* On writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit. Judgment affirmed, per stipulation of counsel to abide the decision in No. 13, *United States* v. *Stewart.*

purchases were made for the prospective increment to the bonds and not for their interest. At the time the purchases were made the banks were in receivership. The bonds were acquired at prices substantially below par. In making these purchases respondent relied upon statements contained in circulars and bulletins issued by the Farm Loan Board, reasonably believing that he was purchasing securities the profit upon which in case of sale would be exempt income. A part of the bonds so purchased, with their appurtenant coupons, was sold in 1931; and a part was surrendered in that year to the receiver of the issuing bank in exchange for cash paid to respondent "under and pursuant to the covenants contained" in the bonds. Each of these transactions resulted in a profit to respondent.[1] The Commissioner held that those gains were taxable income. Consequently respondent included them in his income tax return for the year 1931 and claimed a refund. On disallowance of that claim, this suit for refund was instituted. The district court determined that the gains so realized were income and taxable. (24 F. Supp., 145.) The circuit court of appeals reversed.

Section 22(a) of the Revenue Act of 1928 (45 Stat., 791) includes in gross income "gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal." Section 22(b)4 exempts from taxation "Interest upon * * * securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended."

If those two sections are controlling, it is clear that respondent is taxable on these gains, for they fall squarely within the definition of gross income contained in section 22(a) and they are not "interest"[2] within the meaning of section 22(b)4. But respondent places his main reliance on section 26 of the Federal Farm Loan Act which provides that "farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation." It is urged that the gains here involved were "income derived" from the bonds within the meaning of that section.

We disagree with that conclusion. It is our view that under section 26 respondent is entitled to an exemption only for interest on the bonds.

To be sure, "income" is a generic term amply broad to include capital gains for purposes of the income tax. (*Merchants' Loan & Trust Co.* v. *Smietanka*, 255 U. S., 509 [Ct. D. 6, C. B. 4, 34 (1921)].) It is likewise true that Congress will be presumed to have used a word in its usual and well-settled sense. (*Old Colony Railroad Co.* v. *Commissioner*, 284 U. S., 552 [Ct. D. 456, C. B. XI–1, 274 (1932)]; *Deputy* v. *du Pont*, 308 U. S., 488 [Ct. D. 1435, C. B. 1940–1, 118].) But section 26 does not exempt simply "income"; it exempts the bonds and the "income derived therefrom." Analytically, income derived from mere ownership of the bonds is clearly different from income derived from dealings or transactions in the bonds. As stated in *Willcuts* v. *Bunn* (282 U. S., 216, 227–228 [Ct. D. 280, C. B. X–1, 309 (1931)]):

"The tax upon interest is levied upon the return which comes to the owner of the security according to the provisions of the obligation and without any further transaction on his part. The tax falls upon the owner by virtue of the mere fact of ownership, regardless of use or disposition of the security. The tax upon profits made upon purchases and sales is an excise upon the result of the combination of several factors, including capital investment and, quite generally, some measure of sagacity; the gain may be regarded as 'the creation of capital, industry and skill.' (*Tax Commissioner* v. *Putnam*, 227 Mass., 522, 531.)"

True, the Bunn case dealt only with the alleged constitutional inhibition against taxation of capital gains on municipal bonds and not with a specific statutory exemption. But its analysis is cognate here as indicating that, in absence of clear countervailing evidence, an exemption of "income derived" from a security does not embrace "income derived" from transactions in that security.

There are no circumstances here which should make the reasoning of the Bunn case inapplicable.

The Revenue Act of 1916 (39 Stat., 756) was enacted shortly after the Farm Loan Act by the same Congress and at the same session.[3] Section 2 of that Act,

[1] These purchases were for respondent and his wife who filed separate returns for the year in question.

[2] The record does not show what portion, if any, of the sums received on the sale or on the exchange of the bonds and appurtenant coupons was received as payment on accrued interest. Nor did the complaint allege that any portion of the sums received was exempt because it was "interest" on the bonds. Hence that point was not raised below or here.

[3] The Farm Loan Act became law on July 17, 1916, the Revenue Act of 1916 on September 8, 1916.

like section 22(a) of the 1928 Act, included in taxable income "gains, profits, and income derived from * * * sales, or dealings in property." And section 4 of that Act, like section 22(b)4 of the 1928 Act, exempted from taxation "interest upon * * * securities issued under the provisions of the Federal Farm Loan Act." It is clear that "all Acts *in pari materia* are to be taken together, as if they were one law." (*United States* v. *Freeman*, 3 How., 556, 564.) That these two Acts are *in pari materia* is plain. Both deal with precisely the same subject matter, viz, the scope of the tax exemption afforded farm loan bonds. The later Act can therefore be regarded as a legislative interpretation of the earlier Act (*Cope* v. *Cope*, 137 U. S., 682, 688; cf. *Stockdale* v. *Insurance Companies*, 20 Wall., 323, 331–332) in the sense that it aids in ascertaining the meaning of the words as used in their contemporary setting.[4] It is therefore entitled to great weight in resolving any ambiguities and doubts. (Cf. *United States* v. *Stafoff*, 260 U. S., 477, 480.) In that view the express exemption of interest alone makes tolerably clear that capital gains are not exempt.

In support of the contrary view great stress is placed on the legislative history of section 26. Extensive references are made to the hearings on this bill and to the debates in Congress. Typical are the statements or criticisms that the bill gave "these investments a distinct advantage over other investments,"[5] that the exemption provision was important,[6] that maintenance of a market for the bonds was desirable,[7] that the exemption was too broad.[8] These comments, however, are inconclusive. They are not sufficiently discriminating in their analysis or criticism to throw light on the narrow issue involved here.

Respondent's resort to administrative interpretation of section 26 is equally unproductive. No established administrative practice is shown. The holding of the unpublished memorandum[9] of the General Counsel of the Bureau of Internal Revenue relied upon is not precisely in point, even were we to assume that it is entitled to authoritative weight.[10] It merely ruled that a joint-stock land bank was not taxable on gains from purchases of its own bonds. And when the question of the taxability of an individual on his capital gains from sales of these bonds was raised less than two years later, another such ruling was issued to the effect that he did not have the benefit of any exemption.[11]

Nor is respondent materially aided by the change in section 26 made by section 817 of the Revenue Act of 1938 (52 Stat., 447, 578). That amendment provides

[4] It should be noted in this connection that the exemption of "interest" contained in section 4 of the 1916 Act was continued in each subsequent Revenue Act until 1934. Section 213(b)4, Revenue Act of 1918 (40 Stat., 1057, 1065); section 213(b)4, Revenue Act of 1921 (42 Stat., 227, 238); section 213 (b)4, Revenue Act of 1924 (43 Stat., 253, 268); section 213(b)4, Revenue Act of 1926 (44 Stat., 9, 24); section 22(b)4, Revenue Act of 1928 (45 Stat., 791, 798); section 22(b)4, Revenue Act of 1932 (47 Stat., 169, 178). By section 22(b)4 of the Revenue Act of 1934 (48 Stat., 680, 687) the exemption was generalized so as to include interest on obligations of any Federal corporation which is an instrumentality of the United States, subject to the limitation that interest is exempt only if and to the extent provided for in the Acts of Congress authorizing the issuance of such obligations. The Senate committee (S. Rept. No. 558, Seventy-third Congress, second session, pages 23–24 [C. B. 1939–1 (Part 2), page 604]), made the following comment on that change:

"This is merely a clarifying change made by the House. Under the language of this section, as contained in existing law, interest on securities issued under the Federal Farm Loan Act, or such Act as amended, is expressly excluded from gross income and thereby made exempt from the income tax. Other Acts have been enacted which also exempt the interest on obligations issued thereunder from tax. In order to bring the section into accord with the Acts authorizing such exemptions and to avoid the necessity of referring to all such Acts, a general provision has been inserted by the House excluding from gross income the interest upon the obligations of a corporation organized under Act of Congress if such corporation is an instrumentality of the United States; subject to the limitation, however, that the interest is exempt only to the extent provided for in the Acts of Congress authorizing the issuance of such obligations."

[5] Cong. Record, Sixty-fourth Congress, first session, volume 53, Part 8, page 7312. And see H. Rept. No. 630, Sixty-fourth Congress, first session, page. 8.

[6] Joint hearings before Sub-Committees of the Committees on Banking and Currency, Rural Credits, Sixty-third Congress, second session, pages 95–97; S. Doc. No. 380, Sixty-third Congress, second session, Agricultural Credit, Report U. S. Commission, pages 17, 33.

[7] H. Doc. No. 679, Sixty-third Congress, second session, pages 15, 16.

[8] Cong. Record, *op. cit.*, supra, note 5, pages 6850, 7311. Nor is it significant that substitute bills were offered (Cong. Record, *op cit.*, supra, note 5, pages 7385, 7387; S. 4061, Sixty-third Congress, second session) by the terms of which "interest" was exempted. These were overall substitutes. Therefore the implication is not warranted that the failure of their adoption was due to the desire of Congress to grant a broader exemption than "interest."

[9] This is reproduced, so far as material here, in S. Hearings, Committee on Finance, Seventy-fifth Congress, third session, H. R. 9682, Part 4, pages 619–621.

[10] See *Helvering* v. *New York Trust Co.* (292 U. S., 455, 468 [Ct. D. 840, C. B. XIII–1, 188 (1934)]).

[11] See *Agricultural Securities Corporation* v. *Commissioner* (39 B. T. A., 1103. 1111).

that "all income, except interest, derived" from such bonds shall be included in gross income.[12] It is urged that this amendment is affirmative recognition by the Congress that section 26 exempts these capital gains. But here again the legislative record is ambiguous and hence inconclusive. The purpose of section 817, as originally introduced, clearly was to make certain that capital gains realized by joint-stock land banks on transactions in their own obligations would not be exempt.[13] The section was amended on the floor of the Senate to its present form on the suggestion that "perhaps the language is not as broad as it should be."[14] The purpose of the amendment may well have been to clarify the doubtful and uncertain status of capital gains which were not covered by the committee's recommendation. There is no clear and convincing evidence that it was designed to change existing law, so far as these other categories of capital gains were concerned. But even if a contrary implication were to be assumed, it would not override so belatedly the clear inference, based on a long series of Revenue Acts exempting only interest, that capital gains were taxable.

Respondent further argues that comparison of other exemption statutes with the language of section 26 reinforces the view that these capital gains are exempt. In that connection our attention is called to numerous statutes—some exempting only bonds[15] and others exempting principal and interest;[16] some exempting a corporation, "including the capital stock and surplus therein, and the income derived therefrom,"[17] and others[18] containing somewhat similar exemptions for the corporation but only an exemption as to principal and interest for its bonds; and still others[19] containing the same kind of exemption as section 26 of the Farm Loan Act. From this painstaking review respondent argues that where Congress has desired to exempt only "interest" it has said so and where it has intended to grant a broader exemption it has used the word "income"; that

[12] This amendment is prospective only. It provides:

"Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, in the case of mortgages made or obligations issued by any joint-stock land bank after the date of the enactment of this Act, all income, except interest, derived therefrom shall be included in gross income and shall not be exempt from Federal income taxation."

[13] S. Rept. No. 1567, Seventy-fifth Congress, third session, page 47. This report clearly indicates that the committee was of the view that under section 26 joint-stock land banks were exempt from capital gains resulting from purchases of their own obligations. A change in that regard was clearly intended, for the committee said, page 47:

"This section subjects to Federal income taxation the capital gain realized by a joint-stock land bank on the purchase of its own obligations or of mortgages made by it. It has been brought to the attention of the committee that these banks have been purchasing their own bonds at below par and issuing new bonds at or above par. Gain realized on such a purchase is, under the law, taxable income and in the case of an ordinary corporation, is taxed. Under the Federal Farm Loan Act, however, which governs the taxability of obligations of joint-stock land banks, such income is exempt. The committee is of the opinion that such income ought to be taxed."

The committee draft of section 817 (then section 816) provided for that change as follows (H. R. 9682, Seventy-fifth Congress, third session):

"Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, gain realized on the acquisition by a joint-stock land bank of obligations issued by it or mortgages made by it, if such obligations or mortgages are made or issued after the date of the enactment of this Act, shall not be exempt from Federal income taxation."

As indicated, supra, note 9, the unpublished memorandum of the General Counsel of the Bureau of Internal Revenue ruling that a joint-stock land bank was not taxable on gains from purchases of its own bonds was before the Senate committee. Cf. the recommendation made to the committee. S. Hearings, op. cit., supra, note 9, pages 614, 615.

[14] Statement by Senator King, member of the Committee on Finance, Congressional Record, volume 83, Seventy-fifth Congress, third session, page 4959. When Senator King offered the amendment, he gave the following explanation (*id.*, page 5174):

"The bill as reported subjected to Federal income taxation capital gains realized by a joint-stock land bank on obligations issued and mortgages made by it after the date of enactment of the Act. The effect of the amendment is not only to tax that gain but also to tax gain realized by another joint-stock land bank or by an individual or corporation which itself is not exempt from Federal taxation. Thus, gain on a sale of such a joint-stock land bank bond by an investor is subject to tax. The amendment continues the present provision of law under which interest on such bonds and mortgages is exempt from Federal taxation."

[15] Statutes governing Panama Canal toll bonds (32 Stat., 481, 484; 36 Stat., 11, 117) and Postal Savings bonds (36 Stat., 814, 817) are cited.

[16] Reference is made to various statutes including those pertaining to Treasury notes (38 Stat., 251, 269) and several of the Liberty loans (40 Stat., 35; 40 Stat., 288, 291; 40 Stat., 1309, 1310).

[17] Federal Reserve Act of December 23, 1913 (38 Stat., 251, 258). And see Bankhead-Jones Farm Tenant Act of July 22, 1937 (50 Stat., 522, 528); Agricultural Adjustment Act of 1938 (52 Stat., 31, 75).

[18] Reference is made to the War Finance Corporation Act of April 5, 1938 (40 Stat., 506, 511); Reconstruction Finance Corporation Act of January 22, 1932 (47 Stat., 5, 9); Home Owners' Loan Act of June 13, 1933 (48 Stat., 128, 130).

[19] Federal Farm Mortgage Corporation Act of January 31, 1934 (48 Stat., 344, 347); Commodity Credit Corporation Act of March 8, 1938 (52 Stat., 107, 108).

statutes exempting only "interest" have a narrower meaning than those exempting "income"; and that this long and recurrent legislative practice discloses a clear design on the part of Congress to draw distinctions and to shape the various exemptions to suit its differing policy in divers situations.

Suggestive as this analysis is, it is entitled to little weight. No mere collation of other statutes can be decisive in determining what the instant statute means. The meaning of each phrase must be closely related to the time and circumstance of its use. The phrase "income derived therefrom" as used in section 26 clearly has taken on coloration from the express exemption for nearly a quarter century of only interest on these bonds. We have no occasion to intimate an opinion as to the meaning of other similar statutes. It is sufficient here to note that in another legislative setting "income derived" from bonds may or may not be synonymous with "interest" on bonds. That must necessarily be dependent on a host of factors which only a minute scrutiny of the particular legislative scheme would reveal. For this reason the fact that the same Congress which in 1938 amended section 26 granted an exemption to another Federal instrumentality [20] couched in the identical language of the original section 26 is merely a straw in the wind. So far as the instant bonds are concerned, that in itself is entitled to little weight as against the long standing express exemption in successive Revenue Acts of interest alone.

Respondent also stresses the fact that circulars, prepared and distributed by the Farm Loan Board "advising investors of the merits and advantages of farm loan bonds," [21] stated that these bonds and their income were "free from all forms of taxation" including the income tax, that "this exemption is complete," etc. As we have said, it was found that respondent relied upon such statements reasonably believing that capital gains would not be taxable. But aside from the fact that those statements are hardly more specific than the statute itself, they can not be accorded the weight of uniform and long standing administrative treatment.[22] There was no authority for the Board to make representations that capital gains were or were not tax exempt. That administrative function resided only in the Treasury. An officer or agency of the United States to whom no administrative authority has been delegated can not estop the United States even by an affirmative undertaking to waive or surrender a public right. (*Utah* v. *United States*, 284 U. S., 534, 545–546; *Wilber National Bank* v. *United States*, 294 U. S., 120, 123–124.)

We return to our conclusion that the weight of these various considerations leans to the view that only interest is exempt. The cumulative strength of the several factors urged by respondent is not such clear evidence of Congressional purpose as to make inapposite the application of the reasoning of *Willcuts* v. *Bunn*, supra, to this situation. In that posture of the case, respondent has succeeded only in casting some doubt on the proper construction of the statute. Yet those who seek an exemption from a tax must rest it on more than a doubt or ambiguity. (*Bank of Commerce* v. *Tennessee*, 161 U. S., 134, 146; 163 U. S., 416, 423.) Exemptions from taxation can not rest upon mere implications. (*United States Trust Co.* v. *Helvering*, 307 U. S., 57, 60 [Ct. D. 1396, C. B. 1939–1, 330].) As stated by Mr. Justice Cardozo in *Trotter* v. *Tennessee* (290 U. S., 354, 356), "Exemptions from taxation are not to be enlarged by implication if doubts are nicely balanced." And see *Pacific Co., Ltd.*, v. *Johnson* (285 U. S., 480, 491). Hence broad, generalized statutory exemptions have frequently been construed narrowly and confined to those situations where the subject matter of the exemption was directly, not indirectly or remotely, involved. (*Murdock* v. *Ward*, 178 U. S., 139; *Hale* v. *State Board of Assessment and Review*, 302 U. S., 95; *United States Trust Co.* v. *Helvering*, supra.) The exemption contained in section 26 of the Farm Loan Act must be so construed.

For these reasons the challenged judgment must be reversed.

Mr. Justice ROBERTS is of opinion that the judgment should be affirmed on the grounds stated by the circuit court of appeals in its opinion below (106 Fed. (2d), 405).

[20] Commodity Credit Corporation Act, supra, note 19.

[21] Pursuant to the authority vested in the Federal Farm Loan Board by section 3 of the Act.

[22] Nor can the casual statement by the Secretary of the Treasury, in the course of a Congressional hearing on the Revenue Act of 1918, to the effect that "Land bank bonds carry a wider exemption than Liberty bonds" (S. Hearings, H. R. 12863, Sixty-fifth Congress, third session, Part 4, page 117) carry authoritative weight, as it does not even purport to be a discriminating analysis of this problem in its various aspects.

ARTICLE 22(a)-1: What included in gross income. (Also section 43, Article 43-2.) 1940-49-10505 G. C. M. 22404

REVENUE ACT OF 1934.

Where processors sold goods in 1935 under "Charlotte clause" contracts, in which it was provided that should the Agricultural Adjustment Act (48 Stat., 31) be declared unconstitutional, processing taxes included in the selling price of goods sold within the period of 90 days prior to the decision of the Supreme Court of the United States invalidating that Act would be refunded or credited, liabilities set up in 1935 on the books of such processors, who kept their books on the accrual basis, to take care of such a contingency (which actually happened on January 6, 1936) are proper deductions from gross income.

Recommended that I. T. 3143 (C. B. 1937-2, 216) be revoked.

An opinion is requested whether I. T. 3143 (C. B. 1937-2, 216) should be revoked in view of the decision of the Board of Tax Appeals in *Sanford Cotton Mills, Inc.*, v. *Commissioner* (42 B. T. A., 190).

In July, 1935, textile manufacturers and other processors in North Carolina began to enter into contracts with their vendees containing a provision known as the "Charlotte clause," which provided that should the Agricultural Adjustment Act (48 Stat., 31) be held unconstitutional all processing taxes included in the sales prices of goods sold within the period of 90 days prior to the date of the decision of the Supreme Court of the United States invalidating the Act would be repaid or credited to the vendees. The decision of the Supreme Court in *United States* v. *Butler* (297 U. S., 1) declaring the Agricultural Adjustment Act unconstitutional was rendered on January 6, 1936. The Sanford Cotton Mills, Inc., kept its books on the accrual basis. After the Butler decision it reversed an accrual of processing taxes which it had not paid to the collector and accrued on its books as of December 31, 1935, the amount of $22,468.12 as credits to the accounts of its vendees under the "Charlotte clause." The processors have contended, as did the Sanford Cotton Mills, Inc., before the Board, that under the circumstances the processor was under a definite liability at December 31, 1935, either to pay the processing taxes to the Government under the Act, or to repay to, or credit the accounts of, its vendees under its contracts with them. Therefore, the processors have contended that so much of the liability to vendees which became definite on January 6, 1936, as might be deemed an accrual as of December 31, 1935, should be allowed as a deduction from gross income for 1935 for Federal income tax purposes.

In I. T. 3143 (C. B. 1937-2, 216), involving the "Charlotte clause," it was held that at December 31, 1935, the liability under the provisions of such clause was a contingent one which could not be held to have ripened into a definite, accruable liability before January 6, 1936. (Cf. *Brown* v. *Helvering*, 291 U. S., 193, Ct. D. 786, C. B. XIII-1, 223 (1934).)

The Board of Tax Appeals held in *Sanford Cotton Mills, Inc.*, v. *Commissioner*, supra, that as the obligation of the taxpayer to repay

to the vendee an amount equivalent to the processing taxes involved in 1935 sales prices affected by the "Charlotte clause" was contemporaneous with the inclusion of such amount in the sales prices, either the accrual of so much of the sales prices should have been deferred in 1935 or the accrual of the obligation to repay should be deducted from gross income for that year, particularly since the decision in the Butler case was rendered shortly after December 31, 1935, while the taxpayer's books were still open for the year 1935. The Board regarded the matter as presenting a practical question of clear accounting in a situation where it is more convenient, and without any real sacrifice of accuracy, "to treat such a contingent accrual as flexible enough to conform to the outcome of the contingency" which transpired in so short a time after the close of the taxable year. The Board stated that an attempted adjustment to reflect an event occurring after the books have been closed might involve consideration which would probably variously affect the rule.

Such treatment of contingent accruals, which regards the accounting therefor as a flexible matter so long as the books for the taxable year remain open, is a departure from the strict rule that a contingent liability, which is dependent on the last day of the accounting period upon a future event, is not a deductible accrued liability for the taxable year. (Cf. *Brown* v. *Helvering*, supra.) It may nevertheless be that it derives some support from *Fawcus Machine Co.* v. *United States* (282 U. S., 375, Ct. D. 278, C. B. X-1, 424 (1931)).

Under the circumstances of this case, it is the opinion of this office that the decision of the Board should be accepted *as to the result* and applied in the disposition of cases involving accruals under the "Charlotte clause." Consequently, it is recommended that I. T. 3143, supra, be revoked.

In view of the fact, however, that the decision of the Board in *Sanford Cotton Mills, Inc.*, v. *Commissioner*, supra, is a departure from the strict rule that a contingent liability, which is dependent on the last day of the accounting period upon a future event, is not a deductible accrued liability for such accounting period, it is recommended that nonacquiescence in the decision of the Board be announced. However, no appeal from that decision will be taken.

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

ARTICLE 22(a)-1: What included in gross income. 1940-49-10506
I. T. 3430

REVENUE ACT OF 1934.

In view of G. C. M. 22404 (page 304, this Bulletin), I. T. 3143 (C. B. 1937-2, 216) is revoked.

ARTICLE 22(a)–1: What included in gross income. 1940–50–10518
Ct. D. 1472

INCOME TAX—REVENUE ACT OF 1934—DECISION OF SUPREME COURT.

1. GROSS INCOME—GIFT OF NEGOTIABLE INTEREST COUPONS—TAXABLE TO GRANTOR.

The gift of negotiable interest coupons detached from negotiable bonds by the owner thereof shortly before their due date and delivered to his son, who in the same year collected them at maturity, is the realization of income taxable to the donor, under the provisions of section 22 of the Revenue Act of 1934. The power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment and hence the realization of the income by him who exercises it. The dominant purpose of the revenue laws is the taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid.

2. CASE DISTINGUISHED.

Blair v. *Commissioner* (300 U. S., 5 [Ct. D. 1205, C. B. 1937–1, 175]) distinguished.

3. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Second Circuit (107 Fed. (2d), 906), reversing decision of the United States Board of Tax Appeals (39 B. T. A., 757), reversed.

SUPREME COURT OF THE UNITED STATES.

Guy T. Helvering, petitioner, v. *Paul R. G. Horst.*
[61 S. Ct., 144.]

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[November 25, 1940.]

OPINION.

Mr. Justice STONE delivered the opinion of the Court.

The sole question for decision is whether the gift, during the donor's taxable year, of interest coupons detached from the bonds, delivered to the donee and later in the year paid at maturity, is the realization of income taxable to the donor.

In 1934 and 1935 respondent, the owner of negotiable bonds, detached from them negotiable interest coupons shortly before their due date and delivered them as a gift to his son who in the same year collected them at maturity. The Commissioner ruled that under the applicable section 22 of the Revenue Act of 1934 (48 Stat., 680, 686), the interest payments were taxable, in the years when paid, to the respondent donor who reported his income on the cash receipts basis. The circuit court of appeals reversed the order of the Board of Tax Appeals sustaining the tax. (107 Fed. (2d), 906; 39 B. T. A., 757.) We granted certiorari (309 U. S., 650), because of the importance of the question in the administration of the revenue laws and because of an asserted conflict in principle of the decision below with that of *Lucas* v. *Earl* (281 U. S., 111) and with that of decisions by other circuit courts of appeals. (See *Bishop* v. *Commissioner*, 54 Fed. (2d), 298 [Ct. D. 477, C. B. XI–1, 164 (1931)]; *Dickey* v. *Burnet*, 56 Fed. (2d), 917, 921; *Van Meter* v. *Commissioner*, 61 Fed. (2d), 817 [Ct. D. 675, C. B. XII–1, 207 (1933)].)

The court below thought that as the consideration for the coupons had passed to the obligor, the donor had, by the gift, parted with all control over them and their payment, and for that reason the case was distinguishable from *Lucas* v. *Earl*, supra, and *Burnet* v. *Leininger* (285 U. S., 136), where the assignment of compensation for services had preceded the rendition of the services, and where the income was held taxable to the donor.

The holder of a coupon bond is the owner of two independent and separable kinds of right. One is the right to demand and receive at maturity the principal

amount of the bond representing capital investment. The other is the right to demand and receive interim payments of interest on the investment in the amounts and on the dates specified by the coupons. Together they are an obligation to pay principal and interest given in exchange for money or property which was presumably the consideration for the obligation of the bond. Here respondent, as owner of the bonds, had acquired the legal right to demand payment at maturity of the interest specified by the coupons and the power to command its payment to others which constituted an economic gain to him.

Admittedly not all economic gain of the taxpayer is taxable income. From the beginning the revenue laws have been interpreted as defining "realization" of income as the taxable event rather than the acquisition of the right to receive it. And "realization" is not deemed to occur until the income is paid. But the decisions and regulations have consistently recognized that receipt in cash or property is not the only characteristic of realization of income to a taxpayer on the cash receipts basis. Where the taxpayer does not receive payment of income in money or property realization may occur when the last step is taken by which he obtains the fruition of the economic gain which has already accrued to him. (*Old Colony Trust Co.* v. *Commissioner*, 279 U. S., 716 [Ct. D. 80, C. B. VIII-2, 222 (1929)]; *Corliss* v. *Bowers*, 281 U. S., 376, 378 [Ct. D. 188, C. B. IX-1, 254 (1930)]. Cf. *Burnet* v. *Wells*, 289 U. S., 670 [Ct. D. 688, C. B. XII-1, 261 (1933)].)

In the ordinary case the taxpayer who acquires the right to receive income is taxed when he receives it, regardless of the time when his right to receive payment accrued. But the rule that income is not taxable until realized has never been taken to mean that the taxpayer, even on the cash receipts basis, who has fully enjoyed the benefit of the economic gain represented by his right to receive income, can escape taxation because he has not himself received payment of it from his obligor. The rule, founded on administrative convenience, is only one of postponement of the tax to the final event of enjoyment of the income, usually the receipt of it by the taxpayer, and not one of exemption from taxation where the enjoyment is consummated by some event other than the taxpayer's personal receipt of money or property. (Cf. *Aluminum Castings Co.* v. *Routzahn*, 282 U. S., 92, 98 [Ct. D. 270, C. B. X-1, 352 (1931)].) This may occur when he has made such use or disposition of his power to receive or control the income as to procure in its place other satisfactions which are of economic worth. The question here is, whether because one who in fact receives payment for services or interest payments is taxable only on his receipt of the payments, he can escape all tax by giving away his right to income in advance of payment. If the taxpayer procures payment directly to his creditors of the items of interest or earnings due him (see *Old Colony Trust Co.* v. *Commissioner*, supra; *Bowers* v. *Kerbaugh Empire Co.*, 271 U. S., 170 [T. D. 3881, C. B. V-1, 199 (1926)]; *United States* v. *Kirby Lumber Co.*, 284 U. S., 1 [Ct. D. 420, C. B. X-2, 356 (1931)]), or if he sets up a revocable trust with income payable to the objects of his bounty (sections 166, 167, Revenue Act of 1934, *Corliss* v. *Bowers*, supra; cf. *Dickey* v. *Burnet*, 56 Fed. (2d), 917, 921), he does not escape taxation because he did not actually receive the money. (Cf. *Douglas* v. *Willcuts*, 296 U. S., 1 [Ct. D. 1041, C. B. XIV-2, 250 (1935)]; *Helvering* v. *Clifford*, 309 U. S., 331 [Ct. D. 1440, C. B. 1940-1, 105].)

Underlying the reasoning in these cases is the thought that income is "realized" by the assignor because he, who owns or controls the source of the income, also controls the disposition of that which he could have received himself and diverts the payment from himself to others as the means of procuring the satisfaction of his wants. The taxpayer has equally enjoyed the fruits of his labor or investment and obtained the satisfaction of his desires whether he collects and uses the income to procure those satisfactions, or whether he disposes of his right to collect it as the means of procuring them. (Cf. *Burnet* v. *Wells*, supra.)

Although the donor here, by the transfer of the coupons, has precluded any possibility of his collecting them himself he has nevertheless, by his act, procured payment of the interest, as a valuable gift to a member of his family. Such a use of his economic gain, the right to receive income, to procure a satisfaction which can be obtained only by the expenditure of money or property, would seem to be the enjoyment of the income whether the satisfaction is the purchase of goods at the corner grocery, the payment of his debt there, or such nonmaterial satisfactions as may result from the payment of a campaign or community chest contribution, or a gift to his favorite son. Even though he never receives the money he derives money's worth from the disposition of the coupons which he has

used as money or money's worth in the procuring of a satisfaction which is procurable only by the expenditure of money or money's worth. The enjoyment of the economic benefit accruing to him by virtue of his acquisition of the coupons is realized as completely as it would have been if he had collected the interest in dollars and expended them for any of the purposes named. (*Burnet* v. *Wells*, supra.)

In a real sense he has enjoyed compensation for money loaned or services rendered and not any the less so because it is his only reward for them. To say that one who has made a gift thus derived from interest or earnings paid to his donee has never enjoyed or realized the fruits of his investment or labor because he has assigned them instead of collecting them himself and then paying them over to the donee, is to affront common understanding and to deny the facts of common experience. Common understanding and experience are the touchstones for the interpretation of the revenue laws.

The power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment and hence the realization of the income by him who exercises it. We have had no difficulty in applying that proposition where the assignment preceded the rendition of the services (*Lucas* v. *Earl*, supra; *Burnet* v. *Leininger*, supra), for it was recognized in the Leininger case that in such a case the rendition of the service by the assignor was the means by which the income was controlled by the donor and of making his assignment effective. But it is the assignment by which the disposition of income is controlled when the service precedes the assignment and in both cases it is the exercise of the power of disposition of the interest or compensation with the resulting payment to the donee which is the enjoyment by the donor of income derived from them.

This was emphasized in *Blair* v. *Commissioner* (300 U. S., 5 [Ct. D. 1205, C. B. 1937-1, 175]), on which respondent relies, where the distinction was taken between a gift of income derived from an obligation to pay compensation and a gift of income-producing property. In the circumstances of that case the right to income from the trust property was thought to be so identified with the equitable ownership of the property from which alone the beneficiary derived his right to receive the income and his power to command disposition of it that a gift of the income by the beneficiary became effective only as a gift of his ownership of the property producing it. Since the gift was deemed to be a gift of the property the income from it was held to be the income of the owner of the property, who was the donee, not the donor, a refinement which was unnecessary if respondent's contention here is right, but one clearly inapplicable to gifts of interest or wages. Unlike income thus derived from an obligation to pay interest or compensation, the income of the trust was regarded as no more the income of the donor than would be the rent from a lease or a crop raised on a farm after the leasehold or the farm had been given away. (*Blair* v. *Commissioner*, supra, 12, 13 and cases cited. See also *Reinecke* v. *Smith*, 289 U. S., 172, 177 [Ct. D. 664, C. B. XII-1, 256 (1933)].) We have held without deviation that where the donor retains control of the trust property the income is taxable to him although paid to the donee. (*Corliss* v. *Bowers*, supra. Cf. *Helvering* v. *Clifford*, supra.)

The dominant purpose of the revenue laws is the taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid. (See *Corliss* v. *Bowers*, supra, 378; *Burnet* v. *Guggenheim*, 288 U. S., 280, 283 [Ct. D. 636, C. B. XII-1, 374 (1933)].) The tax laid by the 1934 Revenue Act upon income "derived from * * * wages or compensation for personal service, of whatever kind, and in whatever form paid, * * *; also from interest * * *" therefore can not fairly be interpreted as not applying to income derived from interest or compensation when he who is entitled to receive it makes use of his power to dispose of it in procuring satisfactions which he would otherwise procure only by the use of the money when received.

It is the statute which taxes the income to the donor although paid to his donee. (*Lucas* v. *Earl*, supra; *Burnet* v. *Leininger*, supra.) True, in those cases the service which created the right to income followed the assignment and it was arguable that in point of legal theory the right to the compensation vested instantaneously in the assignor when paid although he never received it; while here the right of the assignor to receive the income antedated the assignment which transferred the right and thus precluded such an instantaneous vesting. But the statute affords no basis for such "attenuated subtleties." The distinction was explicitly rejected as the basis of decision in *Lucas* v. *Earl*. It should be

rejected here, for no more than in the Earl case can the purpose of the statute to tax the income to him who earns, or creates and enjoys it be escaped by "anticipatory arrangements however skillfully devised" to prevent the income from vesting even for a second in the donor.

Nor is it perceived that there is any adequate basis for distinguishing between the gift of interest coupons here and a gift of salary or commissions. The owner of a negotiable bond and of the investment which it represents, if not the lender, stands in the place of the lender. When, by the gift of the coupons, he has separated his right to interest payments from his investment and procured the payment of the interest to his donee, he has enjoyed the economic benefits of the income in the same manner and to the same extent as though the transfer were of earnings and in both cases the import of the statute is that the fruit is not to be attributed to a different tree from that on which it grew. (See *Lucas* v. *Earl*, supra, 115.)

Reversed.

ARTICLE 22(a)-1: What included in gross income. 1940-50-10519 Ct. D. 1473

INCOME TAX—REVENUE ACT OF 1932—DECISION OF SUPREME COURT.

1. GROSS INCOME—RENEWAL COMMISSIONS—ASSIGNMENT AFTER TERMINATION OF AGENCY CONTRACT—TAXABLE TO ASSIGNOR.

Renewal commissions to become payable to a life insurance agent for services which had been rendered, assigned by him after the termination of his agency contracts and services as agent, constitute income taxable to the assignor under the provisions of section 22 of the Revenue Act of 1932 in the year when such commissions were paid, where no purpose of the assignments appears other than to confer on the assignees the power to collect the commissions as and when they became payable.

2. DECISION FOLLOWED.

Helvering v. *Horst*, decided by this Court on November 25, 1940 [Ct. D. 1472, page 206, this Bulletin], followed.

3. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Second Circuit (110 Fed. (2d), 737), reversing decision of the United States Board of Tax Appeals (39 B. T. A., 583), reversed.

SUPREME COURT OF THE UNITED STATES.

Guy T. Helvering, Commissioner of Internal Revenue, petitioner, v. *Gerald A. Eubank.*

[61 S. Ct., 149.]

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[November 25, 1940.]

OPINION.

Mr. Justice STONE delivered the opinion of the Court.

This is a companion case to No. 27, *Helvering* v. *Horst*, decided this day [Ct. D. 1472, page 206, this Bulletin], and presents issues not distinguishable from those in that case.

Respondent, a general life insurance agent, after the termination of his agency contracts and services as agent, made assignments in 1924 and 1928 respectively of renewal commissions to become payable to him for services which had been rendered in writing policies of insurance under two of his agency contracts. The Commissioner assessed the renewal commissions paid by the companies to the assignees in 1933 as income taxable to the assignor in that year under the provisions of the 1932 Revenue Act (47 Stat., 169), section 22 of which does not differ in any respect now material from section 22 of the 1934 Revenue Act involved in the Horst case. The Court of Appeals for the Second Circuit reversed the order of the Board of Tax Appeals sus-

taining the assessment. (110 Fed. (2d), 737; 39 B. T. A., 583.) We granted certiorari October 14, 1940.

No purpose of the assignments appears other than to confer on the assignees the power to collect the commissions, which they did in the taxable year. The Government and respondent have briefed and argued the case here on the assumption that the assignments were voluntary transfers to the assignees of the right to collect the commissions as and when they became payable, and the record affords no basis for any other.

For the reasons stated at length in the opinion in the Horst case, we hold that the commissions were taxable as income of the assignor in the year when paid. The judgment below is reversed.

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

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

REVENUE ACT OF 1934 AND PRIOR REVENUE ACTS.

Amounts received under so-called endowment, income, and final sum policy. (See I. T. 3402, page 57.)

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

ARTICLE 23(c)-1: Taxes.

1940-52-10532
G. C. M. 22454

REVENUE ACTS OF 1928, 1932, AND 1934.

Real estate taxes in Nebraska accrue, for Federal income tax purposes, when they become a charge against and a lien upon the land taxed rather than on the date as of which they are assessed.

Recommended that I. T. 2849 (C. B. XIV-1, 60 (1935)) be modified.

An opinion is requested whether the conclusion reached in I. T. 2849 (C. B. XIV-1, 60 (1935)) should be followed in view of the decision of the Circuit Court of Appeals for the Eighth Circuit in *Helvering* v. *Schimmel et al.* (114 Fed. (2d), 554 [Ct. D. 1475, page 211, this Bulletin]).

It was held in the Schimmel case that Nebraska real estate taxes accrue, for Federal income tax purposes, when they become a charge against and a lien upon the land taxed rather than on the date as of which they are assessed, as held in I. T. 2849, supra. The court relied on *Lifson et al.* v. *Commissioner* (98 Fed. (2d), 508, Ct. D. 1409, C. B. 1939-2, 198, certiorari denied, 305 U. S., 662), in which it was held that real estate taxes accrue in Minnesota when they become a lien on the real estate. The decision in the Lifson case contains reasoning contrary to the Bureau position that generally State property taxes accrue on the date as of which the assessment of the tax is made. (See G. C. M. 15305, C. B. XIV-2, 80 (1935), and rulings cited therein.) However, upon the basis of the Lifson decision, the Bureau changed its rule as to the accrual date of real property taxes in Minnesota, but held that such decision should not affect existing rulings as to the

accrual dates of taxes in other States. (G. C. M. 21373, C. B. 1939-2, 82.) Accordingly, the decision in the Schimmel case will not be given general application but will be applied only in cases involving real property taxes in Nebraska. In determining the accrual date of property taxes in other States or in determining the accrual date of personal property taxes in Nebraska, existing Bureau rulings with regard thereto are not to be considered as affected by the Schimmel decision.

It is recommended that I. T. 2849, supra, which is inconsistent with the Schimmel decision, be modified to accord therewith.

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

ARTICLE 23(c)-1: Taxes. 1940-52-10533
I. T. 3437

REVENUE ACTS OF 1928, 1932, AND 1934.

I. T. 2849 (C. B. XIV-1, 60 (1935)) is modified to accord with the conclusion reached in G. C. M. 22454 (page 210, this Bulletin).

ARTICLE 23(c)-1: Taxes. 1940-52-10534
Ct. D. 1475

INCOME TAX—REVENUE ACT OF 1932—DECISION OF COURT.

1. DEDUCTION—TAXES PAID OR ACCRUED WITHIN TAXABLE YEAR—CITY REAL ESTATE TAXES—LIEN—NEBRASKA LAW.

The owner of real estate in a city of the metropolitan class in the State of Nebraska who kept his accounts and filed his income tax returns on the accrual basis was entitled to a deduction in 1932 for city taxes paid on the property in that year, although assessment and levy were made in 1931, since under Nebraska law such taxes become due and a lien on the property on May 1 of the year following the year of assessment and levy.

2. DECISION AFFIRMED.

Decision of the United States Board of Tax Appeals (1939) (39 B. T. A., 989) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

Guy T. Helvering, Commissioner of Internal Revenue, petitioner, v. *Mary Schimmel and Abram Q. Schimmel, Executors of the Estate of Charles Schimmel, Deceased,*[1] *respondents.*

[114 Fed. (2d), 554.]

On petition to review decision of the United States Board of Tax Appeals.

Before SANBORN, THOMAS, and VAN VALKENBURGH, Circuit Judges.

[September 13, 1940.]

OPINION.

VAN VALKENBURGH, Circuit Judge, delivered the opinion of the court.

This is a proceeding to review a decision of the Board of Tax Appeals. It involves solely the question of when, for the purpose of taking a deduction from

[1] See G. C. M. 22454, page 210, this Bulletin.

income by a taxpayer on the accrual basis, general city taxes on real estate in cities of the metropolitan class in Nebraska, accrue.

As stipulated:

"During the taxable year 1932 Charles Schimmel (the taxpayer, now deceased) was a resident of the State of Nebraska, wherein he owned and operated the Blackstone Hotel in the city of Omaha, county of Douglas, which city was at all times here material a city of the metropolitan class as defined by the laws of the State of Nebraska.

"During the year 1932, and for several years prior and subsequent thereto, the taxpayer kept his books of account and filed his Federal income tax returns on the accrual basis.

* * * * * * *

"It was further agreed before the Board that section 514 of chapter 14 of the Compiled Statutes of Nebraska provides that city taxes shall be assessed and levied a year in advance of the year in which they are paid and that in respect of the laws of Nebraska in effect during the year 1932 in the city of Omaha, Nebr., the city real estate and personal taxes were assessed and levied a year in advance of the year in which they were paid, the assessment being made on April 1 of each year for the following year. City real estate and personal taxes were levied in the year before the year in which they became due. City real estate taxes became a lien on May 1 of the year in which they were due, being the year after the year of assessment and levy. City personal taxes became a lien on November 1 of the year in which they were levied, being the year before the year in which they were due. City real estate and personal taxes became due on May 1 of the year after the year they were assessed and levied, and became delinquent on July 1, or two months after they were due."

As stated by counsel for both parties in their briefs, there is but one question involved in this appeal. The Board of Tax Appeals, holding that the taxpayer's 1932 city taxes on real estate accrued in 1932, when such taxes became due and a first lien upon the property, upheld the taxpayer in his claim of deduction for that calendar year, and accordingly reduced the amount of deficiency to $1,985.48 from the amount of $2,387.55 determined by the Commissioner. The Commissioner claims the decision of the Board is erroneous because the city real estate taxes which became due and were paid in 1932 and were deducted in the taxpayer's 1932 return, were levied in 1931.

The taxpayer's Federal income tax returns for the calendar year 1932 contained debits on his reserve account for payment of taxes other than 1932 city real estate taxes. Since the issue here is confined to the latter, the others may be disregarded. In these returns the taxpayer listed for reduction 1932 city real estate taxes paid July 1, 1932, in the amount of $10,280.76; while the amount of $8,878.10 allowed by the Commissioner as accrued in 1932 represented 1933 city real estate taxes which were assessed and levied in 1932, but which were paid on July 31, 1933. We have not here before us a condition where taxes were assessed and had become liens upon the lands while in other ownerships and were paid by the new owner after acquisition. Charles Schimmel was the owner of the city property when the assessment was made, when the tax lien accrued, and when the taxes were paid. And it was this ownership of the property on May 1, 1932, when such taxes became due and a first lien upon it, that in the opinion of the Board of Tax Appeals, determined the right of the taxpayer to claim in his 1932 return deduction for such taxes paid in 1932.

We think the underlying purpose of the Congress in enacting paragraph 13d of the Revenue Act of 1916 (ch. 463, 39 Stat., 756, et seq.), authorizing the tax return to be made on the basis on which the taxpayer's books were kept, providing only that the basis was one reflecting income, should have a decisive bearing upon the decision of the question here presented. The Supreme Court, in *United States* v. *Anderson* (269 U. S., 422, 440 [T. D. 3839, C. B. V–1, 179 (1926)]), has made a very clear statement of that purpose:

"It was to enable taxpayers to keep their books and make their returns according to scientific accounting principles, by charging against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period."

The record sustains the claim of the taxpayer that his books and the returns based thereon "charged against income earned during the taxable period the expenses incurred in and properly attributable to the process of earning income during that period." This being so, the purpose at least of the congressional act

has been satisfied. We are, therefore, relegated to an examination of the appropriate mechanics incidental to the execution of this taxing law. In so doing we are to decide whether, under the Nebraska law, the assessment and levy in 1931 or the impressment of the tax lien in 1932, coupled with the ownership of the property, was the event which determined the taxpayer's liability for Omaha city real estate taxes, and therefore, the year in which such taxes accrued and were deductible. The Board found this issue in favor of the taxpayer.

It is conceded that, in Nebraska, no personal liability exists at any time for the payment of real estate taxes, and this court in *Lifson et al.* v. *Commissioner* (98 Fed. (2d), 508 [Ct. D. 1409, C. B. 1939-2, 198], certiorari denied, 305 U. S., 662) has held that such taxes "accrue in Minnesota when they become a charge against and a lien upon the land taxed," and that the taxes in that case accrued when they became a lien on the real estate. Such, we have seen, is the rule in Nebraska.

Concurrence in the principle announced by the Board of Tax Appeals is to be found in the decisions of other circuits: *Walsh-McGuire Co.* v. *Commissioner* (6 Cir., 97 Fed. (2d), 983), *Commissioner* v. *Plestcheeff* (9 Cir., 100 Fed. (2d), 62 [Ct. D. 1410, C. B. 1939-2, 200]), *Commissioner* v. *Patrick Cudahy Co.* (7 Cir., 102 Fed. (2d), 930 [Ct. D. 1411, C. B. 1939-2, 202]), and in many other cited cases.

We think the apparent conflict in the decisions arises chiefly in the application of the rule to the facts of the special cases rather than to disagreement with the rule itself. It follows that the decision of the Board of Tax Appeals should be approved and affirmed, and it is so ordered.

ARTICLE 23(c)-2: Federal duties and excise taxes. 1940-44-10469
I. T. 3422

REVENUE ACT OF 1932.

Processing taxes collected by the vendor from the vendee, pursuant to the provisions of section 625 of the Revenue Act of 1932 (now section 3447 of the Internal Revenue Code), and paid to the United States by the vendor are deductible for Federal income tax purposes only by the vendor.

Mim. 3988 (C. B. XI-2, 25 (1932)) modified.

Mimeograph 3988 (C. B. XI-2, 25 (1932)) has been given reconsideration in view of the decision in the case of *Zinsmaster Baking Co.* v. *Commissioner* (109 Fed. (2d), 738).

The next to last paragraph of Mimeograph 3988, under the heading "Title IV—Manufacturers' Excise Taxes," provides as follows:

> In accordance with the provisions of section 625, if any person has, prior to May 1, 1932, made a bona fide contract for the sale, after the tax takes effect, of any article in respect of which a tax is imposed under this title of the Act, and such contract does not permit the adding to the amount to be paid thereunder of the whole of such tax, then (unless the contract prohibits such addition) the vendee shall, in lieu of the vendor, pay so much of the tax as is not permitted to be added to the contract price. *It follows, therefore, that in such a case the tax, although collected by the vendor from the vendee, is actually levied against the vendee and consequently is deductible from the gross income of the vendee.* [Italics supplied.]

In the Zinsmaster Baking Co. case, supra, the Processing Tax Board of Review held that the processing taxes collectible by the vendor from the vendee, pursuant to the provisions of section 625 of the Revenue Act of 1932 (now section 3447 of the Internal Revenue Code), are taxes imposed upon the first domestic processor, and, therefore, the vendor, and not the vendee, is the taxpayer. The decision of the Board was sustained by the Circuit Court of Appeals for the Eighth Circuit.

The Bureau holds that Federal excise taxes upon the manufacture, sale, or distribution of any commodity are deductible, for Federal income tax purposes, only by the person, firm, or corporation upon

whom such taxes are *imposed*. The Zinsmaster Baking Co. case clearly establishes that the vendor, and not the vendee, is the taxpayer in such cases falling under section 625, supra.

In view of the foregoing, Mimeograph 3988 (C. B. XI-2, 25 (1932)) is modified by substituting for the next to last paragraph under the heading "Title IV—Manufacturers' Excise Taxes" (beginning "In accordance with the provisions of section 625") the following paragraph:

In accordance with the provisions of section 625, if any person has, prior to May 1, 1932, made a bona fide contract for the sale, after the tax takes effect, of any article in respect of which a tax is imposed under this title of the Act, and such contract does not permit the adding to the amount to be paid thereunder of the whole of such tax, then (unless the contract prohibits such addition) the vendee shall, in lieu of the vendor, pay so much of the tax as is not permitted to be added to the contract price. *Although the tax is collected by the vendor from the vendee, it is actually levied against the vendor and consequently is deductible only from the gross income of the vendor. It is recognized, of course, that the amount paid to the vendor constitutes an addition to the purchase price and may be taken into consideration in computing the cost of goods sold during the taxable year.* [New material in italics.]

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

ARTICLE 23(e)-1: Losses by individuals. 1940-41-10149
G. C. M. 22272

REVENUE ACT OF 1918.

The subletting of an apartment by a tenant who is required to change his residence to another city is a "transaction entered into for profit." A loss sustained in such a transaction is deductible for Federal income tax purposes.

Recommended that O. D. 42 (C. B. 1, 124 (1919)) be revoked.

Advice is requested whether the conclusion reached in O. D. 42 (C. B. 1, 124 (1919)) is correct.

The ruling published as O. D. 42, supra, holds that the subletting of an apartment by a tenant who is required to change his residence to another city is not a "transaction entered into for profit" under section 214(a)5 of the Revenue Act of 1918, and, therefore, a loss sustained through such a transaction is not deductible from gross income.

In *Heiner* v. *Tindle* (276 U. S., 582: T. D. 4212, C. B. VII-2, 272 (1928)) the Supreme Court of the United States held that where property purchased by a taxpayer as his personal residence is later appropriated exclusively to the production of taxable income a loss resulting from its sale is deductible from gross income under section 214(a)5 of the Revenue Act of 1918; and that the basis for determining the amount of the deductible loss is the fair market value of the property when appropriated to the production of taxable income. The Court stated that the words, "any transaction entered into for profit," as used in section 214(a)5, supra, are broad enough to embrace any action or business operation, such as that with which the Court was concerned, by which property previously acquired is devoted exclusively to the production of taxable income.

In *Schmidlapp* v. *Commissioner* (96 Fed. (2d), 680) the facts were that the taxpayer had leased and occupied an apartment which he abandoned, moving to another. Because he was still responsible for the lease of the first apartment, he retained a broker in an attempt to dispose of it. He was unsuccessful and deducted the rent paid for the first apartment as a loss incurred in a transaction entered into for profit. The Court sustained the Board of Tax Appeals in disallowing the loss. In its opinion the Court cited the case of *Heiner* v. *Tindle*, supra, and said that there existed a difference between a house actually let and one unsuccessfully put upon the market. After citing other cases to the effect that only "in actual letting creates a 'transaction'," the Court stated that "only then does it become impossible for the owner to resume his original occupation."

The case of *Heiner* v. *Tindle*, supra, lays down the test that the transaction is entered into for profit when there is an actual appropriation of the property for rental purposes. The language of the Court in *Schmidlapp* v. *Commissioner*, supra, indicates that the same reasoning should be applied to an apartment which has been leased and then sublet by the original lessee. It is the opinion of this office, therefore, that O. D. 42 is in conflict with the principle announced by the Supreme Court in *Heiner* v. *Tindle*, supra. Accordingly, revocation of O. D. 42 is recommended.

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

ARTICLE 23(e)-1: Losses by individuals. 1940-41-10450
I. T. 3416

REVENUE ACT OF 1918.

In view of G. C. M. 22272 (page 214, this Bulletin), O. D. 42 (C. B. 1, 124 (1919)) is revoked.

SECTION 23(k).—DEDUCTIONS FROM GROSS INCOME: BAD DEBTS.

ARTICLE 23(k)-1: Bad debts.

REVENUE ACTS OF 1932 AND 1934.

Regulations 77 and 86, amended. (See T. D. 4978, page 75.)

ARTICLE 23(k)-1: Bad debts.

REVENUE ACT OF 1934 AND PRIOR REVENUE ACTS.

Recoveries of bad debts charged off in prior years. (See G. C. M. 22163, page 76.)

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

ARTICLE 23(m)-16: Charges to capital and to expense in the case of oil and gas wells. 1940-34-10394 G. C. M. 22224

REVENUE ACTS OF 1924 AND 1926.

Where a contract is entered into between the owner of an oil lease or fee property and another for the assignment of an undivided interest in the lease or fee property in consideration of an agreement by the assignee to drill one or more wells on the land, drilling expenditures made by the assignee are not deductible as expenses but should be capitalized, regardless of whether the assignment was made prior to or after the drilling of the wells.

G. C. M. 10686 (C. B. XI-2, 257 (1932)) modified.

Reconsideration of G. C. M. 10686 (C. B. XI-2, 257 (1932)) has been requested in view of the decision of the United States Circuit Court of Appeals for the Ninth Circuit in the case of *United States* v. *Sentinel Oil Co.* (109 Fed. (2d), 854, certiorari denied, 60 S. Ct., 1095).

The syllabus of G. C. M. 10686, supra, sets out briefly the conclusions reached in that memorandum and reads as follows:

The taxpayer as the assignee of a one-half interest in certain oil leases, the assignment being made in consideration of the drilling of an oil well on the property, may deduct one-half of the intangible cost of drilling the initial well or wells as an expense, or at its option same may be capitalized. The intangible cost of drilling a test well where the taxpayer did not obtain title to the lease until after the well was completed constitutes a capital investment and is not deductible as an expense.

It will be noted that a distinction was drawn between the situation where the assignee receives an assignment of an interest in the lease *prior* to the drilling and the situation where he is not entitled to the assignment *until after* the well is completed. In the first situation, it was held that the assignee might expense his proportionate share of the intangible development cost. In the latter situation, it was held that the assignee must capitalize all of his intangible development cost.

Before discussing the Sentinel Oil Co. case, it is necessary to review a prior decision of the Circuit Court of Appeals for the Ninth Circuit, *State Consolidated Oil Co.* v. *Commissioner* (66 F. (2d), 648, certiorari denied, 290 U. S., 704). There the taxpayer made expenditures in connection with oil drilling operations under a contract by the terms of which the taxpayer was to drill two wells on two lots belonging to the other party to the contract. The proceeds resulting from any oil and gas discovered were to be applied, first, to reimbursing the taxpayer for its expenses in drilling, equipping, and operating the wells, and, second, to paying the landowner $1,400. *Thereafter* the taxpayer was to receive a deed to a one-half interest in the property, which was thenceforth to be jointly operated. The taxpayer contended that it should be allowed to deduct the intangible development costs of drilling these wells as operating expenses. The court held for the Government, saying:

The Commissioner contends, however, that the regulations were not intended to apply to one who drills a well upon land in performance of a contract to

purchase an interest therein. In this contention we concur. The expenditures in controversy were merely to be exchanged for a capital asset or to be recouped out of the land. Nothing in the regulations requires their application to such a case * * *. The argument that the expenditures are similar in principle to expenditures made in drilling on one's own or on leased land, a situation concededly within the regulations, is without merit.

In that case, the taxpayer was not entitled to an assignment of an interest in the property until he had completed the drilling of the wells. However, nothing in the court's opinion indicated that the decision was based upon the time of the assignment.

In the case of *United States* v. *Sentinel Oil Co.*, supra, the court clearly indicated that its decision in *State Consolidated Oil Co.* v. *Commissioner*, supra, was not based upon the fact that the assignment in that case was not made *until after* the drilling of the wells. In the Sentinel Oil Co. case the taxpayer entered into agreements with the owners of three separately owned tracts of real property looking toward the drilling of an oil well on each tract. The taxpayer was assigned an undivided interest in fee in each tract and agreed to drill an oil well on each tract. The taxpayer completed the drilling of two producing wells and one dry hole. The taxpayer claimed a loss for the dry hole drilled, under the authority of *Bliss* v. *Commissioner* (57 F. (2d), 984). The Commissioner contended that the taxpayer could not deduct any part of the loss occasioned by the dry hole until it disposed of its interest in the fee. The court held for the Government, stating in part as follows:

> Perhaps it is unfortunate that we are not furnished with the text of the agreement between the oil company and the original owners of the property, but in the circumstances we can not go behind the following, taken from the agreed statement of the case: "The consideration for the transfer * * * was an understanding between the grantor and the grantee that the latter would proceed to drill an oil well on each tract."
>
> We think this statement compels the conclusion that the drilling costs constituted the purchase price for the undivided interest in the land acquired by appellee, and represented a capital investment. The appellee's investment was therefore in the land, and title to that land remained in appellee throughout the taxable year.
>
> * * * * * * *
>
> This court has already spoken upon the main point in this case in *Consolidated Oil Co.* v. *Commissioner* (9 Cir., 1933, 66 Fed. (2d), 648). * * *
>
> Appellee attempts to distinguish the State Consolidated Oil case from the instant one, by the fact that in the former case title to the property was not to pass until after the property owner had received his $1,400 from the proceeds of the well, while in the instant case title passed upon the execution of the contract. We do not think that this distinction changes the situation. In both cases the drilling expenditures were the consideration for the passing of title to the land.

The court refused to adopt the distinction set out in G. C. M. 10686, supra, and took the view that, regardless of when the assignment is made, if the drilling expenditures are the consideration for the assignment, they must be capitalized.

After reconsidering the question, this office is of the opinion that G. C. M. 10686, supra, is incorrect in so far as it holds that the time of the assignment is determinative. Accordingly, it is held that if, in the type of case considered here, it appears that the drilling expenditures are made by the assignee in consideration of an assignment of an interest in the lease or fee property, all of such expend-

itures should be capitalized regardless of whether the assignment of the interest is made to the assignee prior to or after the drilling of the wells. G. C. M. 10686, supra, is modified to conform with the views expressed herein.

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

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

ARTICLE 23(o)-1: Contributions or gifts by individuals.

REVENUE ACT OF 1934.

Deduction of combined charitable contribution by husband and wife filing joint returns. Validity of article 23(o)-1, Regulations 86. (See Ct. D. 1478, below.)

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

SECTION 43.—PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

ARTICLE 43-2: When charges deductible.

REVENUE ACT OF 1934.

Amounts paid or credited by processors under "Charlotte clause" contracts. (See G. C. M. 22404, page 204.)

PART V.—RETURNS AND PAYMENT OF TAX.

SECTION 51.—INDIVIDUAL RETURNS.

ARTICLE 51-1: Individual returns. 1940-52-10539
(Also Section 23(o), Article 23(o)-1.) Ct. D. 1478

INCOME TAX—REVENUE ACT OF 1934—DECISION OF SUPREME COURT.

1. DEDUCTION—CHARITABLE CONTRIBUTIONS—JOINT RETURN.

A husband and wife filing a joint return are entitled to deduct their combined charitable contributions from their aggregate income, under the provisions of section 51(b)2 of the Revenue Act of 1934.

2. VALIDITY OF REGULATIONS.

Article 23(o)-1 of Regulations 86 is ineffective to deprive husband and wife filing a joint return of the right to deduct their combined charitable contributions from their aggregate income.

3. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Second Circuit (1940) (111 Fed. (2d), 145), affirming decision of the United States Board of Tax Appeals (1939) (40 B. T. A., 229), reversed.

SUPREME COURT OF THE UNITED STATES.

Henry W. Taft and Julia W. S. Taft, petitioners, v. *Guy T. Helvering, Commissioner of Internal Revenue.*

[61 S. Ct., 244.]

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[December 9, 1940.]

OPINION.

Mr. Chief Justice HUGHES delivered the opinion of the Court.

Petitioners, husband and wife, filed joint income-tax returns for the years 1934 and 1935. In computing their aggregate net income under section 51(b) of the Revenue Act of 1934,[1] they made deductions of their combined charitable contributions.[2] The Commissioner ruled that the deductions on account of the wife's charitable contributions should be reduced to 15 per cent of her separate net income and deficiencies were determined accordingly. The Board of Tax Appeals sustained the Commissioner (40 B. T. A., 229) and the circuit court of appeals affirmed. (111 Fed. (2d), 145.)

Because the question is cognate to that presented in the cases of *Helvering* v. *Janney*, No. 36, and *Gaines* v. *Helvering*, No. 113, decided this day [Ct. D. 1479, page 220, this Bulletin], we granted certiorari. October 14, 1940.

The provision for joint returns in section 51(b) of the Revenue Act of 1934 was in substantially the same form as the corresponding provision in the prior Revenue Acts from 1921. The import of that provision is that in making a joint return the husband and wife should report their aggregate gross income and could combine their deductions in reporting their aggregate net income upon which the tax was to be computed. That was the construction placed upon the original provision for joint returns, in the Revenue Act of 1918, by the Solicitor of Internal Revenue. He said in his ruling: "If a single joint return is filed it is treated as the return of a taxable unit and the net income disclosed by the return is subject to both normal and sur tax as though the return were that of a single individual. In cases, therefore, in which the husband or wife has allowable deductions in excess of his or her gross income, such excess may, if joint return is filed, be deducted from the net income of the other for the purpose of computing both the normal and sur tax."[3] We think that this was the intention of Congress in enacting the Act of 1921[4] and the later Acts containing the same provision for joint returns. We think that it was also the fair import of the Treasury regulations under the Act of 1921 and of subsequent regulations prior to 1934.[5]

Respondent places emphasis on the phrasing of article 401 of Regulations 62 under the Act of 1921, that "in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income." The argument stresses the words "to which either is entitled" and it is urged that each spouse is entitled only to deduct 15 per cent of his or her separate net income. But we think that this is an inadmissible construction of the statute and is not a necessary construction of the regulation. Such a construction is inconsistent with the premise of the Solicitor's opinion, above mentioned, that a joint return "is treated as the return of a taxable unit" and the tax is to be laid as though the return were that "of a single individual." The more specific language of the provision in the Act of 1921, which for the present purpose is the same as that in the Act of 1934, affords a stronger basis for this conclusion. It provides specifically for the inclusion of the income of each spouse "in a single joint return" and in that case that "the tax shall be computed on the aggregate income." The principle that the joint return is to be treated as the return of a "taxable unit" and as though it were made by a "single individual" would be violated if in making a joint return each spouse were compelled to calculate his or her charitable contributions as if he or she were making a separate return. The principle of a joint return

[1] 48 Stat., 697.
[2] Section 23(o), 48 Stat., 690
[3] Sol. Op. 90 (C. B. 4, 236 (1921)). See *Helvering* v. *Janney*, No. 36, decided this date.
[4] House Rept. No. 350, Sixty-seventh Congress, first session; Senate Rept. No. 275, Sixty-seventh Congress, first session.
[5] Treasury Regulations Nos. 65 and 69, article 401; Regulations Nos. 74 and 77, article 381.

permitted aggregation of income and deductions and thus overrode the limitations incident to separate returns. We find no indication in article 401 of Regulations 62 under the Act of 1921 of any intention to depart from the Solicitor's view as to the purport of the statute.

In 1935, by article 23(o)–1 of Treasury Regulations 86, the Department sought to require a husband and wife, whether they make "a joint return or separate returns," to base their deduction for charitable contributions on the separate net income of the spouse making them. We are of the opinion that under the Revenue Act of 1934, taken with the meaning we think it had when enacted, petitioners were entitled to the combined deductions they claimed, and that the departmental regulation to the contrary was ineffective to deprive them of that right.

The judgment of the circuit court of appeals is reversed.

MR. JUSTICE ROBERTS took no part in the consideration and decision of this case.

ARTICLE 51–1: Individual returns. (Also Section 117, Article 117–5.)

1940–52–10540
Ct. D. 1479

INCOME TAX—REVENUE ACT OF 1934—DECISION OF SUPREME COURT.

1. DEDUCTION—CAPITAL LOSSES—LIMITATION—JOINT RETURN.

In the case of a joint return by husband and wife, capital losses of one spouse may be deducted from the capital gains of the other, under the provisions of sections 51(b)2 and 117(d) of the Revenue Act of 1934.

2. VALIDITY OF REGULATIONS.

Article 117–5 of Regulations 86, which provides that the limitation on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets, is invalid.

3. DECISION AFFIRMED.

Decision of the United States Circuit Court of Appeals, Third Circuit (1939) (108 Fed. (2d), 564), reversing decision of the United States Board of Tax Appeals (1939) (39 B. T. A., 240), affirmed.

4. DECISION REVERSED.

Decision of the United States Cirquit Court of Appeals, Second Circuit (1940) (111 Fed. (2d), 144), affirming unreported decision of the United States Board of Tax Appeals, reversed.

SUPREME COURT OF THE UNITED STATES.

No. 36. *Guy T. Helvering, Commissioner of Internal Revenue, petitioner,* v. *Walter C. Janney and Pauline F. M. Janney.*

On writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

No. 113. *Chester Gaines and Theresa Gaines, petitioners,* v. *Guy T. Helvering, Commissioner of Internal Revenue.*

[61 S. Ct., 241.]

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[December 9, 1940.]

OPINION.

MR. Chief Justice HUGHES delivered the opinion of the Court.

These cases present the same question, that is, whether under the Revenue Act of 1934, in the case of a joint return by husband and wife, the capital losses of one spouse may be deducted from the capital gains of the other.

In *Helvering* v. *Janney*, the wife realized net gains from the sale of capital assets during 1934, and the husband realized net losses from the sale of capital assets during the same year. They filed a joint income tax return reporting the capital gain, which represented the difference between the wife's adjusted capital gains and the husband's adjusted capital losses. The Commissioner ruled that the husband's losses could not be applied to reduce the gains realized by his wife and accordingly determined a deficiency. The Board of Tax Appeals sustained the Commissioner (39 B. T. A., 240) but the Circuit Court of Appeals for the Third Circuit reversed. (108 Fed. (2d), 564.)

In *Gaines* v. *Helvering*, the husband realized a net gain from the sale of capital assets during 1934, while his wife sustained a net loss from the sale of capital assets. They filed a joint return reporting a capital loss, which represented the difference between the husband's net capital gain and his wife's net capital loss. The Commissioner, as in the Janney case, decided against this adjustment and the Board of Tax Appeals affirmed. The Circuit Court of Appeals for the Second Circuit affirmed the decision of the Board. (111 Fed. (2d), 144.)

In view of the conflict between these decisions, we granted certiorari. (No. 36, 310 U. S., 617; No. 113, October 14, 1940.)

Section 51(b) of the Revenue Act of 1934[1] with respect to the returns of husband and wife provided:

"(b) HUSBAND AND WIFE.—If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—

"(1) Each shall make such a return, or

"(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income."

The same provision in substance is found in the earlier Revenue Acts from that of 1921.[2]

The "aggregate income," to which paragraph 2 of section 51(b) refers, is clearly the aggregate net income as it is the aggregate income on which "the tax is to be computed." In that view the deductions to which either spouse would be entitled would be taken, in the case of a joint return, from the aggregate gross income.

That was the construction placed upon the provision for a joint return in the Revenue Act of 1918 by the Solicitor of Internal Revenue in an opinion rendered in 1921.[3] After considering the terms of the statute and the reasonable inference as to the intent of Congress, the Solicitor concluded:

"From the foregoing it follows that the proper construction of the Revenue Act of 1918 permits a husband and wife living together, at their option, to file separate returns or a single joint return. If a single joint return is filed it is treated as the return of a taxable unit and the net income disclosed by the return is subject to both normal and sur tax as though the return were that of a single individual. In cases, therefore, in which the husband or wife has allowable deductions in excess of his or her gross income, such excess may, if joint return is filed, be deducted from the net income of the other for the purpose of computing both the normal and sur tax."

The terms of the Revenue Act of 1921 made this view even clearer.[4] Treasury Regulations 62, article 401, promulgated under the Revenue Act of 1921, apparently followed the same view. That article provided as to joint returns of husband and wife—

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[1] 48 Stat., 697.

[2] The Revenue Act of 1918, section 223, also provided for a joint return by husband and wife. (40 Stat., 1074.)

Section 223(b) of the Revenue Act of 1921 provided (42 Stat., 250):

"(b) If a husband and wife living together have an aggregate net income for the taxable year of $2,000 or over, or an aggregate gross income for such year of $5,000 or over—

"(1) Each shall make such a return, or

"(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income."

[3] Sol. Op. 90 (C. B. 4, 236 (1921)).

[4] The Committee on Ways and Means of the House of Representatives reported with respect to the provision of the bill which became the Revenue Act of 1921 as follows:

"Section 231 of the bill proposes to amend section 223 of the present law in such a manner as to clear up the doubt now existing as to the right of husband and wife in all cases to make a joint return and have the tax computed on the combined income." (House Rept. No. 350, Sixty-seventh Congress, first session. See, also, Senate Rept. No. 275, Sixty-seventh Congress, first session.)

"Where the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income." [5]

The question as to deductions for losses on sales or exchanges of securities arose under section 23(r)1 of the Revenue Act of 1932.[6] That provided that losses as there described should be allowed only to the extent of gains derived from such sales or exchanges. Nothing was said in this section which in any way affected the provision of the statute as to joint returns by husband and wife. The question in that relation, that is, as to deduction for losses on sales of securities, was submitted to the Commissioner of Internal Revenue and was answered by him on December 29, 1932, as follows:

"The specific question presented is whether the loss sustained by the husband may be applied to offset the same amount of gain realized by the wife in rendering joint income tax return for the year. In reply you are advised that, in the case of a husband and wife living together who file a joint income tax return, the tax liability is computed on the aggregate income as provided by section 51(b)2 of the Revenue Act of 1932, and such joint return is treated as if it was the return of a single individual. The aggregate income in such case would of course embrace the gains as well as the allowable deductions of each spouse. If it is correctly understood from your letter that the gains and losses in the illustration presented are from transactions falling within the same class within the meaning of the statute such as sales of securities not held for a period of more than two years, the loss sustained by the husband would offset the same amount of gain realized by the wife from such source."

This statement by the Commissioner applied the same principle which had previously been followed with respect to deductions in the joint returns of husband and wife, there having been no indication by Congress of any different purpose.

Treasury Regulations No. 77, promulgated under the Act of 1932, contained nothing to the contrary and the regulation theretofore obtaining as to such joint returns was left unchanged. (Article 381.)

The Revenue Act of 1934 continued the prior statutory provisions as to joint returns of husband and wife, and section 117(d) of that Act, as to capital losses, did not purport to alter the rule as to the right of the spouses to deductions in their joint return. Section 117(d) merely limited the amount of losses which could be deducted, as follows:

"(d) LIMITATION ON CAPITAL LOSSES.—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges."

The conclusion of the Commissioner with respect to the Act of 1932, in the opinion above mentioned, was equally applicable to the new Act.

It was not until 1935 that the Treasury Department by article 117–5 of Regulations 86 undertook to provide that "the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets." [7]

We are of the opinion that under the provision of the Act of 1934 as to joint returns of husband and wife, which embodied a policy set forth in substantially the same terms for many years, Congress intended to provide for a tax on the aggregate net income and that the losses of one spouse might be deducted from the gains of the other; and that this applied as well to deductions for capital losses as to other deductions. This, we think, was the meaning of the provision of the Revenue Act of 1934 when it was enacted, and it was subject to change only by Congress, and not by the Department.

In No. 36, the judgment of the circuit court of appeals is affirmed.

In No. 113, the judgment of the circuit court of appeals is reversed and the cause is remanded for further proceedings in conformity with this opinion.

It is so ordered.

Mr. Justice ROBERTS took no part in the consideration and decision of this case.

[5] The same provision was continued in substance in succeeding regulations. Article 401 of Treasury Regulations 65 and 69 under the Revenue Acts of 1924 and 1926; article 381 of Regulations 74 and 77 under the Revenue Acts of 1928 and 1932.

[6] 47 Stat., 183. Section 23(r)1 provided: "Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations)."

[7] It was also in 1935 that the Bureau of Internal Revenue announced the same ruling under the Act of 1932. (G. C. M. 15438, C. B. XIV–2, 156.)

SECTION 55.—PUBLICITY OF RETURNS.

REVENUE ACT OF 1934 AND PRIOR REVENUE ACTS.

Treasury Decision 4873 (C. B. 1938-2, 261), relating to the inspection of certain returns, amended. (See T. D. 4991, page 92.)

REVENUE ACT OF 1934 AND PRIOR REVENUE ACTS.

Treasury Decision 4873 (C. B. 1938-2, 261), relating to the inspection of certain returns, amended. (See T. D. 5019, page 95.)

SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A.—RATES OF TAX.

SECTION 101.—EXEMPTIONS FROM TAX ON CORPORATIONS.

ARTICLE 101(11)-1: Farmers' or other mutual hail, cyclone, casualty, or fire insurance companies or associations.

REVENUE ACTS OF 1928, 1932, AND 1934.

Character of the business actually done as determinative of the right to exemption. (See Ct. D. 1474, page 184.)

SUPPLEMENT B.—COMPUTATION OF NET INCOME.

SECTION 112.—RECOGNITION OF GAIN OR LOSS.

ARTICLE 577: Definitions. 1940-30-10342
G. C. M. 21873

REVENUE ACT OF 1932.

The transaction between the M Corporation and the N Corporation, whereby the former acquired all of the properties of the latter, constituted a reorganization as defined in section 112(i) of the Revenue Act of 1932 and a tax-free exchange under section 112(b)4 of that Act.

G. C. M. 7472 (C. B. IX-1, 184 (1930)) modified. Recommended that the nonacquiescence in *Winston Bros. Co.* v. *Commissioner* (C. B. XIII-2, 38 (1934)) be withdrawn.

An opinion is requested with respect to the effect for Federal income tax purposes of a certain transaction between the M Corporation and the N Corporation.

In 1933 the M Corporation owned $43x$ shares of the N Corporation stock, the N Corporation having issued $49x$ shares of stock which were then outstanding. At that time, the M Corporation (hereinafter referred to as M) submitted an offer to the N Corporation (hereinafter referred to as N) to acquire all of N's properties in exchange for stock

of M. The number of shares of M stock could, however, be reduced by delivery of waivers of the rights of holders and owners of shares of N stock then owned by M to receive upon dissolution of N any moneys or assets which, except for such waivers, would be payable or distributable with respect to N stock, together with the certificates representing such stock. The offer so made was accepted by N, and in consummating the transaction, M decided not to deliver its own stock in exchange for the N shares held by it but, in lieu thereof, to file written waivers as provided in the offer. The M shares actually issued for the N properties amounted to only $3x$ shares, which shares were distributed to the minority stockholders of N.

Under the particular facts involved in this case, it is the opinion of this office that the above-described transaction constituted a reorganization as defined in section 112(i) of the Revenue Act of 1932 and that the transfer was a tax-free exchange within the meaning of section 112(b)4 of that Act.

G. C. M. 7472 (C. B. IX-1, 184 (1930)), wherein it was concluded in a similar situation that the acquiring corporation received the properties (to the extent it held stock in the other corporation) through a distribution in partial liquidation, is modified to accord with the foregoing conclusion, and it is recommended that the nonacquiescence in *Winston Bros. Co.* v. *Commissioner* (29 B. T. A., 905, nonacquiescence, C. B. XIII-2, 38 (1934), affirmed, 76 F. (2d), 381) be withdrawn, such nonacquiescence being inconsistent herewith.

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

SECTION 113(b).—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS: ADJUSTED BASIS.

ARTICLE 113(b)-2: Adjusted basis: Cancellation of indebtedness.

REVENUE ACT OF 1934.

Regulations 86, amended. (See T. D. 5003, page 107.)

ARTICLE 113(b)-3: Adjusted basis: Cancellation of indebtedness: Special cases.

REVENUE ACT OF 1934.

Regulations 86, amended. (See T. D. 5003, page 107.)

ARTICLE 113(b)-4: Substituted basis.

REVENUE ACT OF 1934.

Regulations 86, amended. (See T. D. 5003, page 107.)

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION.

ARTICLE 114–1: Basis for allowance of depreciation and depletion. 1940–48–10499 Ct. D. 1469

INCOME TAX—REVENUE ACT OF 1934—DECISION OF SUPREME COURT.

1. RETURN—"FIRST RETURN"—AMENDMENT FILED AFTER STATUTORY PERIOD FOR FILING ORIGINAL RETURN—ELECTION—ALLOWANCE FOR DEPLETION.

An amended return filed after the expiration of the statutory period for filing the original return is not a "first return" within the meaning of section 114(b)4 of the Revenue Act of 1934, which requires a taxpayer to elect in his "first return" whether allowance for depletion is to be computed with or without regard to percentage depletion.

2. DECISION AFFIRMED.

Decision of the United States Circuit Court of Appeals, Ninth Circuit (110 Fed. (2d), 655), affirming unreported decision of the United States Board of Tax Appeals, affirmed.

SUPREME COURT OF THE UNITED STATES.

J. E. Riley Investment Co., petitioner, v. *Commissioner of Internal Revenue.*
[61 S. Ct., 95.]

On writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[November 12, 1940.]

OPINION.

Mr. Justice DOUGLAS delivered the opinion of the Court.

This case is here on certiorari to resolve the conflict of the decision below (110 Fed. (2d), 655) with *C. H. Mead Coal Co.* v. *Commissioner* (106 Fed. (2d), 388).

Petitioner is engaged in the business of mining gold at Flat, Alaska. The winter mail service to and from that remote place was so uncertain and slow that, in order to avoid delinquency in income tax returns, petitioner's officers were accustomed to use the forms for an earlier year. Consequently petitioner's original return for the calendar year 1934 was filed on a 1933 form which had been mailed to petitioner by the collector at Tacoma, Wash. This return was executed on January 2, 1935, and reached Tacoma on January 29, 1935. When it was executed petitioner did not know of the provision[1] in the Revenue Act of 1934 (48 Stat., 680) allowing percentage depletion. But petitioner did know that unless the law had been changed it was not entitled to depletion, as it had no basis for cost depletion. The collector in sending the 1933 forms had not advised petitioner with respect to percentage depletion. And it was found that if petitioner had known of the statutory provision for percentage depletion, it

[1] Section 114(b)4 provided:

"The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. A taxpayer making his first return under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. The method, determined as above, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer, or of any other person if the basis of the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer, either directly or through one or more substituted bases, as defined in that section."

would have elected to take advantage of it. Petitioner first actually learned of the provision in August, 1935. On March 3, 1936, petitioner filed an amended return for 1934 upon which a deduction of percentage depletion was taken; and it asked for a refund. The Board of Tax Appeals upheld the Commissioner's ruling denying percentage depletion and the circuit court of appeals affirmed.

Section 114(b)4 of the 1934 Act required the taxpayer to elect in his "first return" whether the depletion allowance was to be computed with or without regard to percentage depletion. The method so elected is applicable not only to the year in question but to all subsequent taxable years.

We think that petitioner's amended return, filed on March 3, 1936, was not a "first return" within the meaning of section 114(b)4. By section 53(a)1 of the 1934 Act, the return was due on or before March 15, 1935. By section 53(a)2 the Commissioner was empowered to grant a reasonable extension for filing returns [2] but, so far as applicable here, not exceeding six months. *Haggar Co.* v. *Helvering* (308 U. S., 389 [Ct. D. 1433, C. B. 1940–1, 237]) would compel the conclusion that had the amended return been filed within the period allowed for filing the original return, it would have been a "first return" within the meaning of section 114(b)4. But we can find no statutory support for the view that an amendment making the election provided for in that section may be filed as of right after the expiration of the statutory period for filing the original return.

We are not dealing with an amendment designed merely to correct errors and miscalculations in the original return. Admittedly the Treasury has been liberal in accepting such amended returns even though filed after the period for filing original returns.[3] This, however, is not a case where a taxpayer is merely demanding a correct computation of his tax for a prior year based on facts as they existed. Petitioner is seeking by this amendment not only to change the basis upon which its taxable income was computed for 1934 but to adopt a new method of computation for all subsequent years. That opportunity was afforded as a matter of legislative grace; the election had to be made in the manner and in the time prescribed by Congress. The offer was liberal. But the method of its acceptance was restricted. The offer permitted an election only in an original return or in a timely amendment. An amendment for the purposes of section 114(b)4 would be timely only if filed within the period provided by the statute for filing the original return. No other time limitation would have statutory sanction. To extend the time beyond the limits prescribed in the Act is a legislative not a judicial function.

Strong practical considerations support this position.

If petitioner's view were adopted, taxpayers with the benefit of hindsight could shift from one basis of depletion to another in light of developments subsequent to their original choice. It seems clear that Congress provided that the election must be made once and for all in the first return in order to avoid any such shifts. And to require the administrative branch to extend the time for filing on a showing of cause for delay would be to vest in it discretion which the Congress did not see fit to delegate.

Petitioner urges that this result will produce a hardship here. It stresses the fact that it had no actual knowledge of the new opportunity afforded it by section 114(b)4 of the 1934 Act and that equitable considerations should therefore govern. That may be the basis for an appeal to Congress in amelioration of the strictness of that section. But it is no ground for relief by the courts from the rigors of the statutory choice which Congress has provided.

Finally, petitioner asserts that we can not consider the question of the timeliness of the amended return since before the Board of Tax Appeals and the circuit court of appeals respondent urged only that petitioner's claim was based upon an amended, rather than an original, return. But even on the assumption that that issue did not embrace the question of timeliness, the circuit court of appeals was justified in affirming the decision of the Board of Tax Appeals. Where the decision below is correct it must be affirmed by the appellate court though the lower tribunal gave a wrong reason for its action. (*Helvering* v. *Gowran*, 302 U. S., 238, 245–246 [Ct. D. 1292, C. B. 1938–1, 300].)

Affirmed.

[2] See Treasury Regulations No. 86, articles 53–1 to 53–4, inclusive.

[3] See, for example, Treasury Regulations No. 86, article 43–2, governing the filing of amended returns for the purpose of deducting losses which were sustained during a prior taxable year. (Cf. *Union Metal Mfg. Co.*, 1 B. T. A., 395.)

SECTION 116.—EXCLUSIONS FROM GROSS INCOME.

1940-49-10507
G. C. M. 22383

REVENUE ACT OF 1928.

B, a master of a steamship engaged in coastwise trade between ports of the United States, was not a *bona fide* nonresident citizen of the United States for more than six months of the taxable year within the meaning of section 116(a) of the Revenue Act of 1928, even though he was outside the territorial waters of the United States for 234 days of his taxable year.

G. C. M. 12167 (C. B. XII-2, 126 (1933)) revoked. Recommended that I. T. 2293 (C. B. V-2, 33 (1926)) be modified.

This office has reconsidered G. C. M. 12167 (C. B. XII-2, 126 (1933)) in view of the apparent conflict of that ruling with article 119-4 of Regulations 86, Regulations 94, and Regulations 101. The last sentence of that article reads as follows:

> Except as provided in section 119(a)3, wages received for services rendered inside the territorial limits of the United States and wages of an alien seaman earned on a coastwise vessel are to be regarded as from sources within the United States.

In G. C. M. 12167, supra, it was held that the taxpayer, a master of a steamship engaged in coastwise trade between ports of the United States, was a *bona fide* nonresident citizen of the United States for more than six months of the taxable year within the meaning of section 116(a) of the Revenue Act of 1928, by virtue of the fact that he was absent from the United States and its territorial waters for 234 days during the year in question.

In G. C. M. 22065 (C. B. 1940-1, 100) this office held that to come within the exemption provisions of section 116(a) of the Revenue Act of 1936 a taxpayer must be absent from the United States for more than six full calendar months during the taxable year, and that "fractional parts of months from several trips may not be added together 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, supra, was modified accordingly. Such modification appeared to have the practical effect of barring seamen engaged in coastwise shipping between United States ports from qualifying for the exemption in question.

It is the opinion of this office, however, that in so far as G. C. M. 12167, supra, holds that the wages of a citizen seaman earned on a coastwise vessel while such vessel is out of the United States and its territorial waters are from sources without the United States, it is directly contrary to the rule set forth in the last sentence of article 119-4 of Regulations 101, above quoted, to the effect that wages of an alien seaman earned on a coastwise vessel are to be regarded as from sources within the United States. There appears to be no difference in principle between the case of citizen seamen and the case of alien seamen. This office is of the opinion that the test as to whether wages earned by seamen in coastwise trade are from sources within or without the United States should be the same for all such taxpayers. It is, therefore, believed that the rule set forth in the regulations respecting alien seamen should be applied generally.

Accordingly, it is concluded that wages earned by any seaman while engaged in coastwise trade between American ports should be regarded as from sources within the United States. G. C. M. 12167, supra, is hereby revoked. To the extent that I. T. 2293 (C. B. V-2, 33 (1926)) is inconsistent with the conclusion reached in G. C. M. 22065, supra, and in this memorandum with respect to the computation of time of absence from the United States, it is recommended that it be modified.

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

1940-49-10508
I. T. 3431

REVENUE ACT OF 1926.

I. T. 2293 (C. B. V-2, 33 (1926)) is modified to the extent that it is inconsistent with G. C. M. 22383 (page 227, this Bulletin).

SECTION 117.—CAPITAL GAINS AND LOSSES.

ARTICLE 117-2: Limitations on capital gains and capital losses. 1940-48-10500 Ct. D. 1470

INCOME TAX—REVENUE ACT OF 1932—DECISION OF SUPREME COURT.

1. DEDUCTION — LOSS — LIMITATION ON STOCK LOSSES — PARTNER TRADING IN NONCAPITAL ASSETS FOR PARTNERSHIP AND FOR HIS OWN ACCOUNT.

An individual engaged in the business of trading in securities for his own account and for a partnership of which he was a member is entitled, under section 23(r)1 of the Revenue Act of 1932, to deduct from his gross income the amount of net loss on private transactions in stocks and bonds which were not capital assets, where his distributive share of the noncapital security gains of the partnership exceeded the amount of such loss. The word "gains" in section 23(r)1 includes gains from sales or exchanges of partnership stocks and bonds which are not capital assets as defined in section 101 of the Act.

2. DECISION REVERSED.

Decision of the United States Circuit Court of Appeals, Second Circuit (104 Fed. (2d), 649), affirming decision of the United States Board of Tax Appeals (37 B. T. A., 223), reversed.

SUPREME COURT OF THE UNITED STATES.

Harry H. Neuberger, petitioner, v. *Commissioner of Internal Revenue, respondent.*
[61 S. Ct., 97.]

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[November 12, 1940.]

OPINION.

Mr. Justice MURPHY delivered the opinion of the Court.

Petitioner, a resident of New York, was a member of the New York Stock Exchange. He was engaged in the business of trading in securities on the

floor of the exchange for the partnership of Hilson & Neuberger, of which he was a member, executing orders on behalf of customers of the partnership. In addition he made numerous purchases and sales of securities for his own account.

During the year 1932, the one here in question, Hilson & Neuberger derived a profit of $142,862.29 from the sale of securities which were not capital assets as defined in section 101 of the Revenue Act of 1932. (47 Stat., 169, 191.) The firm had other income of $170,830.65 and deductions of $203,981.78, or net income of $109,651.16. Petitioner's distributive share was $44,158.55. During the same year petitioner sustained a net loss of $25,588.93 on his private transactions in stocks and bonds which were not capital assets as defined in section 101.

In his income tax return for the year 1932 petitioner deducted from gross income the loss of $25,588.93. The Commissioner disallowed the deduction and assessed a deficiency. The Board of Tax Appeals upheld the action of the Commissioner. (37 B. T. A., 223.) On appeal the Second Circuit Court of Appeals affirmed. (104 Fed. (2d), 649.) Because of substantial conflict with *Jennings* v. *Commissioner* (110 Fed. (2d), 945), and *Craik* v. *United States* (31 Fed. Supp., 132), we granted certiorari limited to the questions whether section 23(r)1 of the Revenue Act of 1932 (47 Stat., 169, 183) authorized the claimed deduction and whether, in the event that it did not, the statute as so construed was constitutional. (310 U. S., 655.)

Section 23 of the Revenue Act of 1932 sets out the allowable deductions from gross income. Section 23(r)1 provides:

"Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed [as deductions from gross income] only to the extent of the gains from such sales or exchanges. * * *"

The basic and narrow question is whether, in computing the income of an individual partner, the word "gains" in section 23(r)1 includes gains from sales or exchanges of partnership stocks and bonds which are not capital assets as defined in section 101. We are of opinion that it does

In computing gross income prior to the Revenue Act of 1932, subject to certain limitations a taxpayer was entitled to deduct the full amount of his losses from transactions in securities. (Revenue Act of 1928, sections 23(e), 23(g), 101(b), 113.) But the growing custom of diminishing ordinary income by deducting losses realized on the sale of securities which had shrunk in value, due no doubt to the fall in prices after 1929, led Congress to provide in section 23(r)1 that deductions for such losses should be limited to gains from similar transactions.

That this was the purpose and the only purpose of section 23(r)1 abundantly appears from the report of the Senate Finance Committee accompanying the bill.[1] Nowhere does there appear any intention to deny to a taxpayer who chooses to execute part of his security transactions in partnership with another the right to deductions which plainly would be available to him if he had executed all of them singly. Nowhere is there any suggestion that Congress intended to tax noncapital security gains until they exceeded similar losses. The language of section 23(r)1 does not require such a construction. Nor do the available evidences of Congressional intent indicate such a purpose.

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[1] Report of Senate Finance Committee (Seventy-second Congress, first session), No. 705, page 10:

"Your committee believes that security gains and losses should be segregated, that security losses should be deducted solely from security gains; but that security gains should not be taxed until they actually exceed security losses."

See also report of House Ways and Means Committee (Seventy-second Congress, first session), No. 708, pages 12–13:

"There are no provisions in existing law corresponding to section 23(r). * * * Many taxpayers have been completely or partially eliminating from tax their income from salaries, dividends, rents, etc., by deducting therefrom losses sustained in the stock and bond markets, with serious effect upon the revenue. Your committee is of the opinion that some limitation ought to be placed on the allowance of such losses."

Respondent points out, however, that under sections 181–189 of the Revenue Act of 1932 (49 Stat., 169, 222–223),[2] partnership income is computed on an entity basis, that items of partnership gross income do not appear on a partner's return, that only partnership net income is reflected in the individual partner's income and is reported only in the form of a distributable or distributed share. He contends that since partnership income is computed in the same way as an individual's the deduction afforded by section 23(r)1 to the partnership is a distinct privilege not to be confused or combined with that afforded to the individual. Thus, he argues, the deduction claimed here is inconsistent with the general scheme created for reporting partnership income as well as, in effect, a second or double use of section 23(r)1.

It is not to be doubted that in the enactment of section 23(r)1 Congress intended not only to deal with individual security gains and losses, but also to permit losses suffered in partnership security transactions to be applied against partnership gains in like transactions. It does not follow, however, and the language of the statute does not provide, either expressly or by necessary implication, that losses sustained in an individual capacity may not be set off against gains from identical though distinct partnership dealings. If the individual losses are actually incurred in similar transactions it can not justly be said that the same deduction is taken a second time, or that the real purpose of the statute, which is ultimately to tax the net income of the individual partner, would thereby be impaired.

Sections 181–189 of the Revenue Act of 1932 (49 Stat., 169, 222–223), provide generally for computation and reporting of partnership income. In requiring a partnership informational return although only individual partners pay any tax, Congress recognized the partnership both as a business unit and as an association of individuals. This weakens rather than strengthens respondent's argument that the privileges are distinct or that the unit characteristics of the partnership must be emphasized. (Compare *Jennings* v. *Commissioner*, 110 Fed. (2d), 945; *Craik* v. *United States*, 31 Fed. Supp., 132; *United States* v. *Coulby*, 251 Fed., 982 (affirmed, 258 Fed., 27).) Nor is the deduction claimed here precluded because Congress, in sections 184–188, has particularized instances where partnership income retains its identity in the individual partner's return. The maxim "expressio unius est exclusio alterius" is an aid to construction not a rule of law. It can never override clear and contrary evidences of Congressional intent. (*United States* v. *Barnes*, 222 U. S., 513.)

It is true that the Treasury Department adopted a contrary position and denied the claimed deduction. (G. C. M. 14012, C. B. XIV–1, 145 (1935); I. T. 2892, C. B. XIV–1, 148 (1935).) Under different circumstances great weight has been at-

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[2] SEC. 181. Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

SEC. 182. (a) There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year.

(b) * * *

SEC. 183. The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except that the so-called "charitable contribution" deduction provided in section 23(n) shall not be allowed.

SEC. 184. The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts of dividends and interest specified in section 25 (a) and (b) as are received by the partnership.

SEC. 185. In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement.

SEC. 186. In the case of the members of a partnership the proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under the rules and regulations to be prescribed by the Commissioner with the approval of the Secretary, and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement, but at the rates and in the manner provided in section 101 (a) and (b), relating to capital net gains and losses.

SEC. 187. The benefit of the special deduction for net losses allowed by section 117 shall be allowed to the members of a partnership under regulations prescribed by the Commissioner with the approval of the Secretary.

SEC. 188. The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of the member of a partnership to the extent provided in section 131.

SEC. 189. Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

tached to administrative practice and Treasury rulings, but beyond question they can not narrow the scope of a statute when Congress plainly has intended otherwise. (*Rasquin* v. *Humphreys*, 308 U. S., 54; *Norwegian Nitrogen Products Co.* v. *United States*, 288 U. S., 294.)

It is true, too, that in some cases the characteristics of partnerships as business units have been emphasized (*Forres* v. *Commissioner*, 25 B. T. A., 154; *Wilson* v. *Commissioner*, 17 B. T. A., 976 (appeal dismissed, 55 Fed. (2d), 1086); *Burns* v. *Commissioner*, 12 B. T. A., 1209; *Appeal of Menken*, 8 B. T. A., 1062), while in others the characteristics of partnerships as associations of individuals have been stressed. (*United States* v. *Coulby*, supra. Compare *Bruce* v. *United States*, 18 Fed. Supp., 848.) These cases, not decided under the Revenue Act of 1932 and turning, as they must, on their own peculiar facts, are little aid in ascertaining the effect to be given to section 23(r)1.

It is not true, however, as respondent argues, that the asserted deduction can not be allowed because petitioner has suggested no way to calculate it properly or to import items of gross income from the partnership informational return. The Board of Tax Appeals expressly found the amount of partnership gains from security transactions and the proportion in which petitioner was to share in the profits of the partnership. (37 B. T. A., 223, 224.) Since petitioner's share of these noncapital security gains is greater than his loss of $25,588.93, the limit on deductions set by section 23(r)1 is not exceeded.

Our conclusion that this is the proper construction of section 23(r)1 is confirmed by the action of Congress since 1932. In 1933 Congress amended section 182(a) of the Revenue Act of 1932 to deny to individual partners deductions for partnership losses which had been disallowed in the partnership return, the converse of the instant case. (48 Stat., 195, 209.[3]) More significantly, in 1938, after the Treasury Department had ruled to the contrary (G. C. M. 14012, C. B. XIV-1, 145; I. T. 2892, C. B. XIV-1, 148), Congress expressly provided for the deduction of individual security losses from similar partnership gains. (Revenue Act of 1938, sections 182–183; 52 Stat., 447, 521.[4]) That the amendment of 1933 changed and the Revenue Act of 1938 restored the law of 1932 as we have explained it is plain from the legislative history of the two Acts and of section 23(r)1.

Shearer v. *Burnet* (285 U. S., 228 [Ct. D. 436, C. B. XI-1, 232 (1932)]) is not contrary to the conclusion we reach here. There the decision turned on the proper construction to be given to section 218(a) of the Revenue Act of 1924 (43 Stat., 253, 275), and the court correctly concluded that Congress had not intended to allow the asserted credit.

We conclude that petitioner is entitled to the deduction. The decision of the Second Circuit Court of Appeals is reversed, and the case is remanded with directions to remand to the Board of Tax Appeals for proceedings in conformity with this opinion.

Reversed and remanded.

MR. JUSTICE ROBERTS, MR. JUSTICE BLACK, and MR. JUSTICE DOUGLAS are of opinion that the judgment should be affirmed.

ARTICLE 117-5: Application of section 117 in the case of husband and wife.

REVENUE ACT OF 1934.

Deductibility of capital losses of one spouse from capital gains of the other in joint returns. Validity of article 117-5, Regulations 86. (See Ct. D. 1479, page 220.)

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[3] In Senate Finance Committee Report No. 114 (Seventy-third Congress, first session) accompanying the bill, it is stated at page 7:

"Subsection (d) amends the partnership provisions of existing law. Under existing law the individual members of a partnership are entitled to reduce their individual net incomes by their distributive shares of a net loss incurred by the partnership."

[4] In House Ways and Means Committee Report No. 1860 (Seventy-fifth Congress, third session) accompanying the bill, it is stated at pages 42–43:

"The method of treatment provided in these sections of the bill is a logical corollary of the principle that only the partners as individuals, not the partnership as an entity, are taxable persons and is necessary to give the partners as individuals the benefit of the alternative tax in the case of net long-term capital gains, provided in section 117(c), with respect to such gains realized upon the sale or exchange of partnership capital assets. It should be noted that this method involves a departure from the principle adopted in the Revenue Acts of 1934 and 1936. * * *"

SECTION 162.—NET INCOME.

ARTICLE 162–1: Income of estates and trusts. 1940–35–10400
Mim. 5091

Application of G. C. M. 21799 (C. B. 1940–1, 159) without retroactive effect in certain cases.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., August 1, 1940.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, Heads of Field Divisions of the Technical Staff, and Other Officers and Employees of the Bureau of Internal Revenue Concerned:

1. Reference is made to G. C. M. 21799 (C. B. 1940–1, 159), which held that, under the 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 and not to the beneficiary. In view thereof, I. T. 3352 (C. B. 1940–1, 162) revoked I. T. 2595 (C. B. X–2, 353 (1931)), relating to income of estates and trusts.

2. G. C. M. 21799 revoked G. C. M. 8724 (C. B. X–2, 197 (1931)) and G. C. M. 15401 (C. B. XIV–2, 242 (1935)), both of which held that the entire income was currently distributable to the beneficiary and taxable to him in the year of actual receipt. G. C. M. 21799, supra, therefore, conforms to the decision of the Circuit Court of Appeals for the Tenth Circuit in *Commissioner* v. *Mason L. Dean* (102 Fed. (2d), 699), affirming *Dean* v. *Commissioner* (35 B. T. A., 839, acquiescence, C. B. 1940–1, 2).

3. Prior to the issuance of G. C. M. 21799, the Bureau followed the ruling contained in G. C. M. 15401, supra, which was contrary to the decision of the Board of Tax Appeals in *Augustus H. Eustis* v. *Commissioner* (30 B. T. A., 820), the facts of which, in so far as material, were the same as in the Dean case. Originally, acquiescence in the Eustis case was published in C. B. XIII–2, 7 (1934) and upon issuance of G. C. M. 15401, nonacquiescence was published in C. B. XIV–2, 30 (1935). In view of the decision in the Dean case, the facts of which, as stated, paralleled those of the Eustis case, acquiescence in the latter was republished in C. B. 1940–1, 2.

4. It appears that since 1931 many taxpayers have cooperated with the Bureau in following the principles outlined in G. C. M. 8724 and G. C. M. 15401 and returns have been filed by both the trusts and the beneficiaries in accordance with such principles. To apply G. C. M. 21799, supra, without retroactive effect will obviate the necessity of disturbing returns filed pursuant to G. C. M. 8724 and G. C. M. 15401, and will provide a simple and practical method

of transition from compliance with the rulings contained in G. C. M. 8724 and G. C. M. 15401 to that contained in G. C. M. 21799, supra.

5. In view of the foregoing, the Bureau will not apply the provisions of G. C. M. 21799, supra, to returns for taxable years ended prior to January 1, 1940, if

(1) The trust has deducted in its returns for such years, as distributable within the current year, the entire net income to be distributed, including that to be distributed in the succeeding year, in accordance with the principles of G. C. M. 8724 and G. C. M. 15401, and the beneficiaries have correspondingly included in their net income such entire net income of the trust as and when it became distributable to them; and

(2) The beneficiaries agree to include that portion of the income of the trust for the last year ended prior to January 1, 1940, which becomes distributable after the close of such year in their returns for the year in which such portion becomes distributable.

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

TIMOTHY C. MOONEY,
Acting Commissioner.

Approved August 1, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

SUPPLEMENT G.—INSURANCE COMPANIES.

SECTION 203(a).—NET INCOME OF LIFE INSURANCE COMPANIES: GENERAL RULE.

ARTICLE 203(a)(2)-1: Reserve funds. 1940-52-10536
Ct. D. 1477

INCOME TAX—REVENUE ACT OF 1932—DECISION OF SUPREME COURT.

1. NET INCOME—DEDUCTIONS—DISABILITY RESERVES OF LIFE INSURANCE COMPANY INCLUDED IN "RESERVE FUNDS REQUIRED BY LAW."

In computing taxable net income under section 203(a)2 of the Revenue Act of 1932, a life insurance company issuing policies of combined life, health, and accident insurance is entitled to deduct from gross income a percentage of the mean of its reserves maintained for disability benefits as well as for death benefits, both such reserves being included within the term "reserve funds required by law" as used in that section.

2. DECISION AFFIRMED.

Decision of the United States Circuit Court of Appeals, Fifth Circuit (1940) (111 Fed. (2d), 366), affirming decision of the United States Board of Tax Appeals (1938) (38 B. T. A., 1430), affirmed.

SUPREME COURT OF THE UNITED STATES.

Guy T. Helvering, Commissioner of Internal Revenue, petitioner, v. *Pan-American Life Insurance Co.*

[61 S. Ct., 210.]

On writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[December 9, 1940.]

OPINION.

Mr. Justice BLACK delivered the opinion of the Court.

This case involves respondent's income tax for the tax year 1933. It is in all respects governed by our decision in *Helvering* v. *Oregon Mutual Life Ins. Co.*, No. 564, this day decided [Ct. D. 1476, below], and on the authority of that case the decision below is affirmed.

ARTICLE 203(a)(2)–1: Reserve funds. 1940–52–10537
Ct. D. 1476

INCOME TAX—REVENUE ACTS OF 1932 AND 1934—DECISION OF SUPREME COURT.

1. NET INCOME—DEDUCTIONS—DISABILITY RESERVES OF LIFE INSURANCE COMPANY INCLUDED IN "RESERVE FUNDS REQUIRED BY LAW."

In computing taxable net income under section 203(a)2 of the Revenue Acts of 1932 and 1934, a life insurance company issuing policies of combined life, health, and accident insurance is entitled to deduct from gross income a percentage of the mean of its reserves maintained for disability benefits as well as for death benefits, both such reserves being included within the term "reserve funds required by law" as used in that section.

2. CASES DISTINGUISHED.

Helvering v. *Inter-Mountain Life Insurance Co.* (1935) [Ct. D. 950, C. B. XIV–1, 339] (294 U. S., 686) and *Helvering* v. *Illinois Life Insurance Co.* (1936) [Ct. D. 1175, C. B. XV–2, 244] (299 U. S., 88) distinguished.

3. DECISION AFFIRMED.

Decision of the United States Circuit Court of Appeals, Ninth Circuit (1940) (112 Fed. (2d), 468), affirming unreported decision of the United States Board of Tax Appeals, affirmed.

SUPREME COURT OF THE UNITED STATES.

Guy T. Helvering, Commissioner of Internal Revenue, petitioner, v. *Oregon Mutual Life Insurance Co.*

[61 S. Ct., 207.]

On writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[December 9, 1940.]

OPINION.

Mr. Justice BLACK delivered the opinion of the Court.

In computing its net taxable income for 1933 and 1934, respondent took a deduction of 3¾ per cent of the reserves it had set aside with respect to its combined policies of life, health, and accident insurance. Section 203(a)2 of the 1932 and 1934 Revenue Acts permits a life insurance company to deduct from

its gross income "An amount equal to [3¾ per cent] of the mean of the reserve funds required by law * * *." [1] That respondent was a life insurance company as defined by the Revenue Acts and that it was required by law to maintain reserves to protect both death and disability benefits were conceded. The Commissioner allowed a deduction for death reserves, but disallowed as to disability reserves, on the hypothesis that the words "reserve funds required by law" should be construed to apply only to reserves for death losses—thereby excluding disability reserves. The Board of Tax Appeals held the deductions allowable in both respects and reversed the Commissioner.[2] The Court of Appeals for the Ninth Circuit affirmed; [3] certiorari was granted because the Court of Claims had reached an opposite result on the same question.[4]

[NOTE.—Per curiam: The judgment is affirmed upon the first ground set forth in the opinion of the Court of Claims with respect to investment expenses, the views expressed on the second question considered by the Court of Claims as to the right of deduction on account of insurance reserves not being an essential basis for the judgment and being contrary to *Helvering* v. *Oregon Mutual Life Insurance Co.*, No. 564, decided this day.]

Legislative history discloses that a deduction similar to that allowed by section 203(a)2 first appeared in the Revenue Act of 1921,[5] and has reappeared in every revenue measure since, including that of 1939.[6] Prior to 1921, insurance companies had not been allowed such a deduction, but had been subject to the same tax plan as corporations generally; the 1921 Act, however, wholly exempted insurance companies from the general scheme of corporate taxation and set up special systems applicable to them alone.[7] The new plan, as it related to life insurance companies, had as a major objective the elimination of premium receipts from the field of taxable income. It had long been pointed out to Congress that these receipts, except as to a very minor proportion of each premium, were not true income but were analogous to permanent capital investment.[8] In all the Revenue Acts from 1921 through 1939, the gross income of life insurance companies no longer included premium receipts, but was limited to income "from interest, dividends, and rents." [9] And, pursuant to the conceived analogy of reserves to capital investment, net income was to be determined by permitting, among other deductions from gross income, that same deduction here in dispute—a percentage of the "reserve funds required by law."

As entirely new and separate tax provisions relating only to life insurance companies were thus enacted, it became necessary specifically to define what constituted a "life insurance company" within the meaning of the Act. Therefore, it was declared in the 1921 Act and all its successors that "when used in this title the term 'life insurance company' means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds." [10]

Under the Congressional plan, there is granted a deduction based on those "reserve funds required by law." Section 203(a)2 grants this deduction; section 201 defines life insurance companies. It seems clear that Congress intended to permit the deduction of reserves based on those policies that make a company

[1] 47 Stat., 224; 48 Stat., 732.
[2] The opinion is not officially reported; the Board relied on its earlier decisions in *Equitable Life Assurance Society* v. *Commissioner* (33 B. T. A., 708); *Monarch Life Ins. Co.* v. *Commissioner* (38 B. T. A., 716); and *Pan-American Life Inc. Co.* v. *Commissioner* (38 B. T. A., 1430).
[3] 112 Fed. (2d), 468. Other circuits reached a like result: *Commissioner* v. *Pan-American Life Ins. Co.* (111 Fed. (2d), 366 (C. C. A. 5)); *Commissioner* v. *Monarch Life Ins. Co.* (114 Fed. (2d), 314 (C. C. A. 1)).
[4] *New World Life Ins. Co.* v. *United States* (26 Fed. Supp., 444).
[5] 42 Stat., 261, section 245(a)2.
[6] 53 Stat., 72.
[7] The history of this legislation is set out in *National Life Ins. Co.* v. *United States* (277 U. S., 508, 523–524 [T. D. 4206, C. B. VII–2, 296 (1928)]).
[8] See, e. g., S. Rept. No. 617, part 1, page 9, Sixty-fifth Congress, third session.
[9] E. g., section 244(a), Act of 1921 (42 Stat., 261); section 202(a), Act of 1939 (53 Stat., 71).
[10] E. g., section 242, Act of 1921 (42 Stat., 261); section 201, Act of 1939 (53 Stat., 71). The Government contends that the determinative ratio under this section is death reserves to total reserves; the insurance companies contend that the ratio is all reserves on the enumerated types of policies to total reserves. Since Oregon Mutual is admittedly a "life insurance company" regardless of which of these contentions is correct, this question is not before us.

a "life insurance company" under the Act, which, by definition, includes policies of "combined life, health, and accident insurance." The reserves here related to the disability provisions of such combined policies. The same underlying considerations that prompted the deduction for death reserves are applicable to the reserves for disability in these combined policies. And disability as well as death reserves fall literally within the language of the deduction provision. It is not disputed that administrative regulations promulgated under every Revenue Act from 1921 through 1932 recognized the right of life insurance companies to take deductions both for death and for disability reserves on policies such as those here involved.[11] Nor is it denied that the 1934 reenactment of section 203(a)2 followed 13 years of administrative regulation and practice under which substantially identical provisions had been so construed and applied that life insurance companies could and did obtain these deductions. During that entire period, the Treasury found no ambiguity in section 203(a)2, and expressed no doubt as to a life insurance company's right to make such deductions. But on February 11, 1935, regulations were promulgated asserting disability reserves to be nondeductible under the 1934 Act;[12] and on December 18, 1935, a Treasury decision declared that this regulation applied retroactively to the 1932 and earlier Acts.[13] Respondent now says that its former practice in permitting disability reserve deductions was erroneous,[14] and that the new regulation should be given full retroactive effect.

It is the Government's contention that the change in the regulations was particularly appropriate because induced by judicial decision.[15] And it is true that this Court has held that reserves set aside by life insurance companies to protect payment of policy investment purchases can not be used as the basis for deductions.[16] But those decisions rested upon the conclusion that the investment fund features had no relation to the insurance risks. Here, in the combined life and health and accident policies, the health and accident reserves are based upon contingencies of the commencement and continuance of disability. They have a direct and inseparable relationship to the very insurance contracts which bring respondent under a special tax scheme.[17] Nor is there a distinction, as respondent urges, between that part of the reserve set aside to protect policy holders not yet disabled and that part set aside to protect those already disabled. The liability to those who have incurred disability is not a fixed sum, but remains a contingency, still uncertain in duration and amount. Reserves held for such a contingent liability are true reserves in the insurance sense.

We find it unnecessary to discuss the extent to which such a regulation might, under different circumstances, be given retroactive effect by virtue of the statutory power of the Commissioner.[18] Nor do we find it necessary to discuss the argument that the policy behind the special treatment afforded life insurance companies does not warrant allowing this deduction. For it is our conclusion that by section 203(a)2 of the 1932 and 1934 Acts, Congress has granted life insurance companies a deduction for disability reserves which only Congress can take away.[19]

Affirmed.

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[11] Article 681 of Regulations 62, 65, 69, and article 971 of Regulations 74 and 77.

[12] Article 203(a)2 of Regulations 86.

[13] Treasury Decision 4615 (C. B. XIV–2, 310).

[14] In support of the Commissioner's right to change the regulations under this supposed state of facts, the Government cites *Manhattan General Equipment Co.* v. *Commissioner* (297 U. S., 129, 134–135 [Ct. D. 1086, C. B. XV–1, 280 (1936)]) and *Murphy Oil Co.* v. *Burnett* (287 U. S., 299 [Ct. D. 619, C. B. XII–1, 231 (1933)]).

[15] Cf. *Morrissey* v. *Commissioner* (296 U. S., 344, 355 [Ct. D. 1064, C. B. XV–1, 264 (1936)]). The judicial decisions relied on are those cited in the following footnote.

[16] *Helvering* v. *Inter-Mountain Life Ins. Co.* (294 U. S., 686 [Ct. D. 950, C. B. XIV–1, 339 (1935)]); *Helvering* v. *Illinois Life Ins. Co.* (299 U. S., 88 [Ct. D. 1175, C. B. XV–2, 244 (1936)]).

[17] Cf. *Rhine* v. *New York Life Ins. Co.* (273 N. Y., 1); *Rubin* v. *Metropolitan Life Ins. Co.* (278 N. Y., 625).

[18] For the Commissioner's power to promulgate retroactive regulations, respondent relies on section 506 of the Revenue Act of 1934, which amended section 1108(a) of the 1926 Act.

[19] *Biddle* v. *Commissioner* (302 U. S., 573, 582 [Ct. D. 1303, C. B. 1938–1, 309]); *Koshland* v. *Helvering* (298 U. S., 441, 446–447 [Ct. D. 1124, C. B. XV–1, 219 (1936)]).

SUPPLEMENT I.—FOREIGN CORPORATIONS.

SECTION 231.—GROSS INCOME.

ARTICLE 231-2: Exclusion of earnings of foreign ships from gross income.

REVENUE ACT OF 1934 AND PRIOR REVENUE ACTS.

Inclusion of terms "airship or airships" or "airplane or airplanes" in term "ships or ships." (See I. T. 3399, page 156.)

SUPPLEMENT M.—INTEREST AND ADDITIONS TO THE TAX.

SECTION 293.—ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

REVENUE ACT OF 1934 AND PRIOR REVENUE ACTS.

Collectibility, after death of the taxpayer, of 50 per centum addition to tax for fraud. (See G. C. M. 22326, page 159.)

SUPPLEMENT O.—OVERPAYMENTS.

SECTION 322.—REFUNDS AND CREDITS.

ARTICLE 322-3: Claims for refund by taxpayers.

REVENUE ACT OF 1928.

Account stated. (See Ct. D. 1464, page 195.)

EMPLOYMENT TAXES.

INTERNAL REVENUE CODE.

CHAPTER 9, SUBCHAPTER A.—EMPLOYMENT BY OTHERS THAN CARRIERS.

SECTIONS 1400 AND 1410: Rate of tax.
REGULATIONS 106, SECTION 402.303: When employees' tax attaches.

Bonus payments made pursuant to profit-sharing bonus plan. (See S. S. T. 400, page 263.)

SECTIONS 1400 AND 1410: Rate of tax.
REGULATIONS 106, SECTION 402.403: When employers' tax attaches.

Bonus payments made pursuant to profit-sharing bonus plan. (See S. S. T. 400, page 263.)

SECTION 1401: Deduction of tax from wages. 1940–53–10544
REGULATIONS 106, SECTION 402.705: Special refunds of employees' tax on wages over $3,000. Mim. 5142

Special refunds of employees' tax on wages over $3,000.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., December 13, 1940.

Collectors of Internal Revenue and Others Concerned:

1. Section 1401(d) of the Internal Revenue Code, as added by section 602(b) of the Social Security Act Amendments of 1939, provides as follows:

> If by reason of an employee rendering service for more than one employer during any calendar year after the calendar year 1939, the wages of the employee with respect to employment during such year exceed $3,000, the employee shall be entitled to a refund of any amount of tax, with respect to such wages, imposed by section 1400, deducted from such wages and paid to the collector, which exceeds the tax with respect to the first $3,000 of such wages paid. Refund under this section may be made in accordance with the provisions of law applicable in the case of erroneous or illegal collection of the tax; except that no such refund shall be made unless (1) the employee makes a claim, establishing his right thereto, after the calendar year in which the employment was performed with respect to which refund of tax is claimed, and (2) such claim is made within two years after the calendar year in which the wages are paid with respect to which refund of tax is claimed. No interest shall be allowed or paid with respect to any such refund. (Section 1401(d), Internal Revenue Code, as added by section 602(b), Social Security Act Amendments of 1939.)

2. Section 402.705 of Regulations 106 contains the regulations with respect to claims filed under section 1401(d) of the Code. The provisions of section 402.705 of Regulations 106 are summarized as follows:

(*a*) If an employee receives wages in excess of $3,000 from two or more employers for services performed during the calendar year 1940 or any subsequent calendar year, the employee may file a claim for refund of the amount, if any, by which the employees' tax deducted and paid to a collector with respect to such wages exceeds the employees' tax with respect to the first $3,000 of such wages.

(*b*) Each claim shall be made with respect to wages for services performed within one calendar year.

(*c*) The employee shall submit with the claim a statement from each employer for whom he performed services during the calendar year. If the statement of any employer is not submitted with the claim, the employee shall include in the claim an explanation of his inability to submit such statement.

(*d*) The employee's claim shall be made on Form 843 and shall be filed with the collector for the district in which the employee resides.

(*e*) No refund will be made under this section unless (1) the employee files a claim, establishing his right thereto, after the calendar year in which the employment was performed with respect to which refund of tax is claimed, and (2) such claim is filed within two years after the calendar year in which the wages are paid with respect to which refund of tax is claimed.

3. It is expected that shortly after January 1, 1941, collectors will receive numerous requests for the proper forms to be used by employees in claiming the special refund of employees' tax on wages over $3,000. Form 843 should be furnished to such employees, and also Form SS–9, "Employer's Statement to Support Employee's Claim for Special Refund of Employees' Tax." Three copies of such statement should be furnished for each employer involved, the original to be attached to the claim when filed and one copy each to be retained by the employer and the employee. The Bureau will furnish an initial supply of Form SS–9 to each collector without requisition therefor. Collectors, however, should submit their requisitions for subsequent supplies. If the employee in his request for forms fails to state the number of employers involved he should be furnished six copies of Form SS–9 and advised that if more than two employers are involved additional copies (three for each employer) will be supplied upon request.

4. Before transmitting these claims to the Bureau, a review of the claims and supporting statements shall be made in the collector's office to determine whether the claim has been properly prepared and whether Form SS–9 has been attached for each employer involved. If such Form SS–9 has not been attached, collectors must require that, in lieu of such statement, the claimant include as a part of the claim an explanation of his inability to submit such statement.

5. Since an employee is required to file his claim with the collector for the district in which he resides it is possible that none of the employers concerned will have filed their returns, Form SS–1a, in that same district. However, if any of the employers involved in an employee's claim filed such returns in the same district, such employers' accounts should be certified for the period involved on the reverse side of the employee's claim. Each employer's name should be shown on the reverse side of the claim together with the other data called for by the claim. If more space is necessary to certify employers' accounts, in addition to that on the reverse side of the claim, Form 899 should

be prepared and securely attached to the Form 843. In the case of an employer who filed his return, Form SS–1a, in a district other than that in which the employee resides, the Bureau will communicate with the appropriate collector and request a certification of such employer's account upon receipt of the employee's claim.

6. If an employee files a claim in a district other than that in which he resides the appropriate record will be prepared and certification made with respect to the payments by the employers, if any, who have filed returns, Form SS–1a, in his district and the claim will be forwarded to the Bureau. If no employer has filed such returns in the district in which the claim is filed, the claim should be forwarded to the Bureau. The necessary certifications will then be requested of the appropriate collector.

7. The instructions in paragraph 5 of Mimeograph 4702, which require that related returns should be transmitted with claims, will not apply to employees' claims filed under section 1401(d) of the Internal Revenue Code. It will not be necessary for collectors to transmit any returns to this office with such claims unless they are specifically requested to do so by the Bureau.

8. The instructions in Mimeograph 5137 designated "Form SS–1c (Revised August, 1940)" do not apply to claims filed under section 1401(d) of the Internal Revenue Code. Forms SS–1c will not be prepared or forwarded to the Social Security Board in connection with special refund claims.

9. Correspondence in regard to the procedure outlined herein should refer to the number of this mimeograph and to the symbols A&C:A.

GUY T. HELVERING,
Commissioner.

SECTION 402.705 OF REGULATIONS 106, RELATING TO SPECIAL REFUNDS UNDER SECTION 1401(d) OF THE INTERNAL REVENUE CODE, AS ADDED BY SECTION 602 OF THE SOCIAL SECURITY ACT AMENDMENTS OF 1939.—SPECIAL REFUNDS OF EMPLOYEES' TAX ON WAGES OVER $3,000.

If an employee receives wages in excess of $3,000 from two or more employers for services performed during the calendar year 1940 or any subsequent calendar year, the employee may file a claim for refund of the amount, if any, by which the employees' tax deducted and paid to a collector with respect to such wages exceeds the employees' tax with respect to the first $3,000 of such wages. * * * Each claim shall be made with respect to wages for services performed within one calendar year. The employee shall submit with the claim the best available information establishing, with respect to each employer for whom he performed services during the calendar year, (1) the name and address of such employer, (2) the account number of the employee and the employee's name as reported by the employer on his returns, (3) the amount of wages paid during the calendar year to which the claim relates for services performed by the employee during that year, (4) the amount of wages, if any, paid during each subsequent calendar year for services performed by the employee during the year to which the claim relates, (5) the amount of employees' tax, if any, deducted from such wages during each of such years and paid to the collector, and (6) the address of the collector to whom such tax was paid. Such information shall be furnished, if possible, in the form of statements made by the employers, each of whom should include in his statement the fact that it is made in support of a claim against the United States to be filed by the employee for refund of employees' tax. If the statement of any employer is not submitted with the claim, the employee shall include in the claim an explanation of his inability to submit such statement. Other information may be required, but should be submitted only upon the receipt of a specific request therefor. The employee's claim shall be made on Form 843, in accordance with these regulations and the instructions relating to such form, and shall be filed with the collector for the district in

which the employee resides. No interest will be allowed or paid by the Government on the amount of any refund under this section. No refund will be made under this section unless (1) the employee files a claim, establishing his right thereto, after the calendar year in which the employment was performed with respect to which refund of tax is claimed, and (2) such claim is filed within two years after the calendar year in which the wages are paid with respect to which refund of tax is claimed.

Example: Employee A receives taxable wages in the amount of $2,000 from each of his employers, X, Y, and Z, for services performed during the calendar year 1942, or a total of $6,000 for such year. The first $2,000 of such wages is paid during the calendar year 1942 by employer X, who deducts employees' tax in the amount of $20 from A's wages, and pays such tax to the collector. The second $2,000 of such wages is paid during the calendar year 1942 by employer Y, who pays employees' tax in the amount of $20 to the collector without deducting such tax from A's wages. Employer Z pays $1,000 of such wages to A during the year 1942 and $1,000 during the year 1943. The rate of such tax for the year 1942 is 1 per cent and the rate for 1943 is 2 per cent. Employer Z deducts employees' tax in the amount of $30 from such wages ($10 during 1942 and $20 during 1943) and pays such tax to the collector. Thus, employees' tax in the total amount of $50 is deducted from A's wages and paid to a collector. The amount of employees' tax with respect to the first $3,000 of such wages is $30. A may file a claim for refund of $20.

[Form SS–9. Treasury Department. Internal Revenue Service. December, 1940.]

EMPLOYER'S STATEMENT TO SUPPORT EMPLOYEE'S CLAIM FOR SPECIAL REFUND OF EMPLOYEES' TAX.

This statement is made by or on behalf of_____

(Name, address, and identification number of employer.)

hereinafter called the employer, in support of a claim filed, or to be filed, by

(Name and account number of employee.)

hereinafter called the claimant, for special refund of employees' tax under section 1401(d) of the Internal Revenue Code, as added by the Social Security Act Amendments of 1939. The claimant EARNED wages in total amount of $_____ for services performed during the calendar year 194__ in the employ of the employer.[1] Such wages were PAID by the employer in the amounts, and during the calendar year or years, shown below.[2] Employees' tax in the amounts stated below, with respect to such wages, was collected by the employer from the claimant, and the total amount of such employees' tax was paid by the employer to the United States collector of internal revenue. _____

(Address of collector.)

Calendar year of wage payment.[2]	Amount of wages paid to employee during year.	Employees' tax collected and paid to collector.
194_____	$_____	$_____
194_____	_____	_____
194_____	_____	_____
194_____	_____	_____
Totals_	_____	_____

The foregoing statement is correct and complete to the best of my knowledge and belief.

Name of employer (if other than individual)_____.

(Signed) _____

(Title) _____

(Owner, president, partner, etc.)

[1] This statement should be made with respect to services performed in only ONE calendar year. Show the total amount of wages EARNED by the employee in the employ of the employer during that ONE calendar year, WHETHER OR NOT SUCH WAGES WERE PAID.

[2] Show the total amount of wages PAID by the employer to the employee during EACH calendar year for services performed during the ONE calendar year of services covered by this statement.

SECTION 1420: Collection and payment of taxes. 1940-33-10383
REGULATIONS 106, Subpart F: Returns, payment of tax, and records. Mim. 5089
(Also Subchapter C (Federal Unemployment Tax Act), Sections 1604 and 1605; Social Security Act, Sections 807 and 905; Regulations 91 and 90, Chapters IV and III; Subchapter B, Section 1530; Carriers Taxing Act of 1937, Section 7; Regulations 100, Chapter V.)

Power of attorney form for use in granting authority to execute and file returns under Titles VIII and IX of the Social Security Act, Subchapters A and C, Chapter 9, of the Internal Revenue Code (Federal Insurance Contributions Act and Federal Unemployment Tax Act, respectively), as amended, Carriers Taxing Act of 1937, and Subchapter B, Chapter 9, of the Internal Revenue Code. (Superseding Mimeograph 4780 (C. B. 1938-1, 383).)

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., July 25, 1940.

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

The attached form of power of attorney is to be used by taxpayers in granting to an attorney in fact authority confined to the execution and filing of returns under Titles VIII and IX of the Social Security Act, Subchapters A and C, Chapter 9, of the Internal Revenue Code (Federal Insurance Contributions Act and Federal Unemployment Tax Act, respectively), as amended, Carriers Taxing Act of 1937, or Subchapter B, Chapter 9, of the Internal Revenue Code. Such form shall be used in lieu of the power of attorney forms prescribed in Mimeograph 4780 (C. B. 1938-1, 383). However, new powers of attorney authorizing the execution and filing of returns will not be required to replace those already properly executed on forms heretofore prescribed.

The form of power of attorney prescribed in this mimeograph is to be used by the taxpayer *only* to delegate authority to an attorney in fact *to execute and file the returns designated.* It is not to be used, and will not be accepted, for other or additional purposes, such as the delegation of authority to sign claims or to otherwise act for the taxpayer. Powers of attorney other than for the execution and filing of returns should be prepared in accordance with the instructions contained in the Conference and Practice Requirements, Bureau of Internal Revenue, revised August, 1939.

Pursuant to the provisions of Mimeograph 4637 (C. B. 1937-2, 646), which modified Mimeograph 4507 (C. B. XV-2, 540 (1936)), the statement relative to fees, to be filed with each power of attorney, will not be required in this instance.

Collectors should mimeograph a sufficient quantity of the form of power of attorney to meet the needs in their respective districts.

This mimeograph supersedes Mimeograph 4780, supra.

Correspondence relating to this mimeograph should refer to its number and to the symbols A&C: S: F.

TIMOTHY C. MOONEY,
Acting Commissioner.

POWER OF ATTORNEY FOR EXECUTING AND FILING RETURNS UNDER TITLES VIII AND IX OF THE SOCIAL SECURITY ACT, SUBCHAPTERS A AND C, CHAPTER 9, OF THE INTERNAL REVENUE CODE (FEDERAL INSURANCE CONTRIBUTIONS ACT AND FEDERAL UNEMPLOYMENT TAX ACT, RESPECTIVELY), AS AMENDED, CARRIERS TAXING ACT OF 1937, AND SUBCHAPTER B, CHAPTER 9, OF THE INTERNAL REVENUE CODE.

KNOW ALL MEN BY THESE PRESENTS, That _____
(Name.)
_____, located at
(State whether individual, partnership, or corporation, etc.)
_____, _____, _____, has made,
(Street address.) (City.) (State.)
constituted, and appointed, and by these presents does hereby make, constitute, and appoint _____, _____
(Name.) (Address.)
(its) (my) true and lawful attorney for (it) (me) and in (its) (my) name, place and stead to execute and to file on (its) (my) behalf, returns required under
_____
(Indicate whether under Title VIII or IX of the Social Security Act,
_____
Subchapter A or C, Chapter 9, of the Code, as amended, Carriers Taxing
_____
Act of 1937, or Subchapter B, Chapter 9, of the Code.)

In delegating authority to the attorney in fact herein designated to execute and file the returns specified above it is understood that each return executed by such attorney in fact must include the taxable remuneration of ALL employees of the employer-taxpayer for the taxable period covered by the return, regardless of where the employees' services are performed, and that each return must be filed with the collector of internal revenue at _____, in whose district the taxpayer's principal place of business is located.

Dated at _____ this _____ day of _____, 19____.

(If a corporation affix seal)

_____
(Name of taxpayer.)

By _____
(See instructions.)

ATTEST:

_____
(Signature.)

_____
(Title.)

_____
(Title.)

EXECUTED IN THE PRESENCE OF:

_____
(Witness.)

_____
(Witness.)

Acknowledged before me this _____ day of _____, 19____.

[NOTARIAL SEAL] _____, _____
(Signature of officer administering oath.) (Title.)

INSTRUCTIONS.

This form must be filed by the attorney in fact with the first tax return executed by him as such attorney in fact. As this form of power of attorney is not valid for the purpose of representing the taxpayer generally before the Treasury Department, it will not be necessary that a statement relative to fees accompany it.

A power of attorney must be signed by (1) the individual, if the employer is an individual; (2) the president, vice president, or other principal officer, if the employer is a corporation; (3) a responsible and duly authorized member or officer having knowledge of its affairs, if the employer is a partnership or other unincorporated organization; or (4) the fiduciary, if the employer is a trust or estate. The power of attorney must also either be witnessed by two disinterested individuals, or be acknowledged before a notary public or other officer authorized to take acknowledgments.

The taxpayer and the attorney in fact are responsible for the return, or returns, as made and incur liability for the penalties provided for false or fraudulent returns.

SECTION 1420: Collection and payment of taxes. 1940-40-10437
REGULATIONS 106, SECTION 402.602: When to report wages. Mim. 5107
(Also Subchapter C (Federal Unemployment Tax Act), Section 1604; Regulations 107, Section 403.502; and Social Security Act, Section 807, Regulations 91, Article 402½; Section 905, Regulations 90 (as amended), Articles 210 and 300.)

Reporting employment taxes with respect to wages paid in one tax-return period for services in a prior period.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., September 6, 1940.

Collectors of Internal Revenue and Others Concerned:

Employers who have paid wages to employees in the year 1940 for employment in prior years have made numerous inquiries concerning the method of reporting such wages for purposes of the taxes imposed by Titles VIII and IX of the Social Security Act and 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. There appears to be some confusion because of the fact that such wages are paid in a current tax-return period for services performed in prior tax-return periods.

With respect to Title VIII of the Social Security Act and Subchapter A of Chapter 9 of the Internal Revenue Code, as amended, amounts paid in any calendar quarter of 1940 or thereafter as wages for services performed at any time subsequent to December 31, 1936, should be reported by each employer of one or more on the return on Form SS-1a for the quarter in which such wages are paid, in the same manner as wages currently earned and paid during such quarter are reported. For example, if employee A receives $150 during the quarter for services performed during the quarter, and also receives $100 during the quarter for services performed in 1938, employee A's wages should be entered on the quarterly return as $250, and no explanation need be made on the return regarding the periods during which such wages were earned.

Annual returns on Form 940 filed by employers of eight or more under Subchapter C of Chapter 9 of the Internal Revenue Code, as amended, for the calendar year 1939 and for each calendar year thereafter should include all wages paid during such calendar year for employment after December 31, 1938. Thus, wages paid during the year 1940 for services performed after December 31, 1938, should be included in the return on Form 940 filed for the year 1940. A different rule is applicable, however, to wages paid for services performed in the year 1936, 1937, or 1938. If services were performed in 1936, 1937, or 1938, and the employer failed to include in his return on Form 940 for such year the amount of wages payable for such services, the employer must file with the collector of internal revenue an amended return or a statement under oath showing the amount of such wages (regardless of when the wages are paid), and pay the tax with respect to such wages. If wages paid during 1939 with respect

to employment after December 31, 1938, were not included in the return on Form 940 for the year 1939, such wages must be similarly reported to the collector in an amended return or a statement under oath and the tax must be paid.

Statutory provisions limit the applicability of certain taxes herein considered to the first $3,000 of remuneration with respect to employment during any one calendar year paid, as taxable wages, to an individual by an employer with respect to employment during such calendar year. The limitation relates to wages for employment during any one calendar year and not to the amount of remuneration (irrespective of the year of employment) which is paid or received in any one calendar year. For example, assume that employee B earns $3,000 in wages during 1939 and $3,000 in wages during 1940. If wages in the amount of $2,000 were paid to him during 1939, only such $2,000 will be included in his employer's returns on Form SS–1a and Form 940 covering the year 1939. If the remaining wages of $4,000 are paid to B during 1940, the entire $4,000 will be included in his employer's returns on Form SS–1a and Form 940 covering the year 1940. B's employer will not be required to explain on his returns covering 1940 that the amount of $1,000 of the $4,000 was earned in 1939, and that the remainder of $3,000 was earned in 1940. (It should be remembered, however, that there is no similar limitation of $3,000 on the applicability of the tax imposed by Title IX of the Social Security Act with respect to wages earned in the calendar years 1936, 1937, and 1938, or the tax imposed by Subchapter C of Chapter 9 of the Internal Revenue Code, as amended, with respect to wages paid in 1939 for services performed after December 31, 1938.)

Correspondence relating to this mimeograph should refer to its number and the symbols A&C:RR.

GUY T. HELVERING,
Commissioner.

SECTION 1426: Definitions. 1940–29–10330
REGULATIONS 106, SECTION 402.203: Employment after December 31, 1939. S. S. T. 395

Services performed subsequent to December 31, 1939, by officers and members of the crew engaged by the M Company under a contract entered into outside of the United States to operate a cable ship, an American vessel, constitute "employment" for purposes of the taxes imposed by Subchapter A, Chapter 9, Internal Revenue Code, as amended by the Social Security Act Amendments of 1939, since during the year 1940 such ship touched at a port in the United States.

The question is presented whether services performed subsequent to December 31, 1939, by officers and members of the crew of the M Company's cable ship constitute "employment" for purposes of the taxes imposed by Subchapter A, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

The M Company is incorporated under the laws of the State of R. It owns and operates a cable repair ship stationed in waters outside the United States. The officers and members of the crew are employed under a contract which was entered into in the year 1939 at

a port outside the United States. In carrying out its operations during the year 1940, the ship touched at a port in the United States. The question arises as to the period during which the remuneration paid to officers and members of the crew is subject to the taxes imposed under the above-mentioned provisions of law.

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, of whatever nature, performed after December 31, 1939, by an employee for the person employing him, irrespective of the citizenship or residence of either, (A) within the United States, or (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 * * *.

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.

Section 3797(a)9 of the Internal Revenue Code provides as follows:

> *United States.*—The term "United States" when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

Inasmuch as the vessel here involved is owned by a corporation organized under the laws of the State of R and its crew is employed by such corporation, it is an "American vessel" within the meaning of section 1426(g), supra.

Since the cable ship (an American vessel) operated by the M Company touched at a port in the United States during the year 1940, it is held, in view of the provisions of section 1426(b), supra, that all of the services performed subsequent to December 31, 1939, on or in connection with such vessel under the contract of service in effect at the time of touching at the port in the United States, including the services performed both prior and subsequent to the date of touching at such port, constitute "employment" for purposes of the taxes imposed by Subchapter A, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

SECTION 1426: Definitions. 1940-30-10343
REGULATIONS 106, SECTION 402.204: Who are employees. S. S. T. 396
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.204.)

> Individuals, known as piecemakers and skidders, engaged in cutting timber and skidding forest products 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.

Advice is requested whether individuals known as piecemakers and skidders performing services 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 M Company is engaged in a general logging business consisting of the production and sale of logs, ties, pulpwood, posts, and poles. Individuals known as piecemakers are engaged under oral contracts to cut timber standing on strips of land assigned to them. The strips, which vary from 3 to 10 acres in area, are variously designated by natural boundaries, such as creeks and roads, and by blazing or marking of trees. No other piecemakers are permitted by the company to enter a strip which has been assigned to any piecemaker except as hereinafter indicated. Under the oral contracts, the piecemaker is paid an agreed price per piece for the timber which is converted into specified products of designated length and diameter. The piecemaker furnishes his own tools and, if he desires, may engage his own assistants although the limited area of the strip seldom necessitates such action. He may choose his own hours of labor but it is understood that the contract will be completed within the particular cutting season.

The company also engages individuals known as skidders who drag logs and other forest products by horses or tractors from the place where they are cut to the banking grounds or roads. These individuals are engaged under oral contracts to skid logs and wood products from a particular strip to a designated location. The same general arrangements exist with respect to the skidders as above set out in the case of the piecemakers.

The facts presented further disclose that sometimes piecemakers and skidders, due to illness or other reasons, fail to complete their contract within the cutting season and that, prior to the expiration of the season, other individuals are engaged to complete the work. Also, when the company finds it necessary to expedite operations in a particular area, piecemakers and skidders in other areas are moved to the new scene of operations prior to completion of their original contracts. The company employs a foreman who inspects the various strips to determine whether the operations are being performed in accordance with the terms of the oral contracts. If, in the opinion of the foreman, a piecemaker or skidder is not properly carrying out his contract, the foreman replaces the individual by entering into a new contract with another for the cutting or removal of the wood. At certain times the wood is scaled, the determination of the company being final, and the individuals are then paid. The piecemaker or skidder receives no remuneration for wood which does not meet the specifications or which is skidded or piled improperly.

Based on the foregoing facts, it is the opinion of the Bureau that the piecemakers and skidders, together with any assistants engaged with the express or implied consent of the M Company, are employees of that company for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended.

SECTION 1426: Definitions. 1940-33-10384
REGULATIONS 106, SECTION 402.204: Who are employees. S. S. T. 398
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.204.)

A, who operates the M Patrol Service, is not an employee of the various merchants for whom he performs patrol services within the meaning 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 the merchants for whom he performs patrol services.

A, who operates the M Patrol Service, furnishes patrol services to merchants in the city of R. He enters into a separate agreement with each merchant who engages his services specifying the services to be rendered and the remuneration to be paid. Such services usually consist of examining locks on doors, turning off lights, and lowering awnings. Approximately 60 merchants engage these services and each merchant is at liberty to discontinue the engagement of A at will. Furthermore, the merchants contracting with A do not act as a group in supervising such services, and it is expressly agreed that none of such merchants will require duties of A which can not be carried out in conjunction with his duties to others engaging him. No instructions are given to A as to the manner in which his services are to be performed, the sole requirement being that the specified duties be performed each night. A sometimes engages substitutes and assistants to perform the required services. A furnishes the uniforms, badges, and all other equipment used by him and his assistants.

In S. S. T. 281 (C. B. 1938-1, 413) it was held that the so-called merchants' police under consideration in that case were employees, for purposes of the taxing provisions of the Social Security Act, of the various merchants for whom they performed services. In that case the merchants had the right to direct and control the policemen in the performance of their services. In the instant case, however, the merchants do not, either individually or as a group, retain the right to supervise or control the performance of the duties required of A or his assistants.

On the basis of the facts in this case, it is held that A is not an employee, for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended, of the various merchants for whom he performs services. (See S. S. T. 153, C. B. 1937-1, 390.)

SECTION 1426: Definitions. 1940-36-10411
REGULATIONS 106, SECTION 402.204: Who are employees. S. S. T. 399
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.204.)

A, who contracted to cut, skid, and haul timber for the N Company, was not an employee 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.

Advice is requested whether, for employment tax purposes, A was an employee of the N Company with respect to services performed under contract in cutting, skidding, and hauling timber for that company.

The N Company, owner of a tract of land, entered into a contract with A for removal of the timber therefrom and delivery of the logs to the company's sawmill. The company agreed that A should have the exclusive right to cut, skid, and haul all of the merchantable timber, estimated to approximate several million feet, and A agreed to complete the contract within the specified time. A was paid x dollars per thousand feet of timber cut and delivered.

For purposes of carrying out the terms of the contract, A erected camp buildings at his own expense wherein he housed and fed the logging crew, which was composed of about 30 men who were hired, paid, and controlled by A. He furnished all equipment, including axes, saws, tongs, horses, tractors, and trucks. A had entered into a number of similar contracts with other persons in the past and is known in his locality as a "logging contractor."

Under the contract between A and the N Company, A was given the right and was legally obligated to remove all of the merchantable timber from a certain area. The operations were extensive in character, and required the services of a large crew and the maintenance of a camp for its convenience. All of the equipment, which was of substantial value, was furnished by A, and all of the operating expenses were borne by him. He personally hired and paid the members of the crew and directed and controlled all of the details of their work. Further, he offers his services as a "logging contractor" to the general public.

On the basis of the facts presented, it is held that during performance of the contract A was not an employee of the N Company for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended. A was, however, the employer of the individuals comprising the crew for employment tax purposes. (See S. S. T. 396, page 246, this Bulletin.)

SECTION 1426: Definitions. 1940–38–10425
REGULATIONS 106, SECTION 402.204: Who are employees. S. S.T. 401
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.204.)

B, a "free-lance" jockey who was engaged for one race under oral arrangements with A, a race horse owner, was an employee of such owner 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 B, a "free-lance" jockey who was engaged for one race under oral arrangements with A, a race horse owner, was an employee of A for employment tax purposes.

Under oral arrangements for his services as a jockey, B rode a horse owned by A. He performed no services for A other than the actual riding of the horse in the race. Like services are performed

for other owners. A contends that B should not be classed as his employee but as an independent contractor.

In S. S. T. 311 (C. B. 1938–2, 284) it was held (syllabus):

B, a jockey engaged under contract with A, a race horse owner, is an employee of such owner within the meaning of Titles VIII and IX of the Social Security Act.

The facts involved in the case of a "free-lance" jockey, as distinguished from a jockey under contract to one owner, do not warrant a different conclusion. The jockey does not contract with each owner to produce a desired result by methods of his own choosing, which would be true if an independent contractor relationship existed, but is always subject to control and direction by each owner for whom he rides as to the methods he shall follow in racing the horse. Even though a jockey may be so familiar with the method of riding the horse of a certain owner that it is not necessary for such owner to issue detailed instructions to the jockey, nevertheless the right to direct and control the jockey rests with the owner.

In view of the foregoing, it is held that B is an employee of A for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended.

SECTION 1426: Definitions. 1940–42–10454
REGULATIONS 106, SECTION 402.204: Who are employees. S. S. T. 403
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.204.)

Truck owners and drivers performing services in delivering coal for the M Coal Co. 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.

Advice is requested whether truck owners and drivers performing services in delivering coal for the M Coal Co. 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 M Coal Co. operates several coal yards in the city of R. The company owns a number of trucks which it uses to deliver coal to its customers. The drivers of such trucks have been considered employees of the company and employment taxes have been reported and paid with respect to their wages.

In order to meet the demands for coal during the winter season, it is necessary for the company to engage additional trucking equipment. The company enters into oral agreements with various truck owners who are paid on a tonnage basis. The owners may operate their trucks or engage others to operate them. Expenses incurred in connection with the operation of the trucks (including the wages of any assistants) are borne by the owners. The company engages dispatchers who issue instructions to the drivers with respect to the delivery of coal, such as where and when to make delivery, whom to see at the place of delivery, etc. Such dispatchers have authority to discharge the drivers at any time. The company requires the owner-

operators and drivers engaged by the truck owners to report for duty at a specified time each day, to report when leaving the coal yards, to remain at the yards and wait for hauls, to give notice when they are unable to perform services on any particular day, and to purchase their gasoline from the company. The drivers may be transferred by the company from one of its yards to another. Eight hours constitute a working day but the drivers are required to remain longer if orders of any customers must be filled on a particular day. Public liability insurance covering the drivers is carried by the company. However, the truck owners pay the amounts of the premiums. Although the owner-operators and drivers are occasionally engaged by other concerns, the services performed for the company constitute their main source of income. The names of the drivers are carried on the company's pay roll and the conditions and circumstances under which they perform services are substantially similar to those under which the drivers of company-owned trucks perform services. The agreements may be terminated at any time by either the truck owners or the company.

On the basis of the facts presented, it is held that the truck owners and drivers performing services for the M Coal Co. 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.

SECTION 1426: Definitions. 1940-53-10546
REGULATIONS 106, SECTION 402.204: Who are employees. S. S. T. 408
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.204.)

Special services, in addition to their regular services as trustees, performed by E and F, trustees of the M Trust, constitute "employment" for purposes of the taxes imposed by 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 special services performed for the M Trust by E and F, two of the trustees of that trust, constitute "employment" for Federal employment tax purposes.

Each of the 10 trustees of the M Trust receives a fee of $2x$ dollars for attendance at meetings of the trustees and small allowances for secretarial or appraisal work performed solely in connection with their duties as trustees. In addition to the above amounts, E and F receive compensation for certain special services apart from their regular duties as trustees.

E devotes a substantial amount of time, in addition to attending meetings of the board, to rendering executive and legal services in connection with the management of the trust. For such services the trust pays him a salary of $250x$ dollars a year in addition to his regular fees as trustee. He has no definite duties from month to month but prepares annual reports for and supplies information concerning the trust to the security holders, and renders whatever legal services are required.

F devotes his entire time to his duties for the trust. He has charge of all construction work, maintenance of properties, and similar ac-

tivities. He supervises the reconditioning of trust property which is held for sale. In addition to his regular fees as trustee, he receives a salary of 1,000x dollars a year for his special services.

Under the facts presented in this case, E and F are performing special services in addition to their regular duties as trustees for which they receive added remuneration. Under such circumstances, it is held that the special services performed by E and F constitute "employment" and that they are employees of the M Trust with respect to such services for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended. The amounts of compensation received for such special services, therefore, constitute "wages" subject to the taxes imposed by the above provisions of law.

SECTION 1426: Definitions. 1940-40-10138
REGULATIONS 106, SECTION 402.207: Included and excluded services. S. S. T. 402
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.207.)

Services performed within the United States by the flight personnel of the M Air Lines, operating between foreign and United States airports, constitute "employment" for purposes of the taxes imposed by 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 services performed within the United States by the flight personnel of the M Air Lines, operating between foreign and United States airports, constitute "employment" for purposes of the taxes imposed by Subchapters A and C, Chapter 9 of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

Section 1426(b), Subchapter A, Chapter 9 of the Internal Revenue Code, as amended, provides in part:

EMPLOYMENT.—The term "employment" means * * * any service, of whatever nature, performed after December 31, 1939, by an employee for the person employing him, irrespective of the citizenship or residence of either, (A) within the United States, or (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—

* * * * * * *

(5) Service performed on or in connection with a vesseel not an American vessel by an employee, if the employee is employed on and in connection with such vessel when outside the United States * * *.

Section 1607(c), Subchapter C, Chapter 9 of the Internal Revenue Code, as amended, provides in part:

EMPLOYMENT.—The term "employment" means * * * any service, of whatever nature, performed after December 31, 1939, within the United States by an employee for the person employing him, irrespective of the citizenship or residence of either, except—

* * * * * * *

(4) Service performed as an officer or member of the crew of a vessel on the navigable waters of the United States * * *.

The provisions of sections 1426(b) and 1607(c), supra, are specific in that services performed "within the United States" by an employee for the person employing him, irrespective of the citizenship or residence of either, constitute "employment." The exceptions from "employment" accorded by paragraphs (5) and (4), respectively, of those sections to service performed by an employee on or in connection with a vessel which is not an American vessel, and to service performed as an officer or member of the crew of a vessel on the navigable waters of the United States, do not apply to service performed on or in connection with aircraft. Accordingly, it is held that services performed within the United States by the flight personnel of the M Air Lines, operating between foreign and United States airports, constitute "employment" for purposes of the taxes imposed by Subchapters A and C, Chapter 9 of the Internal Revenue Code, as amended.

Sections 1426(c) and 1607(d), Subchapters A and C, respectively, of Chapter 9 of the Internal Revenue Code, as amended, provide in part as follows:

INCLUDED AND EXCLUDED SERVICE.—If the services performed during one-half or more of any pay period by an employee for the person employing him constitute employment, all the services of such employee for such period shall be deemed to be employment; but if the services performed during more than one-half of any such pay period by an employee for the person employing him do not constitute employment, then none of the services of such employee for such period shall be deemed to be employment. As used in this subsection the term "pay period" means a period (of not more than thirty-one consecutive days) for which a payment of remuneration is ordinarily made to the employee by the person employing him. * * *

In the opinion of the Bureau, sections 1426(c) and 1607(d), supra, were not intended to include as "employment" services performed outside the United States or to exclude from "employment" services performed within the United States on the basis of the relation in quantity of services performed within the United States to the entire services performed both within and without the United States. Accordingly, it is held that such sections are not applicable with respect to the services performed by the flight personnel of the M Air Lines.

SECTION 1426: Definitions. 1940-28-10319
REGULATIONS 106, SECTION 402.208: Agricultural labor. S. S. T. 394
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.208.)

Services performed by employees of the M Company on or after January 1, 1940, in connection with the ginning of cotton, including direct supervision of the ginning process by gin managers, constitute "agricultural labor" within the meaning of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

Clerical services relating to the operation of the enterprise do not constitute "agricultural labor" within the above-mentioned provisions of law.

The question is presented whether services performed by employees of the M Company on or after January 1, 1940, in connection with the operation of its cotton ginning business constitute "agricultural

labor" within the meaning of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended, effective January 1, 1940, by the Social Security Act Amendments of 1939. The services in question include services rendered by gin managers and other employees in the course of the physical process of cotton ginning and clerical services relating to the operation of the ginning business.

Section 1426(h) of Subchapter A, Chapter 9, of the Internal Revenue Code provides in part as follows:

AGRICULTURAL LABOR.—The term "agricultural labor" includes all services performed—

* * * * * * *

(3) * * * in connection with the ginning of cotton * * *.

Section 1607(1) of Subchapter C, Chapter 9, of the Internal Revenue Code contains identical provisions.

It is the opinion of the Bureau that the phrase "the ginning of cotton" refers to a particular operation as distinguished from a business, and that the services contemplated by the above-quoted provisions of law, in order to constitute "agricultural labor," must be rendered directly in connection with that particular operation. Mere connection with the business of which the operation is a part is not sufficient. The ginning of cotton is a physical operation and a service *in connection therewith* is a service which is a *part* of the ginning process. Inasmuch as the actual ginning of cotton is a result of mechanical operation, the law and regulations must refer to the manual labor required to begin and conclude the process as well as services required in the running of the machine itself. It appears that in the ordinary case the process of cotton ginning may well be regarded as beginning with the receiving and weighing of the seed cotton and as ending with the tagging of the bale as it comes from the press.

It is held that services performed by employees of the M Company on or after January 1, 1940, in connection with the ginning of cotton, that is, services which are a part of the ginning process, including direct supervision of the ginning process by gin managers whose services are an integral part thereof, constitute "agricultural labor" within the meaning of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939; and that clerical services relating to the operation of the enterprise, which services are not considered to be a part of the ginning process, do not constitute "agricultural labor" within the meaning of the above-mentioned provisions of law.

It is to be noted that sections 1426(c) and 1607(d) of Subchapters A and C, respectively, Chapter 9, of the Internal Revenue Code, as amended, provide in part as follows:

If the services performed during one-half or more of any pay period by an employee for the person employing him constitute employment, all the services of such employee for such period shall be deemed to be employment; but if the services performed during more than one-half of any such pay period by an employee for the person employing him do not constitute employment, then none of the services of such employee for such period shall be deemed to be employment. As used in this subsection the term "pay period" means a period (of not more than 31 consecutive days) for which a payment of remuneration is ordinarily made to the employee by the person employing him.

These rules should be followed in cases in which a particular employee of the operator of a cotton ginning establishment performs during the same pay period services that constitute "agricultural labor" and services that constitute "employment." For example, if 75 per cent of an employee's time during a pay period is devoted to the operation of the ginning machinery, which services constitute "agricultural labor," and the remainder of his time in such pay period is devoted to clerical duties, which services constitute "employment," all of his services rendered during such period should be deemed to be "agricultural labor" for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended.

SECTION 1426: Definitions. 1940-46-10487
REGULATIONS 106, SECTION 402.208: Agricultural labor. S. S. T. 405
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.208.)

Status of various types of services rendered by employees of a cooperative association of fruit and vegetable growers 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 various types of services rendered by employees of the M Association, a cooperative organization of fruit and vegetable growers, are excepted from "employment" as "agricultural labor" 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 association supervises the activities of its members and performs services from the beginning of the growing period until the products are on their way to market. It employs inspectors who advise the growers with respect to production methods, obtain crop estimates from time to time for financing purposes, and during the packing and processing season supervise the grading and packing of the products and check the condition of those in storage. It aids the growers in financing the growing, harvesting, and processing of their products, purchases materials and supplies, and stores them until needed by the growers, at which time they are distributed to the growers by truck.

The association manufactures spray materials which it sells exclusively to its members at cost. It also manufactures cider and vinegar from apples raised exclusively by its members. It packs apples, pears, cherries, potatoes, and other fruits and vegetables, all of which are raised by its members. The association operates a cannery in which it handles only fruits and vegetables produced by its members, and a cold storage warehouse in which its members' products are held for market after they are processed and packed. Ice is manufactured for freight cars carrying the products to market and some electricity is generated for use in the above-mentioned plants. A reservoir and pipe line owned and operated by the association furnish water for power and other purposes in its plants. The association sells a small amount of ice and furnishes some water to a railroad company for the latter's engines. The net returns from these operations aid in

reducing the cost of the above-mentioned services to the members of the association. The association employs, among others, department managers, sales promotion men, accountants, clerical workers, and maintenance men.

Upon the basis of the facts presented and in view of the provisions of sections 1426(h) and 1607(l) of the Code, as amended, it is held that services performed by employees of the M Association in connection with the cultivation of the soil and the raising and harvesting of products on the farms of its members, and in packing, packaging, processing, grading, storing (including the actual operation of packing and cold storage equipment but not canning equipment), and delivering to storage or to market, or to a carrier for transportation to market, the fruits and vegetables produced by its members, together with services rendered by officers and other employees of the association in the direct supervision of such services, constitute "agricultural labor" for purposes of Subchapters A and C, Chapter 9, of the Code, as amended.

It is also held that services performed by employees of the M Association in connection with the canning of the products of its members, the manufacture of spray materials, cider, vinegar, and ice, the generation of electricity, the operation of the reservoir and pipe line under the circumstances stated, the inspection of members' crops, the furnishing of advice to members, the promotion of sales, the repair of the plants and equipment, and clerical work, together with the supervision of such services, constitute "employment" for purposes of such subchapters.

SECTION 1426: Definitions. 1940-49-10509
REGULATIONS 106, SECTION 402.209: Domestic service. S. S. T. 407
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.209.)

Services performed in the employ of the M University Women's Club in connection with the operation of its clubhouse are not excepted from "employment" under sections 1426(b)2 and 1607(c)2, Subchapters A and C, respectively, of Chapter 9 of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

Advice is requested whether services performed in the employ of the M University Women's Club in connection with the operation of its clubhouse are excepted from "employment" under sections 1426(b)2 and 1607(c)2, Subchapters A and C, respectively, of Chapter 9 of the Internal Revenue Code, as amended.

The M University Women's Club was incorporated under the laws of the State of R to promote friendly intercourse among its members and to provide a place for their professional and social meetings. Its activities consist of maintaining and operating a clubhouse for the use and benefit of the members. In addition to its social program, the club provides a limited number of rooms for the lodging of members and operates a cafe where meals are served to members and their guests. The income, which is derived from dues and house charges levied upon the members, is used to defray operating expenses.

Membership is composed of four classes, referred to as active, associate, life, and nonresident. Active membership is open to women

at the university who are members of the faculty; administrative, scientific, and library staffs; staffs of affiliated organizations of the university; the board of trustees; and adult women of the families of members and former members of the university organizations in the foregoing groups. All active members who sever their connection with the university but continue to reside in the community may, with the approval of the board of directors, retain such membership. Associate membership, which carries all the privileges of active membership except those of voting and holding office, is open to adult women of the families of the members and former members of the university organizations: graduate students and students in the professional schools, including those on part-time university appointments; chaperons of sororities, church houses, and cooperative houses; social workers connected with the student churches and other organizations connected with the university; secretaries of the Y. W. C. A.; and residents of the community not to exceed 10 per cent of the total membership. Life membership is open to any active member upon the payment of x dollars. Nonresident membership is open to all women eligible to active membership who live outside the county in which the university is located, and to former members of the club who, upon moving from the university community, desire such membership.

Section 1426(b), Subchapter A, Chapter 9, of the Internal Revenue Code, as amended, provides in part:

> The term "employment" means * * * any service, of whatever nature, performed after December 31, 1939, by an employee for the person employing him * * * except:
>
> * * * * * * *
>
> (2) Domestic service in a private home, local college club, or local chapter of a college fraternity or sorority * * *.

Section 1607(c), Subchapter C, Chapter 9, of the Internal Revenue Code, as amended, contains a similar provision.

Section 402.209 of Regulations 106, issued pursuant to Subchapter A of Chapter 9 of the Code, as amended, provides in part:

> Services of a household nature performed by an employee * * * in or about the club rooms or house of a local college club * * * by which he is employed, are included within the above exception.
>
> * * * * * * *
>
> A local college club * * * does not include an alumni club * * *.
>
> * * * * * * *
>
> In general, services of a household nature in or about the club rooms or house of a local college club * * * include services rendered by cooks, maids, butlers, laundresses, furnacemen, waiters, and housemothers.

Section 403.209 of Regulations 107, issued pursuant to Subchapter C of Chapter 9 of the Code, as amended, contains substantially the same provisions.

It is apparent that the M University Women's Club is not a student organization but is composed to a large extent of persons whose only connection with the university is through family relationship of members and former members of the various university departments and of persons performing services for organizations only remotely connected with the university proper. Approximately 10 per cent of its membership is composed of individuals whose only qualification is that they reside in the community. Therefore, it is

the opinion of the Bureau that the M University Women's Club is not a "local college club" within the meaning of sections 1426(b)2 and 1607(c)2 of the Code, supra. Accordingly, it is held that the services performed by the individuals in connection with the operation of the clubhouse are not excepted from "employment" by virtue of the above provision of law.

SECTION 1426: Definitions. 1940–45–10478
REGULATIONS 106, SECTION 402.210: Casual labor not in the course of employer's trade or business. Mim. 5121
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.210.)

Rules for determining whether services constitute "casual labor" under section 1426(b)3, Subchapter A, and section 1607(c)3, Subchapter C, of Chapter 9 of the Internal Revenue Code, as such sections were amended, effective January 1, 1940, by sections 606 and 614, respectively, of the Social Security Act Amendments of 1939.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., October 12, 1940.

Collectors of Internal Revenue and Others Concerned:

1. Reference is made to Mimeograph 4847 (C. B. 1938–2, 310), prescribing rules for determining whether services constitute "casual labor" as used in section 811(b)3, Title VIII, of the Social Security Act.

2. The purpose of this mimeograph is to make the rules set forth in Mimeograph 4847 applicable in determining whether services constitute "casual labor" under Subchapters A and C of Chapter 9 of the Internal Revenue Code (Federal Insurance Contributions Act and Federal Unemployment Tax Act, respectively), as amended.

3. Section 1426(b)3 of Subchapter A of Chapter 9 of the Internal Revenue Code, as amended, provides, in part:

> The term "employment" means any service * * * except—
> * * * * * * *
> (3) Casual labor not in the course of the employer's trade or business.

Section 1607(c)3 of Subchapter C of Chapter 9 of the Internal Revenue Code, as amended, contains a similar provision.

4. Section 402.210 of Regulations 106, issued pursuant to Subchapter A of Chapter 9 of the Code, as amended, provides, in part:

> The term "casual labor" includes labor which is occasional, incidental, or irregular.
>
> The expression "not in the course of the employer's trade or business" includes labor that does not promote or advance the trade or business of the employer.
>
> Thus, labor which is occasional, incidental, or irregular, *and* does not promote or advance the employer's trade or business, is excepted.
>
> * * * * * * *
>
> Casual labor, that is, labor which is occasional, incidental, or irregular, but which *is* in the course of the employer's trade or business, does not come within the above exception.
>
> * * * * * * *
>
> Casual labor performed for a corporation does not come within this exception.

Section 403.210 of Regulations 107, issued pursuant to Subchapter C of Chapter 9 of the Code, as amended, similarly provides.

5. The most common examples of cases in which the rules set forth herein will have application are found in those instances in which an individual employs workmen to build, remodel, or repair his home, summer cottage, garage, and other similar structures for his own occupancy and use and not to promote or advance his trade or business.

6. Each of the two rules set forth below is a rule of presumption only. If the presumption raised by either of the rules is that the service to which the rule applies constitutes "employment," then, in accordance with such presumption, the service is not excepted as "casual labor" and should not be treated as such unless and until the employer is advised in writing by the collector of internal revenue or by the Commissioner that on the basis of evidence submitted it has been determined that the presumption has been rebutted. This is true even though the presumption raised under the other rule is that the service constitutes "casual labor." The presumption raised by either of the rules may be rebutted by any employer or employee affected by the rule, or by the Bureau of Internal Revenue. No person is required to submit evidence in rebuttal of any such presumption unless called upon by the Bureau of Internal Revenue to do so. Except in special cases, the controlling presumption in the case will not be disturbed by the Bureau since it is administratively desirable that the question be set at rest in the limited field in which the rules are intended to apply. The rules as stated below cover those situations where the only question involved is whether the service is or is not "casual labor." See paragraph 7 for the application of the rules in any case in which the service being performed by one or more employees is otherwise excepted, as, for example, where a part of the service is performed by a child under the age of 21 in the employ of his father or mother or by an employee who in more than one-half of the same pay period performs service for the same employer which is excepted as "agricultural labor." The rules follow:

RULE A. The term "casual labor" means all service performed by an employee for his employer during a period of one calendar month or any two consecutive calendar months if such service is performed on not more than 10 calendar days, whether or not such days are consecutive. Such service does not constitute "employment," and is not taxable under Subchapters A and C of Chapter 9 of the Internal Revenue Code, as amended, *provided it does not promote or advance the employer's trade or business.* If the employee performs service for the employer on 11 or more calendar days during such period (irrespective of the duration of performance on any such day, and whether or not such days are consecutive), the term "casual labor" does not include any of such service; and, whether or not it promotes or advances the employer's trade or business, all of such service of the employee, including that performed on the first 10 days, constitutes "employment," and is taxable under Subchapters A and C, as amended.

RULE B. If the total number of hours of service performed by all employees of the employer on the particular job or project is more than 200, the term "casual labor" does not include the service (irrespective of its duration) of any such employee. Whether or not it promotes or advances the employer's trade or business, all of such service, including that performed during the first 200 hours, constitutes "employment," and is taxable under Subchapters A and C of Chapter 9 of the Internal Revenue Code, as amended.

7. In computing the total number of hours of service performed on a particular job or project, for purposes of rule B, the hours of serv-

ice of each employee performed thereon must be counted whether or not the service of the employee is otherwise excepted from "employment" under Subchapters A and C of Chapter 9 of the Internal Revenue Code, as amended. For example, service performed by a child under the age of 21 in the employ of his father or mother (which is excepted from "employment" under Subchapters A and C by sections 1426(b)4 and 1607(c)5 thereof, as amended) must be included in computing the total hours of service on the job or project. Although excepted service must be included for the purposes as provided in this paragraph, the operation of the rules is not intended to result in holding services taxable which are otherwise excepted from employment. Thus, in no event should remuneration for service performed by a child under the age of 21 in the employ of his father or mother be reported as taxable wages.

Example (1): A, B, and C are hired as employees of M to construct an addition to M's home. C is M's 18 year old son. A and B each work 70 hours on the project, or an aggregate of 140 hours. C works 65 hours on the project. C's hours of service must be added to those of A and B in determining the total number of hours of service on the project, bringing the total to 205 hours. Applying rule B, the services of A and B constitute "employment" and are taxable, and do not constitute "casual labor," since the total number of hours of service performed by M's employees on the project is more than 200. However, C's service does not constitute "employment" and is not taxable, since his service was performed in the employ of his father before he attained the age of 21. M should report the remuneration of A and B as taxable wages, but not the remuneration of C.

Example (2): N, a farmer and merchant, employs E and F to construct an addition to his home in town. G, one of N's farm hands who has had experience as a carpenter, works with E and F on the project. E and F each work 80 hours on the project, or an aggregate of 160 hours. G works 45 hours on the project and, during the same pay period, works 60 hours on N's farm in service classified as "agricultural labor." Applying the "included and excluded service" provisions contained in sections 1426(c) and 1607(d) of Subchapters A and C, as amended, the 45 hours spent by G on the construction project are not deemed to be "employment" since G's services for N during more than one-half of the pay period do not constitute "employment." However, G's hours of service must be added to those of E and F in determining the total number of hours of service on the project, bringing the total up to 205 hours. Applying rule B, the services of E and F may not be classed as "casual labor." N should report the remuneration of E and F as taxable wages, but not the remuneration of G.

8. Any employer or employee affected who desires to rebut the presumption raised by rule A or B is privileged to submit a complete and detailed written statement of the facts for that purpose. The statement shall be submitted to the collector of internal revenue for the district in which the employer's principal place of business is situated. If the statement is submitted by an employer, it must include—

(*a*) a description of the employer's business, trade, or occupation (or all of his businesses, trades, or occupations, if more than one),

(*b*) a description of the job or project on which the services in question were performed,

(*c*) the date on which his employees began work on the job or project and, if completed or the services of the employees finally terminated, the date of such completion or termination,

(*d*) the total number of hours worked by all of his employees on the job or project,

(*e*) a list of the names, addresses, and social security account numbers of his employees who worked upon it,

(*f*) the number of calendar days on which each employee worked thereon,

(*g*) the total remuneration paid to each employee for his services on the job or project,

(*h*) in the case of each employee who worked on less than 11 calendar days and did not, because of injury, discharge, voluntarily quitting, or any other reason, complete the work to which he was assigned, a statement of the intent of the employer as to the total number of calendar days on which the employee was to work, excluding those on which he actually worked (supported by such additional evidence of that intent as may be available), and

(*i*) any additional facts and grounds bearing upon a determination of whether the service in question constitutes "casual labor."

If the employee submits the case for determination, he must furnish the information called for in (*a*) through (*i*) of this paragraph in as much detail as practicable, and include in his statement the name and address to the employer.

9. It is desired to emphasize that labor which is in the course of the employer's trade or business, that is, *labor which in any way promotes or advances the trade or business of the employer*, is not excepted under Subchapters A and C of Chapter 9 of the Code, as amended. Such labor, even though it may be casual, constitutes "employment," and is taxable under Subchapters A and C, as amended, in so far as sections 1426(b)3 and 1607(c)3, respectively, are concerned. Labor performed for a corporation is considered in every case to promote or advance the purposes of the corporation, and does not, therefore, fall within the exception provided by such sections.

10. Until collectors are advised to the contrary, statements submitted to them by employers and employees in accordance with paragraph 8 shall be forwarded to the Bureau for consideration.

11. Correspondence in regard to the contents of this mimeograph should refer to its number and to the symbols A&C: RR.

GUY T. HELVERING,
Commissioner.

SECTION 1426: Definitions. 1940-43-10461
REGULATIONS 106, SECTION 402.217: Organizations exempt from income tax. S. S. T. 404
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.217.)

Where a student has completed an academic year at a school, college, or university, but has not enrolled for the succeeding year, services performed by him during the period intervening the two academic years in the employ of an organization exempt from income tax under section 101 of the Internal Revenue Code are not excepted from "employment" under sections 1426(b)10(A)iii and 1607(c)10(A)iii of the Code, as amended by the Social Security Act Amendments of 1939.

Advice is requested whether services performed by a student during the summer vacation intervening two academic years in the employ of an organization exempt from income tax under section 101 of the Internal Revenue Code constitute "employment" for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended.

In the particular case presented, the student enrolled for a course of study in a university on September —, 1939, and regularly attended classes, completing the academic year on June —, 1940. During that period he was employed by an organization which has been held exempt from income tax under section 101 of the Internal Revenue Code, and continued in its employ during the months of July and August, 1940. On September —, 1940, he again enrolled in the university for the succeeding academic year. The question arises as to what extent the services of the student constitute "employment" for purposes of Subchapters A and C, supra.

Sections 1426(b) and 1607(c) of the Code, as amended, provide in part as follows:

The term "employment" means any service performed * * * after December 31, 1939, * * * except—

* * * * * * *

(10) (A) Service performed in any calendar quarter in the employ of any organization exempt from income tax under section 101, if—

* * * * * * *

(iii) Such service is performed by a student who is enrolled and is regularly attending classes at a school, college, or university.

Since, during the period September —, 1939, to June —, 1940, the student was enrolled and regularly attended classes at a university, the services performed by him in the employ of the exempt organization clearly were excepted from "employment" under the above provisions of law. However, since the student was not enrolled and did not regularly attend classes at the university during the several months' period intervening the two academic years, it is evident that the exception does not apply. Accordingly, services performed by the student during that period in the employ of the exempt organization constitute "employment" unless otherwise excepted therefrom.

SECTION 1426: Definitions. 1940–37–10417
REGULATIONS 106, SECTION 402.227: Wages. S. S. T. 400
(Also Sections 1400 and 1410; Regulations 106, Sections 402.303 and 402.403; and Subchapter C (Federal Unemployment Tax Act), Sections 1600 and 1607; Regulations 107, Sections 403.227, 403.303.)

Employment tax liability with respect to bonus payments made by the M Bank to the trustees of its employees' profit-sharing bonus plan is incurred at the time such payments are actually or constructively made to the employees. Dividends on the stock purchased and held by the trustees for the benefit of employees, as well as increment in value of such stock, do not constitute "wages."

Inquiry is made whether the taxes imposed under Subchapters A and C of Chapter 9 of the Internal Revenue Code, as amended, attach to bonus payments made by the M Bank at the time such payments are made by the bank to the trustees of the trust fund or at the time payments are made to the individual employees. Inquiry is also made whether dividends and increments on stock purchased by the trustees for the employees constitute "wages" under the above provisions of law.

The bonus plan was established by a resolution of the board of directors of the M Bank. Pursuant to such resolution an amount equal to x per cent of the monthly salary of each permanent, full-time employee is to be set aside by the bank and delivered to the trustees of the plan. Under the terms of the trust agreement, the amounts are irrevocably paid to the trustees. These amounts are to be used to purchase stock of the bank and the account of each employee eligible to share therein is credited with his proportionate share. Taking the month of January, 1940, as an example, the stock purchased with the bonus payment for that month, together with accruals, if any, is to be delivered to the employees by the trustees in December, 1945, unless sooner distributed under some other provision of the plan. Dividends on full shares of stock are paid to the employees. At the time the January payment was made to the trustees, each employee entitled to share therein acquired a contingent interest in such payment, ultimate receipt being defeated if the employee is discharged for cause. Since receipt by any individual employee may be defeated under the conditions of the plan, the amount of the January payment was not actually or constructively paid to the individuals involved.

On the basis of the facts presented, it is held that the taxes imposed under Subchapters A and C of Chapter 9 of the Code, as amended, attach to the bonus payments in question when such payments are actually or constructively made by the trustees to the employees.

It is clear that the M Bank has relinquished all right, title, and interest in the payments made to the trustees, which payments are used to purchase stock of the bank. Accordingly, dividends and other increments accruing during the period the stock purchased is held in trust do not constitute taxable wages since they do not represent payments made by an employer to his employees. The taxable wages of the employees should be computed at the time of payment by the trustees,

and consist of those portions of the value of the stock and the cash attributable to the bank's contributions. Since, as stated, increments accruing during the period (including any increase in value of the stock) do not constitute wages, in no event will the taxable wages of an employee exceed the amount initially contributed by the M Bank to the trustees.

SECTION 1426: Definitions. 1940–48–10495
REGULATIONS 106, SECTION 402.227: Wages. S. S. T. 406
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.227.)

Payments made by the N Company to former employees called for active military service with the armed forces of the United States or who voluntarily enlist for such service, which payments supplement amounts received by them from the Federal Government, do not constitute "wages" for the 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 has arisen whether certain payments made by the N Company to its former employees who are now in the armed forces of the United States constitute "wages" for employment tax purposes.

On June —, 1940, the company's board of directors by resolution adopted the following plan:

Any person in the employ of the company on June —, 1940, who may be called or who voluntarily enlists for a year's active military service with the armed forces of the United States will be paid an amount equal to the difference between the total remuneration paid by the Federal Government and the salary of such person at the time he leaves the company's employ. If the total remuneration paid by the United States Government to these persons is equal to or in excess of such salary, no payment will be made by this company.

All persons in training or in active service will be permitted to continue in group insurance and annuity plans on basis of salary at time of entering military service. If payment is made by this company to the person, deduction will be made from such payments for premiums due; if no payment is made to such person by this company, he shall remit the necessary amount to continue participation in these benefits.

Upon the return of any of these persons, or their release from military service, every effort will be made by the company to reemploy them at former salaries, but the company does not guarantee such reemployment.

The company reserves the right to modify or abolish this plan and to reduce or discontinue payments thereunder at any time.

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." The term "employment" is defined by sections 1426(b) and 1607(c) of such subchapters, respectively, to include any service, of whatever nature, performed within the United States by an employee for the person employing him, with certain enumerated exceptions.

In S. S. T. 49 (C. B. XV-2, 420 (1936)) it was held that payments made by the M Company to its employees equivalent to the difference between the normal wages of the employees who are absent from work while serving in the State National Guard and the amounts received from the State for such services constitute "wages" within the meaning of section 907(b), Title IX, of the Social Security Act. This conclusion is likewise applicable under Title VIII of the Social Security

Act and under Subchapters A and C, Chapter 9, of the Code, as amended. In that case the employment relationship between the M Company and its employees was not disturbed by their temporary service in the National Guard. In the instant case, however, the employment relationship between the individuals and the N Company was terminated when they enlisted or were called for active military service.

It is held that payments made by the N Company, under the provisions of the plan above set forth, to employees called for active military service with the armed forces of the United States, or who enlist in such service, do not constitute "wages" for purposes of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended.

SECTION 1426: Definitions. 1940–31–10357
REGULATIONS 106, SECTION 402.228: Exclusions from wages. S. S. T. 397
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.228.)

Dismissal payments made to employees of the M Company in accordance with the company's employment manual are not excluded from "wages" under sections 1426(a)4 and 1607(b)4 of Subchapters A and C, respectively, Chapter 9, of the Internal Revenue Code, as amended by the Social Security Act Amendments of 1939.

Inquiry is made whether dismissal payments made by the M Company to its employees are excluded from "wages" as defined in Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended.

The provisions of the company's employment manual relating to dismissal payments are as follows:

DISMISSAL PAYMENTS.

Employees whose services with the company are terminated through no fault of their own, except by death, permanent disability, or retirement on pension, shall be paid a dismissal wage based upon age and length of service with the company as provided in the schedule outlined herein. Employees discharged for cause or resigning voluntarily shall not be eligible. * * *

A printed copy of the manual which contains the above provisions is furnished to each new employee. The company reserves the right to amend or abolish the provisions of the manual relating to dismissal payments at any time but, because of established policy, would take no action detrimental to the accrued rights of the employees.

Sections 1426(a)4 and 1607(b)4 of Subchapters A and C, Chapter 9, of the Internal Revenue Code, as amended, define the term "wages" as all remuneration for "employment" except—

* * * Dismissal payments which the employer is not legally required to make.

Section 402.228(*d*) of Regulations 106, promulgated under section 1426(a)4, supra, provides as follows:

DISMISSAL PAYMENTS.—Any payments made by an employer to an employee on account of dismissal, that is, involuntary separation from the service of the employer, are excluded from "wages," provided the employer is not legally bound by contract, statute, or otherwise, to make such payments.

Generally, a contract of employment embraces rules and regulations promulgated by an employer to govern the activities of his employees, provided the employees have notice thereof. (See *Patton* v. *Babson Statistical Organization, Inc.*, 259 Mass., 424, 156 N. E., 534; *Diamond State Iron Co.* v. *Bell*, 16 Delaware, 303, 43 A., 161; *Lehigh Valley R. Co.* v. *Snyder*, 56 N. J. L., 326, 28 A., 376.) In the instant case the M Company gives each employee a printed copy of its employment manual, and it has been and is the policy of the company to make the dismissal payments as provided therein. It appears that such provisions constitute a part of the employees' contracts of employment and that the M Company is "legally required" to make the payments. Accordingly, it is held that the dismissal payments in question are not excluded from "wages" under sections 1426(a)4 and 1607(b)4 of the Internal Revenue Code, as amended.

CHAPTER 9, SUBCHAPTER B.—EMPLOYMENT BY CARRIERS.

REGULATIONS 100. 1940–45–10479
(Also Carriers Taxing Act of 1937.) T. D. 5017

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 410; SUBCHAPTER E, PART 465, SUBPART B.

Regulations 100, and such regulations as made applicable to the Internal Revenue Code by Treasury Decision 4885 [C. B. 1939–1 (Part 1), 396], amended.

Exclusion from the Carriers Taxing Act of 1937 and Subchapter B of Chapter 9 of the Internal Revenue Code of (1) certain services rendered outside the United States and (2) certain services performed in the mining, preparation, handling, or loading of coal.

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

To Collectors of Internal Revenue and Others Concerned:

In order to conform Regulations 100 [Part 410, Title 26, Code of Federal Regulations], relating to the employers' tax, employees' tax, and employee representatives' tax under the Carriers Taxing Act of 1937 (50 Stat., 435; 45 U. S. C., Sup. V, 261 to 273, inclusive), and such regulations as made applicable to the Internal Revenue Code (53 Stat., Part 1; 26 U. S. C., Sup. V) by Treasury Decision 4885 [C. B. 1939–1 (Part 1), 396] [Part 465, Subpart B, of such Title 26, 1939 Sup.], to section 3 of the joint resolution approved June 11, 1940 (Public Resolution No. 81, Seventy-sixth Congress, third session), and to the Act approved August 13, 1940 (Public, No. 764, Seventy-sixth Congress, third session), each of such regulations is amended as follows:

(1) Immediately preceding article 1 [section 410.1, Title 26, Code of Federal Regulations], the following is inserted:

Section 3 of the Joint Resolution approved June 11, 1940 (Public Resolution No. 81, Seventy-sixth Congress, third session).

Subsection (b) of section 1532 of the Internal Revenue Code, approved February 10, 1939 (53 Stat. 1), is hereby amended by substituting for the second proviso therein the following: "*Provided, however,* That an individual shall not be deemed to be in the employment relation to a carrier

unless during the last pay-roll period in which he rendered service to it he was with respect to that service in the service of an employer in accordance with subsection (d) of this section."

Subsection (d) of section 1532 of said Code is hereby amended by changing the period at the end thereof to a colon and adding the following: "*Provided further*, That an individual not a citizen or resident of the United States shall not be deemed to be in the service of an employer when rendering service outside the United States to an employer who is required under the laws applicable in the place where the service is rendered to employ therein, in whole or in part, citizens or residents thereof; and the laws applicable on August 29, 1935, in the place where the service is rendered shall be deemed to have been applicable there at all times prior to that date."

The amendments in this section shall operate in the same manner and have the same effect as if they had been part of the Internal Revenue Code when that Code was enacted on February 10, 1939, and as if they had been part correspondingly of subsections (b) and (d) of the Carriers Taxing Act of 1937 (50 Stat. 435) when that Act was enacted on June 29, 1937.

Sections 1, 3, 4, and 6 of the Act approved August 13, 1940 (Public, No. 764, Seventy-sixth Congress, third session).

That * * * section 1(a) of the Carriers Taxing Act of 1937, section 1532(a) of the Internal Revenue Code, * * * are amended, effective in the case of each such Act as of the date of its enactment, by adding at the end of each such section the following new sentence: "The term 'employer' shall not include any company by reason of its being engaged in the mining of coal, the supplying of coal to an employer where delivery is not beyond the mine tipple, and the operation of equipment or facilities therefor, or in any of such activities."

SEC. 3. * * * section 1(b) of the Carriers Taxing Act of 1937, section 1532(b) of the Internal Revenue Code, * * * are amended, in the case of each such Act as of the date of its enactment, by adding at the end of each such section * * * the following new paragraph:

"The term 'employee' shall not include any individual while such individual is engaged in the physical operations consisting of the mining of coal, the preparation of coal, the handling (other than movement by rail with standard railroad locomotives) of coal not beyond the mine tipple, or the loading of coal at the tipple."

SEC. 4. (a) The laws hereby expressly amended * * * shall operate as if each amendment herein contained had been enacted as a part of the law it amends, at the time of the original enactment of such law.

* * * * * * *

SEC. 6. Nothing contained in this Act, nor the action of Congress in adopting it, shall be taken or considered as affecting the question of what carriers, companies, or individuals, other than those in this Act specifically provided for, are included in or excluded from the provisions of the various laws to which this Act is an amendment.

(2) Immediately following the provisions of law under the caption "Section 1(a) of the Act" preceding article 2 [section 410.2, Title 26, Code of Federal Regulations], the following is inserted:

Sections 1 and 4 of the Act approved August 13, 1940 (Public, No. 764, Seventy-sixth Congress, third session).

That * * * section 1(a) of the Carriers Taxing Act of 1937, section 1532(a) of the Internal Revenue Code, * * * are amended, effective in the case of each such Act as of the date of its enactment, by adding at the end of each such section the following new sentence:

"The term 'employer' shall not include any company by reason of its being engaged in the mining of coal, the supplying of coal to an employer where delivery is not beyond the mine tipple, and the operation of equipment or facilities therefor, or in any of such activities."

SEC. 4. (a) The laws hereby expressly amended * * * shall operate as if each amendment herein contained had been enacted as a part of the law it amends, at the time of the original enactment of such law.

* * * * * * *

(3) Article 2 [section 410.2, Title 26, Code of Federal Regulations] is amended by adding at the end thereof the following new paragraph:

The term "employer" does not include any company by reason of its being engaged in the mining of coal, the supplying of coal to an employer where delivery is not beyond the mine tipple, and the operation of equipment or facilities for such mining or supplying of coal, or in any of such activities.

(4) Immediately following the provisions of law under the caption "Section 1(b) of the Act" preceding article 3 [section 410.3, Title 26, Code of Federal Regulations], the following is inserted:

Section 3 of the Joint Resolution approved June 11, 1940 (Public Resolution No. 81, Seventy-sixth Congress, third session).

Subsection (b) of section 1532 of the Internal Revenue Code, approved February 10, 1939 (53 Stat. 1), is hereby amended by substituting for the second proviso therein the following: "*Provided, however*, That an individual shall not be deemed to be in the employment relation to a carrier unless during the last pay-roll period in which he rendered service to it he was with respect to that service in the service of an employer in accordance with subsection (d) of this section."

* * * * * * *

The amendments in this section shall operate in the same manner and have the same effect as if they had been part of the Internal Revenue Code when that Code was enacted on February 10, 1939, and as if they had been part correspondingly of subsections (b) and (d) of the Carriers Taxing Act of 1937 (50 Stat. 435) when that Act was enacted on June 29, 1937.

Sections 3 and 4 of the Act approved August 13, 1940 (Public, No. 764, Seventy-sixth Congress, third session).

SEC. 3. * * * section 1(b) of the Carriers Taxing Act of 1937, section 1532 (b) of the Internal Revenue Code, * * * are amended, in the case of each such Act as of the date of its enactment, by adding at the end of each such section * * * the following new paragraph:

"The term 'employee' shall not include any individual while such individual is engaged in the physical operations consisting of the mining of coal, the preparation of coal, the handling (other than movement by rail with standard railroad locomotives) of coal not beyond the mine tipple, or the loading of coal at the tipple."

SEC. 4. (a) The laws hereby expressly amended * * * shall operate as if each amendment herein contained had been enacted as a part of the law it amends, at the time of the original enactment of such law.

* * * * * * *

(5) Immediately following the provisions of law under the caption "Section 1(d) of the Act" preceding article 3 [section 410.3, Title 26, Code of Federal Regulations], the following is inserted:

Section 3 of the Joint Resolution approved June 11, 1940 (Public Resolution No. 81, Seventy-sixth Congress, third session).

* * * * * * *

Subsection (d) of section 1532 of said Code [Internal Revenue Code] is hereby amended by changing the period at the end thereof to a colon and adding the following: "*Provided further*, That an individual not a citizen or resident of the United States shall not be deemed to be in the service of an employer when rendering service outside the United States to an employer who is required under the laws applicable in

the place where the service is rendered to employ therein, in whole or in part, citizens or residents thereof; and the laws applicable on August 29, 1935, in the place where the service is rendered shall be deemed to have been applicable there at all times prior to that date."

The amendments in this section shall operate in the same manner and have the same effect as if they had been part of the Internal Revenue Code when that Code was enacted on February 10, 1939, and as if they had been part correspondingly of subsections (b) and (d) of the Carriers Taxing Act of 1937 (50 Stat. 435) when that Act was enacted on June 29, 1937.

(6) Article 3(*a*) [section 410.3(*a*), Title 26, Code of Federal Regulations] is amended by striking out the last paragraph and inserting in lieu thereof the following:

In determining whether an individual is an employee with respect to services rendered within the United States, the citizenship or residence of the individual, or the place where the contract of service was entered into is immaterial.

If an individual performs services for an employer who does not conduct the principal part of his business within the United States, such individual shall be deemed to be in the service of such employer only to the extent that he performs services for him in the United States. Thus, with respect to services rendered for such employer outside the United States, such individual is not in the service of an employer.

If an individual performs services for an employer who conducts the principal part of his business within the United States, he is in the service of such employer whether his services are rendered within or without the United States; except that in the case of an individual, not a citizen or resident of the United States, rendering services in a place outside the United States to an employer who is required under the laws applicable in such place to employ, in whole or in part, citizens or residents thereof, such individual shall not be deemed to be in the service of an employer with respect to services so rendered.

The term "employee" does not include any individual while he is engaged in the physical operations consisting of the mining of coal, the preparation of coal, the handling (other than movement by rail with standard railroad locomotives) of coal not beyond the mine tipple, or the loading of coal at the tipple.

(7) Article 3(*b*)(2) [section 410.3(*b*)(2), Title 26, Code of Federal Regulations] is amended by striking out the last sentence, preceding the parenthetical cross reference at the end thereof, and inserting in lieu thereof the following:

However, an individual shall not be deemed to be in the "employment relation" to a carrier unless during the last pay-roll period in which he rendered service to it, he was with respect to that service "in the service of an employer" (see paragraph (*a*) of this article [section 410.3(*a*), Title 26, Code of Federal Regulations, 1940 Sup.]).

(8) Article 4 [section 410.4, Title 26, Code of Federal Regulations] is amended by striking out the last sentence and inserting in lieu thereof the following:

In determining whether an individual is an employee representative, his citizenship or residence is material only in so far as those factors may affect the determination of whether he was "in the service of an employer" (see article 3(*a*) [section 410.3(*a*), Title 26, Code of Federal Regulations, 1940 Sup.]). The age of the individual is immaterial.

(9) Immediately following article 706 [section 410.706, Title 26, Code of Federal Regulations], the following is inserted:

Section 4(b) of the Act approved August 13, 1940 (Public, No. 764, Seventy-sixth Congress, third session).

No person (as defined in the Carriers Taxing Act of 1937) shall be entitled, by reason of the provisions of this Act, to a refund of, or relief from liability for, any income or excise taxes paid or accrued, pursuant to the provisions of the Carriers Taxing Act of 1937 or Subchapter B of Chapter 9 of the Internal Revenue Code, prior to the date

of the enactment of this Act by reason of employment in the service of any carrier by railroad subject to Part I of the Interstate Commerce Act, but any individual who has been employed in such service of any carrier by railroad subject to Part I of the Interstate Commerce Act as is excluded by the amendments made by this Act from coverage under the Carriers Taxing Act of 1937 and Subchapter B of Chapter 9 of the Internal Revenue Code, and who has paid income taxes under the provisions of such Act or subchapter, and any carrier by railroad subject to Part I of the Interstate Commerce Act which has paid excise taxes under the provisions of the Carriers Taxing Act of 1937 or Subchapter B of Chapter 9 of the Internal Revenue Code, may, upon making proper application therefor to the Bureau of Internal Revenue, have the amount of taxes so paid applied in reduction of such tax liability with respect to employment, as may, by reason of the amendments made by this Act, accrue against them under the provisions of Title VIII of the Social Security Act or the Federal Insurance Contributions Act (Subchapter A of Chapter 9 of the Internal Revenue Code).

ART. 707 [Sec. 410.707, Title 26, Code of Federal Regulations, 1940 Sup.]. *Treatment under section 4(b) of the Act approved August 13, 1940, of taxes with respect to certain services performed in the employ of carriers by railroad.*—Section 4(b) of the Act approved August 13, 1940 (Public, No. 764, Seventy-sixth Congress, third session), provides that no person shall be entitled, by reason of the provisions of such Act, to a refund of, or relief from liability for, taxes paid or accrued prior to August 13, 1940, pursuant to the Carriers Taxing Act of 1937 or Subchapter B of Chapter 9 of the Internal Revenue Code, with respect to employment in the service of any carrier by railroad subject to Part I of the Interstate Commerce Act. (See sections 3 and 4 of the Act of August 13, 1940; and see article 3(*a*) of these regulations [section 410.3(*a*), Title 26, Code of Federal Regulations, 1940 Sup.].) However, under further provisions of such section 4(*b*) the amount of such taxes paid to the collector may in accordance with such section be applied in reduction of the tax liability, under Title VIII of the Social Security Act or under the Federal Insurance Contributions Act (Subchapter A of Chapter 9 of the Internal Revenue Code), incurred by reason of the provisions of the Act of August 13, 1940. In any such case, a claim for credit shall be made on Form 843 in accordance with the instructions relating to such form and the applicable provisions of article 701 [section 410.701, Title 26, Code of Federal Regulations]. There shall be set forth under oath all grounds in detail and all facts alleged in support of the claim including the amount and date of each payment to the collector of the tax for which credit is claimed, the name and address of the person who paid the tax to the collector, and the period covered by the return on which such tax was reported. Such other or additional proof as the Commissioner may deem necessary to establish the right to the credit shall be submitted.

(This Treasury decision is issued under the authority contained in section 12 of the Carriers Taxing Act of 1937 (50 Stat., 440; 45 U. S. C., Sup. V, 272), sections 1535 and 3791 of the Internal Revenue Code (53 Stat., 183, 467; 26 U. S. C., Sup. V, 1535, 3791), section 3 of the joint resolution approved June 11, 1940 (Public Resolution No. 81, Seventy-sixth Congress, third session), and sections 1, 3, 4, and 6 of the Act approved August 13, 1940 (Public, No. 764, Seventy-sixth Congress, third session).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved October 24, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register October 28, 1940, 10.10 a. m.)

SECTION 1530: Collection and payment of taxes.
REGULATIONS 100, Chapter V: Returns and payment of tax.
Power of attorney form. (See Mim. 5089, page 242.)

CHAPTER 9, SUBCHAPTER C.—TAX ON EMPLOYERS OF EIGHT OR MORE.

SECTION 1600: Rate of tax.
REGULATIONS 107, SECTION 403.303: Rate and computation of tax.

Bonus payments made pursuant to profit-sharing bonus plan. (See S. S. T. 400, page 263.)

SECTION 1604: Returns.
REGULATIONS 107, SECTION 403.502: When to report wages.

Wages paid in one tax-return period for services in a prior period. (See Mim. 5107, page 244.)

SECTION 1604: Returns.
REGULATIONS 107, Subpart E: Returns, payment of tax, and records.

Power of attorney form. (See Mim. 5089, page 242.)

SECTION 1605: Payment of taxes.
REGULATIONS 107, Subpart E: Returns, payment of tax, and records.

Power of attorney form. (See Mim. 5089, page 242.)

SECTION 1607: Definitions.
REGULATIONS 107, Section 403.204: Who are employees.

Individuals engaged in cutting timber and skidding forest products for the M Company. (See S. S. T. 396, page 246.)

SECTION 1607: Definitions.
REGULATIONS 107, Section 403.204: Who are employees.

Individuals performing patrol services for merchants. (See S. S. T. 398, page 248.)

SECTION 1607: Definitions.
REGULATIONS 107, Section 403.204: Who are employees.

Logging contractor. (See S. S. T. 399, page 248.)

SECTION 1607: Definitions.
REGULATIONS 107, Section 403.204: Who are employees.

Jockeys. (See S. S. T. 401, page 249.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.204: Who are employees.

Coal haulers. (See S. S. T. 403, page 250.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.204: Who are employees.

Trustees performing special services. (See S. S. T. 408, above.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.207: Included and excluded services.

Services performed within and without the United States. (See S. S. T. 402, page 252.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.208: Agricultural labor.

Services rendered by employees of a cooperative association. (See S. S. T. 405, page 255.)

SECTION 1607: Definitions.
REGULATIONS 107, Section 403.208: Agricultural labor.

Individuals performing services in the ginning of cotton. (See S. S. T. 394, page 253.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.209: Domestic service.

Services performed for the M University Women's Club. (See S. S. T. 407, page 256.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.210: Casual labor not in the course of employer's trade or business.

Casual labor. (See Mim. 5121, page 258.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.217: Organizations exempt from income tax.

Student performing services in the employ of an organization exempt from income tax under section 101 of the Internal Revenue Code. (See S. S. T. 404, page 262.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.227: Wages.

Payments made by employer to former employees serving with the armed forces of the United States. (See S. S. T. 406, page 264.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.227: Wages.

Bonus payments made pursuant to profit-sharing bonus plan. (See S. S. T. 400, page 263.)

SECTION 1607: Definitions.
REGULATIONS 107, SECTION 403.228: Exclusions from wages.

Dismissal payments made by the M Company pursuant to the provisions of its employment manual. (See S. S. T. 397, page 265.)

SECTION 1601: Credits against tax.
REGULATIONS 90 (as amended), ARTICLE 211 (1): Credit against tax for calendar year 1939 for contributions paid.

Credits against, and refunds of, the tax imposed by the Federal Unemployment Tax Act (Subchapter C, Chapter 9, of the Internal Revenue Code) for the calendar year 1939. (See T. D. 5022, page 275.)

SECTION 1610: Other laws applicable.
REGULATIONS 90 (as amended), ARTICLES 503 AND 503½:
Refunds and credits.

Credits against, and refunds of, the tax imposed by the Federal Unemployment Tax Act (Subchapter C, Chapter 9, of the Internal Revenue Code) for the calendar year 1939. (See T. D. 5022, page 275.)

TAXES UNDER SOCIAL SECURITY ACT.

BANKRUPTCY ACT OF 1938.

LIMITATION PERIOD APPLICABLE TO CLAIMS OF THE UNITED STATES.

1940-30-10344
Ct. D. 1461

FEDERAL TAXES—BANKRUPTCY ACT, AS AMENDED—DECISION OF COURT.

CORPORATION REORGANIZATION PROCEEDINGS—ADJUDICATION OF BANKRUPTCY—CLAIM FOR SOCIAL SECURITY TAXES—LIMITATION PERIOD APPLICABLE TO CLAIMS OF THE UNITED STATES.

Section 238 of the Bankruptcy Act, as amended in 1938, which provides that claims not theretofore filed in corporation reorganization proceedings under Chapter X of the Act, as amended, may, in cases where a corporate reorganization results in bankruptcy, be filed prior to the expiration of three months after the first date set for the first meeting of creditors, does not prevent the Government from filing a claim for social security taxes after three months but within six months from the date set for such meeting, since claims of the United States are not mentioned in that section, and it is essential that the United States be specifically mentioned in order to bring its claims within the limitation provision.

UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF NEW YORK.

In the Matter of the Ervin Service Corporation, Bankrupt.

[May 22, 1940.]

OPINION.

KNIGHT, District Judge: On February 1, 1939, the Ervin Service Corporation filed a petition for corporation reorganization, under Chapter X of the Bankruptcy Act, as amended. On March 27, 1939, the corporation was adjudicated a bankrupt.

The order of adjudication directed that proceedings thereafter be taken pursuant to the Bankruptcy Act. The first meeting of creditors was held on March 27, 1939. On June 30, 1939, the collector of internal revenue filed a claim on account of social security taxes in the amount of $911.20, plus interest. The trustee objected to the allowance of the claim on the ground that it was filed after the expiration of the time within which claims were required to be filed. The referee disallowed the claim, and the collector has petitioned this court for review.

Section 238 of the Bankruptcy Act, as amended in 1938 (section 638, Title 11, U. S. C.) (part of Chapter X), provides that claims not theretofore filed in the corporation reorganization proceedings "may be filed prior to the expiration of three months after the first date set for the first meeting of creditors * * *." Section 57(n) (section 93(n), Title 11, U. S. C.) reads, in part: "all claims * * * including all claims of the United States * * *, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed * * *." Section 238 does not specifically include claims of the United States as coming within the limitation period of three months. Prior to the amendment of 1938, section 57(n) (Act of 1898) contained no provision specifically including claims of the United States. The courts definitely held that such claims did not come under the requirement of old section 57(n). (*In re Stavin*, 12 F. (2d), 471; *In re Morgenstern & Co.*, 57 F. (2d), 163; *In re Swan*, 82 F. (2d), 160; *In re Banner Brewing Co.*, 24 F. Supp., 657; *In re Stoever*, 127 F., 394; *In re J. Menist Co., Inc.*, 294 F., 532.)

In the last-mentioned case, this circuit court of appeals stated and following the rule of law laid down in *Gibson* v. *Chouteau* (80 U. S., 99), that

"It is matter of common knowledge that statutes of limitation do not run against the State. That no laches can be imputed to the king, and no time can bar his rights, was the maxim of the common law, and was founded on the principle of public policy, * * *. The principle is applicable to all governments, which must necessarily act through numerous agents, and is essential to a preservation of the interests and property of the public. It is upon this principle that in this country the statutes of a State prescribing periods within which rights must be prosecuted are not held to embrace the State itself, unless it is specially designated * * * that it necessarily must be included."

Vide also *Guarantee Co.* v. *Title Guaranty Co.* (224 U. S., 155) and *Lewis, Trustee*, v. *United States* (92 U. S., 618). In the light of these decisions it seems to me that section 238, supra, is insufficient to include the claim herein. It should be noted that section 106, which, so far as material, was included in old 77(b), defines "Claims" as including "all claims of whatever character." Under the holding in *Gibson* v. *Chouteau*, supra, this was insufficient to include claims of the United States for taxes. It does not specifically designate this type of claim.

Section 355 (part of Chapter XI) of the Bankruptcy Act was considered by District Judge Goddard in the case of *In re Dorb The Chemist Pharmacies* (29 F. Supp., 832). It was there held that the three months' limitation period provision did not apply to claims filed by a municipality and that the limitation period was fixed by provision of 57(n). The case is parallel in all respects to the one at bar, since the material provisions of section 355 are the same as section 328. The decision therein is based upon the position that section 378, subdivision 2 (11 U. S. C. A., 778, subdivision 2), provides that where proceedings in bankruptcy are directed to be proceeded with, they should be continued so far as possible "in the same manner and with like effect as if a bankruptcy petition for adjudication in bankruptcy had been filed * * *." It was there said that the intent of Congress was that the six months' bar should apply to claims of a municipality presented after adjudication and that such intention was disclosed by the fact that Congress did not include them in section 355.

It is not necessary to disagree with the decision in the Dorb case. It has been urged by counsel that such a decision leads to the logical conclusion that all claims in bankruptcy could be filed within six months. It is preferred to base the decision herein on the ground that it was an absolute essential that claims of the United States be specifically included in order to bring these claims within the three months' limitation provision. In this view whether that was the intention of Congress is immaterial. As to the United States there was no limitation period for filing of claims in reorganization. Reorganization proceedings having been followed by bankruptcy, section 57(n) applies. The claim of the United States was filed within the period there fixed.

The order of the referee disallowing the claim is directed to be vacated and set aside and the claim is allowed.

TITLE VIII.—TAXES WITH RESPECT TO EMPLOYMENT.

SECTION 807: Collection and payment of taxes.
REGULATIONS 91, Chapter IV: Returns, payment of tax, and records.

Power of attorney form. (See Mim. 5089, page 242.)

SECTION 807: Collection and payment of taxes.
REGULATIONS 91, ARTICLE 402½: Taxable wages—when to be reported.

Wages paid in one tax-return period for services in a prior period. (See Mim. 5107, page 244.)

TITLE IX.—TAX ON EMPLOYERS OF EIGHT OR MORE.

SECTION 902: Credit against tax. 1940–49–10510
REGULATIONS 90 (as amended), ARTICLE 211: Credit of contributions against tax for calendar years 1936, 1937 and 1938. T. D. 5022
(Also Section 905, Articles 503 and 503½; Internal Revenue Code, Chapter 9, Subchapter C (Federal Unemployment Tax Act), Sections 1601 and 1610; Regulations 90 (as amended), Articles 211(1), 503, and 503⅚.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 400.

Regulations 90, and such regulations as made applicable to the Internal Revenue Code by Treasury Decision 4885 [C. B. 1939–1 (Part 1), 396], amended to conform to section 701 of the Second Revenue Act of 1940.

Credits against, and refunds of, the tax imposed by Title IX of the Social Security Act for the calendar years 1936, 1937, and 1938, and the tax imposed by the Federal Unemployment Tax Act (Subchapter C, Chapter 9, of the Internal Revenue Code) for the calendar year 1939.

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

To Collectors of Internal Revenue and Others Concerned:

Section 701 of the Second Revenue Act of 1940, approved October 8, 1940 (Public, No. 801, Seventy-sixth Congress, third session), provides:

CREDIT AGAINST FEDERAL UNEMPLOYMENT TAXES.

(a) ALLOWANCE OF CREDIT.—Against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, or against the tax imposed by the Federal Unemployment Tax Act for the calendar year 1939, any taxpayer shall be allowed credit for the amount of contributions paid by him into an unemployment fund under a State law—

(1) Before the sixtieth day after the date of the enactment of this Act;

(2) On or after such sixtieth day (except in the case of the tax for the calendar year 1939) with respect to wages paid after the fortieth day after such date of enactment;

(3) Without regard to the date of payment, if the assets of the taxpayer are, at any time during the 59-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction.

The amount of such credit, in the case of contributions with respect to the calendar year 1939 paid after the last day upon which the taxpayer was required under section 1604 of the Federal Unemployment Tax Act to file a return for such year, shall not exceed 90 per centum of the amount which would have been allowable as credit on account of such contributions had they been paid on or before such last day. The provisions of the Social Security Act in force prior to February 11, 1939 (except the provision limiting the credit to amounts paid before the date of filing returns), shall, with respect to the tax for the calendar year 1936, 1937, or 1938, apply to allowance of credit under this section, and the provisions of the Federal Unemployment Tax Act (except section 1601(a)(3)) shall, with respect to the tax for the calendar year 1939, apply to allowance of credit under this section. The terms used in this subsection shall, with respect to the tax for the calendar year 1936, 1937, or 1938, have the same meaning as when used in Title IX of the Social Security Act prior to February 11, 1939, and shall, with respect to the tax for the calendar year 1939, have the same meaning as when used in the Federal Unemployment Tax Act. The total credit allowable against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, or against the tax imposed by section 1600 of the Federal Unemployment Tax Act for the calendar year 1939, shall not exceed 90 per centum of such tax.

(b) REFUND.—Refund of the tax (including penalty and interest collected with respect thereto, if any), based on any credit allowable under this section, may be made in accordance with the provisions of law applicable in the case of erroneous or illegal collection of the tax. No interest shall be allowed or paid on the amount of any such refund.

PARAGRAPH A. *Credit against, and refund of, tax for 1936, 1937, and 1938.*—In order to conform Regulations 90 [Part 400, Title 26, Code of Federal Regulations], relating to the excise tax on employers under Title IX of the Social Security Act (49 Stat., 639; 42 U. S. C., Sup. V, 1101 to 1110, inclusive), to section 701 of the Second Revenue Act of 1940, such regulations are amended as follows:

(1) Immediately preceding article 211, as amended by Treasury Decision 4812 [C. B. 1938–2, 462] [section 400.211, Title 26, Code of Federal Regulations, 1938 Sup.] and by Treasury Decision 4937 [C. B. 1939–2, 320] [section 400.211 of such Title 26, 1939 Sup.], relating to credit of contributions against the tax for the calendar years 1936, 1937, and 1938, the following is inserted:

Section 701 of the Second Revenue Act of 1940.

CREDIT AGAINST FEDERAL UNEMPLOYMENT TAXES.

(a) ALLOWANCE OF CREDIT.—Against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, * * * any taxpayer shall be allowed credit for the amount of contributions paid by him into an unemployment fund under a State law—

(1) Before the sixtieth day after the date of the enactment of this Act;

(2) On or after such sixtieth day * * * with respect to wages paid after the fortieth day after such date of enactment;

(3) Without regard to the date of payment, if the assets of the taxpayer are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction.

* * The provisions of the Social Security Act in force prior to February 11, 1939 (except the provision limiting the credit to amounts paid before the date of filing returns), shall, with respect to the tax for the calendar year 1936, 1937, or 1938, apply to allowance of credit under this section * * *. The terms used in this subsection shall, with respect to the tax for the calendar year 1936, 1937, or 1938, have the same meaning as when used in Title IX of the Social Security Act prior

to February 11, 1939 * * *. The total credit allowable against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, * * * shall not exceed 90 per centum of such tax.

* * * * * * *

(2) Article 211(*b*), as amended by Treasury Decision 4812 [supra] [section 400.211(*b*), Title 26, Code of Federal Regulations, 1938 Sup.] and by Treasury Decision 4937 [supra] [section 400.211(*b*) of such Title 26, 1939 Sup.], relating to the limitations on the allowance of contributions as credit against the tax for the calendar years 1936, 1937, and 1938, is further amended to read as follows:

(*b*) *Limitations on allowance of contributions as credit against tax.*—The allowance of contributions as credit against the tax for the calendar year 1936, 1937, or 1938 is subject to the following limitations:

(1) The total credit allowed to any taxpayer for contributions to State unemployment funds with respect to employment during any one year shall not exceed 90 per cent of the tax against which such credit is applied.

(2) The contributions must have been actually paid into the State unemployment fund. Such payment must have been made before December 7, 1940, except that:

(*i*) The contributions with respect to wages paid after September 19, 1939 (for employment during the calendar year 1936, 1937, or 1938), may be paid into the State fund on or after December 7, 1940, subject, however, to the provisions of article 503 of these regulations [section 400.503, Title 26, Code of Federal Regulations], relating to the statutory period of limitations applicable to credits.

(*ii*) The contributions of a taxpayer whose assets, at any time during the period August 11, 1939, to October 8, 1939, inclusive, or during the period October 9, 1940, to December 6, 1940, inclusive, are in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction, may be paid into the State fund at any time, subject, however, to the provisions of article 503 of these regulations [section 400.503, Title 26, Code of Federal Regulations], relating to the statutory period of limitations applicable to credit.

(*iii*) The contributions paid into the unemployment fund of a State which are required under the unemployment compensation law of that State, with respect to remuneration on the basis of which the taxpayer had, prior to such payment, erroneously paid an amount as contributions under another unemployment compensation law, shall be deemed to have been made at the time of the erroneous payment. If, by reason of such other law, the taxpayer was entitled to cease paying contributions with respect to services subject to such other law, the payment into the proper fund shall be deemed to have been made on the date the return for the taxable year was actually filed under section 905 of the Social Security Act.

(3) The contributions must have been paid with respect to employment as defined in section 907(c) of the Social Security Act, that is, with respect to services performed by an employee within the United States and not excepted by such Act. (See articles 206 to 206(7) [sections 400.206 to 400.206(7), Title 26, Code of Federal Regulations], inclusive.)

(4) The contributions must have been paid with respect to services performed during the calendar year covered by the return.

(3) Immediately preceding article 503½, added by Treasury Decision 4812 [section 400.503½, Title 26, Code of Federal Regulations, 1938 Sup.], as amended by Treasury Decision 4937 [section 400.503½ of such Title 26, 1939 Sup.], the following is inserted:

Section 701(b) of the Second Revenue Act of 1940.

REFUND.—Refund of the tax (including penalty and interest collected with respect thereto, if any), based on any credit allowable under this section, may be made in accordance with the provisions of law applicable in the case of erroneous or illegal collection of the tax. No interest shall be allowed or paid on the amount of any such refund.

(4) Article 503½, added by Treasury Decision 4812 [section 400.503½, Title 26, Code of Federal Regulations, 1938 Sup.], as amended by Treasury Decision 4937 [section 400.503½ of such Title 26, 1939 Sup.], is amended to read as follows:

ART. 503½ [Sec. 400.503½, Title 26, Code of Federal Regulations, 1940 Sup.]. *Refund, under section 902(d) of Social Security Act Amendments of 1939 or section 701(b) of Second Revenue Act of 1940, of tax for calendar year 1936, 1937, or 1938.*—If the tax for the calendar year 1936, 1937, or 1938 against which an amount is allowable as credit under section 902 of the Social Security Act Amendments of 1939 or under section 701 of the Second Revenue Act of 1940 (see article 211 [section 400.211, Title 26, Code of Federal Regulations, 1939 Sup. and 1940 Sup.]) has been paid without the benefit of such credit, the taxpayer shall be entitled to a refund of the tax equal to the amount of such allowable credit. The taxpayer shall also be entitled to a refund of the amount of interest or penalty, if any, collected from him with respect to the amount of tax refunded. No interest, however, shall be allowed or paid by the Government on the amount of any such refund. Every claim for such refund shall be made on Form 843 in accordance with the provisions of this article and article 503 [section 400.503, Title 26, Code of Federal Regulations], relating to refund and credit of taxes erroneously collected. A claim which does not comply with these requirements will not be considered for any purpose as a claim for refund.

PARAGRAPH B. *Credit against, and refund of, tax for 1939.*—In order to conform Regulations 90, only as made applicable to the Internal Revenue Code (53 Stat., Part 1; 26 U. S. C., Sup. V) by Treasury Decision 4885 [C. B. 1939–1 (Part 1), 396 [Chapter I, note, Title 26, Code of Federal Regulations, 1939 Sup.], to section 701 of the Second Revenue Act of 1940, such regulations are amended as follows:

(1) Immediately preceding article 211(1), added by Treasury Decision 4953 [C. B. 1939–2, 297] [section 400.211(1), Title 26, Code of Federal Regulations, 1939 Sup.], relating to credit against the tax for the calendar year 1939 for contributions paid, the following is inserted:

Section 701 of the Second Revenue Act of 1940.

CREDIT AGAINST FEDERAL UNEMPLOYMENT TAXES.

(a) ALLOWANCE OF CREDIT.—* * * against the tax imposed by the Federal Unemployment Tax Act for the calendar year 1939, any taxpayer shall be allowed credit for the amount of contributions paid by him into an unemployment fund under a State law—

(1) Before the sixtieth day after the date of the enactment of this Act;

* * * * *

(3) Without regard to the date of payment, if the assets of the taxpayer are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction.

The amount of such credit, in the case of contributions with respect to the calendar year 1939 paid after the last day upon which the taxpayer was required under section 1604 of the Federal Unemployment Tax Act to file a return for such year, shall not exceed 90 per centum of the amount which would have been allowable as credit on account of such contributions had they been paid on or before such last day. * * * the provisions of the Federal Unemployment Tax Act (except section 1601(a)(3)) shall, with respect to the tax for the calendar year 1939, apply to allowance of credit under this section. The terms used in this subsection * * * shall, with respect to the tax for the calendar year 1939, have the same meaning as when used in the Federal Unemployment Tax Act. The total credit allowable * * * against the tax imposed by section 1600 of the Federal Unemployment Tax Act for the calendar year 1939, shall not exceed 90 per centum of such tax.

* * * * * * *

(2) Article 211(1)(*b*) (except examples A to F, inclusive, of such article), added by Treasury Decision 4953 [supra] [section 400.211(1)(*b*), Title 26, Code of Federal Regulations, 1939 Sup.], relating to the limitations on the allowance of contributions as credit against the tax for the calendar year 1939, is amended to read as follows:

(*b*) *Limitations on allowance of contributions as credit against tax.*—The allowance of contributions as credit against the tax for the calendar year 1939 is subject to the following limitations:

(1) The total credit allowed to any taxpayer for contributions to State unemployment funds shall not exceed 90 per cent of the tax against which such credit is applied.

(2) The contributions must have been actually paid into the State unemployment fund. Such payment must have been made on or before the last day upon which the return for the taxable year is required to be filed (see article 303 [section 400.303, Title 26, Code of Federal Regulations], article 304 [section 400.304 of such Title 26, and 1939 Sup.], and article 305 [section 400.305 of such Title 26]), except that:

(*i*) Contributions may be paid into a State unemployment fund after such last day but before December 7, 1940, and in such case, may be credited against the tax in an amount not to exceed 90 per cent of the amount which would have been allowable as credit on account of such contributions had they been paid into the State unemployment fund on or before such last day.

(*ii*) Contributions of a taxpayer whose assets, at any time during the period from such last day for filing a return for the calendar year 1939, to June 30, 1940, both dates inclusive, are in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction (whether or not such assets continue in such custody or control on or after October 9, 1940) may be paid into the State fund at any time, and upon such payment may be credited against the tax in the same amount that would have been allowable as credit had the contributions been paid on or before the last day upon which the return for the taxable year was required to be filed. The contributions of a taxpayer (other than a taxpayer entitled to credit under the preceding sentence) whose assets, at any time during the period October 9, 1940, to December 6, 1940, inclusive, are in the custody or control of such a receiver, trustee, or other fiduciary, may be paid into the State fund at any time, and upon such payment may be credited against the tax in an amount not to exceed 90 per cent of the amount which would have been allowable as credit on account of such contributions had they been paid on or before the last day upon which the return for the taxable year was required to be filed. (The provisions with respect to credit for payments made into the State fund at any time are subject to the provisions of article 503 [section 400.503, Title 26, Code of Federal Regulations], relating to the statutory period of limitations applicable to credits.)

(*iii*) Contributions for the calendar year 1939 paid into the unemployment fund of a State which are required under the unemployment compensation law of that State, but which are paid with respect to remuneration on the basis of which the taxpayer had, prior to such payment, erroneously paid an amount as contributions under another unemployment compensation law, shall be deemed for purposes of credit to have been paid at the time of the erroneous payment. If, by reason of such other law, the taxpayer was entitled to cease paying contributions for the calendar year 1939 with respect to services subject to such other law, the payment into the proper fund shall be deemed for purposes of credit to have been made on the date the return for the calendar year 1939 was actually filed under section 1604 of the Federal Unemployment Tax Act.

(3) The contributions must have been paid with respect to the calendar year 1939.

(3) Examples A, B, and C of article 211(1)(*b*), added by Treasury Decision 4953 [section 400.211(1)(*b*), Title 26, Code of Federal Regulations, 1939 Sup.], relating to the limitations on the allowance of contributions as credit against the tax for the calendar year 1939, are amended by striking out the date "July 1, 1940" wherever it

appears in each such example and by inserting in lieu thereof the date "December 7, 1940."

(4) Immediately preceding article 503⅝, added by Treasury Decision 4953 [supra] [section 400.503⅝, Title 26, Code of Federal Regulations, 1939 Sup.], the following is inserted:

Section 701(b) of the Second Revenue Act of 1940.

REFUND.—Refund of the tax (including penalty and interest collected with respect thereto, if any), based on any credit allowable under this section, may be made in accordance with the provisions of law applicable in the case of erroneous or illegal collection of the tax. No interest shall be allowed or paid on the amount of any such refund.

(5) Article 503⅝, added by Treasury Decision 4953 [section 400.503⅝, Title 26, Code of Federal Regulations, 1939 Sup.], is amended to read as follows:

ART. 503⅝ [Sec. 400.503⅝, Title 26, Code of Federal Regulations, 1940 Sup.]. *Refund, under section 1601(a)(5) of Federal Unemployment Tax Act or section 701(b) of Second Revenue Act of 1940, of tax for calendar year 1939.*—If the tax for the calendar year 1939 against which an amount is allowable as credit under section 1601 of the Federal Unemployment Tax Act or under section 701 of the Second Revenue Act of 1940 has been paid without the benefit of such credit, the taxpayer shall be entitled to a refund of the tax equal to the amount of such allowable credit. (See article 211(1) [section 400.211(1), Title 26, Code of Federal Regulations, 1939 Sup. and 1940 Sup.], articles 212 and 213 [sections 400.212 and 400.213 of such Title 26, 1939 Sup.], relating, respectively, to credit against the tax for contributions paid, additional credit, and proof of credit, for the calendar year 1939.) The taxpayer shall also be entitled to a refund of the amount of interest or penalty, if any, collected from him with respect to the amount of tax refunded. No interest, however, shall be allowed or paid by the Government on the amount of any such refund. Every claim for such refund shall be made on Form 843 in accordance with the provisions of this article and article 503 [section 400.503, Title 26, Code of Federal Regulations], relating to refund and credit of taxes erroneously collected. A claim which does not comply with these requirements will not be considered for any purpose as a claim for refund.

(Paragraph A of this Treasury decision is issued under the authority contained in sections 902 and 908 of the Social Security Act (49 Stat., 639, 643; 42 U. S. C., Sup. V, 1102, 1108), section 902 (a), (b), (c), and (d) of the Social Security Act Amendments of 1939 (53 Stat., 1399; 42 U. S. C., Sup. V, 1102, note), and section 701 of the Second Revenue Act of 1940 (Public, No. 801, Seventy-sixth Congress, third session). Paragraph B of this Treasury decision is issued under the authority contained in section 1601 of the Internal Revenue Code, as amended by section 609 of the Social Security Act Amendments of 1939 (53 Stat., 1387; 26 U. S. C., Sup. V, 1601), section 1609 of the Internal Revenue Code (53 Stat., 188; 26 U. S. C., Sup. V, 1609), and section 701 of the Second Revenue Act of 1940 (Public, No. 801, Seventy-sixth Congress, third session).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved November 20, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register November 23, 1940, 9.58 a. m.)

SECTION 905: Administration, refunds, and penalties.
REGULATIONS 90, Chapter III; Returns and records.

Power of attorney form. (See Mim. 5089, page 242.)

SECTION 905: Administration, refunds, and penalties.
REGULATIONS 90 (as amended), ARTICLE 210: Adjustments of tax.

Wages paid in one tax-return period for services in a prior period. (See Mim. 5107, page 244.)

SECTION 905: Administration, refunds, and penalties.
REGULATIONS 90 (as amended), ARTICLE 300: Returns.

Wages paid in one tax-return period for services in a prior period. (See Mim. 5107, page 244.)

SECTION 905: Administration, refunds, and penalties.
REGULATIONS 90 (as amended), ARTICLES 503 and 503½:
Refunds and credits.

Credits against, and refunds of, the tax imposed by Title IX of the Social Security Act for the calendar years 1936, 1937, and 1938. (See T. D. 5022, page 275.)

CARRIERS TAXING ACT OF 1937.

REGULATIONS 100.

Exclusion of certain services rendered outside the United States and certain services performed in the mining of coal, Regulations 100 amended. (See T. D. 5017, page 266.)

SECTION 7: Collection and payment of taxes.
REGULATIONS 100, Chapter V: Returns and payment of tax.

Power of attorney form. (See Mim. 5089, page 242.)

MISCELLANEOUS TAX RULINGS.

ESTATE TAX.

INTERNAL REVENUE CODE.

CHAPTER 3, AS AMENDED BY SECTION 206 OF REVENUE ACT OF 1940.

REGULATIONS 80 (1937), ARTICLE 1: Estate tax statutes. 1940-33-10385
T. D. 4995
ARTICLE 8: Computation of tax.

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 80.—ESTATE TAX.

Articles 1 and 8 of Regulations 80 (1937 edition) as made applicable to the Internal Revenue Code, amended.—Defense tax for five years.

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

To Collectors of Internal Revenue and Others Concerned:

In order to conform Regulations 80 [Part 80, 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, 1939 Sup.], to the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), approved June 25, 1940, such regulations are amended as follows:

1. Insert immediately preceding article 1 [section 80.1 of such Title 26]:

SEC. 206. ESTATE TAX. (REVENUE ACT OF 1940.)

Chapter 3 of the Internal Revenue Code is amended by inserting at the end thereof the following new subchapter:

"SUBCHAPTER C—DEFENSE TAX FOR FIVE YEARS.

"SEC. 951. DEFENSE TAX FOR FIVE YEARS.

"In the case of a decedent dying after the date of the enactment of the Revenue Act of 1940 and before the expiration of five years after such date, the total amount of tax payable under this chapter shall be 10 per centum greater than the amount of tax which would be payable if computed without regard to this section. For the purposes of this section, the tax computed without regard to this section shall be such tax after the application of the credits provided for in section 813 and section 936."

2. The first paragraph of article 1 [section 80.1, Title 26, Code of Federal Regulations] is amended to read as follows:

Federal estate taxation under Chapter 3 of the Internal Revenue Code, as amended, consists of, *first*, the basic estate tax, *second*, the additional estate tax,

and *third*, if the decedent died after June 25, 1940, and before June 26, 1945, the defense tax. The defense tax is 10 per cent of the total of the net basic estate tax and the net additional estate tax (such total being the amount computed after the application of any credits authorized for gift, estate, inheritance, legacy, or succession taxes).

3. Insert the following paragraph immediately after the first paragraph of article 8 [section 80.8, Title 26, Code of Federal Regulations]:

The defense tax, applicable if the decedent died after June 25, 1940, and before June 26, 1945, is obtained by computing 10 per cent of the total net tax (the total net tax being the sum of the net basic tax and the net additional tax).

(This Treasury decision is issued under the authority contained in section 951 of the Internal Revenue Code, as added by section 206 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), approved June 25, 1940, and section 3791(a)1 of the Internal Revenue Code (53 Stat., 467).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved August 1, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register August 5, 1940, 3.54 p. m.)

CHAPTER 3.

REGULATIONS 80 (1937). 1940-40-10439
(Also Chapter 4—Gift tax; and Regulations 79 (1936).) Mim. 5109

Application of the Federal estate and gift taxes to United States savings bonds.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., September 9, 1940.

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

Numerous inquiries are being received by the Bureau, particularly from taxpayers, regarding the status of United States savings bonds for Federal estate and gift tax purposes. The purpose of this mimeograph is to furnish such information as will apprise persons concerned of the application and effect of such taxes on savings bonds and thereby make unnecessary many inquiries.

IN GENERAL.

Various statutory provisions, which exempt bonds, notes, bills, and certificates of indebtedness of the Federal Government or its agencies and the interest thereon from taxation, are not applicable to estate and gift taxes, since these taxes are excises imposed on the transfer of property and not on the property itself. Under existing law, transfers of the property in United States savings bonds are not exempt from Federal estate and gift taxes (except in respect of such bonds while beneficially owned by a nonresident alien who is not

engaged in business in the United States). Whether a particular transfer of the property in such bonds entails liability for Federal estate or gift tax, and, if so, the amount thereof, depends upon the value of the property transferred, the specific exemption, etc., allowable under the law, and the tax rates in effect at the time of the transfer.

WHEN PURCHASED AND REGISTERED IN CERTAIN AUTHORIZED FORMS.

If "John Jones" purchases with his separate funds savings bonds and has them registered in his name as owner and the bonds are so held at the time of his death, the redemption value of the bonds constitutes a part of his gross estate for Federal estate tax purposes.

If "John Jones" purchases with his separate funds savings bonds and has them registered in his name as owner, payable on death to an individual as beneficiary, for example, "John Jones, payable on death to Miss Mary Jones," no gift results from the transaction. In such case "John Jones" alone, as the registered owner, may during his lifetime redeem the bonds and retain the proceeds. For Federal estate tax purposes, however, upon the death of "John Jones" while the bonds are so held, their entire redemption value at the time of death would form a part of his gross estate.

If "John Jones" purchases with his separate funds savings bonds and has them gratuitously registered in the name of "Mary Jones" as owner, the transaction results in a gift from "John Jones" to "Mary Jones" during the year in which the bonds are purchased and registered, and the cost of the bonds must be considered in determining the donor's gift tax liability for such year. If "Mary Jones" dies while the bonds are so registered, the redemption value of the bonds at the time of her death would be includible in her gross estate for Federal estate tax purposes.

If "John Jones" purchases with his separate funds savings bonds and gratuitously has them registered in the name of "Miss Mary Jones, payable on death to Miss Helen Jones," he has made a gift in the amount of the purchase price and such amount must be considered in determining his gift tax liability, if any, for the calendar year in which the gift was made. "John Jones" having made, during his lifetime, a gift of his investment in the bonds (and provided the transfer was not made in contemplation of death), his estate will not be subject to any Federal estate tax liability in respect of the bonds.

If "John Jones" purchases with his separate funds savings bonds and gratuitously has them registered in the name of "Miss Mary Jones or Miss Helen Jones," he has made a gift, for Federal gift tax purposes, to each of them of one-half of the amount of the purchase price of the bonds, and (provided the gifts were not made in contemplation of death) his estate will not be subject to any Federal estate tax liability in respect of the bonds.

If "John Jones" purchases with his separate funds savings bonds and has them registered in his name and that of another individual in the alternative as coowners, for example, "John Jones or Mrs. Ella S. Jones," there is no gift for Federal gift tax purposes, unless and until he during his lifetime gratuitously permits "Mrs. Ella S. Jones" to redeem them and retain the proceeds as her separate property, in which event a gift of the then redemption value of the bonds would be made. Of course, such bonds if not previously redeemed would, on the death

of "John Jones" be includible in his gross estate for estate tax purposes at their full redemption value.

If savings bonds are purchased with the separate funds of two individuals and registered in their names as coowners, for example, "John Jones or Ella S. Jones," the amount includible in the gross estate, for Federal estate tax purposes, of the first coowner to die (if the bonds were not previously redeemed) is the full redemption value of the bonds less such part thereof as is proportionate to the amount of the purchase price furnished by the survivor and not acquired from the decedent for less than an adequate and full consideration in money or money's worth.

STATE ESTATE, INHERITANCE, LEGACY, OR GIFT TAXES.

Statutory provisions exempting bonds and other obligations of the Federal Government from certain taxation are not applicable to estate, inheritance, legacy or gift taxes imposed by a State Government. The extent to which United States savings bonds are subject to such State taxes depends upon the applicable State law. Inquiries regarding such laws should be addressed to the proper State tax officials.

Inquiries with regard to the provisions of this mimeograph should be addressed to the Commissioner of Internal Revenue, Washington, D. C., for the attention of MT:ET:RR.

GUY T. HELVERING,
Commissioner.

SECTION 811.—GROSS ESTATE.

REGULATIONS 80 (1937), ARTICLE 13: Property of decedent at time of death. 1940-49 10511 E. T. 18

Amounts payable under Title II of the Social Security Act, as amended, to the widow, children, or parents of a "fully insured" or "currently insured" decedent who died on or after January 1, 1940, are not includible in the decedent's gross estate for Federal estate tax purposes. As to payments to the estate of a decedent who died prior to January 1, 1940, see E. T. 10 (C. B. 1937-2, 469).

Advice is requested whether amounts payable under Title II of the Social Security Act, as amended by the Act of August 10, 1939 (53 Stat., 1360), to the widow, children, or parents of a "fully insured" or "currently insured" decedent who died on or after January 1, 1940, are includible in the gross estate of such decedent for Federal estate tax purposes.

Section 811 of the Internal Revenue Code 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 of the United States—

(a) DECEDENT'S INTEREST.—To the extent of the interest therein of the decedent at the time of his death;

* * * * * * *

The amounts in question are payable to the widow, children, or parents of a decedent, who at the time of his death on or after January 1, 1940 (the effective date of the amendment of Title II of the

Social Security Act by the Act of August 10, 1939), was a "fully insured" or "currently insured" individual within the meaning of Title II of the Social Security Act, as amended, supra. An examination of section 202 (c), (d), (e), (f), and (g) of that Act, as amended, which deals with the type of payments under consideration, shows that the decedent has no control over the designation of the beneficiaries or the amounts payable to them. The beneficiaries and the amounts payable to them are fixed by the provisions of the Social Security Act, as amended, and the payments are made directly to the beneficiaries. The decedent has no property interest in the "Federal Old-Age and Survivors Insurance Trust Fund" created under section 201(a) of Title II of the Social Security Act, as amended, from which the amounts in question are payable.

In view of the foregoing, it is held that amounts payable under Title II of the Social Security Act, as amended, to the widow, children, or parents of a decedent who died on or after January 1, 1940, and who at the time of his death was a "fully insured" or "currently insured" individual within the meaning of that Act, as amended, do not constitute property of such decedent, and are not includible in his gross estate for Federal estate tax purposes.

This ruling does not affect E. T. 10 (C. B. 1937–2, 469), relating to payments under section 203 of the Social Security Act to the estate of a decedent who died prior to January 1, 1940.

REGULATIONS 80 (1937), ARTICLE 15: Transfers during life. 1940–40–10440
ARTICLE 17: Transfers conditioned upon survivorship. T. D. 5008

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 80—ESTATE TAX.

Articles 15 and 17, Regulations 80 (1937 edition) amended. Transfers where the passing from the decedent of a retained interest is conditioned upon his death.

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

To Collectors of Internal Revenue and Others Concerned:

Articles 15 and 17, Regulations 80, 1937 edition (sections 80.15 and 80.17, Title 26, Code of Federal Regulations), and those articles as made applicable to the Internal Revenue Code by Treasury Decision 4885, approved February 11, 1939 (Part 465, Subpart B, of such Title 26, 1939 Sup. (C. B. 1939–1 (Part 1), 396)), are amended as herein indicated.

The clause in article 15, which reads—

(2) transfers to the extent that title remained in the decedent at the time of his death and the passing thereof was conditioned upon his death (see article 17);

is amended to read as follows:

(2) transfers conditioned upon the decedent's death (see article 17);

Article 17, which reads—

ART. 17. *Transfers conditioned upon survivorship.*—The statutory phrase, "a transfer * * * intended to take effect in possession or enjoyment at or after his death," includes a transfer by the decedent (other than a bona fide sale for an adequate and full consideration in money or money's worth) whereby and to the extent that the beneficial title to the property (if the transfer was in trust), or the legal title thereto (if the transfer was otherwise than in trust), remained in the decedent at the time of his death and the passing thereof was subject to the condition precedent of his death. If the tax applies, it does so without regard to the time of the transfer, whether before or after the enactment of the Revenue Act of 1916.

On the other hand, if, as a result of the transfer, there remained in the decedent at the time of his death no title or interest in the transferred property, then no part of the property is to be included in the gross estate merely by reason of a provision in the instrument of transfer to the effect that the property was to revert to the decedent upon the predecease of some other person or persons or the happening of some other event. (See article 15.)

is amended to read as follows:

ART. 17. *Transfers conditioned upon survivorship.*—The statutory phrase, "a transfer * * * intended to take effect in possession or enjoyment at or after his death," includes a transfer by the decedent prior to his death (other than a bona fide sale for an adequate and full consideration in money or money's worth) whereby and to the extent that the beneficial title to the property transferred (if the transfer was in trust), or the legal title thereto (if the transfer was otherwise than in trust), is not to pass from the decedent to the donee unless the decedent dies before the donee or another person, or its passing is otherwise conditioned upon decedent's death; or, if title passed to the donee, it is to be defeated and the property is to revert to the decedent as his own should he survive the donee or another person, or the reverting of the property to the decedent is conditioned upon some other contingency terminable by his death. Since in such transfers the decedent's death is requisite to a termination of his interest in the property, it is unimportant whether his interest be denominated a reversion or a possibility of reverter, whether it arose by implication of law or by the express terms of the instrument of transfer, and whether the interest of the donee be contingent or vested subject to be divested, and the tax will apply, unless otherwise provided in the next succeeding paragraph, without regard to the time when the transfer was made, whether before or after the enactment of the Revenue Act of 1916. Thus, upon a transfer by a decedent of property in which an estate for life is given to one and an estate in remainder to another, but with a provision added that the estate in remainder shall revest in the decedent should he survive the owner of the life estate, there is to be included, in determining the value of the decedent's gross estate following his death, the value as of the date of his death of the estate in remainder, if the life estate is then outstanding. The value of the outstanding life estate is not to be included in determining the value of the gross estate, unless that estate had been transferred in contemplation of the decedent's death, or otherwise as to render it a part of the gross estate. If by reason of an election by the executor the valuation of the gross estate is governed by the provisions of article 11, adjustments in the values of such transferred estates may be required. (See article 15.)

Where the transfer was made during the period between November 11, 1935 (that being the date upon which the Supreme Court of the United States rendered its decisions in the cases of *Helvering* v. *St. Louis Union Trust Co.* (296 U. S., 39 [Ct. D. 1047, C. B. XIV–2, 339 (1935)]) and *Becker* v. *St. Louis Union Trust Co.* (296 U. S., 48 [Ct. D. 1046, C. B. XIV–2, 337 (1935)]) and January 29, 1940 (that being the date upon which such Court rendered its decisions in *Helvering* v. *Hallock* and companion cases (309 U. S., 106 [Ct. D. 1440, C. B. 1940–1, 223]), and the Commissioner, whose determination therein shall be conclusive, determines that such transfer is classifiable with the transfers involved in such two cases decided on November 11, 1935, rather than with the transfer involved in the case of *Klein* v. *United States* (283 U. S., 231 [Ct. D. 333, C. B. X–1, 462 (1931)]), previously decided by such Court, then the property so transferred shall not be included in the decedent's gross estate under the provisions of this article, if the following condition is also met: Such transfer shall have been finally treated for all gift tax purposes, both as to the calendar year of such transfer and subsequent calendar years, as a gift in an amount measured by the value of the

property undiminished by reason of a provision in the instrument of transfer by which the property, in whole or in part, is to revert to the decedent should he survive the donee or another person, or the reverting thereof is conditioned upon some other contingency terminable by decedent's death.

(This Treasury decision is issued under the authority contained in the following sections of law: Sections 811, 937, and 3791 of the Internal Revenue Code (53 Stat., 120, 143, and 467); 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(a)(1)); section 403 of the Revenue Act of 1932 (47 Stat., 245, 26 U. S. C., 537); and section 1108(a) of the Revenue Act of 1926, as amended by section 605 of the Revenue Act of 1928 and by section 506 of the Revenue Act of 1934 (44 Stat., 114, 45 Stat., 874, 48 Stat., 757, 26 U. S. C., 1691(b).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved September 19, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register September 23, 1940, 3.10 p. m.)

SECTION 863(b).—PROPERTY WITHOUT THE UNITED STATES—BANK DEPOSITS.

REGULATIONS 80 (1937), ARTICLE 50: Situs of property. 1940-51-10527 G. C. M. 22419

The words "moneys deposited," as used in section 863(b) of the Internal Revenue Code and section 303(e) of the Revenue Act of 1926, as amended by section 403(d) of the Revenue Act of 1934, apply to so-called general deposits with a bank where the relationship of debtor and creditor between the bank and the depositor exists with respect to such deposits, and do not apply to funds held in a fiduciary capacity. Accordingly, such funds held in a fiduciary capacity are includible in the gross estate of a nonresident not a citizen of the United States who was not engaged in business in the United States at the time of his death.

An opinion is requested whether funds placed with a bank within the United States by or for a nonresident not a citizen of the United States and held by such bank as trustee or as custodian constitute "moneys deposited with any person carrying on the banking business" within the meaning of section 863(b) of the Internal Revenue Code or section 303(e) of the Revenue Act of 1926, as amended by section 403(d) of the Revenue Act of 1934.

Section 863 of the Internal Revenue Code provides in part as follows:

The following items shall not, for the purpose of this subchapter, be deemed property within the United States:

* * * * * * *

(b) BANK DEPOSITS.—Any moneys deposited with any person carrying on the banking business, by or for a nonresident not a citizen of the United States who was not engaged in business in the United States at the time of his death.

Section 303(e) of the Revenue Act of 1926, as amended by section 403(d) of the Revenue Act of 1934, is in substance the same as section 863(b) of the Internal Revenue Code.

Section 863(b) of the Code and the corresponding provision of the Revenue Act of 1926, as amended, are exemption provisions, and must, therefore, be strictly construed. (*Bank of Commerce* v. *Tennessee*, 161 U. S., 134.)

The term "deposit" has a well accepted meaning in the banking business, and has been defined as the act of placing or lodging money in the custody of a bank or banker, for safety or convenience, to be withdrawn at the will of the depositor or under rules and regulations agreed on; as a sum of money left with a banker for safe-keeping, subject to order and payable not in the specific money deposited but in an equal sum; or the amount or balance due the depositor. (Black's Law Dictionary; Cf. *People ex rel. Nelson* v. *First State Bank of Mineral*, 275 Ill. App., 123; *Andrew* v. *Iowa Savings Bank*, 241 N. W., 412; *In Law's Estate*, 144 Pa., 499, 22 A., 831; *In re Liquidation of State Bank of Binghamton*, 274 N. Y. S., 41, 54.)

Deposits with a bank are either general or special. A general deposit consists of *money* paid to a bank for the convenience of the depositor and to his general credit to be repaid in current funds on his order or demand. Title to the money passes to the bank wherein the deposit is made, and the money is mingled with the general funds of the bank and used in the banking business. The relationship of debtor and creditor is created by such a deposit. A special deposit is made where *property*, or even money, is delivered to a bank for the purpose of having it safely kept and the identical thing deposited returned to the depositor, or where the thing delivered to the bank is for some specific purpose not contemplating a credit on general account. In the case of a special deposit the thing deposited may not be commingled with other funds or assets of the bank and used in the banking business, and with respect to it a fiduciary relationship, of either principal and agent, bailor and bailee, trustee and cestui que trust, or a combination of such relationships, is created between the bank and the depositor. (Cf. *Busher* v. *Fulton*, 128 Ohio St., 485, 191 N. E., 752; *Bank of America Nat. Trust & Savings Assn.* v. *California Savings Assn. & Commercial Bank*, 22 P. (2d), 704; *Wasserman* v. *Broderick*, 250 N. Y. S., 84; *Mellon Nat. Bank* v. *Citizens Bank & Trust Co. of Camden, Ark.*, 88 Fed. (2d), 128; *In re McCarthy's Funds*, 248 N. Y. S., 335; *Squire* v. *Branciforti*, 131 Ohio St., 344, 2 N. E. (2d), 878.)

In the trial of a cashier of a national bank charged with making false entries in the books of the bank, the jury was instructed substantially that if a sum of $10,000 was left with the bank with the intention to call for and receive the identical sum so left on the surrender of the "deposit slip," and if the bank so received the same to be returned on the surrender of the slip, "then I charge you that the bank was a bailee or custodian of said money, and had no right to enter the same on its books as money deposited with the bank, * * * but if you find that the use so permitted was that the money was to be considered a loan to the bank, or that it might be considered a loan to the bank, or that it should be mingled with the funds of the bank as an ordinary deposit, subject to withdrawal by check in the ordinary course of business, the entry of such item on the books would be lawful and proper." In denying a motion for a new trial (*United States* v. *Peters*, 87 Fed., 984, 990), this

charge to the jury was sustained again in *Peters* v. *United States* (94 Fed., 127). This indicates that where money or property is left with a bank under circumstances which create a relationship other than that of debtor and creditor, such transaction is not strictly a "deposit."

In *Genesee Wesleyan Seminary* v. *United States Fidelity & Guaranty Co.* (247 N. Y., 52, 159 N. E., 720) it was held that a "special deposit" may exist where the duty of the depositary is to hold, not identical bills or coins, but an equivalent sum to be kept intact for use of the depositor. That proposition is further supported by *Bank of America National Trust & Savings Association* v. *California Savings Ass'n & Commercial Bank*, supra, wherein the Supreme Court of California in a per curiam opinion stated:

> Where a fungible, such as money, is made the subject of a pledge, trust, or special deposit, in our view it can serve no purpose, and therefore it is not required that the identity of the particular money delivered be preserved in specie, as by setting it aside in a marked bag or package. The test for determining whether a general deposit or a deposit for a special purpose exists is not, therefore, whether it was intended that specific coins or currency should be kept separate and apart in specie from other funds of the custodian. In ordinary commercial transactions, either with banks or individuals, such an intent almost never will be present, and certainly will not be presumed to exist, in the absence of a clear expression thereof. In the case of a general deposit in a bank, the relationship of the bank and depositor is that of debtor and creditor, and the funds deposited become a part of the general assets of the bank, which it may use in making loans and investments and otherwise conducting a general banking business. When the nature of the transaction is such that it must be said that the depositor does not intend that such use shall be made of the amount of his deposit, then it becomes the duty of the bank, not to preserve the identity of the specific coins or currency delivered, or to physically segregate a sum of money, but, rather, at all times to keep on hand cash in a sum equal to said deposit and those of similar depositors, and the amount thereof constitutes a fund which the bank is not authorized to use in its general banking operations. (See *Missouri Mut. Ass'n* v. *Holland Bank Co.*, 220 Mo. App., 1256, 290 S. W., 100, 102.) As to such funds, the amount of which will be indicated by the bank's bookkeeping records, said depositors are entitled to a preference in the event of the bank's insolvency to the extent that the bank's cash has not been reduced below the amount of such deposits, as will be more fully discussed hereinafter.

In this connection, section 9(b), Regulations F of the Board of Governors of the Federal Reserve System, provides that funds received or held by a national bank as fiduciary awaiting investment or distribution shall not be used by the bank *in the conduct of its business* unless it first delivers to its trust department, as collateral security, certain specified bonds, etc. (See Fed. Res. Bull., September, 1936, page 691.) This arrangement, while it authorizes under certain conditions funds in a special deposit to be used in the banking business, does not change the relationship between the depositor and the bank with respect to such fund.

The conclusion to be drawn from the foregoing is that the words "moneys deposited," as used in section 863(b) of the Internal Revenue Code, and section 303(e) of the Revenue Act of 1926, as amended by section 403(d) of the Revenue Act of 1934, apply to so-called general deposits where the relationship of debtor and creditor between the bank and the depositor exists with respect to such deposits and where the money so deposited may rightfully be used in the banking business, but do not apply to funds held in a fiduciary capacity.

It is, therefore, the opinion of this office that the exemption provided in section 863(b) of the Internal Revenue Code, and in section 303(e) of the Revenue Act of 1926, as amended, does not apply to deposits held by a trustee or by a custodian acting in a fiduciary capacity, even though such trustee or custodian is carrying on a banking business. Whether deposits in a custodian account create between the custodian and the depositor the relationship of debtor and creditor or whether, on the other hand, they create a fiduciary or other non-debtor-creditor relationship depends upon the intent of the parties as evidenced by the agreement creating the relationship. Funds held in a custodian account which, under the agreement in the particular case, are held by the custodian in a fiduciary capacity are not "moneys deposited" within the meaning of the sections above indicated, and are, therefore, includible in the gross estate of the decedent.

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

SECTION 302, REVENUE ACT OF 1924.

REGULATIONS 68 (1924), ARTICLE 15: Transfers during life. 1940-27-10309 Ct. D. 1459

ESTATE TAX.—REVENUE ACT OF 1924—DECISION OF 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.

The decedent in his lifetime created a trust by the terms of which the net income was to be paid to a designated beneficiary during her life, and upon her death the corpus was to be paid to him if he survived her, and if not, it was to be distributed or held in trust for his children and others. The decedent did not survive the life beneficiary. *Held:* That the value of the remainder interest in the trust property is includible in the gross estate of the decedent, such interest coming within the terms of the taxing statute as a transfer intended to take effect in possession or enjoyment at or after his death.

2. Decision followed.

Helvering v. *Hallock* (1940) (309 U. S., 106 [Ct. D. 1440, 1940-1, 223]), followed.

DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MASSACHUSETTS.

Gertrude Bradlee et al., Exec. u/w Arthur T. Bradlee, v. *Thomas W. White, Collector of Internal Revenue.*

[31 F. Supp., 569.]

[February 2, 1940.]

OPINION.

SWEENEY, J.: This is an action to recover estate taxes alleged to have been illegally assessed, collected, and retained. The plaintiffs are the duly appointed and qualified executors of the will of Arthur T. Bradlee, who died on August 31, 1925.

The case was tried and submitted on November 7, and decision was withheld pending the United States Supreme Court's decision in *Helvering* v. *Hallock* and *Rothensies* v. *Huston* (60 S. Ct., 444), both of which were decided January 29, 1940.

FINDINGS OF FACT.

The agreed statement of facts filed by the parties is adopted as my findings of fact under rule 52 of the rules of civil procedure.

They disclose that on April 24, 1922, the plaintiff's testator, Arthur T. Bradlee, created a trust in which it was provided that:

"*First.* The trustees shall pay the entire net income of the trust fund in their hands as trustees quarterly, or oftener at their discretion, to Gertrude Bradlee Senior during her life."

and

"*Second.* Upon the death of said Gertrude Bradlee Senior, the entire trust fund then in the hands of the trustees shall be transferred and paid over, absolutely and free of all trust, to said Arthur T. Bradlee if he survives her; and if he does not survive her, said trust fund shall be distributed or held in trust" for the children of said Arthur T. Bradlee, and others, as provided therein. The creator of the trust did not survive Gertrude Bradlee, Sr.

The estate tax return filed by these plaintiffs did not include the value on August 31, 1925, of the remainder interest, after the death of Gertrude Bradlee, Sr., in the property held under the declaration of trust. The Commissioner ruled that this should have been included in the gross estate. The value of this remainder interest was $63,348.75. Eventually the plaintiffs paid a tax of $14,016.14 together with interest in the amount of $1,116.61. A claim for refund having been denied, this suit was brought to recover the amounts paid.

It was agreed between the parties that the transfers by the deceased Bradlee to the trustees under the declaration of trust were not in fact made in contemplation of death. The question is therefore whether the remainder interest should have been included in the gross estate of the deceased Bradlee as an interest therein "of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, * * * intended to take effect in possession or enjoyment at or after his death."

The plaintiffs rely on the decision of *Helvering* v. *St. Louis Trust Co.* (296 U. S., 39), and seek to distinguish that case from *Klein* v. *United States* (283 U. S., 231 [Ct. D. 333, C. B. X–1, 462 (1931)]). It is unnecessary to consider this attempted distinguishment, since the Supreme Court, on Monday of this week, in the case of *Helvering* v. *Hallock*, supra, and associated cases, clearly disposed of the "seeming disharmony" of the results in those cases. It specifically rejected "as untenable the diversities taken in the St. Louis Trust cases in applying the Klein doctrine" because they ate "into the principle which those cases professed to accept." Adhering to those principles, and adopting the language of the Klein case, the court stated: "It is perfectly plain that the death of the grantor was the indispensable and intended event which brought the larger estate into being for the grantee and affected its transmission from the dead to the living, thus satisfying the terms of the taxing Act and justifying the tax imposed."

On the agreed facts I reach the conclusion of law that a remainder interest in the trust property was retained by Arthur T. Bradlee, the transmission of which could only be effected upon his death during the life of Gertrude Bradlee, Sr. When that event happened the remainder vested in the erstwhile contingent beneficiaries, and, being grounded upon the death of the grantor, it plainly comes within the terms of the taxing statute. The value of the remainder interest as of August 31, 1925, has been stipulated by the parties. The assessment and collection of the taxes was therefore proper.

The plaintiff's motion for judgment is denied. Judgment may be entered for the defendant with costs.

GIFT TAX.

INTERNAL REVENUE CODE.

SECTION 1000.—IMPOSITION OF TAX.

REGULATIONS 79 (1936), ARTICLE 3: Cessation of donor's dominion and control. 1940–40–10441 T. D. 5010

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 85; SUBCHAPTER E, PART 465, SUBPART B.—GIFT TAX.

Article 3, Regulations 79 (1936 edition), amended. Transfers subject to a reserved power.

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

To Collectors of Internal Revenue and Others Concerned:

Article 3 of Regulations 79, 1936 edition (section 85.3, 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 (Part 465, Subpart B, of such Title 26 (C. B. 1939–1 (Part 1), 396)), is hereby amended by striking out the second and third paragraphs thereof reading as follows:

As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to cause the beneficial title to be revested in himself, the gift is complete. But a transfer (in trust or otherwise), though passing both legal and beneficial title, is still in essence merely formal so long as there remains in the donor a power to cause the revesting of the beneficial title in himself, and the gift, from the standpoint of substance, remains incomplete during the existence of the power. A donor shall be considered as having the power to revest in himself the beneficial title to the property transferred if he has such power in conjunction with any person not having a substantial adverse interest in the disposition of the property or the income therefrom. A trustee, as such, is not a person having a substantial adverse interest in the disposition of the trust property or the income therefrom. The relinquishment or termination of the power, occurring otherwise than by the death of the donor (the statute being confined to transfers by living donors), is regarded as the event which completes the gift and causes the tax to apply.[1] The receipt of income or of other enjoyment of the transferred property by the transferee or by the beneficiary (other than by the donor himself) during the interim between the making of the formal transfer and the relinquishment or termination of the power operates to free such income or other enjoyment from the donor's power to receive it himself, and constitutes a gift of such income or of such other enjoyment taxable in the calendar year of its receipt.

If the donor contends that a power retained by him constitutes beneficial dominion and control, and that by reason thereof the transfer is not in substance a gift, the transaction shall be disclosed in the return and evidence showing all relevant facts, including a copy of the instrument by which the transfer was made, should be submitted.

and substituting in lieu thereof the following:

As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change the

[1] So held in *Burnet* v. *Guggenheim* (288 U. S., 280, 53 S. Ct., 369 [Ct. D. 636, C. B. XII–1, 374 (1933)]) of a transfer in trust, made in 1917, with power in the donor to revoke, which power he relinquished in 1925, the relinquishment being treated a gift subject to the tax imposed by the gift tax title of the Revenue Act of 1924.

disposition thereof, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over the disposition thereof, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and their scope determined.

A gift is incomplete in every instance where a donor reserves the power to revest the beneficial title to the property in himself. A gift is also incomplete where and to the extent that a reserved power gives the donor the right to name new beneficiaries or to change the interests of the beneficiaries as between themselves. Thus, the transfer of an estate for life where, by an exercise of the power, the estate may be terminated or cut down to one of less value, and without restriction upon the extent to which the estate may be so cut down, constitutes an incomplete gift. Modifying the example by treating the power as confined to the right to cut down the estate for life to one for a term of five years, the certainty of an estate for not less than that term results in a gift to that extent complete.

A gift shall not be considered incomplete, however, merely because the donor reserves the power to change the manner or time of enjoyment thereof. Thus, the creation of a trust the income of which is to be paid annually to the donee for a period of years, the corpus being distributable to him at the end of the period, and the power reserved by the donor being limited to a right to require that, instead of the income being so payable, it should be accumulated and distributed with the corpus to such donee at the termination of the period, constitutes a completed gift.

A donor shall be considered as himself having the power where it is exercisable by him in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. A trustee, as such, is not a person having an adverse interest in the disposition of the trust property or its income.

The relinquishment or termination of a power to change the disposition of the transferred property, occurring otherwise than by the death of the donor (the statute being confined to transfers by living donors), is regarded as the event which completes the gift and causes the tax to apply. The receipt of income or of other enjoyment of the transferred property by the transferee or by the beneficiary (other than by the donor himself) during the interim between the making of the initial transfer and the relinquishment or termination of the power operates to free such income or other enjoyment from the power, and constitutes a gift of such income or of such other enjoyment taxable as of the calendar year of its receipt.

If the donor contends that the power is of such nature as to render the gift incomplete, and hence not subject to the tax as of the calendar year of the initial transfer, the transaction shall be disclosed in the return and evidence showing all relevant facts, including a copy of the instrument of transfer, should be submitted.

If for any calendar year prior to the calendar year 1939 a transfer has been subjected to payment of the tax despite the fact that the donor retained a power to name new beneficiaries or to change the interests of the beneficiaries as between themselves, and if the tax for such calendar year has been finally determined on such basis, and for all gift tax purposes such transfer has been treated, for such calendar year and each subsequent calendar year, as subject to the tax, and the donor agrees, in a closing agreement executed under the provisions of section 3760, that he will continue so to treat such transfer, then the relinquishment or termination of the power so retained by the donor shall not be treated as a gift subject to the tax.

(This Treasury decision is issued under the authority contained in the following sections of law: Sections 1000, 1029, and 3791 of the Internal Revenue Code (53 Stat., 144, 157, 467); sections 501 and 530 of the Revenue Act of 1932 (47 Stat., 245, 259, 26 U. S. C., 550, 579); and section 1108(a) of the Revenue Act of 1926, as amended by section 605

of the Revenue Act of 1928 and by section 506 of the Revenue Act of 1934 (44 Stat., 114, 45 Stat., 874, 48 Stat., 757, 26 U. S. C., 1691(b).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved September 19, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register September 23, 1940, 3.10 p. m.)

SECTION 1001, AS AMENDED BY SECTION 207 OF REVENUE ACT OF 1940.

REGULATIONS 79 (1936), ARTICLE 5: Computation of tax. 1940-33-10386 T. D. 4996

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 85.—GIFT TAX.

Article 5 of Regulations 79 (1936 edition) as made applicable to the Internal Revenue Code, amended.—Defense tax for 1940–1945.

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

To Collectors of Internal Revenue and Others Concerned:

In order to conform Regulations 79 [Part 85, 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, 1939 Sup.], to the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), approved June 25, 1940, such regulations are amended as follows:

1. Insert immediately preceding article 5 [section 85.5 of such Title 26]:

SEC. 207. GIFT TAX. (REVENUE ACT OF 1940.)

Section 1001 of the Internal Revenue Code is amended by adding at the end thereof the following new subsection:

"(d) DEFENSE TAX FOR 1940–1945.—Despite the provisions of subsection (a)—

"(1) The tax for each of the calendar years 1941 to 1945, both inclusive, shall be an amount equal to the excess of—

"(A) 110 per centum of a tax, computed in accordance with the Rate Schedule hereinbefore set forth, on the aggregate sum of the net gifts for such calendar year and for each of the preceding calendar years, over

"(B) 110 per centum of a tax, computed in accordance with the said Rate Schedule, on the aggregate sum of the net gifts for each of the preceding calendar years.

"(2) The tax for the calendar year 1940 shall be the sum of (A) the tax computed under subsection (a), plus (B) an amount which bears the same ratio to 10 per centum of the tax so computed as the amount of gifts made after the date of the enactment of the Revenue Act of 1940 bears to the total amount of gifts made during the year. For the purposes of this paragraph, the term 'gifts' does not include gifts which, under section 1003(b)(2), are not to be included in computing the total amount of gifts made during the calendar year 1940, or gifts which, in the case of a citizen or resident, are allowed as a deduction by section 1004(a)(2), or gifts which, in the case of a nonresident not a citizen of the United States, are allowed as a deduction by section 1004(b)."

2. Article 5 [section 85.5 of such Title 26] is amended by striking out the last sentence of the first paragraph and the whole of the second paragraph and substituting in lieu thereof the following:

If the return is for a calendar year prior to 1940 or subsequent to 1945, the amount remaining after such subtraction is the tax for such calendar year.

If the return is being prepared for the calendar year 1941, 1942, 1943, 1944, or 1945, the defense tax imposed by subsection (d) of section 1001 of the Internal Revenue Code, as added by section 207 of the Revenue Act of 1940, must be ascertained by computing 10 per cent of the tax determined in the manner set forth in the first paragraph of this article. For any such calendar year the total amount of tax payable is the amount determined in the manner explained in that paragraph plus the defense tax of 10 per cent thereof. In the case of a return for the calendar year 1940, the amount of the defense tax to be added is that proportion of 10 per cent of the tax computed in the manner indicated in the first paragraph of this article which the total amount of the gifts made after June 25, 1940 (determined after the allowance of any applicable exclusions authorized by section 1003(b)2 of the Internal Revenue Code, or deductions for charitable, etc., gifts authorized by sections 1004(a)2 and 1004(b) of the Internal Revenue Code, but without the allowance of the specific exemption or any portion thereof), bears to the total amount of gifts made during the calendar year determined in the same manner.

In case no reportable gifts were made during the preceding calendar years, considering only gifts made after June 6, 1932, the tax for the calendar year for which the return is being prepared is the tax computed in accordance with the rate schedule in force for such year upon the amount of the net gifts for such calendar year, plus the amount of the defense tax, if applicable.

Example (1) (showing computation of defense tax for calendar year 1941): During the calendar year 1941 a resident donor makes the following gifts:

To daughter	$44,000
To son	14,000
To a charitable organization	10,000

The amount of his net gifts for preceding calendar years, subsequent to June 6, 1932, is $50,000. Only $25,000 of his specific exemption was claimed for such preceding years. The remaining $15,000 of his specific exemption is claimed for the calendar year 1941.

The amount of the net gifts for the calendar year 1941 is determined as follows:

Total gifts		$68,000.00
Less exclusions under section 1003(a)2 of the Internal Revenue Code		12,000.00
Total included amount of gifts for year		56,000.00
Total deductions for charitable gifts ($10,000 less exclusion of $4,000)	$6,000	
Specific exemption claimed	15,000	
Total deductions		21,000.00
Amount of net gifts for year		35,000.00

The total amount of the tax payable for the calendar year 1941 is computed as follows:

1. Amount of net gifts for year	$35,000.00
2. Total amount of net gifts for preceding years	50,000.00
3. Total net gifts	85,000.00
4. Tax computed on item 3 (in accordance with rate schedule)	5,625.00
5. Tax computed on item 2 (in accordance with rate schedule)	2,250.00
6. Tax on net gifts for year without addition of defense tax (item 4 minus item 5)	3,375.00
7. Defense tax (10 per cent of item 6)	337.50
8. Total tax payable for year (item 6 plus item 7)	3,712.50

Example (2) (showing computation of defense tax for calendar year 1940): The facts are the same as in the preceding example except that the remaining $15,000 of his specific exemption is claimed for the calendar year 1940 and the gifts to the daughter, son, and charitable organization were made during the calendar year 1940, as follows:

To daughter before June 26, 1940	$44,000
To son after June 25, 1940	14,000
To charitable organization after June 25, 1940	10,000

The determination of the amount of the net gifts and the computation of the tax, without the addition of the defense tax, is the same as in the preceding example.

The computation of the defense tax and the total amount of the tax payable for the calendar year 1940 is shown as follows:

Total included amount of gifts for year, less amount deducted for charitable gift ($56,000 minus $6,000)	$50,000.00
Total included amount of gifts made after June 25, 1940, less amount deducted for charitable gift made after June 25, 1940 ($16,000 minus $6,000)	10,000.00
10 per cent of $33,375, the amount of the tax without the addition of the defense tax	337.50
Defense tax for 1940 $\left(\frac{10,000}{50,000} \times \$337.50\right)$	67.50
Total amount of tax payable for calendar year 1940 ($33,375 plus $67.50)	3,442.50

(This Treasury decision is issued under the authority contained in subsection (d) of section 1001 of the Internal Revenue Code, as added by section 207 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), approved June 25, 1940, and section 3791(a)1 of the Internal Revenue Code (53 Stat., 467).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved August 1, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register August 5, 1940, 3.54 p. m.)

CAPITAL STOCK TAX.

INTERNAL REVENUE CODE.

SECTION 1200, AS AMENDED BY SECTION 205 OF THE REVENUE ACT OF 1940.

REGULATIONS 64 (1938), ARTICLE 41: Nature and rate of tax. (Also Article 61.) 1940–30–10351 T. D. 4983

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 137, SUBPART B; SUBCHAPTER E, PART 465, SUBPART B.—CAPITAL STOCK TAX.

Section 205, Revenue Act of 1940.—Articles 41 and 61 of Regulations 64 (1938), as amended, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Section 205 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), provides that:

SEC. 205. CAPITAL STOCK TAX.

Section 1200 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsection:

"(c) DEFENSE TAX FOR FIVE YEARS.—For the year ending June 30, 1940, and for the four succeeding years ending June 30, the rates provided in subsections (a) and (b) shall be $1.10 in lieu of $1."

In order to conform Regulations 64, approved February 4, 1939 (Part 137, Subpart B, Title 26, Code of Federal Regulations, 1939 Sup.), 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, of such Title 26, 1939 Sup.), and as amended by Treasury Decision 4912, approved July 24, 1939 [C. B. 1939–2, 347], to the above-quoted amendment to the Internal Revenue Code, such regulations are amended as follows:

1. The fourth sentence of article 41 (section 137.41 of such title), as made applicable to the Internal Revenue Code, is amended to read as follows:

The tax is imposed at the rate of $1 for each full $1,000 of the adjusted declared value of the capital stock, except that for the taxable years ending June 30, 1940, to June 30, 1944, inclusive, the rate of tax is $1.10.

2. The second sentence of article 61 (section 137.61 of such title) as made applicable to the Internal Revenue Code, is amended to read as follows:

The tax is imposed at the rate of $1 for each full $1,000 of the adjusted declared value of capital employed by a foreign corporation in the transaction of business in the United States, except that for the taxable years ending June 30, 1940, to June 30, 1944, inclusive, the rate of tax is $1.10.

(This Treasury decision is prescribed pursuant to section 1200(c) as added to the Internal Revenue Code by section 205 of the Revenue

Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), and section 3791 of the Internal Revenue Code (53 Stat., 467).)

TIMOTHY MOONEY,
Acting Commissioner of Internal Revenue.

Approved July 16, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 18, 1940, 11.51 a. m.)

SECTIONS 1203 AND 1205.

1940-31-10361
T. D. 4984

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 137, SUBPART D.—CAPITAL STOCK TAX.

Sections 1203 and 1205, Internal Revenue Code.—Extension of time for filing capital stock tax returns and paying tax.

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

To Collectors of Internal Revenue and Others Concerned:

SEC. 137D. *General extension.*—Returns of capital stock tax under Chapter 6 of the Internal Revenue Code (53 Stat., Part 1), as amended, for the year ended June 30, 1940, are required to be filed and the tax paid on or before July 31, 1940, unless the time for filing returns and paying the tax is extended under the provisions of sections 1203 and 1205 of the afore-mentioned chapter.

In accordance with the provisions of these sections, the period during which the returns of capital stock tax may be filed and the tax paid by corporations having no principal place of business within the continental United States is extended to September 29, 1940. Collectors of internal revenue are authorized to accept returns of such corporations without assertion of penalties for delinquency or of interest if the returns of such corporations are filed and the tax paid on or before the extended date. (Secs. 1203, 1205, 3791, 53 Stat., 171, 467.)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved July 18, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 22, 1940, 11.57 a. m.)

MANUFACTURERS' EXCISE TAXES.

INTERNAL REVENUE CODE.

CHAPTER 29, AS AMENDED BY SECTIONS 209, 210, AND 216 OF THE REVENUE ACT OF 1940.

REGULATIONS 46 (1940), SECTIONS 316.2, 316.9, 316.32, 316.41, 316.51, 316.52, 316.54, 316.56, 316.60, 316.62, 316.73, 316.82.

1940–33–10387
T. D. 4998

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 316.—MANUFACTURERS' EXCISE TAXES.

Sections 316.2, 316.9, 316.32, 316.41, 316.51, 316.52, 316.54, 316.56, 316.60, 316.62, 316.73, and 316.82 of Regulations 46 (1940 edition), amended.

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

To Collectors of Internal Revenue and Others Concerned:

In order to conform Regulations 46 (Part 316, Title 26, Code of Federal Regulations, 1939 Sup.), relating to excise taxes on sales by the manufacturer under the Internal Revenue Code, to sections 209, 210, and 216 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), such regulations are amended as follows:

PARAGRAPH 1. Immediately preceding section 316.2, there are inserted a heading and a quotation of section 209 of the Revenue Act of 1940, as follows:

SEC. 209. CONTINUATION OF EXCISE TAXES. (REVENUE ACT OF 1940.)

Sections * * * 3403(f)(1), 3452 * * * of the Internal Revenue Code are amended by striking out "1941" wherever appearing therein and inserting in lieu thereof "1945".

PAR. 2. The second paragraph of section 316.2 is amended to read as follows:

No such sale, lease, or use after June 30, 1945 (or after July 31, 1945, in the case of articles taxable under sections 3400 and 3403 of the Internal Revenue Code, relating to the tax on tires and inner tubes and automobiles, etc.), is taxable under the title except that with respect to firearms, shells, and cartridges taxable under section 3407 of the Internal Revenue Code, the limitation does not apply.

PAR. 3. Immediately preceding section 316.8, there are inserted a heading and a quotation of section 210 of the Revenue Act of 1940, as follows:

SEC. 210. MISCELLANEOUS EXCISES. (REVENUE ACT OF 1940.)

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

* * * * * * *

"(b) In the application of section 3441(c) to the articles with respect to which the rate of tax is increased by this section, where the lease, contract of sale, or conditional sale, and delivery thereunder, was made before July 1, 1940, the total tax referred to in such section shall be the tax at the rate in force on June 30, 1940, and not at the increased rate."

PAR. 4. Section 316.9 is amended by inserting between the first and second sentences of paragraph 2 thereof a new sentence to read as follows:

If the lease, contract of sale, or conditional sale, and delivery thereunder, was made prior to July 1, 1940, the tax is due at the rate in force on June 30, 1940, and not at the increased rate provided for in section 1650 of the Internal Revenue Code, as added by section 210 of the Revenue Act of 1940.

PAR. 5. Immediately preceding section 316.30, there are inserted a heading and a quotation of section 210 of the Revenue Act of 1940, as follows:

SEC. 210. MISCELLANEOUS EXCISES. (REVENUE ACT OF 1940.)

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	* *
3400(1)	Tires	2¼ cents	2½ cents.
3400(2)	Tubes	4 cents	4½ cents.
*	* * *	*	* *

* * * * * * *

PAR. 6. The first paragraph of section 316.32 is amended to read as follows:

SEC. 316.32. *Rate and computation of tax.*—The tax is payable by the manufacturer at the following rates: (*a*) tires, 2¼ cents prior to July 1, 1940, and for the month of July, 1945, and 2½ cents for the period July 1, 1940, to June 30, 1945, inclusive, a pound on total weight (exclusive of metal rims or rim bases); and (*b*) inner tubes (for tires) 4 cents prior to July 1, 1940, and for the month of July, 1945, and 4½ cents for the period July 1, 1940, to June 30, 1945, inclusive, a pound on total weight.

PAR. 7. Immediately preceding section 316.40, there are inserted a heading and a quotation of section 210 of the Revenue Act of 1940, as follows:

SEC. 210. MISCELLANEOUS EXCISES. (REVENUE ACT OF 1940.)

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

" Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	* *
3401	Toilet preparations	10 percent	11 percent.
*	* * *	*	* *

* * * * * * *

PAR. 8. Section 316.41 is amended by inserting "(11 per cent for the period July 1, 1940, to June 30, 1945, inclusive)" after " 10 per cent " wherever appearing therein.

PAR. 9. Immediately preceding section 316.50, there are inserted a heading and a quotation of section 210 of the Revenue Act of 1940, as follows:

SEC. 210. MISCELLANEOUS EXCISES. (REVENUE ACT OF 1940.)

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

" CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

" SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

" Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	*
3403(a)	Automobile truck chassis, etc.	2 percent	2½ percent.
3403(b)	Automobiles, etc	3 percent	3½ percent.
*	* * *	*	*

* * * * * * *

PAR. 10. Section 316.51 is amended by inserting "(2½ per cent for the period July 1, 1940, to June 30, 1945, inclusive)" after " 2 per cent "; and inserting "(3½ per cent for the period July 1, 1940, to June 30, 1945, inclusive)" after " 3 per cent."

PAR. 11. Section 316.52 is amended by inserting "(2½ per cent and 3½ per cent for the period July 1, 1940, to June 30, 1945, inclusive)" after " 3 per cent " in the first sentence; and inserting "(3½ per cent and 2½ per cent for the period July 1, 1940, to June 30, 1945, inclusive)" after " 2 per cent " in the second sentence.

PAR. 12. Immediately preceding section 316.54, there are inserted a heading and a quotation of section 216 of the Revenue Act of 1940, as follows:

SEC. 216. CREDITS ON TAX ON AUTOMOBILES, ETC. (REVENUE ACT OF 1940.)

Section 3403(e) of the Internal Revenue Code is amended by adding at the end thereof the following new sentence: " With respect to the period after June 30, 1940, and before July 1, 1945, the rates of the credits above provided shall, in lieu of 2 per centum and 3 per centum, be 2½ per centum and 3½ per centum, respectively."

PAR. 13. Section 316.54 is amended as follows:

(A) The last sentence of the first paragraph is amended to read as follows:

For example, if the sale price of an automobile is $1,000, the tax payable thereon $35, and the cost to the automobile manufacturer of the tires sold on or in connection therewith $40, the manufacturer will be permitted to take a credit

against the tax payable on the selling price of the automobile, prior to July 1, 1940, and for the month of July, 1945, in an amount equal to 3 per cent of $40, namely, $1.20, and for the period July 1, 1940, to June 30, 1945, inclusive, in an amount equal to 3½ per cent of $40, or $1.40.

(B) The first sentence of the second paragraph is amended by inserting "(3½ per cent for the period July 1, 1940, to June 30, 1945, inclusive)" after "3 per cent"; and inserting "(2½ cents and 4½ cents per pound for the period July 1, 1940, to June 30, 1945, inclusive)" after "4 cents per pound."

PAR. 14. Immediately preceding section 316.55, there are inserted a heading and a quotation of section 210 of the Revenue Act of 1940, as follows:

SEC. 210. MISCELLANEOUS EXCISES. (REVENUE ACT OF 1940.)

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	* *
3403(c)	Parts	2 percent	2½ percent.
*	* * *	*	* *

* * * * * * *

PAR. 15. Section 316.56 is amended by inserting "2½ per cent for the period July 1, 1940, to June 30, 1945, inclusive)" after "2 per cent."

PAR. 16. Immediately preceding section 316.60, there are inserted a heading and a quotation of section 210 of the Revenue Act of 1940, as follows:

SEC. 210. MISCELLANEOUS EXCISES. (REVENUE ACT OF 1940.)

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	* *
3404	Radios	5 percent	5½ percent.
*	* * *	*	* *

* * * * * * *

PAR. 17. The first sentence of the fifth paragraph of section 316.60 is amended by inserting "(2½ per cent for the period July 1, 1940, to June 30, 1945, inclusive)" after "2 per cent."

PAR. 18. Section 316.62 is amended by inserting "(5½ per cent for the period July 1, 1940, to June 30, 1945, inclusive)" after "5 per cent."

PAR. 19. Immediately preceding section 316.70, there are inserted a heading and a quotation of section 210 of the Revenue Act of 1940, as follows:

SEC. 210. MISCELLANEOUS EXCISES. (REVENUE ACT OF 1940.)

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	* *
3405	Mechanical refrigerators	5 percent	5½ percent.
*	* * *	*	* *

* * * * * * *

PAR. 20. Section 316.73 is amended by inserting "(5½ per cent for the period July 1, 1940, to June 30, 1945, inclusive)" after "5 per cent."

PAR. 21. Immediately preceding section 316.80, there are inserted a heading and a quotation of section 210 of the Revenue Act of 1940, as follows:

SEC. 210. MISCELLANEOUS EXCISES. (REVENUE ACT OF 1940.)

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	* *
3407	Firearms	10 percent	11 percent.
*	* * *	*	* *

* * * * * * *

PAR. 22. Section 316.82 is amended by inserting "(11 per cent for the period July 1, 1940, to June 30, 1945, inclusive)" after "10 per cent."

(This Treasury decision is issued under the authority of sections 3403(f)1 and 3452 of the Internal Revenue Code (53 Stat., 411, 420), as amended by section 209 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session); section 3403(e) of such Code (53 Stat., 410), as amended by section 216 of such Revenue

Act; sections 3400, 3401, 3403 (a), (b), (c), 3404, 3405, and 3407 of such Code (53 Stat., 409, 410, 411, 412), as modified by section 210 of such Revenue Act; and section 3450 of such Code (53 Stat., 419).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved August 1, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register August 5, 1940, 3.55 p. m.)

SECTION 3413, AS AMENDED BY SECTION 210 OF THE REVENUE ACT OF 1940.—TAX ON LUBRICATING OILS.

REGULATIONS 44 (1939), SECTION 314.43: Sales of oil for nonlubricating uses. 1940-36-10409 S. T. 905

Sales of certain oils are not subject to manufacturers' excise tax when sold direct by the manufacturer to consumers for nonlubricating uses under the conditions prescribed in section 314.43 of Regulations 44 (1939).

In S. T. 558 (C. B. XI-2, 450 (1932)), as modified by S. T. 839 (C. B. XV-1, 379 (1936)), it was held that buffing oil, burning oil, concrete form oil, core oil, floor oil, harness oil, leather oil, quenching oil, slushing oil, tempering oil, lard oil, and refined and deodorized neatsfoot oil were not subject to tax when sold by the manufacturer under a name identifying such oils for purposes other than lubrication, or when used as a component material in the manufacture of other articles taxable under Title IV of the Revenue Act of 1932, provided the manufacturer obtained from the purchaser a certificate to the effect that the oil so sold would not be used for lubrication. It was further held that crude neatsfoot oil and oil manufactured and sold specifically for use in electrical transformers and large outdoor oil circuit breakers as an insulating agent, generally known as transformer or insulating oil, were not sold or used for lubricating purposes and, therefore, were not subject to tax as lubricating oil when sold, no exemption certificates being required with respect to sales of such oils.

In addition to the oils enumerated above, the following oils are held not subject to tax when sold direct by the manufacturer to a consumer for nonlubricating uses under the conditions prescribed in section 314.43 of Regulations 44 (1939): agricultural spray oil, air conditioning oil, battery oil, cordage oil, cotton softener oil, electrical impregnating oil, floor sweeping compound, fur dressing oil, ink oil, metal wash oil, meter oil, molding oil (for rubber tires), oil used as a nonlubricating component material in the manufacture of a nontaxable product, paint oil, paper impregnating oil, putty oil, rayon oil, rust preventative, silk oil, slab oil, soap stock, technical white oil, and wood-preserving oil.

Sales of any of the foregoing oils by the manufacturer for resale to consumers must be made tax-paid, but credit may be claimed for the tax paid on such sales upon receipt of evidence that the oil was resold to consumers for nonlubricating uses.

REGULATIONS 44 (1939), SECTIONS 314.2, 314.4, 314.35, 314.44, 314.52.

1940-31-10368
T. D. 4990

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 314.—TAXES ON GASOLINE, LUBRICATING OIL, AND MATCHES.

Sections 314.2, 314.4, 314.35, 314.44, and 314.52 of Regulations 44 (1939 edition) amended.

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

To Collectors of Internal Revenue and Others Concerned:

In order to conform Regulations 44 (Part 314, Title 26, Code of Federal Regulations, 1939 Sup.), relating to taxes on gasoline, lubricating oils, and matches under the Internal Revenue Code, to sections 209 and 210 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), such regulations are amended as follows:

The following is inserted immediately preceding section 314.2:

SEC. 209. CONTINUATION OF EXCISE TAXES. (REVENUE ACT OF 1940.)

Sections * * * 3542 * * * of the Internal Revenue Code are amended by striking out "1941" wherever appearing therein and inserting in lieu thereof "1945".

Paragraph 2 of section 314.2 is amended to read as follows:

The tax is imposed upon any sale or use prior to July 1, 1945, of gasoline, lubricating oils, or matches by the manufacturer or other person liable for tax under the provisions of section 3445 of the Internal Revenue Code irrespective of when the article was manufactured, produced, or imported.

The following is inserted immediately preceding section 314.3:

SEC. 210. MISCELLANEOUS EXCISES. (REVENUE ACT OF 1940.)

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

* * * * * * *

"(b) In the application of section 3441(c) to the articles with respect to which the rate of tax is increased by this section, where the lease, contract of sale, or conditional sale, and delivery thereunder, was made before July 1, 1940, the total tax referred to in such section shall be the tax at the rate in force on June 30, 1940, and not at the increased rate."

Section 314.4 is amended by inserting between the first and second sentences of paragraph 5 thereof a new sentence to read as follows:

Where the lease, contract of sale, or conditional sale, and delivery thereunder, was made prior to July 1, 1940, the tax is due at the rate in force on June 30, 1940, and not at the increased rate.

The following is inserted immediately preceding section 314.30:

SEC. 210. MISCELLANEOUS EXCISES. (REVENUE ACT OF 1940.)

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	* *
3412	Gasoline	1 cent	1½ cents.
*	* * *	*	* *

* * * * * * *

The following is inserted immediately preceding section 314.40:

SEC. 210. MISCELLANEOUS EXCISES. (REVENUE ACT OF 1940.)

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	* *
3413	Lubricating oils	4 cents	4½ cents.
*	* * *	*	* *

* * * * * * *

The following is inserted immediately preceding section 314.50:

SEC. 210. MISCELLANEOUS EXCISES. (REVENUE ACT OF 1940.)

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	* *
3409	Matches	5 cents	5½ cents.
*	* * *	*	* *

* * * * * * *

Section 314.35 is amended to read as follows:

SEC. 314.35. *Rate of tax.*—The tax is payable by the importer or producer thereof, or by any producer of gasoline, at the rate of 1 cent a gallon prior to July 1, 1940, and at the rate of 1½ cents a gallon for the period July 1, 1940, to June 30, 1945, inclusive.

Section 314.44 is amended to read as follows:

SEC. 314.44. *Rate of tax.*—The tax is payable by the manufacturer at the rate of 4 cents per gallon prior to July 1, 1940, and at the rate of 4½ cents per gallon for the period July 1, 1940, to June 30, 1945, inclusive. A manufacturer of nonfluid lubricating oils which are sold by weight may use 8 pounds to the gallon as a basis for computing and reporting the tax upon the sale or use of such oils.

Section 314.52 is amended to read as follows:

SEC. 314.52. *Rate of tax.*—The tax is payable at the rate of 5 cents per thousand prior to July 1, 1940, and at the rate of 5½ cents for the period July 1, 1940, to June 30, 1945, inclusive.

(This Treasury decision is prescribed pursuant to section 3452 of the Internal Revenue Code (53 Stat., 420), as amended by section 209 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), sections 3409, 3412, 3413 of such Code (53 Stat., 412, 413, 414), as modified by section 210 of such Revenue Act, and section 3450 of such Code (53 Stat., 419).)

TIMOTHY C. MOONEY.
Acting Commissioner of Internal Revenue.

Approved July 19, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 22, 1940, 3.57 p. m.)

ELECTRICAL ENERGY TAX.

SECTION 3411, AS AMENDED BY SECTION 210 OF THE REVENUE ACT OF 1940.

REGULATIONS 42 (1932), ARTICLE 40: Scope of tax. 1940-50-10523
S. T. 909

Sales of electrical energy to educational institutions not operated for profit, churches, convents, and charitable organizations for consumption in a domestic or commercial activity of such organizations are subject to tax under section 3411 of the Internal Revenue Code, as amended.

S. T. 535 (C. B. XI-2, 500 (1932)) and S. T. 544 (C. B. XI-2, 500 (1932)) modified.

Advice is requested whether electrical energy sold to educational institutions not operated for profit, churches, and charitable institutions for consumption in a commercial or domestic activity of the organization is subject to tax under section 3411 of the Internal Revenue Code, as amended by section 210 of the Revenue Act of 1940.

Section 3411 of the Internal Revenue Code, as amended, provides in part as follows:

(a) There shall be imposed upon electrical energy sold *for domestic or commercial consumption* * * * a tax * * * to be paid by the vendor under such rules and regulations as the Commissioner, with the approval of the Secretary, shall prescribe. [Italics supplied.]

Article 40 of Regulations 42 (1932), as amended by Treasury Decision 4393 (C. B. XII-2, 322 (1933)), reads in part as follows:

The term "electrical energy sold for domestic or commercial consumption" does not include * * * electrical energy * * * sold for other uses which likewise can not be classed as domestic or commercial, such as the electrical energy used by * * * educational institutions not operated for profit, churches, and charitable institutions. * * *

The above-quoted provisions of Regulations 42 were meant to serve as an administrative guide and in no way were intended to restrict the scope of the law. Such provisions merely attempt to define "domestic or commercial consumption" as it appears in the statute by pointing out typical institutions or organizations which would not ordinarily purchase electrical energy for a domestic or commercial purpose. The taxability of sales of electrical energy is determined by the nature of the consumption rather than of the consumer. Ordinarily educational institutions not operated for profit, churches, convents, and charitable institutions do not use electrical energy in the domestic or commercial sense intended by the statute. But where such an organization consumes through a separate meter electrical energy in a domestic or commercial phase of its activities, or through a single meter if the activity at the location served by the single meter is primarily domestic or commercial, a sale of electrical energy to such an organization for such use is a sale for "domestic or commercial consumption" within the meaning of the law and regulations.

In view of the foregoing, it is held that sales of electrical energy to educational institutions not operated for profit, churches, conventions, and charitable organizations for consumption through a separate meter in a domestic or commercial activity, or through a single

meter if the activity at the location served by the single meter is primarily domestic or commercial, are subject to tax under section 3411 of the Internal Revenue Code, as amended.

S. T. 535 (C. B. XI-2, 500 (1932)) and S. T. 544 (C. B. XI-2, 500 (1932)) are modified accordingly.

REGULATIONS 42 (1932), ARTICLE 42: Rate of tax. 1940-29-10333
Mim. 5067

Computation of tax on electrical energy.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., June 29, 1940.

Collectors of Internal Revenue and Others Concerned:

A question has arisen as to the manner in which power companies should account for manufacturers' excise tax on invoices covering electrical energy furnished or sold before and after July 1, 1940, in view of the provisions of section 210 of the Revenue Act of 1940, which amended section 3411 of the Internal Revenue Code by raising the rate of tax on sales of electrical energy from 3 percent of the charge to 3⅓ percent of the charge, effective July 1, 1940.

It is held that where bills rendered after July 1, 1940, include energy furnished both before and after that date the tax on energy so furnished shall be computed on a pro rata basis for the number of days covered by each period. In other words, if a meter is read on July 10, 1940, and the bill rendered includes energy furnished from June 10 to July 10, the tax will be due at the rate of 3 per cent for 20/30 of such bill and at the rate of 3⅓ per cent for 10/30 thereof.

Correspondence in regard to this mimeograph should refer to its number and to the symbols MT:ST.

GUY T. HELVERING,
Commissioner.

SECTIONS 209 AND 210, REVENUE ACT OF 1940.—CONTINUATION OF EXCISE TAXES; DEFENSE TAX.

REGULATIONS 42 (1932), ARTICLES 1, 8, 25, 27, 32, 39, and 42. (Also Section 210.) 1940-31-10363
T. D. 4986

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 130; SUBCHAPTER E, PART 465, SUBPART B.—TAXES ON TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES; TRANSPORTATION OF OIL BY PIPE LINE; SAFE DEPOSIT BOXES; AND ELECTRICAL ENERGY.

Articles 1, 8, 25, 27, 32, 39, and 42 of Regulations 42, approved October 22, 1932, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Section 209 of the Revenue Act of 1940, approved June 25, 1940, reads in part as follows:

SEC. 209. CONTINUATION OF EXCISE TAXES.

Sections * * * 3452, 3460(a), 3465, * * * of the Internal Revenue Code are amended by striking out "1941" wherever appearing therein and inserting in lieu thereof "1945".

In conformity with the provision of law quoted above, articles 1, 8, 25, and 39 of Regulations 42 (revised October, 1932), as amended [sections 130.1, 130.8, 130.25, and 130.39 of Title 26, Code of Federal Regulations], but only as prescribed and 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), are further amended to read as follows:

ARTICLE 1. *Effective period.*—The tax is imposed upon payments for the transmission by telegraph, telephone, cable, or radio of dispatches, messages, and conversations originating in the United States prior to July 1, 1945, regardless of the date of payment.

ART. 8. *Effective period.*—The tax imposed under section 3465(b) attaches to the amount paid for any leased wire or talking circuit special service furnished prior to July 1, 1945. If the rendition of the service occurs prior to July 1, 1945, the tax attaches thereto notwithstanding the date of payment.

ART. 25. *Effective period.*—The tax imposed under section 3460 applies to all transportation of crude petroleum and liquid products thereof by pipe line where the movement begins prior to July 1, 1945. In the case of any such transportation by pipe line where the movement originates prior to July 1, 1945, and ends on or after that date, the tax attaches to the entire amount charged for the transportation, although paid on or after July 1, 1945.

ART. 39. *Effective period.*—The tax applies to electrical energy sold prior to July 1, 1945.

Section 210 of the Revenue Act of 1940 reads in part as follows:

SEC. 210. MISCELLANEOUS EXCISES.

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading * * * 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	* *
1850(a)	Safe-deposit boxes	10 percent	11 percent.
*	* * *	*	* *
3411	Electrical energy	3 percent	3⅛ percent.
*	* * *	*	* *
3460(a) (1), (2), and (3).	Transportation of oil	4 percent	4½ percent.
*	* * *	*	* *

* * * * * * *

In conformity with the provision of law quoted above articles 27, 32, and 42 of Regulations 42 (revised October, 1932), as amended [sections 130.27, 130.32, and 130.42 of Title 26, Code of Federal Regulations], but only as prescribed and 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), are further amended to read as follows:

ART. 27. *Rate and computation of tax.*—Where a "fair charge" for the transportation is collected, the tax attaches at the rate of 4 per cent prior to July 1, 1940, and at the rate of 4½ per cent on and after that date, of such charge. If in a transaction not at arm's length a charge less than a "fair charge" is made for the services rendered, or in case no charge for the transportation is made by reason of the ownership of the commodity transported or otherwise, the tax will attach to a fair charge for such services, as determined by the Commissioner.

ART. 32. *Rate and basis of tax.*—The tax imposed is at the rate of 10 per cent (11 per cent after June 30, 1940, and before July 1, 1945) of the amount paid for the use of a safe deposit box and is to be paid by the person paying such amount.

ART. 42. *Rate of tax.*—The tax is imposed upon electrical energy sold for domestic or commercial consumption at the rate of 3 per cent prior to July 1, 1940, and at the rate of 3⅓ per cent on and after that date, of the price for which sold.

(This Treasury decision is prescribed pursuant to sections 3452, 3460, and 3465 of the Internal Revenue Code (53 Stat., 420, 421, 422), as amended by section 209 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), sections 1850, 3411, and 3460 of such Code (53 Stat., 205, 412, 421), as modified by section 210 of such Revenue Act, and sections 1855, 3450, and 3472 of such Code (53 Stat., 206, 419, 423).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved July 18, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 22, 1940, 11.57 a. m.)

TITLE IV.—MANUFACTURERS' EXCISE TAXES. (1932)

SECTION 605. TAX ON JEWELRY, ETC.

REGULATIONS 46 (1932), ARTICLE 28: Scope of tax. 1940–34–10395
Ct. D. 1463

MANUFACTURERS' EXCISE TAX—REVENUE ACT OF 1932—DECISION OF COURT.

1. TAX ON JEWELRY—SALES BY NEWLY FORMED AND WHOLLY OWNED CORPORATION TO WHICH MANUFACTURER TRANSFERRED HIS ENTIRE STOCK.

A manufacturer of jewelry is subject to excise tax on sales made by a wholly owned corporation which he had caused to be organized after the passage of the Act imposing the tax and before its effective date, and to which corporation he had transferred his entire stock of jewelry. The sales by the controlled corporation were as much sales by the manufacturer as if he had sold in his own name or in that of any other agent.

2. DECISION FOLLOWED IN PRINCIPLE.

Higgins v. *Smith* (1940) (308 U. S., 473) [Ct. D. 1434, C. B. 1940–1, 127] followed in principle.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Jacob Mehrlust, appellee, v. *Joseph T. Higgins, Collector, appellant.*
[112 F. (2d), 717.]

Appeal from a judgment of the District Court for the Southern District of New York in an action to recover excise taxes erroneously collected.

[June 17, 1940.]

OPINION.

L. HAND, C. J.: This is an appeal from a judgment for the plaintiff in an action to recover taxes, erroneously collected under section 605 of the Revenue Act of 1932. That Act was passed on June 6, and became effective on June 21; it imposed an excise of 10 per cent on sales of jewelry by a manufacturer, producer, or importer. The plaintiff, who was such a manufacturer, on June 6, 1932, had on hand a stock of jewelry, valued at $628,243. He organized a corporation on June 17, for 500 of whose 1,000 authorized shares he paid into its treasury $2,500 in cash. He thus became, and has always remained its sole shareholder, and its only salaried officer. On the same day he sold to the company all the jewelry just mentioned, and took in exchange the company's demand note for $626,243 and $2,000 in cash out of the $2,500 he had just paid in. The company then began to sell the jewelry, as the plaintiff had done before; it kept a full set of books and did its business in its corporate name, like any other merchant. On June 18, the plaintiff had owed the banks about $235,000 in notes, and he procured the company to execute similar notes, which he indorsed and exchanged for his own at the banks. By January 1, 1939, the company's note to him had been paid down to about $84,000, in part by the notes just mentioned, in part in other ways. The Commissioner insisted upon disregarding the sale of June 18, 1932, and taxed the plaintiff as though he had himself continued to sell the jewelry after June 21. The plaintiff paid the taxes so levied, and sued the collector. The case was tried to a judge upon an agreed statement of facts, and judgment was entered for the plaintiff.

In *Burnet* v. *Commonwealth Improvement Co.* (287 U. S., 415 [Ct. D. 622, C. B. XII–1, 277 (1933)])—where the question was of income and excess profit taxes—one, Widener, had purchased all the shares of a corporation to which he then transferred certain property in exchange for the issue of some of the corporation's securities. Later the corporation sold this property back to Widener's trustees, and then sought to maintain that, since Widener, or his trustees,

had always been the sole owners of its shares, it was entitled to take as the "basis" on this sale the value of the property on March 1, 1913. This the court refused to allow, declaring that while there were exceptional circumstances which made it possible to disregard a corporation as a jural person, the situation then at bar was not among them. In *Higgins* v. *Smith* (308 U. S., 473 [Ct. D. 1434, C. B. 1940–1, 127]), the opposite situation arose; it was the Treasury, not the taxpayer, which wished to disregard the corporate personality. Smith, the taxpayer, had sold securities to a corporation of which he was the sole shareholder, and sought to deduct a loss based upon the price at which he sold. We allowed him to do so (102 Fed. (2d), 456) because we understood that under *Burnet* v. *Commonwealth Improvement Co.*, supra (287 U. S., 415), it was irrelevant to the "recognition" of gain or loss arising from a sale, that the seller was in absolute and immediate control of the buyer. The Supreme Court, however, said no; it distinguished *Burnet* v. *Commonwealth Improvement Co.*, supra (287 U. S., 415), because the Treasury had there merely refused to allow the taxpayer to ignore a juristic device of its maker's contriving; having dealt with Widener's trustees as buyers, the corporation was not free to deny that it was a seller. On the other hand, the Treasury was under no such disability; and upon looking at the facts, it was at once apparent that there had been no such sale as would defeat the tax. "Title, we shall assume, passed to Innisfall but the taxpayer retained the control" (page 476). So in the case at bar, though we assume that, in insolvency for example, the corporate property would be subject to corporate creditors alone, since they had with reason looked to the corporation as their debtor, nevertheless, the tax was laid upon an act—sale by a manufacturer—which the plaintiff could, and did, perform as much by means of a corporation, absolutely and immediately responsive to his will, as though he had sold in his own name, or in that of any other agent. *Griffiths* v. *Commissioner* (308 U. S., 355 [Ct. D. 1431, C. B. 1940–1, 136]) is to the same effect. Both were decided after the judgment at bar was entered.

Judgment reversed; complaint dismissed.

ADMISSIONS TAX.

INTERNAL REVENUE CODE.

SECTION 1700(a)1, AS AMENDED BY SECTION 1 OF THE REVENUE ACT OF 1939 AND SECTION 211 OF THE REVENUE ACT OF 1940.

REGULATIONS 43 (1940), SECTION 101.5: Free and reduced rate admissions. 1940–50–10522 S. T. 910

Students 12 years of age or over, inmates of charitable institutions, members of the Civilian Conservation Corps, and enlisted men of the United States Army, Navy, or Marine Corps admitted to a theater or other place free or at a reduced rate (except to certain spoken plays) are subject to the tax imposed on free and reduced rate admissions by section 1700(a)1 of the Internal Revenue Code, as amended.

Advice is requested whether students 12 years of age or over, inmates of charitable institutions, members of the Civilian Conservation Corps, and enlisted men of the United States Army, Navy, or Marine Corps admitted to a theater or other place free or at a reduced rate are subject to the tax imposed on free and reduced rate admissions by section 1700(a)1 of the Internal Revenue Code, as amended by section 1 of the Revenue Act of 1939 and section 211 of the Revenue Act of 1940.

Section 1700(a)1, as amended, imposes a tax of 1 cent for each 10 cents or fraction thereof of the amount paid for admission to any place, including admission by season ticket or subscription, where the amount paid is 21 cents or more. In the case of persons (except bona fide employees, municipal officers on official business, and children under 12 years of age) admitted free or at reduced rates to any place at a time when and under circumstances under which an admission charge is made to other persons, an equivalent tax based on the price so charged to such other persons for the same or similar accommodations must be paid by the person so admitted, except that no tax is imposed with respect to free admissions to certain spoken plays (not a mechanical reproduction), as defined by the statute, and that in the case of tickets or cards of admission to such spoken plays sold at ticket offices of theaters at reduced rates the tax shall be based upon the price for which the tickets are sold.

Since under the law the only persons who are exempt from the tax on free or reduced rate admissions (except admissions to certain spoken plays) are bona fide employees of the management of the theater or other place, municipal officers on official business, and children under 12 years of age, it is held that students 12 years of age or over, inmates of charitable institutions, members of the Civilian Conservation Corps, and enlisted men of the United States Army, Navy, or Marine Corps admitted to a theater or other place free or at a reduced rate (except admissions to certain spoken plays) are subject to the tax imposed on free or reduced rate admissions by section 1700(a)1 of the Internal Revenue Code, as amended, even though the reduced rate may be less than 21 cents. For example, if one of the foregoing persons is admitted to a theater or other place (other than to a spoken play as defined by the law) free or at an admission charge of 15 cents, the regular or established price paid by other persons for the same or similar accommodations being 35 cents, the person so admitted must pay 4 cents tax.

SECTION 1700(a)1, AS AMENDED BY SECTION 1 OF THE REVENUE ACT OF 1939 AND SECTION 211 OF THE REVENUE ACT OF 1940.

REGULATIONS 43 (1932), ARTICLE 24: Admissions by or for the benefit of Federal, State, or municipal governments. 1940-37-10418 S. T. 907

An amount paid for admission to a swimming pool or "any place" operated by a city or other municipality is subject to tax under section 1700(a)1 of the Internal Revenue Code, as amended, if the admission charge is 21 cents or more.

Advice is requested whether an amount paid for admission to a swimming pool or "any place" operated by a city or other municipality is subject to tax under section 1700(a)1 of the Internal Revenue Code, as amended by section 1 of the Revenue Act of 1939 and section 211 of the Revenue Act of 1940.

Section 1700(a)1, as amended, imposes a tax of 1 cent for each 10 cents or fraction thereof of "the amount paid for admission to any place" if the admission charge is 21 cents or more.

Article 24 of Regulations 43 (1932) provides as follows:

* * * The fact that the authority charging admissions or receiving the proceeds thereof is the United States or an agency thereof, or a State or Territory or political subdivision thereof, such as a county, city, town, or other municipality, does not make such admissions exempt. The Act specifically provides that the taxes on admission shall be paid by the person paying for admission. It is not, therefore, a tax on the person or authority selling the admissions or receiving the proceeds thereof.

Since the law specifically provides that the tax shall be paid by the person paying for the admission, the city or municipality collecting the admission charge does not bear the burden of the tax. No exemption is provided with respect to amounts paid for admission to "any place" operated by a city or other municipality where the admission charge is 21 cents or more, even though the proceeds of such admissions inure to the benefit of such city or other municipality.

In view of the foregoing, it is held that an amount paid for admission to a swimming pool or "any place" operated by a city or other municipality is subject to the tax imposed by section 1700(a)1 of the Internal Revenue Code, as amended, if the admission charge is 21 cents or more.

SECTION 1700(a)1, AS AMENDED BY SECTION 211 OF THE REVENUE ACT OF 1940.

REGULATIONS 43 (1932), ARTICLE 29: Requirements applicable to tickets. 1940-29-10331 Mim. 5060

Overstamping admission tickets.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., June 26, 1940.

Collectors of Internal Revenue and Others Concerned:

Section 1700(a)1 of the Internal Revenue Code, under which a tax is imposed on admissions of 41 cents or more, has been amended

by section 211 of the Revenue Act of 1940 to make the tax on admissions applicable to admissions of 21 cents or more.

Representations have been made by the amusement industry to the effect that with respect to admissions from 21 cents to 40 cents, inclusive, which will be taxable after June 30, 1940, it will in most instances be impossible to secure tickets for use by July 1, 1940, which will be printed as required by the law and existing regulations.

In recognition of the foregoing situation, the following procedure has been approved:

(*a*) In all instances where it is practicable new tickets must be provided or the tickets on hand overprinted or overstamped, to show the established price and the tax applicable thereto.

(*b*) Section 1702 of the Internal Revenue Code specifically provides that the price for which every admission ticket or card is sold shall be printed, stamped, or written on the ticket. Accordingly, in every case where the established price of admission is changed new tickets will have to be provided or the tickets on hand must be overprinted or overstamped.

(*c*) Where the established price is not changed, for a limited time until properly printed tickets can be obtained the use of tickets now on hand which do not show the tax due under the Revenue Act of 1940 will be permitted. However, the manager or proprietor must keep conspicuously posted at the outer entrance and near the box office one or more signs accurately stating each of the established prices of admission, and in the case of each such price the tax due and the sum total.

Correspondence in regard to this mimeograph should refer to its number and to the symbols MT:ST.

GUY T. HELVERING,
Commissioner.

SECTION 1650, ADDED BY SECTION 210 OF THE REVENUE ACT OF 1940, AND SECTION 1700 AS AMENDED BY SECTION 211 OF THE REVENUE ACT OF 1940.

REGULATIONS 43 (1932), ARTICLES 1, 3, 4, 6, 7, 8, 10, 11, 12, 29, 30, 34, 40, 41, 43, 49, and 57. 1940–31–10371 T. D. 4992

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 100; SUBCHAPTER E, PART 465, SUBPART B.

Regulations 43, as amended, relating to taxes on admissions, dues, and initiation fees, as made applicable to the Internal Revenue Code by Treasury Decision 4885 [C. B. 1939–1 (Part 1), 396], amended.

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

To Collectors of Internal Revenue and Others Concerned:

Section 210 and section 211 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), approved June 25, 1940, provide in part as follows:

SEC. 210. MISCELLANEOUS EXCISES.

The Internal Revenue Code is amended by inserting at the end of Chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
1700(b)	Box seats	10 percent	11 percent.
1700(c)	Sales outside box office	10 percent	11 percent.
1700(e)	Cabaret	1½ cents	2 cents.
1710(a)(1)	Dues	10 percent	11 percent.
1710(a)(2)	Initiation fees	10 percent	11 percent.

* * * * * * *

SEC. 211. ADMISSIONS TAX.

Section 1700(a)(1) of the Internal Revenue Code is amended by striking out "until July 1, 1941, is less than 41 cents" and inserting in lieu thereof "until July 1, 1940, is less than 41 cents, and after June 30, 1940, and before July 1, 1945, is less than 21 cents" and by striking out "is less than 41 cents, until July 1, 1941" and inserting in lieu thereof "is less than 41 cents until July 1, 1940, and is less than 21 cents after June 30, 1940, and before July 1, 1945."

In conformity with the provisions of law above quoted, Regulations 43 (revised June, 1932), as amended [Part 100, Title 26, Code of Federal Regulations], but only as prescribed and 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, 1939 Sup.], are further amended as follows:

(1) Article 1 [section 100.1] is amended as follows:

(*a*) By inserting after the words "41 cents" wherever appearing therein the words, "(21 cents on and after July 1, 1940, and before July 1, 1945)."

(*b*) By striking out the sixth sentence of the fifth paragraph and inserting in lieu thereof the following: "If, in a case similar to the ones above, the amount paid for admission on and after July 1, 1940, and before July 1, 1945, is 20 cents, and a second charge of 20 cents is made for a reserved seat, or for the use of a table, no tax would attach at the time of the payment of the 20-cent admission charge, since admissions of less than 21 cents are not subject to tax, but a tax of 4 cents must be collected at the time of the payment of the additional 20 cents for the reserved seat or for the use of the table, which is 1 cent for each 10 cents or fraction thereof of the total 40 cents paid for admission and for the reserved seat or table."

(2) Articles 3, 4, 29, 30, and 43 [sections 100.3, 100.4, 100.29, 100.30, 100.43] are amended by inserting after the words "41 cents" wherever appearing therein the words, "(21 cents on and after July 1, 1940, and before July 1, 1945)."

(3) Article 6 [section 100.6] is amended as follows:

(*a*) By striking out the last line of the table at the end of the second paragraph which reads as follows:

Tax due at 10 per cent ..... .065

(*b*) By inserting after the words "10 per cent" wherever appearing therein the words, "(11 per cent on and after July 1, 1940, and before July 1, 1945)."

(*c*) By inserting at the end of example (1) in the seventh paragraph the following:

NOTE.—If the resale is made on and after July 1, 1940, and before July 1, 1945, the tax would be $0.088 instead of $0.08.

(*d*) By inserting in the last line of example (2) after the words "1 cent" the words, "(1.1 cents on and after July 1, 1940, and before July 1, 1945)."

(4) Article 7 [section 100.7] is amended by inserting in the example after the words "5 cents" the words, "(5½ cents on and after July 1, 1940, and before July 1, 1945)," and after the words "10 per cent," the words "(11 per cent)."

(5) Article 8 [section 100.8] is amended as follows:

(*a*) By inserting in the second paragraph after the words "10 per cent" wherever appearing therein the words, "(11 per cent on and after July 1, 1940, and before July 1, 1945)."

(*b*) By inserting at the end thereof the following new paragraph:

If the leases in the above three examples were made on and after July 1, 1940, and before July 1, 1945, the rate of tax would be 11 per cent instead of 10 per cent.

(6) Article 10 [section 100.10] is amended as follows:

(*a*) By inserting after the words "1½ cents" wherever appearing therein the words, "(2 cents on and after July 1, 1940, and before July 1, 1945)."

(*b*) By inserting at the end thereof the following new paragraph:

The examples in this article are applicable to the period prior to July 1, 1940. For the period on and after July 1, 1940, and before July 1, 1945, the tax is computed at the rate of 2 cents for each 10 cents or fraction thereof of the amount paid instead of 1½ cents.

(7) Article 11 [section 100.11] is amended by inserting in lieu of the last sentence the following sentence:

This tax applies to each individual payment for a dinner ticket.

(8) Article 12 [section 100.12] is amended by inserting in example (1) after the words "10 cents" the words, "(11 cents on and after July 1, 1940, and before July 1, 1945)."

(9) Articles 34, 40, 41, and 49 [sections 100.34, 100.40, 100.41, and 100.49] are amended by inserting after the words "10 per cent" wherever appearing therein the words, "(11 per cent on and after July 1, 1940, and before July 1, 1945)."

(10) Article 57 [section 100.57], as amended by Treasury Decision 4923, approved August 15, 1939 [C. B. 1939–2, 372], is further amended to read as follows:

ART. 57. *Effective date of change in exemption.*—The sums paid for admission prior to July 1, 1940, which are not subject to tax under section 1700(a)(1) of the Internal Revenue Code, as amended, are those which are "less than 41 cents." Effective July 1, 1940, any admission charge of 21 cents or more is subject to tax. Effective July 1, 1945, any sum of "$3 or less" paid for admission will not be taxable. The time of payment and not the time of admission will govern in determining which exemption is applicable. Consequently, if prior to July 1, 1940, a person should purchase a ticket of admission for less than 41 cents where the payment was made before July 1, 1940, for an admission to take place after that date, the payment so made would not be subject to tax.

Likewise, if a person should purchase after June 30, 1940, and before July 1, 1945, a ticket for 21 cents or more and less than $3 for an admission to take place after July 1, 1945, the amount so paid would be subject to tax.

(This Treasury decision is issued under the authority of sections 1700(a), 1700(b), 1700(c), 1700(e), and 1710 of the Internal Revenue Code (53 Stat., 189, 190, 192), as amended by section 210 and section 211 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session) and section 3791 of the Internal Revenue Code (53 Stat., 467).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved July 23, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 25, 1940, 12:11 p.m.)

TAXES ON ADMISSIONS, DUES AND INITIATION FEES, AND LEASES OF SAFE DEPOSIT BOXES.

SECTION 1700(a)1, AS AMENDED BY SECTION 1 OF THE REVENUE ACT OF 1939, AND SECTION 211 OF THE REVENUE ACT OF 1940. SECTION 1650, AS ADDED BY SECTION 210 OF THE REVENUE ACT OF 1940.—DEFENSE TAX FOR FIVE YEARS.

REGULATIONS 43 (1932), ARTICLE 1: Basis, rate, and computation of tax. 1940–32–10377 S. T. 904
(Also Regulations 43 (1932), Article 34; Regulations 42 (1932), Article 32: Rate and basis of tax.)

The date an amount is paid (1) for admission to any place, (2) as dues or initiation fees, or (3) for the lease of a safe deposit box governs in determining whether the rates in effect prior to July 1, 1940, or the rates in effect on and after that date, apply regardless of whether the admission takes place before or on or after July 1, 1940, or whether the dues, initiation fees, or safe deposit box rental cover periods beginning or ending prior to or on or after that date.

Advice is requested whether the date on which an amount is paid (1) for admission to any place, (2) as dues or initiation fees, or (3) for the lease of a safe deposit box governs in determining whether the rates of tax provided in section 1700 of the Internal Revenue Code, as amended by section 1 of the Revenue Act of 1939, and in sections 1710 and 1850 of such Code, effective prior to July 1, 1940, or the rates provided in section 1700 of such Code, as amended by section 211 of the Revenue Act of 1940, and in section 1650 of such Code, as added by section 210 of the Revenue Act of 1940, effective on and after July 1, 1940, are applicable regardless of whether the admission takes place before or on or after July 1, 1940, or the dues, initiation fees, or safe deposit box rental cover periods beginning or ending prior to or on or after that date.

The taxes imposed by the foregoing provisions of the Internal Revenue Code are based upon the amount *paid* (1) for admission to any

place, (2) as dues or initiation fees, and (3) for the lease of a safe deposit box, and attach at the time such payments are made. Accordingly, the date on which the amount is paid governs in determining whether the rates of tax in effect prior to July 1, 1940, or the rates in effect on and after July 1, 1940, apply regardless of whether the admission takes place before or on or after July 1, 1940, or the dues, initiation fees, or safe deposit box rental cover periods beginning or ending prior to or on or after that date.

STAMP TAXES.

INTERNAL REVENUE CODE.

SECTIONS 209 (CONTINUATION OF EXCISE TAXES) AND 210 (MISCELLANEOUS EXCISES), REVENUE ACT OF 1940.

REGULATIONS 71 (1932), ARTICLES 2, 26, 32, 33, 69, and 121.

1940–31–10365
T. D. 4988

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 111; SUBCHAPTER E, PART 465, SUBPART B.

Regulations 71, as amended, relating to stamp taxes, as made applicable to the Internal Revenue Code by Treasury Decision 4885 [C. B. 1939–1 (Part 1), 396], amended.

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

To Collectors of Internal Revenue and Others Concerned:

Sections 209 and 210 of the Revenue Act of 1940, Public, No. 656, Seventy-sixth Congress, third session, approved June 25, 1940, provide, respectively:

SEC. 209. CONTINUATION OF EXCISE TAXES.

Sections 1801, 1802, * * * 3481(b), and 3482 of the Internal Revenue Code are amended by striking out "1941" wherever appearing therein and inserting in lieu thereof "1945".

SEC. 210. MISCELLANEOUS EXCISES.

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	* *
1801	Corporate securities	10 cents	11 cents.
1802(a)	Capital stock issues	10 cents	11 cents.
1802(a)	Capital stock issues	2 cents	3 cents.
1802(b)	Capital stock transfers	4 cents	5 cents.
1802(b)	Capital stock transfers	5 cents	6 cents.
1804	Insurance policies	3 cents	4 cents.
1806	Passage tickets	$1	$1.10.
1806	Passage tickets	$3	$3.30.
1806	Passage tickets	$5	$5.50.
*	* * *	*	* *
3481(a)	Transfer of bonds	4 cents	5 cents.
3482	Conveyances	50 cents	55 cents.

* * * * * * *

Pursuant to the above amendments, Regulations 71, approved July 16, 1932, as amended [Part 111 of Title 26, Code of Federal Regulations], but only as prescribed and 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 Title 26, Code of Federal Regulations, 1939 Sup.], are amended as follows:

Article 2, as amended by Treasury Decision 4920, approved August 10, 1939 [C. B. 1939–2, 374] [section 111.2 of such Title 26, 1939 Sup.], is amended to read as follows:

ART. 2. *Effective period.*—The stamp tax provisions of the Internal Revenue Code, as amended by the Revenue Act of 1939 and as further amended by the Revenue Act of 1940, are in full force and effect. The rates of tax imposed by sections 1801, 1802(a), and 1802(b) of the Internal Revenue Code, which would have been reduced on July 1, 1941, and the stamp taxes imposed by sections 3481 and 3482 of the Internal Revenue Code, which would have been repealed as of that date, will remain effective to and including June 30, 1945, subject, however, to the increase in rates provided for in section 210 of the Revenue Act of 1940, which apply to all the stamp taxes with respect to the period July 1, 1940, to June 30, 1945, inclusive.

Article 26 [section 111.26] is amended as follows:

(*a*) By inserting in paragraph (*a*) after the words "10 cents" the words "(11 cents on and after July 1, 1940, and prior to July 1, 1945)."

(*b*) By inserting in paragraph (*b*) after the words "10 cents" the words "(11 cents on and after July 1, 1940, and prior to July 1, 1945)," and after the words "2 cents" the words "(3 cents on and after July 1, 1940, and prior to July 1, 1945)."

Article 32 [section 111.32] is amended as follows:

(*a*) By inserting in paragraphs (*a*) and (*b*) after the words "4 cents" wherever appearing therein the words "(5 cents on and after July 1, 1940, and prior to July 1, 1945)."

(*b*) By inserting in paragraph (*c*) after the words "5 cents instead of 4 cents" the words "(6 cents instead of 5 cents on and after July 1, 1940, and prior to July 1, 1945)."

Article 33 [section 111.33] is amended as follows:

(*a*) By inserting in paragraph (*b*) after "$1" the words "($1.25 on and after July 1, 1940, and prior to July 1, 1945)."

(*b*) By inserting in paragraph (*c*) after the words "80 cents" the words "($1 on and after July 1, 1940, and prior to July 1, 1945)."

(*c*) By inserting in paragraph (*d*) after the words "5 cents instead of 4 cents" the words "(6 cents instead of 5 cents on and after July 1, 1940, and prior to July 1, 1945)."

Article 69 [section 111.69] is amended by inserting after the words "3 cents" wherever appearing therein the words "(4 cents on and after July 1, 1940, and prior to July 1, 1945)," and by inserting after the words "33 cents" the words "(44 cents on and after July 1, 1940, and prior to July 1, 1945)."

Article 121 [section 111.121] is amended by inserting after the words "4 cents" the words "(5 cents on and after July 1, 1940, and prior to July 1, 1945)."

(This Treasury decision is issued under the authority contained in sections 1801, 1802, 1804, 1806, 3481, and 3482 of the Internal Revenue Code (53 Stat., 195, 196, 197, 199, 424, 425), as amended by sections 1 and 402 of the Revenue Act of 1939 (53 Stat., 862, 883) and as

further amended by sections 209 and 210 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session), and section 3791 of the Internal Revenue Code (53 Stat., 467).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved July 18, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 22, 1940, 11.58 a. m.)

SECTION 1650, AS ADDED BY SECTION 210 OF THE REVENUE ACT OF 1940—DEFENSE TAX FOR FIVE YEARS.

REGULATIONS 71 (1932), ARTICLE 31: Basis of tax. (Also Article 120.) 1940–31–10358 S. T. 902

Shares or certificates of corporate stock and corporate bonds presented for transfer on the issuing corporation's books on or after July 1, 1940, will be regarded as representing sales or transfers effected on or after that date unless such stock and bonds are accompanied by a memorandum of sale dated prior to July 1, 1940, or bear the prescribed certificate showing that the sale or transfer was made prior to that date.

Advice is requested whether the increased rates of tax provided by section 1650 of the Internal Revenue Code, as added by section 210 of the Revenue Act of 1940, apply to corporate stock and corporate bonds presented for transfer on the books of the issuing corporation on or after July 1, 1940, where the sale or transfer of such stock and bonds was effected prior to that date.

Under the provisions of section 1650 of the Internal Revenue Code, supra, the rates of tax imposed by sections 1802(b) and 3481(a) of such Code upon the sale or transfer of corporate stock (and similar interests) and bonds are increased for the period July 1, 1940, to June 30, 1945, inclusive, from 4 cents and 5 cents to 5 cents and 6 cents, respectively, in the case of stock, and from 4 cents to 5 cents in the case of bonds.

Shares or certificates of corporate stock (and similar interests) and corporate bonds presented for transfer on the books of the issuing corporation on or after July 1, 1940, will be regarded as representing sales or transfers thereof effected on or after that date which are taxable at the increased rates, unless the shares or certificates of stock or bonds are accompanied by a memorandum of sale dated prior to July 1, 1940, or there appears thereon when presented for transfer a certificate in the following form signed by the transferor or his agent:

This is to certify that the sale of this instrument or transfer of title thereto was made prior to July 1, 1940.

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SECTION 1801, AS AMENDED BY SECTION 1 OF THE REVENUE ACT OF 1939, AND SECTIONS 209 AND 210 OF THE REVENUE ACT OF 1940.—CORPORATE SECURITIES.

REGULATIONS 71 (1932), ARTICLE 8: Bonds renewed by agreement extending mortgage. (Also Article 9.) 1940–32–10375 G. C. M. 22207

Where a real estate bond and mortgage are executed by a corporation in New York or in New Jersey and the corporation thereafter conveys the mortgaged real estate to an individual as its nominee, straw man, or other type of agent who assumes the mortgage debt and then enters into an agreement with the mortgagee whereby the bond and mortgage are extended, the original corporate obligor continues liable under the bond and the extension of the bond and mortgage constitutes a renewal of a corporate bond subject to stamp tax.

An opinion is requested whether in the States of New York and New Jersey the extension of a bond and mortgage under the circumstances hereinafter stated constitutes a renewal of a corporate bond subject to stamp tax under section 1801 of the Internal Revenue Code, as amended by section 1 of the Revenue Act of 1939, and sections 209 and 210 of the Revenue Act of 1940.

Section 1801, as amended, imposes a stamp tax upon every renewal of a bond, debenture, or certificate of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities.

The bonds and mortgages here under consideration involve real estate in the States of New York and New Jersey and were executed by a corporation. The corporation thereafter conveyed the mortgaged premises to an individual who assumed the mortgage debt. The mortgagee, without notice to or the express consent of the original mortgagor, entered into an agreement with such individual grantee whereby the maturity of the bond and mortgage was extended.

The question arises in the determination of the issue presented as to whether under the laws of New York and New Jersey the original corporate obligor of the bond was released from its liability thereunder by reason of the extension of the bond and mortgage under the circumstances set forth above.

In *Grace* v. *Wilson* (139 Misc. Rep., 757, 250 N. Y. S., 212) the Supreme Court of New York stated as follows:

The sole issue presented is the effect of this extension upon the liability of the defendants who were the original mortgagors and signers on the bond for any deficiency judgment which may result on the sale of said mortgaged premises. The plaintiffs claim that they are liable for such deficiency, and defendants assert that they have been discharged therefrom.

Nothing can be clearer both upon principle and authority than the doctrine that, when the mortgagor conveys the property mortgaged, and his grantee assumes the payment of the mortgage, the grantee thereby becomes the principal debtor, and the status of his grantor is changed to one of surety. (*Wagoner* v. *Brady*, 221 App. Div., 405, 223 N. Y. S., 99; *Paine* v. *Jones*, 76 N. Y., 274, 278.)

By the transactions here disclosed, the original mortgagors became sureties, and as to them the mortgagee was under the obligation to respect their rights accordingly. The extension of the time of payment of the debt imposed a condition upon their liability which was fatal to the right of the mortgagee to now assert it.

The leading case on this subject is that of *Calvo* v. *Davies* (73 N. Y., 211, 29 Am. Rep., 130), and in that case the rule is clearly stated as follows: "Where a deed contains a covenant, upon the part of the grantee, to pay a mortgage upon the premises, executed by the grantor, the relation of principal and surety is created between the parties, and an agreement by the holder of the mortgage with the grantee to extend the time of payment, made without the consent of the grantor, discharges the grantor."

In *Wittson* v. *Englewood Plumbing Supply Co.* (189 A., 920) the Court of Chancery of New Jersey states the rule as follows:

It is beyond all controversion that a valid agreement extending the time of payment of the mortgage debt made between the holder of the mortgage and the grantee of the mortgaged premises, with notice or knowledge by the former of the conveyance of the mortgaged premises to, and the assumption of the mortgage debt by, the latter, operates to discharge the mortgagor from liability upon his bond, in the event that he has not assented to said extension. This well-recognized principle finds pertinent illustration in the discussion of the highest tribunals of this and other States. (*Gorenberg* v. *Hunt*, 107 N. J. Eq., 582, 153 A., 587; *Reeves* v. *Cordes*, 108 N. J. Eq., 469, 155 A., 547; *Delacroix* v. *Stanley*, 113 N. J. Eq., 121, 165 A., 882; *Mann* v. *Bugbee*, 113 N. J. Eq., 434, 167 A., 202; *De Lotto* v. *Zipper*, 116 N. J. Eq., 344, 173 A., 588; *Meyer* v. *Blacker*, 120 N. J. Eq., 35, 184 A., 191.)

It will be noted that the courts place emphasis upon the fact that the extension agreements in the cases before them were made *without the consent of the original mortgagor*. Only in those cases where the original mortgagor does not consent to the extension agreement entered into by the mortgage holder and the grantee does the rule apply to relieve such original mortgagor from liability under the bond. On the other hand, if such original mortgagor does consent to the extension agreement, he continues to be liable under the bond as extended.

It follows that, where an original corporate obligor conveys the mortgaged property securing the bond to an individual as its nominee, straw man, or any other type of agent, and such individual enters into an agreement with the mortgagee whereby the bond and mortgage are extended, the original corporate obligor upon whose instructions such individual acted can not be heard to deny its consent to the extension agreement. The consent of a grantee who is a nominee, straw man, or other agent of the original corporate obligor is also the consent of the original corporate obligor. Accordingly, where the grantee is a nominee, straw man, or other agent of the original corporate obligor, such corporate obligor continues to be liable on the bond under the extension agreement.

In view of the foregoing, it is the opinion of this office that the extension of a bond and mortgage in New York or in New Jersey under the circumstances set forth above constitutes a renewal of the bond subject to stamp tax under section 1801 of the Internal Revenue Code, as amended.

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

SECTION 1802(a), AS AMENDED BY SECTION 1 OF THE REVENUE ACT OF 1939.—CAPITAL STOCK (AND SIMILAR INTERESTS)—ORIGINAL ISSUE.

REGULATIONS 71 (1932), ARTICLE 28: Issues subject to tax. 1940–36–10410 S. T. 906

The issuance of new stock of the M Corporation upon the exercise of option warrants issued to the old stockholders of the corporation pursuant to a plan of reorganization under Chapter X of the Bankruptcy Act, as amended, is subject to stamp tax under section 1802(a) of the Internal Revenue Code, as amended.

Advice is requested whether the issuance of stock by the M Corporation upon the exercise of option warrants to purchase such stock under the circumstances hereinafter stated is subject to stamp tax under 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, whether on organization or reorganization, of shares or certificates of stock, or of profits, or of interest in property or accumulations, by any corporation. (Section 1802(a) is derived from subdivision 2 of Schedule A of Title VIII of the Revenue Act of 1926.)

Under the plan of reorganization under Chapter X of the Bankruptcy Act, as amended (52 Stat., 883), which plan was confirmed by the court in April, 1939, the holders of the old common stock of the M Corporation received for each share of such stock one-sixth of a share of new common stock and an option warrant entitling the holder thereof to purchase at his election for a period of 10 years after the date of issuance of such warrant one share of the new common stock of the M Corporation at $15x$ dollars per share or, for a period of 5 years after the date of issuance of such warrant, and upon the surrender thereof, one-half share of the new common stock at $10x$ dollars per share. In December, 1939, the court entered an order in the reorganization proceedings which provided in part as follows:

Section 267 of Chapter X of the United States Bankruptcy Act which became effective September 22, 1938, shall apply to the consummation of said plan.

Section 267 of Chapter X of the Bankruptcy Act, as amended, provides:

The issuance, transfer, or exchange of securities, or the making or delivery of instruments of transfer under any plan confirmed under this chapter, shall be exempt from any stamp taxes now or hereafter imposed under the laws of the United States or of any State.

Subdivision (f) of section 77B of the Bankruptcy Act, which is superseded by section 267 above-quoted, provides in part as follows:

* * * The provisions of subdivisions 1, 2, and 3 of Schedule A of Title VIII * * * shall not apply to the issuance, transfers, or exchanges of securities or making or delivery of conveyances to make effective any plan of reorganization confirmed under the provisions of this section.

Under the exemption provisions of section 77B(f) quoted above, only those issuances, transfers, and exchanges of securities are exempt which "make effective" a plan of reorganization. It therefore appears that the phrase "to make effective any plan of reorganization"

demonstrates that the words "issuance, transfers, or exchanges of securities" in the same section were used, not in a broad general sense, but rather in one closely relating to corporate reorganization. In other words, the terms "issuance, transfers, or exchanges of securities" were used by Congress to describe certain incidents which normally constitute an integral part of a corporate reorganization. Although the words "make effective" do not appear in section 267, it would seem that the words "issuance, transfer, or exchange of securities" are used in that section in the same technical sense as in section 77B(f). This view is supported by the following language in Report No. 1916, (page 39) of the Senate Committee on the Judiciary, dated May 27, 1938:

> Section 267 preserves an exemption from stamp taxes which is presently contained in section 77B(f).

It follows that the issuance of common stock upon the exercise of the option warrants to purchase such stock is not exempt from stamp tax under section 267 unless such issuance was an incident of the corporate reorganization; that is, one of the steps necessary to effect the corporate reorganization as set forth in the plan confirmed by the court. Under that plan the old stockholders were to receive for each share of the old common stock one-sixth share of new common stock and the option warrant to purchase more common stock under the terms therein set forth. The issuance of the fractional shares of new common stock and of the option warrants upon the surrender of the old common stock certificates were both incidents of the corporate reorganization and necessary to make effective the plan of reorganization. The issuance of the common stock upon the exercise of the option warrants, which issuance might occur several years after the corporate reorganization was an accomplished fact, was not an essential step to make the reorganization effective. Consequently, the exemption provisions of section 267 of the Bankruptcy Act, as amended, do not apply.

In view of the foregoing, it is held that the issuance of the new common stock of the M Corporation upon the exercise of the option warrants by the holders thereof is subject to stamp tax under section 1802(a) of the Internal Revenue Code, as amended.

SECTION 1802(b), AS AMENDED BY SECTION 1 OF THE REVENUE ACT OF 1939.—CAPITAL STOCK (AND SIMILAR INTERESTS)—SALES AND TRANSFERS.

REGULATIONS 71 (1932), ARTICLE 34: Sales or transfers subject to tax. (Also Article 35(r).) — 1940-30-10346 G. C. M. 22169

> An individual domiciled in Texas was the registered holder of stock at the time of his death intestate, leaving his wife and two children surviving. Under the laws of Texas the stock was community property.
>
> *Held*, the wife and children took legal title to the stock as tenants in common; that such vesting of legal title in the wife and children was wholly by operation of law and involved no transfer subject to stamp tax; and that the subsequent transfer on the corporation's books of their respective interests to their individual names is subject to stamp tax based upon the full amount of stock so transferred.

An opinion is requested whether the distribution and transfer of corporate stock held as community property by a stockholder who was domiciled in Texas at the time of his death intestate, leaving his wife and two children surviving, involved a transfer of legal title to the stock subject to stamp tax under section 1802(b) of the Internal Revenue Code, as amended by section 1 of the Revenue Act of 1939.

The law imposes a stamp tax on all sales or transfers of legal title to shares or certificates of corporate stock, with certain exceptions not here applicable.

Article 2578 of Vernon's Annotated Texas Statutes provides as follows:

> Upon the dissolution of the marriage relation by death, all property belonging to the community estate of the husband and wife shall go to the survivor, if there be no child or children of the deceased or their descendants; but if there be a child or children of the deceased, or descendants of such child or children, then the survivor shall be entitled to one-half of said property, and the other half shall pass to such child or children, or their descendants. But such descendants shall inherit only such portion of said property as the parent through whom they inherit would be entitled to if alive.

The Texas courts have held in the case of community property that the surviving spouse and children become tenants in common. (*Carl et al.* v. *Settegast*, 211 S. W., 506; *Spencer* v. *Pettit*, 2 S. W. (2d), 422.) In *Spencer* v. *Pettit*, supra, the court said (page 424):

> Upon the death of Amanda Elizabeth Pettit her one-half of the community estate of herself and husband immediately vested in her children. Thereafter, in the absence of administration or guardianship with partition, the surviving husband and children became tenants in common of the property * * *.

The Texas law further provides that when a person dies testate or intestate his property vests in his legatees or heirs immediately and title does not first vest in his personal representative. (Article 3314, Vernon's Annotated Texas Statutes.)

In view of the foregoing, it is the opinion of this office that upon the death of the stockholder the legal title to the stock vested in his wife and two children as tenants in common, the wife having an undivided one-half interest and each of the two children having an undivided one-fourth interest; that the vesting of legal title to such interests in the wife and children was wholly by operation of law, and, therefore, involved no transfer subject to stamp tax (article 35(r), Regulations 71); and that the subsequent transfer on the books of the corporation of the respective interests of the wife and children in the stock to their individual names effected a voluntary partition of the stock held as tenants in common and involved a transfer of legal title thereto subject to stamp tax upon the basis of the full number of shares transferred. (MS. 42, C. B. IV–1, 338 (1925).)

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

REGULATIONS 71, ARTICLE 35: Sales or transfers not subject to tax. 1940–32–10376
S. T. 903

The transfer of corporate stock from the name of a guardian to the name of a ward in the State of Kentucky is not subject to stamp tax.

Advice is requested whether the transfer of corporate stock from the name of a guardian to the name of a ward in the State of Kentucky is subject to stamp tax under section 1802(b) of the Internal Revenue Code, as amended by section 1 of the Revenue Act of 1939.

The law imposes a stamp tax on all sales and transfers of legal title to any shares or certificates of corporate stock, with certain exceptions not here applicable. The taxability of the transfer of corporate stock from the name of a guardian to the name of a ward depends upon whether, under the laws of the jurisdiction, legal title to the stock remains in the ward or vests in the guardian at the time of his appointment. If under the laws of the jurisdiction legal title to the stock remains in the ward, there is no transfer of legal title when the stock is transferred from the name of the guardian to the name of the ward. (S. T. 873, C. B. 1938–2, 410; S. T. 855, C. B. 1937–1, 336.)

The Court of Appeals of Kentucky has held that a guardian in that State has the custody and control of the ward's personal estate but that the legal title to such property remains in the ward during the guardianship. (*Spicer* v. *Smith* (1933), 288 U. S., 430, affirming decision of the Court of Appeals of Kentucky, 244 Ky., 68; 50 S. W. (2d), 64; *Department of Public Welfare* v. *Allen*, 255 Ky., 301, 74 S. W. (2d), 329.) Since in Kentucky the guardian does not acquire legal title to the personal property of his ward by virtue of his appointment as guardian, it is held that the transfer of corporate stock from the name of a guardian to the name of a ward in that State is not subject to stamp tax under section 1802(b) of the Internal Revenue Code, as amended.

REGULATIONS 71 (1932), ARTICLE 35: Sales or transfers not subject to tax. 1940–30–10345
S. T. 901

The transfer of corporate stock from the name of a guardian to the name of a ward in the State of New Jersey is not subject to stamp tax.

Advice is requested whether the transfer of corporate stock from the name of a guardian to the name of a ward in the State of New Jersey is subject to stamp tax under section 1802(b) of the Internal Revenue Code, as amended by section 1 of the Revenue Act of 1939.

The law imposes a stamp tax on all sales and transfers of legal title to any shares or certificates of corporate stock, with certain exceptions not here applicable. Where corporate stock is transferred from the name of a guardian to the name of a ward, the transfer is subject to stamp tax if under the local law the guardian, and not the ward, held the legal title to the stock. (S. T. 855, C. B. 1937–1, 336; S. T. 873, C. B. 1938–2, 410.)

There is no provision of law or decision by the courts of New Jersey which indicates that a guardian in that State acquires legal title to the personal property of his ward. Since the guardian in the instant case

did not acquire legal title to the stock by virtue of his appointment as guardian, such title remaining in the ward during the period of guardianship, the transfer of the stock from the name of the guardian to the name of the ward is not subject to stamp tax.

SECTION 1802(b), AS AMENDED BY SECTIONS 1 AND 402 OF THE REVENUE ACT OF 1939, AND SECTIONS 209 AND 210 OF THE REVENUE ACT OF 1940.—CAPITAL STOCK (AND SIMILAR INTERESTS)—SALES AND TRANSFERS.

REGULATIONS 71 (1932), ARTICLE 35: Sales or transfers not subject to tax. 1940–52–10535 S. T. 911

The transfer of corporate stock from the name of a guardian to the name of his ward in the State of Georgia, or from the name of a minor to the name of his tutor or tutrix in the State of Louisiana, is not subject to stamp tax.

Advice is requested whether the transfer of corporate stock from the name of a guardian to the name of his ward in the State of Georgia, or from the name of a minor to the name of his tutor or tutrix in the State of Louisiana, is subject to stamp tax under section 1802(b) of the Internal Revenue Code, as amended by sections 1 and 402 of the Revenue Act of 1939, and sections 209 and 210 of the Revenue Act of 1940.

The law imposes a stamp tax on all sales and transfers of legal title to any shares or certificates of corporate stock, with certain exceptions not here applicable. The taxability of the transfer of corporate stock from the name of a guardian to the name of a ward depends upon whether, under the laws of the jurisdiction, legal title to the stock remains in the ward or vests in the guardian at the time of his appointment. If under the laws of the jurisdiction legal title to the stock remains in the ward, there is no transfer of legal title when the stock is transferred from the name of the guardian to the name of the ward. (S. T. 855, C. B. 1937–1, 336; S. T. 873, C. B. 1938–2, 410.) The same rule applies to the transfer of stock from the name of a ward to the name of his guardian.

There is no provision of law or a decision by the courts of Georgia which indicates that a guardian in that State acquires legal title to the personal property of his ward.

Under article 337 of section 11, Title VIII of the Civil Code of Louisiana, the tutor or tutrix for a minor has the care of the person and property of the minor, as in the case of a guardian. There is no provision of the Code of Louisiana or a decision by the courts of that State which indicates that the tutor or tutrix for a minor takes legal title to the minor's property.

Since in Georgia the guardian does not acquire legal title to the personal property of his ward, and in Louisiana a tutor or tutrix does not acquire legal title to the personal property of the minor, it is held that the transfer of corporate stock from the name of a guardian to the name of his ward in the State of Georgia, or from the name of a minor to the name of his tutor or tutrix in the State of Louisiana, is not subject to stamp tax under section 1802(b) of the Internal Revenue Code, as amended.

REGULATIONS 71 (1932), ARTICLE 35: Sales or transfers not subject to tax. 1940-41-10451 G. C. M. 22315

Transfer of legal title to corporate stock held by a limited partnership created under the Uniform Limited Partnership Act of New York does not result from the death of a limited partner in such a partnership or from an assignment of such a partner's interest therein, except where the certificate of partnership provides that the limited partner has an interest in the partnership property.

An opinion is requested whether a transfer of legal title to corporate stock held by a limited partnership in the State of New York results from the death of a limited partner in such a partnership or from an assignment of the interest of such a partner.

Section 1802(b) of the Internal Revenue Code, as amended by sections 1 and 402 of the Revenue Act of 1939 and sections 209 and 210 of the Revenue Act of 1940, imposes a stamp tax on all sales or transfers of legal title to any shares or certificates of corporate stock, with certain exceptions not here applicable.

Section 90 of the Uniform Limited Partnership Act of New York (L. 1922, ch. 640; McKinney's Consolidated Laws of New York, Book 38) provides in part that a limited partnership is a partnership formed by two or more persons under the provisions of section 91, having as members one or more general partners and one or more limited partners; and that the limited partners, as such, shall not be bound by the obligations of the partnership. Section 91 provides, among other things, that the certificate of partnership shall state the amounts contributed by each limited partner, the time, if agreed upon, when the contribution of each limited partner is to be returned, the share of profits or the other compensation by way of income which each limited partner shall receive by reason of his contribution, and the right, if given, of a limited partner to demand and receive property other than cash in return for his contribution. Section 93 provides that contributions of a limited partner may be in cash or other property but not in services. Section 99 provides that a limited partner shall have the right to receive a share of the profits or other compensation by way of income and to the return of his contribution as provided in sections 104 and 105. Section 105(3) provides that in the absence of any statement in the certificate to the contrary or the consent of all members, a limited partner, irrespective of the nature of his contribution, has only the right to demand and receive cash in return for his contribution. Section 108 provides that the interest of a limited partner is assignable and that the assignee may become a substituted limited partner and have the rights and powers of his assignor.

In *Harris* v. *Murray* (28 N. Y., 574, 86 Am. Dec., 268, 270) it is held:

The interest of Harris [a special partner] in the property of a limited partnership can hardly be said to be an interest in the property of the firm. He advanced to the firm a sum of money, which he is entitled to receive back, with interest, at the termination of the partnership. He is also entitled to a share in the profits. But he is to no further extent the owner of the property. Upon payment of these claims, the property would belong to the general parties [sic].

In view of the foregoing, it is held that a limited partner in a limited partnership created under the Uniform Limited Partnership

Act of New York is not a coowner of corporate stock held by such partnership, except where the certificate of partnership provides that such partner has an interest in the partnership property. Consequently, a transfer of legal title to corporate stock held by such a limited partnership does not result from the death of a limited partner in such a partnership or from the assignment of such partner's interest therein, except where the certificate of partnership provides that the limited partner has an interest in the partnership property.

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

SECTION 3482, AS AMENDED BY SECTION 1 OF THE REVENUE ACT OF 1939.—CONVEYANCES.

REGULATIONS 71, ARTICLE 84: What constitutes real property determinable by law of State where located. 1940–27–10310 G. C. M. 22132

Under the laws of Louisiana, a mineral deed which conveys the absolute property right to oil, gas, or other minerals; an oil, gas, or other mineral lease or royalty deed of indefinite duration (such as those containing the usual "thereafter" clause); a royalty deed of unlimited duration; or an assignment of any of such instruments constitute conveyances of realty subject to stamp tax under section 3482 of the Internal Revenue Code, as amended. A royalty deed of limited duration with respect to such minerals is not taxable as a conveyance of realty.

G. C. M. 913 (C. B. V–2, 255 (1926)) is revoked in so far as it applies to oil, gas, or other mineral deeds, and its application to oil, gas, or other mineral leases is limited to such leases executed prior to the effective date of Act No. 205 of 1938 (Louisiana).

An opinion is requested whether the instruments hereinafter described affecting oil, gas, and other minerals, and rights thereto, located in and under lands situated in Louisiana constitute conveyances of realty subject to stamp tax under section 3482 of the Internal Revenue Code, as amended by section 1 of the Revenue Act of 1939.

The following types of instruments are presented:

(1) A mineral deed;

(2) A lease or royalty deed of indefinite duration (such as those containing the usual "thereafter" clause whereby the lessee or grantee may explore for and extract oil and/or gas for a definite period and "thereafter as long as oil and/or gas is produced");

(3) A royalty deed of unlimited duration;

(4) Assigments of the foregoing instruments;

(5) A royalty deed for a limited period, i. e., having a fixed time for termination.

The law 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 * * *." What constitutes "lands, tenements, or other realty" is determinable by the law of the State in which the property is situated. (Article 84, Regulations 71.)

It was held in G. C. M. 913 (C. B. V-2, 255 (1926)) (syllabus) that—

Instruments which purport to convey the absolute property right to oil and gas in place in Louisiana, or which purport to lease property in that State with the attendant right to extract such oil and gas from the soil and convert the same to the use of the lessee, are not conveyances of realty within the meaning of Schedule A–5 of the Revenue Act of 1924, and are not subject to the stamp tax imposed thereunder.

Act No. 205 of 1938 (Louisiana), approved July 5, 1938, provides in part as follows:

SECTION 1. * * * That oil, gas and other mineral leases, and contracts applying to and affecting such leases or the right to reduce oil, gas or other minerals to possession, together with the rights, privileges and obligations resulting or flowing therefrom, are hereby defined and classified as real rights and incorporeal immovable property, and may be asserted, protected and defended in the same manner as may be the ownership or possession of other immovable property by the holder of such rights, without the concurrence, joinder or consent of the landowner, and without impairment of rights of warranty, in any action or by any procedure available to the owner of immovable property or land.

SEC. 2. That this act shall apply to all such transactions whether entered into prior to the passage of this act or not.

Act No. 205, supra, defines and classifies "mineral leases, and contracts applying to and affecting such leases or the right to reduce oil, gas or other minerals to possession, together with the rights, privileges and obligations resulting or flowing therefrom, * * * as real rights and incorporeal immovable property * * *." The purpose of the statute was to overcome the effect of the decision of the Supreme Court of Louisiana in *Gulf Refining Co. of Louisiana* v. *Glassell et al.* (171 So., 846, 180 La., 190) that the holder of a mineral lease had not a "real right" in the leased land and therefore could not institute successfully a petitory or possessory action. (*Allison* v. *Maroun*, 190 So., 408; 193 La., 286.) Article 5 of the Louisiana Code of Practice defines a petitory action as one "by which he who has the property of a real estate, or of a right upon or growing out of it, proceeds against the person having the possession, in order to obtain the possession of the immovable property, or the enjoyment of the rights upon it, to which he is entitled." Article 45 of the code of practice provides that "The petitory action may be brought by one who has the ownership only of an undivided part of an estate, or of a real right to which such an estate is subjected, though his ownership may be limited to a certain period, or end by the occurrence of a certain event."

The court in *Gulf Refining Co. of Louisiana* v. *Glassell et al.*, supra, stated at page 849:

We stress the fact that in every instance where the court had squarely before it the juridical nature or the proper legal classification of a mineral, oil, and gas lease the conclusion was reached that it was a contract of letting and hiring, and therefore did not create a real right in the land, or right of servitude on the property.

The statute, then, in effect redefined the nature of mineral leases and not mineral deeds, since the latter were always considered as "real rights" under the law of Louisiana. The court further stated at pages 848–850:

On the other hand, in all those cases in which there had been a sale or conveyance of the mineral rights or a sale or conveyance of the land, with reservation of the mineral rights, this court held that the legal effect produced

by such a transfer was a right of servitude on the realty or a real right in the land. [Citing cases.]

* * * * * * *

Oil and gas are fugitive minerals, and the owners of the land which contain such deposits are not the owners of the oil and gas until they reduce the fugitive minerals to actual possession. The owners of land have a real right in their property to go upon it and explore it for these minerals, in order to gain ownership thereof by securing possession of them. [Citing cases.] They may sell this real right separate from the fee of the realty, or reserve this real right when they sell the land, and, in both instances, a real right in the land exists. They may lease this right to a third person who obtains thereby a personal right.

The effect of Act No. 205, supra, was to place the leasing of the right referred to above in the same category as a sale or reservation of the right. The question then arises whether such real right in the land or right of servitude on the realty is within the meaning of the phrase "lands, tenements, or other realty" as used in section 3482, supra. In this connection it is to be observed, as heretofore pointed out, that under the present status of the Louisiana law a mineral deed and a mineral lease are in the same category for the purpose of determining this question.

In G. C. M. 11732 (C. B. XII–1, 439 (1933)) it was held:

The terms "lands, tenements, or other realty," as used in the statute, clearly means that estate or interest in land known as real property, which must be an estate for life or greater estate. Any less estate, as for a number of years, does not amount to a fee but is a chattel real, or personal property.

In G. C. M. 20898 (C. B. 1938–2, 414) it was held that a grant of perpetual flowage rights to the United States with respect to lands in Louisiana constituted a conveyance of realty subject to stamp tax. That memorandum reads in part as follows:

In Louisiana, where the civil law, as distinguished from the common law, prevails, an easement is called a servitude, and servitudes are of two general classes—real or predial servitudes and personal servitudes. The real or predial servitude takes the place of the common-law appurtenant easement and is so called because it is attached to another estate. The personal servitude takes the place of the common-law easement in gross and is so called because it attaches to a person, not to another estate. It is immaterial whether the servitude described in the deed be considered a real or a personal servitude. In either case it is an interest in real property and a real obligation (as distinguished from a personal obligation of the grantor), and it is to last forever. (See *Frost-Johnson Lumber Co.* v. *Salling's Heirs* (La., 1922), 91 So., 207, 214, 245.)

The court in *Frost-Johnson Lumber Co.* v. *Salling's Heirs*, supra, stated at page 245:

As to the nature of the right reserved [mineral reservation] we liken it to the right to draw water from another's land; and that is a right of servitude.

In S. T. 860 (C. B. 1937–1, 341) it was held that a deed conveying water rights in California, the local law construing same as a servitude, was subject to stamp tax. See also G. C. M. 13035 (C. B. XIII–1, 427 (1934)), wherein it was held that a "servitude or easement is, generally, an incorporeal hereditament, and as such constitutes an interest in real property" and that a deed conveying such a right in perpetuity is subject to stamp tax.

With respect to royalty deeds, the Supreme Court of Louisiana in *Vincent et al.* v. *Bullock et al.* (187 So., 35, 192 La., 1) held:

The reservation in controversy here [royalty] as shown hereinabove, is a real obligation in favor of the plaintiffs, their heirs or assigns, and in our opinion is a species of real right * * *.

The royalty reservation in that case was by the terms of the instrument of unlimited duration. See also Summers, *Oil and Gas*, volume 3, section 578, page 366, wherein it is stated:

> State and Federal courts in Louisiana have held that the lessor's royalty interest under an oil and gas lease is an interest in land and real property which may be conveyed in whole or in part.

In view of the foregoing, it is the opinion of this office that, under the laws of Louisiana, mineral deeds which convey the absolute property right to oil, gas, or other minerals; oil, gas, or other mineral leases or royalty deeds of indefinite duration (such as those containing the usual "thereafter" clause); royalty deeds of unlimited duration; or an assignment of any of the foregoing instruments, constitute conveyances of realty subject to stamp tax under section 3482 of the Internal Revenue Code, as amended; and that a royalty deed of limited duration with respect to such minerals is a chattel real or personal property and is not taxable as a conveyance of realty.

G. C. M. 913 (C. B. V-2, 255 (1926)) is revoked in so far as it applies to oil, gas, or other mineral deeds, and its application to oil, gas, or other mineral leases is limited to such leases as were executed prior to the effective date of Act No. 205 of 1938, supra.

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

SECTION 3482, AS AMENDED BY SECTION 1 OF THE REVENUE ACT OF 1939, AND SECTIONS 209 AND 210 OF THE REVENUE ACT OF 1940.—CONVEYANCES.

REGULATIONS 71 (1932), ARTICLE 84: What constitutes real property determinable by law of State where located. 1940-50-10521 G. C. M. 22393

> An oil, gas, or other mineral lease or a royalty deed covering lands in Louisiana, regardless of the date of execution or whether of definite or indefinite duration, or an assignment of any such instrument, constitutes a conveyance of realty subject to stamp tax under section 3482 of the Internal Revenue Code, as amended.
>
> G. C. M. 22132 (page 333, this Bulletin) modified.
>
> G. C. M. 913 (C. B. V-2, 255 (1926)) revoked.

An opinion is requested whether an oil, gas, or other mineral lease or a royalty deed covering lands in Louisiana, whether of definite or indefinite duration, or an assignment of any such instrument, constitutes a conveyance of realty subject to stamp tax under section 3482 of the Internal Revenue Code, as amended by section 1 of the Revenue Act of 1939, and sections 209 and 210 of the Revenue Act of 1940. The question is presented in connection with a request for reconsideration of G. C. M. 22132 (page 333, this Bulletin).

The law 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 * * *." What constitutes "lands, tenements, or other realty" is determinable by the law of the State in which the property is situated. (Article 84, Regulations 71.)

In G. C. M. 22132, supra, it was held (syllabus):

Under the laws of Louisiana, a mineral deed which conveys the absolute property right to oil, gas, or other minerals; an oil, gas, or other mineral lease or royalty deed of indefinite duration (such as those containing the usual "thereafter" clause); a royalty deed of unlimited duration; or an assignment of any of such instruments constitute conveyances of realty subject to stamp tax under section 3482 of the Internal Revenue Code, as amended. A royalty deed of limited duration with respect to such minerals is not taxable as a conveyance of realty.

G. C. M. 913 (C. B. V-2, 255 (1926)) is revoked in so far as it applies to oil, gas, or other mineral deeds, and its application to oil, gas, or other mineral leases is limited to such leases executed prior to the effective date of Act No. 205 of 1938 (Louisiana).

Subsequent to the rendition of G. C. M. 22132, the Supreme Court of Louisiana, in *Tyson* v. *Surf Oil Co.* (195 La., 248, 196 So., 336), considered the effect of Act No. 205 of 1938 (Louisiana), approved July 5, 1938. The following appears in the opinion of the court:

This court has consistently applied the codal provisions, whenever possible, to oil and gas leases for many years. Having declined to enact laws for the regulation of the oil industry and, particularly, having declined to adopt a mineral code, the legislature has placed the stamp of approval upon the system of interpretation of oil and gas contracts which this court has followed for so many years. Only a few situations have arisen which the lawmaker has seen fit to correct, the principal one being the want of an adequate remedy in the oil and gas lessee to protect or assert his rights, without concurrence of his lessor, as dealt with by this court in *Gulf Refining Co. of Louisiana* v. *Glassell* (186 La., 190, 171 So., 846). In that case it was held that a lessee of the usual mineral or gas and oil lease can not, in his own right or name, institute a petitory or possessory action, as he has no real right in or servitude on the leased land.

This defect or deficiency in procedure was provided for by the passage of Act 205 of 1938. (*Allison* v. *Maroun*, 193 La., 286, 190 So., 408.)

Act 205 of 1938, although it declares that rights created by an oil and gas lease shall be "*incorporeal immovable property*," simply supplied a name for those characteristics which this court has declared many times were inherent in such agreements; "*incorporeal immovable property*" being merely a synonym for "incorporeal real right," or a real servitude imposed upon the land leased in favor of the lessee.

Without expressing an opinion as to whether the Supreme Court of Louisiana in effect overruled its decision in *Gulf Refining Co. of Louisiana* v. *Glassell* (186 La., 190, 171 So., 846), in which it was held that a mineral lease did not create a real right in the land, or a right of servitude on the property, but only a personal right, this office will follow the Louisiana Supreme Court's construction of Act 205, supra, and its characterization of a mineral lease in determining what constitutes "lands, tenements, or other realty" for purposes of the Federal stamp tax. (Article 84, Regulations 71.) So doing, it appears that Act 205 is only procedural in purpose but that a mineral lease, even without Act 205, confers a real servitude on the leased land in favor of the lessee. It follows that G. C. M. 22132, supra, should be modified in so far as its application was limited to mineral leases executed after the effective date of Act 205. In other words, if G. C. M. 22132, supra, is otherwise correct, it follows that that opinion should be applied to mineral leases without regard to the date of their execution, and that G. C. M. 913, supra, should be revoked in its entirety.

The contention has been advanced that an oil, gas, or other mineral lease is, under the law of Louisiana, only a contract of letting and hiring and that, consequently, the Federal stamp tax is inapplicable

to such leases. This position is predicated on the language of section 3482 of the Internal Revenue Code, which imposes a 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." Admittedly, if the contract involved is only a "lease" of real property, it is not subject to tax. (Article 108, Regulations 71.) However, this question is so interwoven with the proposition that it must be "lands, tenements, or other realty" which are sold in order to make the stamp tax applicable that both should be considered together, bearing in mind that the determination of the question as to what constitutes "lands, tenements, or other realty" is to be determined by the law of Louisiana.

It is recognized that in certain cases and for certain purposes the Supreme Court of Louisiana has characterized a mineral lease as a contract of "letting and hiring" (*Gulf Refining Co. of Louisiana* v. *Glassell*, supra; *Gulf Refining Co. of Louisiana* v. *Hayne* (138 La., 555, 70 So., 509)), and has indicated that it will treat mineral leases as "leases" and will apply to them the codal provisions applicable to ordinary leases, *in so far as they may be*, until the legislature of Louisiana shall have passed laws specifically applicable to the industry of mining. (*Spence* v. *Lucas*, 138 La., 763, 70 So., 796; *Logan* v. *State Gravel Co.*, 158 La., 105, 103 So., 526; *Tyson* v. *Surf Oil Co.*, supra.) On the other hand, there are decisions by the Supreme Court of Louisiana and the Federal courts holding that under the Louisiana law a mineral lease is a conveyance of an interest in real property. In this connection see 13 Tulane Law Review, 416, citing and explaining the following cases: *Rives* v. *Gulf Refining Co. of Louisiana* (133 La., 178, 62 So., 623); *Cooke* v. *Gulf Refining Co.* (135 La., 609, 65 So., 758); *Hanby* v. *Texas Co.* (140 La., 189, 72 So., 933); *Nabors Oil & Gas Co.* v. *Louisiana Oil Refining Co.* (151 La., 361, 91 So., 765); *Shaw* v. *Watson* (151 La., 893, 92 So., 375); *Noble* v. *Plouf* (154 La., 429, 97 So., 599); *Wiley* v. *Davis* (164 La., 1090, 115 So., 280); *Rockmill* v. *Nixon* (182 La., 597, 162 So., 191); *Payne* v. *Walmsley* (185 So., 88).

In *Hamilton* v. *Glassell* (57 Fed. (2d), 1032) the United States Circuit Court of Appeals for the Fifth Circuit stated that: "They [oil and gas leases] are likewise immovable property in Louisiana." In *Angichiodo* v. *Cerami* (28 Fed. Supp., 720) the United States District Court for the District of Louisiana held that: "An oil and mineral lease, or a royalty interest, is an interest in real property and is governed by the same rule as that which governs property rights." In *Munn* v. *Wadley* (192 La., 874, 189 So., 561) the Supreme Court of Louisiana had before it a case where an Arkansas corporation sold land in Louisiana, reserving the mineral rights for 35 years. Later the corporation dissolved. One of its stockholders was a minor. The question was whether the prescriptive period had been suspended because of the minor involved. Under the Arkansas law, the property of a dissolved corporation goes to the stockholders. In Louisiana it does not. In determining which law should govern, the court, stating it to be immaterial whether the rights reserved under the deed were a lease or a mandate coupled with an interest, held: "But the mineral right that is in contest in this case is not personal property but real estate, and hence the law of Louisiana is the law which governs the transfer of the title."

Article 731 of the Louisiana Civil Code, which deals with real servitudes, provides as follows:

> It is not sufficient to be an owner in order to establish a servitude, one must be master of his rights and have the power to alienate; *for the creation of a servitude is an alienation of a part of the property.*
>
> Thus minors, married women, persons interdicted, can not establish servitudes on their estates, except according to the forms prescribed for the alienation of their property. [Italics supplied.]

Article 817, *ibid.*, provides:

> The express release must be made in writing, and is confined to what is clearly express in the act containing it, because one is not easily presumed to have renounced his right.
>
> Besides, the owner who makes the release must be capable of disposing of immovables; *this release of a servitude being a real alienation.* [Italics supplied.]

The case of *Barthold* v. *Dover* (153 So., 49), involving the question of whether a tax deed carries the whole ownership of the land where there is a mineral deed outstanding, is pertinent. The Circuit Court of Appeals of Louisiana for the Second Circuit in that case, after stating the rule that "mineral rights constitute a servitude or mere right to go upon the land and explore for and reduce to possession minerals," held as follows:

> Unquestionably, a tax sale transfers the whole ownership of the property where there has been no dismemberment of the title prior to the sale. A sale of mineral rights constitutes such a dismemberment of the ownership and is a transfer of one of its material elements * * * and amounts to a partial alienation of property.

Under the Louisiana Civil Code, unlike the common law, the character of the estate transferred is not determined by its tenure. The only estates in land recognized by the law of Louisiana are "(1) simple ownership of the soil; and (2) servitude thereon (including usufruct). * * * no individual is free to establish any other estate therein, whether by will or by contract. * * * such inhibition against the establishment of novel estates and new tenures is conformable to general law, and a matter of high public policy." (*Wemple* v. *Nabors Oil & Gas Co.*, 154 La., 483, 97 So., 666.) Since, under the laws of Louisiana, tenure does not determine the nature of the estate conveyed, and since article 84 of Regulations 71 provides that "what constitutes 'lands, tenements, or other realty' is determinable by the law of the State wherein the property is situated," it is concluded that oil and gas leases and royalty deeds of definite duration covering lands in Louisiana are not distinguishable from such instruments of indefinite duration. Under this theory, it is immaterial whether the estate created be of definite or indefinite duration.

In view of the foregoing, it is the opinion of this office that an oil, gas, or other mineral lease or a royalty deed covering lands in Louisiana, regardless of the date of execution or whether of definite or indefinite duration, or an assignment of any such instrument, constitutes a conveyance of realty subject to stamp tax under section 3482 of the Internal Revenue Code, as amended.

G. C. M. 22132, supra, is modified to the extent that it is inconsistent with this opinion, and G. C. M. 913, supra, is revoked.

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

PLAYING CARDS.

SECTION 1807, AS AMENDED BY SECTION 215 OF THE REVENUE ACT OF 1940.

REGULATIONS 66 (1933), ARTICLE 8: Tax on playing cards. 1940–31–10364
T. D. 4987
ARTICLE 19: Imported playing cards.

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 305; SUBCHAPTER E, PART 465, SUBPART B.—TAX ON PLAYING CARDS.

Increase of rate of tax under section 1807 of the Internal Revenue Code, as amended by the Revenue Act of 1940.

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

To Collectors of Internal Revenue and Others Concerned:

In order to conform Regulations 66 (Part 305, Title 26, Code of Federal Regulations), relating to the tax on playing cards under the Internal Revenue Code, to section 215 of the Revenue Act of 1940 (Public, No. 656, Seventy-Sixth Congress, third session), approved June 25, 1940, amending section 1807 of the Internal Revenue Code, such regulations, but only as prescribed and 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, 1939 Supp.), are amended as follows:

Immediately prior to article 8 [section 305.8] there are substituted for the quotations of law shown, a heading and quotation of section 1807 of the Internal Revenue Code and a heading and quotation of section 215 of the Revenue Act of 1940, as follows:

Section 1807 of the Internal Revenue Code.

SEC. 1807. PLAYING CARDS.

Upon every pack of playing cards containing not more than fifty-four cards, manufactured or imported, and sold, or removed for consumption or sale, a tax of 10 cents per pack. This tax shall be in addition to any import duties imposed on such articles of foreign manufacture.

Section 215 of the Revenue Act of 1940.

SEC. 215. PLAYING CARDS.

Section 1807 of the Internal Revenue Code is amended by inserting "(a) GENERAL RULE.—" before the first paragraph and inserting at the end thereof the following new subsection:

"(b) DEFENSE TAX FOR FIVE YEARS.—In lieu of the rate of tax specified in subsection (a), the rate of tax for the period after June 30, 1940, and before July 1, 1945, shall be 11 cents."

The first paragraph of article 8 is amended to read as follows:

ART. 8. *Tax on playing cards.*—Prior to July 1, 1940, and after June 30, 1945, the rate of tax on playing cards is 10 cents per pack containing not more than 54 cards. For the period July 1, 1940, to June 30, 1945, inclusive, the rate of tax is 11 cents on each such pack. Each additional 54 cards or fraction thereof in a pack constitutes a new pack on which tax must be paid. For example, if a pack contains 120 cards it must be considered as constituting three packs, two packs of 54 cards and one pack of 12 cards, and each such pack is subject to tax at the rate in effect when liability is incurred.

Immediately prior to article 19 [section 305.19] there are substituted for the quotations of law shown, a heading and quotation of section 1807 of the Internal Revenue Code and a heading and quotation of section 215 of the Revenue Act of 1940, as follows:

Section 1807 of the Internal Revenue Code.

SEC. 1807. PLAYING CARDS.

Upon every pack of playing cards containing not more than fifty-four cards, manufactured or imported, and sold, or removed for consumption or sale, a tax of 10 cents per pack. This tax shall be in addition to any import duties imposed on such articles of foreign manufacture.

Section 215 of the Revenue Act of 1940.

SEC. 1807. PLAYING CARDS.

Section 1807 of the Internal Revenue Code is amended by inserting "(a) GENERAL RULE.—" before the first paragraph and inserting at the end thereof the following new subsection:

"(b) DEFENSE TAX FOR FIVE YEARS.—In lieu of the rate of tax specified in subsection (a), the rate of tax for the period after June 30, 1940, and before July 1, 1945, shall be 11 cents."

The first paragraph of article 19 is amended to read as follows:

ART. 19. *Imported playing cards.—(a) Liability to tax.*—Prior to July 1, 1940, and after June 30, 1945, playing cards imported from foreign countries must be tax-paid at the rate of 10 cents per pack of not more than 54 cards. For the period July 1, 1940, to June 30, 1945, inclusive, the rate of tax is 11 cents on each such pack. Such tax is in addition to any import duty and must be paid by affixing the required stamps prior to release of the cards from customs custody.

(This Treasury decision is prescribed pursuant to section 1807 of the Internal Revenue Code, as amended by section 215 of the Revenue Act of 1940, and sections 1835 and 3791 of such Code (53 Stat., 204, 467).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved July 18, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 22, 1940, 11.58 a. m.)

FIREARMS.

INTERNAL REVENUE CODE.

SECTION 2733.—DEFINITIONS.

REGULATIONS 88 (1934), ARTICLE 20: Meaning of terms. 1940-42-10456 S. T. 908

A Luger or Mauser pistol equipped with a lug, spur, slot, or other device for the attachment of a shoulder stock is a "firearm" within the meaning of section 2733(a) of the Internal Revenue Code.

Advice is requested whether a Luger or Mauser pistol equipped with a lug, spur, slot, or other device for the attachment of a shoulder stock is a "firearm" within the meaning of section 2733(a) of the Internal Revenue Code, which provides in part as follows:

* * * The term "firearm" means a shotgun or rifle having a barrel of less than 18 inches in length, or any other weapon, except a pistol or revolver, from which a shot is discharged by an explosive if such weapon is capable of being concealed on the person * * *.

It is the evident purpose of the law to subject to its provisions every weapon held out as and adapted to use as a "firearm," as defined in the above-quoted provisions of section 2733(a), even though it may be capable of other use. (S. T. 788, C. B. XIII-2, 436 (1934).) A pistol equipped with a lug, spur, slot, or other device for the attachment of a shoulder stock can not properly be classed as a mere pistol. It is clearly a "weapon * * * from which a shot is discharged by an explosive" and "is capable of being concealed on the person." Furthermore, it is adapted to use as a firearm.

It is held that a Luger or Mauser pistol equipped with a lug, spur, slot, or other device for the attachment of a shoulder stock is a "firearm" within the meaning of section 2733(a) of the Internal Revenue Code.

Under the provisions of section 2730(a) of the Internal Revenue Code any firearm which has at any time been transferred in violation of the applicable provisions of law is subject to seizure and forfeiture.

It appears that pistols equipped as above stated have been transferred without compliance with the provisions of law applicable to firearms, such pistols not having been considered "firearms" within the meaning of the law. Any such pistol reported after the publication of this ruling to have been so transferred without any intention of violating any law will not be seized and forfeited if the owner or possessor of the pistol within a reasonable time removes the lug, spur, or other device or fills in the slot, as the case may be, and presents the pistol to the collector of internal revenue for inspection. Any such pistol which is not so altered and presented will be subject to seizure and forfeiture and the owner or possessor thereof will be subjected to the prescribed penalties.

FLOOR STOCKS TAX ON CIGARETTES.

SECTION 2005, AS ADDED BY SECTION 212 OF THE REVENUE ACT OF 1940.—FLOOR STOCKS TAX.

1940-29-10332
Mim. 5066

Procedure respecting the filing of returns and payment of the tax imposed by section 2005 of the Internal Revenue Code on floor stocks of cigarettes held for sale on July 1, 1940.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., June 29, 1940.

Collectors of Internal Revenue and Others Concerned:

Section 2005 of the Internal Revenue Code (as added by section 212 of the Revenue Act of 1940, approved June 25, 1940) imposes a floor stocks tax on small and large cigarettes held by any person for sale on July 1, 1940. Pending the issuance of regulations and further instructions regarding the administration of this tax, the instructions contained herein are to be followed:

1. *Law.*—Section 212 of the Revenue Act of 1940 reads as follows:

SEC. 212. CIGARETTES.

Subchapter A of Chapter 15 of the Internal Revenue Code is amended by inserting at the end thereof the following new sections:

"SEC. 2004. DEFENSE TAX FOR FIVE YEARS.

"In lieu of the rates of tax specified in section 2000(c)(2), the rates of tax for the period after June 30, 1940, and before July 1, 1945, shall be $3.25 and $7.80, respectively.

"SEC. 2005. FLOOR STOCKS TAX.

"(a) FLOOR STOCKS TAX.—Upon cigarettes subject to tax under section 2000(c)(2) which on July 1, 1940, are held by any person for sale, there shall be levied, assessed, collected, and paid a floor stocks tax at a rate equal to the increase in rate of tax made applicable to such articles by section 2004.

"(b) RETURNS.—Every person required by this section to pay any floor stocks tax shall, on or before August 1, 1940, under such regulations as the Commissioner with the approval of the Secretary shall prescribe, make a return and pay such tax, except that in the case of articles held by manufacturers and importers the Commissioner may collect the tax with respect to all or part of such articles by means of stamp rather than return, and in such case may make an assessment against such manufacturer or importer having tobacco tax stamps on hand July 1, 1940, for the difference between the amount paid for such stamps and the increased rates specified in section 2004.

"(c) LAWS APPLICABLE.—All provisions of law, including penalties, applicable in respect of the taxes imposed by section 2000 shall, insofar as applicable and not inconsistent with this section, be applicable with respect to the floor stocks tax imposed by subsection (a)."

2. *Liability for the tax.*—All persons holding cigarettes for sale at the first moment of July 1, 1940, are liable to the tax. The tax is imposed on the holding of such articles and not on the actual sale. Cigarettes are regarded as held for sale by the owner thereof on July 1, 1940, although they may be at that time in transit to the owner or in a warehouse, storeroom, or distributing depot of the owner.

In the case of manufacturers, a tax is also imposed on unattached cigarette stamps held at the first moment of July 1, 1940, purchased at the rates of tax in effect prior to July 1, 1940.

Form 187 is prescribed as the return form for persons other than manufacturers and Form 188 as the return form for manufacturers.

3. *Rate of tax.*—The rates of tax are:

Small cigarettes—25 cents per thousand.

Large cigarettes—60 cents per thousand.

4. *Inventory.*—(*a*) *General.*—Except as to unstamped cigarettes held by manufacturers, every person liable to the tax shall promptly make an itemized inventory of all cigarettes held for sale at the first moment of July 1, 1940. The inventory shall be prepared in accordance with the inventory schedules on the back of Forms 187 and 188.

Persons holding cigarettes at more than one location shall prepare *in triplicate* a separate inventory for each such location. One copy shall be retained on the premises, one copy shall be forwarded to the taxpayer's principal place of business, and one copy shall be forwarded to the collector of internal revenue for the district in which the particular premises are located.

The copy of each separate inventory forwarded to the collector of internal revenue shall show the taxpayer's name, the location of the particular premises for which the inventory is made, and the name and address of the principal office from which the consolidated return and inventory will be filed. (See paragraph 5 hereinafter.)

Separate inventories which have been forwarded to the taxpayer's principal place of business shall there be consolidated into a single inventory for the purposes of return and payment of tax.

(*b*) *Manufacturers.*—In addition to preparing inventories of stamped cigarettes, manufacturers shall prepare inventories of unattached cigarette tax stamps held or in transit from the collector or a stamp deputy at the first moment of July 1, 1940, purchased at rates of tax in effect prior to July 1, 1940. Such stamp inventories shall be prepared and handled in the same manner as cigarette inventories.

5. *Return and payment of tax.*—(*a*) *General.*—Floor stocks tax return and inventory of cigarettes and unattached cigarette tax stamps shall be made in duplicate on the form prescribed and shall be filed with the collector of internal revenue for the district in which is located the taxpayer's principal place of business on or before August 1, 1940, accompanied by remittance of the tax due.

Where a taxpayer holds cigarettes at more than one location and separate inventories have been prepared, as required by paragraph 4, the copies of the separate inventories shall be retained by the taxpayer at his principal place of business and shall not be filed with the consolidated tax return and inventory.

(*b*) *Manufacturers.*—The return of manufacturers shall include stamped cigarettes and unattached cigarette stamps but shall not include unstamped cigarettes. The floor stocks tax applicable to unstamped cigarettes held at the first moment of July 1, 1940, will be paid by affixing to such cigarettes tax stamps paid for at the rate of $3.25 per thousand in the case of small cigarettes and $7.50 per thousand in the case of large cigarettes. Tax paid by stamp in this manner will thus include the manufacturers' tax at the old rates of $3 per thousand and $7.20 per thousand, respectively, plus the floor

stocks tax of 25 cents per thousand and 60 cents per thousand, respectively.

6. *Cigarettes in customs custody and control.*—No return and inventory shall be filed with respect to cigarettes in customs custody and control at the first moment of July 1, 1940. As in the case of unstamped cigarettes held by manufacturers, the floor stocks tax applicable to such cigarettes will be paid by affixing at the time of removal tax stamps paid for at the rate of $3.25 per thousand in the case of small cigarettes and $7.80 per thousand in the case of large cigarettes. (See subparagraph (*b*) of paragraph 5.)

7. *Penalty and interest.*—The penalty and interest provisions of sections 2156, 3612, and 3655 of the Internal Revenue Code are applicable to the cigarette floor stocks tax.

Correspondence in regard to the procedure described herein shall refer to the number of this mimeograph and to the symbols MT:T.

GUY T. HELVERING,
Commissioner.

REGULATIONS 8 (1934), ARTICLES 194–200 (added). 1940–33–10388
T. D. 4997

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 140; SUBCHAPTER E, PART 465, SUBPART B.

Regulations 8, as amended, relating to taxes on tobacco products, etc., as made applicable to the Internal Revenue Code by Treasury Decision 4885 [C. B. 1939–1 (Part 1), 396], amended.

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

To Collectors of Internal Revenue and Others Concerned:

Regulations 8 (revised November, 1934) [Part 140, Title 26, Code of Federal Regulations], but only as prescribed and 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, 1939 Sup.], are amended as follows:

Article 194 [section 140.194, Title 26, Code of Federal Regulations] is renumbered as article 200 [Section 140.200].

Immediately following article 193 [section 140.193] the following new Chapter XV is added:

CHAPTER XV.

FLOOR STOCKS TAX ON CIGARETTES.

SEC. 212. CIGARETTS. (REVENUE ACT OF 1940.)

Subchapter A of chapter 15 of the Internal Revenue Code is amended by inserting at the end thereof the following new sections:

" SEC. 2004. DEFENSE TAX FOR FIVE YEARS.

" In lieu of the rates of tax specified in section 2000 (c) (2), the rates of tax for the period after June 30, 1940, and before July 1, 1945, shall be $3.25 and $7.80, respectively.

"SEC. 2005. FLOOR STOCKS TAX.

"(a) *Floor stocks tax.*—Upon cigarettes subject to tax under section 2000 (c) (2) which on July 1, 1940, are held by any person for sale, there shall be levied, assessed, collected, and paid a floor stocks tax at a rate equal to the increase in rate of tax made applicable to such articles by section 2004.

"(b) *Returns.*—Every person required by this section to pay any floor stocks tax shall, on or before August 1, 1940, under such regulations as the Commissioner with the approval of the Secretary shall prescribe, make a return and pay such tax, except that in the case of articles held by manufacturers and importers the Commissioner may collect the tax with respect to all or part of such articles by means of stamp rather than return, and in such case may make an assessment against such manufacturer or importer having tobacco tax stamps on hand July 1, 1940, for the difference between the amount paid for such stamps and the increased rates specified in section 2004.

"(c) *Laws applicable.*—All provisions of law, including penalties, applicable in respect of the taxes imposed by section 2000 shall, insofar as applicable and not inconsistent with this section, be applicable with respect to the floor stocks tax imposed by subsection (a)."

ART. 194 [Section 140.194]. *Scope of tax.*—The floor stocks tax under section 2005 of the Internal Revenue Code is imposed upon all cigarettes, whether large or small, which on the first moment of July 1, 1940, are held by any person for sale. The tax applies without regard to where the cigarettes are held. Subject to the exemptions provided for with respect to the withdrawal of tobacco products for export (see article 185 [section 140.185]), the withdrawal of tobacco products for use as sea stores (see article 186 [section 140.186]), and the withdrawal of tobacco products for use of the United States (see Regulations 34 [Part 450, Title 26, Code of Federal Regulations]), the tax applies also without regard to the disposition of the cigarettes on or after July 1, 1940.

The term "small cigarettes" means cigarettes weighing NOT more than 3 pounds per thousand, and the term "large cigarettes" means cigarettes weighing MORE than 3 pounds per thousand.

ART. 195 [Section 140.195] *Rates of tax.*—The rate of tax applicable to small cigarettes is 25 cents per thousand. The rate applicable to large cigarettes is 60 cents per thousand, except that cigarettes measuring more than 6½ inches in length are taxable as small cigarettes counting each 2¾ inches (or fraction thereof) of the length of each cigarette as one small cigarette. These rates are equal to the increases in the rates of tax made applicable to cigarettes by section 2004 of the Internal Revenue Code.

ART. 196 [Section 140.19]. *Payment of tax.*—The tax is payable on or before August 1, 1940, by every person who at the first moment of July 1, 1940, held cigarettes for sale. The tax shall be paid at the time of filing the return on Form 187, or Form 188 (see article 197 [section 140.197]).

Manufacturers who held unstamped cigarettes on July 1, 1940, shall pay the tax applicable to such cigarettes by affixing, at the time of the withdrawal of such cigarettes from the factory, stamps paid for at the increased rates in effect on and after July 1, 1940. To permit the use for this purpose of unattached cigarette stamps purchased at the rates in effect on June 30, 1940, manufacturers shall, with respect to such stamps, pay as part of their floor stocks tax liability an amount equal to the difference between the amount paid for such stamps and the amount which would have been paid if they had been purchased on or after July 1, 1940.

ART. 197 [Section 140.197]. *Inventory and return.*—(a) *General.*—Every person who held stamped cigarettes for sale on the first moment of July 1, 1940, shall make and file an inventory and return of the cigarettes so held. The inventory and return shall be made on Form 187 by persons other than manufacturers and on Form 188 by manufacturers.

Where the stamped cigarettes were held by a taxpayer at only one place of business, the inventory and return shall be filed in duplicate with the collector of the district in which such place of business is located.

Where the stamped cigarettes were held at more than one place of business, a consolidated inventory and return of the stamped cigarettes held at each place

of business shall be filed in duplicate with the collector for the district in which is located the taxpayer's principal place of business. In addition thereto, a separate inventory shall be prepared in triplicate on Form 187 or Form 188 (whichever is applicable) with respect to the stamped cigarettes held at each place of business; one copy of which shall be retained at the particular premises where the cigarettes were held, one copy shall be filed with the collector for the district in which the particular premises are located, and one copy shall be forwarded to and be retained at the principal place of business of the taxpayer for use in preparing and verifying the consolidated inventory and return. The copy of each separate inventory forwarded to the collector of internal revenue shall show the taxpayer's name, the location of the particular premises for which the inventory is made, and the name and address of the principal office from which the consolidated return and inventory will be filed.

Stamped cigarettes in transit at the first moment of July 1, 1940, shall be included in the inventory of the person having title thereto at that time.

The inventory and return shall be filed on or before August 1, 1940. Failure to file the inventory and return and pay the tax due thereon within the time specified will subject the taxpayer to the penalties set forth in article 199 [section 140.199].

The oath required on Form 187 may be administered by any officer authorized to administer oaths for general purposes, or by a deputy collector or internal revenue agent. If the total amount of tax shown to be due by the return is $10 or less, the return may be acknowledged before two subscribing witnesses in lieu of an oath.

(*b*) *Manufacturers.*—In addition to the requirements set forth in subsection (*a*) of this article, manufacturers shall, for the purpose of the additional payment specified in article 196 [section 140.196], include in their inventory and return an inventory of all unattached cigarette stamps held at the first moment of July 1, 1940, and of all cigarette stamps ordered and paid for at the rates in effect on June 30, 1940, but not received until after the first moment of July 1, 1940.

(*c*) *Records.*—Every person required by this article to file an inventory and return shall keep, at the premises where the cigarettes inventoried were located, accurate records showing the details of the inventory, and how and by whom the inventory was taken. Such records shall at all times be open for inspection by internal revenue officers, and shall be retained for a period of at least four years from August 1, 1940.

ART. 198 [Section 140.198]. *Refunds.*—A claim for refund may be filed by any person who has paid a floor stocks tax on cigarettes (including unattached cigarette stamps) and who claims that he made an overpayment of such tax. Such claim must be made under oath on Form 843, contain the information required by the form, and be supported by a statement of the facts and evidence upon which the claim is based. The claim shall be filed with the collector of internal revenue to whom the tax was paid.

ART. 199 [Section 140.199]. *Penalties and interest.*—The penalty under section 3612 (d) (1) and (e) of the Internal Revenue Code for delinquency in filing an inventory and return is 5 per cent of the amount of the tax if the failure is for not more than 30 days, with an additional 5 per cent for each additional 30 days or fraction thereof during which failure continues, not to exceed 25 per cent in the aggregate. The penalty does not apply where the return is later filed and failure to file the return within the prescribed time is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect.

Where an assessment of the floor stocks tax is made, and payment is not made within 10 days after the issuance of the first notice and demand (Form 17), there will accrue, under section 3655 of the Internal Revenue Code, a 5 per cent penalty and interest at the rate of 6 per cent per annum computed upon the entire assessment from the date of issuance of Form 17 until date of payment.

In case a false or fraudulent inventory and return is willfully made, the penalty under section 3612 (d) (2) and (e) of the Internal Revenue Code is 50 per cent of the total tax due.

The several criminal penalties set out in article 113 [section 140.113] are also applicable to the floor stocks tax.

(This Treasury decision is issued under authority of sections 2004 and 2005 of the Internal Revenue Code as added by section 212 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session) and section 3791 of such Code (53 Stat., 467).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved August 1, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register August 5, 1940, 3.54 p. m.)

TOBACCO, ETC., TAXES.

SECTION 2004, AS ADDED BY SECTION 212 OF THE REVENUE ACT OF 1940.—CIGARETTES.

REGULATIONS 8 (1934), ARTICLE 72: Rates of tax on cigars and cigarettes—Date effective. 1940–31–10362 T. D. 4985

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 140; SUBCHAPTER E, PART 465, SUBPART B.

Regulations 8, as amended, relating to taxes on tobacco products, etc., as made applicable to the Internal Revenue Code by Treasury Decision 4885 [C. B. 1939–1 (Part 1), 396], amended.

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

To Collectors of Internal Revenue and Others Concerned:

Section 212 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session) provides as follows:

SEC. 212. CIGARETTES.

Subchapter A of chapter 15 of the Internal Revenue Code is amended by inserting at the end thereof the following new sections:

"SEC. 2004. DEFENSE TAX FOR FIVE YEARS.

"In lieu of the rates of tax specified in section 2000(c)(2), the rates of tax for the period after June 30, 1940, and before July 1, 1945, shall be $3.25 and $7.80, respectively.

* * * * * * *

In conformity with the provision of law quoted above, Regulations 8 (revised November, 1934) [Part 140, Title 26, Code of Federal Regulations], but only as prescribed and 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, 1939 Sup.], is amended as follows:

Article 72 [section 140.72] is amended by adding the following note at the end of paragraph (*a*):

NOTE.—For the period after June 30, 1940, and before July 1, 1945, the rates of tax on cigarettes as specified in the above table, namely, $3, $7.20, and $3 are $3.25, $7.80, and $3.25, respectively.

(This Treasury decision is issued under the authority of section 2004 of the Internal Revenue Code as added by section 212 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress, third session) and section 3791 of such Code (53 Stat., 467).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved July 18, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 22, 1940, 11.57 a. m.)

TAX ON MANUFACTURE OF MANUFACTURED SUGAR.

SECTION 3493 OF THE INTERNAL REVENUE CODE, AS AMENDED BY ACT OF OCTOBER 8, 1940 (PUBLIC, NO. 807, SEVENTY-SIXTH CONGRESS).

REGULATIONS 99, ARTICLE 300: Who may file the claim. 1940–48–10502
T. D. 5021
ARTICLE 303: Limitations on allowance.

TITLE 26—INTERNAL REVENUE.—CHAPTER I, PART 312, SUBPART D.—EXPORT PAYMENTS.

Manufactured sugar tax.—Amending Regulations 99 as made applicable to the Internal Revenue Code by Treasury Decision 4885 [C. B. 1939–1 (Part 1), 396].

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

To Collectors of Internal Revenue and Others Concerned:

In order to conform Regulations 99 [Part 312, Title 26, Code of Federal Regulations] relating to the tax on the manufacture of manufactured sugar as made applicable to the Internal Revenue Code (53 Stat., Part I) 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, 1939 Sup.], to the provisions of the Act approved October 8, 1940 (Public, No. 807, Seventy-sixth Congress, third session), such regulations are amended as follows:

PARAGRAPH 1. In lieu of the headings and quotations of law appearing after the words "Export Payments" and preceding article 300 [section 312.300 of such Title 26] substitute the following:

Section 3493 of the Internal Revenue Code, as amended by the Act approved October 8, 1940 (Public, No. 807, Seventy-sixth Congress).

SEC. 3493. EXPORTATION.

(a) REFUND OF TAX PAID.—Upon the exportation from the United States to a foreign country, or the shipment from the United States to any possession of the United States except Puerto Rico, of any manufactured sugar, or any article manufactured wholly or partly from manufactured sugar, with respect to which tax under the provisions of section 3490 has been paid, the amount of such tax shall be paid by the Commissioner of Internal Revenue to the consignor named in the bill of lading under which the article was exported or shipped to a possession, or to the shipper, or to the manufacturer of the manufactured sugar or of the articles exported, if the consignor waives any claim thereto in favor of such shipper or manufacturer: *Provided*, That no such payment shall be allowed with respect to any manufactured sugar, or article, upon which, through substitution or otherwise, a drawback of any tax paid under section 3500 has been or is to be claimed under any provisions of law made applicable by section 3501.

(b) PERIOD FOR FILING REFUND CLAIM.—No payment shall be allowed under this section unless within two years after the right to such payment has accrued a claim therefor is filed by the person entitled thereto.

PAR. 2. Article 300 [section 312.300 of such Title 26] is amended to read as follows:

ART. 300. *Who may file the claim.*—The person named as consignor in the bill of lading under which the manufactured sugar, or an article processed wholly or partly therefrom, is exported or shipped has the primary right to claim the export payment provided for in section 3493(a) of the Internal Revenue Code, as amended. Such person may, however, waive any claim thereto in favor of the shipper or the manufacturer, in which case the shipper or the manufacturer, as the case may be, will be recognized as the proper claimant.

A waiver in substantially the following form shall be used:

_____, the consignor(s) named in the bill of lading to which this waiver is affixed or attached, do(es) waive in favor of _____ _____ (shipper) (manufacturer) any claim for payment allowable under the provisions of section 3493(a) of the Internal Revenue Code by reason of the exportation or shipment of the articles described in such bill of lading, and state(s) that such party is the actual shipper or the actual manufacturer of the article or articles exported.

_____.
(Consignor named in the bill of lading.)

PAR. 3. Subdivision (*a*) of article 303 [subsection (*a*) of section 312.303 of such Title 26] is amended to read as follows:

ART. 303. *Limitations on allowance.*—(*a*) *Time for filing claim.*—No export payment shall be allowed unless claim therefor is filed by the person entitled thereto within two years from the date the right to such payment accrued. The right to payment accrues as of the date the articles are exported.

(This Treasury decision is prescribed pursuant to the authority conferred by section 3497 and section 3791 of the Internal Revenue Code.)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved November 18, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register November 22, 1940, 10.28 a. m.)

PROCESSING TAXES.

TITLE VII.—REFUNDS OF AMOUNTS COLLECTED UNDER THE AGRICULTURAL ADJUSTMENT ACT. (1936)

REGULATIONS 96, ARTICLE 202: Facts and evidence in support of claim. 1940–39–10431 Ct. D. 1465

PROCESSING TAX—REVENUE ACT OF 1936—AGRICULTURAL ADJUSTMENT ACT—DECISION OF COURT.

1. PETITION FOR REVIEW—CLAIM FOR REFUND—SUFFICIENCY OF CLAIM.

The United States Processing Tax Board of Review properly dismissed a petition to review the action of the Commissioner in disallowing a claim for refund of processing taxes paid on the ground that the claim failed to comply with the requirements of Title VII of the Revenue Act of 1936 and the regulations promulgated thereunder. The function of the facts called for by the schedules of the prescribed form is to facilitate research, and the Commissioner is entitled to insist upon compliance with their directions. A claim that refers to no facts upon which it may be founded is ineffective and will not supply a basis for a suit against the Government when there has been neither waiver by the Commissioner nor amendment by the taxpayer.

2. MOTION TO DISMISS—JURISDICTION OF BOARD OF REVIEW.

The allegation in the petition for review that a claim for refund had been filed was jurisdictional in character and was appropriately challenged by a motion to dismiss. The Board of Review was required to determine that issue before proceeding to a hearing on the merits. The clear intent of section 903 of the Revenue Act of 1936 is to require a claimant to seek a ruling by the Commissioner on the merits of a claim before applying to the Board for a review, and the power of the Board to allow a refund is dependent upon whether a claim for refund has been filed in compliance with the statute. A claim that fails to meet the statutory requirements and that has been properly disallowed by the Commissioner as defective leaves the Board without jurisdiction to grant a refund.

3. CONSTITUTIONALITY OF STATUTE.

Title VII of the Revenue Act of 1936 is not unconstitutional on the ground that it imposes an impossible burden of proof upon a taxpayer who failed to keep records to show that it bore the burden of the tax.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

Lee Wilson & Co., petitioner, v. *Commissioner of Internal Revenue, respondent.*
[111 Fed. (2d), 313.]

On petition to review decision of United States Processing Tax Board of Review.

Before GARDNER, WOODROUGH, and THOMAS, Circuit Judges.

[April 22, 1940.]

OPINION.

THOMAS, Circuit Judge, delivered the opinion of the court.

This is a petition to review an order of the United States Processing Tax Board of Review. It involves a claim for refund of the sum of $2,218.61 collected from the petitioner as a tax on the domestic processing of hogs pursuant to the provisions of the Agricultural Adjustment Act (ch. 25, 48 Stat., 31, 7 U. S. C. A., section 601 et seq.). The Commissioner of Internal Revenue disallowed the petitioner's claim on the grounds (1) that the claim is

not founded on the basis that petitioner had borne the burden of the tax; (2) that no evidence was submitted to establish that the burden of the tax was borne by the petitioner; (3) that the claim as filed does not conform to the provisions of sections 902 and 903 of Title VII of the Revenue Act of 1936 (ch. 690, 49 Stat., 1747, 7 U. S. C. A., sections 644, 645); and (4) that the claim as filed afforded no basis for the Commissioner to consider it on its merits.

The petitioner thereupon sought a review of the decision of the Commissioner before the Board of Review created by the Act, praying that it be granted a hearing; that the decision of the Commissioner be reversed; and alleging that Title VII of the Revenue Act of 1936 is unconstitutional, null, and void, in so far as it purports to condition refund of the tax upon proof that the taxpayer bore the burden of the tax, or in so far as it requires proof based upon records not theretofore required to be kept by the taxpayer.

Upon motion of the respondent the Board dismissed the petition on the ground that "the claim for refund, the disallowance by the respondent of which is sought to be reviewed, fails to comply with the requirements of Title VII of the Revenue Act of 1936 and of the Treasury regulations promulgated thereunder."

The appeal is before this court pursuant to section 906(g) of the Revenue Act of 1936 (ch. 690, 49 Stat., 1648, 1750, 7 U. S. C. A., section 648(g)). The single question presented is the propriety of the Board's order. The petitioner contends: (1) that the claim filed by it was a good claim under the law; (2) that the petition filed with the Board stated a good cause of action; (3) that the Board is without power to dismiss a properly drawn petition and thus refuse a hearing on the merits; and (4) that if Title VII of the Revenue Act of 1936 is to be construed as respondent urges, it is null and void as an infringement of the petitioner's constitutional rights.

The respondent denies each of the petitioner's contentions and urges that the petitioner, by proceeding upon a claim properly rejected by the Commissioner as defective, failed to comply with an essential prerequisite to the maintenance of its cause of action before the Board.

The validity of the claim must be determined in the light of the relevant statute and the regulations promulgated thereunder. The pertinent sections of the Revenue Act of 1936 are set out in the margin.[1]

Section 916 of the Revenue Act of 1936 (7 U. S. C. A., section 658) empowers the Commissioner to prescribe "such rules and regulations as may be deemed necessary to carry out the provisions of this title." Proceeding under this grant of authority the Commissioner promulgated Treasury Regulations 96 designed to prescribe the essentials of the claim required by section 903 of the Act, and intended to provide the necessary information requisite to the allowance of a refund under the conditions set forth in section 902 of the

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[1] SEC. 902. CONDITIONS OF ALLOWANCE OF REFUNDS.—No refund shall be made or allowed, in pursuance of court decisions or otherwise, of any amount paid by or collected from any claimant as tax under the Agricultural Adjustment Act, unless the claimant establishes to the satisfaction of the Commissioner in accordance with regulations prescribed by him, with the approval of the Secretary, or to the satisfaction of the trial court, or the Board of Review in cases provided for under section 906, as the case may be—

(a) That he bore the burden of such amount and has not been relieved thereof nor reimbursed therefor nor shifted such burden, directly or indirectly, (1) through inclusion of such amount by the claimant, or by any person directly or indirectly under his control, or having control over him, or subject to the same common control, in the price of any article with respect to which a tax was imposed under the provisions of such Act, or in the price of any article processed from any commodity with respect to which a tax was imposed under such Act, or in any charge or fee for services or processing; (2) through reduction of the price paid for any such commodity; or (3) in any manner whatsoever; and that no understanding or agreement, written or oral, exists whereby he may be relieved of the burden of such amount, be reimbursed therefor, or may shift the burden thereof; or

(b) That he has repaid unconditionally such amount to his vendee (1) who bore the burden thereof, (2) who has not been relieved thereof nor reimbursed therefor, nor shifted such burden, directly or indirectly, and (3) who is not entitled to receive any reimbursement therefor from any other source, or to be relieved of such burden in any manner whatsoever. (U. S. C., Supp. IV, Title 7, section 644.)

SEC. 903. FILING OF CLAIM.—No refund shall be made or allowed of any amount paid by or collected from any person as tax under the Agricultural Adjustment Act unless, after the enactment of this Act, and prior to July 1, 1937, a claim for refund has been filed by such person in accordance with regulations prescribed by the Commissioner with the approval of the Secretary. All evidence relied upon in support of such claim shall be clearly set forth under oath. * * * (U. S. C., Supp. IV, Title 7, section 645.)

Act. The pertinent articles of Treasury Regulations 96 promulgated under the Revenue Act of 1936 will be found in the footnote.[2]

The claim for refund filed with the collector was made on P. T. Form 79 prescribed by the regulations. The claimant filled in the blanks on the first page, stating its name and address, the name of the commodity processed, and the amount of the tax and of the refund claimed. Following these blanks on the first page of the form is a printed affidavit to be executed by the claimant. The affidavit sets out in seven numbered paragraphs the essential elements of a claim to conform to the provisions of the statute with an averment that they are true and correct. The claimant crossed out paragraph number 4 of the affidavit. The deleted paragraph reads as follows:

"4. (*a*) That the amount of the burden of the processing tax on the processing of the commodity named above which was borne by the claimant as set forth in column 2 above is true and correct; that the claimant has not been relieved thereof nor reimbursed therefor nor shifted such burden, directly or indirectly, (1) through inclusion of such amount by the claimant, or by any person directly or indirectly under his control, or having control over him, or subject to the same common control, in the price of any article processed from such commodity; (2) through reduction of the price paid for such commodity; or (3) in any manner whatsoever; and that no understanding or agreement, written or oral, exists whereby he may be relieved of the burden of such amount, be reimbursed therefor, or may shift the burden thereof; and (*b*) that the data and statements submitted in and made a part of Schedule D are true and correct;"

The remaining seven pages of the prescribed form contain Schedules A, B, C, D, E, and a detailed set of instructions as to the information desired. Schedule A requires the date, place, and amount of each tax payment. Schedules B and C call for information as to amounts of the tax refunded to, or for which credit has been taken by, the claimant or by others. Schedule D provides for data relative to the computation of the average margin for the tax period necessary to the prima facie showing referred to in section 907 of the Act and in article 605 of the regulations. Schedule E asks for information as to vendees to whom the processing tax was repaid and who bore the burden of such tax.

The petitioner filled in Schedule A and left the remaining schedules blank without explanation. In lieu, apparently, of its failure to provide the desired information it appended to the claim the following statement:

[2] ART. 201. *Claims—Form and where to file.*—Claims for the refund of tax shall be made on the prescribed forms. Such claims shall be prepared in accordance with the instructions contained on the forms and in accordance with the provisions of these regulations. * * *

ART. 202. *Facts and evidence in support of claims.*—Each claim shall set forth in detail and under oath each ground upon which the refund is claimed. It is incumbent upon the claimant to prepare a true and complete claim and to substantiate by clear and convincing evidence all of the facts necessary to establish his claim to the satisfaction of the Commissioner; failure to do so will result in the disallowance of the claim.

The provisions of these regulations require that certain specific facts shall be stated in support of any claim for refund. The claimant is privileged to prove those facts in any manner available to him and to submit such evidence to that end as he may desire.

ART. 601. *Claim form prescribed.*—Claims for refund of amounts paid as processing tax (as defined in section 913(b) of the Act) shall be filed on P. T. Form 79. * * *

ART. 603. *Payment of tax.*—The claimant shall set forth in the claim complete data with respect to the amount of processing tax which he has paid on the processing of the commodity. (Detailed instructions follow.)

ART. 605. *Evidence as to margins.*—Section 907 of the Act (ch. 690, 49 Stat., 1751, 7 U. S. C. A., section 649) provides that in claims for refund of amounts paid as processing tax it shall be prima facie evidence that the burden of such amount was borne by the claimant to the extent (not to exceed the amount of the tax) that the average margin per unit of the commodity processed was lower during the tax period than the average margin per unit of such commodity was during the period before and after the tax. If the average margin during the tax period was not lower, it shall be prima facie evidence that none of the burden of such amount was borne by the claimant but that it was shifted to others.

There shall be submitted with, and as a part of, each claim, a statement showing the average margin for the tax period and for the period before and after the tax. * * * (Detailed instructions for the computation of the average margin follow.)

In support of such statement there shall be submitted, verified by appropriate affidavit, a detailed showing of the manner in which the margins for each month and the average margins for each period were ascertained, the data and records on which they were based, the location of such data and records, and all other related matters including the accounting procedure of the claimant, which entered into the computations of such margins. All elements, factors, units, or measures entering into the computation of such margins, and any departure from uniformity in the use thereof in making such computation for any part of either period, must be fully explained and justified.

ART. 606. *Other evidence.*—In addition to the showing as to margins, the claimant is privileged to submit with his claim any other evidence available to him tending to establish that he bore the burden of the tax. Such evidence may be submitted to support the prima facie presumption, if such presumption is in favor of the claimant, or to rebut such presumption if it is against him. (See section 902 and subsection (e) of section 907 of the Act.)

"It is impossible to determine and prove how much of the tax, if any, was not absorbed by claimant and claimant believes and therefore asserts that it absorbed all the tax.

"Claimant demands refund of the entire amount paid because the Supreme Court has held that it was illegally assessed and collected and because any attempt to condition or restrict the refund thereof, by requiring proof that the tax was absorbed by the claimant, is unconstitutional and void."

It is obvious that the petitioner did not file a claim for refund that met the requirements of section 903 of the statute. The unsworn statement that the entire amount of the tax was borne by the petitioner and not shifted to others is not supported by a single statement of fact that would have permitted the Commissioner to determine the merits of the petitioner's right to a refund under section 902. The regulations, the substance of which is set forth in the instructions accompanying the form, are disregarded without other explanation than that the conditions imposed by the Act and required by the regulation are unconstitutional.

The function of the facts called for by the schedules is to facilitate research; and the Commissioner was entitled to insist upon compliance with their directions as to the desired information. A claim that refers to no facts upon which it may be founded is ineffective and "will not supply a basis for a suit against the Government when there has been neither waiver by the Commissioner nor amendment by the taxpayer." (*United States* v. *Memphis Cotton Oil Co.*, 288 U. S., 62, 72 [Ct. D. 626, C. B. XII–1, 307 (1933)]; *United States* v. *Felt & Tarrant Co.*, 283 U. S., 269, 272 [Ct. D. 336, C. B. X–1, 431 (1931)]; *Maas & Waldstein Co.* v. *United States*, 283 U. S., 583, 589 [Ct. D. 353, C. B. X–1, 433 (1931)]; *United States* v. *Andrews*, 302 U. S., 517, 521 [Ct. D. 1300, C. B. 1938–1, 322]; *Dascomb* v. *McCuen*, 2 Cir., 73 Fed. (2d), 417, 419; *Continental-Illinois Nat. Bank & Trust Co.* v. *United States*, 7 Cir., 67 Fed. (2d), 153, 155; *Snead* v. *Elmore*, 5 Cir., 59 Fed. (2d), 312, 314; *Taber* v. *United States*, 8 Cir., 59 Fed. (2d), 568, 571; *Weagant* v. *Bowers*, 2 Cir., 57 Fed. (2d), 679, 680.)

It will be observed that section 903 of the Act provides that no refund of any processing tax shall be allowed unless a claim therefor shall have been filed in accordance with regulations prescribed by the Commissioner prior to July 1, 1937. There is then added: "All evidence relied upon in support of such claim shall be clearly set forth under oath." It is apparent from the second paragraph of the statement attached to the claim, supra, that at the time the claim was filed the petitioner was of the impression that Congress could not "condition or restrict" the refund of processing taxes, and that the claimant could not be required to furnish evidence to support the burden cast upon it by paragraph 4 which it deleted from the affidavit on the first page of the claim. The Act was subsequently held to be valid by the Supreme Court in *Anniston Mfg. Co.* v. *Davis* (301 U. S., 337 [Ct. D. 1234, C. B. 1937–1, 485]). Now it is claimed the requirement of the statute that the evidence relied upon to support the claim must be set forth under oath is not subject to the limitation of time for filing the claims provided in the first sentence of section 903. The argument is opposed to the plain mandate of the statute. This section of the statute provides for filing claims, and requires that "All evidence relied upon in support of such claim" must be "set forth under oath." Where must such evidence be set forth? Clearly it must be in connection with the claim. And that evidence set forth "in accordance with regulations prescribed by the Commissioner" must be sufficient to establish "to the satisfaction of the Commissioner * * * of the trial court, or the Board of Review * * * That he bore the burden" prescribed by the statute.

The petitioner contends further that it was entitled to a hearing before the Board on the merits of the allegations in its petition without regard to whether the Commissioner was right in disallowing the claim for noncompliance with the regulations. The argument is that the petitioner was entitled under section 902 to present evidence as to its right to a refund to either the Commissioner or the Board; that section 906 (7 U. S. C. A., 648 (b)), which provides that upon petitioning the Board "the claimant shall be entitled to a hearing as provided herein," is mandatory in its terms; that the Board is given no authority by statute to dismiss a properly drawn petition and deny a hearing on the merits; and that for the purposes of ruling on the motion to dismiss the Board was required to accept as true all well pleaded facts alleged in the petition (*F. & F. Laboratories, Inc.*, v. *Commissioner*, 7 Cir., 104 Fed. (2d), 563 [Ct. D. 1418, C. B. 1939–2, 396]) without reference to the attached claim.

In substance the petition to the Board alleges that petitioner paid processing taxes on hogs in the amount of $2,218.61 in 1935; that it bore the burden of such

taxes and was not relieved therefrom, or reimbursed therefor, and did not shift that burden to others, either directly or indirectly; that on June 25, 1937, after the enactment of the Revenue Act of 1936, it filed a claim for refund of the processing taxes paid by it; that said claim was disallowed by the Commissioner of Internal Revenue on March 10, 1939. Certain errors committed by the Commissioner in disallowing the claim and certain constitutional questions are alleged. A hearing on the merits is requested.

Assuming that the allegations with respect to the burden of the tax are sufficient to establish the validity of the petitioner's claim for purposes of the motion to dismiss, it does not follow that a cause of action was stated which the Board had authority to hear and determine on the merits. The allegation that a claim had been filed was jurisdictional in character and was appropriately challenged by the motion to dismiss. The Board was required to determine that issue before proceeding to a hearing on the merits. Under section 903 of the Act the power of the Board to allow a refund is dependent upon whether a claim for refund has been filed in compliance with the statute. The clear intent of the statute is to require a claimant to seek a ruling by the Commissioner on the merits of the claim before applying to the Board for a review. A claim that fails to meet the statutory requirements and that has been properly disallowed by the Commissioner as defective leaves the Board without jurisdiction to grant a refund. (See *United States* v. *Felt & Tarrant Co.*, supra.) If it were otherwise the claimant could proceed directly to the Board merely by filing a formal claim for refund unsupported by any facts that would permit the Commissioner to rule on its merits. The action of the Board in dismissing the petition upon respondent's motion was proper and there is no merit in the contention that it was without power so to do. (*Arabi Packing Co.* v. *Commissioner*, 5 Cir., 109 Fed. (2d), 278; *Oswald Jaeger Baking Co.* v. *Commissioner*, 7 Cir., 108 Fed. (2d), 375; *Grain Belt Supply Co.* v. *Commissioner*, 8 Cir., 109 Fed. (2d), 490; *F. & F. Laboratories* v. *Commissioner*, supra.)

Finally, the petitioner contends that, as construed by the respondent, Title VII of the Revenue Act of 1936 is unconstitutional. The argument is that if the "margin" data required by Schedule D of P. T. Form 79 and article 605, supra, is a mandatory prerequisite under section 907, supra, to the right to a refund the Act imposes an impossible burden of proof upon a taxpayer who failed to keep records to show that it bore the burden of the tax. Section 907, supra, specifically provides for the case of a taxpayer in this situation, and, aside from the fact that there is an entire absence in this record of any facts showing impossibility of proof under this section of the statute, the petitioner's contention is wholly without merit. (*Anniston Mfg. Co.* v. *Davis*, 301 U. S., 337; *United States* v. *Jefferson Electric Co.*, 291 U. S., 386 [Ct. D. 803, C. B. XIII-1, 393 (1934)]; *Burnet* v. *Houston*, 283 U. S., 223, 228 [Ct. D. 328, C. B. X-1, 343 (1931)].)

The order of the Board of Review is affirmed.

SECTION 902.

REGULATIONS 96, ARTICLE 204: Conditions as to tax burden with respect to amount of refund allowable. 1940-28-10320 Ct. D. 1460

PROCESSING TAXES—AGRICULTURAL ADJUSTMENT ACT—REVENUE ACT OF 1936—DECISION OF COURT.

1. CLAIM FOR REFUND—TAXES PAID BY PROCESSORS WITH MONEY ADVANCED BY VENDEE—CONDITIONS ON ALLOWANCE OF REFUND—CONSTITUTIONALITY OF STATUTE.

Manufacturers of serum who purchased hogs for use in their business, processed them, and sold the carcasses to a packing company, are not entitled to recover from the Commissioner the amount of processing taxes paid by them, the vendee company having advanced sufficient money for payment of the taxes with the understanding that it would be repaid only if and to the extent that the taxes were refunded, and the claimants having failed to fulfill the conditions necessary to entitle them to a refund under section 902

of the Revenue Act of 1936, in that it affirmatively appeared from their petitions that they did not bear the burden of the taxes paid by them and that they had not repaid unconditionally such amounts to the vendee. The statutory restriction of the right to refund to those who bore the burden of the tax does not infringe due process.

2. CERTIORARI DENIED.

Petition for certiorari denied May 6, 1940.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

Southwestern Serum Co., petitioner, v. *Commissioner of Internal Revenue, respondent.*

Colorado Serum Co., petitioner, v. *Commissioner of Internal Revenue, respondent.*

[108 F. (2d), 843.]

Petitions for review of decisions of the United States Processing Tax Board of Review.

Before PHILLIPS, BRATTON, and HUXMAN, Circuit Judges.

[January 4, 1940.]

OPINION.

BRATTON, Circuit Judge, delivered the opinion of the court.

These are two separate petitions to review orders of the United States Processing Tax Board of Review in accordance with the provisions of Title VII of the Revenue Act of 1936 (49 Stat., 1648, 1747). One petitioner paid processing taxes for the period commencing February 1, 1934, and ending August 31, 1934, and for the period commencing April 1, 1935, and ending August 31, 1935, in the amount of $10,837.42; and the other petitioner paid like taxes for the period commencing February 1, 1934, and ending October 31, 1935, in the amount of $35,853.92. Separate claims for refund were submitted to the Commissioner of Internal Revenue, and disallowed. Separate petitions to review the action of the Commissioner were seasonably lodged with the Board. Except in respect to the period of time covered and the amount of taxes paid, the allegations in the two petitions were substantially identical. Accordingly, they may be stated together. These facts were alleged in the petitions and the attached copies of the claims. Petitioners were at all material times engaged—one at Wichita, Kans., and the other at Denver, Colo.—in the business of manufacturing anti-cholera serum and other serum for use on hogs. In the course of that business they raised, fattened, purchased in the open market, inoculated, and then slaughtered hogs, and used the blood extracted from them in the manufacture of the serum. Immediately after the blood had been extracted, the carcasses were sold and delivered to Cudahy Packing Co. Live hogs were purchased at flat prices in the open market in competition with other buyers, including the Cudahy company. There was no contract, understanding, or agreement, express or implied, between petitioners and the vendors from whom they purchased live hogs that any amount of processing tax should be included in or deducted from the prices paid, and no such amount was included or deducted. The prices which the Cudahy company paid petitioners for the carcasses were the flat, open market prices computed on the live weight of the hogs, and paid solely to obtain the carcasses and for nothing else. Petitioners and the Cudahy company did not have any contract, understanding, or agreement, express or implied, allocating any portion of the prices paid to processing taxes and no amount was added, allocated, or apportioned to such taxes, or stated in any sales invoice as a separate item or otherwise, or included in any identifiable manner in such prices. And the prices at which petitioners sold serum did not in any identifiable manner, or otherwise, include or recognize processing taxes. Processing taxes were paid on the total live weight of the hogs. The blood extracted for use in the manufacture of the serum had a relatively small weight and value when compared with the total weight and value of the carcasses. Due to these factors, petitioners were unable without financial assistance to finance the payment of the taxes imposed. To do so would have forced them to suspend business. In order that they might not be compelled to suspend business and the Cudahy company thus lose valuable sources of hog carcasses, the Cudahy company loaned and advanced to each petitioner sufficient money

to enable it to pay the taxes asserted against it, and the money was used for that purpose. Petitioners are definitely and unconditionally obligated to repay such advances, respectively, only to the extent that any of the taxes paid are refunded.

The Board dismissed the petitions for failure to allege the conditions necessary to authorize refunds in that it affirmatively appeared from such petitions that the burden of the amount of the taxes had been borne solely by the vendee of petitioners, and that petitioners had not repaid unconditionally such amount to such vendee.

The processing taxes which petitioners paid with the money advanced for that purpose by the Cudahy company were imposed under the Agricultural Adjustment Act of May 12, 1933 (48 Stat., 31). The Act was declared unconstitutional in January, 1936. (*United States* v. *Butler*, 297 U. S., 1, 56 S. Ct., 312, 80 L. Ed., 477, 102 A. L. R., 914 [Ct. D. 1070, C. B. XV–1, 421 (1936)].) Thereafter Congress enacted Title VII of the Revenue Act of 1936, supra. Section 902 provides that no refund shall be made or allowed, pursuant to a court decision or otherwise, of any amount paid by or collected from a claimant as tax under the Agricultural Adjustment Act, unless such claimant establishes to the satisfaction of the Commissioner, or the satisfaction of the Board of Review in a case coming before it, or the satisfaction of the trial court in a case coming before the court, that he bore the burden of such amount and has not been relieved thereof or reimbursed therefor or shifted such burden, directly or indirectly, (1) through inclusion of such amount in the price of any article with respect to which a tax was imposed under the provisions of such Act, or in any charge or fee for services or processing, (2) through reduction of the price paid for any such commodity, or (3) in any manner whatsoever; and that no understanding or agreement exists whereby he may be relieved of the burden of such amount, be reimbursed therefor, or shift it; or that he has repaid unconditionally such amount to his vendee (1) who bore the burden, (2) who has not been relieved thereof or reimbursed therefor or shifted it, and (3) who is not entitled to receive reimbursement from any source, or to be relieved of the burden in any manner.

The intent of the statute is plain. Its broad language indicates clearly a deliberate and studied legislative purpose to confine the right of refund to those who bore the burden of the payment of processing taxes wrongfully exacted, and to deny such right to all others. Petitioners paid money in extinguishment of such taxes, but the money was furnished for that purpose by the Cudahy company with the understanding and agreement that petitioners would not repay it unless and only to the extent that it was refunded. That appears from the claims and the petitions, and it was freely admitted at the bar of this court in the course of oral argument. Petitioners did not bear the burden of the payment of the taxes even though they had the technical, legal title to the money with which such taxes were paid. They were out nothing when the taxes were paid, and they would be in nothing if refunds were made. They suffered no financial injury, and they seek no relief for their own benefit or gain. In rationale and effect, they seek refunds without having borne the initial burden of the taxes, and in doing so they are met with the letter and spirit of the statute.

It is contended that petitioners paid the taxes with their own money to which they had title as against the world; that the right to refund immediately arose and became vested; that under the procedure then existing and recognized by law they were required to show merely that the collection was illegal, and that the taxes were paid; and that if section 902, supra, is construed to make a substantive change in such right of petitioners, it is unconstitutional and void. The statute merely provides that only those who bore the burden of the illegal taxes and have not shifted such burden or been relieved of it in any manner shall be entitled to relief. It does no more than provide that refunds shall be made only to those who suffered injury and are therefore the real parties in interest. That is an element of the right to a refund of such taxes. The restriction of the right to claimants coming within that class does not infringe due process. (*Anniston Mfg. Co.* v. *Davis*, 301 U. S., 337 [Ct. D. 1234. C. B. 1937–1, 485]; *United States* v. *Jefferson Electric Co.*, 291 U. S., 386 [Ct. D. 803, C. B. XIII–1, 393 (1934)].)

Other questions are presented, but our conclusion upon those discussed eliminates need to consider them.

The decisions of the Board are severally affirmed.

TITLE IV.—EXPORT, CHARITABLE, ETC., REFUNDS AND FLOOR STOCKS ADJUSTMENT UNDER AGRICULTURAL ADJUSTMENT ACT (1936).

1940–49–10512
Ct. D. 1471

PROCESSING TAX—REVENUE ACT OF 1936—AGRICULTURAL ADJUSTMENT ACT—DECISION OF SUPREME COURT.

1. SUIT—CLAIMS FOR REFUND—TAXES PAID WITH RESPECT TO PRODUCTS EXPORTED—JURISDICTION OF COURT.

The Court of Claims is without jurisdiction of suits based upon the denial by the Commissioner of Internal Revenue of claims for the refunding of processing and floor stock taxes paid with respect to products exported, under sections 9(a) and 16(a), respectively, of the Agricultural Adjustment Act. Such claims are governed by the limitations imposed by section 601(e) of Title IV of the Revenue Act of 1936, which prevents judicial review of the Commissioner's action.

2. DECISION AFFIRMED.

Decision of the United States Court of Claims (30 F. Supp., 672) affirmed.

SUPREME COURT OF THE UNITED STATES.

Wilson & Co., Inc., petitioner, v. *United States, respondent.*

Wilson & Co., Inc., of Kansas, petitioner, v. *United States, respondent.*

T. M. Sinclair & Co., Ltd., petitioner, v. *United States, respondent.*
[61 S. Ct., 120.]

On writs of certiorari to the United States Court of Claims.

[November 18, 1940.]

OPINION.

Mr. Justice MURPHY delivered the opinion of the Court.

Petitioners are corporations engaged in the preparation, packing, and sale of meat products in foreign and domestic commerce. Between November 5, 1933, and January 6, 1936, they exported to foreign countries large quantities of hog products with respect to which they paid processing taxes under section 9(a) and floor stock taxes under section 16(a) of the Agricultural Adjustment Act. (48 Stat., 31, 35, 40.) Subsequent to exportation petitioners filed claims for refunds under section 17(a). (48 Stat., 31, 40.) The Commissioner of Internal Revenue denied all of the claims and suit in the Court of Claims followed. The United States thereupon moved to dismiss the petitions on the ground that the Court of Claims was without jurisdiction because of certain provisions of Title VII of the Revenue Act of 1936. (49 Stat., 1648, 1747–1755.) The Court of Claims dismissed the actions for want of jurisdiction, on the ground, however, that section 601(e) of Title IV of the Revenue Act of 1936 (49 Stat., 1648, 1740) prevented judicial review of the Commissioner's action. (30 F. Supp., 672.) To resolve the conflict with *Cudahy Bros. Co.* v. *LaBudde* (92 Fed. (2d), 937) and *Neuss, Hesslein & Co., Inc.*, v. *United States* (30 Fed. Supp., 595), we granted certiorari. (309 U. S., 651.)

The single question presented is whether the Court of Claims was without jurisdiction of petitioners' suits. We hold that it was.

Title VII conditions payment of refunds upon proof that the claimant actually bore the burden of the tax sought to be refunded or that he unconditionally repaid it to his vendee who bore the burden. Since petitioners do not allege satisfaction of these conditions it is plain that they do not claim under Title VII. Indeed, they disown any attempt to bring their claims within its provisions.

Title IV provides for refunds to exporters of products upon which processing or floor stock taxes have been paid. It is true that section 17(a) of the Agri-

cultural Adjustment Act provided for these refunds before the Act was held unconstitutional in *United States* v. *Butler* (297 U. S., 1 [Ct. D. 1070, C. B. XV–1, 421 (1936)]). Whether petitioners could still establish refund claims under that section if the Act had never been invalidated is a question we need not consider. For whatever the effect of that decision on section 17(a), Congress expressly made it a part of Title IV by reenacting it in section 601(a). (49 Stat., 1648, 1739.[1]) It follows that petitioners' claims, purportedly based on section 17(a), must be governed by Title IV and the limitations it imposes.

Section 601(e) of Title IV provides:

"The determination of the Commissioner of Internal Revenue with respect to any refund under this section shall be final and no court shall have jurisdiction to review such determination."

Petitioners contend that Congress intended to commit to the final determination of the Commissioner only "such matters as findings of fact, computations, and the like." Quite apart from the fact that in section 601(d)[2] Congress uses virtually the quoted words in limiting review by administrative officers, we fail to see how the argument can aid petitioners here because the record does not show why their claims were denied. Since the record is silent on this point, such decisions as *United States* v. *Williams* (278 U. S., 255) and *Silberschein* v. *United States* (266 U. S., 221) are plainly distinguishable.

We hold that upon this record the determination of the Commissioner is final. Thus we see no occasion to narrow the effect of section 601(e). The decision of the Court of Claims was correct and must be affirmed.

Affirmed.

[1] SEC. 601. (a) The provisions of sections * * * 17(a) of the Agricultural Adjustment Act, as amended, are hereby reenacted but only for the purpose of allowing refunds in accordance therewith in cases where * * * the exportation * * * took place prior to January 6, 1936.

[2] SEC. 601. (d) In the absence of fraud, the findings of fact and the decision of the Commissioner of Internal Revenue upon the merits of any claim adjusted pursuant to this section and the mathematical calculation therein shall not be subject to review by any administrative or accounting officer, employee, or agent of the United States.

DISTILLED SPIRITS.

INTERNAL REVENUE CODE.

1940–27–10314
T. D. 4976

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C—MISCELLANEOUS EXCISE TAXES. PART 171—MISCELLANEOUS REGULATIONS RELATED TO LIQUOR.

Floor stocks tax on distilled spirits and fermented malt liquors.

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

To Collectors of Internal Revenue, District Supervisors, and Others Concerned:

Sections 213 and 214 of the Revenue Act of 1940, approved June 25, 1940 (Public, No. 656, Seventy-sixth Congress), read as follows:

SEC. 213. DISTILLED SPIRITS.

(a) Section 2800 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsections:

"(g) DEFENSE TAX FOR FIVE YEARS.

* * * * * * *

"(h) FLOOR STOCKS TAX.

"(1) Upon all distilled spirits produced in or imported into the United States upon which the internal-revenue tax imposed by law has been paid, and which on July 1, 1940, are held and intended for sale or for use in the manufacture or production of any article intended for sale, there shall be levied, assessed, collected, and paid a floor stocks tax of 75 cents on each proof-gallon, and a proportionate tax at a like rate on all fractional parts of such proof-gallon. The tax imposed by this subsection shall not apply to 100 wine gallons of the retail stocks of distilled spirits held by a person on premises as to which such person has incurred occupational tax as a retail dealer in liquors for the period beginning on July 1, 1940, and as to which no other occupational tax with respect to dealing in distilled spirits has been incurred by such person for a period beginning on such date.

"(2) Every person required by this subsection to pay any floor stocks tax shall, on or before August 1, 1940, under such regulations as the Commissioner, with the approval of the Secretary, shall prescribe, make a return and pay such tax. Payment of the tax shown to be due may be extended to a date not later than February 1, 1941, upon the filing of a bond for payment thereof in such form and amount and with such surety or sureties as the Commissioner, with the approval of the Secretary, may prescribe. Every retail dealer in liquors (even though not liable to pay such tax) shall make the return required by this paragraph.

"(3) All provisions of law, including penalties, applicable in respect of internal-revenue taxes on distilled spirits shall, insofar as applicable and not inconsistent with this subsection, be applicable in respect of the floor stocks tax imposed hereunder."

SEC. 214. WINES AND FERMENTED MALT LIQUORS.

Chapter 26 of the Internal Revenue Code is amended by inserting at the end thereof the following new subchapter:

"SUBCHAPTER F—DEFENSE TAX FOR FIVE YEARS.

"SEC. 3190. DEFENSE TAX FOR FIVE YEARS.

* * * * * * *

SEC. 3191. FLOOR STOCKS TAX ON FERMENTED MALT LIQUORS.

"(a) FLOOR STOCKS TAX.—Upon all fermented malt liquors upon which the internal-revenue tax imposed by law has been paid, and which on July 1, 1940, are held by any person and intended for sale there shall be levied, assessed, collected, and paid a floor stocks tax at a rate equal to the increase in rate of tax made applicable to such articles by section 3190. The tax imposed by this subsection shall not apply to the retail stocks of fermented malt liquors held by a person on premises as to which such person has incurred occupational tax as a retail dealer in liquors or a retail dealer in malt liquors for the period beginning on July 1, 1940, and as to which no other occupational tax with respect to dealing in distilled spirits, wines, or malt liquors, has been incurred by such person for a period beginning on such date.

"(b) RETURNS.—Every person required by subsection (a) to pay any floor stocks tax shall, on or before August 1, 1940, under such regulations as the Commissioner with the approval of the Secretary shall prescribe, make a return and pay such tax. Payment of the tax shown to be due may be extended to a date not later than February 1, 1941, upon the filing of a bond for payment thereof in such form and amount and with such surety or sureties as the Commissioner, with the approval of the Secretary, may prescribe.

"(c) LAWS APPLICABLE.—All provisions of law, including penalties, applicable in respect of the taxes imposed by section 3150(a) shall, insofar as applicable and not inconsistent with this subsection, be applicable with respect to the floor stocks tax imposed by subsection (a)."

Pursuant to the above sections of law, the following regulations are prescribed:

DISTILLED SPIRITS.

1. Each distiller, proprietor of an industrial alcohol plant, internal revenue bonded warehouse, alcohol bonded warehouse, or tax-paid bottling house, rectifier, wholesale dealer in liquors, retail dealer in liquors, manufacturer, or any other person, corporation, partnership, or association holding on July 1, 1940, tax-paid alcohol or other tax-paid distilled spirits intended for sale or for use in the manufacture or production of any article intended for sale, shall before beginning business on that date prepare an inventory of all such tax-paid distilled spirits.

2. The inventory shall be prepared in triplicate on sheets of paper not larger than 10½ by 16 inches to be furnished by the taxpayer. The distilled spirits shall be listed separately by kinds, that is, there will be a separate listing of alcohol, whisky, brandy, gin, rum, cordials, liqueurs, cocktails, etc. The inventory will consist of two sections.

The first section will cover bottled distilled spirits and will be divided into six columns which will be designated:

(*a*) Kind.
(*b*) Size of bottle.
(*c*) Number of bottles.
(*d*) Wine gallons.
(*e*) Proof of spirits.
(*f*) Proof gallons.

The name of the distiller, rectifier, importer, or bottler, and the serial numbers need not be shown in the inventory of unbroken cases, except when such cases are in transit on July 1, 1940. The size of the bottles contained in the cases must be stated. Bottled distilled spirits removed from the original cases shall be listed as separate items, showing the number of bottles of each size containing spirits of the same kind and proof, the wine gallons, proof, and proof gallons.

The second section will cover distilled spirits in packages (barrels or drums) and tanks. The serial numbers of packages and the name of the distiller must be shown.

Spirits in process of rectification and in bottling or storage tanks shall be measured and proofed and the wine gallons, proof, and proof-gallon content of each tank reported separately on the inventory. The number and kind of receptacle containing the spirits should also be shown.

3. The term "distilled spirits" shall include, among others, the following which are subject to the floor tax of 75 cents a proof gallon when they have been tax-paid according to law prior to July 1, 1940, and on that date are intended for sale or for use in the manufacture or production of any article intended for sale:

(*a*) Alcohol.
(*b*) Spirits—grain, spirits—cane, and spirits—fruit.
(*c*) Whisky, rum, gin, and brandy.
(*d*) Vermouth containing distilled spirits or brandy.
(*e*) Cocktails containing distilled spirits or brandy.
(*f*) Liqueurs, cordials, and similar compounds containing distilled spirits or brandy.
(*g*) Distilled spirits of any kind held by any person for use in the manufacture of any article intended for sale, regardless of whether the article to be produced is in itself unfit for beverage purposes.

4. An exemption of 100 wine (liquid) gallons is allowed to each retail dealer in liquors (a person who sells or offers for sale distilled spirits, wines, or malt liquors in quantities of less than 5 wine gallons to the same person at the same time).

A person operating more than one retail establishment is entitled to the exemption of 100 wine gallons for the stocks at each such place of business. A person engaged in the business of selling distilled spirits at both wholesale and retail on the same premises may not claim the exemption on any spirits on such premises.

To be eligible for this exemption, a person must sell, or offer for sale, distilled spirits during July, 1940, at retail only, and he must not make sales in larger quantities during the entire month of July. The exemption applies only to distilled spirits on the premises of the person claiming the exemption. It is not applicable to spirits stored elsewhere or in transit.

Persons claiming this exemption must select the items on which the exemption is claimed and list them separately on the inventory. The wine gallons of such selected items must be converted into proof gallons, and the amount in proof gallons thus obtained shall be inserted at line 2 on Form 758.

Any retail dealer in liquors entitled to this exemption must prepare the inventory and file a return, even though he has less than 100 wine gallons on his premises.

FERMENTED MALT LIQUORS.

5. Each brewer, wholesale dealer in liquors, wholesale dealer in malt liquors, or any other person, corporation, partnership, or association (except such retail dealers as are hereinafter exempted) holding on July 1, 1940, tax-paid fermented malt liquors intended for sale shall also before beginning business on that date prepare an inventory of all such tax-paid fermented malt liquors.

The inventory of fermented malt liquors shall be prepared in triplicate on sheets of paper not larger than 10½ by 16 inches to be furnished by the taxpayer. The inventory will be made in three sections.

The first section will cover malt liquors in packages or barrels and will be divided into 7 columns in the following order:

(*a*) ⅛ barrel.
(*b*) ⅙ barrel.
(*c*) ¼ barrel.
(*d*) ⅓ barrel.
(*e*) ½ barrel.
(*f*) 1 barrel.
(*g*) Equivalent in barrels of 31 gallons.

The second will cover malt liquors in bottles or cans and will be divided into 5 columns in the following order:

(*a*) Number of cases.
(*b*) Size of bottles or cans.
(*c*) Number of bottles or cans in case.
(*d*) Number of gallons per case.
(*e*) Equivalent in barrels of 31 gallons.

The third section will cover fermented malt liquors in tanks in bottling houses. Malt liquors in such tanks will be measured and reported in terms of barrels of 31 gallons.

The inventory of fermented malt liquors may be made a part of the inventory of distilled spirits if the person preparing the inventory also holds distilled spirits subject to the floor stocks tax.

6. The floor tax of $1 a barrel on fermented malt liquors is not applicable to retail stocks of malt liquors held by a person on premises as to which such person incurs liability to special (occupational) tax as a retail dealer in liquors or as a retail dealer in malt liquors for the period beginning July 1, 1940, and as to which premises no other special (occupational) tax with respect to dealing in distilled spirits, wines, or malt liquor is incurred by such person for the period beginning July 1, 1940.

To be eligible for this exemption, a person must incur special tax liability during July, 1940, as a retail dealer in liquors or retail dealer in malt liquors only, on the premises where the malt liquor stocks are held. Any person claiming this exemption must not incur special tax liability as a wholesale dealer in malt liquors, or as a wholesale dealer in liquors on the same premises at any time during the month of July, 1940.

The exemption applies only to fermented malt liquors on the premises of the person claiming the exemption. It is not applicable to malt liquors stored elsewhere or in transit.

Persons entitled to this exemption are not required to pay a floor stocks tax on fermented malt liquors and need not prepare an inventory of such fermented malt liquors, but if such person holds distilled spirits, he must make an inventory and file a return covering such distilled spirits.

SPIRITS OR MALT LIQUORS ON OTHER PREMISES OR IN TRANSIT.

7. The inventory shall show separately all tax-paid distilled spirits and fermented malt liquors not on the premises of the taxpayer, but owned by him and stored elsewhere, or consigned to him and in transit at 12.01 a. m. on July 1, 1940, giving the name of the consignor. Any spirits or malt liquors which have been consigned to other persons by the person making the inventory and the title thereto has not been transferred to the consignee shall also be included by the person making the inventory, giving the name of the consignee.

When tax-paid distilled spirits or fermented malt liquors are consigned by the shipper to his own order with instructions on the shipping tag to notify the person named thereon, who is a bona fide purchaser, and bill of lading is indorsed in good faith to the person named on the shipping tag and draft attached for the sum due, and bill of lading with draft attached is sent to a bank or other collection agency for collection, the purchaser only is liable for the floor tax and shall include such spirits or malt liquors in his inventory.

If tax-paid distilled spirits or fermented malt liquors are in transit under bills of lading in which the shipper is named as consignee and the bills of lading are not indorsed or are indorsed in blank, the spirits or malt liquors will be presumed to be the property of the shipper held for sale and the shipper shall inventory such spirits or malt liquors.

FILING OF RETURN AND PAYMENT OF TAX.

8. Each taxpayer designated in paragraphs 1 and 5 shall make a return on Form 758 (revised 1940), in triplicate, for each place where distilled spirits or fermented malt liquors are held, in accordance with the instructions thereon. The original and duplicate copies must be filed with the collector of internal revenue of the district in which the distilled spirits or fermented malt liquors are held not later than August 1, 1940. The triplicate copy will be retained at the location covered by the return. A copy of the inventory must be attached to each copy of Form 758.

9. The floor tax shown by the return to be due shall be paid to the collector of internal revenue at the time the return is filed, except that the time for payment of this tax may be extended to a date not later than February 1, 1941, upon the filing of a bond on Form 723-A, in duplicate, in a penal sum of not less than the amount of the tax, including penalty, if any.

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved June 26, 1940.

HERBERT E. GASTON,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register June 27, 1940, 11.43 a. m.)

REGULATIONS 4(1940), SECTIONS 183.60, 183.95, 183.136 (a), (b), 183.161, 183.167, 183.168, 183.169, 183.256, 183.264, 183.265, 183.295, 183.309, and 183.390.

1940–39–10433
T. D. 5007

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 183.—PRODUCTION OF DISTILLED SPIRITS[1]

Amending Regulations 4.

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

To District Supervisors, Collectors of Internal Revenue, and Others Concerned:

Section 213 of the Act of June 25, 1940 (Public, No. 656, Seventy-sixth Congress), is as follows:

(a) Section 2800 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsections:

"(g) DEFENSE TAX FOR FIVE YEARS.—In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
2800(a)(1)	Distilled spirits generally	$2.25	$3.00
2800(a)(1)	Brandy	2.00	2.75
*	* * *	*	* *

* * * * * * *

Pursuant to the foregoing provision of law, sections 2802(a), 2812, 3176, and 3254(g) of the Internal Revenue Code, and sections 3 and 6 of the Federal Alcohol Administration Act, as amended (27 U. S. C., Sup., 203, 206), section 183.95 of Regulations 4 is hereby revoked, and the title to Article IX and sections 183.60, 183.136 (a), (b), 183.161, 183.167, 183.168, 183.169, 183.256, 183.264, 183.265, 183.295, 183.309, and 183.390 of the said regulations are hereby amended to read as follows:

ARTICLE IX.—FEDERAL ALCOHOL ADMINISTRATION ACT PERMIT.

SEC. 183.60. *Permit required.*—Under the Federal Alcohol Administration Act and the regulations issued pursuant thereto (27 CFR, Part 1), any person, except an agency of a State or political subdivision thereof, or any officer or employee of any such agency, intending to engage in the business of producing distilled spirits, is required to procure a permit therefor. (Sec. 3, 49 Stat., 978; 27 U. S. C., Sup., 203.)

SEC. 183.136. *Change in individual, firm, or corporate name.*—Where there is a change in the individual, firm, or corporate name of the distiller, he must comply with the following requirements:

(*a*) *Amended permit.*—Procure from the district supervisor under the Federal Alcohol Administration Act an amended basic permit authorizing operation of the distillery under the new name.

(*b*) *Amended notice, Form 27–A.*—Submit to the district supervisor an amended notice on Form 27–A, in triplicate, covering the new name, which notice must be approved before operations may be commenced under the new name.

SEC. 183.161. *Examination of other qualifying documents.*—Upon receipt of notice, plat, plans, bond, consent (Form 1602), if any, or indemnity bond in lieu

[1] The asterisk at end of sections refers to section 3176 of the Internal Revenue Code.

thereof, and other documents required by these regulations of persons intending to qualify as distillers, the district supervisor will examine the same to determine whether they have been properly executed, and whether they reflect compliance with the requirements of the law and regulations. Where any required document has not been filed, or where errors or discrepancies are found in those filed, or where the documents filed do not reflect compliance with these regulations, action thereon will be held in abeyance until the omission, or error, or discrepancy has been rectified, and there has been full compliance with all requirements.*

SEC. 183.167. *Approval of qualifying documents.*—If the district supervisor finds, upon examination of the inspection report, that the person seeking to qualify as a distiller has complied in all respects with the requirements of law and these regulations, and the distiller's bond (Form 30) and the consent (Form 1602), if any, or indemnity bond filed in lieu thereof, may properly be approved under section 183.166, and if the applicant is entitled to a permit, he will note his recommendation for approval on all copies of the distiller's bond, consent or indemnity bond, and notice, and his approval on all copies of the plat and plans, and will forward all copies of the distiller's bond, consent or indemnity bond, and notice, and the original copy of the plat, plans, and other qualifying documents, together with a copy of all inspection reports, to the Commissioner for final action. The issuance of a permit should be withheld pending approval by the Commissioner of the notice, bond, and other qualifying documents required under the internal revenue laws.*

SEC. 183.168. *Disapproval of qualifying documents.*—If the district supervisor finds that the applicant has not complied in all respects with the requirements of the law and regulations, or that the situation of the distillery is such as would enable the distiller to defraud the United States, or that the bond should be disapproved under section 183.166, he will note his recommendation for disapproval on the bond, and will forward to the Commissioner for final action such copies of the qualifying documents as are required to be so forwarded by the preceding section in the case of recommendation for approval, together with a copy of all inspection reports. Where a bond is recommended for disapproval, the district supervisor will furnish the Commissioner with a full statement of the reasons therefor. If the applicant is not entitled to a permit, the district supervisor will, upon disapproval of the application therefor, return all copies of the qualifying documents to the applicant without action thereon or reference to the Commissioner.*

SEC. 183.169. *Disposition of qualifying documents.*—Where the distiller's bond (Form 30), consent (Form 1602), if any, or indemnity bond filed in lieu thereof, notice (Form 27–A), and special application (Form 1613), if any, are approved by the Commissioner, the district supervisor will, upon receipt of approved copies of such documents from the Commissioner, as provided in Article XVII, forward one copy of the distiller's bond, consent or indemnity bond, special application, notice, plat, plans, and other qualifying documents to the distiller and will retain one copy of such qualifying documents for the file of the distiller. The extra copy of the special application (Form 1613), if any, received from the Commissioner will be placed by the district supervisor in the file of the rectifier. If the distiller's bond, consent or indemnity bond, or special application, is disapproved, the district supervisor will, upon receipt from the Commissioner of the disapproved copies of such documents and other qualifying documents submitted therewith, return all copies of the qualifying documents to the proprietor, with advice as to the reasons for disapproval.*

SEC. 183.256. *Rate of tax.*—The law imposes a tax on distilled spirits produced in or imported into the United States at the rate of $3 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid when withdrawn from bond, except brandy distilled at less than 190 degrees proof, on which the tax is imposed at the rate of $2.75 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon. (*; Sec. 2800(a), I. R. C., as amended.)

SEC. 183.264. *Unfinished spirits.*—The distiller may take samples of spirits in the course of distillation and prior to their deposit in the cistern room. Each sample may not exceed one-half pint, unless it is shown that such is an insufficient quantity for the purpose for which the sample is desired, and the Commissioner authorizes the taking of a larger sample, not to exceed one pint. The

total number of samples must be restricted to the minimum necessary to determine the quality of the spirits being produced.*

SEC. 183.265. *Finished spirits.*—The distiller may take from the cistern room of the distillery samples of distilled spirits for chemical analysis or organoleptic examination only. Such samples may not exceed one pint for each distillation of each kind of distilled spirits produced daily, unless it is shown that such is an insufficient quantity for the purpose for which the sample is desired, and the Commissioner authorizes the taking of a larger sample, not to exceed one quart.*

SEC. 183.295. *Issuance of tax-paid stamps.*—The collector will issue the requisite tax-paid stamps. Each tax-paid stamp shall bear the signature of the collector, who shall write or stamp thereon the date of payment of the tax, by whom paid, the number of gallons and tenths of gallons of proof spirits, and the serial number of the cask. Facsimile signatures of collectors may be affixed by the use of hand stamps to the tax-paid stamps, care being taken to use only such ink as will neither fade nor blur. The collector will enter the serial numbers of the stamps in the appropriate spaces on all copies of Forms 179 and 1520, sign the certificate of tax-payment on each copy of Form 179, retain one copy of each Form 179 and Form 1520, and return the remaining three copies of Form 179 and two copies of Form 1520 to the distiller with the stamps. (*; Sec. 2802(a), I. R. C.)

SEC. 183.309. *Mixing of different spirits prohibited.*—The product of two or more distillers shall not be mingled in a storage tank; nor shall spirits distilled from different materials, or different combinations of the same materials at less than 190 degrees proof, or which differ in kind according to the standards of identity established under the Federal Alcohol Administration Act, be mingled in a storage tank; nor shall spirits distilled during different distilling seasons, or at proofs differing more than 10 degrees, be so mingled. (*; Sec. 3254(g), I. R. C.)

SEC. 183.390. *Bulk containers.*—Under the regulations issued pursuant to the Federal Alcohol Administration Act (27 CFR, Part 3), distillers may sell or dispose of distilled spirits in bulk, that is, containers having a capacity in excess of 1 gallon, (1) to other distillers and proprietors of internal revenue bonded warehouses, industrial alcohol plants and industrial alcohol bonded warehouses, including those operating tax-paid bottling houses; (2) to proprietors of class 8 customs bonded warehouses (imported spirits only); (3) to rectifiers; (4) to winemakers (brandy or alcohol) for fortification of wine; (5) to any agency of the United States, or of any State or political subdivision thereof; (6) for export; (7) on warehouse receipts, conforming to the regulations issued under the Federal Alcohol Administration Act, for distilled spirits in internal revenue bonded warehouses; and (8) for industrial use, as follows: For experimental purposes, and for use in the manufacture (*a*) of medicinal, pharmaceutical, or antiseptic products, including prescriptions compounded by retail druggists; (*b*) of toilet products; (*c*) of flavoring extracts, sirups, or food products; or (*d*) of scientific, chemical, mechanical, or industrial products; provided such products are unfit for beverage use. Distilled spirits produced at a proof in excess of 159 degrees and reduced in the receiving cisterns to not more than 159 and not less than 100 degrees of proof may, however, upon tax-payment, as provided in section 183.272(d), be transported for beverage purposes only; and under the regulations issued pursuant to the Federal Alcohol Administration Act (27 CFR, Part 3) distillers may not sell in bulk for industrial use other distilled spirits produced under these regulations, unless such spirits are shipped or delivered directly to the industrial user thereof. (Sec. 6, 49 Stat., 985; 27 U. S. C., Sup., 206.)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved September 16, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register September 18, 1940, 11.05 a. m.)

REGULATIONS 10 (1940), SECTIONS 185.27, 185.54, 185.84, 185.90, 185.103, 185.109, 185.110, 185.112, 185.125, 185.131, 185.231, 185.234, 185.238, 185.276, 185.369, 185.844, 185.461.

1940–39–10432
T. D. 5006

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 185—WAREHOUSING OF DISTILLED SPIRITS.[1]

Amending Regulations 10.

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

To District Supervisors, Collectors of Internal Revenue, and Others Concerned:

Section 213 of the Act of June 25, 1940 (Public, No. 656, Seventy-sixth Congress), is as follows:

(a) Section 2800 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsections:

"(g) DEFENSE TAX FOR FIVE YEARS.—In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

" Section.	Description of tax.	Old rate.	Defense-tax rate.
2800(a)(1)	Distilled spirits generally	$2.25	$3.00
2800(a)(1)	Brandy	2.00	2.75
*	* * *	*	* *

* * * * * * *

Pursuant to the foregoing provision of law, sections 2802(a), 2872, 2873, 2883, 2904, 3031(a), as amended, 3037, and 3176 of the Internal Revenue Code, and sections 5(e) and 6 of the Federal Alcohol Administration Act, as amended (27 U. S. C., Sup., 205, 206), section 185.54 of Regulations 10 is hereby revoked, and sections 185.27, 185.84, 185.90 (*a*), (*b*), 185.103, 185.109, 185.110, 185.112, 185.125, 185.131, 185.231, 185.234, 185.238, 185.276, 185.369, 185.444, and 185.461 of the said regulations are hereby amended to read as follows:

SEC. 185.27. *Weighing tanks.*—Where distilled spirits deposited in storage tanks in a warehouse located on the distillery premises are to be withdrawn for transfer by pipe line to the fortifying room of a bonded winery on contiguous premises, or to a denaturing bonded warehouse on the distillery premises, or to a tank car for shipment, as hereinafter provided in these regulations, the proprietor of the warehouse must provide for use in weighing such spirits one or more suitable weighing tanks constructed in accordance with the following section: *Provided*, That where brandy only is to be transferred by pipe line from warehouse storage tanks, and such transfer is to be made direct to a weighing tank in the fortifying room of a contiguous winery and weighed therein as provided in section 185.444, no weighing tank need be installed on the warehouse premises. (*; Sec. 2873, I. R. C.)

SEC. 185.84. *Colors for pipe lines.*—The pipe lines of warehouses located on distillery premises must be shown on the plans in the colors in which they are required to be painted, as follows:

[1] The asterisk at end of sections refers to section 3176 of the Internal Revenue Code.

Black	Distilled spirits.
White	Water.
Aluminum	Steam.
Orange	Air.

(*; Sec. 2873, I. R. C.)

SEC. 185.90. *Change in name.*—Where there is a change in the individual, firm, or corporate name of the proprietor of an internal revenue bonded warehouse, he must comply with the following requirements:

(*a*) *Amended permit.*—If engaged in the business of warehousing and bottling distilled spirits, and if other than an agency of a State or political subdivision thereof, or an officer or employee of any such agency, procure from the district supervisor under the Federal Alcohol Administration Act an amended basic permit authorizing the warehousing and bottling of distilled spirits under the new name.

(*b*) *Amended application, Form 27–D.*—Submit to the district supervisor an amended application on Form 27–D, in triplicate, covering the new name, which application must be approved before operations may be commenced under the new name.

SEC. 185.103. *Examination of qualifying documents.*—Upon receipt of application, plat, plans, transportation and warehousing bond, export storage bond, if any, and other documents required by these regulations of persons desiring the establishment of internal revenue bonded warehouses, the district supervisor will examine the same to determine whether they have been properly executed and whether they reflect compliance with the requirements of the law and regulations. Where any required document has not been filed, or where errors or discrepancies are found in those filed, or where the documents filed do not reflect compliance with these regulations, action thereon will be held in abeyance until the omission, or error or discrepancy, has been rectified, and there has been full compliance with all requirements.*

SEC. 185.109. *Other causes for disapproval.*—The district supervisor will not recommend approval of any application for the establishment of an internal revenue bonded warehouse unless (1) the capacity of the warehouse is commensurate with the prospective needs of the area or locality in which it is situated and in any event not less than 10,000 barrels, or the equivalent thereof in tank or case storage, (2) the location is suitable, (3) the transportation facilities adequate, (4) the design and construction of the warehouse are such as to insure economical supervision by Government officers, and (5) the prospective volume of spirits that will be received, stored, withdrawn, and bottled at the warehouse is sufficient to warrant the establishment of the warehouse and the expense of Government supervision: *Provided*, That these provisions shall not be applicable where the warehouse is an original warehouse to be operated by the distiller (not including lessee distillers) on or contiguous to the distillery premises, or is a second warehouse which the distiller desires to operate on premises contiguous to or near such original warehouse on account of lack of storage space in the original warehouse and the impracticability of expanding such warehouse. In any case where the warehouse has a bottling-in-bond department and the applicant is not entitled to a permit, the district supervisor will, upon disapproval of the permit application, return all copies of the qualifying documents to the applicant without action thereon or reference to the Commissioner. (*; Sec. 2872, I. R. C.)

SEC. 185.110. *Approval of qualifying documents.*—If the district supervisor finds, upon examination of the inspection report and qualifying documents, that the person seeking the establishment of the internal revenue bonded warehouse has complied in all respects with the requirements of the law and these regulations, and that the application and other qualifying documents may properly be approved under sections 185.108 and 185.109, he will note his recommendation for approval on all copies of the application, transportation and warehousing bond, and the export storage bond, if any, and his approval on all copies of the plat and plans, and will forward all copies of the application, transportation and warehousing and export storage bonds, and the original copy of the plat and plans and other qualifying documents, together with a copy of all inspection reports, to the Commissioner for final action. If the warehouse has a bottling-in-bond department, the issuance of a permit should be withheld pending approval by the Commissioner of the application, bond, and other qualifying documents required under the internal revenue laws.*

SEC. 185.112. *Disposition of qualifying documents.*—Where the application, Form 27-D, transportation and warehousing bond, Form 1571, and the export storage bond, Form 654, if any, are approved by the Commissioner, the district supervisor will, upon receipt of approved copies of such documents from the Commissioner, as provided in Article XVI, forward one copy of the application, bonds, plat, plans, and other qualifying documents to the proprietor, and will retain one copy of such qualifying documents on file. If the application, transportation and warehousing bond, and export storage bond, if any, are disapproved, the district supervisor will, upon receipt from the Commissioner of the disapproved copies of such documents, and all qualifying documents submitted therewith, return all copies of the qualifying documents to the proprietor, with advice as to the reasons for disapproval.*

SEC. 185.125. *Transportation and warehousing bonds.*—Transportation and warehousing bonds, Form 1571, may be terminated as to liability (1) for spirits consigned to the internal revenue bonded warehouse after a specified future date, pursuant to application by the surety as provided in section 185.131, (2) for transactions subsequent to the effective date of an approved superseding bond, or (3) for future transactions upon discontinuance of business by the principal after withdrawal of all spirits from the warehouse. (*; Sec. 2872, I. R. C.)

SEC. 185.131. *Application of the surety for relief from bond.*—A surety on any bond required by these regulations may at any time in writing notify the principal and the district supervisor in whose office the bond is on file that he desires, after a date named, which shall be at least 60 days after the date of notification, to be relieved of liability under said bond. The notice shall be executed in triplicate by the surety, who shall deliver one copy to the principal and the other two to the district supervisor, who will retain one copy and transmit the remaining copy to the Commissioner. If such notice is not thereafter in writing withdrawn the rights of the principal as supported by said bond shall be terminated on the date named in the notice, and the surety shall be relieved (1) in the case of a transportation and warehousing bond, Form 1571, from liability for spirits consigned to the internal revenue bonded warehouse wholly subsequent to the date named in the notice, (2) in the case of an export storage bond, Form 654, from liability for spirits bottled in bond for temporary storage for export wholly subsequent to the date named in the notice, or (3) in the case of direct export bonds, Forms 547 and 657, transportation for export bonds, Forms 548 and 658, bonds covering transportation to customs manufacturing bonded warehouses, Forms 643 and 1618, or bonds for the withdrawal of spirits for the use of the United States, Form 544, from liability for distilled spirits withdrawn for direct exportation, transportation for export, transportation to customs manufacturing bonded warehouses, or for the use of the United States, as the case may be, wholly subsequent to the date named in the notice. This notice may not be given by an agent of the surety unless it is accompanied by a power of attorney duly executed by the surety authorizing him to give such notice or by a verified statement that such power of attorney is on file with the Department. The surety must also file with the district supervisor an acknowledgment or other proof of service of such notice on the principal.*

SEC. 185.231. *Rate of tax.*—The law imposes a tax on distilled spirits produced in or imported into the United States at the rate of $3 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid when withdrawn from bond, except brandy distilled at less than 190 degrees of proof, on which the tax is imposed at the rate of $2.75 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon. (*; Sec. 2800(a)(1), I. R. C.)

SEC. 185.234. *Number and size.*—Samples of brandy or fruit spirits for laboratory analysis must be taken from packages designated as sample packages. Such samples may not exceed one-half pint from any package at any one time, unless it is shown that such is an insufficient quantity for the purpose for which the sample is desired, and the Commissioner authorizes the taking of a larger sample, not to exceed 1 pint. The number of packages from which samples are taken must be restricted to the minimum necessary to accomplish the purpose of the laboratory analysis. As a rule, not more than one or two samples should be required at any one time from a given lot of brandy or fruit spirits of the same distillation, kind of cooperage, etc. When the warehouseman desires to procure samples from a given lot of brandy or fruit

spirits in warehouse, he will limit the number of packages from which it is desired to take samples to the minimum necessary to procure representative samples of such spirits. Thereafter, if it is desired to procure additional samples from the same lot of spirits, the samples should be taken from the same packages. (*; Sec. 3037, I. R. C.)

SEC. 185.238. *Number, size, and use.*—The warehouseman may remove from containers in the warehouse samples of distilled spirits other than brandy or fruit spirits, for analytical purposes or organoleptic examination only. Packages from which such samples are taken will be designated as sample packages. Such samples may not exceed one-half pint from any container at any one time, unless it is shown that such is an insufficient quantity for the purpose for which the sample is desired, and the Commissioner authorizes the taking of a larger sample, not to exceed 1 pint. The total number of samples from all containers must be restricted to the minimum necessary to determine the quality of the spirits. As a rule, not more than one or two samples should be required from a given lot of spirits of the same distillation, kind of cooperage, storage, etc. When the warehouseman desires to procure samples from a given lot of spirits in warehouse, he will limit the number of packages from which it is desired to take samples to the minimum necessary to procure representative samples of such spirits. Thereafter, if it is desired to procure additional samples from the same lot of spirits, the samples should be taken from the same packages.*

SEC. 185.276. *Issuance of tax-paid stamps.*—The collector will issue the tax-paid stamps. Each tax-paid stamp shall bear the signature of the collector, who shall write or stamp thereon the date of payment of the tax, by whom paid, the number of gallons and tenths of gallons of proof spirits, and the serial number of the cask. Facsimile signatures of collectors may be affixed by the use of hand stamps to the tax-paid stamps, care being taken to use only such ink as will neither fade nor blur. The collector will enter the serial numbers of the stamps in the appropriate spaces on all copies of Forms 179 and 1520, sign the certificate of tax-payment on all copies of Form 179, retain one copy each of Form 179 and Form 1520, and return the remaining three copies of Form 179 and two copies of Form 1520 to the warehouseman with the stamps. (*; Sec. 2802(a), I. R. C.)

SEC. 185.369. *Records.*—When the spirits have been removed from the export storage warehouse the storekeeper-gauger shall make appropriate entries on Form 1516 in the statement "Export Storage Warehouse Transactions," and the proprietor shall report the removal on Form 52C. (*; Sec. 2904, I. R. C.)

SEC. 185.444. *Gauge of brandy.*—The brandy will be gauged in weighing tanks in the warehouse and run directly from such tanks to fortifying tanks or brandy storage tanks in the fortifying room of the winery, except that where no weighing tank is provided in the warehouse the brandy may be gauged in a weighing tank in the fortifying room, in which case the brandy will be run direct from the storage tanks in the warehouse to the weighing tank in the fortifying room. (*; Secs. 2883, 3031 (a), I. R. C.)

SEC. 185.461. *Bulk containers.*—Under the regulations issued pursuant to the Federal Alcohol Administration Act (27 CFR, Part 3), proprietors of internal revenue bonded warehouses may sell or dispose of distilled spirits in bulk, i. e., in containers having a capacity in excess of 1 gallon, (1) to distillers and proprietors of internal revenue bonded warehouses, industrial alcohol plants and industrial alcohol bonded warehouses, including those operating tax-paid bottling houses; (2) to proprietors of class 8 customs bonded warehouses (imported spirits only); (3) to rectifiers; (4) to winemakers (brandy or alcohol) for fortification of wine; (5) to any agency of the United States, or of any State or political subdivision thereof; (6) for export; (7) on warehouse receipts, conforming to the regulations issued under the Federal Alcohol Administration Act, for distilled spirits in internal revenue bonded warehouses; and (8) for industrial use in accordance with the regulations issued under the Federal Alcohol Administration Act (27 CFR, Part 2), as follows: For experimental purposes, and for use in the manufacture (*a*) of medicinal, pharmaceutical, or antiseptic products, including prescriptions compounded by retail druggists; (*b*) of toilet products; (*c*) of flavoring extracts, sirups, or food products; or (*d*) of scientific, chemical, mechanical, or industrial products; provided such products are unfit for beverage use. Distilled spirits produced at a proof in excess of 159 degrees and reduced in the receiving cisterns to not more than 159 and not less than 100 degrees of proof may, however, upon tax-payment, be transported for beverage purposes only; and under the regulations issued pursuant to the Federal Alcohol Administration Act (27 CFR, Part 3) warehouse-

men may not sell in bulk for industrial use other distilled spirits (except spirits—fruit or alcohol) unless such spirits are shipped or delivered directly to the industrial user thereof. (Sec. 6, 49 Stat., 985; 27 U. S. C., Sup., 206.)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved September 13, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register September 16, 1940, 3.44 p. m.)

REGULATIONS 6 (1938), SECTION 21: Exchanges and redemption of bottled-in-bond stamps, etc. 1940–34–10396 T. D. 5001

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 188.—BOTTLING OF DISTILLED SPIRITS IN BOND.

Amending Regulations 6 (1938).

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

To District Supervisors, Collectors of Internal Revenue, and Others Concerned:

Section 2 of the Act of June 24, 1940 (Public, No. 654, Seventy-sixth Congress), is as follows:

SEC. 2. Section 2903, Internal Revenue Code, is hereby amended by relettering subsections (e), (f), and (g) as (f), (g), and (h), respectively, and by inserting a new subsection (e) to read as follows:

"(e) UNUSED STAMPS; EXCHANGE, REFUND, ETC.—The Commissioner of Internal Revenue, under regulations prescribed by him and approved by the Secretary of the Treasury, may redeem or make allowance for any unused case stamp, with all coupon strip stamps attached thereto, issued under section 1 of the Act entitled 'An Act to allow the bottling of distilled spirits in bond', approved March 3, 1897 (29 Stat. 626), or under said section 1, as variously amended, and may redeem or make allowance for unused strip stamps issued for bottles of distilled spirits bottled in bond under said section 1, as amended by the Act of July 9, 1937 (50 Stat. 487), or under subsection (d) of this section, by exchanging them for strip stamps for bottled-in-bond spirits, or by refunding moneys received therefor: *Provided*, That stamps may be exchanged or the value thereof refunded only in quantities of the value of $5 or more: *And provided further*, That no claim under this subsection for redemption or allowance in respect of case or strip stamps shall be allowed unless presented within two years after the date on which such case or strip stamps were lawfully issued. There are hereby authorized to be appropriated annually, out of any money in the Treasury not otherwise appropriated, such sums as may be necessary to carry out this provision."

Section 3 of the Act of June 24, 1940 (Public, No. 654, Seventy-sixth Congress), is as follows:

SEC. 3. Notwithstanding the limitations contained in sections 2803(c) and 2903(e), Internal Revenue Code, as amended and inserted, respectively, by this Act, as to the time within which claims under such sections must be presented, claims under such sections for the exchange of or refund for stamps lawfully issued prior to the date of enactment of this Act may be allowed if presented within two years from the date of enactment of this Act.

Pursuant to the foregoing provisions of law and to sections 2905 and 3176 of the Internal Revenue Code, section 21, Regulations 6 (26 CFR, 1938 Sup., section 188.21), is amended and a new section numbered 63 added, both to read as follows:

SEC. 21. *Exchange and redemption of bottled-in-bond stamps for distilled spirits for domestic use.*—Unused bottled-in-bond case stamps, with all coupon strip stamps attached thereto, issued under section 1 of the Act of March 3, 1897 (29 Stat., 626), or under said section 1, as variously amended, and unused strip stamps issued under said section 1, as amended by the Act of July 9, 1937 (50 Stat., 487), or under subsection (d) of section 2903 of the Internal Revenue Code, in quantities of the value of $5 or more, may be exchanged for bottled-in-bond strip stamps, of equal value and in any prescribed denomination, or the value thereof may be refunded, provided that a claim for such exchange or refund, establishing the lawful issuance and ownership of the stamps, is filed with the collector of internal revenue who issued the stamps (1) within two years after the date on which such stamps were lawfully issued or (2) if the stamps were lawfully issued prior to June 24, 1940, within two years from the latter date: *Provided, however*, That the value of unused stamps which have been destroyed may be refunded upon the filing of a claim as provided herein with proof to the satisfaction of the Commissioner of the destruction of the stamps. Claims for exchange of stamps will be filed on Form 1579 and claims for refund of the value of stamps on Form 843, in accordance with procedure prescribed by the Commissioner.

(*a*) *Disposition of bottled-in-bond stamps.*—All unused bottled-in-bond stamps, if any, belonging to the proprietor at the time of permanent discontinuance of business will be inventoried by denomination, serial number, and quantity by the storekeeper-gauger or other officer designated by the district supervisor to perform such duty. The officer will deliver such stamps to the proprietor and take his receipt therefor, in triplicate. When delivering the stamps the officer will advise the proprietor that the value of the stamps, if in quantities of the value of $5 or more, may be refunded provided that a claim for such refund on Form 843, establishing the lawful issuance and ownership of the stamps, is filed with the collector of internal revenue who issued the stamps (1) within two years after the date on which such stamps were lawfully issued or (2) if the stamps were lawfully issued prior to June 24, 1940, within two years from the latter date; or that such unused stamps may be destroyed in the presence of a Government officer, and the proprietor thereby relieved from further accountability for the stamps. If the stamps are not surrendered to the collector for refund of their value or are not destroyed, the proprietor must account for the stamps each month by rendering Form 96, properly modified, in duplicate, to the district supervisor. The officer shall make a notation on the receipt as to the disposition made or to be made of the stamps. One copy of the receipt will be delivered to the proprietor and the original and one copy will be delivered to the district supervisor, who will forward the original to the Commissioner. (Sections 2903, 3176, I. R. C.; section 3, Act of June 24, 1940 (Public, No. 654, Seventy-sixth Congress).)

SEC. 63. *Exchange and redemption of bottled-in-bond stamps for distilled spirits for export.*—Provisions of section 21 are applicable to bottled-in-bond stamps for distilled spirits for export. (Sections 2903, 2905, 3176, I. R. C.; section 3, Act of June 24, 1940 (Public, No. 654, Seventy-sixth Congress).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved August 7, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register August 10, 1940, 10.03 a. m.)

SECTION 2810, AMENDED BY REVENUE ACT OF 1940.

REGULATIONS 23 (1940), SECTION 181.15: Registry of stills. 1940–32–10378 T. D. 4993

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 181.—STILLS AND DISTILLING APPARATUS.

Registration of petroleum stills and distilling apparatus not required.

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

To District Supervisors and Others Concerned:

The Act of July 2, 1940 (Public, No. 705, Seventy-sixth Congress), provides as follows:

That section 2810(a), Internal Revenue Code, is amended by adding an additional paragraph at the end thereof to read as follows:

"Stills and distilling apparatus set up at refineries for the refining of crude petroleum or the production of petroleum products and not used in the manufacture of distilled spirits are not required to be registered under this section."

Pursuant to the foregoing provision of law, section 181.15(*d*) of Regulations 23 (Part 181, Title 26, Code of Federal Regulations) is amended to read as follows:

(*d*) *Registration not required in certain cases.*—The registration of stills and distilling apparatus is not required when set up for use by the United States or any governmental agency thereof, other than for distilling as defined by section 181.12, or when set up at refineries for the refining of crude petroleum or the production of petroleum products and not used in the manufacture of distilled spirits.

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved July 25, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 28, 1940, 3.22 p. m.)

REGULATIONS 11, SECTIONS 189.65, 189.78, 189.79, 189.95, 189.111, 189.116, 189.153. 1940–34–10397 T. D. 5002

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 189.—BOTTLING OF TAX-PAID DISTILLED SPIRITS.

Amending Regulations 11.

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

To District Supervisors, Collectors of Internal Revenue, and Others Concerned:

Section 2803(c) of the Internal Revenue Code, as amended by section 1 of the Act of June 24, 1940 (Public, No. 654, Seventy-sixth Congress), reads as follows:

(c) UNUSED STAMPS; EXCHANGE, REFUND, ETC.—The Commissioner of Internal Revenue, under regulations prescribed by him and approved by the Secretary

of the Treasury, may redeem or make allowance for any unused stamps issued under section 203 of the Liquor Taxing Act of 1934 or subsection (b) of this section by exchanging them for other stamps of the same kind or by refunding moneys received therefor: *Provided*, That stamps may be exchanged or the value thereof refunded only in quantities of the value of $5 or more: *And provided further*, That no claim for the exchange of strip stamps or refund therefor shall be allowed unless presented within two years after the date on which such stamps were lawfully issued. There are hereby authorized to be appropriated annually, out of any money in the Treasury not otherwise appropriated, such sums as may be necessary to carry out this provision.

Section 3 of the Act of June 24, 1940 (Public, No. 654, Seventy-sixth Congress), reads as follows:

SEC. 3. Notwithstanding the limitations contained in sections 2803(c) and 2903(e), Internal Revenue Code, as amended and inserted, respectively, by this Act, as to the time within which claims under such sections must be presented, claims under such sections for the exchange of or refund for stamps lawfully issued prior to the date of enactment of this Act may be allowed if presented within two years from the date of enactment of this Act.

Pursuant to the foregoing provisions of law and to sections 2803(d), 2871, 3030(a), and 3176 of the Internal Revenue Code, and section 5(e) of the Federal Alcohol Administration Act, as amended (27 U. S. C. Sup., 205), section 189.31 of Regulations 11 is hereby revoked, and sections 189.65, 189.78, 189.79, 189.95, 189.111, 189.116, and 189.153 of Regulations 11 are hereby amended to read as follows:

SEC. 189.65. *Application, Form 230.*—Proprietors of tax-paid bottling houses desiring to bottle tax-paid spirits will execute application on Form 230, in duplicate, giving all of the data called for by the form as indicated by the headings of the columns and lines and the instructions printed thereon. The proprietor will enter on Form 230 the details of the withdrawal gauge for tax-payment when packages of spirits are to be dumped for bottling, or when liqueurs or cordials are authorized to be bottled from the original package as provided in section 189.78. An actual gauge of the spirits will, however, be made in either case before the bottling begins, and the details of such gauge will also be entered on the form, as provided in sections 189.77 and 189.78. Each Form 230 will be given a serial number beginning with "1" for the 1st day of January of each year and running consecutively thereafter to December 31, inclusive. A separate application on Form 230 must be prepared for each lot of tax-paid spirits to be bottled.*

SEC. 189.78. *Bottling tank to be used.*—All spirits bottled at a tax-paid bottling house must be bottled from approved bottling tanks: *Provided*, That the district supervisor may authorize the bottling from the original package of liqueurs and cordials which it is impracticable to bottle from an approved bottling tank. Where liqueurs or cordials are authorized to be bottled from the original package, the proprietor will gauge such liqueurs or cordials before the bottling begins and enter the details thereof on all copies of Form 230.*

SEC. 189.79. *Reduction of tax-paid rectified spirits prohibited.*—The reduction in proof or the increasing in volume, at a tax-paid bottling house, of rectified spirits on which the rectification tax has been paid is prohibited by law. This prohibition does not forbid the reduction of imported spirits rectified abroad, or of spirits rectified in Puerto Rico, the Virgin Islands, or the Philippine Islands, or of domestically rectified spirits exempt from rectification tax. Liqueurs and cordials may not be reduced in proof or increased in volume, nor may wines be increased in volume or in taxable grade, at a tax-paid bottling house. (*; Sections 2801(b), 3030(a), I. R. C.)

SEC. 189.95. *Rebottling, relabeling, and restamping of bottled spirits.*—Where distilled spirits packaged in bottles are to be rebottled for domestic sale, the bottles, if of a capacity of one-half pint or greater and not exceeding 1 gallon, must conform to the requirements of Regulations 13 (26 CFR, Part 175). The spirits may be rebottled in the same bottles from which removed if such bottles containing the spirits originally conform to the requirements of Regulations 13 and have not been sold to the consumer or opened, and the use of such bottles is authorized by the district supervisor in accordance with the said regulations. The new label must be covered by an appropriate certificate of label approval or

a certificate of exemption from label approval issued under the Federal Alcohol Administration Act. If the new label is covered by a certificate of exemption from label approval, it must conform to the requirements of Regulations 13. If the spirits have left the possession of the original bottler and are to be relabeled without rebottling, authorization to relabel the spirits must be obtained in accordance with regulations issued under the Federal Alcohol Administration Act and submitted to the Government officer supervising operations of the plant, or to the district supervisor or other designated approving officer. Whenever bottled distilled spirits are dumped for rebottling, the red strip stamps on the bottles must be destroyed at the time of dumping, and new red strip stamps must be affixed to the bottles in which the spirits are rebottled.*

SEC. 189.111. *Exchange and redemption of stamps.*—Unused red strip stamps, in quantities of the value of $5 or more, issued under section 203 of the Liquor Taxing Act of 1934 or subsection (b) of section 2803, Internal Revenue Code, may be exchanged for other stamps of the same kind and in any prescribed denomination, or the value thereof may be refunded, provided that a claim for such exchange or refund, establishing the lawful issuance and ownership of the stamps, is filed with the collector of internal revenue who issued the stamps (1) within two years after the date on which such stamps were lawfully issued or (2) if the stamps were lawfully issued prior to June 24, 1940, within two years from the latter date: *Provided, however,* That the value of unused stamps which have been destroyed may be refunded upon the filing of a claim as provided herein with proof to the satisfaction of the Commissioner of the destruction of the stamps. Claims for exchange of stamps will be filed on Form 1579 and claims for refund of the value of stamps on Form 843, in accordance with procedure prescribed by the Commissioner. (*; Section 3, Act of June 24, 1940 (Public, No. 654, Seventy-sixth Congress).)

SEC. 189.116. *Withholding release of spirits.*—Where bottlers of distilled spirits are found to be using labels other than those covered by a certificate of approval of labels, or a certificate of exemption from label approval, or to be affixing labels conforming to those on certificates of label approval to spirits which do not conform to such approved labels or to the Government label, or where bottlers bottling spirits imported in bulk do not have in their possession such certificates of origin, age, and class and type as are required, the officer will withhold release of the spirits and will make a report of the facts to the district supervisor, accompanied by copies of the labels in question. (Section 505, 49 Stat., 1965; 27 U. S. V. Sup., 205.)

SEC. 189.153. *Disposition of strip stamps.*—All unused red strip stamps, if any, belonging to the proprietor at the time of permanent discontinuance of business will be inventoried by denomination, serial number, and quantity, by the storekeeper-gauger or other officer designated by the district supervisor to perform such duty. The officer will deliver such stamps to the proprietor and take his receipt therefor, in triplicate. When delivering the stamps the officer will advise the proprietor that the value of the stamps, if in quantities of the value of $5 or more, may be refunded, provided that a claim for such refund on Form 843, establishing the lawful issuance and ownership of the stamps, is filed with the collector of internal revenue who issued the stamps (1) within two years after the date on which such stamps were lawfully issued or (2) if the stamps were lawfully issued prior to June 24, 1940, within two years from the latter date; or that such unused stamps may be destroyed in the presence of the Government officer and the proprietor thereby relieved from further accountability for the stamps. If the stamps are not surrendered to the collector for refund of their value or are not destroyed, the proprietor must account for the stamps each month by rendering Form 96, in duplicate, to the district supervisor. The officer shall make a notation on the receipt as to the disposition made or to be made of the stamps. One copy of the receipt will be delivered to the proprietor and the original and one copy will be delivered to the district supervisor, who will forward the original to the Commissioner. (*; Section 3, Act of June 24, 1940 (Public, No. 654, Seventy-sixth Congress).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved August 7, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

[Filed with the Division of the Federal Register August 10, 1940, 10.03 a. m.]

PRODUCTION, FORTIFICATION, TAX-PAYMENT, ETC., OF WINE.

REGULATIONS 7 (1937), ARTICLE LXXIII. 1940-27-10315
T. D. 4977

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C.—MISCELLANEOUS EXCISE TAXES. PART 178—PRODUCTION, FORTIFICATION, TAX PAYMENT, ETC., OF WINE.

Credits for taxes on fortified wines (amending Regulations 7).

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

To Collectors of Internal Revenue, District Supervisors, and Others Concerned:

Sections 4 and 5 of the Act of June 24, 1940 (Public, No. 655, Seventy-sixth Congress), read as follows:

SEC. 4. Upon the filing of a claim therefor by the proprietor of any bonded winery or bonded storeroom in which there was stored on June 30, 1940, or to which there was in transit on that date, wine lawfully fortified with brandy or wine spirits, and containing more than 14 per centum of absolute alcohol by volume, and not exceeding 24 per centum of absolute alcohol by volume, the Commissioner of Internal Revenue is authorized to issue to such proprietor suitable documents entitling such proprietor to a credit of 5 cents per gallon in respect of each gallon of such fortified wine which the Commissioner shall find was on such proprietor's bonded winery or bonded storeroom premises on June 30, 1940, or in transit thereto. The amount of such credit shall be allowed in whole or in part in the purchase of wine stamps. The claim shall be supported by an inventory, prepared, and filed by the proprietor in such form and manner as the Commissioner of Internal Revenue shall prescribe by regulations, approved by the Secretary of the Treasury, and by such other proof as the Commissioner may from time to time require. The aforesaid credit to the proprietor may be transferred by the proprietor to whom issued to the proprietor of any other bonded winery or bonded storeroom. All claims under this section must be filed on or before October 1, 1940.

SEC. 5. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe and publish all needful rules and regulations for the enforcement of this Act.

Pursuant to the foregoing sections of law, Regulations 7 (Part 178, Title 26, Code of Federal Regulations) are hereby amended by adding thereto a new article and new paragraphs reading as follows:

ARTICLE LXXIII.—CREDITS FOR TAXES ON FORTIFIED WINES.

PAR. 363. *Inventory of fortified wines.*—Any proprietor of a bonded winery or bonded storeroom desiring to secure the credits authorized by section 4 of the Act of June 24, 1940, shall, at any time on June 30, 1940, if no wine is received into or removed from the winery or storeroom on that date, or at the close of business on June 30, 1940, if wine is received or removed on that date, make an inventory of all untax-paid wine lawfully fortified with brandy or wine spirits and containing more than 14 per centum, but not exceeding 24 per centum, of absolute alcohol by volume then on hand or in transit to such bonded winery or storeroom.

PAR. 364. *Details of inventory.*—(*a*) The inventory shall be prepared in triplicate on sheets of paper not larger than 10½ by 16 inches to be furnished by the taxpayer. The inventory will consist of two sections. The first section will

cover all untax-paid fortified wines on hand or stored on the bonded winery or bonded storeroom, and will be divided into 8 columns designated as follows:

(A) Kind of wine.
(B) Name of producer.
(C) Serial number of tank.
(D) Serial number of packages.
(E) Serial number of cases.
(F) Size of bottles.
(G) Per cent of alcohol.
(H) Gallons of fortified wine.

(*b*) The second section of the inventory will cover all untax-paid fortified wine in transit to the premises of the bonded winery or bonded storeroom, and will be divided into 7 columns designated as follows:

(A) Kind of wine.
(B) Name and address of shipper.
(C) Name of producer.
(D) Kind of container.
(E) Serial number of container.
(F) Per cent of alcohol.
(G) Gallons of fortified wine.

PAR. 365. *Removal of wine shown on inventory.*—The fortified wine shown in the inventory to be on hand shall not be removed from the bonded winery or bonded storeroom before July 1, 1940, and shall on or after that date be tax-paid on removal at the rates of tax imposed by law in effect on the date of removal.

PAR. 366. *Verification of inventories.*—District supervisors will assign inspectors or storekeeper-gaugers to verify and certify inventories made by proprietors of bonded wineries and bonded storerooms.

PAR. 367. *Filing of application for certificate of credit.*—Every proprietor of a bonded winery or storeroom having on hand or in transit thereto untax-paid fortified wine containing more than 14 per centum, but not exceeding 24 per centum, of absolute alcohol by volume, as indicated above, desiring to secure the credits mentioned herein, shall, on or before October 1, 1940, file an application, under oath, with the Commissioner of Internal Revenue, Washington, D. C., for the issuance of a certificate entitling the proprietor to a credit of 5 cents a gallon in respect of each gallon of fortified wine which the Commissioner shall find was on the proprietor's winery or storeroom premises or in transit thereto. No particular form of application will be provided. The application may be made on letter size paper and shall set forth the basis of the claim in sufficient detail to enable the Commissioner to determine the nature thereof. Two copies of the inventory will be attached to the application. The remaining copy of the inventory will be retained by the applicant.

PAR. 368. *Action by Commissioner.*—The application and supporting documents will be examined by the Commissioner, who may call upon the applicant for such other proof and information as he may deem necessary to the consideration of the claim. When the Commissioner determines the quantity of untax-paid fortified wine which was on hand on the applicant's establishment or in transit thereto on June 30, 1940, he will issue to the applicant a certificate or certificates in an amount equal to 5 cents per gallon for the gallonage thus ascertained.

PAR. 369. *Certificates to be used for purchase of wine stamps.*—These certificates may be applied in whole or in part to the purchase of wine tax stamps on presentation to the collector of internal revenue, accompanied by Form 427–B, Order for Stamps—Wine, in quadruplicate.

PAR. 370. *Transfer of certificates.*—(*a*) The certificates may be transferred by the proprietor of a bonded winery or bonded storeroom to whom issued to the proprietor of any other bonded winery or bonded storeroom who may also apply the certificates in whole or in part to the purchase of wine tax stamps, as provided by paragraph 369, or transfer them to another proprietor of a bonded winery or storeroom for such purpose.

(*b*) In such case, the transferor shall indorse the certificate on the back thereof as follows:

Title to this certificate is hereby transferred to_____
Proprietor of B. W. (or B. S.) No_____
Address_____
Signature of transferor_____
Proprietor of B. W. (or B. S.) No_____
Address_____

If the transferred certificate is to be presented to a collector of internal revenue of a district other than that in which the transferor is located, the transferor shall have all signatures of the indorsement guaranteed by a bank or by the collector of internal revenue of his district. In addition to such guaranty, the transferee shall, if he requests stamps in a lesser amount than the face value of the certificate, on presenting the certificate to the collector of such other district, deliver to him a photostatic copy of the face and back of the certificate.

PAR. 371. *Lost or destroyed certificates.*—The Commissioner may issue a certificate to replace any lost or destroyed certificate upon receipt of an application therefor from the person entitled to possession thereof, if the applicant submits satisfactory proof (1) of his right to possess the certificate, (2) of the loss or destruction of the certificate, and (3) of the efforts made to recover the certificate. The application must be accompanied by a bond in double the amount of the face value of the certificate, with surety or sureties approved by the Commissioner, indemnifying the United States against loss in case the missing certificate should be used.

PAR. 372. *Payment of fortification taxes.*—All assessments of taxes on brandy withdrawn and used in the fortification of wine prior to July 1, 1940, will be due and payable within 18 months from the date of notice of assessment thereof.

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved June 26, 1940.

HERBERT E. GASTON,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register June 27, 1940, 11.43 a. m.)

REGULATIONS 7 (1937), PARAGRAPHS 48, 112, 113, 114, 155, 161, 205, 215, 284, 285, 291, 309, 310, 311. 1940–32–10380 T. D 4994

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 178.—PRODUCTION, FORTIFICATION, TAX PAYMENT, ETC., OF WINE.

Tax on wine and withdrawal of brandy for fortification (amending Regulations No. 7).

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

To Collectors of Internal Revenue, District Supervisors, and Others Concerned:

The Act of June 24, 1940 (Public, No. 655, Seventy-sixth Congress), reads in part as follows:

That, effective July 1, 1940, section 3030(a)(1)(A), Internal Revenue Code, is amended to read as follows:

"(A) *Imposition.*—Upon all still wines, including vermouth, and all artificial or imitation wines or compounds sold as still wine produced in or imported into the United States after June 30, 1940, or which on July 1, 1940, were on any winery premises or other bonded premises or in transit thereto or at any customhouse, there shall be levied, collected, and paid taxes at rates as follows, when sold or removed for consumption or sale:

"On wines containing not more than 14 per centum of absolute alcohol, 5 cents per wine-gallon, the per centum of alcohol under this section to be reckoned by volume and not by weight;

"On wines containing more than 14 per centum and not exceeding 21 per centum of absolute alcohol, 15 cents per wine-gallon;

"On wines containing more than 21 per centum and not exceeding 24 per centum of absolute alcohol, 25 cents per wine-gallon;

"All such wines containing more than 24 per centum of absolute alcohol by volume shall be classed as distilled spirits and shall pay tax accordingly.

"Any such wines may, under such regulations as the Commissioner may prescribe, with the approval of the Secretary, be sold or removed tax-free for the manufacture of vinegar, or for the production of dealcoholized wines containing less than one-half of 1 per centum of alcohol by volume.

"The taxes imposed by this subparagraph (A) of this paragraph shall not apply to dealcoholized wines containing less than one-half of 1 per centum of alcohol by volume; nor, subject to regulations prescribed by the Commissioner, with the approval of the Secretary, to wines produced for the family use of the duly registered producer thereof and not sold or otherwise removed from the place of manufacture and not exceeding in any case two hundred gallons per year."

SEC. 2. Effective July 1, 1940, section 3030(a)(2), Internal Revenue Code, is amended to read as follows:

"(2) *Sparkling wines, liqueurs, and cordials.*—Upon the following articles which are produced in or imported into the United States, after June 30, 1940, or which on July 1, 1940, are on any winery premises or other bonded premises or in transit thereto or at any customhouse, there shall be levied, collected, and paid, in lieu of the internal-revenue taxes imposed thereon by law prior to such date, taxes at rates as follows, when sold, or removed for consumption or sale:

"On each bottle or other container of champagne or sparkling wine, 2½ cents on each one-half pint or fraction thereof;

"On each bottle or other container of artificially carbonated wine, 1¼ cents on each one-half pint or fraction thereof;

"On each bottle or other container of liqueurs, cordials, or similar compounds, by whatever name sold, or offered for sale, containing sweet wine, citrus-fruit wine, peach wine, cherry wine, berry wine, apricot wine, prune wine, plum wine, pear wine, or apple wine, fortified, respectively, with grape brandy, citrus-fruit brandy, peach brandy, cherry brandy, berry brandy, apricot brandy, prune brandy, plum brandy, pear brandy, or apple brandy, 1¼ cents on each one-half pint or fraction thereof.

"Any of the foregoing articles containing more than 24 per centum of absolute alcohol by volume (except vermouth, liqueurs, cordials, and similar compounds made in rectifying plants and containing tax-paid sweet wine, citrus-fruit wine, peach wine, cherry wine, berry wine, apricot wine, prune wine, plum wine, pear wine, or apple wine, fortified, respectively, with grape brandy, citrus-fruit brandy, peach brandy, cherry brandy, berry brandy, apricot brandy, prune brandy, plum brandy, pear brandy, or apple brandy) shall be classed as distilled spirits and shall be taxed accordingly.

"The Commissioner under regulations prescribed by him, with the approval of the Secretary, is authorized to remit, refund, and pay back the amount of all taxes on such liqueurs, cordials, and similar compounds paid by or assessed against rectifiers at the distilled spirits rate prior to June 26, 1936."

SEC. 3. Effective July 1, 1940, section 3031(a), Internal Revenue Code, is amended to read as follows:

"(a) *Withdrawal of spirits for fortification.*—Under such regulations and official supervision and upon the giving of such notices and entries as the Commissioner, with the approval of the Secretary, may prescribe, any producer of wines defined under the provisions of this subchapter may withdraw from any fruit distillery or internal revenue bonded warehouse grape brandy (hereafter in this section included in the term 'brandy'), or wine spirits, for the fortification of such wines on the premises where actually made, and any producer of citrus-fruit wines, peach wines, cherry wines, berry wines, apricot wines, prune wines, plum wines, pear wines, or apple wines (hereafter in this section included in the term 'wines') may similarly withdraw citrus-fruit brandy, peach brandy, cherry brandy, berry brandy, apricot brandy, prune brandy, plum brandy, pear brandy, or apple brandy (hereafter in this section included in the term 'brandy') for the fortification of wines as set forth in section 3032, Internal Revenue Code, on the premises where actually made. The amounts of tax at the rate imposed by law on such brandy or wine spirits shall be charged immediately upon withdrawal against the producer withdrawing the same: *Provided*, That whenever such brandy or wine spirits shall be lawfully used in the fortification of wines and accounted for in the manner provided by law and regulations, the producer shall be credited in the amount of the internal-revenue tax on so much of the brandy or wine spirits so withdrawn as was so used. Every producer of wines who withdraws such brandy or wine spirits

shall give bond to fully cover at all times the payment of the internal-revenue tax at the rate imposed by law due on such brandy or wine spirits, which bond shall be in such form as the Commissioner, with the approval of the Secretary, shall, by regulations, prescribe. On and after July 1, 1940, the internal-revenue tax on such brandy or wine spirits shall be assessed against the producer of such wines who has withdrawn brandy or wine spirits for use in the fortification of such wines when such brandy or wine spirits are not lawfully used in the fortification of wines, or when such brandy or wine spirits are not so accounted for in the manner provided by law and regulations as to warrant remission of the tax.

"Nothing contained in this section shall be construed as exempting any wines, cordials, liqueurs, or similar compounds from the payment of any tax provided for in this subchapter.

"Any such wines may, under such regulations as the Commissioner may prescribe, with the approval of the Secretary, be sold or removed tax-free for the manufacture of vinegar, or for the production of dealcoholized wines containing less than one-half of 1 per centum of alcohol by volume.

"The taxes imposed by this subchapter shall not apply to dealcoholized wines containing less than one-half of 1 per centum of alcohol by volume."

Section 210 (Miscellaneous Excises) of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress), approved June 25, 1940, reads in part as follows:

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	* *
3250(a)(1)	Wholesalers in liquor	$100	$110.
3250(b)	Retailers in liquor	$25	$27.50.
*	* * *	*	* *

Section 214 (Wines and Fermented Malt Liquors) of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress), approved June 25, 1940, reads in part as follows:

Chapter 26 of the Internal Revenue Code is amended by inserting at the end thereof the following new subchapter:

"SUBCHAPTER F—DEFENSE TAX FOR FIVE YEARS.

"SEC. 3190. DEFENSE TAX FOR FIVE YEARS.

"In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
3030(a)(1)(A)	Still wines	5 cents	6 cents.
3030(a)(1)(A)	Still wines	15 cents	18 cents.
3030(a)(1)(A)	Still wines	25 cents	30 cents.
3030(a)(2)	Sparkling wines	2½ cents	3 cents.
3030(a)(2)	Sparkling wines	1¼ cents	1½ cents.
*	* * *	*	* *

Pursuant to the above provisions of law, paragraphs 48, 112, 113, 114, 155, 161, 205, 215, 284, 285, 291, 309, 310, and 311, Regulations No. 7, as amended (Part 178, Title 26, Code of Federal Regulations), are hereby amended to read as follows:

PAR. 48. *Bond Form 700–A.*—Except as otherwise provided herein, proprietors of bonded wineries and bonded storerooms shall furnish a separate bond on Form 700–A, in triplicate, with surety or security to cover each winery or storeroom. No wine may be produced or received, and no brandy may be withdrawn for fortification until proper bond is filed and the notice and bond are approved by the district supervisor. Bonds on Form 700–A will be in a penal sum sufficient:

(1) To cover the amount of the tax on all wine to be produced, received, and stored at the bonded winery, received and stored at the bonded storeroom, and in transit from such premises to other bonded premises, at any one time; and

(2) To cover the amount of the tax at the rate imposed by law on all brandy or wine spirits to be withdrawn for use in the fortification of wine and in transit to, or stored at, the bonded winery at any one time.

The penal sum of the bond shall be calculated on the basis of the wine and brandy or wine spirits tax rates, and the maximum quantity of either or both wine or brandy involved, and shall not be less than $500 nor more than $50,000; but where the aggregate amount of either or both such taxes exceeds the amount of bond, additional bond or bonds with surety or security shall be furnished, provided that where the liability to such taxes exceeds $50,000, the penal sum of the additional bond or bonds shall be calculated on the basis of the tax on the excess brandy or wine spirits only. Should the winemaker neglect to file the requisite bond, the district supervisor will refuse to allow him to produce or receive wine or withdraw brandy or wine spirits for fortification until the charges against the outstanding bond are reduced sufficiently to permit such further operations. The filing of blanket bonds by winemakers is not permissible.

Bonds guaranteeing the payment of outstanding assessments of taxes on brandy withdrawn and used in the fortification of wines shall continue in effect as to such taxes except that in the case of a superseding or succeeding bond, the liability shall be assumed by consent of surety on the superseding or succeeding bond.

PAR. 112. *Tax on still wines.*—The following are the rates of tax on still wines, artificial or imitation wines or compounds sold as still wines, and vermouth produced in a bonded winery, the per cent of alcohol to be reckoned by volume:

(*a*) 6 cents per wine gallon when containing not more than 14 per cent of absolute alcohol;

(*b*) 18 cents per wine gallon when containing more than 14 per cent and not exceeding 21 per cent of absolute alcohol;

(*c*) 30 cents per wine gallon when containing more than 21 per cent and not exceeding 24 per cent of absolute alcohol;

(*d*) When containing more than 24 per cent of absolute alcohol, classed as distilled spirits and taxed accordingly.

PAR. 113. *Tax on effervescent wine.*—The following are the rates of tax on champagne or sparkling wine and artificially carbonated wine:

(*a*) On each bottle or other container of champagne or sparkling wine, 3 cents on each one-half pint or fraction thereof;

(*b*) On each bottle or other container of artificially carbonated wine, 1½ cents on each one-half pint or fraction thereof;

(*c*) Any of the foregoing articles containing more than 24 per cent of absolute alcohol by volume shall be classed as distilled spirits and shall be taxed accordingly.

PAR. 114. *Computing tax on champagne.*—The tax on champagne, sparkling wine, and artificially carbonated wine must be computed on each bottle, and not on the aggregate contents of the case. Thus, the tax on a one-fifth gallon bottle of sparkling wine amounts to 12 cents, and on a case of 12 such bottles the tax amounts to $1.44.

PAR. 155. *Marking of packages.*—When shipped each package must be plainly marked "For dealcoholization," in addition to bearing the marks required by paragraph 102 of these regulations.

PAR. 161. *Retention of acetic acid on winery premises.*—Winemakers may not retain acetic acid on the winery or storeroom premises. Where wine is to be converted into vinegar stock in accordance with the foregoing, the material required for such conversion must be brought into the winery or storeroom at the time of conversion, and any residue not used must be immediately removed from the winery or storeroom. Wine converted into vinegar stock must be kept separate and apart from other wines in the winery or storeroom during the period necessary for conversion and shipment. The vinegar stock must be removed from the winery or storeroom immediately after conversion. The officer supervising the conversion will see that these requirements are complied with. District supervisors will advise the Commissioner of all conversions under supervision of their officers.

PAR. 205. *Denominations.*—Stamps for the tax-payment of wines will be provided in denominations of ⅛ cent, ½ cent, 1 cent, 1¼ cents, 1½ cents, 2 cents, 2½ cents, 3 cents, 4 cents, 5 cents, 6 cents, 7½ cents, 10 cents, 12 cents, 15 cents, 18 cents, 20 cents, 24 cents, 30 cents, 36 cents, 40 cents, 48 cents, 50 cents, 60 cents, 72 cents, 80 cents, $1, $1.20, $1.44, $1.50, $1.60, $2, $2.50, $4, $4.80, $5, $9.60, $20, $40, $50, and $100.

PAR. 215. *Retail and wholesale liquor dealer.*—Unless exempted by law, all persons who sell wines in quantities of less than 5 wine gallons to the same person at the same time are liable for special tax as retail dealers in liquors at the rate imposed by law, and all persons who sell wines in quantities of 5 wine gallons or more to the same person at the same time are liable for special tax as wholesale dealers in liquors at the rate imposed by law. Persons selling wine both in retail and wholesale quantities are liable for special taxes as both retail and wholesale dealers in liquors, except that no retail dealer incurs liability as a wholesale dealer solely by reason of sales of 5 wine gallons or more to the same person at the same time if such sales are for immediate consumption on the premises where sold.

PAR. 284. *Application on Form 276.*—When the winemaker desires to begin fortification of wine, he will make application on part 1 of Form 276, Fortification of Wine, in triplicate, to the district supervisor for the assignment of an officer to supervise fortification of the wine, except that where the district supervisor has assigned an officer to the winery and authorized him to supervise fortification upon application of the winemaker, Form 276 will be filed directly with such officer. A separate application will be made for each month in which it is desired to fortify wine.

PAR. 285. *Action by district supervisor.*—If the application is properly prepared and the winemaker's notice of intention to fortify wine, Form 605, has been filed with the district supervisor, and the use of a pipe line for the transfer of brandy has been approved, and the winemaker has procured or been authorized to procure brandy to fortify the wine, the district supervisor will, except in cases where the application is filed directly with a designated officer, as provided in paragraph 284, execute part 2 of the form and deliver all three copies to the officer designated to supervise fortification.

PAR. 291. *Losses.*—Each day wines are fortified the officer will also enter on Form 276 the information called for on that form, as indicated by the headings of the various columns and lines and the instructions printed on the form. Where losses have been sustained the officer will show the serial numbers of the packages involved, the quantity lost from each package, and the apparent reason for the loss. Losses from storage tanks will be determined at the end of the month during which wines are fortified or upon completion of fortification for the month, as provided in paragraph 296a. At the close of the month or upon completion of fortification for the month, the officer will complete the form, retain one copy at the winery as a permanent record, and forward the other two copies to the district supervisor, who will transmit one copy to the Commissioner with his brandy account, Form 200.

ARTICLE LXII—TAX LIABILITY ON BRANDY OR WINE SPIRITS WITHDRAWN FOR FORTIFICATION.

PAR. 309. *Charge against winemaker.*—The amounts of tax at the rates imposed by law on brandy or wine spirits withdrawn from a fruit distillery or an internal revenue bonded warehouse for the fortification of wine shall be charged against the winemaker immediately upon withdrawal of such brandy or wine spirits. When the brandy or wine spirits have been used lawfully in the fortification of wine and accounted for satisfactorily, the winemaker shall be given appropriate credit.

PAR. 310. *Record.*—The district supervisor shall maintain a record which will enable a ready determination regarding the amount of brandy or wine spirits representing a potential tax liability under the winemaker's bond. The amount of fortifying brandy or wine spirits on hand at or deposited in the fortification room of the winery; the amount of brandy or wine spirits lost in transit to or in the fortification room of the winery; and the amount of brandy specified in approved applications on Form 257, but not reported deposited in the fortification room, shall be considered charges against the winemaker. The amounts of brandy or wine spirits shown on Form 275 (Storekeeper-Gauger's Report of Fortification of Wine) shall be considered credits for brandy or wine spirits used. Such credits shall be entered in the record by the district supervisor immediately upon receipt of Form 275. The winemaker shall also be given credit in the record where the tax has been remitted or paid on losses of brandy or wine spirits. The district supervisor shall not disapprove a winemaker's application on Form 257 for the withdrawal of brandy or wine spirits unless he has reason to believe that the penal sum of the winemaker's bond is not sufficient, under the provisions of paragraph 48 of these regulations, to cover the tax liability on the amount of brandy or wine spirits covered by the application.

PAR. 311. *Assessment of tax.*—Where it appears that brandy or wine spirits withdrawn by a winemaker have not been used lawfully in the fortification of wine or that the tax should not be remitted on a loss of brandy in transit to or at the fortification room of a winery, the district supervisor will transmit all pertinent papers with appropriate comment to the Commissioner. If tax is found to be due, it will be assessed by the Commissioner.

Paragraphs 49, 312, 313, 314, 315, and 315a, Regulations No. 7, as amended (Part 178, Title 26, Code of Federal Regulations), are hereby revoked, except as to rights or liabilities arising prior to July 1, 1940.

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved July 30, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register August 1, 1940, 12.52 p. m.)

MISCELLANEOUS RULINGS.

JOINT RULES UNDER EXECUTIVE ORDER No. 8465.

1940-30-10352

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 27.—EXCESS PROFITS ON CONTRACTS FOR NAVAL VESSELS AND ARMY AND NAVY AIRCRAFT.

Joint rules for administration of section 4 of the Act of June 28, 1940, and Executive Order No. 8465.

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SECTION 27.0. *Introductory.*—Pursuant to the authority prescribed by section 4 of the Act of June 28, 1940 (Public, No. 671, Seventy-sixth Congress, third session), and Executive Order No. 8465, June 29, 1940, the following joint rules are hereby prescribed for the administration of such section 4 and such Executive Order:

SEC. 27.1. *Definitions.*—As used in these rules the term—

(*a*) "Act" means the Act of June 28, 1940 (Public, No. 671, Seventy-sixth Congress, third session), entitled "An Act to expedite national defense, and for other purposes."

(*b*) "Executive Order" means Executive Order No. 8465 signed by the President June 29, 1940, prescribing regulations under section 4 of the Act.

(*c*) "Secretary of the department concerned" means the Secretary of War or the Secretary of the Navy as the case may be.

(*d*) "Certification" means a certification made by the Secretary of the department concerned to the Commissioner of Internal Revenue under the provisions of section 4 of the Act and in accordance with the Executive Order.

(*e*) "National emergency" means the national emergency declared by the President on September 8, 1939, to exist.

(*f*) "Contracting party" means the contractor or subcontractor as the case may be.

(*g*) "Contract or subcontract" means a contract or subcontract with respect to which the particular request for certification is made.

SEC. 27.2. *Special additional equipment and facilities.*—A certification will be made only with respect to special additional equipment and facilities acquired to facilitate, during the national emergency, the completion of any complete naval vessel or Army or Navy aircraft or any portion thereof in private plants. Additional equipment and facilities will generally be considered to be of this character, if necessarily acquired specially to facilitate, during the national emergency, the completion of a complete naval vessel or Army or Navy aircraft or any portion thereof. The special additional equipment and facilities may have been acquired before or after the approval of the Act. It is not essential that such special additional equipment and facilities be designed exclusively for any special type of work to be performed under the contract or subcontract or that such special additional equipment and facilities be adaptable only for work required under the contract or subcontract. However, no certification will be made in the case of any item of additional equipment and facilities which, in the absence of the contract or subcontract, would be reasonably necessary in the contracting party's operations.

SEC. 27.3. *Information as to other arrangements affecting cost to be borne by Government.*—At all times prior to the first day on which the certification becomes binding upon the Commissioner of Internal Revenue, the contracting party shall keep the Secretary of the department concerned and the Commissioner of Internal Revenue advised as to whether any other department or agency of the Government has agreed to bear any portion of the cost of such special additional equipment and facilities, or whether it is contemplated that any portion of such cost will be so borne, or whether such additional equipment and facilities have been or will be used by the contracting party in connection with any work other than that required under the contract or subcontract.

SEC. 27.4. *Description of equipment and facilities.*—In the certification to the Commissioner of Internal Revenue, the Secretary of the department concerned will, for the purposes of paragraph (8) of the Executive Order, describe the special additional equipment and facilities in sufficient detail to enable the Commissioner of Internal Revenue to identify all such special additional equipment and facilities for administrative purposes, as, for example, in connection with the audit of the contracting party's report. The Secretary of the department concerned shall in each case determine what information, other than that necessary to comply with paragraph (3) of the Executive Order, shall be submitted by the contracting party for the purpose of enabling such Secretary so to describe each item of such special additional equipment and facilities.

SEC. 27.5. *Types of certifications.*—The certifications which may be made in the case of a particular contract or subcontract, with respect to one or more items of special additional equipment and facilities coming within the scope of section 4 of the Act and the Executive Order (see section 27.2 of these rules), are as follows:

(*a*) *Certification upon the basis of estimated cost.*—Prior to the time when the cost of any particular item or group of items of special additional equipment and facilities is ascertained, a certification may be made in the case of such contract or subcontract upon the basis of estimated cost of such item or items, which certification shall be made as to (*a*) the necessity and estimated cost of such item or items and (*b*) the percentage of cost of each such item to be charged against the contract or subcontract. But see section 27.6 of these rules. Such certification shall be entitled "Form A—Certification upon the basis of estimated cost."

(*b*) *Supplemental certifications.*—Subsequent to the making of a certification upon the basis of estimated cost in the case of such contract or subcontract and after the cost of the item or items covered by such certification is ascertained—

(1) *As to cost.*—A supplemental certification *shall* be made as to the cost of such item or items covered by the certification upon the basis of estimated cost (see section 27.6 of these rules), which supplemental certification shall be entitled "Form B1—Supplemental certification as to cost."

(2) *As to cost and necessity.*—A supplemental certification may be made as to the necessity of the part of the cost of any such item or items which is in excess of the estimated cost thereof, but in such case (in lieu of a supplemental certification as to cost) a supplemental certification shall be made as to (*a*) the cost of all items covered by the certification upon the basis of estimated cost and (*b*) the necessity of the part of the cost of any such item which is in excess of the estimated cost thereof, which certification shall be entitled "Form B2—Supplemental certification as to cost and necessity."

(*c*) *Certification as to necessity, cost and percentage.*—If in the case of a contract or subcontract no certification upon the basis of estimated cost has been made with respect to a particular item or group of items, a certification may be made after the cost thereof is ascertained, which certification shall be as to (*a*) the necessity and cost of such item or items and (*b*) the percentage of cost of each such item to be charged against the contract or subcontract. Such certification shall be entitled "Form C—Certification as to necessity, cost and percentage."

(*d*) *Final certification as to percentage.*—If in the case of any contract or subcontract a certification upon the basis of estimated cost has been made with respect to any particular item or items (see subsection (*a*), above) and a supplemental certification as to cost or a supplemental certification as to cost and necessity has been made as to such item or items (see subsection (*b*) (1) and (2), above), or if a certification as to necessity, cost and percentage has been made with respect to any particular item or items (see subsection (*c*), above), thereafter a certification in the case of such contract or subcontract may be made after completion of the contract or subcontract, finally determining the percentage of cost of each such item to be charged against the contract or subcontract (see section 27.8 of these rules), which certification shall be entitled "Form D—Final certification as to percentage."

No certification shall be made unless a proper request therefor has been filed by the contracting party.

SEC. 27.6. *Certification upon basis of estimated cost of equipment and facilities.*—In any case in which the Secretary of the depart-

ment concerned considers it necessary or advisable in the case of any contract or subcontract to make a certification to the Commissioner of Internal Revenue upon the basis of the estimated cost of any item or items of special additional equipment and facilities, a certification may be made as to (*a*) the necessity and estimated cost of each such item of such special additional equipment and facilities and (*b*) the percentage of the cost of each such item to be charged against the contract or subcontract. Only one certification shall be made upon the basis of estimated cost of any such item in the case of any contract or subcontract. The certification upon the basis of estimated cost, though not objected to by the Commissioner of Internal Revenue in the manner provided for by section 4 of the Act, will not be binding upon him with respect to the necessity for the items which are the subject of the certification except to the extent of the aggregate cost of such items or the aggregate estimated cost of such items, whichever is the smaller. In determining the extent to which such certification shall not be binding as to the necessity for a particular item, the excess of aggregate cost of all items over the aggregate estimated cost of all items shall be distributed among the items the cost of which exceeds the estimated cost, according to the proportion which the excess of cost over estimated cost of a particular item bears to the total amount by which the cost of all such items exceeds the estimated cost thereof. The certification will be binding upon the Commissioner of Internal Revenue with respect to the percentage of cost of each such item to be charged against the contract or subcontract, but no amount may be charged against the contract or subcontract in pursuance of such certification, unless a supplemental certification as to the cost of such item (agreed to by the contracting party and not objected to by the Commissioner of Internal Revenue) is made to the Commissioner of Internal Revenue within the time prescribed by paragraph (7) of the Executive Order. Thus, though a supplemental certification as to cost is later made, a certification upon the basis of estimated cost will not be binding except to the extent of the specified percentage as applied to estimated cost or cost, whichever is the smaller, but this limitation does not prevent the making (after full compliance with the provisions of the Executive Order and these rules) of a supplemental certification as to necessity and cost after cost is ascertained, which supplemental certification may, as to necessity, supersede the certification made upon the basis of estimated cost.

SEC. 27.7 *Certification as to necessity.*—In any case in which a certification is made to the Commissioner of Internal Revenue as to the necessity of any item of special additional equipment and facilities, the certification shall, in conformity with the provisions of paragraph (8) of the Executive Order, state the necessity in reasonable detail. However, if in the opinion of the Secretary of the Department concerned it would be against the public interest to include in the certification all the reasons why such necessity is deemed to exist, then the reasons not set forth in the certification may be transmitted to the Commissioner of Internal Revenue by a confidential statement, accompanying the certification.

SEC. 27.8. *Supplemental certification as to percentage.*—The fact that in the case of any contract or subcontract a certification is

made with respect to any item or items of special additional equipment and facilities, upon the basis of estimated cost (see section 27.5(*b*) and section 27.6 of these rules), or that a certification as to necessity, cost and percentage has been made (see section 27.5(*c*) of these rules), will not preclude the making of a final certification as to percentage (see section 27.5(*d*) of these rules) after the cost of such items is ascertained and after the contract or subcontract is completed, finally determining the percentage of cost of any such item to be charged against the contract or subcontract, which percentage (since it must be agreed to by the contracting party) may be greater or less than the percentage previously certified; but no such certification shall be made unless a request therefor is filed in accordance with paragraphs (3), (4), and (5) of the Executive Order, relating to the contents of, and time for filing, such request, and the filing of copies thereof with the Commissioner of Internal Revenue.

SEC. 27.9. *Percentage of cost of equipment and facilities chargeable against contract or subcontract.*—With respect to any item of special additional equipment and facilities, the percentage of cost thereof to be charged against a contract or subcontract will depend upon the facts in the particular case. Due regard must be given primarily to the nature of the action which will be taken to effect a compliance with the provisions of paragraph (6) of the Executive Order, relating to protection of the interest of the Government, provision for priority for Government work, and preservation for national defense purposes. For example, the reasonableness of the cost of a particular item of special additional equipment and facilities is a pertinent factor in fixing the percentage.

SEC. 27.10. *Effect of subsequent changes affecting Government's interest.*—No certification will be considered to be binding upon the Commissioner of Internal Revenue as to the percentage of cost to be charged against a contract or subcontract in respect of any item of special additional equipment and facilities if, subsequent to the making of such certification, a change adversely affecting the interest of the Government is made in any of the measures taken to effect a compliance with paragraph (6) of the Executive Order. However, in the event such a change is made, a new certification may thereafter be made, provided the requirements of the regulations prescribed by the Executive Order are met.

SEC. 27.11. *When certification is exclusive procedure.*—If in the case of any contract or subcontract a certification is made with respect to any item or items of special additional equipment and facilities coming within the scope of section 4 of the Act and if any such certification has become binding upon the Commissioner of Internal Revenue, the percentage of the cost of each such item to be charged against the contract or subcontract shall be determined only in accordance with the procedure provided for by section 4 of the Act and the regulations prescribed by the Executive Order, and no amount or allowance of any character shall be charged against the contract or subcontract in respect of any such item except to the extent of the percentage of cost of such item which is chargeable against the contract or subcontract in accordance with any such certification which has become binding upon the Commissioner of Internal Revenue. In his request for certification, or prior to mak-

ing of a certification, the contracting party shall agree to the foregoing provisions of this section.

SEC. 27.12. *Effect of contracting party's failure to request certification.*—If in the case of any contract or subcontract a contracting party fails to avail himself of the procedure provided for by section 4 of the Act and the regulations prescribed by the Executive Order in respect of any item of special additional equipment and facilities coming within the scope of such section 4, then in determining the cost of performing such contract or subcontract it will be presumed (*a*) that such items of special additional equipment and facilities will be useful in the contracting party's business throughout the normal useful life of such item and (*b*) that depreciation and obsolescence only as computed upon such basis is allowable as an element of cost of performing the contract or subcontract. Depreciation and obsolescence will not be determined upon any other basis in the absence of clear and convincing evidence by the contracting party as to the useful life of such item. Any depreciation and obsolescence which is allowable as an element of cost of performing the contract or subcontract will be determined (for the purposes of the profit-limiting provisions of section 2(b) of the Act and section 3(b) of the Act of March 27, 1934, as amended, and such section 3(b) as applied to Army aircraft) by the Commissioner of Internal Revenue, but no amount of depreciation and obsolescence will be allowed by the Commissioner of Internal Revenue for such purposes until after the expiration of the period within which a certification may be made by the Secretary of the department concerned with respect to the contract or subcontract. See paragraph (7) of the Executive Order.

SEC. 27.13. *Certification to be separate document.*—A separate certification shall be made with respect to each contract or subcontract. Such certification, agreed to by the contracting party, need not be, and preferably shall not be, included in the contract or subcontract, which may contain such reference to the certification or request for certification as may be agreed upon by the Secretary of the department concerned and the contracting party.

LOUIS JOHNSON,
Acting Secretary of War.
LEWIS COMPTON,
Acting Secretary of the Navy.
TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

(Filed with the Division of the Federal Register July 15, 1940, 4.29 p. m.)

EXECUTIVE ORDER NO. 8465—REGULATIONS GOVERNING CERTIFICATIONS OF THE SECRETARY OF WAR AND THE SECRETARY OF THE NAVY WITH RESPECT TO SPECIAL ADDITIONAL EQUIPMENT AND FACILITIES REQUIRED TO FACILITATE CONSTRUCTION OF NAVAL VESSELS AND ARMY AND NAVY AIRCRAFT.

By virtue of and pursuant to the authority vested in me by section 4 of the Act of June 28, 1940 (Public, No. 671, Seventy-sixth Congress, third session), and as President of the United States, I hereby prescribe the following regulations governing certifications to the

Commissioner of Internal Revenue by the Secretary of War or the Secretary of the Navy as to the percentage of cost of special additional equipment and facilities to be charged against a contract or subcontract for the construction or manufacture of any complete naval vessel or Army or Navy aircraft or any portion thereof:

(1) As used in these regulations the term—

(*a*) "Secretary of the department concerned" means the Secretary of War or the Secretary of the Navy as the case may be.

(*b*) "Contracting party" means the contractor or subcontractor as the case may be.

(2) No certification under the provisions of section 4 of the Act of June 28, 1940 (Public, No. 671, Seventy-sixth Congress, third session), shall be made, in the case of any contract or subcontract or any contract or subcontract as modified, to the Commissioner of Internal Revenue by the Secretary of the department concerned (and any certification made shall be ineffective) unless all the requirements of these regulations are met.

(3) Before a certification is made to the Commissioner of Internal Revenue, the contracting party shall file with the Secretary of the department concerned a request for certification. Such request for certification shall—

(*a*) Specify and itemize the special additional equipment and facilities acquired (or to be acquired) to facilitate, during the national emergency declared by the President on September 8, 1939, to exist, the completion of any complete naval vessel or Army or Navy aircraft or any portion thereof;

(*b*) State the necessity and cost (or estimated cost) of each item of such equipment and the percentage of cost of each such item which the contracting party proposes to charge against the contract or subcontract; and

(*c*) State the action which the contracting party proposes to take in order that there shall be a compliance with the provisions of paragraph (6) of these regulations. If the request for certification is filed in the case of a subcontract or proposed subcontract, it shall be accompanied by a copy of such subcontract or proposed subcontract.

(4) Such a request for certification shall be filed by the contracting party prior to the sixtieth day after the close of the contracting party's first income-taxable year within which is completed a contract or subcontract with respect to which the particular request for certification is made.

(5) On or before the date on which such request for certification is filed with the Secretary of the department concerned, the contracting party shall file with the Commissioner of Internal Revenue at least three copies of such request for certification, together with at least three copies of excerpts of all such provisions of the contract, subcontract, or proposed contract or subcontract as are pertinent to such request for certification.

(6) No certification shall be made to the Commissioner of Internal Revenue with respect to any special additional equipment and facilities unless adequate measures have been taken by the Secretary of the department concerned—

(*a*) To protect the interest of the Government in such special additional equipment and facilities, the cost, or portion of the cost, of which is borne by the Government and is chargeable against the contract or subcontract in accordance with the provisions of section 4 of the above-mentioned Act; and

(*b*) To provide that throughout the useful life of such special additional equipment and facilities the Government shall be given priority in the use thereof and that such special additional equipment and facilities shall be preserved for national defense purposes.

(7) The certification to the Commissioner of Internal Revenue in the case of any contract or subcontract may be made at any time prior to the one hundred and eightieth day after the close of the contracting party's income-taxable year within which the contract or subcontract is completed, or prior to such later time as may be specified by the Commissioner of Internal Revenue, but no certification shall be made in the case of any contract or subcontract unless a certification has been made on all contracts or subcontracts previously completed on which the special additional equipment and facilities were used.

(8) Every certification made to the Commissioner of Internal Revenue by the Secretary of the department concerned shall be executed in triplicate and shall—

(*a*) Specify and itemize the special additional equipment and facilities acquired (or to be acquired) to facilitate, during the national emergency declared by the President on September 8, 1939, to exist, the completion of any complete naval vessel or Army or Navy aircraft or any portion thereof;

(*b*) State the necessity and cost (or estimated cost) of each item of such equipment and facilities, and the percentage of cost of each such item to be charged against the contract or subcontract;

(*c*) Describe the measures which have been taken by the Secretary of the department concerned to effect a compliance with the provisions of paragraph (6) of these regulations; and

(*d*) Contain, or be accompanied by, the contracting party's agreement to such certification.

(9) The Secretary of the department concerned and the Commissioner of Internal Revenue may issue joint rules for the administration of section 4 of the above-mentioned Act and this Executive Order.

FRANKLIN D. ROOSEVELT.

THE WHITE HOUSE,
June 29, 1940.

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).

1940–29–10334
I. T. 3393

The contract awarded to the M Company by the Navy Department for corrosion-resisting steel sheets and plates to become component parts of complete naval vessels, or any portion thereof, being constructed in navy yards to replace existing naval vessels, is within the scope of the profit-limiting provisions of the Vinson Act, as amended.

Advice is requested relative to the application of section 3 of the Vinson Act of March 27, 1934, as amended by the Act of June 25, 1936, and as further amended by the Act of April 3, 1939, to a contract awarded to the M Company in 1940 by the Navy Department.

The contract award was 40x dollars for corrosion-resisting sheets and plates of several dimensions to be used in the construction of naval vessels to replace existing vessels. The M Company agreed therein to the limitation on profit provided in the Vinson Act, as amended, to submit upon completion of the contract a report in accordance with the prescribed regulations, and pay into the Treasury any excess profit realized thereon.

It is contended that the contract is not for the "construction and/or manufacture of any complete naval vessel or aircraft, or any portion thereof" within the meaning of section 3 of the Vinson Act, and, therefore, is not subject to the limitation on profit provided in that section notwithstanding the agreement thereto in the contract. In support of such contention it is pointed out that the schedule states specifically that the material is for the replacement of naval vessels and that the material is intended for several vessels being constructed at certain navy yards.

Section 2 of the Vinson Act of March 27, 1934, provides in part:

* * * That the President of the United States is hereby authorized to replace, by vessels of modern design and construction, vessels in the Navy in the categories limited by the treaties signed at Washington, February 6, 1922, and at London, April 22, 1930, when their replacement is permitted by the said treaties * * *.

Section 3 of the Act, as amended, provides in part:

* * * That no contract shall be made by the Secretary of the Navy for the construction and/or manufacture of any complete naval vessel or aircraft, or any portion thereof, herein, heretofore, or hereafter authorized unless the contractor agrees—

(a) To make a report, as hereinafter described, under oath, to the Secretary of the Navy upon the completion of the contract.

(b) To pay into the Treasury profit, as hereinafter provided shall be determined by the Treasury Department, in excess of 10 per centum of the total contract prices for the construction and/or manufacture of any complete naval vessel or portion thereof, * * * of such contracts within the scope of this section as are completed by the particular contracting party within the income taxable year, such amount to become the property of the United States * * *.

The Bureau has been advised by the Navy Department that the term "replacement of naval vessels" as used in the instant contract

is the term used in the Naval Appropriation Act appropriating funds for construction of new naval vessels to replace old and obsolete naval vessels, and that the material will enter into the construction of new vessels. It is apparent, therefore, that the material was intended to become and will be component parts of complete naval vessels, or any portion thereof, constructed and/or manufactured under the Act.

In view of the foregoing, it is held that the instant contract is within the profit-limiting provisions of the Vinson Act, as amended. Accordingly, the M Company, after completing the contract, will be required to make and file reports of profit and excess profit in respect thereof as prescribed in sections 17.15 and 17.16 of the applicable regulations, contained in Treasury Decision 4906 (C. B. 1939–2, 404), and to pay into the Treasury any excess profit on the contract, less the amount of any Federal income taxes paid or remaining to be paid on the amount of such excess profit.

1940–29–10339
I. T. 3394

ACT OF JUNE 28, 1940 (PUBLIC, NO. 671).

Application of sections 2(b) and 3 of the Act of June 28, 1940, to subcontracts entered into after June 28, 1940, where the prime contract with the War or Navy Department was entered into on or before such date.

Request has been made for a ruling as to whether sections 2(b) and 3 of the Act of June 28, 1940, Public, No. 671 (excess profits on contracts for naval vessels and for aircraft), are applicable to subcontracts entered into after June 28, 1940, where the prime contract with the War or Navy Department was entered into on or before such date.

Section 2(b) of that Act provides as follows:

> After the date of approval of this Act no contract shall be made for the construction or manufacture of any complete naval vessel or any Army or Navy aircraft, or any portion thereof, under the provisions of this section or otherwise, unless the contractor agrees, for the purposes of section 3 of the Act of March 27, 1934 (48 Stat. 505; 34 U. S. C. 496), as amended—
>
> (1) to pay into the Treasury profit in excess of 8 per centum (in lieu of the 10 per centum and 12 per centum specified in such section 3) of the total contract prices of such contracts within the scope of this subsection as are completed by the particular contracting party within the income taxable year;
>
> (2) that any profit in excess of 8.7 per centum of the cost of performing such contracts except prime contracts made on a cost-plus-a-fixed-fee basis as are completed by the contracting party within the income taxable year shall be considered to be profit in excess of 8 per centum of the total contract prices of such contracts; and
>
> (3) that he will make no subcontract which is within the scope of such section 3, unless the subcontractor agrees to the foregoing conditions.

The 8 per centum and 8.7 per centum specified in such section 2(b) are applicable to a subcontract in a case where the prime contract with the War or Navy Department is entered into after June 28, 1940. If, however, such prime contract was entered into on or before that date, the 10 per centum or 12 per centum, as the case may be, as specified in section 3 of the Act of March 27, 1934 (48 Stat., 503, 505), as amended, is applicable, in the opinion of the Bureau, to both the prime contract and any subcontract made with respect thereto, even though the subcontract is entered into after such date.

Section 3 of the Act of June 28, 1940, provides as follows:

The provisions of section 3 of the Act of March 27, 1934 (48 Stat. 505), as amended by the Acts of June 25, 1936 (49 Stat. 1926), and April 3, 1939 (53 Stat. 560; U. S. C., Supp. V, title 34, sec. 496), and as made applicable to contracts for aircraft or any portion thereof for the Army by such Act of April 3, 1939, shall, in the case of contracts or subcontracts entered into after the date of approval of this Act and during the period of the national emergency declared by the President on September 8, 1939, to exist, be limited to contracts or subcontracts where the award exceeds $25,000.

In the opinion of the Bureau, the provisions of such section 3 are applicable in the case of a subcontract entered into after June 28, 1940, and during the period of the national emergency referred to in that Act, even though the prime contract with the War or Navy Department was entered into on or before that date.

1940-37-10419
I. T. 3405

Where the M Company was performing two Navy contracts for the delivery of materials to be used in the construction of certain naval vessels, the materials to be ordered from time to time as needed, the date of the letter from the Navy Department to the M Company advising it that no further orders on the contract would be placed is the date of the completion of the contract in each case.

Advice is requested as to the dates of completion of two Navy contracts, subject to profit-limiting provisions of the Vinson Act, as amended, performed by the M Company.

The contracts were for material to be used in the construction of naval vessels and were subject to the profit-limiting provisions of the Vinson Act, as amended. By the terms of the contracts, deliveries were to be made from time to time as ordered during the construction period of the vessels. As deliveries were contingent on the need for the material for the building of such vessels, it was impossible to determine in advance of an actual need what quantities would be required or the dates of delivery thereof. The last delivery under the first contract was made on August —, 1938, and the last delivery under the second contract was made on January —, 1939. On January —, 1940, it was ascertained that the construction of the vessels for which the material was required had reached a stage where no further deliveries would be required under the first contract. The M Company was, therefore, advised by the Navy Department in a letter dated January —, 1940, that this contract would be considered complete as of that date. On February —, 1940, it was ascertained that the construction of the vessels for which the material was required under the second contract had reached a stage where no further deliveries would be required. The company was, therefore, advised by the Navy Department in a letter dated February —, 1940, that this contract could be considered complete as of that date.

Under the facts set forth above, it is held that the date of completion of the first contract was January —, 1940, and that the date of completion of the second contract was February —, 1940, the respective dates of the letters of notification referred to above. (See generally article 5 (*a*), T. D. 4723, C. B. 1937-1, 519; section 17.5, T. D. 4906, C. B. 1939-2, 404.)

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).—ACT OF JUNE 28, 1940 (PUBLIC, NO. 671).

1940–31–10370
I. T. 3398

Inclusion of certain items as elements of cost of performing a contract or subcontract for the construction or manufacture of naval vessels or Army or Navy aircraft or any portion thereof, for purposes of section 3 of the Vinson Act (48 Stat., 503, 505), as amended, and for purposes of the Act of June 28, 1940 (Public, No. 671).

Advice is requested relative to including certain items as elements of cost of performing a contract or subcontract for the construction or manufacture of naval vessels or Army or Navy aircraft or any portion thereof for purposes of section 3 of the Vinson Act (48 Stat., 503, 505), as amended by the Act of June 25, 1936 (49 Stat., 1926), and by the Act of April 3, 1939 (53 Stat., 555, 560), and for purposes of the Act of June 28, 1940 (Public, No. 671).

Question: Will the fact that inexperienced labor is employed in operating machinery be taken into consideration in determining the amount of depreciation on such machinery to be allocated to the cost of performing a contract or subcontract?

Answer: In determining the amount of depreciation allowable for the purposes of allocating such depreciation to the cost of performing a contract or subcontract, all factors affecting the useful life of the equipment and facilities, including the use of inexperienced labor, will be taken into consideration.

Question: Reference is made to the provisions of section 17.9(*g*) of the regulations contained in Treasury Decision 4906 (C. B. 1939–2, 404) and section 16.9(*g*) of the regulations contained in Treasury Decision 4909 (C. B. 1939–2, 422), which prohibit the inclusion of State income and excess profits taxes and surtaxes as an element of cost of performing a contract or subcontract. Do these provisions prohibit including as an element of such cost a State franchise tax imposed upon the privilege of doing business as a corporation within a State in case the tax paid is measured by income?

Answer: No, if such tax is truly a franchise tax upon the privilege of doing business as a corporation and does not have the characteristics which require the disallowance of income taxes. "The name by which the tax is described in the statute is, of course, immaterial." (*Dawson* v. *Kentucky Distilleries & Warehouse Co.*, 255 U. S., 288.) A tax, though denominated a franchise tax upon the privilege of doing business as a corporation, is nevertheless within the prohibition of the regulations if in character it is essentially an income tax.

In the hearings before the Committee on Naval Affairs of the House of Representatives on sundry legislation affecting the Naval Establishment (1935) (Seventy-fourth Congress, first session), page 1508, it was pointed out that income taxes are not allowable as an element of cost of performing a contract or subcontract for the following reasons:

Income taxes, both State and Federal, have been excluded by specific rulings because such taxes merely represent a payment of a part of the net profits to the Government. Unless net profits are earned no payments are required. It will

be self-evident to the committee that you cannot determine income tax until after you determine profit. Under accepted accounting principles income taxes are treated as a reduction of income received from operation.

Question: Suppose that a contractor disposes of machinery and equipment in connection with the acquisition of special additional machinery and equipment which is acquired to perform a contract or subcontract. Is a loss upon such disposition includible as an element of cost of performing such contract or subcontract?

Answer: If the contractor establishes that such disposition was made in connection with such acquisition, and that the disposition would not have been made but for the acquisition of the special additional machinery and equipment which is necessarily required to perform the contract or subcontract within the time, at the rate, and in the quantity specified, the net loss upon all machinery and equipment so disposed of may be charged off and a proper proportion thereof allocated to the cost of performing such contract or subcontract.

The general provision in the regulations which forbids the allowance of "losses from sales or exchanges of capital assets" is not coextensive with the income tax provisions relative to losses from sales or exchanges of capital assets, as that term is defined in section 117 of the Internal Revenue Code. While under ordinary circumstances the provision in the regulations excludes from the cost of performing a contract or subcontract losses from sales or exchanges of machinery and equipment, such provision is not to be construed as excluding a loss such as that described above, where the purpose is to make possible an acquisition of facilities under the circumstances stated.

1940–33–10390
T. D. 5000

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 26.—EXCESS PROFITS ON CONTRACTS FOR NAVAL VESSELS AND ARMY AND NAVY AIRCRAFT.

Regulations under section 2(b) of the Act of June 28, 1940, and other provisions.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY OF THE TREASURY,
Washington, D. C.

WAR DEPARTMENT,
OFFICE OF THE SECRETARY OF WAR,
Washington, D. C.

NAVY DEPARTMENT,
OFFICE OF THE SECRETARY OF THE NAVY,
Washington, D. C.

To Officers and Employees of the Treasury Department, the War Department, the Navy Department, and Others Concerned:

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SECTION 26.0. *Introductory.*—(*a*) Section 2(b) of the Act entitled "An Act to expedite national defense, and for other purposes," approved June 28, 1940 (Public, No. 671, Seventy-sixth Congress, third session), reads as follows:

(b) After the date of approval of this Act no contract shall be made for the construction or manufacture of any complete naval vessel or any Army or Navy aircraft, or any portion thereof, under the provisions of this section or otherwise, unless the contractor agrees, for the purposes of section 3 of the Act of March 27, 1934 (48 Stat. 505; 34 U. S. C. 496), as amended—

(1) to pay into the Treasury profit in excess of 8 per centum (in lieu of the 10 per centum and 12 per centum specified in such section 3) of the total contract prices of such contracts within the scope of this subsection as are completed by the particular contracting party within the income taxable year;

(2) that any profit in excess of 8.7 per centum of the cost of performing such contracts except prime contracts made on a cost-plus-a-fixed-fee basis as are completed by the contracting party within the income taxable year shall be considered to be profit in excess of 8 per centum of the total contract prices of such contracts; and

(3) that he will make no subcontract which is within the scope of such section 3, unless the subcontractor agrees to the foregoing conditions.

(*b*) Section 14 of the Act entitled "An Act to provide more effectively for the national defense by carrying out the recommendations of the President in his message of January 12, 1939, to the Congress," approved April 3, 1939 (53 Stat., 560; 10 U. S. C., Sup., 311), reads in part as follows:

SEC. 14. All the provisions of section 3 of the Act of March 27, 1934, as amended (48 Stat. 505; 49 Stat. 1926), and as amended by this section shall be applicable with respect to contracts for aircraft or any portion thereof for the Army to the same extent and in the same manner that such provisions are applicable with respect to contracts for aircraft, or any portion thereof for the Navy: *Provided*, That the Secretary of War shall exercise all functions under such section with respect to aircraft for the Army which are exercised by the Secretary of the Navy with respect to aircraft for the Navy * * *.

(*c*) Section 3 of the Act entitled "An Act to establish the composition of the United States Navy with respect to the categories of vessels limited by the treaties signed at Washington, February 6, 1922, and at London, April 22, 1930, at the limits prescribed by those treaties; to authorize the construction of certain naval vessels; and for other purposes," approved March 27, 1934 (48 Stat., 505; 34 U. S. C., 496), as amended by the Act of June 25, 1936 (49 Stat., 1926; 34 U. S. C.,

Sup., 496), and as further amended by section 14 of the Act of April 3, 1939 (53 Stat., 560; 34 U. S. C., Sup., 496), reads as follows:

SEC. 3. The Secretary of the Navy is hereby directed to sumbit annually to the Bureau of the Budget estimates for the construction of the foregoing vessels and aircraft; and there is hereby authorized to be appropriated such sums as may be necessary to carry into effect the provisions of this Act: *Provided*, That no contract shall be made by the Secretary of the Navy for the construction and/or manufacture of any complete naval vessel or aircraft, or any portion thereof, herein, heretofore, or hereafter authorized unless the contractor agrees—

(a) To make a report, as hereinafter described, under oath, to the Secretary of the Navy upon the completion of the contract.

(b) To pay into the Treasury profit, as hereinafter provided shall be be determined by the Treasury Department, in excess of 10 per centum of the total contract prices for the construction and/or manufacture of any complete naval vessel or portion thereof, and in excess of 12 per centum of the total contract prices for the construction and/or manufacture of any complete aircraft or portion thereof, of such contracts within the scope of this section as are completed by the particular contracting party within the income taxable year, such amount to become the property of the United States, but the surety under such contracts shall not be liable for the payment of such excess profit: *Provided*, That if there is a net loss on all such contracts or subcontracts for the construction and/or manufacture of any complete naval vessel or portion thereof completed by the particular contractor or subcontractor within any income taxable year, such net loss shall be allowed as a credit in determining the excess profit, if any, for the next succeeding income taxable year, and that if there is a net loss, or a net profit less than 12 per centum, as aforesaid on all such contracts or subcontracts for the construction and/or manufacture of any complete aircraft or portion thereof completed by the particular contractor or subcontractor within any income taxable year, such net loss or deficiency in profit shall be allowed as a credit in determining the excess profit, if any, during the next succeeding four income taxable years, and that the method of ascertaining the amount of excess profit, initially fixed upon shall be determined on or before June 30, 1939: *Provided further*, That if such amount is not voluntarily paid the Secretary of the Treasury shall collect the same under the usual methods employed under the internal-revenue laws to collect Federal income taxes: *Provided further*, That all provisions of law (including penalties) applicable with respect to the taxes imposed by Title I of the Revenue Act of 1934, and not inconsistent with this section, shall be applicable with respect to the assessment, collection, or payment of excess profits to the Treasury as provided by this section, and to refunds by the Treasury of overpayments of excess profits into the Treasury: *And provided further*, That this section shall not apply to contracts or subcontracts for scientific equipment used for communication, target detection, navigation, and fire control as may be so designated by the Secretary of the Navy, and the Secretary of the Navy shall report annually to the Congress the names of such contractors and subcontractors affected by this provision, together with the applicable contracts and the amounts thereof: *And provided further*, That the income-taxable years shall be such taxable years beginning after December 31, 1935, except that the above provisos relating to the assessment, collection, payment, or refunding of excess profit to or by the Treasury shall be retroactive to March 27, 1934.

(c) To make no subdivisions of any contract or subcontract for the same article or articles for the purpose of evading the provisions of this Act, but any subdivision of any contract or subcontract involving an amount in excess of $10,000 shall be subject to the conditions herein prescribed.

(d) That the manufacturing spaces and books of its own plant, affiliates, and subdivisions shall at all times be subject to inspection and audit by any person designated by the Secretary of the Navy, the Secretary of the Treasury, and/or by a duly authorized committee of Congress.

(e) To make no subcontract unless the subcontractor agrees to the foregoing conditions.

The report shall be in form prescribed by the Secretary of the Navy and shall state the total contract price, the cost of performing the contract, the net income, and the per centum such net income bears to the contract price. A copy of such report shall be transmitted to the Secretary of the Treasury for consideration in connection with the Federal income tax returns of the contractor for the taxable year or years concerned.

The method of ascertaining the amount of excess profit to be paid into the Treasury shall be determined by the Secretary of the Treasury in agreement with the Secretary of the Navy and made available to the public. The method initially fixed upon shall be so determined on or before June 30, 1934: *Provided*, That in any case where an excess profit may be found to be owing to the United States in consequence hereof, the Secretary of the Treasury shall allow credit for any Federal income taxes paid or remaining to be paid upon the amount of such excess profit.

The contract or subcontracts referred to herein are limited to those where the award exceeds $10,000.

(*d*) Sections 3, 4, and 12 of the Act of June 28, 1940, approved June 28, 1940 (Public, No. 671, Seventy-sixth Congress, third session), read, respectively, as follows:

SEC. 3. The provisions of section 3 of the Act of March 27, 1934 (48 Stat. 505), as amended by the Acts of June 25, 1936 (49 Stat. 1926), and April 3, 1939 (53 Stat. 560; U. S. C., Supp. V. Title 34, section 496), and as made applicable to contracts for aircraft or any portion thereof for the Army by such Act of April 3, 1939, shall, in the case of contracts or subcontracts entered into after the date of approval of this Act and during the period of the national emergency declared by the President on September 8, 1939, to exist, be limited to contracts or subcontracts where the award exceeds $25,000.

SEC. 4. In the case of every contract or subcontract for the construction or manufacture of any complete naval vessel or Army or Navy aircraft or any portion thereof which is entered into (whether before or after the date of approval of this Act), the Secretary of War or the Secretary of the Navy, as the case may be, after agreement with the contractor or subcontractor, shall certify to the Commissioner of Internal Revenue as to (a) the necessity and cost of special additional equipment and facilities acquired to facilitate, during the national emergency declared by the President on September 8, 1939, to exist, the completion of such naval vessel or Army or Navy aircraft or portion thereof in private plants; and (b) the percentage of cost of such special additional equipment and facilities to be charged against such contract or subcontract. For all purposes of section 3 of the Act of March 27, 1934 (48 Stat. 505; 34 U. S. C. 496), as amended, such certification shall be subject to such regulations as the President may prescribe, but shall be binding upon the Commissioner of Internal Revenue, unless, within five days after receipt of such certification, he make formal objection thereto to the Secretary of the Navy or the Secretary of War as the case may be. The part of such cost chargeable against the contract or subcontract in pursuance of such certification, shall, for the purposes of such section 3, be considered to be a reduction of the contract price of the contract or subcontract. The amount charged against the contract or subcontract in pursuance of such certification shall, for the purposes of such section 3, be applied against and reduce the cost or other basis of such special additional equipment and facilities as of the date of installation thereof: *Provided*, That the Secretary of War or the Secretary of the Navy, as the case may be, shall report to the Congress, every three months, the cost of such special additional equipment and facilities to be borne by the Government under each contract.

SEC. 12. The provisions of all preceding sections of this Act shall terminate June 30, 1942, unless the Congress shall otherwise provide.

Pursuant to the authority prescribed by section 2(b) of the Act of June 28, 1940 (Public, No. 671, Seventy-sixth Congress, third session), section 14 of the Act of April 3, 1939, and section 3 of the Act of March 27, 1934, as amended, the following regulations are hereby prescribed:

SEC. 26.1. *Definitions.*—As used in these regulations the term—

(*a*) "*Act*" means the Act of June 28, 1940 (Public, No. 671, Seventy-sixth Congress, third session).

(*b*) "*Act of March 27, 1934, as amended*" means section 3 of the Act of March 27, 1934 (48 Stat., 505; 34 U. S. C., 496), as amended by the Act of June 25, 1936 (49 Stat., 1926; 34 U. S. C., Sup. 496), and as further amended and made applicable to contracts and subcontracts for Army aircraft by the Act of April 3, 1939 (53 Stat., 560; 34 U. S. C., Sup., 496).

(*c*) "*Secretary of the department concerned*" means the Secretary of War or the Secretary of the Navy as the case may be.

(*d*) "*Person*," includes an individual, a corporation, a partnership, a trust or estate, a joint-stock company, an association, or a syndicate, group, pool, joint venture, or other unincorporated organization or group, through or by means of which any business, financial operation, or venture is carried on.

(*e*) "*Contract*" means an agreement, made by authority of the Secretary of the department concerned for the construction or manufacture of any complete naval vessel or Army or Navy aircraft, or any portion thereof, entered into after the date of enactment of the Act (June 28, 1940) and before July 1, 1942.

(*f*) "*Contractor*" means a person entering into a direct contract with the Secretary of the department concerned or his duly authorized representative.

(*g*) "*Subcontract*" means an agreement entered into by one person with another person for the construction or manufacture of any complete naval vessel or Army or Navy aircraft, or any portion thereof, the prime contract for such vessel or aircraft or portion thereof having been entered into between a contractor and the Secretary of the department concerned or his duly authorized representative after the date of enactment of the Act (June 28, 1940) and before July 1, 1942. The term "subcontract" does not include such an agreement even though entered into after June 28, 1940, if the prime contract with respect thereto was entered into on or before June 28, 1940, but does include such an agreement entered into after June 30, 1942, if the prime contract with respect thereto was entered into on or before June 30, 1942.

(*h*) "*Subcontractor*" means any person other than a contractor entering into a subcontract.

(*i*) "*Contracting party*" means a contractor or subcontractor as the case may be.

(*j*) "*Contract price*" or "*total contract price*" means the amount or total amount to be received under a contract or subcontract as the case may be.

(*k*) "*Income-taxable year*" means the calendar year, the fiscal year ending during such calendar year, or the fractional part of such calendar or fiscal year upon the basis of which the contracting party's net income is computed and for which its income tax returns are made for Federal income tax purposes.

SEC. 26.2 *Scope of regulations.*—These regulations deal with liability for excess profit on (1) contracts for the construction or manufacture of any complete naval vessel or Army or Navy aircraft, or any portion thereof, entered into after the date of enactment of the Act (June 28, 1940) and before July 1, 1942, and (2) subcontracts made with respect to any such contract. As to contracts for naval vessels and aircraft, entered into on or before June 28, 1940, and subcontracts made with respect to any such contract, see Treasury Decision 4906 [C. B. 1939–2, 404] (sections 17.0 to 17.19, inclusive, Title 26, Code of Federal Regulations, 1939 Sup.). As to contracts for Army aircraft entered into on or before June 28, 1940, and subcontracts made with respect to any such contract, see Treasury Decision 4909 [C. B. 1939–2, 422] (sections 16.0 to 16.18, inclusive, Title 26, Code of Federal Regulations, 1939 Sup.). As to the date of completion of a contract or subcontract within the scope of these regulations, see section 26.5 of these regulations.

SEC. 26.3. *Contracts and subcontracts under which excess profit liability may be incurred.*—Except as otherwise provided with respect to contracts or subcontracts for certain scientific equipment (see section 26.4 of these regulations), every contract entered into after June 28, 1940, and before July 1, 1942, is subject to the provisions of the Act relating to excess profit liability if—

(1) it is entered into prior to the termination of the period of national emergency declared by the President on September 8, 1939, to exist (see Proclamation No. 2352), and is awarded for an amount exceeding $25,000; or

(2) it is entered into after the termination of such period of national emergency and is awarded for an amount in excess of $10,000.

Every subcontract made pursuant to such a contract is subject to the provisions of the Act relating to excess profit liability if—

(*a*) it involves an amount in excess of $25,000 and was entered into prior to the termination of such period of national emergency and before July 1, 1942; or

(*b*) it involves an amount in excess of $10,000 and was entered into after the termination of such period of national emergency or after June 30, 1942, whichever is the earlier.

If a contracting party places orders with another party, aggregating an amount in excess of $25,000 (or $10,000 as the case may be), for articles or materials which are destined to become a component part of a complete naval vessel or Army or Navy aircraft, or any portion thereof, the placing of such orders shall constitute a subcontract within the scope of the Act, unless it is clearly shown that each of the orders involving $25,000 (or $10,000 as the case may be) or less is a bona fide separate and distinct subcontract for articles or materials which are not destined to become and do not become a component part of any such vessel or aircraft, or any portion thereof, constructed or manufactured under one particular contract or subcontract by the contracting party placing the orders, and is not a subdivision made for the purpose of evading the provisions of the Act.

SEC. 26.4. *Contracts or subcontracts for scientific equipment.*—No excess profit liability is incurred upon a contract or subcontract if at the time or prior to the time such contract or subcontract is made it is designated by the Secretary of the department concerned as being exempt under the provisions of the Act of March 27, 1934, as amended, pertaining to scientific equipment used for communication, target, detection, navigation, and fire control.

SEC. 26.5. *Completion of contract defined.*—The date of delivery of the vessel, aircraft, or portion thereof, covered by the contract or subcontract shall be considered the date of completion of the contract or subcontract unless otherwise determined jointly by the Secretary of the department concerned and the Secretary of the Treasury or their duly authorized representatives. In case a contract is for two or more vessels or aircraft, if it appears that the contract constitutes a single undertaking as to such vessels or aircraft and if the work of constructing or manufacturing such vessels or aircraft is prosecuted as a single undertaking, then the date of delivery of the vessel or aircraft last delivered under such contract shall be considered the date of completion of the contract. Except as otherwise provided in the first sentence of this section, the replacement of defective parts of delivered articles or the performance of other guarantee work in respect of such articles will not operate to extend the date of completion. As to the treatment of the cost of such work as a cost of performing a contract or subcontract, see section 26.9(*h*) of these regulations. As to a refund in case of adjustment due to any subsequently incurred additional costs, see section 26.19 of these regulations. If a contract or subcontract is at any time canceled or terminated, it is completed at the time of the cancellation or termination.

SEC. 26.6. *Manner of determining liability.—The first step* in the determination of the excess profit to be paid to the United States by a contracting party with respect to contracts and subcontracts completed within an income-taxable year is to ascertain the total contract prices of all contracts and subcontracts completed by the contracting party within the income-taxable year. As to total contract prices, see section 26.8 of these regulations.

The second step is to ascertain the cost of performing such contracts and subcontracts and to deduct such cost from the total contract prices of such contracts and subcontracts as computed in the first step. See section 26.9 of these regulations.

The amount remaining after such subtraction is the amount of net profit or net loss upon the contracts and subcontracts completed within the income-taxable year.

The third step, in case there is a net profit upon such contracts and subcontracts, is to subtract from the amount of such net profit as computed in the second step the sum of—

(1) Whichever is the lesser of the following: (A) An amount equal to 8 per cent of the total contract prices of the contracts (including prime contracts made on a cost-plus-a-fixed-fee basis) and subcontracts completed within the income-taxable year, or (B) an amount equal to 8.7 per cent of the total cost of performing such contracts (except prime contracts made on a cost-plus-a-fixed-fee basis) and subcontracts plus 8 per cent of the total contract prices of prime contracts made on a cost-plus-a-fixed-fee basis;

(2) The amount of any net loss sustained in a prior income-taxable year and allowable as a credit in determining the excess profit for the income-taxable year (see section 26.10 of these regulations); and

(3) The amount of any deficiency in profit sustained in a prior income-taxable year (on a contract or subcontract for Army or Navy aircraft or any portion thereof) and allowable as a credit in determining the excess profit for the income-taxable year (see section 26.10 of these regulations).

The amount remaining after such subtraction is the amount of excess profit for the income-taxable year.

The fourth step is to ascertain the amount of credit allowed for Federal income taxes paid or remaining to be paid upon the amount of such excess profit (see section 26.11 of these regulations) and then subtract from the amount of such excess profit the amount of credit for Federal income taxes.

The amount remaining after this subtraction is the amount of excess profit to be paid to the United States by the contracting party for the income-taxable year.

SEC. 26.7. *Computation of excess profit liability.*—The application of the provisions of section 26.6 of these regulations may be illustrated by the following examples:

Example (1): On February 1, 1941, the B Corporation which keeps its books and makes its Federal income tax returns on a calendar year basis entered into a contract coming within the scope of the Act, the total contract price of which was $200,000. On March 1, 1941, the corporation entered into another such contract, the total contract price of which was $40,000. Both contracts (neither of which was made on a cost-plus-a-fixed-fee basis) were completed within the calendar year 1941, the first at a cost of $155,000 and the second at a cost of $45,000. During the year 1940 the B Corporation sustained an allowable net loss of $2,500 and an allowable deficiency in profit of $1,000 on contracts and subcontracts coming within the scope of the Act and completed within the income-taxable year 1940. For purposes of the Federal income tax, the net income of the B Corporation for the year 1941 amounted to $96,000, which included the total net profit of $40,000 upon the two contracts. For the purposes of this example, it is assumed that for the year 1941 the B Corporation paid a Federal income tax of $20,500 upon its entire net income. The excess profit liability is $14,600 computed as follows:

Total contract prices:		
Contract No. 1	$200,000	
Contract No. 2	40,000	
		$240,000
Less: Cost of performing contracts—		
Contract No. 1	155,000	
Contract No. 2	45,000	
		200,000
Net profit on contracts		40,000
Less: (1) 8.7 per cent of cost of performing contracts (8.7 per cent of $200,000=$17,400), which amount is less than 8 per cent of total contract prices (8 per cent of $240,000=$19,200)	$17,400	
(2) Net loss from 1940	2,500	
(3) Deficiency in profit from 1940	1,000	
		20,900
Excess profit for year 1941		19,100
Less: Credit for Federal income taxes (assumed Federal income tax on $19,100 at the rates for 1941)		4,500
Amount of excess profit payable to the United States		14,600

Example (2): On February 1, 1941, the B Corporation which keeps its books and makes its Federal income tax returns on a calendar year basis entered into a contract coming within the scope of the Act, the total contract price of which was $200,000. On March 1, 1941, the corporation entered into another such contract on a cost-plus-a-fixed-fee basis, the estimated cost being $100,000 and the stipulated fee being $7,000. Both contracts were completed within the calendar year 1941, the first at a cost of $155,000 and the second at a cost of $90,000. During the year 1940 the B Corporation sustained an allowable net loss of $2,500 and an allowable deficiency in profit of $1,000 on contracts and subcontracts coming within the scope of the Act. For purposes of the Federal income tax, the net income of the B Corporation for the year 1941 amounted to $96,000, which included the total net profit of $52,000 on the two contracts. For the purposes of this example, it is assumed that for the year 1941 the B corporation paid a Federal income tax of $20,500 upon its entire net income. The excess profit liability is $21,255 computed as follows:

Total contract prices:		
Contract No. 1	$200,000	
Contract No. 2 ($90,000 cost plus $7,000 fee)	97,000	
		$297,000
Less: Cost of performing contracts—		
Contract No. 1	155,000	
Contract No. 2	90,000	
		245,000
Net profit on contracts		52,000
Less: (1) 8.7 per cent of cost of performing contract No. 1 plus 8 per cent of total contract price of contract No. 2 (8.7 per cent of $155,000 plus 8 per cent of $97,000=$21,245), which amount is less than 8 per cent of total contract prices (8 per cent of $297,000=$23,760)	$21,245	
(2) Net loss from 1940	2,500	
(3) Deficiency in profit from 1940	1,000	
		24,745
Excess profit for year 1941		27,255
Less: Credit for Federal income taxes (assumed Federal income tax on $27,255 at the rates for 1941)		6,000
Amount of excess profit payable to the United States		21,255

SEC. 26.8. *Total contract price.*—The total contract price of a particular contract or subcontract (see section 26.1 of these regulations) may be received in money or its equivalent. If something other than money is received, only the fair market value of the thing received, at the date of receipt, is to be included in determining the amount received. Bonuses earned for bettering performance and penalties incurred for failure to meet the contract guarantees are to be regarded as adjustments of the original contract price. Trade or other discounts granted by a contracting party in receipt of a contract or subcontract performed by such party are also to be deducted in determining the true total contract price of such contract or subcontract. In the case of a contract made on a cost-plus-a-fixed-fee basis the total contract price is the actual, rather than the estimated, cost of performing the contract plus the stipulated fee and any other amounts received by the contracting party for performing such contract.

For the purposes of the Act and these regulations, the contract price of a contract or subcontract shall be reduced by the part of the cost of special additional equipment and facilities acquired by the contracting party and chargeable against the contract or subcontract in pursuance of a certification made by the Secretary of the department concerned in accordance with the provisions of section 4 of the Act. See Executive Order No. 8465 and Joint Rules issued under such order (page 385, this Bulletin),

SEC. 26.9. *Cost of performing a contract or subcontract.*—(*a*) *General rule.*—The cost of performing a particular contract or subcontract shall be the sum of (1) the direct costs, including therein expenditures for materials, direct labor and direct expenses, incurred by the contracting party in performing the contract or subcontract; and (2) the proper proportion of any indirect costs (including therein a reasonable proportion of management expenses) incident to and necessary for the performance of the contract or subcontract.

(*b*) *Elements of cost.*—No definitions of the elements of cost may be stated which are of invariable application to all contractors and subcontractors. In general, the elements of cost may be defined for purposes of the Act as follows:

(1) Manufacturing cost, which is the sum of factory cost (see paragraph (*c*) of this section) and other manufacturing cost (see paragraph (*d*) of this section);

(2) Miscellaneous direct expenses (see paragraph (*e*) of this section);

(3) General expenses, which are the sum of indirect engineering expenses, usually termed "engineering overhead" (see paragraph (*f*) of this section) and expenses of distribution, servicing and administration (see paragraph (*g*) of this section); and

(4) Guarantee expenses (see paragraph (*h*) of this section).

(*c*) *Factory cost.*—Factory cost is the sum of the following:

(1) *Direct materials.*—Materials, such as those purchased for stock and subsequently issued for contract operations and those acquired under subcon-

tracts, which become a component part of the finished product or which are used directly in fabricating, converting or processing such materials or parts.

(2) *Direct productive labor.*—Productive labor, usually termed "shop labor," which is performed on and is properly chargeable directly to the article manufactured or constructed pursuant to the contract or subcontract, but which ordinarily does not include direct engineering labor (see subparagraph (3) of this paragraph).

(3) *Direct engineering labor.*—The compensation of professional engineers and other technicists (including reasonable advisory fees), and of draftsmen, properly chargeable directly to the cost of the contract or subcontract.

(4) *Miscellaneous direct factory charges.*—Items which are properly chargeable directly to the factory cost of performing the contract or subcontract but which do not come within the classifications in subparagraphs (1), (2), and (3) of this paragraph, as for example, royalties which the contracting party pays to another party and which are properly chargeable to the cost of performing the contract or subcontract (but see paragraph (*d*) of this section).

(5) *Indirect factory expenses.*—Items, usually termed "factory overhead," which are not directly chargeable to the factory cost of performing the contract or subcontract but which are properly incident to and necessary for the performance of the contract or subcontract and consist of the following:

(A) *Labor.*—Amounts expended for factory labor, such as supervision and inspection, clerical labor, timekeeping, packing and shipping, stores supply, services of tool crib attendants, and services in the factory employment bureau, which are not chargeable directly to productive labor of the contract or subcontract.

(B) *Materials and supplies.*—The cost of materials and supplies for general use in the factory in current operations, such as shop fuel, lubricants, heat-treating, plating, cleaning and anodizing supplies, nondurable tools and gauges, stationery (such as time tickets and other forms), and boxing and wrapping materials.

(C) *Service expenses.*—Factory expenses of a general nature, such as those for power, heat and light (whether purchased or produced), ventilation and air-conditioning and operation and maintenance of general plant assets and facilities.

(D) *Fixed charges and obsolescence.*—Recurring charges with respect to property used for manufacturing purposes of the contract or subcontract, such as premiums for fire and elevator insurance, property taxes, rentals and allowances for depreciation of such property, including maintenance and depreciation of reasonable stand-by equipment; and depreciation and obsolescence of special equipment and facilities necessarily acquired primarily for the performance of the contract or subcontract, except special additional equipment and facilities with respect to which the Secretary of the department concerned has made a certification binding upon the Commissioner of Internal Revenue, pursuant to section 4 of the Act, in the case of such contract or subcontract. See Executive Order No. 8465 and Joint Rules issued under such Order (page 385, this Bulletin). In making allowances for depreciation, consideration shall be given to the number and length of shifts.

(E) *Miscellaneous indirect factory expenses.*—Miscellaneous factory expenses not directly chargeable to the factory cost of performing the contract or subcontract, such as purchasing expenses; ordinary and necessary expenses of rearranging facilities within a department or plant; employees' welfare expenses; premiums or dues on compensation insurance; employers' payments to unemployment, old age and social security Federal and State funds not including payments deducted from or chargeable to employees or officers; pensions and retirement payments to factory employees; factory accident compensation (as to self-insurance, see paragraph (*g*) of this section); but not including any amounts which are not incident to services, operations, plant, equipment or facilities involved in the performance of the contract or subcontract.

(*d*) *Other manufacturing cost.*—Other manufacturing cost as used in paragraph (*b*) of this section includes items of manufacturing costs which are not properly or satisfactorily chargeable to factory costs (see paragraph (*e*) of this section) but which upon a complete showing of all pertinent facts are properly to be included as a cost of performing the contract or subcontract, as for instance, payments of royalties and amortization of the cost of designs purchased and patent rights over their useful life; and "deferred" or "unliquidated" experimental and development charges. For example, in case experimental and development costs have been properly deferred or capitalized and are amortized in accordance with a reasonably consistent plan, a proper portion of the

current charge, determined by a ratable allocation which is reasonable in consideration of the pertinent facts, may be treated as a cost of performing the contract or subcontract. In the case of general experimental and development expenses which may be charged off currently, a reasonable portion thereof may be allocated to the cost of performing the contract or subcontract. If a special experimental or development project is carried on in pursuance of a contract, or in anticipation of a contract which is later entered into, and the expense is not treated as a part of general experimental and development expenses or is not otherwise allowed as a cost of performing the contract, there clearly appearing no reasonable prospect of an additional contract for the type of article involved, the entire cost of such project may be allowed as a part of the cost of performing the contract.

(*e*) *Miscellaneous direct expenses.*—Miscellaneous direct expenses as used in paragraph (*b*) of this section include—

(1) *Cost of installation and construction.*—Cost of installation and construction includes the cost of materials, labor, and expenses necessary for the erection and installation prior to the completion of the contract and after the delivery of the product or material manufactured or constructed pursuant to the contract or subcontract.

(2) *Sundry direct expenses.*—Items of expense which are properly chargeable directly to the cost of performing a contract or subcontract and which do not constitute guarantee expenses (see paragraph (*h*) of this section) or direct costs classified as factory cost or other manufacturing cost (see paragraphs (*c*) and (*d*) of this section), such as premiums on performance or other bonds required under the contract or subcontract; State sales taxes imposed on the contracting party; freight on outgoing shipments; fees paid for wind tunnel and model basin tests; demonstration and test expenses; crash insurance premiums; traveling expenses. In order for any such item to be allowed as a charge directly to the cost of performing a contract or subcontract, (1) a detailed record shall be kept by the contracting party of all items of a similar character, and (2) no item of a similar character which is properly a direct charge to other work shall be allowed as a part of any indirect expenses in determining the proper proportion thereof chargeable to the cost of performing the contract or subcontract. As to allowable indirect expenses, see paragraphs (*c*) (5), (*f*), (*g*), and (*j*) of this section.

(*f*) *Indirect engineering expenses.*—Indirect engineering expenses, usually termed "engineering overhead," which are treated in this section as a part of general expenses in determining the cost of performing a contract or subcontract (see paragraph (*b*) of this section), comprise the general engineering expenses which are incident to and necessary for the performance of the contract or subcontract, such as the following:

(1) *Labor.*—Reasonable fees of engineers employed in a general consulting capacity, and compensation of employees for personal services to the engineering department, such as supervision, which is properly chargeable to the contract or subcontract, but which is not chargeable as direct engineering labor (see paragraph (*c*) (3) of this section).

(2) *Material.*—Supplies for the engineering department, such as paper and ink for drafting and similar supplies.

(3) *Miscellaneous expenses.*—Expenses of the engineering department, such as (A) maintenance and repair of engineering equipment, and (B) services purchased outside of the engineering department for blue printing, drawing, computing, and like purposes.

(*g*) *Expenses of distribution, servicing, and administration.*—Expenses of distribution, servicing, and administration, which are treated in this section as a part of general expenses in determining the cost of performing a contract or subcontract (see paraagraph (*b*) of this section), comprehend the expenses incident to and necessary for the performance of the contract or subcontract, which are incurred in connection with the distribution and general servicing of the contracting party's products and the general administration of the business, such as—

(1) *Compensation for personal services of employees.*—The salaries of the corporate and general executive officers and the salaries and wages of administrative clerical employees and of the office services employees such as telephone operators, janitors, cleaners, watchmen, and office equipment repairmen.

(2) *Bidding and general selling expenses.*—Bidding and general selling expenses which by reference to all the pertinent facts and circumstances reasonably constitute a part of the cost of performing a contract or subcontract. The

treatment of bidding and general selling expenses as a part of general expenses in accordance with this paragraph is in lieu of any direct charges which otherwise might be made for such expenses. The term "bidding expenses" as used in this section includes all expenses in connection with preparing and submitting bids.

(3) *General servicing expenses.*—Expenses which by reference to all the pertinent facts and circumstances reasonably constitute a part of the cost of performing a contract or subcontract and which are incident to delivered or installed articles and are due to ordinary adjustments or minor defects; but including no items which are treated as a part of guarantee expenses (see paragraph (*h*) of this section) or as a part of direct costs, such as direct materials, direct labor, and other direct expense.

(4) *Other expenses.*—Miscellaneous office and administrative expenses, such as stationery and office supplies; postage; repair and depreciation of office equipment; contributions to local charitable or community organizations to the extent constituting ordinary and necessary business expenses; employees' welfare expenses; premiums and dues on compensation insurance; employers' payments to unemployment, old age, and social security Federal and State funds, not including payments deducted from or chargeable to employees or officers; pensions and retirement payments to administrative office employees and accident compensation to office employees (as to self-insurance, see the following subparagraph).

Subject to the exception stated in this subparagraph, in cases where a contracting party assumes its own insurable risks (usually termed "self-insurance"), losses and payments will be allowed in the cost of performing a contract or subcontract only to the extent of the actual losses suffered or payments incurred during, and in the course of, the performance of the contract or subcontract and properly chargeable to such contract or subcontract. If, however, a contracting party assumes its own insurable risks (*a*) for compensation paid to employees for injuries received in the performance of their duties, or (*b*) for unemployment risks in States where insurance is required, there may be allowed as a part of the cost of performing a contract or subcontract a reasonable portion of the charges set up for purposes of self-insurance under a system of accounting regularly employed by the contracting party, as determined by the Commissioner of Internal Revenue, at rates not exceeding the lawful or approved rates of insurance companies for such insurance, reduced by amounts representing the acquisition cost in such companies, provided the contracting party adopts and consistently follows this method with respect to self-insurance in connection with all contracts and subcontracts subsequently performed by him.

Allowances for interest on invested capital are not allowable as costs of performing a contract or subcontract.

Among the items which shall not be included as a part of the cost of performing a contract or subcontract or considered in determining such cost, are the following: Entertainment expenses; dues and memberships other than of regular trade associations; donations except as otherwise provided above; losses on other contracts; profits or losses from sales or exchanges of capital assets; extraordinary expenses due to strikes, or lockouts; fines and penalties; amortization of unrealized appreciation of values of assets; expenses, maintenance and depreciation of excess facilities (including idle land and building, idle parts of a building, and excess machinery and equipment) vacated or abandoned, or not adaptable for future use in performing contracts or subcontracts; increases in reserve accounts for contingencies, repairs, compensation insurance (except as above provided with respect to self-insurance) and guarantee work; Federal and State income and excess-profits taxes and surtaxes; cash discount earned up to 1 per cent of the amount of the purchase, except that all discounts on subcontracts subject to the Act will be considered; interest incurred or earned; bond discount or finance charges; premiums for life insurance on the lives of officers; legal and accounting fees in connection with reorganizations, security issues, capital stock issues, and the prosecution of claims against the United States (including income tax matters); taxes and expenses on issues and transfers of capital stock; losses on investments; bad debts; and expenses of collection and exchange.

In order that the cost of performing a contract or subcontract may be accounted for clearly, the amount of any excess profits repayable to the United States pursuant to the Act should not be charged to or included in such cost.

(*h*) *Guarantee expenses.*—Guarantee expenses include the various items of factory cost, other manufacturing cost, cost of installation and construction, indirect engineering expenses, and other general expenses (see paragraphs (*c*)

to (*g*), inclusive, of this section) which are incurred after delivery or installation of the article manufactured or constructed pursuant to the particular contract or subcontract and which are incident to the correction of defects or deficienices which the contracting party is required to make under the guarantee provisions of the particular contract or subcontract. If the total amount of such guarantee expenses is not ascertainable at the time of filing the report required to be filed with the collector of internal revenue (see section 26.16 of these regulations) and the contracting party includes any estimated amount of such expenses as part of the claimed total cost of performing the contract or subcontract, such estimated amount shall be separately shown on the report and the reasons for claiming such estimated amount shall accompany the report; but only the amount of guarantee expenses actually incurred will be allowed. If the amount of guarantee expenses actually incurred is greater than the amount (if any) claimed on the report and the contracting party has made an overpayment of excess profit, a refund of the overpayment shall be made in accordance with the provisions of section 26.19 of these regulations. If the amount of guarantee expenses actually incurred is less than the amount claimed on the report and an additional amount of excess profit is determined to be due, the additional amount of excess profit shall be assessed and paid in accordance with the provisions of section 26.19 of these regulations.

(*i*) *Unreasonable compensation.*—The salaries and compensation for services which are treated as a part of the cost of performing a contract or subcontract include reasonable payments for salaries, bonuses, or other compensation for services. As a general rule, bonuses paid to employees (and not to officers) in pursuance of a regularly established incentive bonus system may be allowed as a part of the cost of performing a contract or subcontract.

The test of allowability is whether the aggregate compensation paid to each individual is for services actually rendered incident to, and necessary for, the performance of the contract or subcontract, and is reasonable. Excessive or unreasonable payments whether in cash, stock, or other property ostensibly as compensation for services shall not be included in the cost of performing a contract or subcontract.

(*j*) *Allocation of indirect costs.*—No general rule applicable to all cases may be stated for ascertaining the proper proportion of the indirect costs to be allocated to the cost of performing a particular contract or subcontract. Such proper proportion depends upon all the facts and circumstances relating to the performance of the particular contract or subcontract. Subject to a requirement that all items which have no relation to the performance of the contract or subcontract shall be eliminated from the amount to be allocated, the following methods of allocation are outlined as acceptable in a majority of cases:

(1) *Factory indirect expenses.*—The allowable indirect factory expenses (see paragraph (*c*) (5) of this section) shall ordinarily be allocated or "distributed" to the cost of the contract or subcontract on the basis of the proportion which the direct productive labor (see paragraph (*c*) (2) of this section) attributable to the contract or subcontract bears to the total direct productive labor of the production department or particular section thereof during the period within which the contract or subcontract is performed, except that if the indirect factory expenses are incurred in different amounts and in different proportions by the various producing departments consideration shall be given to such circumstances to the extent necessary to make a fair and reasonable determination of the true profit and excess profit.

(2) *Engineering indirect expenses.*—The allowable indirect engineering expenses (see paragraph (f) of this section) shall ordinarily be allocated on "distributed" to the cost of the contract or subcontract on the basis of the proportion which the direct engineering labor attributable to the contract or subcontract (see paragraph (*c*) (3) of this section) bears to the total direct engineering labor of the engineering department or particular section thereof during the period within which the contract or subcontract is performed. If the expenses of the engineering department are not sufficient in amount to require the maintenance of separate accounts, the engineering indirect costs may be included in the indirect factory expenses (see paragraph (*c*) (5) of this section) and allocated or distributed to the cost of performing the contract or subcontract as a part of such expenses, provided the proportion so allocated or distributed is proper under the facts and circumstances relating to the performance of the particular contract or subcontract.

(3) *Administrative expenses (or "overhead").*—The allowable expenses of administration (see paragraph (*g*) of this section) or other general expenses

except indirect engineering expenses, bidding and general selling expenses, and general servicing expenses shall ordinarily be allocated or distributed to the cost of performing a contract or subcontract on the basis of the proportion which the sum of the manufacturing cost (see paragraph (*b*) of this section) and the cost of installation and construction (see paragraph (*e*) of this section) attributable to the particular contract or subcontract bears to the sum of the total manufacturing cost and the total cost of installation and construction during the period within which the contract or subcontract is performed.

(4) *Bidding, general selling, and general servicing expenses.*—The allowable bidding and general selling expenses and general servicing expenses (see paragraph (*g*) (2) and (3) of this section) shall ordinarily be allocated or distributed to the cost of performing a contract or subcontract on the basis of—

(i) The proportion which the contract price of the particular contract or subcontract bears to the total sales made (including contracts or subcontracts completed) during the period within which the particular contract or subcontract is performed, or

(ii) The proportion which the sum of the manufacturing cost (see paragraph (*b*) of this section) and the cost of installation and construction (see paragraph (*e*) of this section) attributable to the particular contract or subcontract bears to the sum of the total manufacturing cost and the total cost of installation and construction during the period within which the contract or subcontract is performed.

except that special consideration shall be given to the relation which certain classes of such expenses bear to the various classes of articles produced by the contracting party in each case in which such consideration is necessary in order to make a fair and reasonable determination of the true profit and excess profit. See section 26.14 of these regulations.

SEC. 26.10. *Credit for net loss or for deficiency in profit in computing excess profit.*—The term "net loss," as applied to contracts and subcontracts coming within these regulations, means the amount by which the cost of performing any such contract or subcontract completed by a particular contracting party within the income-taxable year exceeds the total contract price of such contract or subcontract. As to the meaning of income-taxable year, see section 26.1 of these regulations.

The term "deficiency in profit," as applied to contracts and subcontracts for the construction or manufacture of Army or Navy aircraft coming within these regulations, means the amount by which the allowable profit upon all such contracts and subcontracts completed by a particular contracting party within an income-taxable year exceeds the net profit upon all such contracts and subcontracts. For the purposes of this section, the term "allowable profit" means an amount equal to (A) 8 per cent of the total contract prices of all contracts (including prime contracts made on a cost-plus-a-fixed-fee basis) and subcontracts completed within the income-taxable year, or (B) an amount equal to 8.7 per cent of the total cost of performing such contracts (except prime contracts made on a cost-plus-a-fixed-fee basis) and subcontracts plus 8 per cent of the total contract prices of prime contracts made on a cost-plus-a-fixed-fee basis, which ever of such amounts (A) or (B) is the lesser.

A net loss or a deficiency in profit sustained by a contracting party with respect to contracts and subcontracts coming within these regulations and completed within 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 within the first succeeding income-taxable year. The amount of such credit is the sum of the following: (A) The total net loss on contracts and subcontracts for the construction or manufacture of naval vessels completed within an income-taxable year reduced by the excess of the net profit over the allowable profit on contracts and subcontracts for the construction or manufacture of Army or Navy aircraft completed within such year, and (B) the total deficiency in profit and the total net loss on contracts and subcontracts for the construction or manufacture of Army or Navy aircraft completed within such year reduced by the excess of the net profit over the allowable profit on all contracts and subcontracts for the construction or manufacture of naval vessels completed within such year. Any portion of such credit which is attributable to contracts or subcontracts for the construction or manufacture of naval vessels shall be applied against the excess profit before the portion, if any, attributable to contracts or subcontracts for the construction or manufacture of Army or Navy aircraft is so applied. If, after the application

of such credit, there is a remainder, the portion of the amount of such remainder which is attributable to contracts or subcontracts for the construction or manufacture of Army or Navy aircraft is allowable as a credit in computing the contracting party's excess profit on contracts or subcontracts coming within these regulations and completed during the next three 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 26.16 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. The net loss or deficiency in profit claimed is subject to verification and adjustment. As to preservation of books and records, see section 26.14 of these regulations.

Net loss or deficiency in profit sustained on contracts and subcontracts completed within one income-taxable year may not be considered in computing net loss or deficiency in profit sustained on contracts and subcontracts completed within another income-taxable year.

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

Example (1): On July 1, 1940, the A Corporation, which keeps its books and makes its Federal income tax returns on a calendar year basis, entered into the following contracts (none of which was on a cost-plus-a-fixed-fee basis) coming within these regulations:

(1) A contract for the construction of a naval vessel at a contract price of $100,000, which was completed in 1940 at a cost of $170,000.

(2) A contract for the construction of naval aircraft at a contract price of $200,000, which was completed in 1940 at a cost of $190,000.

(3) A contract for the construction of Army aircraft at a contract price of $300,000, which was completed in 1940 at a cost of $250,000.

(4) A contract for the construction of naval aircraft at a contract price of $500,000, which was completed in 1941 at a cost of $450,000.

On contract No. 1 the net loss was $70.000 ($170,000 minus $100,000) and, accordingly, there was no excess of the net profit over the allowable profit.

On contracts Nos. 2 and 3 the total of the contract prices was $500,000 and the total cost was $440,000, resulting in a net profit of $60,000. The allowable profit on such contracts was $38,280 (8.7 per cent of $440,000), which amount is less than $40,000 (8 per cent of $500,000). On such contracts the excess of the net profit ($60,000) over the allowable profit ($38,280) was $21,720, and there was no deficiency in profit because the allowable profit did not exceed the net profit.

The amount of allowable credit is $48,280, computed as follows:

Net loss on naval vessel contract (No. 1)	$70,000
Less: Excess of net profit over allowable profit on aircraft contracts (Nos. 2 and 3)	21,720
	48,280
Deficiency in profit and net loss on aircraft contracts (Nos. 2 and 3)	None
Less: Excess of net profit over allowable profit on naval vessel contract (No. 1)	None
Amount of allowable credit from year 1940	48,280

On the contract for naval aircraft completed in 1941 (No. 4), there was a net profit of $50,000 ($500,000 minus $450,000). The allowable profit on such contract was $39,150 (8.7 per cent of $450,000), which amount is less than $40,000 (8 per cent of $500,000). Accordingly, the excess of the net profit over the allowable profit was $10,850. Against this amount the credit of $48,280 from 1940 may be taken, with the result that there is no excess profit for the year 1941. The remainder of the credit of $48,280 may not be used in subsequent years because none of the credit was attributable to contracts or subcontracts for the construction or manufacture of Army or Navy aircraft.

Example (2): On July 1, 1940, the B Corporation, which keeps its books and makes its Federal income tax returns on a calendar year basis, entered into the following contracts (none of which was on a cost-plus-a-fixed-fee basis) coming within these regulations:

(1) A contract for the construction of a naval vessel at a contract price of $100,000, which was completed in 1940 at a cost of $120,000.

(2) A contract for the construction of Navy aircraft at a contract price of $200,000, which was completed in 1940 at a cost of $188,000.

(3) A contract for the construction of Army aircraft at a contract price of $300,000, which was completed in 1941 at a cost of $275,000.

(4) A contract for the construction of a naval vessel at a contract price of $400,000, which was completed in 1942 at a cost of $360,000.

On contract No. 1 the net loss was $20,000 ($120,000 minus $100,000) and, accordingly, there was no excess of the net profit over the allowable profit.

On contract No. 2 the net profit was $12,000 ($200,000 minus $188,000) and the allowable profit was $16,000 (8 per cent of $200,000), which amount is less than $16,356 (8.7 per cent of $188,000). Accordingly, on such contract there was a deficiency in profit of $4,000 ($16,000 minus $12,000). There was no excess of the net profit over the allowable profit, the latter being larger in amount.

The amount of allowable credit is $24,000, computed as follows:

Net loss on naval vessel contract (No. 1)		$20,000
Less: Excess of net profit over allowable profit on aircraft contract (No. 2)		None
		20,000
Deficiency in profit on aircraft contract (No. 2)	$4,000	
Net loss on aircraft contract (No. 2)	None	
	4,000	
Less: Excess of net profit over allowable profit on naval vessel contract (No. 1)	None	
		4,000
Amount of allowable credit from year 1940		24,000

On the contract for Army aircraft completed in 1941 (No. 3), there was a net profit of $25,000 ($300,000 minus $275,000). The allowable profit on such contract was $23,925 (8.7 per cent of $275,000), which amount is less than $24,000 (8 per cent of $300,000). Accordingly, the excess of the net profit over the allowable profit was $1,075. Against this amount the credit of $24,000 from 1940 may be taken, with the result that there is no excess profit for the year 1941. After applying such credit there is an unused remainder of the credit amounting to $22,925 ($24,000 minus $1,075).

On the Navy vessel contract completed in 1942 (No. 4) there was a net profit of $40,000 ($400,000 minus $360,000). The allowable profit on such contract was $31,320 (8.7 per cent of $360,000), which amount is less than $32,000 (8 per cent of $400,000). Accordingly, the excess of the net profit over the allowable profit is $8,680. Against this amount there may be taken as a credit such part of the unused remainder of the allowable credit from 1940 ($22,925) as is attributable to the contract for Navy aircraft (No. 2). Of the original credit of $24,000 from 1940, only $4,000 was attributable to contract No. 2, and hence $4,000 is the only part of the unused remainder ($22,925) which may be taken as a credit against the excess profit on contract No. 4.

SEC. 26.11. *Credit for Federal income taxes.*—For the purpose of computing the amount of excess profit to be paid to the United States, a credit is allowable against the excess profit for the amount of Federal income taxes paid or remaining to be paid on the amount of such excess profit. The "Federal income taxes," in respect of which this credit is allowable include the income taxes imposed by Chapter 1 and Subchapter A of Chapter 2 of the Internal Revenue Code, as amended, and the excess-profits taxes imposed by Subchapter B of Chapter 2 of the Internal Revenue Code, as amended. This credit is allowable for these taxes only to the extent that it is affirmatively shown that they have been finally determined and paid or remain to be paid and that they were imposed upon the excess profit against which the credit is to be made. In case such a credit has been allowed and the amount of Federal income taxes imposed upon the excess profit is redetermined, the credit previously allowed shall be adjusted accordingly.

SEC. 26.12. *Failure of contractor to require agreement by subcontractor.*—Every contract or subcontract coming within the scope of the Act and these regulations is required by the Act and the Act of March 27, 1934, as amended, to contain, among other things, an agreement by the contracting party to make no subcontract unless the subcontractor agrees—

(*a*) To make a report, as described in the Act of March 27, 1934, as amended, under oath to the Secretary of the department concerned upon the completion of the subcontract;

(*b*) To pay into the Treasury excess profit, as determined by the Treasury Department, in the manner and amounts specified in the Act;

(*c*) To make no subdivision of the subcontract for the same article or articles for the purpose of evading the provisions of the Act and the Act of March 27, 1934, as amended;

(*d*) That the manufacturing spaces and books of its own plant, affiliates, and subdivisions shall at all times be subject to inspection and audit as provided in the Act of March 27, 1934, as amended.

If a contracting party enters into a subcontract with a subcontractor who fails to make such agreement, such contracting party shall, in addition to its liability for excess profit determined on contracts or subcontracts performed by it, be liable for any excess profit determined to be due the United States on the subcontract entered into with such subcontractor. In such event, however, the excess profit to be paid to the United States in respect of the subcontract entered into with such subcontractor shall be determined separately from any contracts or subcontracts performed by the contracting party entering into the subcontract with such subcontractor.

SEC. 26.13. *Evasion of excess profit.*—The Act of March 27, 1934, as amended, provides that the contracting party shall agree to make no subdivisions of any contract or subcontract for the same article or articles for the purpose of evading its provisions. If any such subdivision or subcontract is made for the purpose of evading the provisions of the Act or the Act of March 27, 1934, as amended, it shall constitute a violation of the agreement, and the cost of completing a contract or subcontract by a contracting party which violates such agreement shall be determined in a manner necessary clearly to reflect the true excess profit of such contracting party.

SEC. 26.14. *Books of account and records.*—It is recognized that no uniform method of accounting can be prescribed for all contracting parties subject to the provisions of the Act and the Act of March 27, 1934, as amended. Each contracting party is required by law to make a report of its true profits and excess profit. Such party must, therefore, maintain such accounting records as will enable it to do so. See section 26.9 of these regulations. Among the essentials are the following:

(1) The profit or loss upon a particular contract or subcontract shall be accounted for and fully explained in the books of account separately on each contract or subcontract.

(2) Any cost accounting methods, however standard they may be and regardless of long continued practice, shall be controlled by, and be in accord with, the objectives and purposes of the Act and the Act of March 27, 1934, as amended, and of any regulations prescribed thereunder.

(3) The accounts shall clearly disclose the nature and amount of the different items of cost of performing a contract or subcontract.

In cases where it has been the custom in the past to use so-called "normal" rates of overhead expense or administrative expenses, or "standard" or "normal" prices of material or labor charges, no objection will be made to the use temporarily during the period of performing the contract or subcontract, if the method of accounting employed is such as clearly to reflect, in the final determination upon the books of account, the actual profit derived from the performance of the contract or subcontract and if the necessary adjusting entires are entered upon the books and they explain in full detail the revisions necessary to accord with the facts. As to the elements of cost, see section 26.9 of these regulations.

All books, records, and original evidences of costs (including, among other things, production orders, bills or schedules of materials, purchase requisitions, purchase orders, vouchers, requisitions for materials, standing expense orders, inventories, labor time cards, pay rolls, cost distribution sheets) pertinent to the determination of the true profit, excess profit, deficiency in profit or net loss from the performance of a contract or subcontract shall be kept at all times available for inspection by internal-revenue officers, and shall be carefully preserved and retained so long as the contents thereof may become material in the administration of the Act and the Act of March 27, 1934, as amended. This provision is not confined to books, records, and original evidences pertaining to items which may be considered to be a part of the cost of performing a contract or subcontract. It is applicable to all books, records, and original evidences of costs of each plant, branch, or department involved in the per-

formance of a contract or subcontract or in the allocation or distribution of costs to the contract or subcontract.

SEC. 2615. *Report to Secretary of department concerned.*—Upon the completion of a contract or subcontract coming within the scope of the Act and these regulations, the contracting party is required to make a report, under oath, to the Secretary of the department concerned. As to the date of completion of a contract or subcontract, see section 26.5 of these regulations. Such report shall be in the form prescribed by the Secretary of the department concerned and shall state the total contract price, the cost of performing the contract, the net income from such contract, and the per centum such income bears to the contract price and the cost of performing the contract. The contracting party shall also include as a part of such report a statement showing—

(1) the manner in which the indirect costs were determined and allocated to the cost of performing the contract or subcontract (see section 26.9 of these regulations);

(2) the name and address of every subcontractor with whom a subcontract was made, the object of such subcontract, the date when completed and the amount thereof; and

(3) the name and address of each affiliate or other organization, trade, or business owned or controlled directly or indirectly by the same interests as those who so own or control the contracting party, together with a statement showing in detail all transactions which were made with such affiliate or other organization, trade, or business and are pertinent to the determination of the excess profit.

A copy of the report required to be made to the Secretary of the department concerned is required to be transmitted by the contracting party to the Secretary of the Treasury. Such copy shall not be transmitted directly to the Secretary of the Treasury but shall be filed as a part of the annual report. See section 26.16 of these regulations.

SEC. 26.16. *Annual reports for income-taxable years.*—(*a*) *General requirements.*—Every contracting party completing a contract or subcontract within the scope of these regulations shall file with the collector of internal revenue for the collection district in which the contracting party's Federal income tax returns are required to be filed an annual report on the prescribed form of the profit and excess profit on all such contracts and subcontracts completed within the particular income-taxable year. There shall be included as a part of such report a statement, preferably in columnar form, showing separately for each such contract or subcontract completed by the contracting party within the income-taxable year the total contract price, the cost of performing the contract or subcontract, and the resulting profit or loss on each contract or subcontract, together with a summary statement showing in detail the computation of the net profit or net loss upon all contracts and subcontracts completed within the income-taxable year and the amount of the excess profit, if any, for the income-taxable year covered by the report. A copy of the report made to the Secretary of the department concerned (see section 26.15 of these regulations) with respect to each contract or subcontract covered in the annual report, shall be filed as a part of such annual report. In case the income-taxable year of the contracting party is a period of less than 12 months (see section 26.1 of these regulations), the report required by this section shall be made for such period and not for a full year.

(*b*) *Time for filing annual reports.*—Annual reports of contracts and subcontracts coming within the scope of the Act and these regulations completed by a contracting party within an income-taxable year must be filed on or before the 15th day of the ninth month following the close of the contracting party's income-taxable year. It is important that the contracting party render on or before the due date an annual report as nearly complete and final as it is possible for the contracting party to prepare. An extension of time granted the contracting party for filing its Federal income tax return does not serve to extend the time for filing the annual report required by this section. Authority consistent with authorizations for granting extensions of time for filing Federal income tax returns is hereby delegated to the various collectors of internal revenue for granting extensions of time for filing the reports required by this section. Application for extensions of time for filing such reports should be addressed to the collector of internal revenue for the district in

which the contracting party files its Federal income tax returns and must contain a full recital of the causes for the delay.

SEC. 26.17. *Payment of excess profit liability.*—The amount of the excess profit liability to be paid to the United States shall be paid on or before the due date for filing the report with the collector of internal revenue. See section 26.16 of these regulations. At the option of the contracting party, the amount of the excess profit liability may be paid in four equal installments instead of in a single payment, in which case the first installment is to be paid on or before the date prescribed for the payment of the excess profit as a single payment, the second installment on or before the 15th day of the third month, the third installment on or before the 15th day of the sixth month, and the fourh installment on or before the 15th day of the ninth month, after such date.

SEC. 26.18. *Liability of surety.*—The surety under contracts entered into with the Secretary of the department concerned for the construction or manufacture of any complete naval vessel or Army or Navy aircraft, or any portion thereof, shall not be liable for payment of excess profit due the United States in respect of such contracts.

SEC. 26.19 *Determination of liability for excess profit, interest and penalties; assessment, collection, payment, refunds.*—The duty of determining the correct amount of excess profit liability on contracts and subcontracts coming within the scope of the Act and these regulations is upon the Commissioner of Internal Revenue. Under section 3(b) of the Act of March 27, 1934, as last amended, all provisions of law (including the provisions of law relating to interest, penalties, and refunds) applicable with respect to the taxes imposed by Title I of the Revenue Act of 1934, and not inconsistent with section 3 of the Act of March 27, 1934, as last amended, are applicable with respect to the assessment, collection, or payment of excess profits on contracts and subcontracts coming within the scope of the Act and these regulations and to refunds of overpayments of profits into the Treasury under the Act. Claims by a contracting party for the refund of an amount of excess profit, interest, penalties, and additions to such excess profit shall conform to the general requirements prescribed with respect to claims for refund of overpayments of taxes imposed by Title I of the Revenue Act of 1934 and, if filed on account of any additional costs incurred pursuant to guarantee provisions in a contract, shall be supplemented by a statement under oath showing the amount and nature of such costs and all facts pertinent thereto.

Administrative procedure for the determination, assessment, and collection of excess profit liability under the Act and these regulations and the examination of reports and claims in connection therewith will be prescribed from time to time by the Commissioner of Internal Revenue.

SEC. 26.20. *Applicability of prior regulations.*—The regulations prescribed in Treasury Decision 4906 [C. B. 1939–2, 404] (sections 17.0 to 17.19, inclusive, Title 26, Code of Federal Regulations, 1939 Sup.) and Treasury Decision 4909 [C. B. 1939–2, 422] (sections 16.0 to 16.18, inclusive, Title 26, Code of Federal Regulations, 1939 Sup.) shall not apply to contracts entered into after June 28, 1940, and before July 1, 1942, nor to subcontracts made with respect to such contracts. To this extent such regulations are hereby superseded.

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved July 29, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

Approved August 2, 1940.

HENRY L. STIMSON,
Secretary of War.

Approved August 6, 1940.

FRANK KNOX,
Secretary of the Navy.

(Filed with the Division of the Federal Register August 7, 1940, 3.36 p. m.)

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Treatment of interest paid on indebtedness, the proceeds of which are used solely to acquire special additional equipment and facilities or working capital for the operation thereof, the cost, or portion of the cost, of which is borne by the Government and is chargeable against a contract or subcontract, for the purpose of determining the cost of performing a contract or subcontract coming within the scope of the provisions of section 3(b) of the Act of March 27, 1934, as amended, section 14 of the Act of April 3, 1939, or section 2(b) of the Act of June 28, 1940.

The regulations contained in section 17.9(*g*)4 of Treasury Decision 4906 (C. B. 1939–2, 404) and section 16.8(*g*)4 of Treasury Decision 4909 (C. B. 1939–2, 422) provide that interest incurred or earned shall not be considered in determining the cost of performing a contract or subcontract coming within the scope of section 3(b) of the Act of March 27, 1934, as amended, and section 14 of the Act of April 3, 1939, relating to excess profits on contracts and subcontracts for naval vessels or Army or Navy aircraft or any portion thereof. This provision of the regulations, prescribing a general rule as to interest, is not to be construed as preventing an annual allowance for reasonable interest (not in excess of 4 per cent per annum) paid on indebtedness, the proceeds of which are used solely to acquire special additional equipment and facilities, the cost, or portion of the cost, of which is borne by the Government and, pursuant to a certification made in accordance with the provisions of Executive Order 8465 and the Joint Rules issued thereunder (page 385, this Bulletin) and in accordance with the provisions of section 4 of the Act of June 28, 1940 (Public, No. 671, Seventy-sixth Congress, third session; page 490, this Bulletin), is chargeable against a contract or subcontract coming within the scope of such section 3(b) or section 14.

Such provision of the regulations is also not to be construed as preventing an annual allowance for reasonable interest (not in excess of 4 per cent per annum) paid on indebtedness in case such indebtedness is necessarily incurred to provide, and the proceeds of such indebtedness are used solely to provide, working capital for the operation of such special additional equipment and facilities, the cost, or portion of the cost, of which is borne by the Government and is so chargeable against such a contract or subcontract. No such allowance shall be made unless the contracting party keeps special accounts on his books and special bank accounts clearly showing such use of the funds in the performance of such contracts and subcontracts.

An annual allowance under the preceding paragraphs for interest paid on any indebtedness shall be reduced by all interest earned within the year on the proceeds of such indebtedness.

Interest allowable under the provisions of the preceding paragraphs shall be treated as an indirect factory expense and be allocated to the cost of performing a particular contract or subcontract in accordance with the provisions of the regulations relating to the allocation of indirect factory expense.

The provisions of the preceding paragraphs are equally applicable in determining the cost of performing contracts and subcontracts coming within the scope of section 2(b) of the Act of June 28, 1940 (Public, No. 671, Seventy-sixth Congress, third session; page 490, this Bulletin), relating to payment into the Treasury of profit in excess of the specified 8 per cent and 8.7 per cent.

ALCOHOL TAX.

REGULATIONS 5 (1940), SECTIONS 184.58, 184.121, 184.142, 184.148, 184.149, 184.150, 184.246, 184.255, 184.256, 184.296, 184.310, and 184.412. 1940–42–10457 T. D. 5012

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 184.—PRODUCTION OF BRANDY.[1]

Amending Regulations 5.

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

To District Supervisors, Collectors of Internal Revenue, and others Concerned:

Section 213 of the Act of June 25, 1940 (Public, No. 656, Seventy-sixth Congress), is as follows:

(a) Section 2800 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsections:

"(g) DEFENSE TAX FOR FIVE YEARS.—In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
2800(a)(1)	Distilled spirits generally	$2.25	$3.00
2800(a)(1)	Brandy	$2.00	2.75
*	* * *	*	* *

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Pursuant to the foregoing provision of law, sections 2802(a), 2812, 3037, 3176, and 3254(g) of the Internal Revenue Code, and sections 3 and 6 of the Federal Alcohol Administration Act, as amended (27 U. S. C. Sup., 203, 206), section 184.80 of Regulations 5 is hereby revoked, and the title of Article X and sections 184.58, 184.121(*a*), (*b*), 184.142, 184.148, 184.149, 184.150, 184.246, 184.255, 184.256, 184.296, 184.310, and 184.412 of the said regulations are hereby amended to read as follows:

ARTICLE X.—FEDERAL ALCOHOL ADMINISTRATION ACT PERMIT.

SEC. 184.58. *Permit required.*—Under the Federal Alcohol Administration Act and the regulations issued pursuant thereto (27 CFR, Part 1), any person, except an agency of a State or political subdivision thereof, or any officer or employee of any such agency, intending to engage in the business of producing brandy, is required to procure a permit therefor. (Sec. 3, 49 Stat., 978; 27 U. S. C. Sup., 203.)

SEC. 184.121. *Change in individual, firm, or corporate name.*—Where there is a change in the individual, firm, or corporate name of the distiller, he must comply with the following requirements:

(*a*) *Amended permit.*—Procure from the district supervisor under the Federal Alcohol Administration Act an amended basic permit authorizing operation of the distillery under the new name.

(*b*) *Amended notice, Form 27½.*—Submit to the district supervisor an amended notice on Form 27½, in triplicate, covering the new name, which

[1] The asterisk at end of sections refers to section 3176 of the Internal Revenue Code.

notice must be approved before operations may be commenced under the new name.

SEC. 184.142. *Examination of other qualifying documents.*—Upon receipt of notice, plat, plans, bond, and other documents required by these regulations of persons intending to qualify as fruit distillers, the district supervisor will examine the same to determine whether they have been properly executed, and whether they reflect compliance with the requirements of the law and regulations. Where any required document has not been filed, or where errors or discrepancies are found in those filed, or where the documents filed do not reflect compliance with these regulations, action thereon will be held in abeyance until the omission, or error, or discrepancy has been rectified, and there has been full compliance with all requirements.*

SEC. 184.148. *Approval of qualifying documents.*—If the district supervisor finds, upon examination of the inspection report, that the person seeking to qualify as a fruit distiller has complied in all respects with the requirements of law and these regulations, and the distiller's bond (Form 30½) may properly be approved under section 184.147, and if the applicant is entitled to a permit, he will note his recommendation for approval on all copies of the bond and notice, and his approval on all copies of the plat and plans, and will forward all copies of the bond and notice and the original copy of the plat, plans, and other qualifying documents, together with a copy of all inspection reports, to the Commissioner for final action. The issuance of a permit should be withheld pending approval by the Commissioner of the notice, bond, and other qualifying documents required under the internal revenue laws.*

SEC. 184.149. *Disapproval of qualifying documents.*—If the district supervisor finds that the applicant has not complied in all respects with the requirements of the law and regulations, or that the situation of the distillery is such as would enable the distiller to defraud the United States, or if the bond should be disapproved under section 184.147, he will note his recommendation for disapproval on the bond, and will forward to the Commissioner for final action such copies of the qualifying documents as are required to be so forwarded by the preceding section in the case of recommendation for approval, together with a copy of all inspection reports. Where a bond is recommended for disapproval, the district supervisor will furnish the Commissioner with a full statement of the reasons therefor. If the applicant is not entitled to a permit, the district supervisor will, upon disapproval of the application therefor, return all copies of the qualifying documents to the applicant without action thereon or reference to the Commissioner.*

SEC. 184.150. *Disposition of qualifying documents.*—Where the distiller's bond (Form 30½), notice (Form 27½), and special application (Form 1613), if any, are approved by the Commissioner, the district supervisor will, upon receipt of approved copies of such documents from the Commissioner, as provided in Article XVIII, forward one copy of the bond, special application, if any, notice, plat, plans, and other qualifying documents to the distiller and will retain one copy of such qualifying documents for the file of such distiller. The extra copy of the special application (Form 1613), if any, received from the Commissioner will be placed by the district supervisor in the file of the rectifier. If the bond and special application, if any, are disapproved, the district supervisor will, upon receipt from the Commissioner of the disapproved copies of such documents and other qualifying documents submitted therewith, return all copies of the qualifying documents to the proprietor, with advice as to the reasons for disapproval.*

SEC. 184.246. *Rate of tax.*—The law imposes a tax on distilled spirits produced in or imported into the United States at the rate of $3 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid when withdrawn from bond, except brandy distilled at less than 190 degrees proof, on which the tax is imposed at the rate of $2.75 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon. Spirits distilled from fruit at a proof of 190 degrees or over (spirits—fruit) are subject to the tax at the higher rate. (*; Sec. 2800(a), I. R. C., as amended.)

SEC. 184.255. *Unfinished spirits.*—The distiller may take samples of brandy or fruit spirits in the course of distillation for laboratory analysis. Each sample may not exceed one-half pint, unless it is shown that such is an insufficient quantity for the purpose for which the sample is desired, and the Commissioner authorizes the taking of a larger sample, not to exceed 1 pint. The

total number of samples must be restricted to the minimum necessary to accomplish the purpose of the laboratory analysis. (*; Sec. 3037, I. R. C.)

SEC. 184.256. *Finished spirits.*—The distiller may take from the receiving tanks of the distillery samples of brandy or fruit spirits for laboratory analysis. Such samples may not exceed 1 pint for each distillation of each kind of brandy or fruit spirits produced daily, unless it is shown that such is an insufficient quantity for the purpose for which the sample is desired, and the Commissioner authorizes the taking of a larger sample, not to exceed 1 quart. (*; Sec. 3037, I. R. C.)

SEC. 184.296. *Issuance of tax-paid stamps.*—The collector will issue the tax-paid stamps. Each tax-paid stamp shall bear the signature of the collector, who shall write or stamp thereon the date of payment of the tax, by whom paid, the number of gallons and tenths of gallons of proof spirits, and the serial number of the cask. Facsimile signatures of collectors may be affixed by the use of hand stamps to the tax-paid stamps, care being taken to use only such ink as will neither fade nor blur. The collector will enter the serial numbers of the stamps in the appropriate spaces on all copies of Forms 179 and 1520, sign the certificate of tax-payment on each copy of Form 179, retain one copy each of Form 179 and Form 1520, and return the remaining three copies of Form 179 and two copies of Form 1520 to the distiller with the stamps. (*; Sec. 2802(a), I. R. C.)

SEC. 184.310. *Mixing of different spirits prohibited.*—Brandy or fruit spirits produced by two or more distillers shall not be mingled in a storage tank; nor shall brandy or fruit spirits produced from one kind of fruit or berry be so mingled with brandy or fruit spirits produced from another kind of fruit or berry; nor shall brandy and fruit spirits distilled from the same kind of fruit or berry, or brandies which differ in kind according to the standards of identity established under the Federal Alcohol Administration Act, be mingled in a storage tank; nor shall brandy or fruit spirits distilled from the same kind of fruit or berry during different distilling seasons, or brandy distilled at proofs differing more than 10 degrees, be so mingled. (*; Sec. 3254(g), I. R. C.)

SEC. 184.412. *Bulk containers.*—Under the regulations issued pursuant to the Federal Alcohol Administration Act (27 CFR, Part 3), fruit distillers may sell or dispose of brandy in bulk, that is, containers having a capacity in excess of 1 wine gallon, (1) to other distillers and proprietors of internal revenue bonded warehouses, industrial alcohol plants and industrial alcohol bonded warehouses, including those operating tax-paid bottling houses; (2) to proprietors of class 8 customs bonded warehouses; (3) to rectifiers; (4) to wine-makers (brandy or alcohol) for fortification of wine; (5) to any agency of the United States or of any State or political subdivision thereof; (6) for export; (7) on warehouse receipts, conforming to the regulations issued under the Federal Alcohol Administration Act, for distilled spirits in internal revenue bonded warehouses; and (8) for industrial use, as follows: For experimental purposes, and in the manufacture (*a*) of medicinal, pharmaceutical, and antiseptic products, including prescriptions compounded by retail druggists; (*b*) of toilet products; (*c*) of flavoring extracts, sirups, or food products; or (*d*) of scientific, chemical, mechanical, or industrial products; provided such products are unfit for beverage use. Fruit distillers may not, under the regulations issued pursuant to the Federal Alcohol Administration Act (27 CFR, Part 3), sell or dispose of brandy (not including spirits—fruit) in bulk for industrial use unless such brandy is shipped or delivered directly to the industrial user thereof. (Sec. 6, 49 Stat., 985; 27 U. S. C. Sup., 206.)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved October 5, 1940.

D. W. BELL,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register October 8, 1940, 8.06 p. m.)

REGULATIONS 15 (1940), SECTIONS 190.68, 190.108, etc. 1940–35–10403 T. D. 5004

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 190.—RECTIFICATION OF SPIRITS AND WINES.

Amending Regulations 15.

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

To District Supervisors, Collectors of Internal Revenue, and Others Concerned:

Section 2803(c) of the Internal Revenue Code, as amended by section 1 of the Act of June 24, 1940 (Public, No. 654, Seventy-sixth Congress), reads as follows:

(c) UNUSED STAMPS; EXCHANGE, REFUND, ETC.—The Commissioner of Internal Revenue, under regulations prescribed by him and approved by the Secretary of the Treasury, may redeem or make allowance for any unused stamps issued under section 203 of the Liquor Taxing Act of 1934 or subsection (b) of this section by exchanging them for other stamps of the same kind or by refunding moneys received therefor: *Provided*, That stamps may be exchanged or the value thereof refunded only in quantities of the value of $5 or more: *And provided further*, That no claim for the exchange of strip stamps or refund therefor shall be allowed unless presented within two years after the date on which such stamps were lawfully issued. There are hereby authorized to be appropriated annually, out of any money in the Treasury not otherwise appropriated, such sums as may be necessary to carry out this provision.

Section 3 of the Act of June 24, 1940 (Public, No. 654, Seventy-sixth Congress), reads as follows:

SEC. 3. Notwithstanding the limitations contained in sections 2803(c) and 2903(e), Internal Revenue Code, as amended and inserted, respectively, by this Act, as to the time within which claims under such sections must be presented, claims under such sections for the exchange of or refund for stamps lawfully issued prior to the date of enactment of this Act may be allowed if presented within two years from the date of enactment of this Act.

Section 1650 of the Internal Revenue Code, added by section 210 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress), reads as follows:

(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading "Defense-Tax Rate":

"Section.	Description of tax.	Old rate.	Defense-tax rate.
*	* * *	*	* *
3250(f)(1)	Rectifiers	$200	$220
3250(f)(1)	Rectifiers	$100	$110

* * * * * * *

Section 3190 of the Internal Revenue Code, added by section 214 of the Revenue Act of 1940 (Public, No. 656, Seventy-sixth Congress), reads as follows:

In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the

period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading "Defense-Tax Rate":

"Section.	Description of tax.	Old rate.	Defense-tax rate.
		Cents.	*Cents.*
3030(a)(1)(A)	Still wines	5	6
3030(a)(1)(A)	Still wines	15	18
3030(a)(1)(A)	Still wines	25	30
3030(a)(2)	Sparkling wines	2½	3
3030(a)(2)	Sparkling wines	1¼	1½
3030(a)(2)	Liqueurs, cordials, etc	1¼	1½
*	* * *	*	* *

Pursuant to the foregoing provisions of law and to sections 2801, 2803(d), 2871, 3030(a), and 3176 of the Internal Revenue Code, and section 5(e) of the Federal Alcohol Administration Act, as amended (27 U. S. C., Sup., 205), section 190.68 of Regulations 15 is hereby revoked, and sections 190.108 (a), (b), 190.120, 190.130, 190.131, 190.132, 190.157, 190.158, 190.220, 190.267, 190.268, 190.270, 190.272, 190.290, 190.341, 190.349, 190.360, 190.403, 190.408, and 190.469 of the said regulations are hereby amended to read as follows:

SEC. 190.108. *Change in individual, firm, or corporate name.*—Where there is a change in the individual, firm, or corporate name of the rectifier, he must comply with the following requirements:

(*a*) *Amended permit.*—Procure from the district supervisor under the Federal Alcohol Administration Act an amended basic permit authorizing operation of the rectifying plant under the new name.

(*b*) *Amended notice, Form 27–B.*—Submit to the district supervisor an amended notice on Form 27–B, in triplicate, covering the new name.

SEC. 190.120. *Examination of other qualifying documents.*—Upon receipt of the notice, plat, plans, bond, and other documents required by these regulations of persons intending to qualify as rectifiers, the district supervisor will examine the same to determine whether they have been properly executed, and whether they reflect compliance with the requirements of the law and regulations. Where any required document has not been filed, or where errors or discrepancies are found in those filed, or where the documents filed do not reflect compliance with these regulations, action thereon will be held in abeyance until the omission, or error or discrepancy, has been rectified, and there has been full compliance with all requirements.*

SEC. 190.130. *Approval of qualifying documents.*—If the district supervisor finds, upon examination of the inspection report, that the person seeking to qualify as a rectifier has complied in all respects with the requirements of law and these regulations, and the rectifier's bond, Form 34, may properly be approved under section 190.129, and if the applicant is entitled to a permit, he will note his recommendation for approval on all copies of the bond and notice, and his approval on all copies of the plat and plans, and will forward all copies of the bond and notice, and the original copy of the plat and plans, and other qualifying documents, together with a copy of all inspection reports, to the Commissioner for final action. The issuance of a permit should be withheld pending approval by the Commissioner of the notice, bond, and other qualifying documents required under the internal revenue laws.*

SEC. 190.131. *Disapproval of qualifying documents.*—If the district supervisor finds that the applicant has not complied in all respects with the requirements of the law and regulations, or that the situation of the rectifying plant is such as would enable the rectifier to defraud the United States, or the bond should be disapproved under section 190.129, he will note his recommendation for disapproval on the bond, and will forward to the Commissioner for final action such copies of the qualifying documents as are required to be so forwarded by the preceding section in the case of recommendation for approval, together with a copy of all inspection reports. Where a bond is recommended for disapproval, the district supervisor will furnish the Commissioner with a full statement of the reasons therefor. If the applicant is not entitled to a permit, the district supervisor will, upon disapproval of the application therefor, return all copies

of the qualifying documents to the applicant without action thereon or reference to the Commissioner.*

SEC. 190.132. *Disposition of qualifying documents.*—Where the rectifier's bond, Form 34, notice, Form 27–B, and special application, Form 1613, if any, are approved by the Commissioner, the district supervisor will, upon receipt of approved copies of such documents from the Commissioner, as provided in Article XVIII, forward one copy of the bond, notice, special application, plat, plans, and other qualifying documents to the rectifier and will retain one copy of such qualifying documents for the file. The extra copy of the special application, Form 1613, if any, received from the Commissioner will be placed by the district supervisor in the file of the distiller. If the rectifier's bond, or special application, is disapproved, the district supervisor will, upon receipt from the Commissioner of the disapproved copies of such documents and other qualifying documents submitted therewith, return all copies of the qualifying documents to the proprietor, with advice as to the reasons for such disapproval.*

SEC. 190.157. *Rectifier's special tax.*—Every person engaged in business as a rectifier, within the meaning of the term as defined in Article IV, must file Form 11 with the collector and pay special tax as such. Persons rectifying less than 500 barrels a year, counting 40 proof gallons to the barrel (i. e., less than 20,000 proof gallons), must pay special tax at the rate of $110 per year, and persons rectifying 500 barrels or more a year (i. e., 20,000 proof gallons or more) must pay special tax at the rate of $220 per year. (*; Secs. 1650(a), 3250(f)(1), I. R. C.)

SEC. 190.158. *Change to higher or lower rate.*—A rectifier who has paid the special tax as a rectifier of less than 500 barrels and who exceeds that quantity must immediately pay the special tax due at the higher rate ($220 per year) to the collector for the full period, and obtain a new special tax stamp. The rectifier may submit the stamp representing the special tax paid at the lower rate to the collector with a claim on Form 843 for redemption thereof. A rectifier who has paid special tax at the higher rate, but actually rectifies less than 500 barrels of spirits during the year, may likewise procure a new special tax stamp at the lower rate ($110) and submit the stamp representing the tax paid at the higher rate to the collector with a claim on Form 843 for redemption thereof. (*; Secs. 1650(a), 3250(f)(1), 3304, I. R. C.)

SEC. 190.220. *Additional wine tax.*—Where the taxable grade of wine is increased by blending, additional gallonage wine tax must be paid on the resultant product representing the difference between the tax originally paid on the wine and the tax due on the blended product, as provided in Article XXIX. For example, if 100 gallons of wine containing 20 per cent alcohol, on which wine tax in the amount of $18 has been paid, are blended with 100 gallons of wine containing 12 per cent alcohol, on which wine tax in the sum of $6 has been paid, making a total wine tax paid on the two wines of $24, and the resultant product contains 16 per cent alcohol, the wine tax on which would amount to $36, additional wine tax of $12 must be paid on the blended product, regardless of whether or not the 30-cent rectifying tax is incurred by the blending. (*; Secs. 3030(a), 3190, I. R. C.)

SEC. 190.267. *Vermouth.*—Vermouth made at a rectifying plant, which is subject to the rectifying tax of 30 cents per proof gallon imposed by section 2800(a)(5), I. R. C., is in addition thereto subject to the tax imposed upon vermouth by section 3030(a)(1), as amended by section 3190, I. R. C., which tax is as follows:

(*a*) On vermouth containing not more than 14 per centum of absolute alcohol, 6 cents per wine gallon, the per centum of alcohol to be reckoned by volume and not by weight;

(*b*) On vermouth containing more than 14 per centum and not exceeding 21 per centum of absolute alcohol, 18 cents per wine gallon;

(*c*) On vermouth containing more than 21 per centum and not exceeding 24 per centum of absolute alcohol, 30 cents per wine gallon;

(*d*) All vermouth containing more than 24 per centum of absolute alcohol by volume (except vermouth containing tax-paid sweet wine, citrus-fruit wine, peach wine, cherry wine, berry wine, apricot wine, prune wine, plum wine, pear wine, or apple wine, fortified, respectively, with grape brandy, citrus-fruit brandy, peach brandy, cherry brandy, berry brandy, apricot brandy, prune brandy, plum brandy, pear brandy, or apple brandy) shall be classed as distilled spirits and shall be taxed accordingly.*

SEC. 190.268. *Liqueurs, cordials, etc., taxable under section 3030(a)(2), I. R. C.*—Section 3030(a)(2), as amended by section 3190, I. R. C., imposes a tax on certain products of rectification, as follows:

On each bottle or other container of liqueurs, cordials, or similar compounds, by whatever name sold or offered for sale, containing sweet wine, citrus-fruit wine, peach wine, cherry wine, berry wine, apricot wine, prune wine, plum wine, pear wine, or apple wine, fortified, respectively, with grape brandy, citrus-fruit brandy, peach brandy, cherry brandy, berry brandy, apricot brandy, prune brandy, plum brandy, pear brandy, or apple brandy, 1½ cents on each one-half pint or fraction thereof. Liqueurs, cordials, and similar compounds on which a tax is imposed and paid under section 3030(a)(2), as amended by section 3190, I. R. C., are exempt from the 30-cent rectification tax. By "liqueurs, cordials, or similar compound" is meant those products that contain not less than 2½ per cent by weight of sweetening material and possess the taste, aroma, and characteristics generally attributed to liqueurs and cordials.*

SEC. 190.270. *Carbonated and sparkling wines.*—The carbonating of *tax-paid wines*, either by secondary fermentation of the wine within the bottle or container or by charging the wine artificially with carbon dioxide, must be done at a rectifying plant. The carbonated wine is subject to the rectification tax of 30 cents per proof gallon, and, in addition thereto, the tax imposed by section 3030(a)(2), as amended by section 3190, I. R. C., upon sparkling wine, or artificially carbonated wine, as the case may be, must be paid. This tax is as follows:

(*a*) On each bottle or other container of champagne or sparkling wine, 3 cents on each one-half pint or fraction thereof;

(*b*) On each bottle or other container of artificially carbonated wine, 1½ cents on each one-half pint or fraction thereof;

(*c*) Any of the foregoing articles containing more than 24 per centum of absolute alcohol by volume shall be classed as distilled spirits and shall be taxed accordingly.*

SEC. 190.272. *Blended wines.*—Any blending of tax-paid wines by rectifiers, except the blending of domestic tax-paid wines for the sole purpose of perfecting such wines according to recognized commercial standards, subjects the resultant product to the 30-cent rectification tax. Where the taxable class of wine is increased by blending wines with each other, additional wine tax due on the blended wines must be paid, regardless of whether or not the 30-cent rectification tax is incurred by such blending. This additional wine tax represents the difference between the wine tax due on the blended wine under its new classification and the tax previously paid on the wines used for such blending. Section 3030(a)(1), as amended by section 3190, I. R. C., imposes a tax upon all still wines, and all artificial or imitation wines or compounds sold as still wine, at the following rates:

(*a*) On wines containing not more than 14 per centum of absolute alcohol, 6 cents per wine gallon, the per centum of alcohol to be reckoned by volume and not by weight;

(*b*) On wines containing more than 14 per centum and not exceeding 21 per centum of absolute alcohol, 18 cents per wine gallon;

(*c*) On wines containing more than 21 per centum and not exceeding 24 per centum of absolute alcohol, 30 cents per wine gallon;

(*d*) All such wines containing more than 24 per centum of absolute alcohol by volume shall be classed as distilled spirits and shall be taxed accordingly.*

SEC. 190.290. *Approval by officer assigned to plant.*—If the officer assigned to the plant is satisfied that Form 237 covers lawful, tax-paid spirits and is correctly executed, he will, after ascertaining from the approved formula the rate of tax applicable, note his approval on each copy of the form, subject to payment of tax, filling in the date of approval and the tax or taxes to which the spirits are subject, as "Tax at 30 cents per proof gallon," "Tax at _____ cents per wine gallon," and "Tax at _____ cents per half-pint or fraction thereof in each bottle," as the case may be (see Article XXIX). The officer will then return all copies of Form 237 to the rectifier.*

SEC. 190.341. *Gauge.*—When preparing application for the dumping of spirits for bottling without rectification, the rectifier will enter in the space provided therefor on Form 230 the details of the withdrawal gauge for tax-payment. An actual gauge of the spirits dumped will, however, be made in the bottling tank after they have been reduced to bottling proof, where such reduction is permissible, and before they are released by the Government officer for bottling, and the details of such gauge will be entered in the space provided therefor

on the form. Where spirits are to be bottled from the original package, as provided in section 190.347, the details of the withdrawal gauge for taxpayment will likewise be entered on Form 230 at the time the application is prepared, but an actual gauge will be made before the bottling begins and the details of such gauge will also be entered on the form.*

SEC. 190.349. *Transfer of products to wine bottling room.*—Where the rectifier desires to bottle from the original package wines, cordials, or liqueurs authorized by the district supervisor to be so bottled, such packages will be placed in the wine bottling room and Form 230 will be prepared and submitted to the Government officer assigned to the rectifying plant, or to the district supervisor or designated officer, for approval; but no bottling will be done until the packages have been inspected by an authorized Government officer and an actual gauge of the spirits has been made and the details of such gauge entered on Form 230. When wines, cordials, or liqueurs are to be bottled in the wine bottling room, the rectifier will attach one copy of the approved Form 230 to the door of such room.*

SEC. 190.360. *Rebottling, relabeling, and restamping of bottled spirits.*—Where distilled spirits packaged in bottles are to be rebottled for domestic sale, the bottles, if of a capacity of one-half pint or greater and not exceeding 1 gallon, must conform to the requirements of Regulations 13 (26 CFR, Part 175). The new label must be covered by an appropriate certificate of label approval or a certificate of exemption from label approval. If the new label is covered by a certificate of exemption from label approval it must conform to the requirements of Regulations 13. If the spirits have left the possession of the original bottler and are to be relabeled without rebottling, authorization to relabel the spirits must be obtained in accordance with regulations issued under the Federal Alcohol Administration Act and submitted to the Government officer assigned to the plant, or to the district supervisor or other designated approving officer. Whenever bottled distilled spirits are dumped for rebottling, the red strip stamps on the bottles must be destroyed at the time of dumping, and new red strip stamps must be affixed to the bottles in which the spirits are rebottled. (*; Secs. 2803, as amended, 2871, I. R. C.)

SEC. 190.403. *Exchange and redemption of stamps.*—Unused red strip stamps, in quantities of the value of $5 or more, issued under section 203 of the Liquor Taxing Act of 1934 or subsection (b) of section 2803, Internal Revenue Code, may be exchanged for other stamps of the same kind and in any prescribed denomination, or the value thereof may be refunded, provided that a claim for such exchange or refund, establishing the lawful issuance and ownership of the stamps, is filed with the collector of internal revenue who issued the stamps (1) within two years after the date on which such stamps were lawfully issued or (2) if the stamps were lawfully issued prior to June 24, 1940, within two years from the latter date: *Provided, however,* That the value of unused stamps which have been destroyed may be refunded upon the filing of a claim as provided herein with proof to the satisfaction of the Commissioner of the destruction of the stamps. Claims for exchange of stamps will be filed on Form 1579 and claims for refund of the value of stamps on Form 843, in accordance with procedure prescribed by the Commissioner. (*; Sec. 2803, I. R. C., as amended; Sec. 3, Act of June 14, 1940 (Public, No. 654, Seventy-sixth Congress).)

SEC. 190.408. *Withholding release of spirits.*—Where rectifiers of distilled spirits are found to be using labels other than those covered by a certificate of approval of labels or a certificate of exemption from label approval, or to be affixing labels covered by such certificates to spirits which do not conform to such labels, or where rectifiers bottling spirits imported in bulk do not have in their possession such certificates of origin, age, and class and type as are required, the officer will withhold release of the spirits and will make a report of the facts to the district supervisor, accompanied by copies of the labels in question. (Sec. 595, 49 Stat., 1965; 27 U. S. C., Supp., 205.)

SEC. 190.469. *Disposition of red strip stamps.*—All unused red strip stamps, if any, belonging to the proprietor at the time of permanent discontinuance of business will be inventoried by denomination, serial number, and quantity, by the storekeeper-gauger or other officer designated by the district supervisor to perform such duty. The officer will deliver such stamps to the proprietor and take his receipt therefor, in triplicate. When delivering the stamps the officer will advise the proprietor that the value of the stamps, if in quantities of the value of $5 or more, may be refunded, provided that a claim for such refund on Form 843, establishing the lawful issuance and ownership of the stamps, is filed with the collector of internal revenue who issued the stamps

(1) within two years after the date on which such stamps were lawfully issued or (2) if the stamps were lawfully issued prior to June 24, 1940, within two years from the latter date; or that such unused stamps may be destroyed in the presence of the Government officer and the proprietor thereby relieved from further accountability for the stamps. If the stamps are not surrendered to the collector for refund of their value or are not destroyed, the proprietor must account for the stamps each month by rendering Form 96, in duplicate, to the district supervisor. The officer shall make a notation on the receipt as to the disposition made or to be made of the stamps. One copy of the receipt will be delivered to the proprietor and the original and one copy will be delivered to the district supervisor, who will forward the original to the Commissioner. (*; Sec. 2803, I. R. C., as amended; Sec. 3, Act of June 24, 1940 (Public, No. 654, Seventy-sixth Congress).)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved August 21, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register August 24, 1940, 11.01 a. m.)

REGULATIONS 18 (1940), SECTION 192.113: Application of surety for relief from bond. 1940–36–10413 T. D. 5005

TITLE 26—INTERNAL REVENUE.—CHAPTER I, PART 192.—FERMENTED MALT LIQUORS.

Application of surety for relief from bond.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, D. C.

To District Supervisors and Others Concerned:

Section 192.113 of Regulations 18 (Part 192, Title 26, Code of Federal Regulations, 1940 Sup.) is amended to read as follows:

SEC. 192.113. *Application of surety for relief from bond.*—A surety on any bond required by these regulations may at any time in writing notify the principal and the district supervisor in whose office the bond is on file that he desires after a date named, which shall be at least 60 days after the date of the notification, to be relieved of liability under said bond. The notice shall be executed in triplicate by the surety, who shall deliver one copy to the principal and the other two to the district supervisor, who will retain one copy and transmit the remaining copy to the Commissioner. If such notice is not thereafter in writing withdrawn, the rights of the principal as supported by said bond shall be terminated on the date named in the notice, and the surety shall be relieved, in the case of a brewer's bond, Form 1566, from liability for fermented liquor produced wholly subsequent to the date named in the notice. This notice may not be given by an agent of the surety unless it is accompanied by a power of attorney, duly executed by the surety, authorizing him to give such notice, or by a verified statement that such power of attorney is on file with the Department.

(This Treasury decision is prescribed pursuant to the authority conferred by section 3176 of the Internal Revenue Code.)

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved August 27, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register August 29, 1940, 4.01 p. m.)

1940–53–10548
T. D. 5026

Amending the Gauging Manual.

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

To District Supervisors and Others Concerned:

By virtue of and pursuant to the provisions of sections 2878 and 2883, Internal Revenue Code, paragraph 48 of the Gauging Manual, approved November 21, 1938, is hereby amended to read as follows:

PAR. 48. In lieu of the marks and brands required by paragraphs 55, 56, and 57, when brandy is to be removed in packages from a distillery or from a storage tank in an internal revenue bonded warehouse, immediately and directly to the fortifying room of a winery on contiguous premises under the immediate supervision of the storekeeper-gauger, there will be legibly cut or stenciled upon the head of the package in figures and letters large enough to be easily read, the gross weight, tare, net weight, wine gallons, proof, proof gallons (retaining fractions of gallons in all instances to hundredths), the serial number of the package, the name of the distiller, the registered number of the distillery, the city or town and State in which the distillery is located, the kind of cooperage, and the date the package is filled. The date of original entry for deposit must also be cut or stenciled on the head of packages filled from warehouse storage tanks. The kind, in accordance with paragraph 60 (*b*) and (*f*) of this Manual, will also be cut or stenciled on the head of the package in letters not less than 1 inch in height.

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved December 21, 1940.

HERBERT E. GASTON,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 26, 1940, 10.10 a. m.)

1940–42–10458
T. D. 5013

Amending the Gauging Manual.

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

To District Supervisors and Others Concerned:

By virtue of and pursuant to the provisions of sections 2808 and 3176, Internal Revenue Code, paragraph 85 of the Gauging Manual, approved November 21, 1938, is hereby amended to read as follows:

PAR. 85. When brandy is withdrawn from a bonded warehouse for fortification of wine, there will be cut on the stave to the right of the bung stave of each package withdrawn, beginning in the middle and extending toward the Government head, in the order named, the gross weight, tare (ascertained as herein provided), net weight, wine gallons, proof, and proof gallons, determined at the time of withdrawal, except when withdrawn on the original gauge as provided in paragraph 68, or when the packages are to be removed to a bonded winery for immediate fortification of wine, where such bonded winery is in the immediate vicinity of the bonded warehouse and is operated by the proprietor of the warehouse or a subsidiary, the supervisor to determine from all the circumstances in

each case whether the warehouse and bonded winery are in the immediate vicinity of each other. In the case of metal packages, such marks will be plainly and durably stenciled in the corresponding space on the side of the package, except when not required as provided above.

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved October 7, 1940.

D. W. BELL,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register October 9, 1940, 11.18 a. m.)

1940–29–10338
T. D. 4982

Basic permit procedure under Federal Alcohol Administration Act.

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

To District Supervisors and Others Concerned:

SECTION 1. By virtue of and pursuant to the provisions of the Federal Alcohol Administration Act, as amended (U. S. C. Sup., Title 27), section 3170 of the Internal Revenue Code (53 Stat., Part 1), and section 161 of the Revised Statutes (U. S. C., Title 5, section 22), Part 171 of Title 26 of the Code of Federal Regulations is hereby amended by inserting between Subpart B(A) and Subpart C thereof a new subpart, designated B(B), to read as follows:

SUBPART B(B)—BASIC PERMIT PROCEDURE UNDER FEDERAL ALCOHOL ADMINISTRATION ACT.

SEC. 171.4c. *Delegation of functions to district supervisors.*—The power and duty heretofore vested in the Deputy Commissioner of the Bureau of Internal Revenue in charge of the Alcohol Tax Unit, by Treasury Department Order No. 30, dated June 12, 1940 [T. D. 4974, C. B. 1940–1, 269] (5 F. R., 2212 DI), to issue, amend, deny, revoke, suspend, and annul basic permits under the provisions of the Federal Alcohol Administration Act, shall continue to be exercised by him, and are also hereby delegated to district supervisors of the Alcohol Tax Unit, to be exercised by them, subject to the supervision and direction of the said Deputy Commissioner.

SEC. 171.4d. *Procedure.*—Except as otherwise provided herein, the procedure prescribed by existing regulations for the issuance, amendment, and denial of permits, issuance of citations, holding of hearings, revocation of permits, and appeals to the Commissioner under Part II of Subchapter C of Chapter 26 of the Internal Revenue Code is hereby extended to the issuance, amendment, denial, revocation, suspension, and annulment of basic permits under the Federal Alcohol Administration Act, in so far as applicable and in so far as such procedure is not in conflict with the provisions of such Act. Appeals to the Deputy Commissioner in charge of the Alcohol Tax Unit from orders denying permits shall be taken in conformity with the procedure applicable to appeals from orders revoking permits.

(*a*) An application for basic permit must be filed, and permit issued, to cover each individual plant or premises where any of the businesses specified in section 3 of the Federal Alcohol Administration Act is engaged in, such application to be filed with and permit issued by the district supervisor for the district wherein such plant or premises is located, provided, that in the case of persons engaged in the business of importing into the United States distilled spirits, wine, or malt beverages, and in the case of persons engaged in the business of purchasing for resale at wholesale distilled spirits, wine, or

malt beverages, only one basic permit shall be required, which basic permit shall be issued by the district supervisor of the district wherein the applicant has his main office or place of business. In the case of importers or wholesalers maintaining branch offices or places of business, there shall be kept posted and available for inspection at all times in each such branch office or place of business a copy of the basic permit, and a copy of the basic permit shall also be filed with the appropriate district supervisor.

(*b*) On or before September 1, 1940, basic permits in full force and effect authorizing the warehousing and bottling of distilled spirits at more than one bottling plant shall be superseded by separate permits covering each bottling plant, such permits to be issued as a matter of right upon the filing of application in proper form with the appropriate district supervisor.

(*c*) In order to insure uniformity of administrative action no proceedings shall be instituted by a district supervisor to revoke, suspend, or annul any basic permit issued under the Federal Alcohol Administration Act unless and until a full report of the facts upon which such proceedings are contemplated has been forwarded to the Deputy Commissioner of Internal Revenue in charge of the Alcohol Tax Unit for review and his approval to the institution of such proceedings obtained.

(*d*) Any provisions of Regulations No. 1 Relating to the Issuance, Revocation, Suspension, and Annulment of Basic Permits, which are inconsistent herewith, are repealed to the extent of such inconsistency.

SEC. 2. These regulations shall take effect 15 days after the date of filing with the Division of the Federal Register.

STEWART BERKSHIRE,
Deputy Commissioner of Internal Revenue.

Approved July 3, 1940.

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved July 9, 1940.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register July 11, 1940, 3.42 p. m.)

1940–40–10442
T. D. 5009

Relabeling procedure under Federal Alcohol Administration Act.

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

District Supervisors and Others Concerned:

By virtue of and pursuant to section 5(e) of the Federal Alcohol Administration Act, as amended (U. S. C., Sup., Title 27), section 3170 of the Internal Revenue Code (53 Stat., Part 1), and section 161 of the Revised Statutes (U. S. C., Title 5, section 22), Article III, section 30(*b*), of Regulations 5, relating to Labeling and Advertising of Distilled Spirits (27 CFR, 5.30(*b*)), is amended to read as follows:

(*b*) *Alteration of labels.*—

(1) It shall be unlawful for any person to alter, mutilate, destroy, obliterate or remove any mark, brand, or label upon distilled spirits held for sale in interstate or foreign commerce or after shipment therein, except as authorized by Federal law, or except as provided in paragraph (2) of this subsection; *Provided*, That the district supervisors of the Alcohol Tax Unit may, upon written application, permit additional labeling or relabeling of bottled distilled spirits for purposes of compliance with the requirements of this article or of State law.

(2) No application for permission to relabel bottled distilled spirits need be made in any case where there is added to the bottle, after removal from customs custody or from the bottling premises, a label identifying the wholesale or retail distributor thereof, and containing no references whatever to the characteristics of the product.

DWIGHT E. AVIS,
Acting Deputy Commissioner of Internal Revenue.

Approved September 19, 1940.

GUY T. HELVERING,
Commissioner of Internal Revenue.

JOHN L. SULLIVAN,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register September 23, 1940, 3.10 p. m.)

1940–43–10464
T. D. 5014

Violations of Federal Alcohol Administration Act.

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

To District Supervisors and Others Concerned:

By virtue of and pursuant to the provisions of the Federal Alcohol Administration Act, as amended (U. S. C. Sup., Title 27), section 3170, Internal Revenue Code (53 Stat., Part 1), and section 161 of the Revised Statutes (U. S. C., Title 5, section 22), Part 171 of Title 26, Code of Federal Regulations, is hereby amended by inserting a new subpart, designated B(C), to read as follows:

SUBPART B(C).—VIOLATIONS OF FEDERAL ALCOHOL ADMINISTRATION ACT.

SEC. 171.4e. *Investigations.*—The functions relating to investigations under the Federal Alcohol Administration Act heretofore authorized to be exercised by the Deputy Commissioner of the Bureau of Internal Revenue in charge of the Alcohol Tax Unit, through the Basic Permit and Trade Practice Division, by Treasury Department Order No. 30, dated June 12, 1940 [T. D. 4974, C. B. 1940–1, 269] (5 FR 2212 DI), will be exercised hereafter by him through the district supervisors and the Permissive, Enforcement, and Basic Permit and Trade Practice Divisions, Alcohol Tax Unit.

SEC. 171.4f. *Offers in compromise.*—The functions relating to offers in compromise under the Federal Alcohol Administration Act heretofore authorized to be exercised by the Deputy Commissioner of the Bureau of Internal Revenue in charge of the Alcohol Tax Unit, through the Basic Permit and Trade Practice Division, by Treasury Department Order No. 30, dated June 12, 1940 (5 FR 2212 DI), will be exercised hereafter by him through the district supervisors and the Permissive and Basic Permit and Trade Practice Divisions, Alcohol Tax Unit.

STEWART BERKSHIRE,
Deputy Commissioner, Alcohol Tax Unit.

Approved October 9, 1940.

GUY T. HELVERING,
Commissioner.

Approved October 16, 1940.

HERBERT E. GASTON,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register October 17, 1940, 10.32 a. m.)

MERCHANT MARINE ACT.

1940-50-10520
T. D. 5023

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 32.

General Order No. 35 of the United States Maritime Commission.—Preliminary regulations for establishment of construction reserve funds under section 511 of the Merchant Marine Act, 1936, as amended.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY OF THE TREASURY,
Washington, D. C.

UNITED STATES MARITIME COMMISSION,
Washington, D. C.

To Officers and Employees of the Treasury Department, the United States Maritime Commission, and Others Concerned:

SECTION 32.0. *Introductory.*—An Act entitled "An Act to amend the Merchant Marine Act, 1936, as amended," approved October 10, 1940 (Public, No. 840, Seventy-sixth Congress, third session), adds to the Merchant Marine Act, 1936 (49 Stat., 1985), as amended (46 U. S. C., Sup., sections 1101–1279), section 511 providing for construction reserve funds to be established, maintained, expended, and used in accordance with the provisions of the section and rules or regulations to be prescribed jointly by the United States Maritime Commission, hereinafter referred to as the Commission, and the Secretary of the Treasury. Pursuant to the authority granted by the said section 511 and by the internal revenue laws, and in order to permit the immediate filing of applications for the establishment of construction reserve funds pending the promulgation of comprehensive regulations under said section 511, the following preliminary regulations are hereby prescribed (Public, No. 840, Seventy-sixth Congress, third session, and section 3791, 53 Stat., 467; 26 U. S. C., Sup., 3791):

SEC. 32.1. *Application to establish fund.*—Any person claiming to be entitled to establish a construction reserve fund under the provisions of section 511 may make application in writing to the Commission for permission to establish such fund, which fund shall be in the form of a cash fund established with a depository approved by the Commission, and shall be subject to the joint control of the Commission and the applicant. The application may be in letter form, shall be furnished in triplicate, shall state whether the applicant is a citizen within the meaning of section 2 of the Shipping Act, 1916, as amended, and section 905(c) of the Merchant Marine Act, 1936, as amended, and shall show the following:

(*a*) The name of the applicant and his principal business address;

(*b*) The status of the applicant, i. e., individual, partnership, corporation, etc.;

(*c*) A brief statement of the nature of the business of the applicant, including the trade route or service in which engaged;

(*d*) The amount of the first deposit which the applicant proposes to make in such fund and a brief description of the transaction

from which the funds constituting such first deposit were or will be derived, including identification of the vessel or vessels involved;

(*e*) A brief description of the program of the applicant for the acquisition of new vessels, including a description of the vessels to be acquired, and a statement whether such program is for the purpose of replacing vessels requisitioned or purchased by the United States;

(*f*) The name and address of the proposed depository of the fund, which shall be a bank within the meaning of section 104 of the Internal Revenue Code; and

(*g*) The agreement of the applicant that the fund will be subject to the provisions of section 511, to these preliminary regulations, and to the comprehensive regulations to be promulgated by the Commission and the Secretary of the Treasury with respect to the establishment, maintenance, expenditure, and use of such construction reserve funds, and that upon the promulgation of such comprehensive regulations the applicant will comply therewith as to matters and things done pursuant to these preliminary regulations within such time and in such manner as the Commission and the Secretary of the Treasury shall require.

(Public, No. 840, Seventy-sixth Congress, third session, and section 3791, 53 Stat., 467; 26 U. S. C., Sup. 3791.)

SEC. 32.2. *Joint control of fund.*—If the application and the depository are approved by the Commission, the Commission shall adopt a resolution with respect to the establishment of the construction reserve fund with the depository named in the application, and the making of the deposit therein set forth, and providing for the joint control of the Commission and the applicant over such fund. A certified copy of such resolution shall be furnished to the depository. (Public, No. 840, Seventy-sixth Congress, third session, and section 3791, 53 Stat., 467; 26 U. S. C., Sup., 3791.)

SEC. 32.3. *Establishment of fund.*—Upon delivery to the depository of the copy of the resolution of the Commission and the delivery by the applicant to such depository of a similar agreement or resolution in form and substance as prescribed by the Commission, the applicant may make the deposit set forth in its application and in the Commission's resolution. (Public, No. 840, Seventy-sixth Congress, third session, and section 3791, 53 Stat., 467; 26 U. S. C., Sup., 3791.)

SEC. 32.4. *Administration of fund.*—Subsequent to the making of such deposit the applicant may contract for the acquisition or construction of a new vessel as defined in the Act. A contract for the acquisition or construction of such new vessels will not be recognized, however, for the purposes of section 511 unless said section and these preliminary regulations and the comprehensive regulations to be promulgated under section 511 have been complied with within such time and in such manner as may be prescribed by the Secretary of the Treasury and the Commission. Prior to the promulgation of comprehensive regulations, no withdrawals from the construction reserve fund will be permitted, provided, however, that in exceptional circumstances the Commission may permit the temporary use of other funds of the applicant for the purpose of making necessary down payments on contracts

for the construction and acquisition of new vessels, reserving to the applicant the right to reimburse itself therefor out of the construction reserve fund to the extent permitted by, and subject to the provisions of, the comprehensive regulations. (Public, No. 840, Seventy-sixth Congress, third session, and section 3791, 53 Stat., 467; 26 U. S. C., Sup., 3791.)

GUY T. HELVERING,
Commissioner of Internal Revenue.

HERBERT E. GASTON,
Acting Secretary of the Treasury.

By order of the United States Maritime Commission:

W. C. PEET, JR.,
Secretary.

NOVEMBER 29, 1940.

(Filed with the Division of the Federal Register December 2, 1940, 11.58 a. m.)

PUBLIC SALARY TAX ACT OF 1939.

1940–31–10359
Mim. 5076

Officers and employees of States or political subdivisions thereof—Compensation paid indirectly by the United States—Relief from additions to tax for failure to file return, negligence and fraud.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., July 8, 1940.

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

1. Attention is invited to section 401 of the Revenue Act of 1940, approved June 25, 1940 (Public, No. 656, Seventy-sixth Congress, third session), which amends section 205 of the Public Salary Tax Act of 1939 (Public, No. 32, Seventy-sixth Congress, first session, C. B. 1939–1 [Part 1], 428) to read as follows:

SEC. 205. Compensation shall not be considered as compensation within the meaning of sections 201, 202, and 203 to the extent that it is paid directly or indirectly by the United States or any agency or instrumentality thereof. If the amount of the deficiency in income tax for any taxable year beginning before January 1, 1939, attributable to compensation paid indirectly by the United States, or any agency or instrumentality thereof, for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any of the foregoing, is paid on or before March 15, 1941, then with respect to failure to pay such amount or make return of such compensation: (*a*) No criminal penalty shall apply; and (*b*) the additions to tax provided in sections 291 and 293 of the Internal Revenue Code shall not apply.

2. Sections 291 and 293 of the Internal Revenue Code provide:

SEC. 291. FAILURE TO FILE RETURN.

In case of any failure to make and file return required by this chapter, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the tax: 5 per centum if the failure is for not more than 30 days with an additional 5 per centum for each additional 30 days or fraction thereof during which such failure continues, not exceeding 25 per centum in the aggregate. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amounts so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3612(d)(1).

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

(a) NEGLIGENCE.—If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 272(i), relating to the prorating of a deficiency, and of section 292, relating to interest on deficiencies, shall not be applicable.

(b) FRAUD.—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2).

Similar provisions are contained in sections 291 and 293 of the Revenue Act of 1938 and the corresponding sections of the prior Revenue Acts.

3. In general, sections 201, 202, and 203 of the Public Salary Tax Act of 1939 prevent the taxation for years beginning prior to January 1, 1939, of the compensation for personal services of the officers and employees of the States and their political subdivisions and their agencies and instrumentalities. Section 205 of the Public Salary Tax Act of 1939 makes the relief provisions of sections 201, 202, and 203 inapplicable to compensation received by the officers and employees of the States and their political subdivisions and their agencies and instrumentalities to the extent such compensation is paid directly or indirectly by the United States or any of its agencies or instrumentalities.

4. Section 271 of the Revenue Act of 1938 provides:

SEC. 271. DEFINITION OF DEFICIENCY.

As used in this title in respect of a tax imposed by this title "deficiency" means—

(a) The amount by which the tax imposed by this title exceeds the amount shown as the tax by the taxpayer upon his return; but the amount so shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a deficiency, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or

(b) If no amount is shown as the tax by the taxpayer upon his return, or if no return is made by the taxpayer, then the amount by which the tax exceeds the amounts previously assessed (or collected without assessment) as a deficiency; but such amounts previously assessed, or collected without assessment, shall first be decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax.

Similar provisions are contained in the corresponding provisions of the prior Revenue Acts. In defining the term "deficiency," section 271 recognizes cases where the taxpayer makes a return showing some tax liability; where the taxpayer makes a return showing no tax liability; and where the taxpayer fails to make a return. (Article 271–1, Regulations 101.) It has been held that in case a return is filed and the blank spaces on the return are filled in, including the spaces provided for the computation of the tax, but liability for the tax is not admitted and is denied, the tax so computed constitutes a deficiency. (I. T. 2400, C. B. VII–1, 138 (1928).)

5. Under section 205 of the Public Salary Tax Act of 1939, as amended by the Revenue Act of 1940, if the amount of any deficiency in income tax for any taxable year beginning before January 1, 1939, attributable to compensation paid indirectly by the United States, or any of its agencies or instrumentalities for personal services of an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any of the foregoing, is paid on or before March 15, 1941, then with respect to failure to pay such amount or make a return of such compensation, no criminal penalty shall apply and the additions to the tax provided in sections 291 and 293 of the Revenue Act of 1938 and the corresponding sections of the prior Revenue Acts shall not apply.

6. Taxpayers coming within the purview of section 205 of the Public Salary Tax Act of 1939, as amended by section 401 of the Revenue Act of 1940, may be classified as follows:

(*a*) Those who have filed returns of income but have not paid the tax attributable to the compensation paid to them indirectly by the United States or its agencies or instrumentalities; and

(*b*) Those who have failed to make a return.

In order to obtain the relief granted by section 205 of the Public Salary Tax Act of 1939, as amended, taxpayers falling within class (*a*) should on or before March 15, 1941, notify the collector of internal revenue for the district in which they filed their returns of their desire to obtain such relief and should accompany their notification with payment of the deficiency attributable to the compensation paid to them indirectly by the United States or its agencies or instrumentalities. In order for taxpayers falling within class (*b*) to obtain such relief, they should on or before March 15, 1941, file returns accompanied by payment of the deficiency attributable to the compensation referred to, but the payment should not include any additions to the tax provided in sections 291 and 293 of the Revenue Act of 1938 or the corresponding sections of the prior Revenue Acts. There should be attached to such delinquent returns a statement that the taxpayer desires to obtain the benefits of the relief granted by section 205 of the Public Salary Tax Act of 1939, as amended by section 401 of the Revenue Act of 1940.

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

TIMOTHY C. MOONEY,
Acting Commissioner.

MISCELLANEOUS.

1940–32–10374
Ct. D. 1462

STATE STATUTE—COMPILED GENERAL LAWS OF 1927 (FLORIDA)—DECISION OF SUPREME COURT.

CLAIM AGAINST DECEDENT'S ESTATE—STATUTE OF LIMITATION—STATE STATUTE NOT APPLICABLE TO CLAIM OF UNITED STATES.

A State statute which provides that any claim against the estate of a decedent shall be void if not filed within eight months after first publication of notice to creditors can not deprive the United States of the right to enforce a claim acquired by it from the Federal Housing Administrator, as assignee of a claim against a certain estate, and filed after the expiration of the statutory period. If the statute undertakes to invalidate the claim of the United States because not filed within eight months, it in that sense transgressed the limits of State power. The United States is not bound by State statutes of limitation or subject to the defense of laches in enforcing its rights, and still has its right of action against the administrator of the estate even though the probate court is to be regarded as having no jurisdiction to receive a claim after the expiration of the specified period.

SUPREME COURT OF THE UNITED STATES.

The United States of America, petitioner, v. *Arlene Summerlin, as Ancillary Administratrix of the estate of J. F. Andrew, Deceased.*

[310 U. S., 414.]

On writ of certiorari to the Supreme Court of the State of Florida.

[May 27, 1940.]

OPINION.

Mr. Chief Justice HUGHES delivered the opinion of the Court.

By a series of transactions, which it is unnecessary to review, the Federal Housing Administrator, acting on behalf of the United States, became the assignee of a claim against the estate of one J. F. Andrew, deceased. Respondent was appointed ancillary administratrix of that estate by the county judge of Polk County, Fla. Respondent, on August 13, 1937, gave notice by publication to the creditors of the estate to file proof of their claims within eight months as required by the State statute.

The United States filed its claim in the office of the county judge on July 1, 1938, with a petition asking that the claim be allowed with the priority accorded by the Federal statutes (31 U. S. C., 191, 192) and also asserting that the State statute as to the time for filing claims did not apply to claims of the United States. The county judge denied the petition, holding that the State statute was applicable and further adjudging that the claim of the United States be "disallowed as a claim against the estate" of the decedent.

The United States appealed to the Circuit Court for Polk County, where the order of the county judge was in all respects affirmed. The judgment explicitly declared the claim of the United States to be "void," because not filed within the time prescribed. An appeal to the Supreme Court of Florida resulted in affirmance of the judgment of the circuit court. (191 So., 842.) We granted certiorari because of the importance of the question. (March 25, 1940.)

The statute of Florida (section 5541(92), Compiled General Laws of 1927) provides:

"No claim or demand, whether due or not, direct or contingent, liquidated or unliquidated, or claim for personal property in the possession of the personal representative or for damages, shall be valid or binding upon an estate, or upon

the personal representative thereof, or upon any heir, legatee, or devisee of the decedent unless the same shall be in writing and contain the place of residence and post office address of the claimant and shall be sworn to by the claimant, his agent or attorney, and be filed in the office of the county judge granting letters. Any such claim or demand not so filed within eight months from the time of the first publication of the notice to creditors shall be void even though the personal representative has recognized such claim or demand by paying a portion thereof or interest thereon or otherwise: * * *."

The claim assigned to the Federal Housing Administrator acting on behalf of the United States became the claim of the United States, and the United States thereupon became entitled to enforce it. (Act of June 27, 1934, 48 Stat., 1246. Compare *Graves* v. *New York ex rel. O'Keefe*, 306 U. S., 466, 477; *Pittman* v. *Home Owners Loan Corporation*, 308 U. S., 21, 32, 33.)

It is well settled that the United States is not bound by State statutes of limitation or subject to the defense of laches in enforcing its rights. (*United States* v. *Thompson*, 98 U. S., 486; *United States* v. *Nashville, Chattanooga & St. Louis Rwy. Co.*, 118 U. S., 120, 125, 126; *Stanley* v. *Schwalby*, 147 U. S., 508, 514, 515; *Guaranty Trust Co.* v. *United States*, 304 U. S., 126, 132; *Board of Commissioners* v. *United States*, 308 U. S., 343, 351.) The same rule applies whether the United States brings its suit in its own courts or in a State court. (*Davis, Director General of Railroads*, v. *Corona Coal Co.*, 265 U. S., 219, 222, 223.)

We are of the opinion that the fact that the claim was acquired by the United States through operations under the National Housing Act does not take the case out of this rule. The State court treated the case as in the same category as one of "statutes providing for conveyancing and marketing negotiable instruments, and conducting other business relations." But this is not a case relating to the application of the law merchant as to the transfer of negotiable paper and the diligence necessary to charge an indorser or as to the incurring by the United States of certain responsibilities by becoming a party to such paper. (*United States* v. *Barker*, 12 Wheat., 559; *Cooke* v. *United States*, 91 U. S., 389, 396.) Even as a holder of such paper, as e. g. negotiable bonds, the United States suing the maker is not bound by a State statute of limitations. (*United States* v. *Nashville, Chattanooga & St. Louis Rwy. Co.*, supra.) When the United States becomes entitled to a claim, acting in its governmental capacity and asserts its claim in that right, it can not be deemed to have abdicated its governmental authority so as to become subject to a State statute putting a time limit upon enforcement. (*Chesapeake & Delaware Canal Co.* v. *United States*, 250 U. S., 123, 126, 127.)

The State court, however, has said that the statute in question is not a statute of limitations, but rather a statute of "nonclaim" for the orderly and expeditious settlement of decedents' estates. Presumably the court refers to the provision of the statute that if a claim is not filed within the specified period "it shall be void even though the personal representative has recognized such claim or demand by paying a portion thereof or interest thereon or otherwise."

If this were a statute merely determining the limits of the jurisdiction of a probate court and thus providing that the county judge should have no jurisdiction to receive or pass upon claims not filed within the eight months, while leaving an opportunity to the United States otherwise to enforce its claim, the authority of the State to impose such a limitation upon its probate court might be conceded. But if the statute, as sustained by the State court, undertakes to invalidate the claim of the United States, so that it can not be enforced at all, because not filed within eight months, we think the statute in that sense transgressed the limits of State power. (*Davis, Director General of Railroads*, v. *Corona Coal Co.*, supra.)

Mr. Justice Story had occasion to consider the application to the Government of a State statute purporting to bar claims against decedent's estates in *United States* v. *Hoar* (2 Mason, 311). There an action was brought by the United States against an administrator of an estate and the defendant pleaded the general statute of limitation of Massachusetts as to personal actions and also the particular statute limiting suits against executors and administrators to four years after the acceptance of the trust. Mr. Justice Story thought it clear that the defense of these statutes of limitations could not avail. The question whether a further defense of *plene administravit* was good, that is, whether a distribution of surplus assets after the payment of all known debts among the heirs, either voluntary or under a probate decree, would protect the administrator from suit by the United States, it was thought not necessary to decide. Nor have we such a question here.

We hold that the State statute in this instance requiring claims to be filed within eight months can not deprive the United States of its right to enforce its claim; that the United States still has its right of action against the administrator, even though the probate court is to be regarded as having no jurisdiction to receive a claim after the expiration of the specified period.

So far as the judgment goes beyond the question of the jurisdiction of the probate court and purports to adjudge that the claim of the United States is void as a claim against the estate of the decedent because of failure to comply with the statute, the judgment is reversed.

The cause is remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

OLEOMARGARINE.

1940–27–10312
MS. 227

Schedule of oleomargarine produced and materials used during the month of May, 1940, as compared with May, 1939.

	May, 1940.	May, 1939.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 24,495,589	[2] 22,578,516
Total withdrawn tax-paid	24,094,477	22,806,168
Ingredient schedule of uncolored oleomargarine:		
Babassu oil	961,032	1,320,730
Beef fat		22,384
Coconut oil	2,466,628	2,937,713
Corn oil	48,124	23,695
Cottonseed oil	8,450,271	6,772,514
Derivative of glycerine	66,409	53,417
Lecithin	6,828	5,290
Milk	4,656,147	4,468,069
Neutral lard	493,522	73,577
Oleo oil	919,428	987,278
Oleo stearine	309,575	288,927
Oleo stearine oil	88,000	
Oleo stock	89,614	73,087
Palm oil	480	540
Palm kernel oil		7,543
Peanut oil	132,828	194,105
Salt	981,249	975,501
Soda (benzoate of)	10,200	9,708
Soya bean oil	5,683,591	5,526,001
Soya bean stearine	1,100	
Vitamin concentrate	1,203	1,109
Total	25,366,229	23,741,188
Total production of colored oleomargarine	[3] 180,538	[4] 120,044
Total withdrawn tax-paid	28,168	20,796
Ingredient schedule of colored oleomargarine:		
Babassu oil	1,016	2,589
Coconut oil	60,124	26,498
Color	123	101
Corn oil	1	3
Cottonseed oil	17,487	8,015
Cottonseed stearine	360	780
Derivative of glycerine	425	474
Lecithin	73	2
Milk	34,761	30,420
Neutral lard	3,747	3,541
Oleo oil	13,590	13,108
Oleo stearine	625	1,000
Oleo stock	1,449	20
Palm kernel oil		72
Peanut oil	24	48
Salt	7,564	7,526
Soda (benzoate of)	63	43
Soya bean oil	43,533	42,022
Vitamin concentrate	2	1
Total	184,967	136,263

[1] Of the amount produced, 29,744 pounds were reworked.
[2] Of the amount produced, 35,055 pounds were reworked.
[3] Of the amount produced, 416 pounds were reworked.
[4] Of the amount produced, 1,824 pounds were reworked.

1940–31–10366
MS. 228

Schedule of oleomargarine produced and materials used during the month of June, 1940, as compared with June, 1939.

	June, 1940.	June, 1939.
	Pounds	*Pounds*
Total production of uncolored oleomargarine	[1] 19,570,141	[2] 21,030,442
Total withdrawn tax-paid	19,472,721	20,729,401
Ingredient schedule of uncolored oleomargarine:		
Babassu oil	681,865	1,104,573
Beef fat		14,530
Coconut oil	1,416,518	2,120,921
Corn oil	9,751	21,094
Cottonseed oil	7,377,850	6,702,223
Derivative of glycerine	54,274	49,408
Lecithin	6,119	5,547
Milk	3,757,496	4,093,818
Neutral lard	418,567	81,705
Oleo oil	885,355	997,320
Oleo stearine	233,811	259,907
Oleo stock	68,825	114,521
Palm oil	2,916	
Peanut oil	136,755	166,581
Salt	796,293	919,007
Soda (benzoate of)	7,687	8,784
Soya bean oil	4,431,376	5,435,268
Soya bean stearine	600	
Vitamin concentrate	843	1,194
Total	20,286,901	22,096,341
Total production of colored oleomargarine	[3] 281,891	[4] 80,150
Total withdrawn tax-paid	21,808	15,840
Ingredient schedule of colored oleomargine:		
Babassu oil	873	1,768
Butter flavor	1	
Coconut oil	158,635	7,726
Color	196	100
Corn oil		1
Cottonseed oil	14,566	6,233
Cottonseed stearine	1,470	120
Derivative of glycerine	378	303
Lecithin	68	4
Milk	53,851	17,921
Neutral lard	3,788	3,275
Oleo oil	14,940	11,430
Oleo stearine	2,220	338
Oleo stock	1,256	4
Peanut oil	39	138
Salt	12,362	4,440
Soda (benzoate of)	28	33
Soya bean oil	31,978	34,640
Vitamin concentrate	2	1
Total	296,651	88,475

[1] Of the amount produced, 28,232 pounds were reworked.
[2] Of the amount produced, 26,028 pounds were reworked.
[3] Of the amount produced, 568 pounds were reworked.
[4] Of the amount produced, 376 pounds were reworked.

1940-36-10412
MS. 229

Schedule of oleomargarine produced and materials used during the month of July, 1940, as compared with July, 1939.

	July, 1940.	July, 1939.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 21,812,339	[2] 19,159,532
Total withdrawn tax-paid	22,044,758	20,099,144
Ingredient schedule of uncolored oleomargarine:		
Babassu oil	594,316	1,332,131
Beef fat		11,900
Coconut oil	1,158,645	1,522,418
Corn oil		18,205
Cottonseed oil	8,515,202	5,518,396
Derivative of glycerine	70,691	48,308
Lecithin	6,748	4,880
Milk	4,225,008	3,849,754
Neutral lard	312,360	109,305
Oleo oil	1,109,738	850,486
Oleo stearine	280,807	244,853
Oleo stock	95,839	56,742
Peanut oil	64,994	186,354
Salt	875,639	838,666
Soda (benzoate of)	8,820	7,744
Soya bean oil	5,376,339	5,592,062
Vegetable gum	6	
Vitamin concentrate	974	760
Total	22,696,126	20,192,964
Total production of colored oleomargarine	[3] 208,417	[4] 102,674
Total withdrawn tax-paid	21,170	14,836
Ingredient schedule of colored oleomargarine:		
Babassu oil	725	40
Butter flavor	3	
Coconut oil	102,616	36,943
Color	149	53
Cottonseed oil	11,025	3,116
Cottonseed stearine	630	
Derivative of glycerine	664	255
Lecithin	125	61
Milk	39,251	20,108
Neutral lard	5,333	2,148
Oleo oil	13,282	9,032
Oleo stearine	1,288	875
Oleo stock	350	43
Peanut oil	17	43
Salt	9,220	5,561
Soda (benzoate of)	65	27
Soya bean oil	25,914	32,127
Soya flakes		550
Vegetable stearine	690	
Vitamin concentrate	2	
Total	211,349	110,982

[1] Of the amount produced, 59,091 pounds were reworked.
[2] Of the amount produced, 41,065 pounds were reworked.
[3] Of the amount produced, 5,458 pounds were reworked.
[4] Of the amount produced, 348 pounds were reworked.

1940-40-10444
MS. 230

Schedule of oleomargarine produced and materials used during the month of August, 1940, as compared with August, 1939.

	August, 1940.	August, 1939.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 21,481,135	[2] 21,498,284
Total withdrawn tax-paid	22,476,917	21,192,548
Ingredient schedule of uncolored oleomargarine:		
Babassu oil	445,659	1,344,719
Beef fat		19,700
Coconut oil	1,100,071	1,728,178
Corn oil		21,886
Cottonseed oil	8,259,796	6,980,869
Derivative of glycerine	62,588	53,687
Lecithin	7,356	6,119
Milk	4,141,356	4,292,998
Neutral lard	309,039	123,051
Oleo oil	1,102,247	1,048,166
Oleo stearine	281,803	273,608
Oleo stock	95,684	58,053
Peanut oil	139,278	253,954
Salt	849,991	950,883
Soda (benzoate of)	8,724	8,844
Soya bean oil	5,467,838	5,537,605
Vitamin concentrate	901	1,214
Total	22,272,331	22,703,534
Total production of colored oleomargarine	[3] 182,651	[4] 110,169
Total withdrawn tax-paid	21,202	13,584
Ingredient schedule of colored oleomargarine:		
Babassu oil	140	925
Butter flavor	3	
Coconut oil	80,360	34,497
Color	153	76
Cottonseed oil	15,482	5,317
Cottonseed stearine	840	120
Derivative of glycerine	458	247
Lecithin	77	51
Milk	37,758	21,970
Neutral lard	4,611	1,953
Oleo oil	19,407	11,614
Oleo stearine	954	1,050
Oleo stock	2,099	1,162
Peanut oil	35	37
Salt	7,942	6,564
Soda (benzoate of)	53	36
Soya bean oil	29,117	35,653
Vitamin concentrate	2	1
Total	199,491	121,273

[1] Of the amount produced, 25,256 pounds were reworked.
[2] Of the amount produced, 28,047 pounds were reworked.
[3] Of the amount produced, 52 pounds were reworked.
[4] Of the amount produced, 864 pounds were reworked

1940-45-10481
MS. 231

Schedule of oleomargarine produced and materials used during the month of September, 1940, as compared with September, 1939.

	September, 1940.	September, 1939.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 26,327,721	[2] 27,996,826
Total withdrawn tax-paid	25,693,306	27,897,887
Ingredient schedule of uncolored oleomargarine:		
Babassu oil	331,204	1,498,942
Coconut oil	1,067,159	3,084,624
Corn oil	889	34,830
Cottonseed oil	9,940,576	9,028,238
Cottonseed stearine		9,180
Derivative of glycerine	61,288	63,458
Lecithin	8,303	7,643
Margo	593	
Milk	5,077,784	5,275,388
Monostearine	18,077	
Neutral lard	423,286	112,384
Oleo oil	1,225,590	848,002
Oleo stearine	281,880	329,319
Oleo stock	92,644	62,822
Peanut oil	153,366	258,102
Salt	1,020,803	1,190,929
Soda (benzoate of)	9,854	12,192
Soya bean oil	7,548,595	7,337,913
Vitamin concentrate	1,091	1,379
Total	27,262,962	29,065,395
Total production of colored oleomargarine	213,959	[3] 107,675
Total withdrawn tax-paid	25,432	20,484
Ingredient schedule of colored oleomargarine:		
Babassu oil		145
Butter flavor	1	
Coconut oil	74,647	28,681
Color	140	79
Corn oil		1
Cottonseed oil	15,084	6,046
Cottonseed stearine	60	480
Derivative of glycerine	194	306
Lecithin	71	67
Milk	39,906	21,391
Monostearine	252	
Neutral lard	2,732	2,711
Oleo oil	14,156	13,940
Oleo stearine	433	
Oleo stock	2,169	1,568
Peanut oil	31	115
Salt	9,246	5,065
Soda (benzoate of)	57	39
Soya bean oil	56,975	33,423
Vitamin concentrate	2	2
Total	216,156	114,059

[1] Of the amount produced, 16,307 pounds were reworked.
[2] Of the amount produced, 13,414 pounds were reworked.
[3] Of the amount produced, 1,640 pounds were reworked.

1940–49–10514
MS. 232

Schedule of oleomargarine produced and materials used during the month of October, 1940, as compared with October, 1939.

	October, 1940.	October, 1939.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 29,944,880	[2] 23,634,661
Total withdrawn tax-paid	29,459,381	23,650,040
Ingredient schedule of uncolored oleomargarine:		
Babassu oil	137,948	988,136
Coconut oil	1,331,626	2,122,001
Corn oil	19,145	21,711
Cottonseed oil	11,806,267	8,674,982
Derivative of glycerine	69,477	57,120
Lecithin	9,974	6,870
Milk	5,505,555	4,502,862
Monostearine	19,277	
Neutral lard	422,880	84,348
Oleo oil	1,139,195	602,937
Oleo stearine	346,947	236,212
Oleo stock	103,390	69,517
Peanut oil	184,481	197,034
Salt	1,122,000	1,031,280
Soda (benzoate of)	11,225	9,935
Soya bean oil	8,621,968	5,940,916
Vitamin concentrate	1,353	1,421
Total	30,902,708	24,547,282
Total production of colored oleomargarine	[3] 215,193	[4] 150,154
Total withdrawn tax-paid	30,102	26,041
Ingredient schedule of colored oleomargarine:		
Babassu oil	50	
Butter flavor	2	
Coconut oil	82,771	44,926
Color	201	158
Corn oil	17	15
Cottonseed oil	21,029	13,523
Cottonseed stearine	480	
Derivative of glycerine	323	395
Lecithin	36	60
Milk	39,679	34,843
Monostearine	454	
Neutral lard	3,968	3,400
Oleo oil	20,087	17,161
Oleo stearine	250	
Oleo stock	3,500	1,719
Peanut oil	44	77
Salt	7,635	8,729
Soda (benzoate of)	133	55
Soya bean oil	42,037	41,205
Soya bean stearine	60	
Vitamin concentrate	2	2
Total	222,758	166,268

[1] Of the amount produced, 36,452 pounds were reworked.
[2] Of the amount produced, 14,379 pounds were reworked.
[3] Of the amount produced, 1,664 pounds were reworked.
[4] Of the amount produced, 5,022 pounds were reworked.

TOBACCO.

1940–27–10311
T. 72

Statement of manufactured tobacco produced, by classes, during the month of April, 1940, as compared with April, 1939.

	April, 1940.	April, 1939.
	Pounds.	*Pounds.*
Plug	4,277,764	4,075,854
Twist	458,002	425,507
Fine-cut chewing	361,940	324,963
Scrap chewing	3,507,122	3,023,411
Smoking	16,949,251	15,044,877
Total	25,554,079	22,894,612

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

1940–31–10360
T. 73

Statement of manufactured tobacco produced, by classes, during the month of May, 1940, as compared with May, 1939.

	May, 1940.	May, 1939.
	Pounds.	*Pounds.*
Plug	4,331,018	4,973,571
Twist	502,688	533,545
Fine-cut chewing	511,564	395,198
Scrap chewing	3,539,123	3,501,236
Smoking	18,004,434	17,746,697
Total	26,888,827	27,150,247

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

1940–35–10402
T. 74

Statement of manufactured tobacco produced, by classes, during the month of June, 1940, as compared with June, 1939.

	June, 1940.	June, 1939.
	Pounds.	*Pounds.*
Plug	4,114,862	4,652,401
Twist	416,166	483,727
Fine-cut chewing	366,896	460,748
Scrap chewing	3,187,323	3,916,703
Smoking	16,081,503	17,979,150
Total	24,166,750	27,492,729

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

1940–40–10443
T. 75

Statement of manufactured tobacco produced, by classes, during the month of July, 1940, as compared with July, 1939.

	July, 1940.	July, 1939.
	Pounds.	*Pounds.*
Plug	4, 521, 480	4, 293, 934
Twist	488, 586	405, 001
Fine-cut chewing	431, 679	400, 288
Scrap chewing	3, 984, 975	3, 089, 307
Smoking	17, 460, 495	15, 261, 007
Total	26, 887, 215	23, 449, 537

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

1940–44–10471
T. 76

Statement of manufactured tobacco produced, by classes, during the month of August, 1940, as compared with August, 1939.

	August, 1940.	August, 1939.
	Pounds.	*Pounds.*
Plug	4, 224, 716	5, 152, 871
Twist	496, 657	559, 543
Fine-cut chewing	456, 416	407, 821
Scrap chewing	3, 806, 751	4, 345, 762
Smoking	16, 948, 679	19. 356, 896
Total	25, 933, 219	29, 822, 893

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

1940–49–10513
T. 77

Statement of manufactured tobacco produced, by classes, during the month of September, 1940, as compared with September, 1939.

	September, 1940.	September, 1939.
	Pounds.	*Pounds.*
Plug	4, 145, 011	4, 470, 588
Twist	469, 889	481, 926
Fine-cut chewing	398, 413	348, 371
Scrap chewing	3, 524, 595	3, 521, 475
Smoking	17, 762, 417	17, 503, 308
Total	26, 300, 325	26, 325, 668

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

1940–53–10545
T. 78

Statement of manufactured tobacco produced, by classes, during the month of October, 1940, as compared with October, 1939.

	October, 1940.	October, 1939.
	Pounds.	*Pounds.*
Plug	4, 194, 890	4, 369, 593
Twist	536, 246	518, 382
Fine-cut chewing	443, 166	373, 467
Scrap chewing	4, 009, 057	3, 827, 380
Smoking	21, 949, 933	19, 659, 708
Total	31, 133, 292	28, 748, 530

NOTE.—These figures are subject to revision until published in the Commissioner's annual report.

LEGISLATION.

REVENUE ACT OF 1940.

1940–28–10321

PUBLIC, NO. 656, SEVENTY-SIXTH CONGRESS. (CHAPTER 419, THIRD SESSION [H. R. 10039].)

An Act To provide for the expenses of national preparedness by raising revenue and issuing bonds, to provide a method for paying for such bonds, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I.

SEC. 1. SHORT TITLE.

This Act may be cited as the Revenue Act of 1940.

SEC. 2. SURTAX ON INDIVIDUALS.

Section 12(b) of the Internal Revenue Code is amended to read as follows:

"(b) RATES OF SURTAX.—There shall be levied, collected, and paid for each taxable year upon the surtax net income of every individual a surtax as follows:

"Upon a surtax net income of $4,000 there shall be no surtax; upon surtax net incomes in excess of $4,000 and not in excess of $6,000, 4 per centum of such excess.

"$80 upon surtax net incomes of $6,000; and upon surtax net incomes in excess of $6,000 and not in excess of $8,000, 6 per centum in addition of such excess.

"$200 upon surtax net incomes of $8,000; and upon surtax net incomes in excess of $8,000 and not in excess of $10,000, 8 per centum in addition of such excess.

"$360 upon surtax net incomes of $10,000; and upon surtax net incomes in excess of $10,000 and not in excess of $12,000, 10 per centum in addition of such excess.

"$560 upon surtax net incomes of $12,000; and upon surtax net incomes in excess of $12,000 and not in excess of $14,000, 12 per centum in addition of such excess.

"$800 upon surtax net incomes of $14,000; and upon surtax net incomes in excess of $14,000 and not in excess of $16,000, 15 per centum in addition of such excess.

"$1,100 upon surtax net incomes of $16,000; and upon surtax net incomes in excess of $16,000 and not in excess of $18,000, 18 per centum in addition of such excess.

"$1,460 upon surtax net incomes of $18,000; and upon surtax net incomes in excess of $18,000 and not in excess of $20,000, 21 per centum in addition of such excess.

"$1,880 upon surtax net incomes of $20,000; and upon surtax net incomes in excess of $20,000 and not in excess of $22,000, 24 per centum in addition of such excess.

"$2,360 upon surtax net incomes of $22,000; and upon surtax net incomes in excess of $22,000 and not in excess of $26,000, 27 per centum in addition of such excess.

"$3,440 upon surtax net incomes of $26,000; and upon surtax net incomes in excess of $26,000 and not in excess of $32,000, 30 per centum in addition of such excess.

"$5,240 upon surtax net incomes of $32,000; and upon surtax net incomes in excess of $32,000 and not in excess of $38,000, 33 per centum in addition of such excess.

"$7,220 upon surtax net incomes of $38,000; and upon surtax net incomes in excess of $38,000 and not in excess of $44,000, 36 per centum in addition of such excess.

"$9,380 upon surtax net incomes of $44,000; and upon surtax net incomes in excess of $44,000 and not in excess of $50,000, 40 per centum in addition of such excess.

"$11,780 upon surtax net incomes of $50,000; and upon surtax net incomes in excess of $50,000 and not in excess of $60,000, 44 per centum in addition of such excess.

"$16,180 upon surtax net incomes of $60,000; and upon surtax net incomes in excess of $60,000 and not in excess of $70,000, 47 per centum in addition of such excess.

"$20,880 upon surtax net incomes of $70,000; and upon surtax net incomes in excess of $70,000 and not in excess of $80,000, 50 per centum in addition of such excess.

"$25,880 upon surtax net incomes of $80,000; and upon surtax net incomes in excess of $80,000 and not in excess of $90,000, 53 per centum in addition of such excess.

"$31,180 upon surtax net incomes of $90,000; and upon surtax net incomes in excess of $90,000 and not in excess of $100,000, 56 per centum in addition of such excess.

"$36,780 upon surtax net incomes of $100,000; and upon surtax net incomes in excess of $100,000 and not in excess of $150,000, 58 per centum in addition of such excess.

"$65,780 upon surtax net incomes of $150,000; and upon surtax net incomes in excess of $150,000 and not in excess of $200,000, 60 per centum in addition of such excess.

"$95,780 upon surtax net incomes of $200,000; and upon surtax net incomes in excess of $200,000 and not in excess of $250,000, 62 per centum in addition of such excess.

"$126,780 upon surtax net incomes of $250,000; and upon surtax net incomes in excess of $250,000 and not in excess of $300,000, 64 per centum in addition of such excess.

"$158,780 upon surtax net incomes of $300,000; and upon surtax net incomes in excess of $300,000 and not in excess of $400,000, 66 per centum in addition of such excess.

"$224,780 upon surtax net incomes of $400,000; and upon surtax net incomes in excess of $400,000 and not in excess of $500,000, 68 per centum in addition of such excess.

"$292,780 upon surtax net incomes of $500,000; and upon surtax net incomes in excess of $500,000 and not in excess of $750,000, 70 per centum in addition of such excess.

"$467,780 upon surtax net incomes of $750,000; and upon surtax net incomes in excess of $750,000 and not in excess of $1,000,000, 72 per centum in addition of such excess.

"$647,780 upon surtax net incomes of $1,000,000; and upon surtax net incomes in excess of $1,000,000 and not in excess of $2,000,000, 73 per centum in addition of such excess.

"$1,377,780 upon surtax net incomes of $2,000,000; and upon surtax net incomes in excess of $2,000,000 and not in excess of $5,000,000, 74 per centum in addition of such excess.

"$3,597,780 upon surtax net incomes of $5,000,000; and upon surtax net incomes in excess of $5,000,000, 75 per centum in addition of such excess."

SEC. 3. CORPORATION TAX.

(a) TAX ON CORPORATIONS IN GENERAL.—Section 13(b) of the Internal Revenue Code is amended to read as follows:

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

"(1) GENERAL RULE.—A tax of 19 per centum of the normal-tax net income; or

"(2) ALTERNATIVE TAX (CORPORATIONS WITH NORMAL-TAX NET INCOME SLIGHTLY MORE THAN $25,000).—A tax of $3,775, plus 33 per centum of the amount of the normal-tax net income in excess of $25,000."

(b) TAX ON SPECIAL CLASSES OF CORPORATIONS.—Sections 14 (b) and (c)(1) of the Internal Revenue Code are amended to read as follows:

"(b) CORPORATIONS WITH NORMAL-TAX NET INCOMES OF NOT MORE THAN $25,000.—If the normal-tax net income of the corporation is not more than $25,000, and if the corporation does not come within one of the classes specified in subsection (c), (d), or (e) of this section, the tax shall be as follows:

"Upon normal-tax net incomes not in excess of $5,000, 13½ per centum.

"$675 upon normal-tax net incomes of $5,000, and upon normal-tax net incomes in excess of $5,000 and not in excess of $20,000, 15 per centum in addition of such excess.

"$2,925 upon normal-tax net incomes of $20,000, and upon normal-tax net incomes in excess of $20,000, 17 per centum in addition of such excess.

c) FOREIGN CORPORATIONS.—

"(1) In the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, the tax shall be an amount equal to 19 per centum of the normal-tax net income, regardless of the amount thereof."

(c) TAX ON NONRESIDENT FOREIGN CORPORATIONS.—Section 231(a)(1) of the Internal Revenue Code is amended by striking out "except that in the case of dividends the rate shall be 10 per centum, and" and by striking out "of 10 per centum".

(d) TAX ON MUTUAL INVESTMENT COMPANIES.—Section 362(b) of the Internal Revenue Code is amended to read as follows:

"(b) IMPOSITION OF TAX.—There shall be levied, collected, and paid for each taxable year upon the Supplement Q net income of every mutual investment company a tax equal to 19 per centum of the amount thereof."

SEC. 4. TAX ON NONRESIDENT ALIEN INDIVIDUALS.

(a) TAX IN GENERAL.—Section 211(a)(1)(A) of the Internal Revenue Code (relating to tax on nonresident alien individuals not engaged in trade or business within the United States and not having an office or place of business therein) is amended by striking out "10 per centum" and inserting in lieu thereof "15 per centum".

(b) AGGREGATE RECEIPTS MORE THAN $24,000.—Section 211(a)(2) of the Internal Revenue Code is amended to read as follows:

"(2) AGGREGATE MORE THAN $24,000.—The tax imposed by paragraph (1) shall not apply to any individual if the aggregate amount received during the taxable year from the sources therein specified is more than $24,000."

(c) TAX WHERE GROSS INCOME OF MORE THAN $24,000.—Section 211(c) of the Internal Revenue Code (relating to tax on certain nonresident alien individuals) is amended by striking out "$21,600" wherever occurring therein and inserting in lieu thereof "$24,000"; and by striking out "10 per centum" and inserting in lieu thereof "15 per centum".

SEC. 5. WITHHOLDING OF TAX AT SOURCE.

(a) Section 143 of the Internal Revenue Code is amended by striking out "10 per centum" wherever occurring therein and inserting in lieu thereof "15 per centum".

(b) Section 144 of the Internal Revenue Code is amended by striking out "except that in the case of dividends the rate shall be 10 per centum, and" and by striking out "of 10 per centum".

(c) The amendments made by this section shall take effect on June 26, 1940.

SEC. 6. PERSONAL EXEMPTION.

(a) Section 25(b)(1) of the Internal Revenue Code is amended to read as follows:

"(1) PERSONAL EXEMPTION.—In the case of a single person or a married person not living with husband or wife, a personal exemption of $800; or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $2,000. A husband and wife living together shall receive but one personal exemption. The amount of such personal exemption shall be $2,000. If such husband and wife make separate returns, the personal exemption may be taken by either or divided between them."

(b) Section 214 of the Internal Revenue Code (relating to personal exemption of nonresident alien individuals) is amended by striking out "$1,000" and inserting in lieu thereof "$800".

(c) Section 251(f) of the Internal Revenue Code (relating to personal exemption of citizens entitled to benefits of section 251) is amended by striking out "$1,000" and inserting in lieu thereof "$800".

SEC. 7. RETURNS OF INCOME TAX.

(a) INDIVIDUAL RETURNS.—Section 51(a) of the Internal Revenue Code is amended to read as follows:

"(a) REQUIREMENT.—The following individuals shall each make under oath a return stating specifically the items of his gross income and the deductions and credits allowed under this chapter and such other information for the

purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe—

"(1) Every individual who is single or who is married but not living with husband or wife, if having a gross income for the taxable year of $800 or over.

"(2) Every individual who is married and living with husband or wife, if no joint return is made under subsection (b) and if—

"(A) Such individual has for the taxable year a gross income of $2,000 or over, and the other spouse has no gross income; or

"(B) Such individual and his spouse each has for the taxable year a gross income and the aggregate gross income is $2,000 or over."

(b) FIDUCIARY RETURNS.—Section 142(a) of the Internal Revenue Code is amended to read as follows:

"(a) REQUIREMENT OF RETURN.—Every fiduciary (except a receiver appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for any of the following individuals, estates, or trusts for which he acts, stating specifically the items of gross income thereof and the deductions and credits allowed under this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe—

"(1) Every individual having a gross income for the taxable year of $800 or over, if single, or if married and not living with husband or wife;

"(2) Every individual having a gross income for the taxable year of $2,000 or over, if married and living with husband or wife;

"(3) Every estate the gross income of which for the taxable year is $800 or over;

"(4) Every trust the net income of which for the taxable year is $100 or over, or the gross income of which for the taxable year is $800 or over, regardless of the amount of the net income; and

"(5) Every estate or trust of which any beneficiary is a nonresident alien."

(c) INFORMATION RETURNS.—Section 147(a) of the Internal Revenue Code (relating to information at the source) is amended by striking out "$1,000" wherever occurring therein and inserting in lieu thereof "$800".

SEC. 8. TREATY OBLIGATIONS.

No amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States.

SEC. 9. TAXABLE YEARS TO WHICH APPLICABLE.

The amendments made by this title, except the amendments made by section 5, shall be applicable only with respect to taxable years beginning after December 31, 1939.

TITLE II.

SEC. 201. INCOME TAX.

Chapter 1 of the Internal Revenue Code is amended by inserting after section 14 the following new section:

"SEC. 15. DEFENSE TAX FOR FIVE YEARS.

"In the case of any taxpayer, the amount of tax under this chapter for any taxable year beginning after December 31, 1939, and before January 1, 1945, shall be 10 per centum greater than the amount of tax computed without regard to this section. In no case shall the effect of this section be to increase the tax computed without regard to this section by more than 10 per centum of the amount by which the net income exceeds such tax. For the purposes of this section, the tax computed without regard to this section shall be such tax before the application of the credit provided in section 31 ('foreign tax credit'), and the credit provided in section 32 (taxes withheld at the source)."

SEC. 202. RATES OF WITHHOLDING.

Section 143 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsection:

"(h) RATES UNTIL JANUARY 1945.—For the period after June 25, 1940, and before January 1, 1945, the rate provided in this section and section 144, of 15 per centum shall be 16½ per centum. This subsection or section 15 shall not apply in any case where its operation would be contrary to any treaty obligation of the United States, nor to a resident of, or a corporation organized under

the laws of, a contiguous country so long as there is in effect with such country a treaty, ratified prior to August 26, 1937, relating to rates of income tax."

SEC. 203. PERSONAL HOLDING COMPANIES.

Section 500 of the Internal Revenue Code is amended by inserting "(a) GENERAL RULE.—" before the first paragraph and inserting at the end thereof the following new subsection:

"(b) DEFENSE TAX FOR FIVE YEARS.—In the case of every personal holding company, the amount of surtax under this subchapter for any taxable year beginning after December 31, 1939, and before January 1, 1945, shall be 10 per centum greater than the amount of surtax computed without regard to this subsection."

SEC. 204. EXCESS-PROFITS TAX.

Section 600 of the Internal Revenue Code is amended by inserting "(a) GENERAL RULE.—" before the first paragraph and by inserting at the end of such section the following new subsection:

"(b) DEFENSE TAX FOR FIVE YEARS.—In the case of any taxpayer, the amount of tax payable under this section for any income-tax taxable year ending after June 30, 1940, and before July 1, 1945, shall be 10 per centum greater than the amount of tax which would be payable if computed without regard to this subsection."

SEC. 205. CAPITAL STOCK TAX.

Section 1200 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsection:

"(c) DEFENSE TAX FOR FIVE YEARS.—For the year ending June 30, 1940, and for the four succeeding years ending June 30, the rates provided in subsections (a) and (b) shall be $1.10 in lieu of $1."

SEC. 206. ESTATE TAX.

Chapter 3 of the Internal Revenue Code is amended by inserting at the end thereof the following new subchapter:

"SUBCHAPTER C—DEFENSE TAX FOR FIVE YEARS.

"SEC. 951. DEFENSE TAX FOR FIVE YEARS.

"In the case of a decedent dying after the date of the enactment of the Revenue Act of 1940 and before the expiration of five years after such date, the total amount of tax payable under this chapter shall be 10 per centum greater than the amount of tax which would be payable if computed without regard to this section. For the purposes of this section, the tax computed without regard to this section shall be such tax after the application of the credits provided for in section 813 and section 936."

SEC. 207. GIFT TAX.

Section 1001 of the Internal Revenue Code is amended by adding at the end thereof the following new subsection:

"(d) DEFENSE TAX FOR 1940–1945.—Despite the provisions of subsection (a)—

"(1) The tax for each of the calendar years 1941 to 1945, both inclusive, shall be an amount equal to the excess of—

"(A) 110 per centum of a tax, computed in accordance with the Rate Schedule hereinbefore set forth, on the aggregate sum of the net gifts for such calendar year and for each of the preceding calendar years, over

"(B) 110 per centum of a tax, computed in accordance with the said Rate Schedule, on the aggregate sum of the net gifts for each of the preceding calendar years.

"(2) The tax for the calendar year 1940 shall be the sum of (A) the tax computed under subsection (a), plus (B) an amount which bears the same ratio to 10 per centum of the tax so computed as the amount of gifts made after the date of the enactment of the Revenue Act of 1940 bears to the total amount of gifts made during the year. For the purposes of this paragraph, the term 'gifts' does not include gifts which, under section 1003(b)(2), are not to be included in computing the total amount of gifts made during the calendar year 1940, or gifts which, in the case of a citizen or resident, are allowed as a deduction by section 1004(a)(2), or gifts which, in the case of a nonresident not a citizen of the United States, are allowed as a deduction by section 1004(b)."

SEC. 208. TAX ON TRANSFERS TO AVOID INCOME TAX.

Section 1250 of the Internal Revenue Code is amended by inserting "(a) GENERAL RULE.—" before the first paragraph and inserting at the end thereof the following new subsection:

"(b) DEFENSE TAX FOR FIVE YEARS.—In the case of any transfer during the period after the date of the enactment of the Revenue Act of 1940 and before July 1, 1945, the rate provided in subsection (a) shall be 27½ per centum in lieu of 25 per centum."

SEC. 209. CONTINUATION OF EXCISE TAXES.

Sections 1801, 1802, 3403(f)(1), 3452, 3460(a), 3465, 3481(b), and 3482 of the Internal Revenue Code are amended by striking out "1941" wherever appearing therein and inserting in lieu thereof "1945".

SEC. 210. MISCELLANEOUS EXCISES.

The Internal Revenue Code is amended by inserting at the end of chapter 9 the following new chapter:

"CHAPTER 9A—DEFENSE TAX FOR FIVE YEARS.

"SEC. 1650. DEFENSE TAX FOR FIVE YEARS.

"(a) In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
1700(b)	Box seats	10 percent	11 percent.
1700(c)	Sales outside box office	10 percent	11 percent.
1700(e)	Cabaret	1½ cents	2 cents.
1710(a)(1)	Dues	10 percent	11 percent.
1710(a)(2)	Initiation fees	10 percent	11 percent.
1801	Corporate securities	10 cents	11 cents.
1802(a)	Capital stock issues	10 cents	11 cents.
1802(a)	Capital stock issues	2 cents	3 cents.
1802(b)	Capital stock transfers	4 cents	5 cents.
1802(b)	Capital stock transfers	5 cents	6 cents.
1804	Insurance policies	3 cents	4 cents.
1806	Passage tickets	$1	$1.10.
1806	Passage tickets	$3	$3.30.
1806	Passage tickets	$5	$5.50.
1850(a)	Safe-deposit boxes	10 percent	11 percent.
2700(a)	Pistols and revolvers	10 percent	11 percent.
3250(a)(1)	Wholesalers in liquor	$100	$110.
3250(b)	Retailers in liquor	$25	$27.50.
3250(c)	Brewers	$100	$110.
3250(c)	Brewers	$50	$55.
3250(d)	Wholesalers in malt liquors	$50	$55.
3250(e)	Retailers	$20	$22.
3250(e)(3)	Special cases	$2	$2.20.
3250(f)(1)	Rectifiers	$200	$220.
3250(f)(1)	Rectifiers	$100	$110.
3250(j)	Stills	$50	$55.
3250(j)	Stills	$20	$22.
3400(1)	Tires	2¼ cents	2½ cents.
3400(2)	Tubes	4 cents	4½ cents.
3401	Toilet preparations	10 percent	11 percent.
3403(a)	Automobile truck chassis, etc	2 percent	2½ percent.
3403(b)	Automobiles, etc	3 percent	3½ percent.
3403(c)	Parts	2 percent	2½ percent.
3404	Radios	5 percent	5½ percent.
3405	Mechanical refrigerators	5 percent	5½ percent.
3407	Firearms	10 percent	11 percent.
3409	Matches	5 cents	5½ cents.
3411	Electrical energy	3 percent	3½ percent.
3412	Gasoline	1 cent	1½ cents.
3413	Lubricating oils	4 cents	4½ cents.
3460(a)(1), (2), and (3).	Transportation of oil	4 percent	4½ percent.
3481(a)	Transfer of bonds	4 cents	5 cents.
3482	Conveyances	50 cents	55 cents.

"(b) In the application of section 3441(c) to the articles with respect to which the rate of tax is increased by this section, where the lease, contract of sale, or conditional sale, and delivery thereunder, was made before July 1, 1940, the total

tax referred to in such section shall be the tax at the rate in force on June 30, 1940, and not at the increased rate."

SEC. 211. ADMISSIONS TAX.

Section 1700(a)(1) of the Internal Revenue Code is amended by striking out "until July 1, 1941, is less than 41 cents" and inserting in lieu thereof "until July 1, 1940, is less than 41 cents, and after June 30, 1940, and before July 1, 1945, is less than 21 cents" and by striking out "is less than 41 cents, until July 1, 1941" and inserting in lieu thereof "is less than 41 cents until July 1, 1940, and is less than 21 cents after June 30, 1940, and before July 1, 1945".

SEC. 212. CIGARETTES.

Subchapter A of chapter 15 of the Internal Revenue Code is amended by inserting at the end thereof the following new sections:

"SEC. 2004. DEFENSE TAX FOR FIVE YEARS.

"In lieu of the rates of tax specified in section 2000(c)(2), the rates of tax for the period after June 30, 1940, and before July 1, 1945, shall be $3.25 and $7.80, respectively.

"SEC. 2005. FLOOR STOCKS TAX.

"(a) FLOOR STOCKS TAX.—Upon cigarettes subject to tax under section 200(c)(2) which on July 1, 1940, are held by any person for sale, there shall be levied, assessed, collected, and paid a floor stocks tax at a rate equal to the increase in rates of tax made applicable to such articles by section 2004.

"(b) RETURNS.—Every person required by this section to pay any floor stocks tax shall, on or before August 1, 1940, under such regulations as the Commissioner with the approval of the Secretary shall prescribe, make a return and pay such tax, except that in the case of articles held by manufacturers and importers the Commissioner may collect the tax with respect to all or part of such articles by means of stamp rather than return, and in such case may make an assessment against such manufacturer or importer having tobacco tax stamps on hand July 1, 1940, for the difference between the amount paid for such stamps and the increased rates specified in section 2004.

"(c) LAWS APPLICABLE.—All provisions of law, including penalties, applicable in respect of the taxes imposed by section 2000 shall, insofar as applicable and not inconsistent with this section, be applicable with respect to the floor stocks tax imposed by subsection (a)."

SEC. 213. DISTILLED SPIRITS.

(a) Section 2800 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsections:

"(g) DEFENSE TAX FOR FIVE YEARS.—In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading 'Defense-Tax Rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
2800(a)(1)	Distilled spirits generally	$2.25	$3.
2800(a)(1)	Brandy	$2	$2.75.
2800(a)(3)	Imported perfumes	$2.25	$3.

"(h) FLOOR STOCKS TAX.

"(1) Upon all distilled spirits produced in or imported into the United States upon which the internal-revenue tax imposed by law has been paid, and which on July 1, 1940, are held and intended for sale or for use in the manufacture or production of any article intended for sale, there shall be levied, assessed, collected, and paid a floor stocks tax of 75 cents on each proof-gallon, and a proportionate tax at a like rate on all fractional parts of such proof-gallon. The tax imposed by this subsection shall not apply to one hundred wine gallons of the retail stocks of distilled spirits held by a person on premises as to which such person has incurred occupational tax as a retail dealer in liquors for the period beginning on July 1, 1940, and as to which no other occupational tax with respect to dealing in distilled spirits has been incurred by such person for a period beginning on such date.

"(2) Every person required by this subsection to pay any floor stocks tax shall, on or before August 1, 1940, under such regulations as the Commissioner, with the approval of the Secretary, shall prescribe, make a return and pay such tax. Payment of the tax shown to be due may be extended to a date not later than February 1, 1941, upon the filing of a bond for payment thereof in such form and amount and with such surety or sureties as the Commissioner, with the approval of the Secretary, may prescribe. Every retail dealer in liquors (even though not liable to pay such tax) shall make the return required by this paragraph.

"(3) All provisions of law, including penalties, applicable in respect of internal-revenue taxes on distilled spirits shall, insofar as applicable and not inconsistent with this subsection, be applicable in respect of the floor stocks tax imposed hereunder."

(b) The third paragraph of section 2887 of the Internal Revenue Code (relating to drawback on distilled spirits) is amended by striking out "but shall not exceed a rate of $2.25 (or, in the case of brandy, $2)" and inserting in lieu thereof "but shall not exceed a rate of $3 (or, in the case of brandy, $2.75)".

SEC. 214. WINES AND FERMENTED MALT LIQUORS.

Chapter 26 of the Internal Revenue Code is amended by inserting at the end thereof the following new subchapter:

"SUBCHAPTER F—DEFENSE TAX FOR FIVE YEARS.

"SEC. 3190. DEFENSE TAX FOR FIVE YEARS.

"In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1934, shall be the rates set forth under the heading 'Defense-tax rate':

"Section.	Description of tax.	Old rate.	Defense-tax rate.
3030(a)(1)(A)	Still wines	5 cents	6 cents.
3030(a)(1)(A)	Still wines	15 cents	18 cents.
3030(a)(1)(A)	Still wines	25 cents	30 cents.
3030(a)(2)	Sparkling wines	2½ cents	3 cents.
3030(a)(2)	Sparkling wines	1¼ cents	1½ cents.
3030(a)(2)	Liqueurs, cordials, etc	1¼ cents	1½ cents.
3150(a)	Fermented malt liquors	$5	$6.

"SEC. 3191. FLOOR STOCKS TAX ON FERMENTED MALT LIQUORS.

"(a) FLOOR STOCKS TAX.—Upon all fermented malt liquors upon which the internal-revenue tax imposed by law has been paid, and which on July 1, 1940, are held by any person and intended for sale there shall be levied, assessed, collected, and paid a floor stocks tax at a rate equal to the increase in rate of tax made applicable to such articles by section 3190. The tax imposed by this subsection shall not apply to the retail stocks of fermented malt liquors held by a person on premises as to which such person has incurred occupational tax as a retail dealer in liquors or a retail dealer in malt liquors for the period beginning on July 1, 1940, and as to which no other occupational tax with respect to dealing in distilled spirits, wines, or malt liquors, has been incurred by such person for a period beginning on such date.

"(b) RETURNS.—Every person required by subsection (a) to pay any floor stocks tax shall, on or before August 1, 1940, under such regulations as the Commissioner with the approval of the Secretary shall prescribe, make a return and pay such tax. Payment of the tax shown to be due may be extended to a date not later than February 1, 1941, upon the filing of a bond for payment thereof in such form and amount and with such surety or sureties as the Commissioner, with the approval of the Secretary, may prescribe.

"(c) LAWS APPLICABLE.—All provisions of law, including penalties, applicable in respect of the taxes imposed by section 3150(a) shall, insofar as applicable and not inconsistent with this subsection, be applicable with respect to the floor stocks tax imposed by subsection (a)."

SEC. 215. PLAYING CARDS.

Section 1807 of the Internal Revenue Code is amended by inserting "(a) GENERAL RULE.—" before the first paragraph and inserting at the end thereof the following new subsection:

"(b) DEFENSE TAX FOR FIVE YEARS.—In lieu of the rate of tax specified in subsection (a), the rate of tax for the period after June 30, 1940, and before July 1, 1945, shall be 11 cents."

SEC. 216. CREDITS ON TAX ON AUTOMOBILES, ETC.

Section 3403(e) of the Internal Revenue Code is amended by adding at the end thereof the following new sentence: "With respect to the period after June 30, 1940, and before July 1, 1945, the rates of the credits above provided shall, in lieu of 2 per centum and 3 per centum, be 2½ per centum and 3½ per centum, respectively."

TITLE III.

SEC. 301. The Secretary of the Treasury shall, as soon as practicable after the end of each quarter, determine the additional amount of taxes collected attributable to the increases in taxes made, and to the floor stocks taxes imposed, by the amendments to the Internal Revenue Code in Title II of this Act (not including the amount of taxes attributable solely to section 209 and not including any amount collected under section 1700(a)(1) of the Internal Revenue Code attributable to a basic admission charge of more than 40 cents), and the amounts so determined shall be set aside as a special fund which shall be available only for the retirement of any of the obligations issued pursuant to the authority contained in section 21(b) of the Second Liberty Bond Act, as amended. If at any time the amounts in the fund are not sufficient for such purpose, the Secretary of the Treasury is authorized and directed to transfer to the fund moneys out of the general fund of the Treasury. Any amounts in the special fund not necessary for the retirement of such obligations shall be deposited in the general fund of the Treasury.

SEC. 302. Section 21 of the Second Liberty Bond Act, as amended, is hereby further amended by inserting "(a)" after "21." and by adding at the end of such section a new paragraph as follows:

"(b) In addition to the amount authorized by the preceding paragraph of this section, any obligations authorized by sections 5 and 18 of this Act, as amended, not to exceed in the aggregate $4,000,000,000 outstanding at any one time, less any retirements made from the special fund made available under section 301 of the Revenue Act of 1940, may be issued under said sections to provide the Treasury with funds to meet any expenditures made, after June 30, 1940, for the national defense, or to reimburse the general fund of the Treasury therefor. Any such obligations so issued shall be designated 'National Defense Series'."

TITLE IV.

SEC. 401. Section 205 of the Public Salary Tax Act of 1939 is amended by adding at the end thereof a new sentence to read as follows: "If the amount of the deficiency in income tax for any taxable year beginning before January 1, 1939, attributable to compensation paid indirectly by the United States, or any agency or instrumentality thereof, for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any of the foregoing, is paid on or before March 15, 1941, then with respect to failure to pay such amount or make return of such compensation: (a) No criminal penalty shall apply; and (b) the additions to tax provided in sections 291 and 293 of the Internal Revenue Code shall not apply."

Approved, June 25, 1940, 11.45 a. m., E. S. T.

SECOND REVENUE ACT OF 1940.

1940–44–10470

PUBLIC, NO. 801, SEVENTY-SIXTH CONGRESS. (CHAPTER 75, THIRD SESSION [H. R. 10413].)

An Act To provide revenue, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Second Revenue Act of 1940".

TITLE I—CORPORATION INCOME TAX.

SEC. 101. CORPORATION INCOME TAX.

(a) TAX ON CORPORATIONS IN GENERAL.—Section 13(b) of the Internal Revenue Code, as amended by section 3 of the Revenue Act of 1940, is amended to read as follows:

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

"(1) GENERAL RULE.—A tax of 22½ per centum of the normal-tax net income; or

"(2) ALTERNATIVE TAX (CORPORATIONS WITH NORMAL-TAX NET INCOME SLIGHTLY MORE THAN $25,000).—A tax of $3,775, plus 35 per centum of the amount of the normal-tax net income in excess of $25,000."

(b) TAX ON FOREIGN CORPORATIONS.—Section 14(c)(1) of the Internal Revenue Code, as amended by section 3 of the Revenue Act of 1940, is amended to read as follows:

"(c) FOREIGN CORPORATIONS.—

"(1) In the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, the tax shall be an amount equal to 22½ per centum of the normal-tax net income, regardless of the amount thereof."

(c) TAX ON MUTUAL INVESTMENT COMPANIES.—Section 362(b) of the Internal Revenue Code, as amended by section 3 of the Revenue Act of 1940, is amended to read as follows:

"(b) IMPOSITION OF TAX.—There shall be levied, collected, and paid for each taxable year upon the Supplement Q net income of every mutual investment company a tax equal to 22½ per centum of the amount thereof."

(d) DEFENSE TAX FOR FIVE YEARS.—The first sentence of section 15 of the Internal Revenue Code, added to such Code by section 201 of the Revenue Act of 1940, is amended to read as follows: "In the case of any taxpayer, the amount of tax under this chapter for any taxable year beginning after December 31, 1939, and before January 1, 1945, shall be the tax computed without regard to this section, increased by 10 per centum; except that in the case of a corporation the increase shall be limited to 10 per centum of the tax computed without regard to the amendments made by section 101 (a), (b), and (c) of the Second Revenue Act of 1940."

(e) TAXABLE YEARS TO WHICH APPLICABLE.—Amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1939.

TITLE II—EXCESS PROFITS TAX.

SEC. 201. EXCESS PROFITS TAX OF 1940.

The Internal Revenue Code is amended by inserting after section 706 the following new subchapter which may be cited as the "Excess Profits Tax Act of 1940":

"SUBCHAPTER E—EXCESS PROFITS TAX.

"PART I.

"SEC. 710. IMPOSITION OF TAX.

"(a) IMPOSITION.—There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1939, on the adjusted excess profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax as follows:

"(1) Upon adjusted excess profits net incomes of less than $20,000, 25 per centum of the adjusted excess profits net income.

"$5,000 upon adjusted excess profits net incomes of $20,000; and upon adjusted excess profits net incomes in excess of $20,000, and not in excess of $50,000, 30 per centum in addition of such excess.

"$14,000 upon adjusted excess profits net incomes of $50,000; and upon adjusted excess profits net incomes in excess of $50,000, and not in excess of $100,000, 35 per centum in addition of such excess.

"$31,500 upon adjusted excess profits net incomes of $100,000; and upon adjusted excess profits net incomes in excess of $100,000, and not in excess of $250,000, 40 per centum in addition of such excess.

$91,500 upon adjusted excess profits net incomes of $250,000; and upon adjusted excess profits net incomes in excess of $250,000, and not in excess of $500,000, 45 per centum in addition of such excess.

"$204,000 upon adjusted excess profits net incomes of $500,000; and upon adjusted excess profits net incomes in excess of $500,000, 50 per centum in addition of such excess.

"(2) APPLICATION OF RATES IN CASE OF CERTAIN EXCHANGES.—If the taxpayer's highest bracket amount for the taxable year computed under section 752 (relating to certain exchanges) is less than $500,000, then in the application of paragraph (1) of this subsection to such taxpayer, in lieu of each amount, other than the percentages, specified in such paragraph, there shall be substituted an amount which bears the same ratio to the amount so specified as the highest bracket amount so computed bears to $500,000.

"(b) DEFINITION OF ADJUSTED EXCESS PROFITS NET INCOME.—As used in this section, the term 'adjusted excess profits net income' in the case of any taxable year means the excess profits net income (as defined in section 711) minus the sum of:

"(1) SPECIFIC EXEMPTION.—A specific exemption of $5,000;

"(2) EXCESS PROFITS CREDIT.—The amount of the excess profits credit allowed under section 712; and

"(3) UNUSED EXCESS PROFITS CREDIT.—In the case of a taxpayer the normal-tax net income of which for the taxable year is not more than $25,000, the amount by which the excess profits credit for the preceding taxable year (if beginning after December 31, 1939) exceeds the excess profits net income for such preceding taxable year.

"SEC. 711. EXCESS PROFITS NET INCOME.

"(a) TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1939.—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13(a)(2), for such year except that the following adjustments shall be made:

"(1) EXCESS PROFITS CREDIT COMPUTED UNDER INCOME CREDIT.—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

"(A) Income Taxes.—The deduction for taxes shall be increased by an amount equal to the tax (not including the tax under section 102) under Chapter 1 for such taxable year;

"(B) Long-term Gains and Losses.—There shall be excluded long-term capital gains and losses. There shall be excluded the excess of gains from the sale or exchange of property held for more than eighteen

months which is of a character which is subject to the allowance for depreciation provided in section 23(l) over the losses from the sale or exchange of such property;

"(C) Income From Retirement or Discharge of Bonds, and So Forth.—There shall be excluded, in the case of any taxpayer, income derived from the retirement or discharge by the taxpayer of any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than eighteen months, including, in case the issuance was at a premium, the amount includible in income for such year solely because of such retirement or discharge;

"(D) Refunds and Interest on Agricultural Adjustment Act Taxes.—There shall be excluded income attributable to refund of tax paid under the Agricultural Adjustment Act of 1933, as amended, and interest upon any such refund;

"(E) Recoveries of Bad Debts.—There shall be excluded income attributable to the recovery of a bad debt if a deduction with reference to such debt was allowable from gross income for any taxable year beginning prior to January 1, 1940;

"(F) Dividends Received.—The credit for dividends received shall apply, without limitation, to dividends on stock of domestic corporations.

"(2) EXCESS PROFITS CREDIT COMPUTED UNDER INVESTED CAPITAL CREDIT.—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

"(A) Dividends Received.—The credit for dividends received shall apply, without limitation, to all dividends on stock of all corporations, except dividends (actual or constructive), on stock of foreign personal-holding companies;

"(B) Interest.—The deduction for interest shall be reduced by an amount equal to 50 per centum of so much of such interest as represents interest on the indebtedness included in the daily amounts of borrowed capital (determined under section 719(a));

"(C) Income Taxes.—The deduction for taxes shall be increased by an amount equal to the tax (not including the tax under section 102) under Chapter 1 for such taxable year;

"(D) Long-term Gains and Losses.—There shall be excluded long-term capital gains and losses. There shall be excluded the excess of gains from the sale or exchange of property held for more than eighteen months which is of a character which is subject to the allowance for depreciation provided in section 23(l) over the losses from the sale or exchange of such property;

"(E) Income From Retirement or Discharge of Bonds, and So Forth.—There shall be excluded, in the case of any taxpayer, income derived from the retirement or discharge by the taxpayer of any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than eighteen months, including, in case the issuance was at a premium, the amount includible in income for such year solely because of such retirement or discharge;

"(F) Refunds and Interest on Agricultural Adjustment Act Taxes.—There shall be excluded income attributable to refund of tax paid under the Agricultural Adjustment Act of 1933, as amended, and interest upon any such refund;

"(G) Interest on Certain Government Obligations.—The normal-tax net income shall be increased by an amount equal to the amount of the interest on obligations held during the taxable year which are described in section 22(b)(4) any part of the interest from which is excludible from gross income or allowable as a credit against net income, if the taxpayer has so elected under section 720(d); and

"(H) Recoveries of Bad Debts.—There shall be excluded income attributable to the recovery of a bad debt if a deduction with reference to such debt was allowable from gross income for any taxable year beginning prior to January 1, 1940.

"(3) TAXABLE YEAR LESS THAN TWELVE MONTHS.—If the taxable year is a period of less than twelve months the excess profits net income shall be placed on an annual basis by multiplying the amount thereof by the number of days in the twelve months ending with the close of the taxable year and dividing by the number of days in the taxable year. The tax shall be

such part of the tax computed on such annual basis as the number of days in the taxable year is of the number of days in the twelve months ending with the close of the taxable year.

"(b) TAXABLE YEARS IN BASE PERIOD.—

"(1) GENERAL RULE AND ADJUSTMENTS.—The excess profits net income for any taxable year subject to the Revenue Act of 1936 shall be the normal-tax net income, as defined in section 13(a) of such Act; and for any other taxable year beginning after December 31, 1937, and before January 1, 1940, shall be the special-class net income, as defined in section 14(a) of the applicable revenue law. In either case the following adjustments shall be made (for additional adjustments in case of certain reorganizations, see section 742(e)):

"(A) Income Taxes.—The deduction for taxes shall be increased by an amount equal to the tax (not including the tax under section 102) for such taxable year under Title I or Chapter 1, as the case may be, of the revenue law applicable to such year;

"(B) Long-Term Gains and Losses.—There shall be excluded long-term capital gains and losses. There shall be excluded the excess of gains from the sale or exchange of property held for more than eighteen months which is of a character which is subject to the allowance for depreciation provided in section 23(l) over the losses from the sale or exchange of such property;

"(C) Income From Retirement or Discharge of Bonds, and So Forth.—There shall be excluded, in the case of any taxpayer, income derived from the retirement or discharge by the taxpayer of any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than eighteen months, including, in case the issuance was at a premium, the amount includible in income for such year solely because of such retirement or discharge;

"(D) Deductions on Account of Retirement or Discharge of Bonds, and So Forth.—If during the taxable year the taxpayer retires or discharges any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than eighteen months, the following deductions for such taxable year shall not be allowed:

"(i) The deduction allowable under section 23(a) for expenses paid or incurred in connection with such retirement or discharge;

"(ii) The deduction for losses allowable by reason of such retirement or discharge; and

"(iii) In case the issuance was at a discount, the amount deductible for such year solely because of such retirement or discharge:

"(E) Casualty, Demolition, and Similar Losses.—Deductions under section 23(f) for losses arising from fires, storms, shipwreck, or other casualty, or from theft, or arising from the demolition, abandonment, or loss of useful value of property, not compensated for by insurance or otherwise, shall not be allowed;

"(F) Repayment of Processing Tax to Vendees.—The deduction under section 23(a), for any taxable year, for expenses shall be decreased by an amount which bears the same ratio to the amount deductible on account of any repayment or credit by the corporation to its vendee of any amount attributable to any tax under the Agricultural Adjustment Act of 1933, as amended, as the excess of the aggregate of the amounts so deductible in the base period over the aggregate of the amounts attributable to taxes under such Act collected from its vendees which were includible in the corporation's gross income in the base period and which were not paid, bears to the aggregate of the amounts so deductible in the base period;

"(G) Payment of Judgments, and So Forth.—Deductions attributable to any claim, award, judgment, or decree against the taxpayer, or interest on any of the foregoing, shall not be allowed if in the light of the taxpayer's business it was abnormal for the taxpayer to incur a liability of such character or, if the taxpayer normally incurred such liability, the amount of such liability in the taxable year was grossly disproportionate to the amount of such liability in the four previous taxable years;

"(H) All expenditures for intangible drilling and development costs paid or incurred in or for the drilling of wells or the preparation of wells for the production of oil or gas, or expenditures for development costs in the case of mines, which the taxpayer has deducted from gross income as an expense, shall not be allowed to the extent that in the light of the taxpayer's business it was abnormal for the taxpayer to incur a liability of such a character or, if the taxpayer normally incurred such liability, to the extent that the amount of such liability in the taxable year was grossly disproportionate to the amount of such liability in the four previous taxable years; and

"(I) Dividends Received.—The credit for dividends received shall apply, without limitation, to dividends on stock of domestic corporations.

"(2) CAPITAL GAINS AND LOSSES.—For the purposes of this subsection the normal-tax net income and the special-class net income referred to in paragraph (1) shall be computed as if section 23(g)(2), section 23(k)(2), and section 117 were part of the revenue law applicable to the taxable year the excess profits net income of which is being computed, with the exception that the net short-term capital loss carry-over provided in subsection (e) of section 117 shall be applicable to net short-term capital losses for taxable years beginning after December 31, 1934. Such exception shall not apply for the purposes of computing the tax under this subchapter for any taxable year beginning before January 1, 1941.

"SEC. 712. EXCESS PROFITS CREDIT—ALLOWANCE.

"(a) DOMESTIC CORPORATIONS.—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall, at the election of the taxpayer made in its return for such taxable year, be an amount computed under section 713 or section 714. (For election in case of certain reorganizations of corporations not qualified under the preceding sentence, see section 741.) In the case of all other domestic corporations the excess profits credit for any taxable year shall be an amount computed under section 714. In the case of a domestic corporation which for any taxable year does not file a return before the expiration of the time prescribed by law for filing such return, the excess profits credit for such taxable year shall be an amount computed under section 714.

"(b) FOREIGN CORPORATIONS.—In the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, the first taxable year of which under this subchapter begins on any date in 1940, which was in existence on the day forty-eight months prior to such date and which at any time during each of the taxable years in such forty-eight months was engaged in trade or business within the United States or had an office or place of business therein, the excess profits credit for any taxable year shall, at the election of the taxpayer in its return for such taxable year, be an amount computed under section 713 or section 714. In the case of all other such foreign corporations the excess profits credit for any taxable year shall be an amount computed under section 714. In the case of a foreign corporation which for any taxable year does not file a return before the expiration of the time prescribed by law for filing such return, the excess profits credit for such taxable year shall be an amount computed under section 714.

"SEC. 713. EXCESS PROFITS CREDIT—BASED ON INCOME.

"(a) AMOUNT OF EXCESS PROFITS CREDIT.—The excess profits credit for any taxable year, computed under this section, shall be—

"(1) DOMESTIC CORPORATIONS.—In the case of a domestic corporation—

"(A) 95 per centum of the average base period net income, as defined in subsection (b),

"(B) Plus 8 per centum of the net capital addition as defined in subsection (c), or

"(C) Minus 6 per centum of the net capital reduction as defined in subsection (c).

"(2) FOREIGN CORPORATIONS.—In the case of a foreign corporation, 95 per centum of the average base period net income.

"(b) AVERAGE BASE PERIOD NET INCOME.—For the purposes of this section the average base period net income of the taxpayer shall be determined as follows:

"(1) By computing the aggregate of the excess profits net income for each of the taxable years of the taxpayer beginning after December 31, 1935, and before January 1, 1940, reduced, in the case of each such taxable year in

which the deductions plus the credit for dividends received exceeded the gross income, by the amount attributable to such excess under paragraph (4);

"(2) By dividing the amount ascertained under paragraph (1) by the total number of months in all such taxable years; and

"(3) By multiplying the amount ascertained under paragraph (2) by twelve.

"(4) For the purposes of paragraph (1)—

"(A) In determining whether, for any taxable year, the deductions plus the credit for dividends received exceeded the gross income, and in determining the amount of such excess, the adjustments provided in section 711(b)(1) shall be made; and

"(B) The amount attributable to any taxable year in which there is such an excess shall be the amount of such excess, except that such amount shall be zero if there is only one such year, or, if more than one, shall be zero for the year in which such excess is the greatest.

"(5) For the purposes of paragraph (1), if the taxpayer was in existence during only part of the 48 months preceding the beginning of its first taxable year under this subchapter (hereinafter in this paragraph called 'base period'), its excess profits net income—

"(A) for each taxable year of twelve months (beginning with the beginning of such base period) during which it was not in existence, shall be an amount equal to 8 per centum of the excess of—

"(i) the daily invested capital for the first day of the taxpayer's first taxable year beginning after December 31, 1939, over

"(ii) an amount equal to the same percentage of such daily invested capital as is applicable under section 720 in reduction of the average invested capital of the preceding taxable year;

"(B) for the taxable year of less than twelve months consisting of that part of the remainder of the base period during which it was not in existence, shall be the amount ascertained for a full year under subparagraph (A), multiplied by the number of days in such taxable year of less than twelve months and divided by the number of days in the twelve months ending with the close of such taxable year.

"(6) In no case shall the average base period net income be less than zero.

"(7) For computation of average base period net income in case of certain reorganizations, see section 742.

"(c) ADJUSTMENTS IN EXCESS PROFITS CREDIT ON ACCOUNT OF CAPITAL CHANGES.—For the purposes of this section—

"(1) The net capital addition for the taxable year shall be the excess, divided by the number of days in the taxable year, of the aggregate of the daily capital addition for each day of the taxable year over the aggregate of the daily capital reduction for each day of the taxable year.

"(2) The net capital reduction for the taxable year shall be the excess, divided by the number of days in the taxable year, of the aggregate of the daily capital reduction for each day of the taxable year over the aggregate of the daily capital addition for each day of the taxable year.

"(3) The daily capital addition for any day of the taxable year shall be the aggregate of the amounts of money and property paid in for stock, or as paid-in surplus, or as a contribution to capital, after the beginning of the taxpayer's first taxable year under this subchapter and prior to such day. In determining the amount of any property paid in, such property shall be included in an amount determined in the manner provided in section 718(a)(2). A distribution by the taxpayer to its shareholders in its stock or rights to acquire its stock shall not be regarded as money or property paid in for stock, or as paid-in surplus, or as a contribution to capital. The amount ascertained under this paragraph shall be reduced by the excess, if any, of the excluded capital for such day over the excluded capital for the first day of the taxpayer's first taxable year under this subchapter. For the purposes of this paragraph the excluded capital for any day shall be an amount equal to the sum of the following:

"(A) The aggregate of the adjusted basis (for determining loss upon sale or exchange) as of the beginning of such day, of obligations held by the taxpayer at the beginning of such day, which are described in section 22(b)(4) (A), (B), or (C) any part of the interest from which is excludible from gross income or allowable as a credit against net income; and

"(B) The aggregate of the adjusted basis (for determining loss upon sale or exchange) as of the beginning of such day, of stock of domestic corporations held by the taxpayer at the beginning of such day.

The daily capital addition shall in no case be less than zero. (For daily capital additions and reductions in case of certain reorganizations, see section 743.)

"(4) The daily capital reduction for any day of the taxable year shall be the aggregate of the amounts of distributions to shareholders, not out of earnings and profits, after the beginning of the taxpayer's first taxable year under this subchapter and prior to such day.

"SEC. 714. EXCESS PROFITS CREDIT—BASED ON INVESTED CAPITAL.

"The excess profits credit, for any taxable year, computed under this section, shall be an amount equal to 8 per centum of the taxpayer's invested capital for the taxable year, determined under section 715.

"SEC. 715. DEFINITION OF INVESTED CAPITAL.

"For the purpose of this subchapter the invested capital for any taxable year shall be the average invested capital for such year, determined under section 716, reduced by an amount computed under section 720 (relating to inadmissible assets). If the Commissioner finds that in any case the determination of invested capital, on a basis other than a daily basis, will produce an invested capital differing by not more than $1,000 from an invested capital determined on a daily basis, he may, under regulations prescribed by him with the approval of the Secretary, provide for such determination on such other basis. (For computation of invested capital in case of foreign corporations and corporations entitled to the benefits of section 251, see section 724.)

"SEC. 716. AVERAGE INVESTED CAPITAL.

"The average invested capital for any taxable year shall be the aggregate of the daily invested capital for each day of such taxable year, divided by the number of days in such taxable year.

"SEC. 717. DAILY INVESTED CAPITAL.

"The daily invested capital for any day of the taxable year shall be the sum of the equity invested capital for such day plus the borrowed invested capital for such day determined under section 719.

"SEC. 718. EQUITY INVESTED CAPITAL.

"(a) DEFINITION.—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

"(1) MONEY PAID IN.—Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

"(2) PROPERTY PAID IN.—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined in the same manner as if the property were still held at the beginning of such taxable year. If such unadjusted basis is a substituted basis it shall be adjusted, with respect to the period before the property was paid in, in the manner provided in section 113(b)(2);

"(3) DISTRIBUTION IN STOCK.—Distributions in stock—

"(A) Made prior to such taxable year to the extent to which they are considered distributions of earnings and profits; and

"(B) Previously made during such taxable year to the extent to which they are considered distributions of earnings and profits other than earnings and profits of such taxable year;

"(4) EARNINGS AND PROFITS AT BEGINNING OF YEAR.—The accumulated earnings and profits as of the beginning of such taxable year; and

"(5) INCREASE ON ACCOUNT OF GAIN ON TAX-FREE LIQUIDATION.—In the case of the previous receipt of property (other than property described in the last sentence of section 113(a)(15)) by the taxpayer in complete liquidation of another corporation under section 112(b)(6), or the corresponding provision of a prior revenue law, an amount, with respect to each such liquidation, equal to the amount by which the aggregate of the amount of the money so received and of the adjusted basis, at the time of receipt, of all property (other than money) so received, exceeds the sum of:

"(A) The aggregate of the adjusted basis of each share of stock with respect to which such property was received; such adjusted basis of each share to be determined immediately prior to the receipt of any property in such liquidation with respect to such share, and

"(B) The aggregate of the liabilities of such other corporation assumed by the taxpayer in connection with the receipt of such property, of the liabilities (not assumed by the taxpayer) to which such property so received was subject, and of any other consideration (other than the stock with respect to which such property was received) given by the taxpayer for such property so received.

"(b) REDUCTION IN EQUITY INVESTED CAPITAL.—The amount by which the equity invested capital for any day shall be reduced as provided in subsection (a) shall be the sum of the following amounts—

"(1) DISTRIBUTIONS IN PREVIOUS YEARS.—Distributions made prior to such taxable year which were not out of accumulated earnings and profits;

"(2) DISTRIBUTIONS DURING THE YEAR.—Distributions previously made during such taxable year which are not out of the earnings and profits of such taxable year;

"(3) EARNINGS AND PROFITS OF ANOTHER CORPORATION.—The earnings and profits of another corporation which previously at any time were included in accumulated earnings and profits by reason of a transaction described in section 112(b) to (e), both inclusive, or in the corresponding provision of a prior revenue law, or by reason of the transfer by such other corporation to the taxpayer of property the basis of which in the hands of the taxpayer is or was determined with reference to its basis in the hands of such other corporation, or would have been so determined if the property had been other than money; and

"(4) REDUCTION ON ACCOUNT OF LOSS ON TAX-FREE LIQUIDATION.—In the case of the previous receipt of property (other than property described in the last sentence of section 113(a)(15)) by the taxpayer in complete liquidation of another corporation under section 112(b)(6), or the corresponding provision of a prior revenue law, an amount, with respect to each such liquidation, equal to the amount by which the sum of—

"(A) The aggregate of the adjusted basis of each share of stock with respect to which such property was received; such adjusted basis of each share to be determined immediately prior to the receipt of any property in such liquidation with respect to such share, and

"(B) The aggregate of the liabilities of such other corporation assumed by the taxpayer in connection with the receipt of such property, of the liabilities (not assumed by the taxpayer) to which such property so received was subject, and of any other consideration (other than the stock with respect to which such property was received) given by the taxpayer for such property so received.

exceeds the aggregate of the amount of the money so received and of the adjusted basis, at the time of receipt, of all property (other than money) so received. The amount of the reduction under this paragraph shall not exceed the accumulated earnings and profits as of the beginning of such taxable year.

"(c) RULES FOR APPLICATION OF SUBSECTIONS (A) AND (B).—For the purposes of subsections (a) and (b)—

"(1) DISTRIBUTIONS TO SHAREHOLDERS.—The term 'distribution' means a distribution by a corporation to its shareholders, and the term 'distribution in stock' means a distribution by a corporation in its stock or rights to acquire its stock. To the extent that a distribution in stock is not considered a distribution of earnings and profits it shall not be considered a distribution. A distribution in stock shall not be regarded as money or property paid in for stock, or as paid-in surplus, or as a contribution to capital.

"(2) DISTRIBUTIONS IN FIRST SIXTY DAYS OF TAXABLE YEAR.—In the application of such subsections to any taxable year beginning after December 31, 1940, so much of the distributions (taken in the order of time) made during the first sixty days thereof as does not exceed the accumulated earnings and profits as of the beginning thereof (computed without regard to this paragraph) shall be considered to have been made on the last day of the preceding taxable year.

"(3) COMPUTATION OF EARNINGS AND PROFITS OF TAXABLE YEAR.—For the purposes of subsections (a)(3)(B) and (b)(2) in determining whether a

distribution is out of the earnings and profits of any taxable year, such earnings and profits shall be computed as of the close of such taxable year without diminution by reason of any distribution made during such taxable year or by reason of the tax under this subchapter for such year and the determination shall be made without regard to the amount of earnings and profits at the time the distribution was made.

"(4) STOCK IN CASE OF MERGER OR CONSOLIDATION.—If a corporation owns stock in another corporation, and—

"(A) such corporations are merged or consolidated in a statutory merger or consolidation, or

"(B) such corporations are parties to a transaction which results in the elimination of such stock in a manner similar to that resulting from a statutory merger or consolidation,

then such stock shall not be considered as property paid in for stock of, or as paid-in surplus of, or as a contribution to capital of, the corporation resulting from the transaction referred to in subparagraph (A) or (B).

"(d) For special rules affecting computation of property paid in for stock in connection with certain exchanges and liquidations, see section 751(a).

"(e) For determination of equity invested capital in special cases, see section 723.

"SEC. 719. BORROWED INVESTED CAPITAL.

"(a) BORROWED CAPITAL.—The borrowed capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following:

"(1) The amount of the outstanding indebtedness (not including interest, and not including indebtedness described in section 751(b) relating to certain exchanges) of the taxpayer which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust, plus,

"(2) In the case of a taxpayer having a contract (made before the expiration of 30 days after the date of the enactment of the Second Revenue Act of 1940) with a foreign government to furnish articles, materials, or supplies to such foreign government, if such contract provides for advance payment and for repayment by the vendor of any part of such advance payment upon cancellation of the contract by such foreign government, the amount which would be required to be so repaid if cancellation occurred at the beginning of such day, but no amount shall be considered as borrowed capital under this paragraph which has been includible in gross income.

"(b) BORROWED INVESTED CAPITAL.—The borrowed invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be an amount equal to 50 per centum of the borrowed capital for such day.

"SEC. 720. ADMISSIBLE AND INADMISSIBLE ASSETS.

"(a) DEFINITIONS.—For the purposes of this subchapter—

"(1) The term 'inadmissible assets' means—

"(A) Stock in corporations except stock in a foreign personal-holding company; and

"(B) Except as provided in subsection (d), obligations described in section 22(b)(4) any part of the interest from which is excludible from gross income or allowable as a credit against net income.

"(2) The term 'admissible assets' means all assets other than inadmissible assets.

"(b) RATIO OF INADMISSIBLES TO TOTAL ASSETS.—The amount by which the average invested capital for any taxable year shall be reduced as provided in section 715 shall be an amount which is the same percentage of such average invested capital as the percentage which the total of the inadmissible assets is of the total of admissible and inadmissible assets. For such purposes, the amount attributable to each asset held at any time during such taxable year shall be determined by ascertaining the adjusted basis thereof (or, in the case of money, the amount thereof) for each day of such taxable year so held and adding such daily amounts. The determination of such daily amounts shall be made under regulations prescribed by the Commissioner with the approval of the Secretary. The adjusted basis shall be the adjusted basis for determining loss upon sale or exchange as determined under section 113.

"(c) COMPUTATION IF SHORT-TERM CAPITAL GAIN.—If during the taxable year there has been a short-term capital gain with respect to an inadmissible asset, then so much of the amount attributable to such inadmissible asset under subsection (b) as bears the same ratio thereto as such gain bears to the sum of such gain plus the dividends and interest on such asset for such year, shall, for the purpose of determining the ratio of inadmissible assets to the total of admissible and inadmissible assets, be added to the total of admissible assets and subtracted from the total of inadmissible assets.

"(d) TREATMENT OF GOVERNMENT OBLIGATIONS AS ADMISSIBLE ASSETS.—If the excess profits credit for any taxable year is computed under section 714, the taxpayer may in its return for such year elect to increase its normal-tax net income for such taxable year by an amount equal to the amount of the interest on all obligations held during the taxable year which are described in section 22(b)(4) any part of the interest from which is excludible from gross income or allowable as a credit against net income. In such case, for the purposes of this section, the term 'admissible assets' includes such obligations, and the term 'inadmissible assets' does not include such obligations.

"SEC. 721. ABNORMALITIES IN INCOME IN TAXABLE PERIOD.

"If there is includible in the gross income of the taxpayer for any taxable year an item of income of any one or more of the following classes:

"(a) Arising out of a claim, award, judgment, or decree, or interest on any of the foregoing; or

"(b) Constituting an amount payable under a contract the performance of which required more than 12 months; or

"(c) Resulting from exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing, extending over a period of more than 12 months; or

"(d) Includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's accounting period or method of accounting; or

"(e) In the case of a lessor of real property, amounts included in gross income for the taxable year by reason of the termination of the lease; or

"(f) Dividends on stock of foreign corporations, except foreign personal holding companies;

and, in the light of the taxpayer's business, it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class, the item includible in the gross income of the taxable year is grossly disproportionate to the gross income of the same class in the four previous taxable years, then: (1) the amount of such item attributable to any previous taxable year or years shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary; (2) the amount of such item attributable to any future taxable year or years shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary and shall, for the purposes of this subchapter, be included in the gross income for the future year or years to which attributable; and (3) the tax under this subchapter for the taxable year (in which the whole of such item would, without regard to this section, be includible) shall not exceed the sum of:

"(A) The tax under this subchapter for such taxable year computed without the inclusion in gross income of the portion of such item which is attributable to any other taxable year, and

"(B) The aggregate of the increase in the tax under this subchapter which would have resulted for each previous taxable year to which any portion of such item is attributable, computed as if an amount equal to such portion had been included in gross income for such previous taxable year.

"SEC. 722. ADJUSTMENT OF ABNORMALITIES IN INCOME AND CAPITAL BY THE COMMISSIONER.

"For the purposes of this subchapter, the Commissioner shall also have authority to make such adjustments as may be necessary to adjust abnormalities affecting income or capital, and his decision shall be subject to review by the United States Board of Tax Appeals.

"SEC. 723. EQUITY INVESTED CAPITAL IN SPECIAL CASES.

"Where the Commissioner determines that the equity invested capital as of the beginning of the taxpayer's first taxable year under this subchapter cannot be determined in accordance with section 718, the equity invested capital as of the beginning of such year shall be an amount equal to the sum of (a) the money plus (b) the aggregate of the adjusted basis of the assets of the taxpayer held by the taxpayer at such time, such sum being reduced by the indebtedness outstanding at such time. The amount of the money, assets, and indebtedness at such time shall be determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary. In such case, the equity invested capital for each day after the beginning of the taxpayer's first taxable year under this subchapter shall be determined, in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, using as the basic figure the equity invested capital as so determined.

"SEC. 724. FOREIGN CORPORATIONS AND CORPORATIONS ENTITLED TO BENEFITS OF SECTION 251—INVESTED CAPITAL.

"Notwithstanding section 715, in the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, and in the case of a corporation entitled to the benefits of section 251, the invested capital for any taxable year shall be determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, under which—

"(a) GENERAL RULE.—The daily invested capital for any day of the taxable year shall be the aggregate of the adjusted basis of each United States asset held by the taxpayer on the beginning of such day. In the application of section 720 in reduction of the average invested capital (determined on the basis of such daily invested capital), the terms 'admissible assets' and 'inadmissible assets' shall include only United States assets; or

"(b) EXCEPTION.—If the Commissioner determines that the United States assets of the taxpayer cannot satisfactorily be segregated from its other assets, the invested capital for the taxable year shall be an amount which is the same percentage of the aggregate of the adjusted basis of all assets held by the taxpayer as of the end of the last day of the taxable year which the net income for the taxable year from sources within the United States is of the total net income of the taxpayer for such year.

"(c) DEFINITION OF UNITED STATES ASSET.—As used in this subsection, the term 'United States asset' means an asset held by the taxpayer in the United States, determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary.

"SEC. 725. PERSONAL SERVICE CORPORATIONS.

"(a) DEFINITION.—As used in this subchapter, the term 'personal service corporation' means a corporation whose income is to be ascribed primarily to the activities of shareholders who are regularly engaged in the active conduct of the affairs of the corporation and are the owners at all times during the taxable year of at least 70 per centum in value of each class of stock of the corporation, and in which capital is not a material income-producing factor; but does not include any foreign corporation, nor any corporation 50 per centum or more of whose gross income consists of gains, profits, or income derived from trading as a principal. For the purposes of this subsection, an individual shall be considered as owning, at any time, the stock owned at such time by his spouse or minor child or by any guardian or trustee representing them.

"(b) ELECTION AS TO TAXABILITY.—If a personal service corporation signifies, in its return under Chapter 1 for any taxable year, its desire not to be subject to the tax imposed under this subchapter for such taxable year, it shall be exempt from such tax for such year, and the provisions of Supplement S of Chapter 1 shall apply to the shareholders in such corporation who were such shareholders on the last day of such taxable year of the corporation.

"SEC. 726. CORPORATIONS COMPLETING CONTRACTS UNDER MERCHANT MARINE ACT, 1936.

"(a) If the United States Maritime Commission certifies to the Commissioner that the taxpayer has completed within the taxable year any contracts or subcontracts which are subject to the provisions of section 505(b) of the Merchant Marine Act of 1936, as amended, then the tax imposed by this subchapter for such taxable year shall be, in lieu of a tax computed under section 710, a tax computed under subsection (b) of this section, if, and only if, the tax computed under subsection (b) is less than the tax computed under section 710.

"(b) The tax computed under this subsection shall be the excess of—

"(1) A tentative tax computed under section 710 with the normal-tax net income increased by the amount of any payments made, or to be made, to the United States Maritime Commission with respect to such contracts or subcontracts; over

"(2) The amount of such payments.

"SEC. 727. EXEMPT CORPORATIONS.

"The following corporations shall be exempt from the tax imposed by this subchapter:

"(a) Corporations exempt under section 101 from the tax imposed by Chapter 1.

"(b) Foreign personal-holding companies, as defined in section 331.

"(c) Mutual investment companies, as defined in section 361.

"(d) Investment companies which under the Investment Company Act of 1940 are registered as diversified companies at all times during the taxable year. For the purposes of this subsection, if a company is so registered before July 1, 1941, it shall be considered as so registered at all times prior to the date of such registration.

"(e) Personal-holding companies, as defined in section 501.

"(f) Foreign corporations not engaged in trade or business within the United States and not having an office or place of business therein.

"(g) Domestic corporations satisfying the following conditions:

"(1) If 95 per centum or more of the gross income of such domestic corporation for the three-year period immediately preceding the close of the taxable year (or for such part of such period during which the corporation was in existence) was derived from sources other than sources within the United States; and

"(2) If 50 per centum or more of its gross income for such period or such part thereof was derived from the active conduct of a trade or business.

"(h) Any corporation subject to the provisions of Title IV of the Civil Aeronautics Act of 1938, in the gross income of which for any taxable year beginning after December 31, 1939, there is includible compensation received from the United States for the transportation of mail by aircraft if, after excluding from its gross income such compensation, its adjusted excess profits net income for such year is zero or less.

"SEC. 728. MEANING OF TERMS USED.

"The terms used in this subchapter shall have the same meaning as when used in Chapter 1.

"SEC. 729. LAWS APPLICABLE.

"(a) GENERAL RULE.—All provisions of law (including penalties) applicable in respect of the taxes imposed by Chapter 1, shall, insofar as not inconsistent with this subchapter, be applicable in respect of the tax imposed by this subchapter.

"(b) RETURNS.—Notwithstanding subsection (a), no return under section 52(a) shall be required to be filed by any taxpayer under this subchapter for any taxable year for which its excess profits net income, computed with the adjustments provided in section 711(a)(2) and placed on an annual basis as provided in section 711(a)(3), is not greater than $5,000.

"(c) FOREIGN TAXES PAID.—In the application of section 131 for the purposes of this subchapter the tax paid or accrued to any country shall be deemed to be the amount of such tax reduced by the amount of the credit allowed with respect to such tax against the tax imposed by Chapter 1.

"(d) LIMITATIONS ON AMOUNT OF FOREIGN TAX CREDIT.—The amount of the credit taken under this section shall be subject to each of the following limitations:

"(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's excess profits net income from sources within such country bears to its entire excess profits net income for the same taxable year; and

"(2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's excess profits net income from sources without the United States bears to its entire excess profits net income for the same taxable year.

"SEC. 730. CONSOLIDATED RETURNS.

"(a) PRIVILEGE TO FILE CONSOLIDATED RETURNS.—An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (b) prescribed prior to the last day prescribed by law for the filing of such return; and the making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

"(b) REGULATIONS.—The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the excess profits tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability.

"(c) COMPUTATION AND PAYMENT OF TAX.—In any case in which a consolidated return is made the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the last day prescribed by law for the filing of such return. Only one specific exemption of $5,000 provided in section 710(b)(1) shall be allowed for the entire affiliated group of corporations.

"(d) DEFINITION OF 'AFFILIATED GROUP'.—As used in this section, an 'affiliated group' means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

"(1) At least 95 per centum of each class of the stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

"(2) The common parent corporation owns directly at least 95 per centum of each class of the stock of at least one of the other includible corporations.

As used in this subsection, the term 'stock' does not include nonvoting stock which is limited and preferred as to dividends.

"(e) DEFINITION OF 'INCLUDIBLE CORPORATION'.—As used in this section, the term 'includible corporation' means any corporation except—

"(1) Corporations exempt from the tax imposed by this subchapter.

"(2) Foreign corporations.

"(3) Corporations organized under the China Trade Act, 1922.

"(4) Corporations entitled to the benefits of section 251, by reason of receiving a large percentage of their income from possessions of the United States.

"(5) Personal service corporations.

"(6) Insurance companies subject to taxation under section 201, 204, or 207.

"(f) INCLUDIBLE INSURANCE COMPANIES.—Despite the provisions of paragraph (6) of subsection (e), two or more domestic insurance companies each of which is subject to taxation under the same section of Chapter 1 shall be considered as includible corporations for the purpose of the application of subsection (d) to such insurance companies alone.

"(g) SUBSIDIARY FORMED TO COMPLY WITH FOREIGN LAW.—In the case of a domestic corporation owning or controlling, directly or indirectly, 100 per centum of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of a contiguous foreign country and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for the purpose of this subchapter as a domestic corporation.

"(h) SUSPENSION OF RUNNING OF STATUTE OF LIMITATIONS.—If a notice under section 272(a) in respect of a deficiency for any taxable year is mailed to a corporation, the suspension of the running of the statute of limitations, provided in section 277, shall apply in the case of corporations with which such corporation made a consolidated return for such taxable year.

"SEC. 731. CORPORATIONS ENGAGED IN MINING OF STRATEGIC METALS.

"In the case of any domestic corporation engaged in the mining of tungsten, quicksilver, manganese, platinum, antimony, chromite, or tin, the portion of the adjusted excess profits net income attributable to such mining in the United States shall be exempt from the tax imposed by this subchapter. The tax on the remaining portion of such adjusted excess profits net income shall be an amount which bears the same ratio to the tax computed without regard to this section as such remaining portion bears to the entire adjusted excess profits net income.

"PART II—RULES IN CONNECTION WITH CERTAIN EXCHANGES.

"SUPPLEMENT A—EXCESS PROFITS CREDITS BASED ON INCOME.

"SEC. 740. DEFINITIONS.

"For the purposes of this Supplement—

"(a) ACQUIRING CORPORATION.—The term 'acquiring corporation' means—

"(1) A corporation which has acquired—

"(A) substantially all the properties of another corporation and the whole or a part of the consideration for the transfer of such properties is the transfer to such other corporation of all the stock of all classes (except qualifying shares) of the corporation which has acquired such properties, or

"(B) substantially all the properties of another corporation and the sole consideration for the transfer of such properties is the transfer to such other corporation of voting stock of the corporation which has acquired such properties, or

"(C) before October 1, 1940, properties of another corporation solely as paid-in surplus or a contribution to capital in respect of voting stock owned by such other corporation.

For the purposes of subparagraphs (B) and (C) in determining whether such voting stock or such paid-in surplus or contribution to capital is the sole consideration, the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded. Subparagraph (B) or (C) shall apply only if the corporation transferring such properties is forthwith completely liquidated in pursuance of the plan under which the acquisition is made, and the transaction of which the acquisition is a part has the effect of a statutory merger or consolidation.

(2) A corporation which has acquired property from another corporation in a transaction with respect to which gain or loss was not recognized under section 112(b)(6) of Chapter 1 or a corresponding provision of a prior revenue law;

"(3) A corporation the result of a statutory merger of two or more corporations; or

"(4) A corporation the result of a statutory consolidation of two or more corporations.

"(b) COMPONENT CORPORATION.—The term 'component corporation' means—

"(1) In the case of a transaction described in subsection (a)(1), the corporation which transferred the assets;

"(2) In the case of a transaction described in subsection (a)(2), the corporation the property of which was acquired;

"(3) In the case of a statutory merger, all corporations merged, except the corporation resulting from the merger; or

"(4) In the case of a statutory consolidation, all corporations consolidated, except the corporation resulting from the consolidation.

"(c) QUALIFIED COMPONENT CORPORATION.—The term 'qualified component corporation' means a component corporation which was in existence on the date of the beginning of the taxpayer's base period.

"(b) BASE PERIOD.—In the case of a taxpayer which is an acquiring corporation the base period shall be:

"(1) If the tax is being computed for any taxable year beginning in 1940, the forty-eight months preceding the beginning of such taxable year; or

"(2) If the tax is being computed for any taxable year beginning after December 31, 1940, the forty-eight months preceding what would have been its first taxable year beginning in 1940 if it had had a taxable year beginning in 1940 on the date on which the taxable year for which the tax is being computed began.

"(e) BASE PERIOD YEARS.—In the case of a taxpayer which is an acquiring corporation its base period years shall be the four successive twelve-month periods beginning on the same date as the beginning of its base period.

"(f) EXISTENCE OF ACQUIRING CORPORATION.—For the purposes of subsection (c) and section 741, if any component corporation was in existence on the date of the beginning of the taxpayer's base period (either actually or by reason of this subsection), its acquiring corporation shall be considered to have been in existence on such date.

"(g) COMPONENT CORPORATIONS OF COMPONENT CORPORATIONS.—If a corporation is a component corporation of an acquiring corporation, under subsection (b) or under this subsection, it shall (except for the purposes of section 742(d) (1) and (2) and section 743(a)) also be a component corporation of the corporation of which such acquiring corporation is a component corporation.

"SEC. 741. ELECTION OF INCOME CREDIT.

"In addition to the corporations which under section 712(a) may elect the excess profits credit computed under section 713 or the excess profits credit computed under section 714, a taxpayer which is an acquiring corporation which was in existence on the date of the beginning of its base period shall have such election.

"SEC. 742. AVERAGE BASE PERIOD NET INCOME.

"In the case of a taxpayer which is an acquiring corporation which was actually in existence on the date of the beginning of its base period, or which is entitled under section 741 to elect the excess profits credit computed under section 713, its average base period net income (for the purpose of the credit computed under section 713) shall be computed as follows, in lieu of the method provided in section 713:

"(a) By ascertaining with respect to each of its base period years—

"(1) The amount of its excess profits net income for each of its taxable years beginning after December 31, 1935, and ending with or within such base period year; or, in the case of each such taxable year in which the deductions plus the credit for dividends received exceeded the gross income, the amount of such excess;

"(2) With respect to each of its qualified component corporations, the amount of its excess profits net income for each of its taxable years beginning after December 31, 1935, and ending with or within such base period year of the taxpayer; or, in the case of each such taxable year in which the deductions plus the credit for dividends received exceeded the gross income, the amount of such excess;

"(3) (A) The aggregate of the amounts of excess profits net income ascertained under paragraphs (1) and (2); (B) the aggregate of the excesses ascertained under paragraphs (1) and (2); and (C) the difference between the aggregates found under clause (A) and clause (B). If the aggregate ascertained under clause (A) is greater than the aggregate found under clause (B), the difference shall for the purposes of subsection (b) be designated a 'plus amount', and if the aggregate ascertained under clause (B) is greater than the aggregate found under clause (A), the difference shall for the purposes of subsection (b) be designated a 'minus amount'.

"(b) By adding the plus amounts ascertained under subsection (a)(3) for each year of the base period; and by subtracting from such sum, if for two or more years of the base period there was a minus amount, the sum of such minus amounts, excluding the greatest.

"(c) By dividing the amount ascertained under subsection (b) by four.

"(d) In no case shall the average base period net income be less than zero. In the case of a taxpayer which becomes an acquiring corporation in any taxable year beginning after December 31, 1939, if, on September 11, 1940, and at all times until the taxpayer became an acquiring corporation—

"(1) the taxpayer owned not less than 75 per centum of each class of stock of each of the qualified component corporations involved in the transaction in which the taxpayers became an acquiring corporation; or

"(2) one of the qualified component corporations involved in the transaction in which the taxpayer became an acquiring corporation or taxpayer, and of each of the other qualified component corporations involved in the transaction,

the average base period net income of the taxpayer shall not be less than (A) the average base period net income of that one of its qualified component corporations involved in the transaction the average base period net income of which is greatest, or (B) the average base period net income of the taxpayer computed without regard to the base period net income of any of its qualified component corporations involved in the transaction.

"(e) For the purposes of subsection (a) (1) and (2) of this section—

"(1) There shall be excluded, in the various computations, any dividends paid by the taxpayer or any of its qualified component corporations during any of the taxable years of the payor which are included in the computation of the taxpayer's average base period net income. If the payor corporation is a corporation described in subsection (f) (1) or (2) of this section, the dividends to be excluded under this paragraph shall be only such as are paid after such payor corporation first became an acquiring corporation; and

"(2) In determining whether, for any taxable year, the deductions plus the credit for dividends received exceeded the gross income, and in determining the amount of such excess, the adjustments provided in section 711(b)(1) shall be made.

"(f) (1) In the case of a taxpayer which is an acquiring corporation and which was not actually in existence on the date of the beginning of its base period, there shall be excluded from the various computations under subsection (a)(1) of this section the portion of its excess profits net income, or of the excess over gross income therein referred to, which is attributable to any period before it first became an acquiring corporation.

"(2) In the case of a component corporation which became a qualified component corporation only by reason of section 740(f), there shall be excluded from the various computations under subsection (a)(2) of this section the portion of its excess profits net income, or of the excess over gross income therein referred to, which is attributable to any period before it first became an acquiring corporation.

"(3) In the case of a qualified component corporation which was actually in existence on the date of the beginning of the taxpayer's base period, there shall be excluded from the various computations under subsection (a) (2) of this section the portion of its excess profits net income, or of the excess over gross income therein referred to, which is attributable to the period before such date.

"(4) If during the taxable year for which tax is computed under this subchapter the taxpayer acquires assets in a transaction which constitutes it an acquiring corporation, the amount includible under subsection (a)(2), attributable to such transaction, shall be limited to an amount which bears the same ratio to the amount computed without regard to this paragraph as the number of days in the taxable year after such transaction bears to the total number of days in such taxable year.

"SEC. 743. NET CAPITAL CHANGES.

"(a) For the purposes of section 713(c), upon the date of the transaction which constitutes a corporation an acquiring corporation, there shall be added to its daily capital addition or reduction for such day, the net capital addition or reduction, as the case may be, of each of the component corporations involved in such transaction, but no other capital addition or reduction shall be considered as having been made by reason of such transaction.

"(b) For the purposes of this section—

"(1) In computing the net capital addition of each such component corporation there shall be disregarded property paid in to such corporation by the taxpayer or by any of its component corporations.

"(2) In computing the net capital reduction of each such component corporation there shall be disregarded distributions made to the taxpayer or to any of such component corporations.

"SEC. 744. FOREIGN CORPORATIONS.

"The term 'corporation' as used in this Supplement does not include a foreign corporation.

"SUPPLEMENT B—HIGHEST BRACKET AMOUNT AND INVESTED CAPITAL.

"SEC. 750. DEFINITIONS.

"As used in this Supplement—

"(a) EXCHANGE.—The term 'exchange' means an exchange, to which section 112(b) (4) or (5) or so much of section 112 (c), (d), or (e) as refers to section

112(b) (4) or (5), or to which a corresponding provisions of a prior revenue law, is or was applicable, by one corporation of its property wholly or in part for stock or securities of another corporation, or a transfer of property by one corporation to another corporation after December 31, 1917, the basis of which in the hands of such other corporation is or was determined under section 113(a)(8)(B), or would have been so determined had such section been in effect.

"(b) TRANSFEROR UPON AN EXCHANGE.—The term 'transferor upon an exchange' means a corporation which upon an exchange transfers property to another corporation in exchange, wholly or in part, for stock or securities of such other corporation, or transfers property to another corporation after December 31, 1917, the basis of which in the hands of such other corporation is or was determined under section 113(a)(8)(B), or would have been so determined had such section been in effect.

"(c) TRANSFEREE UPON AN EXCHANGE.—The term 'transferee upon an exchange' means a corporation which upon an exchange acquires property from another corporation in exchange, wholly or in part, for its stock or securities, or which acquires property from another corporation after December 31, 1917, the basis of which in its hands is or was determined under section 113(a)(8)(B), or would have been so determined had such section been in effect.

"(d) CONTROL.—The term 'control' means the ownership of stock possessing at least 90 per centum of the total combined voting power of all classes of stock entitled to vote and at least 90 per centum of the total value of shares of all classes of stock of the corporation.

"(e) HIGHEST BRACKET AMOUNT.—The term 'highest bracket amount' means $500,000 or the highest bracket amount computed under section 752, whichever is the smaller.

"SEC. 751. DETERMINATION OF PROPERTY PAID IN FOR STOCK AND OF BORROWED CAPITAL IN CONNECTION WITH CERTAIN EXCHANGES.

"(a) PROPERTY PAID IN FOR STOCK.—In the application of section 718(a) to a transferee upon an exchange in determining the amount paid in for stock of the transferee, or as paid-in surplus or as a contribution to capital of the transferee, in connection with such exchange, only an amount shall be deemed to have been so paid in equal to the excess of the basis in the hands of the transferee of the property of the transferor received by the transferee upon the exchange over the sum of—

"(1) Any liability of the transferor assumed upon such exchange and any liability subject to which the property was received upon such exchange, plus

"(2) The aggregate of the amount of money and the fair market value of any other property transferred to the transferor not permitted to be received by such transferor without the recognition of gain.

"(b) BORROWED CAPITAL.—In the application of section 719(a) to a transferee upon an exchange, the term 'borrowed capital' shall not include indebtedness originally evidenced by securities issued by the transferee upon such exchange as consideration for the property of the transferor received by the transferee upon such exchange if (1) such securities were property permitted to be received by the person to whom such securities were issued without the recognition of gain and (2) the indebtedness originally evidenced by such securities did not arise out of indebtedness of the transferor (other than indebtedness which in the transferor's hands was subject to the limitations of this subsection) assumed by the transferee in connection with such exchange.

"SEC. 752. COMPUTATION OF HIGHEST BRACKET AMOUNT IN CONNECTION WITH EXCHANGES.

"(a) SPECIAL APPLICATION OF DAILY INVESTED CAPITAL OF TRANSFEROR UPON EXCHANGE.—For the purposes of this section, the daily invested capital of a transferor upon an exchange for the day after the exchange shall be the daily invested capital determined under section 717 reduced by an amount equal to the amount by which the equity invested capital of the transferee upon such exchange was increased by reason of the receipt of property from such transferor upon such exchange.

"(b) HIGHEST BRACKET AMOUNT OF TRANSFEROR.—

"(1) TAXABLE YEAR OF EXCHANGE.—In the case of a transferor upon an exchange after the beginning of its first taxable year under this subchapter, its highest bracket amount for the taxable year in which the exchange takes place shall be the sum of—

"(A) Its highest bracket amount immediately preceding the exchange multiplied by the number of days in the taxable year up to and including the day of the exchange, plus

"(B) Its highest bracket amount for the taxable year after the exchange, multiplied by the number of days in the taxable year remaining after the day of the exchange,

divided by the number of days in the taxable year.

"(2) TAXABLE YEARS AFTER EXCHANGE INVOLVING CONTROL.—In the case of a transferor upon an exchange after the beginning of its first taxable year under this subchapter, if immediately after the exchange the transferor or its shareholders, or both, are in control of the transferee, the transferor's highest bracket amount for any taxable year after the taxable year in which the exchange takes place shall be an amount which is a percentage of its highest bracket amount immediately preceding the exchange equal to the percentage which its daily invested capital for the day after the exchange is of its daily invested capital for the day of the exchange.

"(3) TAXABLE YEARS AFTER EXCHANGE NOT INVOLVING CONTROL.—In the case of a transferor upon an exchange (other than a transferor described in paragraph (4) of this subsection) after the beginning of its first taxable year under this subchapter, if immediately after the exchange no transferor or its shareholders, or both, upon the exchange are in control of the transferee, and if the shareholders of the transferee immediately preceding the exchange are not in control of the transferee immediately after the exchange, the transferor's highest bracket amount for any taxable year after the exchange shall be the excess, if any, of the sum of the transferor's highest bracket amount immediately preceding the exchange and the transferee's highest bracket amount immediately preceding the exchange, over $500,000.

"(4) TAXABLE YEARS AFTER CERTAIN EXCHANGES UNDER SECTION 112(b)(5).—In the case of an exchange after the beginning of the first taxable year under this subchapter of any transferor or transferee upon such exchange, involving two or more transferors, or one or more transferors and one or more other persons, if immediately after the exchange no one of such transferors, or its shareholders, or both, and no one or more of such other persons are in control of the transferee and if such exchange is an exchange described in section 112(b)(5) or so much of section 112(c) or 112(e) as refers to section 112(b)(5), the highest bracket amount of any such transferor for any taxable year after the exchange shall be an amount equal to its highest bracket amount immediately preceding the exchange—

"(A) Minus an amount which bears the same ratio to its highest bracket amount immediately preceding the exchange as the excess of its daily invested capital for the day of the exchange over its daily invested capital for the day after the exchange bears to its daily invested capital for the day of the exchange, and

"(B) Plus an amount which bears the same ratio to the excess over $500,000 of the sum of the amounts computed under subparagraph (A) with respect to each transferor, as the amount computed under subparagraph (A) with respect to such transferor bears to the sum of the amounts computed under such subparagraph with respect to each transferor.

"(c) HIGHEST BRACKET AMOUNT OF TRANSFEREE.—

"(1) TAXABLE YEAR OF EXCHANGE INVOLVING CONTROL.—In the case of a transferee upon an exchange after the beginning of the first taxable year under this subchapter of a transferor upon such exchange the transferee's highest bracket amount for the taxable year in which the exchange takes place shall be the sum of—

"(A) Its highest bracket amount immediately preceding the exchange multiplied by the number of days in the taxable year up to and including the day of the exchange, plus

"(B) Its highest bracket amount for the taxable year after the exchange multiplied by the number of days in the taxable year remaining after the day of the exchange,

divided by the number of days in the taxable year. For the purposes of this paragraph and subsection (d) of this section 'exchange' includes a liquidation described in paragraph (5) of this subsection, and such exchange shall be deemed to have taken place on the day such liquidation was completed.

"(2) TAXABLE YEARS AFTER EXCHANGE INVOLVING CONTROL.—In the case of a transferee upon an exchange after the beginning of the first taxable year under this subchapter of a transferor upon such exchange, if immediately after the exchange any transferor upon such exchange or its shareholders, or both, are in control of the transferee, the transferee's highest bracket amount for any taxable year after the exchange shall be an amount which is a percentage of such transferor's highest bracket amount immediately preceding the exchange equal to the percentage which the excess of the transferee's daily invested capital for the day after the exchange over its daily invested capital for the day of the exchange is of such transferor's daily invested capital for the day of the exchange.

"(3) TAXABLE YEARS AFTER EXCHANGE NOT INVOLVING CONTROL.—In the case of a transferee upon an exchange (other than a transferee described in paragraph (4) of this subsection) after the beginning of the first taxable year under this subchapter of a transferor upon such exchange, if immediately after the exchange no transferor or its shareholders, or both, are in control of the transferee, and if the shareholders of the transferee immediately preceding the exchange are not in control of the transferee immediately after the exchange, the transferee's highest bracket amount for any taxable year after the exchange shall be an amount equal to (A) the sum of the transferor's highest bracket amount immediately preceding the exchange and the transferee's highest bracket amount immediately preceding the exchange, or (B) $500,000, whichever is the smaller.

"(4) TAXABLE YEARS AFTER CERTAIN EXCHANGES UNDER SECTION 112(b)(5).—In the case of an exchange described in subsection (b)(4) of this section, the highest bracket amount of the transferee upon such exchange for any taxable year after the exchange shall be an amount equal (A) to the sum of the amounts computed under subparagraph (A) of such subsection with respect to each transferor or (B) $500,000, whichever is the smaller.

"(5) TAXABLE YEARS AFTER LIQUIDATION IN CASE OF CORPORATION RECEIVING PROPERTY UNDER SECTION 112(b)(6).—Upon the receipt by a corporation during any taxable year under this subchapter of property in complete liquidation of another corporation, gain or loss upon which is not recognized by reason of section 112(b)(6), the highest bracket amount of the corporation receiving such property for any taxable year after the liquidation is completed shall be an amount equal to its highest bracket amount immediately preceding the completion of the liquidation increased, but in no case to an amount above $500,000, by an amount equal to the highest bracket amount of such other corporation immediately preceding the completion of such liquidation, if previously and after the beginning of the first taxable year under this subchapter of the corporation receiving such property such corporation was a transferor upon an exchange with respect to which such other corporation was a transferee.

"(d) HIGHEST BRACKET AMOUNT IN CASE OF TWO OR MORE EXCHANGES IN SAME TAXABLE YEAR.—

"(1) If a transferor upon an exchange is in the same taxable year involved in more than one exchange (either as transferor or transferee), its highest bracket amount for such taxable year shall be the amount determined under subsection (b)(1) with respect to the last exchange in such taxable year. Its highest bracket amount immediately preceding any exchange in such taxable year subsequent to the first exchange therein shall be the amount computed under subsection (b)(1) with respect to the immediately preceding exchange as if the taxable year closed on the day of such subsequent exchange.

"(2) If a transferee upon an exchange is in the same taxable year involved in more than one exchange (either as transferee or transferor), its highest bracket amount for such taxable year shall be the amount determined under subsection (c)(1) with respect to the last exchange in such taxable year. Its highest bracket amount immediately preceding any exchange in such taxable year subsequent to the first exchange therein shall be the amount computed under subsection (c)(1) with respect to the immediately preceding exchange as if the taxable year closed on the day of such subsequent exchange.

"(3) If a transferor or transferee upon an exchange is in the same taxable year involved in more than one exchange (either as transferor or transferee), its highest bracket amount for any taxable year after the taxable

year in which such exchanges took place shall be the amount computed under subsection (b) (2), (3), or (4), or (c) (2), (3), (4), or (5), as the case may be, with respect to the last such exchange."

TITLE III—AMORTIZATION DEDUCTION.

SEC. 301. ALLOWANCE OF AMORTIZATION DEDUCTION.

Section 23 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsection:

"(t) AMORTIZATION DEDUCTION.—The deduction for amortization provided in section 124."

SEC. 302. COMPUTATION OF AMORTIZATION DEDUCTION.

The Internal Revenue Code is amended by inserting after section 123 the following new section:

"SEC. 124. AMORTIZATION DEDUCTION.

"(a) GENERAL RULE.—Every corporation, at its election, shall be entitled to a deduction with respect to the amortization of the adjusted basis of any emergency facility (as defined in subsection (e)), based on a period of sixty months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the adjusted basis of the facility at the end of such month divided by the number of months (including the month for which the deduction is computed) remaining in the period. Such adjusted basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction above provided with respect to any month shall, except to the extent provided in subsection (g) of this section, be in lieu of the deduction with respect to such facility for such month provided by section 23(l), relating to exhaustion, wear and tear, and obsolescence. The sixty-month period shall begin as to any emergency facility, at the election of the taxpayer, with the month following the month in which the facility was completed or acquired, or with the succeeding taxable year.

"(b) ELECTION OF AMORTIZATION.—The election of the taxpayer to take the amortization deduction and to begin the sixty-month period with the month following the month in which the facility was completed or acquired shall (except as provided in subsection (d)(3)) be made only by a statement to that effect in its return for the taxable year in which the facility was completed or acquired. Its election to take the amortization deduction and to begin such period with the taxable year succeeding such year shall be made only by a statement to that effect in its return for such succeeding taxable year.

"(c) TERMINATION OF AMORTIZATION DEDUCTION.—A taxpayer which has elected under subsection (b) to take the amortization deduction provided in subsection (a) may, at any time after making such election, discontinue the amortization deductions with respect to the remainder of the amortization period, such discontinuance to begin as of the beginning of any month specified by the taxpayer in a notice in writing filed with the Commissioner before the beginning of such month. The deduction provided under section 23(l) shall be allowed, beginning with the first month as to which the amortization deduction is not applicable, and the taxpayer shall not (except as provided in subsection (d)) be entitled to any further amortization deductions with respect to such emergency facility.

"(d) TERMINATION OF AMORTIZATION PERIOD.—

"(1) If the President has proclaimed the ending of the emergency period (as defined in subsection (e)), or if the Secretary of War or the Secretary of the Navy has, in accordance with regulations prescribed by the President, certified to the Commissioner that an emergency facility ceased, on the date specified in the certificate, to be necessary in the interest of national defense during the emergency period, and if the date of such proclamation or the date specified in such certificate occurs within sixty months from the beginning of the amortization period with respect to such emergency facility, then the taxpayer may elect (in accordance with paragraph (4) of this subsection) to terminate the amortization period with respect to such emergency facility as of the end of the month in which such proclamation was issued or in which occurred the date specified in such certificate, whichever is the earlier. In such case the amortization period with respect to such facility shall end with the end of such month in lieu of the end of the sixty-month period.

"(2) If the date of the proclamation or the date specified in the certificate referred to in paragraph (1) of this subsection occurs within sixty months

from the beginning of the amortization period with respect to such emergency facility and after the beginning of the month which the taxpayer has previously fixed under subsection (c) for the taking, in lieu of the amortization deduction provided in this section, of the deduction allowed by section 23(l), the taxpayer may elect (in accordance with paragraph (4) of this subsection) to terminate the amortization period with respect to such emergency facility as of the end of the month in which such proclamation was issued or in which occurred the date specified in such certificate, whichever is the earlier. In such case the amortization period with respect to such facility shall end with the end of such month in lieu of the end of the sixty-month period, and the termination of the amortization deduction under subsection (c) shall be disregarded.

"(3) In the case of a taxpayer which has not in either of its returns specified in subsection (b) elected to take an amortization deduction with respect to an emergency facility, if the date of the proclamation or the date specified in the certificate, referred to in paragraph (1) of this subsection, whichever is earlier, is before the expiration of sixty months from the last day of the month in which such emergency facility was completed or acquired, then the taxpayer may elect (in accordance with paragraph (4) of this subsection) the amortization deduction provided in subsection (a), using an amortization period beginning with the month following the month in which the emergency facility was completed or acquired and ending as of the end of the month within which such proclamation was issued or within which occurred the date specified in such certificate, whichever is the earlier.

"(4) The election provided in paragraph (1), (2), or (3) shall be made by filing with the Commissioner, in such manner, in such form, and within such time, as the Commissioner with the approval of the Secretary may by regulations prescribe, a statement of such election. When such election has been so made, then, under regulations prescribed by the Commissioner with the approval of the Secretary, the taxes for all taxable years, beginning with the taxable year in which the amortization period began, shall be computed in accordance with an amortization deduction computed in accordance with the method provided in subsection (a), but using (in lieu of the sixty-month period provided in such subsection) the amortization period specified in paragraph (1), (2), or (3), as the case may be.

"(5) RECOMPUTATION OF TAX IN CASE OF ELECTION UNDER THIS SUBSECTION.—If the adjustment of the income or excess-profits tax liability for any taxable year necessary to give effect to paragraph (4) of this subsection is prevented (A) on the date of the certificate of the Secretary of War or the Secretary of the Navy or on the date of the President's proclamation, whichever is the basis of the taxpayer's election under this subsection, or (B) within one year from such date, by any provision of law (other than this paragraph and other than section 3761, relating to compromises), an adjustment of the tax liability shall nevertheless be made if in respect of such taxable year a notice of deficiency is mailed or a claim for refund is filed, as the case may be, within one year after the date of such certificate or such proclamation, whichever is the basis of the taxpayer's election under this subsection. If at the time of the mailing of such notice of deficiency or the filing of such claim for refund, the adjustment is so prevented, then the amount of the adjustment authorized in this paragraph shall be limited to the increase or decrease in the tax previously determined for such taxable year which results solely from the effect of paragraph (4) of this subsection, and such amount shall be assessed and collected, or credited or refunded, in the same manner as if it were a deficiency or an overpayment, as the case may be, for such taxable year and as if on the date of such certificate or such proclamation, whichever is the basis of the taxpayer's election under this subsection, one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for the taxable year. The tax previously determined shall be ascertained in accordance with section 3801(d). The amount to be assessed and collected under this paragraph in the same manner as if it were a deficiency, or to be refunded or credited in the same manner as if it were an overpayment, shall not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of paragraph (4) of this subsection. Such amount, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss, other than one resulting from the effect of paragraph (4) of this subsection.

"(e) DEFINITIONS.—

"(1) EMERGENCY FACILITY.—As used in this section, the term 'emergency facility' means any facility, land, building, machinery, or equipment, or part thereof, the construction, reconstruction, erection, or installation of which was completed after June 10, 1940, or which was acquired after such date, and with respect to which a certificate under subsection (f) has been made.

"(2) EMERGENCY PERIOD.—As used in this section, the term 'emergency period' means the period beginning June 10, 1940, and ending on the date on which the President proclaims that the utilization of a substantial portion of the emergency facilities with respect to which certifications under subsection (f) have been made, is no longer required in the interest of national defense.

"(f) DETERMINATION OF ADJUSTED BASIS OF EMERGENCY FACILITY.—In determining, for the purposes of subsection (a) or subsection (h), the adjusted basis of an emergency facility—

"(1) There shall be included only so much of the amount otherwise constituting such adjusted basis as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after June 10, 1940, as the Advisory Commission to the Council of National Defense and either the Secretary of War or the Secretary of the Navy have certified, within the time specified in paragraph (3) of this subsection, and under such regulations as the President may prescribe, as necessary in the interest of national defense dur ng the emergency period;

"(2) After the completion or acquisition of any emergency facility with respect to which a certificate under paragraph (1) has been made, any expenditure (attributable to such facility and to the period after such completion or acquisition) which does not represent construction, reconstruction, erection, installation, or acquisition included in such certificate, but with respect to which a separate certificate is made under paragraph (1), shall not be applied in adjustment of the basis of such facility and shall be considered as an expenditure with respect to a new emergency facility; and

"(3) The certificate provided for in paragraph (1) shall have no effect unless made before whichever of the following dates is the later: (A) The beginning of such construction, reconstruction, erection, or installation, or the date of such acquisition, or (B) the one hundred and twentieth day after the date of the enactment of the Second Revenue Act of 1940.

"(g) DEPRECIATION DEDUCTION.—If the adjusted basis of the emergency facility computed without regard to subsection (f) of this section is in excess of the adjusted basis computed under such subsection, the deduction provided by section 23(l) shall, despite the provisions of subsection (a) of this section, be allowed with respect to such emergency facility as if its adjusted basis were an amount equal to the amount of such excess.

"(h) PAYMENT BY UNITED STATES OF UNAMORTIZED COST OF FACILITY.—If an amount is properly includible in the gross income of the taxpayer on account of a payment with respect to an emergency facility and such payment is certified as provided in this paragraph, then, at the election of the taxpayer in its return for the taxable year in which such amount is so includible—

"(1) The amortization deduction for the month in which such amount is so includible shall (in lieu of the amount of the deduction for such month computed under subsection (a)) be the amount so includible, but such deduction shall not be in excess of the adjusted basis of the emergency facility as of the end of such month (computed without regard to any amortization deduction for such month). Payments referred to in this paragraph shall be payments the amounts of which are certified, under such regulations as the President may prescribe, by either the Secretary of War or the Secretary of the Navy as compensation to the taxpayer for the unamortized cost of the emergency facility made because—

"(A) a contract with the United States involving the use of the facility has been terminated by its terms or by cancellation, or

"(B) the taxpayer had reasonable grounds (either from provisions of a contract with the United States involving the use of the facility, or from written or oral representations made under authority of the United States) for anticipating future contracts involving the use of the facility, which future contracts have not been made.

"(2) In case the taxpayer is not entitled to any amortization deduction with respect to the emergency facility the deduction allowable under section 23(l) on account of the month in which such amount is so includible shall be increased by such amount, but such deduction on account of such month

shall not be in excess of the adjusted basis of the emergency facility as of the end of such month (computed without regard to any amount allowable, on account of such month, under section 23(l) or this paragraph).

"(i) PROTECTION OF THE UNITED STATES.—If the taxpayer has been or will be reimbursed by the United States for all or a part of the cost of any emergency facility pursuant to any contract with the United States, either—

"(1) directly, by a provision therein dealing expressly with such remibursement, or

"(2) indirectly, because the price paid by the United States (insofar as return of cost of the facility is used as a factor in the fixing of such price) is recognized by the contract as including a return of cost greater than the normal exhaustion, wear and tear,

no amortization deduction with respect to such emergency facility shall be allowed for any month after the end of the month in which such contract is made, unless, before the expiration of ninety days after the making of such contract or one hundred and twenty days after the date of the enactment of the Second Revenue Act of 1940, whichever of such periods expires the later, the Advisory Commission to the Council of National Defense, and either the Secretary of War or the Secretary of the Navy certify to the Commissioner that such contract adequately protects the United States with reference to the future use and disposition of such emergency facility. A certificate by the Advisory Commission to the Council of National Defense and either the Secretary of War or the Secretary of the Navy, made to the Commissioner before the expiration of ninety days after the making of a contract or one hundred and twenty days after the date of the enactment of the Second Revenue Act of 1940, whichever of such periods expires the later, to the effect that, under such contract, reimbursement for all or a part of the cost of any emergency facility is not provided for within the meaning of clause (1) or clause (2), shall be conclusive for the purposes of this subsection.

"The terms and conditions of contracts with reference to reimbursement of the cost of emergency facilities and the protecting of the United States with reference to the future use and disposition of such emergency facilities shall be made available to the public."

TITLE IV—SUSPENSION OF PROFIT-LIMITING PROVISIONS OF THE VINSON ACT AND CERTAIN PROVISIONS OF THE MERCHANT MARINE ACT, 1936.

SEC. 401. SUSPENSION OF PROFIT-LIMITING PROVISIONS OF THE VINSON ACT.

The provisions of section 3 of the Act of March 27, 1934 (48 Stat. 505; 34 U. S. C., section 496), as amended, beginning with the first proviso thereof, and section 2(b) of the Act of June 28, 1940 (Public, Numbered 671, Seventy-sixth Congress, third session), shall not apply to contracts or subcontracts for the construction or manufacture of any complete naval vessel or any Army or Navy aircraft, or any portion thereof, which are entered into in any taxable year to which the excess profits tax provided in Subchapter E of Chapter 2 of the Internal Revenue Code is applicable or would be applicable if the contractor or subcontractor, as the case may be, were a corporation, and any agreement to pay into the Treasury profit in excess of 10 per centum, 12 per centum, or 8 per centum, as the case may be, of the contract prices of any such contracts or subcontracts shall be without effect. This section shall also apply to such contracts or subcontracts which were entered into before the date of the beginning of the contractor's or subcontractor's first taxable year which begins in 1940 and which are not completed before such date.

SEC. 402. SUSPENSION OF PROFIT-LIMITING PROVISIONS OF THE MERCHANT MARINE ACT, 1936, AS TO CERTAIN SUBCONTRACTS.

(a) The provisions of section 505(b) of the Merchant Marine Act of 1936, as amended, shall not apply to any subcontract which would otherwise be within such provisions if such subcontract is entered into in any taxable year of the subcontractor to which Subchapter E of Chapter 2 of the Internal Revenue Code is applicable and if the principal contractor and the subcontractor between which such subcontract is entered into are not affiliated within the meaning of subsection (b) of this section at the time such subcontract is entered into or at any time thereafer up to and including the date of its completion; and any agreement, pursuant to which the subcontractor is required to pay to the United States Maritime Commission profit in excess of 10 per centum of the contract price of any such subcontract or pursuant to which such an agreement is required to be obtained

from such subcontractor relative to such subcontract, shall be without effect. This subsection shall apply only if both the principal contractor and the subcontractor are corporations.

(b) For the purposes of this section, two or more corporations shall be deemed to be affiliated (1) if one corporation owns at least 95 per centum of the stock of the other or others, or (2) if at least 95 per centum of the stock of two or more corporations is owned by the same interests. As used in this subsection, the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

TITLE V—AMENDMENTS TO INTERNAL REVENUE CODE.

SEC. 501. EARNINGS AND PROFITS OF CORPORATIONS.

(a) UNDER INTERNAL REVENUE CODE.—Section 115 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsections:

"(l) EFFECT ON EARNINGS AND PROFITS OF GAIN OR LOSS AND OF RECEIPT OF TAX-FREE DISTRIBUTIONS.—The gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation—

"(1) for the purpose of the computation of earnings and profits of the corporation, shall be determined, except as provided in paragraph (2), by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, except that no regard shall be had to the value of the property as of March 1, 1913; but

"(2) for the purpose of the computation of earnings and profits of the corporation for any period beginning after February 28, 1913, shall be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain.

Gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent to which such a realized gain or loss was recognized in computing net income under the law applicable to the year in which such sale or disposition was made. Where in determining the adjusted basis used in computing such realized gain or loss the adjustment to the basis differs from the adjustment proper for the purpose of determining earnings or profits, then the latter adjustment shall be used in determining the increase or decrease above provided. Where a corporation receives (after February 28, 1913) a distribution from a second corporation which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, the amount of such distribution shall not increase the earnings and profits of the first corporation in the following cases:

"(1) No such increase shall be made in respect of the part of such distribution which (under such law) is directly applied in reduction of the basis of the stock in respect of which the distribution was made.

"(2) No such increase shall be made if (under such law) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received.

"(m) EARNINGS AND PROFITS—INCREASE IN VALUE ACCRUED BEFORE MARCH 1, 1913.—

"(1) If any increase or decrease in the earnings or profits for any period beginning after February 28, 1913, with respect to any matter would be different had the adjusted basis of the property involved been determined without regard to its March 1, 1913, value, then, except as provided in paragraph (2), an increase (properly reflecting such difference) shall be made in that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

"(2) If the application of subsection (1) to a sale or other disposition after February 28, 1913, results in a loss which is to be applied in decrease of earnings and profits for any period beginning after February 28, 1913, then, notwithstanding subsection (1) and in lieu of the rule provided in paragraph (1) of this subsection, the amount of such loss so to be applied shall be reduced by the amount, if any, by which the adjusted basis of the property used in determining the loss, exceeds the adjusted basis computed without regard to the value of the property on March 1, 1913, and if such amount so applied in reduction of the decrease exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913."

(b) EFFECTIVE DATE OF AMENDMENT.—The amendment made by subsection (a) shall be applicable to taxable years beginning after December 31, 1938.

(c) UNDER PRIOR ACTS.—For the purposes of the Revenue Act of 1938 or any prior Revenue Act the amendments made to the Internal Revenue Code by subsection (a) of this section shall be effective as if they were a part of each such Revenue Act on the date of its enactment. Nothing in this subsection shall affect the tax liability of any taxpayer for any year which, on September 20, 1940, was pending before, or was theretofore determined by, the Board of Tax Appeals, or any court of the United States.

SEC. 502. TAX OF SHAREHOLDERS OF PERSONAL SERVICE CORPORATIONS.

The Internal Revenue Code is amended by inserting after section 373 the following new Supplement:

"SUPPLEMENT S—TAX OF SHAREHOLDERS OF PERSONAL SERVICE CORPORATIONS.

"SEC. 391. APPLICABILITY OF SUPPLEMENT.

"If a personal service corporation (as defined in section 725) is exempt under such section for any taxable year from the excess profits tax imposed by such subchapter, the provisions of this Supplement shall be applicable with respect to each shareholder of such corporation who was a shareholder in such corporation on the last day of such taxable year of the corporation.

"SEC. 392. UNDISTRIBUTED SUPPLEMENT S NET INCOME.

"For the purposes of this chapter, the term 'undistributed Supplement S net income' means the Supplement S net income (as defined in section 393) minus the amount of the dividends paid during the taxable year. For the purposes of this section the amount of dividends paid shall be computed in the same manner as provided in subsections (d), (e), (f), (g), (h), and (i) of section 27 for the purpose of the basic surtax credit provided in section 27.

"SEC. 393. SUPPLEMENT S NET INCOME.

"For the purposes of this chapter 'Supplement S net income' means the net income, except that there shall be allowed as additional deductions—

"(a) The Federal income tax payable under this chapter for the taxable year; and

"(b) In lieu of the deduction allowed by section 23(q), contributions or gifts, payment of which is made within the taxable year, to or for the use of donees described in section 23(q) for the purposes therein specified, to an amount which does not exceed 15 per centum of the corporation's net income, computed without the benefit of this subsection and section 23(q).

"SEC. 394. CORPORATION INCOME TAXED TO SHAREHOLDERS.

"(a) GENERAL RULE.—The undistributed Supplement S net income of a personal service corporation shall be included in the gross income of the shareholders in the manner and to the extent set forth in this Supplement.

"(b) AMOUNT INCLUDED IN GROSS INCOME.—Each shareholder who, on the last day of the taxable year of the corporation, was a shareholder in such corporation shall include in his gross income, as a dividend, for the taxable year in which or with which the taxable year of the corporation ends, the amount he would have received as a dividend if on such last day there had been distributed by the corporation, and received by the shareholders, an amount equal to the undistributed Supplement S net income of the corporation for its taxable year.

"(c) CREDIT FOR OBLIGATIONS OF THE UNITED STATES AND ITS INSTRUMENTALITIES.—Each such shareholder shall be allowed a credit against net income, for the purposes of the tax imposed by section 11, 13, 14, 201, 204, 207, or 362, of his proportionate share of the interest specified in section 25(a) (1) or (2) which is included in the gross income of the corporation.

"(d) EFFECT ON CAPITAL ACCOUNT OF PERSONAL SERVICE CORPORATION.—An amount equal to the undistributed Supplement S net income of the personal service corporation for its taxable year shall be considered as paid in as of the close of such taxable year as paid-in surplus or as a contribution to capital, and the accumulated earnings and profits as of the close of such taxable year shall be correspondingly reduced, if such amount or any portion thereof is required to be included as a dividend in the gross income of the shareholders.

"(e) BASIS OF STOCK IN HANDS OF SHAREHOLDERS.—The amount required to be included in the gross income of the shareholder under subsection (b) shall,

for the purpose of adjusting the basis of his stock with respect to which the distribution would have been made (if it had been made), be treated as having been reinvested by the shareholder as a contribution to the capital of the corporation; but only to the extent to which such amount is included in his gross income in his return, increased or decreased by any adjustment of such amount in the last determination of the shareholder's tax liability, made before the expiration of seven years after the date prescribed by law for filing the return.

"(f) PERIOD OF LIMITATION ON ASSESSMENT AND COLLECTION.—For period of limitation on assessment and collection without assessment, in the case of failure to include in gross income the amount properly includible therein under subsection (b), see section 275(d).

"SEC. 395. NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS.

"In the case of a shareholder taxable under section 211(a) or 231(a), his distributive share of the undistributed Supplement S net income of the corporation required to be included in the gross income shall be considered as a dividend received by him from sources within the United States.

"SEC. 396. SHAREHOLDER'S TAX PAID BY CORPORATION.

"If a personal service corporation is exempt for any taxable year under section 725 from excess profits tax, it shall, at the time of filing its return, pay to the collector an amount equal to the amount that would be required by section 143(b) or section 144 to be deducted and withheld by the corporation if any amount required by this Supplement to be included in the gross income of the shareholder had been, on the last day of the taxable year of the corporation, paid to the shareholder in cash as a dividend. Such amount shall be collected and paid in the same manner as the amount of tax due in excess of that shown by the taxpayer upon a return in the case of a mathematical error appearing on the face of the return."

SEC. 503. STATUTE OF LIMITATIONS IN CASE OF CONSTRUCTIVE DIVIDENDS.

Section 275(d) of the Internal Revenue Code (relating to statute of limitations) is amended to read as follows:

"(d) CONSTRUCTIVE DIVIDENDS.—If the taxpayer omits from gross income an amount properly includible therein—

"(1) FOREIGN PERSONAL-HOLDING COMPANIES.—Under section 337(b) (relating to the inclusion in the gross income of United States shareholders of their distributive shares of the undistributed Supplement P net income of a foreign personal-holding company); or

"(2) PERSONAL SERVICE CORPORATIONS.—Under section 394(b) (relating to the inclusion in the gross income of shareholders of their distributive shares of undistributed Supplement S net income of a personal service corporation);

the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within seven years after the return was filed."

SEC. 504. CREDIT OF NONRESIDENT ALIEN OF TAX AS SHAREHOLDER IN PERSONAL SERVICE CORPORATION.

Section 216 of the Internal Revenue Code (relating to credit against tax of a nonresident alien individual) is amended by adding at the end thereof a new sentence to read as follows: "A nonresident alien individual shall be allowed as a credit against his tax the amount required by section 396 to be paid by the personal service corporation of which he is a shareholder with respect to his tax liability under Supplement S."

SEC. 505. CREDIT OF FOREIGN CORPORATION OF TAX AS SHAREHOLDER IN PERSONAL SERVICE CORPORATION.

Section 234 of the Internal Revenue Code (relating to credits against tax of foreign corporations) is amended by adding at the end thereof a new sentence to read as follows: "A foreign corporation shall be allowed as a credit against its tax the amount required by section 396 to be paid by the personal service corporation of which it is a shareholder with respect to its tax liability under Supplement S."

SEC. 506. CHANGE OF NAME OF EXISTING EXCESS-PROFITS TAX.

(a) Subchapter B of Chapter 2 of the Internal Revenue Code is amended, effective February 10, 1939, by striking out, in the heading of such subchapter,

"EXCESS PROFITS TAX" and inserting in lieu thereof "DECLARED VALUE EXCESS-PROFITS TAX", and by striking out, in the first paragraph of section 600 of such subchapter, "excess-profits tax" and inserting in lieu thereof "declared value excess-profits tax".

(b) Section 23(c)(1) of the Internal Revenue Code (relating to taxes not deductible in computing net income) is amended, effective February 10, 1939, to read as follows:

"(1) Federal income, war-profits, and excess-profits taxes (other than the excess-profits tax imposed by section 106 of the Revenue Act of 1935 (49 Stat. 1019), or by section 602 of the Revenue Act of 1938 (52 Stat. 567), and other than the declared value excess-profits tax imposed by section 600);".

SEC. 507. PUBLICITY OF RETURNS OF SUBCHAPTER E EXCESS PROFITS TAX.

Section 55(a)(2) of the Internal Revenue Code is amended by striking out "Subchapters A, B, and D of Chapter 2" and inserting in lieu thereof "Subchapters A, B, D, and E of Chapter 2".

SEC. 508. TECHNICAL AMENDMENTS.

(a) LIMITATION ON ASSESSMENT AND COLLECTION.—Section 3312 of the Internal Revenue Code (relating to period of limitation on assessment and collection of taxes) is amended by striking out "Except in the case of income, estate, and gift taxes" and inserting in lieu thereof "Except in the case of income, war-profits, excess-profits, estate, and gift taxes".

(b) ABATEMENT, CREDIT, AND REFUND OF TAXES.—Section 3770(a)(1) of the Internal Revenue Code (relating to authority to abate, credit, or refund tax) is amended by striking out "Except as otherwise provided by law in the case of income, estate, and gift taxes" and inserting in lieu thereof "Except as otherwise provided by law in the case of income, war-profits, excess-profits, estate, and gift taxes".

TITLE VI—NATIONAL SERVICE LIFE INSURANCE AND PROVISIONS AFFECTING THE RAILROAD RETIREMENT BOARD.

PART I—NATIONAL SERVICE LIFE INSURANCE.

SEC. 601. When used in this part—

(a) The term "person" means (1) a commissioned officer; (2) a warrant officer; (3) enlisted personnel (including persons selected for training and service under the Selective Training and Service Act of 1940); (4) a member of the Army Nurse Corps (female); and (5) a member of the Navy Nurse Corps (female);

(b) The term "Administrator" means the Administrator of Veterans' Affairs;

(c) The term "active service" means active service in the land or naval forces (including the Coast Guard) of the United States and service in the land or naval forces of the United States under the Selective Training and Service Act of 1940, but the service of any person ordered to active duty in any such force for a period of thirty days or less, shall not be deemed to be active service in such force during such period;

(d) The term "insurance" means National Service Life Insurance;

(e) The term "child" includes an adopted child.

SEC. 602. (a) Every person who is commissioned and hereafter ordered into, or who is hereafter examined, accepted, and enrolled in, the active service and while in such active service shall, upon application in writing (made within one hundred and twenty days after entrance into such active service) and payment of premiums as hereinafter provided and without further medical examination, be granted insurance on the five-year level premium term plan by the United States against the death of such person occurring while such insurance is in force.

(b) Any person who is released from active service within one hundred and twenty days after such enrollment shall be granted such insurance upon application therefor in writing (made within one hundred and twenty days after a subsequent enrollment or entrance into active service and before discharge or resignation therefrom), and upon payment of premiums and evidence satisfactory to the Administrator showing such person to be in good health at the time of such application.

(c) Any person upon reenlistment or reentrance into or reemployment in active service and before discharge or resignation therefrom and any person in the active service upon discharge to accept a commission and before resignation therefrom, shall be granted such insurance upon application therefor in writing

(made within one hundred and twenty days following such reenlistment, reentrance, reemployment, or discharge to accept a commission), and upon payment of premiums and evidence satisfactory to the Administrator showing such person to be in good health at the time of such application.

(d) Any person who has been commissioned, or examined, accepted, and enrolled, in the active service and is in such active service on the date of enactment of this Act shall be granted such insurance upon application therefor in writing (made within one hundred and twenty days after the date of enactment of this Act and before discharge or resignation from such active service), and upon payment of premiums and evidence satisfactory to the Administrator showing such person to be in good health at the time of such application.

(e) The premium rates for such insurance shall be the net rates based upon the American Experience Table of Mortality and interest at the rate of 3 per centum per annum. All cash, loan, paid up, and extended values, and all other calculations in connection with such insurance, shall be based upon said American Experience Table of Mortality and interest at the rate of 3 per centum per annum.

(f) Such insurance shall be issued upon the five year level premium term plan, with the privilege of conversion as of the date when any premium becomes or has become due, or exchange as of the date of the original policy, upon payment of the difference in reserve, at any time after such policy has been in effect for one year and within the five year term period, to policies of insurance upon the following plans: Ordinary life, twenty payment life, thirty payment life. All five year level premium term policies shall cease and terminate at the expiration of the five year term period. Provisions for cash, loan, paid up, and extended values, dividends from gains and savings, refund of unearned premiums, and such other provisions as may be found to be reasonable and practicable, may be provided for in the policy of insurance or from time to time by regulations promulgated by the Administrator.

(g) The insurance shall be payable only to a widow, widower, child (including a stepchild or an illegitimate child if designated as beneficiary by the insured), parent (including person in loco parentis if designated as beneficiary by the insured), brother or sister of the insured. The insured shall have the right to designate the beneficiary or beneficiaries of the insurance, but only within the classes herein provided, and shall, subject to regulations, at all times have the right to change the beneficiary or beneficiaries of such insurance without the consent of such beneficiary or beneficiaries but only within the classes herein provided.

(h) Such insurance shall be payable in the following manner:

(1) If the beneficiary to whom payment is first made is under thirty years of age at the time of maturity, in two hundred and forty equal monthly installments.

(2) If the beneficiary to whom payment is first made is thirty or more years of age at the time of maturity, in equal monthly installments for one hundred and twenty months certain, with such payments continuing during the remaining lifetime of such beneficiary.

(3) Any installments certain of insurance remaining unpaid at the death of any beneficiary shall be paid in equal monthly installments in an amount equal to the monthly installments paid to the first beneficiary, to the person or persons then in being within the classes hereinafter specified and in the order named, unless designated by the insured in a different order—

(A) to the widow or widower of the insured, if living;

(B) if no widow or widower, to the child or children of the insured, if living, in equal shares;

(C) if no widow, widower, or child, to the parent or parents of the insured, if living, in equal shares;

(D) if no widow, widower, child, or parent, to the brothers and sisters of the insured, if living, in equal shares.

(i) If no beneficiary is designated by the insured or if the designated beneficiary does not survive the insured, the beneficiary shall be determined in accordance with the order specified in subsection (h)(3) of this section and the insurance shall be payable in equal monthly installments in accordance with subsection (h) (1) or (2), as the case may be. The right of any beneficiary to payment of any installments shall be conditioned upon his or her being alive to receive such payments. No person shall have a vested right to any install-

ment or installments of any such insurance and any installments not paid to a beneficiary during such beneficiary's lifetime shall be paid to the beneficiary or beneficiaries within the permitted class next entitled to priority, as provided in subsection (h).

(j) No installments of such insurance shall be paid to the heirs or legal representatives as such of the insured or of any beneficiary, and in the event that no person within the permitted class survives to receive the insurance or any part thereof no payment of the unpaid installments shall be made.

(k) When the amount of an individual monthly payment is less than $5, such amount may, in the discretion of the Administrator, be allowed to accumulate without interest and be disbursed annually.

(l) Any payments of insurance made to a person represented by the insured to be within the permitted class of beneficiaries shall be deemed to have been properly made and to satisfy fully the obligation of the United States under such insurance policy to the extent of such payments.

(m) The Administrator shall, by regulations, prescribe the time and method of payment of the premiums on such insurance, but payments of premiums in advance shall not be required for periods of more than one month each, and may at the election of the insured be deducted from his active service pay or be otherwise made.

(n) Upon application by the insured and under such regulations as the Administrator may promulgate, payment of premiums on such insurance may be waived during continuous total disability of the insured which commenced subsequent to the effective date of such insurance and which has existed for six consecutive months or more prior to the attainment by the insured of the age of sixty years, effective as of the due date of the monthly premium becoming payable on or after the first day of the seventh consecutive month of such disability: *Provided*, That application for waiver is made while the insurance is currently kept in force by the payment of premiums, and the insured furnishes proof satisfactory to the Administrator showing that he is and has been continuously totally disabled for six or more months prior to attaining sixty years of age. Any waiver granted by the Administrator under this subsection shall not become effective prior to the date of application therefor; except that, in the discretion of the Administrator, it may be made effective at any time within a period of not more than six months prior to such date but in no event prior to the first day of the seventh month of such continuous disability. Any premiums tendered to cover a period during which such waiver is effective shall be refunded. The Administrator shall provide by regulations for reexaminations of beneficiaries under this subsection and, in the event that it is found that an insured is no longer totally disabled, the waiver of premiums shall cease as of the date of such finding and the policy of insurance may be continued by payment of premiums as provided in said policy. Premium rates shall be calculated without charge for the cost of the waiver of premiums herein provided and no deduction from benefits otherwise payable shall be made on account thereof.

(o) The Administrator shall promptly determine and publish the terms and conditions of such insurance. Pending the promulgation of the terms and conditions of the five year level premium term policy and the printing of such policy, the Administrator may issue a certificate in lieu thereof as evidence that insurance has been granted and the rights and liabilities of the applicant and of the United States shall be those specified by the terms and conditions of the policy when published.

(p) Such insurance may be made effective, as specified in the application, not later than the first day of the calendar month following the date of application therefor, but the United States shall not be liable thereunder for death occurring prior to such effective date.

(q) Such insurance shall be issued in any multiple of $500 and the amount of such insurance with respect to any one person shall be not less than $1,000 or more than $10,000.

SEC. 603. No person may carry a combined amount of National Service Life Insurance and United States Government life insurance in excess of $10,000 at any one time.

SEC. 604. There is hereby authorized to be appropriated, out of any money in the Treasury not otherwise appropriated, such sums as may be necessary to carry out the provisions of this part, to be known as the National Service Life Insurance appropriation, for the payment of liabilities under National Service

Life Insurance. Payments from this appropriation shall be made upon and in accordance with awards by the Administrator.

SEC. 605. (a) There is hereby created in the Treasury a permanent trust fund to be known as the National Service Life Insurance Fund. All premiums paid on account of National Service Life Insurance shall be deposited and covered into the Treasury to the credit of such fund, which, together with interest earned thereon, shall be available for the payment of liabilities under such insurance, including payment of dividends and refunds of unearned premiums. Payments from this fund shall be made upon and in accordance with awards by the Administrator.

(b) The Administrator is authorized to set aside out of such fund such reserve amounts as may be required under accepted actuarial principles, to meet all liabilities under such insurance; and the Secretary of the Treasury is hereby authorized to invest and reinvest such fund, or any part thereof, in interest-bearing obligations of the United States or in obligations guaranteed as to principal and interest by the United States, and to sell such obligations for the purposes of such fund.

SEC. 606. The United States shall bear the cost of administration in connection with this part, including expenses for medical examinations, printing and binding, and for such other expenditures as are necessary in the discretion of the Administrator. The appropriations made for the Veterans' Administration for the fiscal year 1941 for administrative expenses shall be available for the payment of such costs of administration under this part.

SEC. 607. (a) The United States shall bear the excess mortality cost and the cost of waiver of premiums on account of total disability traceable to the extra hazard of military or naval service, as such hazard may be determined by the Administrator.

(b) Whenever benefits under such insurance become payable because of the death of the insured as the result of disease or injury traceable to the extra hazard of military or naval service, as such hazard may be determined by the Administrator, the liability for payment of such benefits shall be borne by the United States in an amount which, when added to the reserve of the policy at the time of death of the insured, will equal the then value of such benefits under such policy. The Administrator is authorized and directed to transfer from time to time from the National Service Life Insurance appropriation to the National Service Life Insurance Fund such sums as may be necessary to carry out the provisions of this section.

(c) Whenever the premiums under such insurance are waived as provided in section 602(n) because of the total disability of the insured as the result of disease or injury traceable to the extra hazard of military or naval service, as such hazard may be determined by the Administrator, the premiums so waived shall be paid by the United States and the Administrator is authorized and directed to transfer from time to time an amount equal to the amount of such premiums from the National Service Life Insurance appropriation to the National Service Life Insurance Fund.

SEC. 608. The Administrator, subject to the general direction of the President, shall administer, execute and enforce the provisions of this part, shall have power to make such rules and regulations, not inconsistent with the provisions of this part, as are necessary or appropriate to carry out its purposes, and shall decide all questions arising hereunder. All officers and employees of the Veterans' Administration shall perform such duties in connection with the administration of this part as may be assigned to them by the Administrator. All official acts performed by such officers or employees designated therefor by the Administrator shall have the same force and effect as though performed by the Administrator in person. Except in the event of suit as provided in section 617 hereof, all decisions rendered by the Administrator under the provisions of this part, or regulations issued pursuant thereto, shall be final and conclusive on all questions of law and fact, and no other official or court of the United States shall have jurisdiction to review by motion or otherwise any such decision.

SEC. 609. (a) There shall be no recovery of payments made under this part from any person who, in the judgment of the Administrator, is without fault on his part and where, in the judgment of the said Administrator, such recovery would defeat the purpose of benefits otherwise authorized herein or would be against equity and good conscience. No disbursing officer or certifying officer shall be held liable for any amount paid to any person where the recovery of such amount is waived under this section.

(b) Where, under the provisions of this section, the recovery of a payment made from the National Service Life Insurance Fund is waived, the National Service Life Insurance Fund shall be reimbursed for the amount of such payment from the current appropriation for National Service Life Insurance.

SEC. 610. No State law providing for presumption of death shall be applicable to claims for National Service Life Insurance. If evidence satisfactory to the Administrator is produced establishing the fact of the continued and unexplained absence of any individual from his home and family for a period of seven years, during which period no evidence of his existence has been received, the death of such individual as of the date of the expiration of such period may, for the purposes of this part, be considered as sufficiently proved.

SEC. 611. No United States Government life insurance shall be granted hereafter to any person under the provisions of section 300 of the World War Veterans' Act, 1924, as amended: *Provided*, That this section shall not be construed to prohibit the issue of United States Government life insurance policies in cases in which acceptable applications accompanied by proper and valid remittances or authorizations for the payment of premiums have, prior to the date of enactment of this Act, been received by the Veterans' Administration or which have, prior to said date, been placed in the mails properly directed to said Veterans' Administration, or been delivered to an authorized representative of the War Department, the Navy Department, or the Coast Guard, and which are forwarded to the Veterans' Administration not later than one hundred and twenty days subsequent to said date.

SEC. 612. Any person guilty of mutiny, treason, spying, or desertion, or who, because of conscientious objections, refuses to perform service in the land or naval forces of the United States or refuses to wear the uniform of such force, shall forfeit all rights to insurance under this part. No insurance shall be payable for death inflicted as a lawful punishment for crime or for military or naval offense, except when inflicted by an enemy of the United States; but the cash surrender value, if any, of such insurance on the date of such death shall be paid to the designated beneficiary, if living, or otherwise to the beneficiary or beneficiaries within the permitted class in accordance with the order specified in section 602(h)(3).

SEC. 613. Whoever in any claim for insurance issued under the provisions of this part makes any sworn statement of a material fact knowing it to be false, shall be guilty of perjury and shall, upon conviction thereof, be punished by a fine of not more than $5,000, or by imprisonment for not more than two years, or by both such fine and imprisonment.

SEC. 614. Whoever, with intent to defraud the United States or any beneficiary of such insurance, shall obtain or receive any money or check for National Service Life Insurance without being entitled to the same, shall, upon conviction thereof, be punished by a fine of not more than $2,000, or by imprisonment for not more than one year, or by both such fine and imprisonment.

SEC. 615. Any person who shall knowingly make or cause to be made, or conspire, combine, aid, or assist in, agree to, arrange for, or in any wise procure the making or presentation of a false or fraudulent affidavit, declaration, certificate, statement, voucher, or paper, or writing purporting to be such, concerning any application for insurance or reinstatement thereof, waiver of premiums or claim for benefits under National Service Life Insurance for himself or any other person, shall, upon conviction thereof, be punished by a fine of not more than $1,000, or imprisonment for not more than one year, or by both such fine and imprisonment.

SEC. 616. The provisions of Public Law Numbered 262, Seventy-fourth Congress, approved August 12, 1935 (49 Stat. 607), and titles II and III of Public Law Numbered 844, Seventy-fourth Congress, approved June 29, 1936 (49 Stat. 2031), insofar as they are applicable, shall apply to the provisions of this part.

SEC. 617. In the event of a disagreement as to claim arising under this part, suit may be brought in the same manner and subject to the same conditions and limitations as are applicable to United States Government (converted) life insurance under the provisions of sections 19 and 500 of the World War Veterans' Act, 1924, as amended: *Provided*, That in any such suit the decision of the Administrator as to waiver or nonwaiver of premiums under section 602(n) shall be conclusive and binding on the court.

SEC. 618. This part may be cited as the "National Service Life Insurance Act of 1940".

PART II—CREDITING MILITARY SERVICE FOR ANNUITY PURPOSES UNDER THE RAILROAD RETIREMENT ACTS.

SEC. 625. The Act entitled "An Act to amend an Act entitled 'An Act to establish a retirement system for employees of carriers subject to the Interstate Commerce Act, and for other purposes,' approved August 29, 1935," approved June 24, 1937 (50 Stat. 307), is hereby amended by inserting after section 3 the following new section:

"MILITARY SERVICE.

"SEC. 3A. (a) For the purposes of determining eligibility for an annuity and computing an annuity, including a minimum annuity, there shall also be included in an individual's years of service, within the limitations hereinafter provided in this section, voluntary or involuntary military service of an individual prior to January 1, 1937, within or without the United States during any war service period: *Provided, however*, That such military service shall be included only subject to and in accordance with the provisions of subsection (b) of section 3, in the same manner as though military service were service rendered as an employee: *Provided further*, That an individual who entered military service prior to a war service period shall not be regarded as having been in military service in a war service period with respect to any part of the period for which he entered such military service.

"(b) For the purpose of this section and section 202, as amended, an individual shall be deemed to have been in 'military service' when commissioned or enrolled in the active service of the land or naval forces of the United States and until resignation or discharge therefrom; and the service of any individual in any reserve component of the land or naval forces of the United States who was ordered to active duty in any such force for a period of thirty days or less shall be deemed to have been active service in such force during such period.

"(c) For the purpose of this section and section 202, as amended, a 'war service period' shall mean (1) any war period, or (2) with respect to any particular individual, any period during which such individual (i) having been in military service at the end of a war period, was required to continue in military service, or (ii) was required by any Act of Congress, any regulation promulgated, order issued, or proclamation made, in pursuance of such Act, to enter and continue in military service.

"(d) For the purpose of this section and section 202, as amended, a 'war period' shall be deemed to have begun on whichever of the following dates is the earliest: (1) the date on which the Congress of the United States declared war; or (2) the date as of which the Congress of the United States declared that a state of war has existed; or (3) the date on which war was declared by one or more foreign states against the United States; or (4) the date on which any part of the United States or any territory under its jurisdiction was invaded or attacked by any armed force of one or more foreign states; or (5) the date on which the United States engaged in armed hostilities for the purpose of preserving the Union or of maintaining in any State of the Union a republican form of government.

"(e) For the purpose of this section and section 202, as amended, a 'war period' shall be deemed to have ended on the date on which hostilities ceased.

"(f) Military service shall not be included in the years of service of an individual unless, in the calendar year in which his military service in a war service period began, or in the calendar year next preceding such calendar year, he rendered service for compensation to an employer, or to a person service to which is otherwise creditable under this Act, or lost time as an employee for which he received remuneration, or was serving as an employee representative.

"(g) A calendar month in which an individual was in military service which may be included in the individual's years of service or service period, as the case may be, shall be counted as a month of service: *Provided, however*, That no calendar month shall be counted as more than one month of service.

"(h) In determining the monthly compensation for computing an annuity, military service and any remuneration therefor shall be disregarded.

"(i) In the event military service is or has been used as the basis or as a partial basis for a pension, disability compensation, or any other gratuitous benefits payable on a periodic basis under any other Act of Congress, any

annuity under this Act or the Railroad Retirement Act of 1935, which is based in part on such military service and is with respect to a calendar month for all or part of which such pension or other benefit is also payable, shall be reduced with respect to that month by the proportion which the number of years of service by which such military service increases the years of service, or the service period, as the case may be, bears to the total years of service, or by the aggregate amount of such pension or other benefit with respect to that month, whichever would result in the smaller reduction.

"(j) Any department or agency of the United States maintaining records of military service, at the request of the Board, shall certify to the Board, with respect to any individual, the number of months of military service which such department or agency finds the individual to have had during any period or periods with respect to which the Board's request is made, the date and manner of entry into such military service, and the conditions under which such service was continued. Any department or agency of the United States which is authorized to make awards of pensions, disability compensation, or any other gratuitous benefits or allowances payable, on a periodic basis or otherwise, under any other Act of Congress on the basis of military service, at the request of the Board, shall certify to the Board, with respect to any individual, the calendar months for all or part of which any such pension, compensation, benefit, or allowance is payable to, or with respect to, the individual, the amounts of any such pension, compensation, benefit, or allowance, and the military service on which such pension, compensation, benefit, or allowance is based. Any certification made pursuant to the provisions of this subsection shall be conclusive on the Board: *Provided*, That if evidence inconsistent with any such certification is submitted, and the claim is in the course of adjudication or is otherwise open for such evidence, the Board shall refer such evidence to the department or agency which made the original certification and such department or agency shall make such recertification as in its judgment the evidence warrants. Such recertification, and any subsequent recertification, shall be conclusive, made in the same manner, and subject to the same conditions as an original certification.

"(k) In the event that an individual was, on or before the date of enactment of the Second Revenue Act of 1940, denied an annuity but could have been granted an annuity under the provisions of this Act or the Railroad Retirement Act of 1935 had military service been included in his years of service or service period, as the case may be, no annuity shall be payable with respect to such individual, or with respect to his death, by reason of the provisions of this section, unless such individual files a new application with the Board. In determining the earliest date upon which an annuity can begin to accrue for such an individual in accordance with the provisions of section 2, the filing date of the application shall be the date on which such new application is filed.

"(l) An individual who, on or before the date of enactment of the Second Revenue Act of 1940, was awarded an annuity under the provisions of this Act or the Railroad Retirement Act of 1935, but whose annuity would have been increased if his military service had been included in his years of service or service period, as the case may be, may, notwithstanding the previous award of an annuity, make application (in such manner and form as may be prescribed by the Board) for an increase in such annuity based on his military service. Upon the filing of such application, if the Board finds that the military service thus claimed is creditable and would result in an increase in the annuity, the Board, notwithstanding the previous award, shall recertify the annuity on an increased basis in the same manner as though this section had been in effect at the time of the original certification: *Provided, however*, That if the annuity previously awarded is a joint and survivor annuity, the increased annuity shall be a joint and survivor annuity of the same type except that if on the date the increase begins to accrue the individual has no spouse for whom the election of the joint and survivor annuity was made, the increase on a single life basis shall be added to the individual's annuity: *And provided further*, That such increase in the annuity shall not begin to accrue more than sixty days before the filing date of the application for an increase in the annuity based on military service, and in the event the annuity is a joint and survivor annuity, the actuarial value of the increase in annuity shall be computed as of the effective date of the increase.

"(m) In addition to the amount authorized to be appropriated in subsection (a) of section 15 of this Act, there is hereby authorized to be appropriated to the Railroad Retirement Account for each fiscal year, beginning with the fiscal year ending June 30, 1941, an amount sufficient to meet the additional expenditures necessary

to be made during each such fiscal year by reason of crediting under the Railroad Retirement Acts military service prior to January 1, 1937. The Railroad Retirement Board, as promptly as practicable after the date of enactment of the Second Revenue Act of 1940, and thereafter annually, shall submit to the Bureau of the Budget estimates of such military service appropriations to be made to the account in addition to the annual estimates by the Board, in accordance with subsection (a) of section 15 of this Act, of the appropriations to be made to the account to provide for the payment of annuities, pensions and death benefits not based on military service. Each such estimate shall take into account the excess or the deficiency, if any, in such military service appropriation for the preceding fiscal year."

SEC. 626. Section 202 of such Act of June 24, 1937, is hereby amended by inserting immediately after the second proviso of such section the following new proviso: "*And provided further*, That for the purposes of determining eligibility for an annuity and computing an annuity there shall also be included in an individual's service period, subject to and in accordance with subsections (a) to (l), inclusive, of section 3A of this Act, voluntary or involuntary military service of an individual prior to January 1, 1937, within or without the United States during any war service period, if, in the calendar year in which his military service in a war service period began, or in the calendar year next preceding such calendar year, he was in the compensated service of a carrier, or of a person service to which is otherwise creditable, or was serving as a representative; but such military service shall be included only subject to and in accordance with the provisions of the Railroad Retirement Act of 1935, in the same manner as though military service were service rendered as an employee: ".

TITLE VII—CREDIT AGAINST FEDERAL UNEMPLOYMENT TAXES.

SEC. 701. CREDIT AGAINST FEDERAL UNEMPLOYMENT TAXES.

(a) ALLOWANCE OF CREDIT.—Against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, or against the tax imposed by the Federal Unemployment Tax Act for the calendar year 1939, any taxpayer shall be allowed credit for the amount of contributions paid by him into an unemployment fund under a State law—

(1) Before the sixtieth day after the date of the enactment of this Act;

(2) On or after such sixtieth day (except in the case of the tax for the calendar year 1939) with respect to wages paid after the fortieth day after such date of enactment;

(3) Without regard to the date of payment, if the assets of the taxpayer are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction.

The amount of such credit, in the case of contributions with respect to the calendar year 1939 paid after the last day upon which the taxpayer was required under section 1604 of the Federal Unemployment Tax Act to file a return for such year shall not exceed 90 per centum of the amount which would have been allowable as credit on account of such contributions had they been paid on or before such last day. The provisions of the Social Security Act in force prior to February 11, 1939 (except the provision limiting the credit to amounts paid before the date of filing returns) shall, with respect to the tax for the calendar year 1936, 1937, or 1938, apply to allowance of credit under this section, and the provisions of the Federal Unemployment Tax Act (except section 1601(a)(3)) shall, with respect to the tax for the calendar year 1939, apply to allowance of credit under this section. The terms used in this subsection shall, with respect to the tax for the calendar year 1936, 1937, or 1938, have the same meaning as when used in title IX of the Social Security Act prior to February 11, 1939, and shall, with respect to the tax for the calendar year 1939, have the same meaning as when used in the Federal Unemployment Tax Act. The total credit allowable against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, or against the tax imposed by section 1600 of the Federal Unemployment Tax Act for the calendar year 1939, shall not exceed 90 per centum of such tax.

(b) REFUND.—Refund of the tax (including penalty and interest collected with respect thereto, if any), based on any credit allowable under this section, may be made in accordance with the provisions of law applicable in the case of erroneous or illegal collection of the tax. No interest shall be allowed or paid on the amount of any such refund.

Approved, October 8, 1940, 11 p. m., E. S. T.

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1940–30–10348

PUBLIC, NO. 671, SEVENTY-SIXTH CONGRESS (CHAPTER 440, THIRD SESSION [H. R. 9822]).

An Act To expedite national defense, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

* * * * * * *

SEC. 2.

* * * * * * *

(b) After the date of approval of this Act no contract shall be made for the construction or manufacture of any complete naval vessel or any Army or Navy aircraft, or any portion thereof, under the provisions of this section or otherwise, unless the contractor agrees, for the purposes of section 3 of the Act of March 27, 1934 (48 Stat. 505; 34 U. S. C. 496), as amended—

(1) to pay into the Treasury profit in excess of 8 per centum (in lieu of the 10 per centum and 12 per centum specified in such section 3) of the total contract prices of such contracts within the scope of this subsection as are completed by the particular contracting party within the income taxable year;

(2) that any profit in excess of 8.7 per centum of the cost of performing such contracts except prime contracts made on a cost-plus-a-fixed-fee basis as are completed by the contracting party within the income taxable year shall be considered to be profit in excess of 8 per centum of the total contract prices of such contracts; and

(3) that he will make no subcontract which is within the scope of such section 3, unless the subcontractor agrees to the foregoing conditions.

SEC. 3. The provisions of section 3 of the Act of March 27, 1934 (48 Stat. 505), as amended by the Acts of June 25, 1936 (49 Stat. 1926), and April 3, 1939 (53 Stat. 560; U. S. C., Supp. V, title 34, section 496), and as made applicable to contracts for aircraft or any portion thereof for the Army by such Act of April 3, 1939, shall, in the case of contracts or subcontracts entered into after the date of approval of this Act and during the period of the national emergency declared by the President on September 8, 1939, to exist, be limited to contracts or subcontracts where the award exceeds $25,000.

SEC. 4. In the case of every contract or subcontract for the construction or manufacture of any complete naval vessel or Army or Navy aircraft or any portion thereof which is entered into (whether before or after the date of approval of this Act), the Secretary of War or the Secretary of the Navy, as the case may be, after agreement with the contractor or subcontractor, shall certify to the Commissioner of Internal Revenue as to (a) the necessity and cost of special additional equipment and facilities acquired to facilitate, during the national emergency declared by the President on September 8, 1939, to exist, the completion of such naval vessel or Army or Navy aircraft or portion thereof in private plants; and (b) the percentage of cost of such special additional equipment and facilities to be charged against such contract or subcontract. For all purposes of section 3 of the Act of March 27, 1934 (48 Stat. 505; 34 U. S. C. 496, as amended, such certification shall be subject to such regulations as the President may prescribe, but shall be binding upon the Commissioner of Internal Revenue, unless, within five days after receipt of such certification, he make formal objection thereto to the Secretary of the Navy or the Secretary of War as the case may be. The part of such cost chargeable against the contract or subcontract in pursuance of such certification, shall, for the purposes of such section 3, be considered to be a reduction of the contract price of the contract or subcontract. The amount charged against the contract or subcontract in pursuance of such certification shall, for the purposes of such section 3, be applied against and reduce the cost or other basis of such special additional equipment and facilities as of the date of installation thereof: *Provided*, That the Secretary of War or the Secretary of the Navy, as the case may be, shall report to the Congress, every three months, the cost of such special additional equipment and facilities to be borne by the Government under each contract.

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SEC. 12. The provisions of all preceding sections of this Act shall terminate June 30, 1942, unless the Congress shall otherwise provide.

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Approved, June 28, 1940.

1940–30–10349

PUBLIC, NO. 699, SEVENTY-SIXTH CONGRESS (CHAPTER 500, THIRD SESSION [H. R. 9864]).

An Act amending the Bankruptcy Act with respect to the basis of property.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That effective as of June 22, 1938, section 270 of the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States", approved July 1, 1898, as amended, is amended to read as follows:

"SEC. 270. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section."

SEC. 2. Effective as of June 22, 1938, section 396 of such Act, as amended, is amended to read as follows:

"SEC. 396. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income-tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the arrangement. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section."

SEC. 3. Effective as of June 22, 1938, section 522 of such Act, as amended, as amended to read as follows:

"SEC. 522. In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income-tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the arrangement. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section."

Approved, July 1, 1940.

1940–32–10379

PUBLIC, NO. 704, SEVENTY-SIXTH CONGRESS (CHAPTER 509, THIRD SESSION [H. R. 4185]).

An Act To repatriate native-born women residents of the United States who have heretofore lost their citizenship by marriage to an alien.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Act entitled "An Act to repatriate native-born women who have heretofore lost their citizenship by marriage to an alien, and for other purposes," approved June 25, 1936 (U. S. C., 1934 edition, Supp. IV, Title 8, section 9a), is amended by inserting after "terminated" the following: "or who has resided continuously in the United States since the date of such marriage,".

Approved, July 2, 1940.

1940–44–10472

PUBLIC, NO. 811, SEVENTY-SIXTH CONGRESS, THIRD SESSION (CHAPTER 799 [H. R. 10464]).

An Act To assist in the national-defense program by amending sections 3477 and 3737 of the Revised Statutes to permit the assignment of claims under public contracts.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That sections 3477 and 3737 of the Revised Statutes be amended by adding at the end of each such section the following new paragraph:

"The provisions of the preceding paragraph shall not apply in any case in which the moneys due or to become due from the United States or from any agency or department thereof, under a contract providing for payments aggregating $1,000 or more, are assigned to a bank, trust company, or other financing institution, including any Federal lending agency: *Provided*,

"1. That in the case of any contract entered into prior to the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned without the consent of the head of the department or agency concerned:

"2. That in the case of any contract entered into after the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned if it arises under a contract which forbids such assignment;

"3. That unless otherwise expressly permitted by such contract any such assignment shall cover all amounts payable under such contract and not already paid, shall not be made to more than one party, and shall not be subject to further assignment, except that any such assignment may be made to one party as agent or trustee for two or more parties participating in such financing;

"4. That in the event of any such assignment, the assignee thereof shall file written notice of the assignment together with a true copy of the instrument of assignment with—

"(a) the General Accounting Office,

"(b) the contracting officer or the head of his department or agency,

"(c) the surety or sureties upon the bond or bonds, if any, in connection with such contract, and

"(d) the disbursing officer, if any, designated in such contract to make payment.

Notwithstanding any law to the contrary governing the validity of assignments, any assignment pursuant to the Assignment of Claims Act of 1940 shall constitute a valid assignment for all purposes."

Any contract entered into by the War Department or the Navy Department may provide that payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract.

SEC. 2. This Act may be cited as the "Assignment of Claims Act of 1940."

Approved, October 9, 1940.

1940–45–10480

PUBLIC, NO. 861, SEVENTY-SIXTH CONGRESS, THIRD SESSION (CHAPTER 888 [S. 4270]).

An Act To promote and strengthen the national defense by suspending enforcement of certain civil liabilities of certain persons serving in the Military and Naval Establishments, including the Coast Guard.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the Soldiers' and Sailors' Civil Relief Act of 1940.

* * * * * * *

SEC. 513. The collection from any person in the military service of any tax on the income of such person, whether falling due prior to or during his period of military service, shall be deferred for a period extending not more than six months after the termination of his period of military service if such person's ability to pay such tax is materially impaired by reason of such service. No interest on any amount of tax, collection of which is deferred for any period under this section, and no penalty for nonpayment of such amount during such period, shall accrue for such period of deferment by reason of such nonpayment. The running of any statute of limitations against the collection of such tax by distraint or otherwise shall be suspended for the period of military service of any individual the collection of whose tax is deferred under this section, and for an additional period of nine months beginning with the day following the period of military service. The provisions of this section shall not apply to the income tax on employees imposed by section 1400 of the Federal Insurance Contributions Act.

* * * * * * *

SEC. 603. If any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of the Act, and the application of such provision to other persons or circumstances, shall not be affected thereby.

SEC. 604. This Act shall remain in force until May 15, 1945: *Provided*, That should the United States be then engaged in a war, this Act shall remain in force until such war is terminated by a treaty of peace proclaimed by the President and for six months thereafter: *Provided further*, That wherever under any section or provision of this Act a proceeding, remedy, privilege, stay, limitation, accounting, or other transaction has been authorized as provided with respect to military service performed prior to the date herein fixed for the termination of this Act, such section or provision shall be deemed to continue in full force and effect so long as may be necessary to the exercise or enjoyment of such proceeding, remedy, privilege, stay, limitation, accounting, or other transaction.

SEC. 605. The provisions of section 4 of the joint resolution approved August 27, 1940 (Public Resolution Numbered 96, Seventy-sixth Congress), and the provisions of section 13 of the Selective Training and Service Act of 1940, shall not be applicable with respect to any military service performed after the date of enactment of this Act.

Approved, October 17, 1940.

1940–51–10528

PUBLIC, NO. 840, SEVENTY-SIXTH CONGRESS (CHAPTER 849, THIRD SESSION [H. R. 9581]).

An Act To amend the Merchant Marine Act, 1936, as amended.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That title V of the Merchant Marine Act, 1936, as amended, is hereby amended by adding at the end thereof a new section to read as follows:

"SEC. 511. (a) When used in this section the term 'new vessel' means any vessel (1) documented or agreed with the Commission to be documented under the laws of the United States; (2) constructed in the United States after Decem-

ber 31, 1939, or the construction of which has been financed under titles V or VII of this Act, as amended, or the construction of which has been aided by a mortgage insured under title XI of this Act as amended; and (3) either (A) of such type, size, and speed as the Commission shall determine to be suitable for use on the high seas or Great Lakes in carrying out the purposes of this Act, but not of less than two thousand gross tons or of less speed than twelve knots, unless the Commission shall determine and certify in each case that a vessel of a specified lesser tonnage or speed is desirable for use by the United States in case of war or national emergency, or (B) constructed to replace a vessel or vessels requisitioned or purchased by the United States.

" (b) For the purposes of promoting the construction of vessels necessary to carrying out the policy set forth in title I of this Act, any citizen of the United States who is operating a vessel or vessels in the foreign or domestic commerce of the United States or in the fisheries or owns a vessel or vessels being so operated, or who, at the time of purchase or requisition of the vessel by the Government, was operating a vessel or vessels so engaged or owned a vessel or vessels being so operated, may establish a construction reserve fund, for the construction or acquisition of new vessels, to be composed of deposits of proceeds from sales of vessels, indemnities on account of losses of vessels, earnings from the operation of vessels, and receipts in the form of interest or otherwise, with respect to amounts previously deposited. Such construction reserve fund shall be established, maintained, expended, and used in accordance with the provisions of this section and rules or regulations to be prescribed jointly by the Commission and the Secretary of the Treasury.

"(c) In the case of the sale or actual or constructive total loss of a vessel, if the taxpayer deposits an amount equal to the net proceeds of the sale or to the net indemnity with respect to the loss in a construction reserve fund established under subsection (b), then, if the taxpayer so elects in his income-tax return for the taxable year in which the gain was realized, no gain shall be recognized to the taxpayer in respect of such sale or indemnification in the computation of net income for the purposes of Federal income or excess-profits taxes. For the purposes of this subsection no amount shall be considered as deposited in a construction reserve fund unless it is deposited within sixty days after it is received by the taxpayer except that in the case of amounts received on or before the date of enactment of this section or within sixty days after such date, the deposit may be made within one hundred and twenty days after the date of enactment of this section. As used in this subsection the term 'net proceeds' and the term 'net indemnity' mean the sum of (1) the adjusted basis of the vessel and (2) the amount of gain which would be recognized to the taxpayer without regard to this subsection.

"(d) The basis for determining gain or loss and for depreciation, for the purpose of Federal income or excess-profits taxes, of any new vessel constructed or acquired by the taxpayer in whole or in part out of the construction reserve fund shall be reduced by that portion of the deposits in the fund expended in the construction or acquisition of the new vessel which represents gain not recognized under subsection (c).

"(e) For the purposes of this section, (1) if the net proceeds of a sale or the net indemnity in respect of a loss are deposited in more than one deposit, the amount consisting of the gain shall be considered as first deposited; (2) amounts expended, obligated, or otherwise withdrawn shall be applied against the amounts deposited in the fund in the order of deposit; and (3) if any deposit consists in part of gain not recognized under subsection (c), any expenditure, obligation, or withdrawal applied against such deposit shall be considered to consist of gain in the proportion that the part of the deposit consisting of gain bears to the total amount of the deposit.

"(f) With respect to any taxable year, amounts on deposit on the last day of such year in a construction reserve fund in accordance with this section and with respect to which all the requirements of subsection (g) have been satisfied, to the extent that such requirements are applicable as of the last day of said taxable year, shall not constitute an accumulation of earnings or profits within the meaning of section 102 of the Internal Revenue Code.

"(g) The provisions of subsections (c) and (f) shall apply to any deposit in the construction reserve fund only to the extent that such deposit is expended or obligated for expenditure, in accordance with rules and regulations to be prescribed jointly by the Commission and the Secretary of the Treasury, under

a contract for the construction or acquisition of a new vessel or vessels entered into within two years from the date of such deposit, and only if under such rules and regulations—

"(1) within such period of two years not less than 12½ per centum of the construction or contract price of the vessel or vessels is paid or irrevocably committed on account thereof and the plans and specifications therefor are approved by the Commission to the extent by it deemed necessary; and

"(2) in case of a vessel or vessels not constructed under the provisions of this title or not purchased from the Commission, (A) said construction is completed, within six months from the date of the construction contract, to the extent of not less than 5 per centum thereof (or in case the contract covers more than one vessel, the construction of the first vessel so contracted for is so completed to the extent of not less than 5 per centum) as estimated by the Commission and certified by it to the Secretary of the Treasury, and (B) all construction under such contract is completed with reasonable dispatch thereafter.

"(h) The Commissioner of Internal Revenue is authorized under rules and regulations to be prescribed jointly by the Secretary of the Treasury and the Commission to grant extensions of the period within which the deposits shall be expended or obligated or within which construction shall have progressed to the extent of 5 per centum of completion as provided herein, but such extension shall not be for an aggregate additional period in excess of two years with respect to the expenditure or obligation of such deposits or more than one year with respect to the progress of such construction.

"(i) Any such deposited gain or portion thereof which is not so expended or obligated within the period provided, or which is otherwise withdrawn before the expiration of such period, or with respect to which the construction has not progressed to the extent of 5 per centum of completion within the period provided, or with respect to which the Commission finds and certifies to the Secretary of the Treasury that, for causes within the control of the taxpayer, the entire construction is not completed with reasonable dispatch, if otherwise taxable income under the law applicable to the taxable year in which such gain was realized, shall be included in the gross income for such taxable year, except for the purpose of the declared value excess-profits tax and the capital stock tax. If any such deposited gain or portion thereof is so included in gross income for such taxable year, there shall (in addition to any other deficiency) be assessed, collected, and paid in the same manner as if it were a deficiency, an amount equal to 1.1 per centum of the amount of gain so included, such amount being in lieu of any adjustment with respect to the declared value excess-profits tax for such taxable year.

"(j) Notwithstanding any other provision of law, any deficiency in tax for any taxable year resulting from the inclusion of any amount in gross income as provided by subsection (i), and the amount to be treated as a deficiency under such subsection in lieu of any adjustment with respect to the declared value excess-profits tax, may be assessed or a proceeding in court for the collection thereof may be begun without assessment, at any time: *Provided, however*, That interest on any such deficiency or amount to be treated as a deficiency shall not begin until the date the deposited gain or portion thereof in question is required under subsection (i) to be included in gross income.

"(k) This section shall be applicable to a taxpayer only in respect of sales or indemnifications for losses occurring within a taxable year beginning after December 31, 1939, and only in respect of earnings derived during a taxable year beginning after December 31, 1939.

"(l) For the purposes of this section a vessel shall be considered as constructed or acquired by the taxpayer if constructed or acquired by a corporation at a time when the taxpayer owns at least 95 per centum of the total number of shares of each class of stock of the corporation.

"(m) The terms used in this section shall have the same meaning as in chapter 1 of the Internal Revenue Code."

Approved, October 10, 1940.

COMMITTEE REPORTS.

1940-42-10455

THE SECOND REVENUE BILL OF 1940.

[House of Representatives Report No. 2894, Seventy-sixth Congress, Third Session.]

[August 28, 1940.]

Mr. Doughton, from the Committee on Ways and Means, submitted the following report [to accompany H. R. 10413]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 10413) to provide revenue, and for other purposes, having had the same under consideration, report it back to the House without amendment and recommend that the bill do pass.

The bill may be divided into three general parts: (*a*) the excess-profits tax, (*b*) the suspension of the application of the provisions of the Vinson-Trammell Act restricting profits upon the construction of naval vessels and aircraft, and (*c*) the provision of special amortization in respect of facilities necessary for national defense.

NEED FOR THE LEGISLATION.

On May 16, 1940, the President, in his message to the Congress, outlined the immediate necessity for increasing the outlays for national defense. In response to this and to subsequent messages the Congress has made available in direct appropriations and contract authorizations $14,702,000,000 for national defense, of which the revised budget of August 5, 1940, estimates that $5,000,000,000 will be expended in the fiscal year 1941.

In further response to the message of May 16, in order to finance the additional appropriations there requested, your committee reported and the Congress enacted the revenue bill of 1940. This measure, approved June 25, 1940, provided for a $4,000,000,000 increase in the national debt and additional tax revenues of $1,000,000,000 annually for a 5-year period—an amount sufficient to retire the additional borrowings at maturity.

In its report on the revenue bill of 1940, your committee expressed the desire that the rearmament program should furnish no opportunity for the creation of new war millionaires or the further substantial enrichment of already wealthy persons. Your committee is still of this opinion but, at the same time, deems it advisable to stimulate the cooperation of private enterprise in the defense program by suspending the profit limitations of the Vinson-Trammell Act, applicable to the construction of naval vessels and Army and Navy aircraft. In addition, it is considered desirable to provide special amortization with respect to the facilities necessary in the national defense, in order further to encourage the participation of private enterprise in the rearmament program.

While these benefits are being accorded to business engaged directly in the defense program, your committee feels that they should be accompanied by a general excess-profits tax rather than one limited to contractors for Army and Navy aircraft and naval vessels or even to munitions manufacturers generally. Accordingly, the tax provided in the bill will apply to corporate profits from all sources. This is felt desirable since the segregation of profits directly attributable to the expenditures of the Government for the defense program presents insuperable difficulties.

For these reasons your committee recommends the incorporation in the same bill of these three interrelated features, each of great importance to the financial aspects of the defense program: the suspension of the profit limitations under the Vinson-Trammell Act, the provision of special amortization for defense facilities, and an excess-profits tax.

In the opinion of your committee, this integrated plan presents the best method of effectuating the recommendation of the President as expressed in the following message:

To the Congress of the United States:

We are engaged in a great national effort to build up our national defenses to meet any and every potential attack.

We are asking even our humblest citizens to contribute their mite.

It is our duty to see that the burden is equitably distributed according to ability to pay so that a few do not gain from the sacrifices of the many.

I, therefore, recommend to the Congress the enactment of a steeply graduated excess-profits tax, to be applied to all individuals and all corporate organizations without discrimination.

FRANKLIN D. ROOSEVELT.

THE WHITE HOUSE,
July 1, 1940.

Upon thorough examination, it appeared that the excess-profits tax should apply only to corporations, as individual and partnership incomes are subject to heavy surtaxes upon net income, whether or not left in the business, while, in general, neither corporations nor their stockholders pay surtaxes upon earnings which are not distributed. Moreover, since all of the assets of an individual, whether he be a sole proprietor or a member of a partnership, are at the risk of the business, it is extremely difficult, if not impossible, to determine the capital actually invested.

The matters included in the bill were referred by your committee to its Subcommittee on Internal Revenue Taxation on August 1, 1940. On August 8 the subcommittee, in a printed report, submitted its recommendations, which formed the basis for full public hearings, held jointly by your committee and the Committee on Finance of the Senate. The recommendations of the subcommittee, modified as to rates and further modified with a view to the relief of certain types of cases disclosed in the hearings, are embodied in the bill.

ESTIMATES OF REVENUE.

It is estimated that the excess-profits tax will yield $305,000,000 gross revenue for the calendar year 1940 and over $700,000,000 for a calendar year in which the defense program becomes fully operative.

SUMMARY OF PRINCIPAL FEATURES.

I. EXCESS-PROFITS TAX.

1. TAXABLE YEARS.

The tax imposed by the bill is applicable with respect to all taxable years beginning after December 31, 1939.

2. CORPORATIONS TAXABLE.

The bill provides that all corporations except the following shall be subject to the excess-profits tax:

(*a*) Corporations exempt from income tax.
(*b*) Personal holding companies.
(*c*) Foreign personal holding companies.
(*d*) Mutual investment companies.
(*e*) Diversified investment companies registered with the Securities and Exchange Commission.
(*f*) Foreign corporations not engaged in trade or business within the United States and not having an office or place of business therein.

Corporations with excess-profits net incomes of not more than the specific exemption are not subjected to tax and need not file excess-profits tax returns. Since the specific exemption for a taxable year of 12 months is $5,000, and since only about 70,000 of the almost 500,000 active corporations in the United States have net incomes for general income-tax purposes in excess of $5,000, it is apparent that a large number of small corporations will be relieved from the excess-profits tax.

A personal service corporation, as defined in the bill, may be relieved from the excess-profits tax for any year by electing to have its income for such year taxed in the hands of the shareholders, whether or not actually distributed to them.

3. BASE PERIOD.

For the purpose of ascertaining the previous earning experience to be used as a comparative measure of earnings for the taxable years under the bill, the years 1936 to 1939, inclusive, are selected to constitute a base period.

4. MEASURE OF EXCESS PROFITS.

(*a*) *Corporations in existence during entire base period.*—In determining the portion of the earnings to be considered as excess profits, the taxpayer, if in existence actually or constructively during the entire base period, may choose either of two standards of measurement.

The choice is available to the following classes of corporations:

(1) A domestic corporation, the first taxable year of which begins in 1940, if it was in existence for at least 48 months prior to the beginning of such taxable year.

(2) A domestic corporation, which, while not in existence for the period specified under (1), is deemed to have been in existence for a period of 48 months prior to the beginning of its first taxable year beginning in 1940, because it acquired, or resulted from the coalescing of, other corporations through certain tax-free exchanges or reorganizations, where such other corporations were in existence at the beginning of such 48-month period or had predecessors who were in existence at that time. In the opinion of your committee, the denial of the privilege of election to corporations in this category would be inequitable.

The two methods of measuring excess profits are outlined below.

First method—Based on income.

If this method is chosen, the taxpayer measures its excess profits by a comparison of its earnings for the taxable year with its average earnings for the base period. For the purposes of the comparison, the average earnings for the base period are increased by 8 per cent of the net additions to capital occurring after the beginning of the taxpayer's first taxable year under the bill, or decreased by 6 per cent of the net reductions in capital during the same period. The amount so arrived at constitutes the taxpayer's excess-profits credit which, when deducted from the earnings for the taxable year, determines the excess profits, or the portion of the income which after the deduction of the specific exemption of $5,000 is subjected to excess-profits tax.

Second method—Based on income and invested capital.

Under this method, the portion of the earnings for the taxable year to be considered as excess profits, to which the tax will apply, is ascertained by deducting from the earnings of the taxpayer for the taxable year an amount equal to the percentage of its invested capital for such year which its earnings during the base period bear to its invested capital for the base period. Such percentage may not be more than 10 or less than 5, except that with respect to the first $500,000 of invested capital for the taxable year the minimum percentage is 7 instead of 5. These minimum percentages establish a floor for corporations with low earnings during the base period, thus allowing such corporations a reasonable return on their invested capital before becoming subject to excess-profits tax. In addition, corporations, under this method, are allowed a 10 per cent tax-free return on new capital, to the extent that it does not cause the invested capital to exceed $500,000, and 8 per cent on new capital in excess of that figure.

(*b*) *Corporations in existence during only part of the base period.*—Corporations in existence for only a part of the base period must measure their excess profits by the second method.

For this purpose they are supplied an invested capital for the period during which they were not in existence equal to their invested capital at the beginning of their 1940 taxable year, and upon that hypothetical invested capital they are deemed to have earned 10 per cent of the first $500,000 of such invested capital and 8 per cent of the amount in excess of $500,000.

For example, corporation A came into existence on January 1, 1938. It had an invested capital as of January 1, 1940, of $800,000 and keeps its books and accounts on a calendar-year basis. It had an average invested capital and excess-profits net income for the portion of the base period during which it was

actually in existence as indicated. These factors for the portion of the base period during which it was not in existence are supplied as follows:

Year.	Invested capital.	Excess profits net income.	Base period percentage.
1936	*$800,000	*$74,000	
1937	*800,000	*74,000	
1938	650,000	45,500	
1939	700,000	63,000	
Total	2,950,000	256,500	8.7
1940	800,000		

The amounts marked by an asterisk (*) do not represent the actual experience of the corporation but have been supplied by the invested capital for 1940, upon which a yield of 10 per cent for the first $500,000 and 8 per cent on the balance is assumed.

Thus, the portion of the earnings for the taxable year in excess of an amount equal to 8.7 per cent of the invested capital for the taxable year is considered excess profits and, after being reduced by the specific exemption of $5,000, is subject to tax.

(c) *Corporations not in existence in the base period.*—Corporations which come into existence after the close of the base period (other than those companies which are allowed the use of a substituted base-period experience because of certain tax-free exchanges and reorganizations) must measure their excess profits under the second method. For this purpose, they are allowed a credit equal to 10 per cent of the first $500,000 of their invested capital for the taxable year and 8 per cent of such capital in excess of $500,000.

5. COMPUTATION OF THE EXCESS-PROFITS CREDIT.

First method—Based on income.

Under this method the excess-profits credit for the taxable year is the aggregate of earnings for all of its taxable years in the base period divided by the total number of those years. In the event of a deficit for one year in the base period, the aggregate earnings for the other years are not reduced thereby. If there are deficits in more than one year in the base period, the aggregate earnings for the other years are reduced by all such deficits except the one for the year in which the greatest deficit occurred. But in all cases the aggregate so determined is divided by the total number of years in the base period.

For example, corporation X had earnings of $300,000 in 1936, and $200,000 in 1937. In 1938 it had a deficit (that is, an excess of deductions and net income credits over gross income) of $150,000 and in 1939 another of $100,000. Its aggregate earnings for the base period are $400,000; that is, $300,000 plus $200,000 minus $100,000; the greatest deficit, the $150,000 deficit, being disregarded. The average earnings for the base period are, therefore, $100,000, or $400,000 divided by the number of years in the period.

Second method—Based on income and invested capital.

This method involves the same procedure as the first for determining the average earnings of the base period. In determining the average invested capital, however, the invested capital for no year is eliminated.

Additions to invested capital are allowed a tax-free return of 10 per cent to the extent that they do not cause it to exceed $500,000; a tax-free return of 8 per cent is allowed on new capital above that figure. For the purpose of distinguishing between old capital and new, all capital in excess of that for the beginning of the taxpayer's first taxable year under the bill is considered to be new. But, if the invested capital subsequently reaches a lower figure, that figure would become the measure of new capital.

For example, a corporation on a calendar-year basis had on January 1, 1940, the beginning of its first taxable year under the excess-profits tax, an invested capital of $100,000. In 1941 its invested capital had increased to $150,000. This $50,000 increase would be considered as new capital and allowed a return of 10 per cent. In 1942 its invested capital was $130,000, or $20,000 less than 1941, but

still $30,000 more than in 1940. This $30,000 would still be regarded as new capital as it is in excess of the measure established by 1940. However, if in 1943 the invested capital were to be reduced to $75,000, this figure would replace the $100,000 figure for 1940 as the measurement of new capital. That is, for years subsequent to 1943 any invested capital in excess of $75,000 will be considered as new capital until a new low is established.

The following tables prepared by the Treasury Department illustrate the effect of the tax under the first and second methods:

TABLE I.—*Illustrations of sample corporations, showing excess-profits taxes under (1) average base period earnings method and (2) percentage return on invested capital method.*[1]

	Corporation 1.	Corporation 2.	Corporation 3.	Corporation 4.	Corporation 5.	Corporation 6.	Corporation 7.	Corporation 8.
Normal tax net income: [2]								
Average for base period—								
Amount	$50,000	$50,000	$50,000	$1,000,000	$1,000,000	$1,000,000	$500,000	$1,250,000
Per cent of invested capital	6	9	30	6	9	30	10	25
Taxable year—								
Amount	$60,000	$60,000	$60,000	$1,200,000	$1,200,000	$1,200,000	$1,500,000	$1,500,000
Per cent of invested capital	7.2	10.8	36	7.2	10.8	36	30	30
Net income for excess-profits tax: [3]								
Average for base period	$42,000	$42,000	$42,000	$840,000	$840,000	$840,000	$420,000	$1,050,000
Taxable year	$47,460	$47,460	$47,460	$949,200	$949,200	$949,200	$1,186,500	$1,186,500
Taxable excess profits: [4]								
Base period earnings method	$460	$460	$460	$104,200	$104,200	$104,200	$761,500	$131,500
Return on invested capital method	-------	$460	$25,793	$100,867	$104,200	$610,867	$761,500	$681,500
Excess-profits tax:								
(1) Base period earnings method—								
Flat rate tax (4.1 per cent) [5]	$2,460	$2,460	$2,460	$49,200	$49,200	$49,200	$61,500	$81,500
Graduated rate tax	$115	$115	$115	$33,180	$33,180	$33,180	$334,750	$44,100
Total excess-profits tax	$2,575	$2,575	$2,575	$82,380	$82,380	$82,380	$396,250	$105,600
(2) Return on invested capital method	-------	$92	$5,418	$26,802	$27,970	$228,890	$296,675	$260,675

TABLE II.

	Corporation 9.	Corporation 10.
Equity capital	$5,000,000	$3,500,000
Borrowed capital	----------	$1,500,000
Total capital	$5,000,000	$5,000,000
Invested capital	$5,000,000	$4,000,000
Normal tax net income: [2]		
Average for base period—		
Amount	$500,000	$500,000
Per cent of total capital	10	10
Taxable year—		
Amount	$750,000	$750,000
Per cent of total capital	15	15
Net income for excess profits tax: [3]		
(1) Base period earnings method—		
Average for base period	$420,000	$420,000
Taxable year	$593,250	$593,250
(2) Return on invested capital method—		
Average for base period	$420,000	$445,000
Taxable year	$593,250	$618,250
Taxable excess profits: [4]		
Base period earnings method	$168,250	$168,250
Return on invested capital method	$168,250	$213,250
Excess profits tax:		
(1) Base period earnings method—		
Flat rate tax (4.1 per cent) [5]	$30,750	$30,750
Graduated rate tax	$58,800	$58,800
Total tax	$89,550	$89,550
(2) Return on invested capital method	$50,388	$66,138

See footnotes at end of Table III.

TABLE III.—*Corporation 11.*[7]

	1936	1937	1938	1939	Taxable year.
Invested capital	$1,000,000	$1,500,000	$2,000,000	$2,500,000	$2,500,000
Normal tax net income:[2]					
Amount	$100,000	$150,000	$200,000	$250,000	$500,000
Per cent of invested capital	10	10	10	10	20
Net income for excess profits tax[3]	$86,160	$128,660	$167,000	$205,000	$395,500

	Base period earnings method.	Return on invested capital method.
Net income for excess profits tax:[3]		
Average for base period—		
Amount	$146,705	$146,705
Per cent of invested capital	8.4	8.4
Taxable year—		
Amount	$395,500	$395,500
Per cent of invested capital	15.8	15.8
Taxable excess profits[4]	$243,795	$180,500
Excess profits tax:		
Flat rate tax (4.1 per cent)[5]	$20,500	
Graduated rate tax	$89,018	$54,675
Excess profits	$109,518	$54,675
Excess profits tax as per cent of net income after income tax	27.7	13.8

[1] Except where otherwise indicated it is assumed that (1) invested capital remains unchanged; (2) for the base period Federal income taxes amounted to 16 per cent of net income; (3) the corporation derived no income from dividends from domestic corporations, interest on taxable United States securities, or capital gains; and (4) the corporation had no borrowed capital.

[2] Net income before deduction of normal tax.

[3] Net income after deduction of normal tax. The amount for the taxable year is the "excess profits net income."

[4] Excess profits net income for the taxable year less the specific exemption of $5,000 and the excess profits credit.

[5] Flat rate tax of 4.1 per cent is computed on normal tax net income.

[6] Invested capital consists of the $3,500,000 equity capital and 33⅓ per cent of the $1,500,000 borrowed capital.

[7] It is assumed that this corporation (1) distributed all its net income in dividends; (2) derived no income from dividends from domestic corporations, interest on taxable United States securities or capital gains; and (3) had no borrowed capital. Normal income taxes are computed at rates effective in the several years.

6. EXCESS-PROFITS NET INCOME.

The net income for excess-profits tax purposes is the normal-tax net income for the purposes of the general corporate income tax with certain adjustments. For both the taxable years and the years in the base period, where either method of measuring excess profits is used, the normal-tax net income is adjusted by the exclusion of gain or loss from the sale or exchange of capital assets (depreciable or nondepreciable) held for more than 18 months, the deduction of the normal corporate income tax, and the exclusion of income arising from the retirement or discharge of the taxpayer's own indebtedness.

Where the second method of measuring excess-profits is used, the normal-tax net income for both the taxable years and the years in the base period is further adjusted by increasing the credit for dividends received to 100 per cent and making it applicable to dividends on the stock of all corporations, whether domestic or foreign, except dividends (actual or constructive) on stock of foreign personal holding companies. In addition, the deduction for interest paid or accrued is reduced by an amount which is the same percentage of so much of such interest as represents interest on borrowed capital (as defined in the bill) as the borrowed invested capital (as defined in the bill) is of the total borrowed capital.

For the years in the base period only, where either method of measuring excess profits is used, the normal-tax net income is adjusted further by the addition thereto of the amount of losses, not compensated for by insurance or otherwise, arising from fires, storms, shipwreck, or other casualty, or from theft. In addition, there is added back, for the years in the base period, the amounts which were deductible on account of any repayment or credit by a corporation to its vendee of any amount attributable to any tax under the Agricultural Adjustment Act.

The adjustment of income to take care of these unusual and nonrecurring items makes for equity and the removal of hardships which would otherwise occur.

For the purposes of the application of the 4.1 per cent tax (described below), which is a prerequisite to the use of the first method of measuring excess profits, the tax base is the same to which the general corporate income tax applies. This 4.1 per cent tax, however, is a part of the excess-profits tax structure and for this reason is not deductible from the normal-tax net income in arriving at the excess-profits net income for the purposes of the graduated excess-profits tax.

7. SPECIFIC EXEMPTION.

After the amount of the excess profits is determined under either the first or second method, the amount so determined is reduced by a specific exemption of $5,000 before the application of the graduated excess-profits tax. It is felt that this liberal exemption will be a substantial benefit and encouragement to small corporations.

8. RATES OF TAX.

There are two distinct sets of excess-profits tax rates the election of which depends upon the method used to measure the excess profits.

First method—Based on income.

If the taxpayer has elected to measure its excess profits by this method, it is required to pay a tax of 4.1 per cent, in addition to its general corporate income tax at a maximum rate of 20.9 per cent, upon its normal-tax net income. In addition, it is required to pay on its excess-profits net income, reduced by the excess-profits credit and the specific exemption of $5,000, a tax at the following graduated rates:

Amount of excess profits:	*Rate of tax, per cent.*
First $20,000	25
Next $30,000	30
Next $50,000	35
Next $150,000	40
Next $250,000	45
Over $500,000	50

The following will illustrate the computation of the excess-profits tax under this method, the normal income tax, and the total:

Normal tax net income		$2,200,000
Excess-profits net income		2,000,000
Less credits:		
Specific exemption	$5,000	
Base period average excess-profits net income	500,000	
Normal tax (20.9 per cent of $2,200,000)	459,800	
		964,800
Excess-profits tax base		1,035,200
Excess-profits tax:		
Under graduated schedule—		
25 per cent of $20,000		5,000
30 per cent of $30,000		9,000
35 per cent of $50,000		17,500
40 per cent of $150,000		60,000
45 per cent of $250,000		112,500
50 per cent of $535,200		267,600
Total		471,600
Under flat rate (4.1 per cent of $2,200,000)		90,200
Total excess-profits tax		561,800
Normal tax (20.9 per cent of $2,200,000)		459,800
Total income and excess-profits tax		1,021,600

Second method—Based on income and invested capital.

If this method is used to measure the excess profits, the 4.1 per cent tax required under the first method is not imposed. There is imposed, however, upon the taxpayer's excess-profits net income, reduced by the excess-profits credit and the specific exemption of $5,000, a tax at the following graduated rates:

Amount of excess profits:	*Rate of tax, per cent.*
First $20,000	20
Next $30,000	25
Next $50,000	30
Next $150,000	35
Next $250,000	40
Over $500,000	45

The tax computation under this method, together with the normal income tax and the total, may be illustrated as follows:

Normal tax net income		$3,300,000
Invested capital		20,000,000
Base period percentage		15
Excess profits		3,040,200
Less credits:		
Specific exemption	$5,000	
10 per cent of $20,000,000	2,000,000	
		2,005,000
Excess-profits tax base		1,035,200
Excess-profits tax:		
$20,000 at 20 per cent		4,000
$30,000 at 25 per cent		7,500
$50,000 at 30 per cent		15,000
$150,000 at 35 per cent		52,500
$250,000 at 40 per cent		100,000
$535,200 at 45 per cent		240,840
Excess-profits tax		419,840
Income tax (20.9 per cent of $3,300,000)		689,700
Total tax		1,109,540

9. INVESTED CAPITAL.

The invested capital for any day of the taxable year consists of equity invested capital and borrowed invested capital.

(*a*) *Equity invested capital.*—Equity invested capital is the sum of the following items:

(1) Money paid in for stock or as paid-in surplus or as a contribution to capital;

(2) Property paid in for stock or as paid-in surplus or as a contribution to capital;

(3) Taxable stock dividends; and

(4) Accumulated earnings and profits as of the beginning of the taxable year;

reduced by the sum of the following items:

(1) Distributions out of capital during prior taxable years;

(2) Distributions previously made during the taxable year out of capital or out of the accumulated earnings and profits as of the beginning of the taxable year.

Fluctuations in the earnings and profits account for the taxable year have no effect upon the invested capital for the taxable year. Deficits in the earnings and profits account, moreover, do not reduce the invested capital. Nevertheless, deficits in the earnings and profits account must be made good out of earnings and profits before any increase in invested capital results from the earnings and profits account.

(*b*) *Borrowed invested capital.*—Borrowed capital is included in invested capital under a graduated limitation at varying percentages (100, 66⅔, 33⅓), these percentages depending upon the amount of equity invested capital.

For example, if the equity invested capital of a corporation is $60,000, it is allowed to include $40,000 of its borrowed capital at 100 per cent, $900,000 at 66⅔ per cent, and all remaining borrowed capital at 33⅓ per cent. Thus if this corporation has an equity invested capital of $60,000 and borrowed capital of $2,000,000, its invested capital will be increased as follows:

Borrowed capital:	*Borrowed capital included in invested capital.*
$40,000 ($100,000 less $60,000 (equity invested capital)), at 100 per cent	$40,000
$900,000, at 66⅔ per cent	600,000
$1,060,000, at 33⅓ per cent	353,333
Totals ($2,000,000)	993,333

If the equity invested capital is $100,000 or more, say $300,000, and the borrowed capital is the same, that is, $2,000,000, the invested capital would be increased as follows:

Borrowed capital:	*Borrowed capital included in invested capital.*
$700,000 ($1,000,000 less $300,000 (equity invested capital)), at 66⅔ per cent	$466,667
$1,300,000 ($2,000,000 less $700,000), at 33⅓ per cent	433,333
Total	900,000

10. ADMISSIBLE AND INADMISSIBLE ASSETS.

The average invested capital as computed above is reduced by a percentage which is the ratio of the inadmissible assets of the corporation for the year to the total of admissible and inadmissible assets for such year.

"Inadmissible assets" are (1) corporate stocks (except stock in a foreign personal holding company), and (2) State and local securities, obligations of corporate agencies of the United States, and obligations of the United States or its possessions. All other assets are "admissible assets."

The invested capital is so reduced for the reason that since the income from inadmissible assets is not taxable to the corporation, the assets from which such income arose should be excluded from invested capital.

Inadmissible assets are not deducted directly from the invested capital for the reason that the total of admissible and inadmissible assets is not ordinarily equal to the invested capital.

11. PERSONAL SERVICE CORPORATIONS.

Under the bill, a personal service corporation may signify in its return for any taxable year its desire not to be subject to the excess-profits tax, and it will be exempt from the tax for such year. However, in order for the corporation to be exempt, the shareholders are required to include the undistributed income of such a corporation in their gross income, which then is subject to normal and sur tax. A personal service corporation is defined as a corporation whose income is to be ascribed primarily to the activities of shareholders who are regularly engaged in the active conduct of the affairs of the corporation and are the owners at all times during the taxable year of at least 80 per cent in value of all the stock of the corporation and in which capital is not a material income-producing factor. For this purpose an individual is considered as owning at any time the stock owned at such time by his spouse or minor child. Thus, all the shareholders who are regularly engaged in the active conduct of the affairs of the corporation may be counted in determining whether such a corporation may be classified as a personal service corporation, instead of merely the principal shareholders. Moreover, to determine whether such shareholders own at least 80 per cent in value of the stock of the corporation, the stock owned by their spouses or minor children may be included. A personal service corporation does not include a foreign corporation or any corporation 50 per cent or more of whose gross income consists of gains, profits, or income derived from trading as a principal.

12. FOREIGN CORPORATIONS.

In the case of a foreign corporation in existence during the entire base period and engaged in trade or business in the United States or having an office or place of business therein, its excess-profits credit consists of the excess of its excess-profits net income for the taxable year over its average excess-profits net income for the base period, with no adjustments for additions to or reductions in capital. Such corporations will also be entitled to a specific exemption of $5,000. In the case of such foreign corporations which were not in existence during the entire base period, the tax is computed by reference to the invested capital, which is determined as follows:

The daily invested capital for any day of the taxable year is the aggregate of the adjusted basis of each United States asset held by the taxpayer in the United States on the beginning of such day. For the purpose of reducing the average invested capital by the ratio of inadmissible assets to total assets, the terms "admissible assets" and "inadmissible assets" include only United States assets.

13. CREDIT FOR FOREIGN TAXES.

The bill allows a credit against the excess-profits tax for income and profit taxes paid or accrued during the taxable year by any domestic corporation to any foreign country or to any possession of the United States. The credit is subject to the same limitations which apply to the credit allowed for the purpose of the corporate normal income tax. This prevents the credit from reducing the tax on any excess-profits tax net income derived from American sources. The American tax, by reason of the credit, will apply against the income from foreign sources only where the foreign tax rate is less than the tax rate imposed by the United States. It was believed necessary to provide such a credit to place our American corporations on an equal competitive basis with foreign corporations located abroad.

14. EXCESS PROFITS CREDIT IN CONNECTION WITH CERTAIN EXCHANGES.

First method—Based on income.

Under the provisions of Supplement A of the bill a domestic corporation which was not in existence at the beginning of its base period is allowed to compute its excess-profits credit under this method if it acquired, or resulted from the coalescing of, another corporation through certain tax-free exchanges, where the other corporation was in existence at the beginning of the base period or had a predecessor which was in existence at such time; and, having so elected, it is allowed to use as its excess-profits net income for the taxable years in the base period prior to such acquiring or coalescing the excess-profits net income of the other corporation. For the years in the base period subsequent to such acquiring or coalescing, it uses its own excess-profits net income for the purpose of computing the credit.

A domestic corporation which was in existence at the beginning of the base period and which is thereby entitled to elect to compute its excess-profits credit under section 713 by virtue of the provisions of section 712, if it does elect to compute such credit under section 713, is permitted to add to its excess-profits net income for the years in the base period the excess-profits net income of corporations which it absorbs by a statutory merger or by liquidation under section 112(b)(6), where such merged or liquidated corporation was in existence at the beginning of the base period or had predecessors in existence on such date.

Second method—Based on income and invested capital.

Supplement B contains provisions relative to the effect of certain tax-free exchanges upon the computation of the excess-profits credit based on income and invested capital. Such provisions are designed (1) to permit the base period experience of all corporations which coalesced during the base period to be used in computing the base period experience of the successor corporation, (2) to prevent large corporations from obtaining undue advantage from reorganizing, by means of tax-free transactions, into groups of small corporations, (3) to prevent invested capital acquired in certain tax-free exchanges from being treated as new capital to any greater extent than it was so treated in the hands of the corporation from which it was acquired, (4) to prevent step-ups of base period percentages, and (5) to prevent a corporation the proportion of whose

borrowed capital which may be included in invested capital at 100 per cent or 66⅔ per cent or the proportion of whose invested capital which is given favorable base period percentage or new capital treatment has been adjusted because of previous reorganizations from undoing the effects of such adjustments through transferring its assets, tax-free, to another corporation which is little more than a dummy. The nontaxable exchanges covered by Supplement B fall into two general classes: (*a*) Whereby one corporation becomes several corporations, and (*b*) whereby several corporations become one corporation.

15. SPECIAL RELIEF PROVISIONS.

Your committee has recommended certain special relief provisions, which are as follows:

(1) Special treatment is allowed for corporations which were required to refund to their vendees amounts attributable to any tax which was not paid under the Agricultural Adjustment Act of 1933, as amended. These amounts were allowed as deductions for business expenses in computing income subject to the corporation normal tax for the taxable years in the base period. This resulted in a distortion of the income in the base period. Your committee has provided that any deduction for business expenses in the base period may be decreased by the amount of the excess of such repayments over the amount required to be included in gross income by reason of such taxes for the purpose of the excess-profits tax.

(2) A corporation which suffered losses during the base period because of fire, storm, shipwreck, or other casualty or from theft, not compensated for by insurance or otherwise, is afforded relief by having such deductions disallowed for the purpose of the excess-profits tax computation of the base period income. This has the effect of increasing the base period income.

(3) The elimination of gains or losses from the sale or exchange of assets (depreciable or nondepreciable) held over 18 months, for the purpose of the base period as well as the taxable year.

(4) The exclusion of income derived from the retirement or discharge of any bonds, debentures, notes, or certificates or other evidences of indebtedness which have been outstanding for more than 18 months.

(5) Many corporations which had operating deficits would sustain severe hardships if their invested capital was reduced by such deficits. Your committee provided that operating deficits should reduce invested capital only to the extent of the earned surplus.

Your committee has granted special relief in cases where the Commissioner is unable to determine the taxpayer's equity invested capital for the first day of the first taxable year beginning after December 31, 1939. In such a case, such equity invested capital shall be an amount, determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, equal to the cash on hand plus the aggregate of the adjusted bases at such time of the assets of the taxpayer then held minus the indebtedness outstanding at such time. The equity invested capital for each day in the taxpayer's base period and for each day after the beginning of the taxpayer's taxable year shall be determined, using as the basic figure the equity invested capital as of the beginning of such first taxable year.

The following example will illustrate how this provision will apply. The equity invested capital as of January 1, 1940, is computed as follows:

Assets:	*Adjusted basis.*
Cash	$100,000
Other assets	400,000
Total	500,000
Less: Liabilities	200,000
Equity invested capital	300,000

When the equity invested capital has been determined as of any particular date, for example, January 1, 1940, it may be computed for any other date by making adjustments for profits and losses, dividends paid, and additions or withdrawals of capital occurring during the intervening period. Thus, if between January 1, 1937, and January 1, 1940, the above corporation had profits (after taxes) of $200,000 and paid dividends of $150,000, the equity invested

capital as of January 1, 1936, would have been $250,000. Similarly, if between January 1, 1940, and January 1, 1942, the corporation had profits of $100,000 and paid dividends of $60,000, its equity invested capital as of January 1, 1942, would be $340,000.

16. CONSOLIDATED RETURNS.

Your committee gave consideration to requiring consolidated returns in connection with the excess-profits tax. However, it was not possible to prepare a consolidated return provision without delaying the bill for a considerable length of time.

II. SUSPENSION OF THE VINSON-TRAMMELL ACT.

The provisions of the Vinson-Trammell Act, as amended, relating to limitation of profit on contracts for the construction or manufacture of naval vessels and Army and Navy aircraft, are suspended as to contracts or subcontracts for such construction or manufacture which are entered into or completed during the taxable years to which the excess-profits tax will be applicable.

Since the proposed excess-profits tax will apply to all corporations, including corporations now subject to the special profit-limiting provisions of the Vinson-Trammell Act, it is felt that such special provisions should not apply while the excess-profits tax is in force. Uniformity will thereby be achieved in the treatment for tax purposes of all abnormal profits resulting from the national defense program. It is not believed that the limited types of businesses affected by the Vinson-Trammell Act should be treated, during the period in which the excess-profits tax applies, differently from the way in which other businesses engaged in production for the national defense are treated.

III. PROFIT LIMITATIONS UNDER THE MERCHANT MARINE ACT.

The Merchant Marine Act of 1936, as amended, contains provisions relating to the recapture by the Maritime Commission of profits in excess of 10 per cent of the total contract price of contracts and subcontracts for ship construction under that Act. It is not believed desirable to suspend these provisions of the Merchant Marine Act since there are commercial considerations involved which do not apply in the case of the Vinson-Trammell Act. Private ship operators for whom vessels are constructed under the construction differential subsidy and charter provisions of the Merchant Marine Act are vitally interested in the cost of such vessels to the Commission. Furthermore, money recaptured by the Commission under ship construction contracts and subcontracts paid into the Commission's revolving construction fund where it is available for further ship construction and has the effect of reducing the amounts which otherwise would be required to be appropriated from time to time by the Congress for Maritime Commission shipbuilding.

In order to protect shipbuilders, machinery manufacturers, and others engaged on Maritime Commission contracts from being subject to two profit limitation provisions at the same time, that is, the limitation provisions of the Merchant Marine Act and the excess-profits tax provisions of the bill, your committee has suggested special treatment for excess-profits tax purposes. Under the bill, the shipbuilder or other person engaged on Maritime Commission contracts will be required to compute its excess-profits tax under two different methods and pay the lesser tax computed under either method.

Under the first method, the taxpayer will be required to include only the 10 per cent profit it is permitted to retain under the Merchant Marine Act in its gross income and compute the excess-profits tax on that basis. Under the other method, the taxpayer is required to include in gross income the entire amount of the gross proceeds from its contract and credit against the excess-profits tax the amount of any payments recaptured within the taxable year by the United States Maritime Commission with respect to such contracts or subcontracts. Under this second method, the taxpayer is thus allowed credit for any amounts recaptured by the Commission. In cases where such credit is less than the total tax so computed, the effect to the taxpayer is exactly the same as though the provisions of the Merchant Marine Act were suspended in the same manner as is proposed in the case of the Vinson-Trammell Act.

IV. AMORTIZATION OF EMERGENCY FACILITIES.

The extension of existing facilities is a necessary and vital part of the national defense program. To obtain the needed facilities will require the investment of hundreds of millions of dollars. Your committee has been informed by the Ad-

visory Commission to the Council of National Defense that substantial amounts of private capital will not be invested in the construction of such facilities unless corporations are assured, in view of the fact that such facilities will be of use chiefly only during the period of national emergency, that they will be permitted to amortize the cost thereof over a shorter period than would be permitted under the depreciation provisions of the Internal Revenue Code.

Under the bill, accordingly, a corporation is allowed a deduction for income and excess profits tax purposes for the amortization of certain facilities which are certified by the Advisory Commission to the Council of National Defense and either the Secretary of War or the Secretary of the Navy as necessary in the interest of national defense during the present emergency. Such facilities are land, buildings, machinery, and equipment, or parts thereof, constructed, reconstructed, erected, installed, or acquired after July 10, 1940, and the construction, reconstruction, erection, installation, or acquisition of which was contracted for prior to the termination of the present emergency. The write-off of the cost (adjusted basis for income-tax purposes) of such facilities is permitted to be spread over a period of 60 months, this deduction to be in lieu of the present deduction for exhaustion, wear and tear, and obsolescence provided for in section 23(l) of the Internal Revenue Code. The taxpayer has the option of beginning the 60-month period either with the month following the month in which the facility is completed, or with the taxable year following the year in which the facility is completed, by signifying on the appropriate income-tax return its desire to have the benefits of the amortization deduction.

It is further provided that if, after having elected the amortization deduction, the taxpayer desires to terminate such deduction and use the deduction provided by section 23(l) of the Internal Revenue Code with respect to the remainder of the adjusted basis of the facility, he be permitted to do so upon notice to the Commissioner at any time prior to the termination of the 60-month period and that (except as set forth below) he be not permitted thereafter again to elect amortization with respect to the same facility.

The bill also provides that if the President has proclaimed the ending of the emergency, or the Secretary of War or the Secretary of the Navy has certified to the Commissioner of Internal Revenue that the facility ceased to be necessary in the interest of national defense during the emergency, and such proclamation or certificate is made before the end of the 60-month period, the taxpayer may elect to recompute the amortization deduction on the basis of the period as terminated by the proclamation or certificate in lieu of the 60-month period. The benefits of this election are accorded regardless of whether the taxpayer has in the past elected the amortization deduction with respect to the facilities involved.

It is further provided that a deduction be allowed, in lieu of the amortization deduction above-described, equal to the amount of certain payments received from the United States with respect to a facility if such payments are required to be included in the taxpayer's gross income. It is felt that the payments referred to should consist only of amounts certified by either the Secretary of War or the Secretary of the Navy as compensation to the taxpayer for the unamortized cost of the facility, made because further contracts with the United States involving the use of the facility are not forthcoming.

DETAILED DISCUSSION OF CERTAIN TECHNICAL PROVISIONS OF THE BILL.

SECTION 710. IMPOSITION OF TAX.

Section 710 imposes an excess-profits tax at the rates hereinbefore set forth. If the taxpayer's excess-profits credit is based upon income and invested capital, the tax is measured by the adjusted excess profits net income. Adjusted excess profits net income is defined as the excess-profits net income less the sum of a specific exemption of $5,000 and the amount of the excess-profits credit. If the taxpayer's excess-profits credit is based upon income, the excess-profits tax consists of the sum of a tax measured by adjusted excess-profits net income plus a tax measured by the normal-tax net income as defined in section 13(a)(2) of the Internal Revenue Code.

In order that corporations shall not secure undue advantage under the graduated rate schedules by splitting up in tax-free exchanges, a special application of the rates is provided in section 710(a)(3). Thus, if a corporation were to split into halves, the top bracket of $500,000 in the rate schedules must likewise be reduced by one-half to $250,000 in the case of each corporation and the lower

brackets reduced proportionately in order to prevent avoidance of the graduated rate schedule. The reduction accomplished in the bill is based upon the relation of the invested capital of the corporation prior to the split-up to the reduced invested capital after the split-up. Since the bill, in section 759, makes a similar reduction in the $500,000 figure which provides the dividing line between the 8 per cent and 10 per cent new capital rate, and since such $500,000 figure is the same figure as the top bracket under the rate schedules, the reduction in section 710(a)(3) in the rate schedules is for convenience based upon the reduction accomplished under section 759. The reduced amount computed under that section is called the preferential rate amount. Therefore, where the preferential rate amount of a corporation is less than $500,000 as a result of a split-up, the dollar amounts designating the amounts of tax and the upper and lower limitations of the various brackets in the rate schedules are to be reduced to amounts bearing the same ratio to the amounts which would otherwise be applicable as such preferential rate amount bears to $500,000.

No such reduction is to be made in the amounts of excess profits credit, normal-tax net income, or adjusted excess profits net income, which are determinable only by reference to other sections of the bill. Section 710(a)(3) is applicable both to a taxpayer whose credit is based upon income and to a taxpayer whose credit is based upon income and invested capital. In the case of a taxpayer of the former class having a preferential rate amount of $300,000, the graduated rate schedule measured by adjusted excess profits net income will, therefore, read as follows:

Upon adjusted excess profits net incomes of less than $12,000, 25 per cent of the adjusted excess profits net income.

$3,000 upon adjusted excess profits net incomes of $12,000; and upon adjusted excess profits net incomes in excess of $12,000, and not in excess of $30,000, 30 per cent in addition of such excess.

$8,400 upon adjusted excess profits net incomes of $30,000; and upon adjusted excess profits net incomes in excess of $30,000, and not in excess of $60,000, 35 per cent in addition of such excess.

$18,900 upon adjusted excess profits net incomes of $60,000; and upon adjusted excess profits net incomes in excess of $60,000, and not in excess of $150,000, 40 per cent in addition of such excess.

$54,900 upon adjusted excess profits net incomes of $150,000; and upon adjusted excess profits net incomes in excess of $150,000, and not in excess of $300,000, 45 per cent in addition of such excess.

$122,400 upon adjusted excess profits net incomes of $300,000; and upon adjusted excess profits net incomes in excess of $300,000, 50 per cent in addition of such excess.

Thus, if the taxpayer's adjusted excess profits net income were $180,000, his excess-profits tax would be $68,400, computed under the rate schedule above plus 4⅒ per centum of the normal tax net income.

In the case of a taxpayer using the credit based upon income and invested capital, the rate schedule set forth in section 710(a)(2), applicable to such taxpayers, is similarly adjusted under subsection (a)(3).

Section 711. Excess-Profits Net Income.

The excess-profits net income for purposes of the Act is defined in section 711. For taxable years beginning after December 31, 1939, the excess-profits net income is the normal tax net income for such year, as defined in section 13(a)(2), with certain prescribed adjustments depending upon which of the alternative methods provided for computing the excess-profits credit is used.

The adjustments to the normal tax net income for the purpose of determining the excess-profits net income are as follows:

(A) If the excess-profits credit for the taxable year is computed under section 713 on the basis of the average earnings for the base period, the adjustments to be made are as follows:

(1) The deduction for taxes paid or accrued under the law applicable to the taxable year is to be increased by an amount equal to the amount of the tax under Chapter 1 payable for such taxable year.

(2) The amount of any gain or loss realized upon the sale or exchange of a capital asset held for more than 18 months shall be excluded. For the purpose of this adjustment, capital asset means a capital asset as defined in section 117 of the Internal Revenue Code but without any exception with respect

to an asset of a character which is subject to the allowance for depreciation if such asset otherwise constitutes a capital asset within the meaning of the definition.

(3) There shall be excluded the amount of any income derived from the retirement or discharge by the corporation of any of its bonds, debentures, notes, or certificates of indebtedness, or any indebtedness evidenced by a writing which (including renewed obligations) were outstanding for more than 18 months prior to the date of such retirement or discharge.

(B) If the excess-profits credit is computed under section 714 by the invested-capital method, the following additional adjustments shall be made:

(4) The deduction allowable for interest paid or accrued during the taxable year shall be reduced by an amount which is the same percentage of so much of such interest as represents interest on borrowed capital as the borrowed invested capital is of the total borrowed capital.

(5) Instead of the limited credit for dividends received, allowed in computing the normal tax net income, a credit is to be allowed in the full amount of all dividends received (without regard to the limitation as to the amount of the adjusted net income) from another corporation, whether foreign or domestic, except dividends (actual or constructive) on stock of foreign personal holding companies.

For taxable years in the base period, the excess-profits net income is determined in the same manner as described for taxable years beginning after December 31, 1939, but with the additional adjustments hereinafter described. For taxable years subject to the Revenue Act of 1936, the basis for the application of the various adjustments is the normal tax net income as defined in section 13(a) of such Act, and for any other taxable year beginning after December 31, 1937, and before January 1, 1940, the special class net income as defined in section 14(a) of the applicable revenue law.

The normal tax net income or the special class net income for taxable years in the base period is to be computed as if section 117 of the Internal Revenue Code were a part of the revenue law applicable to the taxable year for which such income is being determined, with the exceptions hereinafter noted. In the application of section 117, the definition of capital assets is to be applied in the case of property held for more than 18 months as if depreciable assets were not excluded; that is, depreciable assets would be treated as capital assets if they are otherwise qualified as capital assets under the definition. If the computation of the excess-profits net income for a taxable year in the base period is being made in connection with the determination of the excess-profits tax liability for a taxable year beginning after December 31, 1940, then the net short-term capital loss carry-over provided in section 117(e) shall be applicable to net short-term capital losses for taxable years beginning after December 31, 1934. Section 117(e) is not applicable if the base period computation is being made for the purpose of determining the excess-profits tax liability for a taxable year beginning before January 1, 1941.

Additional adjustments with respect to the base period are that deductions for losses arising from fires, storms, shipwreck, or other casualty, or from theft, not compensated for by insurance or otherwise are not included, and the deduction for expenses is diminished by payments or credits to vendees of reimbursements to them of processing and other taxes under the Agricultural Adjustment Act of 1933. The effect of these adjustments is to increase the excess-profits tax net income in the base period.

Section 712. Excess-Profits Credits.

Section 712 provides that a domestic corporation, the first excess-profits tax taxable year of which begins on any date in 1940, and which was in existence during the entire 48 months prior to such date, shall be permitted to elect for each taxable year the credit under section 713 or section 714. The election must be made in its return for the taxable year and once having been made is irrevocable for such year. In the case of all other domestic corporations, the excess-profits credit for any taxable year must be computed in accordance with the invested capital method provided in section 714.

In the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, if its first excess-profits tax taxable year begins on any date in 1940 and it was in existence during the entire 48 months prior to such date and was engaged in trade or business within the United States or had an office or place of business therein at any time

during each of the taxable years in the 48 months prior to such date, it must compute its excess-profits credit by the method provided in section 713. All other foreign corporations engaged in trade or business within the United States or having an office or place of business therein are required to compute their excess-profits credit in accordance with the method provided in section 714. If the excess-profits credit of a foreign corporation is required to be computed under section 713, no adjustments are allowed for additions to or reductions in capital.

SECTION 713. EXCESS-PROFITS CREDIT BASED ON AVERAGE BASE PERIOD INCOME.

The credit provided under section 713 is based upon a comparison of income for the taxable year with the average income for the base period. Such credit consists of the average base period net income reduction in capital after the beginning of such taxable year. The term " base period " means the taxable years beginning after December 31, 1935, and before January 1, 1940.

The base period net income consists of the aggregate of the excess-profits net income for each of the taxable years of the taxpayer included in the base period less, in the case of taxable years included in such base period in which the deductions plus the credit for dividends received exceed the gross income, the amount of such excess, except as pointed out in the following paragraph of this report. In determining such excess, the adjustments required by section 711(b) (in respect of long-term capital gains and losses, the deduction for taxes, casualty losses, processing tax repayments, and the exclusion of income derived from the retirement or discharge of indebtedness of the corporation) for the purpose of computing the excess-profits net income shall be made. The average base period net income is determined by dividing the base period net income by the total number of months in the taxable years included in the base period and multiplying the quotient thus obtained by 12.

With respect to taxable years in which the deductions plus the credit for dividends received exceed the gross income the following rules are applicable to the treatment of such excess: If the deductions plus the credit for dividends received exceeded the gross income in only one year, the amount of the excess to be taken into account in computing the average base period net income shall be zero. If the deductions plus the credit for dividends received exceed the gross income in more than one of the taxable years included in such base period, the amount to be taken into account in computing the average base period net income shall be zero for the year in which such excess is the greatest and for the other year or years shall be the amount of the excess determined in respect of such year or years.

For the purpose of the excess-profits credit, the average base period net income shall not in any case be less than zero.

If a domestic corporation computes its excess-profits credit on the basis of the average earnings for the base period, such credit is adjusted for any changes in capital occurring after the beginning of its first taxable year under the excess-profits tax. The excess-profits credit will be increased by 8 per cent of the net capital addition for the taxable year or decreased by 6 per cent of the net capital reduction for the taxable year. The net capital addition for the taxable year is computed by taking the aggregate of the daily capital addition for each day of the taxable year and subtracting therefrom the aggregate of the daily capital reduction for each day of the taxable year. The difference thus obtained is divided by the number of days in the taxable year. If the aggregate of the daily capital reductions exceeds the aggregate of the daily capital additions, the excess divided by the number of days in the taxable year represents the net capital reduction for the taxable year.

The daily capital addition for any day of the taxable year is the aggregate of the amount of money and property paid in for stock, or as paid-in surplus, or as a contribution to capital, after the beginning of the taxpayer's first taxable year under the excess-profits tax and prior to the day for which the computation is made. Property paid in is included in an amount equal to its unadjusted basis for determining loss upon sale or exchange. If such unadjusted basis is a substituted basis, it is adjusted with respect to the period before the property was paid in, in the manner provided in section 113(b)(2). For the purpose of determining the amount of the daily capital addition a distribution by the taxpayer to its shareholders in its stock or right to acquire its stock shall not be regarded as money or property paid in for stock, or as paid-in surplus, or as a contribution to capital.

The amount of the daily capital addition as above computed shall be reduced by the excess, if any, of the excluded capital for such day over the excluded capi-

tal for the first day of the taxpayer's first taxable year under the excess-profits tax. Excluded capital consists of (1) obligations described in section 22(b)(4) (A), (B), or (C), any part of the interest upon which is excludible from gross income or allowable as a credit against net income, and (2) stock held by the taxpayer the dividends upon which are allowed as a credit under section 26(b). The excluded capital for any day is an amount equal to the sum of the following:

(1) The aggregate of the adjusted basis (for determining loss upon sale or exchange) as of the beginning of such day of the above-described obligations held by the taxpayer at the beginning of such day; and

(2) Eighty-five per cent of the aggregate of the adjusted basis (for determining loss upon sale or exchange) as of the beginning of such day of the above-described stock held by the taxpayer at the beginning of such day.

The capital so excluded for the purpose of determining the additions to invested capital represents capital the income from which is not subjected to tax.

The daily capital reduction for any day of the taxable year is the aggregate of the amounts of distributions to shareholders after the beginning of the taxpayer's first taxable year under the excess-profits tax and prior to such day, which distributions are not out of earnings and profits.

SECTION 714. EXCESS-PROFITS CREDIT BASED UPON INCOME AND INVESTED CAPITAL.

Domestic corporations which were in existence during the whole of the base period may elect, and all other domestic corporations are required, to compute the excess-profits credit by the method provided in section 714. Such credit is based upon the relationship of income to invested capital. In determining such credit, there is first ascertained the base period percentage. This is defined in section 714 as the percentage which the base period net income is of the aggregate of the invested capital for each of the taxable years in the base period but not to exceed 10 per cent or be less than 5 per cent. With respect to the first $500,000 of invested capital in the taxable year, not in excess of the lowest invested capital, the minimum is 7 per cent.

Any increase in the invested capital over the invested capital at the close of the base period or the invested capital for any taxable year beginning after December 31, 1939, and preceding the taxable year for which the credit is being computed, whichever is the lower, will increase the credit computed upon such previous invested capital by 10 per cent of so much of the new invested capital as does not produce a total invested capital in excess of $500,000, and by 8 per cent of the remainder of the new invested capital. An example of the operation of this rule is set forth in the preceding portion of this report.

The term "base period" means the taxable years beginning after December 31, 1935, and before January 1, 1940, except that in the case of a taxpayer the first taxable year of which under the excess-profits tax begins on any date in 1940, and which was in existence during only part of the 48 months prior to such date, the base period shall be such 48 months. With respect to a corporation which was in existence during only part of the base period, the bill provides that for each of the taxable years of 12 months during the whole of which it was not in existence, it shall be deemed to have an invested capital equal to its invested capital as of the first day of its taxable year beginning in 1940, reduced by an amount which is the same percentage of such invested capital as the percentage which the total of the inadmissible assets for the preceding taxable year is of the total of inadmissible and admissible assets for such taxable year, such percentage to be computed in accordance with the method provided in section 720. The invested capital for the taxable year consisting of the remainder of that part of its base period during which it was not in existence shall be an amount determined as above, multiplied by the number of days in such remainder and divided by the number of days in the 12 months preceding the first day of its existence.

The excess-profits net income for any of the taxable years of 12 months in the base period during which the corporation was not in existence is an amount equal to 10 per cent of the first $500,000 of the constructive invested capital and 8 per cent of the balance of such constructive invested capital. The excess-profits net income for any period of less than 12 months during which the corporation was not in existence is a proportionate part of such amount.

Corporations which were not in existence during any part of the base period are allowed an excess-profits credit equal to 10 per cent of that part of the invested capital which does not exceed $500,000 plus 8 per cent of the remainder.

For the purpose of determining the excess-profits credit based upon invested capital under section 714, the base period net income is computed in the same manner as the base period net income for the purpose of the excess-profits credit provided under section 713, except that in determining the excess-profits net income, or the excess of the deductions plus the credit for dividends received over the gross income, for taxable years in the base period, the following additional adjustments are made:

(1) The adjustment provided in section 711(b) with respect to the credit for dividends received; and

(2) The adjustment provided in section 711(b) with respect to the deduction allowable for interest paid or accrued during the taxable year.

These adjustments are described in the discussion of the section dealing with the determination of excess-profits net income.

Also, similar to the treatment provided under section 713, if the deductions plus the credit for dividends received exceed the gross income for one of the taxable years in the base period, such excess is treated as zero in determining the base period net income. If there was such an excess in more than one of the taxable years in the base period, only the excess for the taxable year in which such excess was greatest shall be treated as zero. The rule permitting such an excess to be treated as zero applies with respect to taxable years in the base period not only in the case of corporations which were in existence during the whole of the base period but also in the case of corporations which were in existence during only part of the base period. This rule has the effect of preventing too great a reduction of the excess-profits credit for an abnormal year.

Sections 715–719. Invested Capital.

Invested capital for any taxable year, including the taxable years in the base period, is defined in section 715 as the average invested capital for such year and is based on the invested capital for each day of the taxable year. Average invested capital is the aggregate of the daily invested capital for each day of the taxable year divided by the number of days in such taxable year or, for a taxable year in the base period, the aggregate of the daily invested capital for each day of such taxable year divided by the number of days in the 12 months ending with the close of the taxable year. The invested capital for a taxable year consists of two component parts: (*a*) Equity invested capital; and (*b*) borrowed invested capital.

(*a*) *Equity invested capital.*—The equity invested capital for any day of the taxable year is determined under section 718, which provides that it shall be determined as of the beginning of such day and shall be the sum of the following amounts—

(1) *Money paid in.*—Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital.

(2) *Property paid in.*—Property other than money previously paid in for stock, or as paid-in surplus, or as a contribution to capital, regardless of the time paid in. Such property shall be included at an amount equal to its unadjusted basis for determining loss upon sale or exchange. If the unadjusted basis of such property is a substituted basis it shall be adjusted, with respect to the period before the property was paid in, in the manner provided in section 113(b)(2). The use of the unadjusted basis is dictated by the fact that adjustments of basis, notably for depreciation, are reflected in earnings and profits. If the property so paid in was disposed of before the beginning of the taxable year, such basis is determined in the same manner as if the property were still held by the taxpayer at the beginning of the taxable year. The result is uniformity of basis treatment, regardless of the law in effect at the time of the disposition of the property.

(3) *Taxable stock dividends.*—Distributions in stock of the corporation, or in rights to acquire its stock, to the extent to which they constitute a distribution of earnings and profits other than earnings and profits of the taxable year. Taxable stock dividends are included in invested capital because they represent, in effect, a reinvestment of earnings in the business. Conversely, if a stock dividend was not subject to tax in the hands of the distributee because it did not constitute income to him within the meaning of the sixteenth amendment to the Constitution or was not taxable to him under the applicable revenue law, it is not deemed to reduce the earnings and profits account and is therefore already reflected in the accumulated earnings and profits. In determining

whether a taxable stock dividend is out of the earnings and profits of the taxable year, such earnings and profits are computed as of the close of such taxable year without diminution by reason of any distribution made during such taxable year or by reason of the excess-profits tax for such year, and the determination is to be made without regard to the amount of earnings and profits at the time the distribution was made. This rule avoids the necessity of adjusting the earnings and profits of the taxable year by reason of the excess-profits tax imposed with respect to such earnings or by reason of any distribution made during such taxable year for the purpose of determining the amount of earnings and profits available as of the date of distribution.

(4) *Earnings and profits at beginning of year.*—The accumulated earnings and profits as of the beginning of the taxable year. If there is a deficit in the accumulated earnings and profits as of the beginning of the taxable year, such deficit shall not be taken into account and in such cases the earnings and profits as of the beginning of the taxable year shall be considered as zero, for the purpose of computing the invested capital for such year. In computing such earnings and profits for taxable years beginning after December 31, 1940, distributions made during the first 60 days of the taxable year are deemed, to the extent they do not exceed the accumulated earnings and profits as of the beginning of the taxable year, to have been made on the last day of the preceding taxable year.

Under various provisions of the Internal Revenue Code dealing with exchanges and liquidations, the transfer of the property by a corporation to another corporation results in the nonrecognition, in whole or in part, of the gain or loss realized by the transferor upon such transfer. In such cases well established principles of income tax law require that the earnings and profits of the transferor shall go over to the transferee and shall be considered to be earnings and profits of the transferee for tax purposes. Subsection (c)(4) of section 718 provides that such transferred earnings and profits shall not be taken into account in computing the earnings and profits as of the beginning of the taxable year for the purpose of determining the equity invested capital. Inasmuch as the property received by the transferee upon such a transfer is included in such cases in the equity invested capital at its adjusted basis in the hands of the transferor, it is necessary to exclude the earnings and profits acquired by the transferee by reason of such transfer in order to avoid duplication.

The sum of the above-described amounts shall be reduced by the sum of the following:

(1) *Distributions in previous years.*—Distributions made in prior taxable years which were not out of accumulated earnings and profits.

(2) *Distributions during the year.*—Distributions previously made during the taxable year which are not out of the earnings and profits of such taxable year. Distributions made during the first 60 days of the taxable year, to the extent they do not exceed the accumulated earnings and profits as of the beginning of the taxable year, are deemed to have been made on the last day of the preceding taxable year. Moreover, in determining whether a distribution is out of the earnings and profits of any taxable year, such earnings and profits are computed as of the close of such taxable year without diminution by reason of any distribution made during such taxable year or by reason of the excess-profits tax for such year, and the determination is to be made without regard to the amount of the earnings and profits at the time the distribution was made. The purpose of this latter rule is the same as indicated in the paragraph dealing with taxable stock dividends.

For the purpose of the conclusive presumption respecting dividends out of earnings and profits paid during the first 60 days of the taxable year, such distributions shall be considered in the order of time and the accumulated earnings and profits as of the beginning of the taxable year shall be computed without regard to the presumption. The presumption applies only with respect to taxable years beginning after December 31, 1940.

(*b*) *Borrowed invested capital.*—Borrowed invested capital for any day of the taxable year is to be based on the borrowed capital at the beginning of such day. Borrowed capital consists of the outstanding indebtedness of the taxpayer (exclusive of interest) which is evidenced by bond, note, debenture, bill of exchange, certificate of indebtedness, mortgage, or deed of trust, or any other written evidence of indebtedness. The amount to be included in invested capital is limited to varying percentages of the borrowed capital, depending upon the amount of the equity invested capital. These limitations are as follows:

(1) If the equity invested capital is less than $100,000, 100 per cent of that portion of the borrowed capital which does not exceed the difference between $100,000 and the equity invested capital, plus 66⅔ per cent of so much of the remainder of the borrowed capital as does not exceed $900,000, plus 33⅓ per cent of any remaining borrowed capital.

(2) If the equity invested capital is $100,000 or more and less than $1,000,000, 66⅔ per cent of that portion of the borrowed capital which does not exceed the difference between $1,000,000 and the equity invested capital, plus 33⅓ per cent of the remainder of the borrowed capital.

(3) If the equity invested capital is $1,000,000 or more, 33⅓ per cent of the borrowed capital.

SECTION 720. INADMISSIBLE ASSETS.

Sections 715 and 720 of the bill provide that the average invested capital of the taxable year shall be reduced by an amount which is the same percentage of invested capital as the inadmissible assets are of the total of admissible and inadmissible assets, with an adjustment for short-term capital gain realized upon the sale or other disposition of such inadmissible assets. The terms "admissible" and "inadmissible assets" are defined in section 720 and the computation to determine the percentage of reduction is made in accordance with the provisions of such section.

Inadmissible assets are:

(1) Stock in a corporation except stock in a foreign personal holding company, and

(2) Obligation described in section 22(b)(4) (A), (B), or (C) any part of the interest from which is excludible from gross income or allowable as a credit against net income. Such obligations include State and local securities, obligations of corporate agencies organized under an Act of Congress, and obligations of the United States or its possessions.

Admissible assets are all assets other than inadmissible assets, except as provided in section 753.

The invested capital is so reduced because the income from inadmissible assets is not includible in the excess profits net income of the corporation and, therefore, the assets from which such income arose should be excluded from invested capital. The inadmissible assets are not deducted directly from the invested capital for the reason that the total of admissible and inadmissible assets is not ordinarily equal to the invested capital.

For the purpose of determining the ratio of inadmissibles to the total of admissibles and inadmissibles, section 720(b) of the bill provides that the amount attributable to each asset shall be determined, under regulations prescribed by the Commissioner with the approval of the Secretary, by ascertaining the adjusted basis thereof for each day of the taxable year and adding such daily amounts. In the case of a taxable year for which the excess-profits tax is being determined, the adjusted basis shall be the adjusted basis for determining loss upon sale or exchange under section 113, and in the case of a taxable year in the base period the adjusted basis shall be the adjusted basis for determining loss upon sale or exchange as determined under the law applicable to such taxable year.

Section 720(c) of the bill provides that if during the taxable year there has been a short-term capital gain with respect to an inadmissible asset, an adjustment shall be made for the purpose of determining the inadmissible ratio. Under this provision there is added to the total of admissible assets and subtracted from the total of inadmissible assets that proportion of the amount attributable to any inadmissible asset upon which a short-term capital gain was realized which such gain bears to the sum of such gain plus the dividends and interest on such asset for such year. For the purpose of this provision, short-term capital gain means a short-term capital gain as defined in section 117 of the Internal Revenue Code. The effect of this adjustment is to include as an admissible asset that proportion of the amount attributable to the inadmissible asset which the earnings on such asset included in taxable income bear to the total of the earnings on such asset during the taxable year.

SECTION 721. EQUITY INVESTED CAPITAL IN SPECIAL CASES.

The bill provides a special method of determining equity invested capital in cases where the Commissioner is unable to determine the taxpayer's equity invested capital for the first day of the first taxable year beginning after December 31, 1939, under the rules previously discussed. In such a case, the equity invested

capital as of such date shall be an amount equal to the cash on hand plus the aggregate of the adjusted bases at such time of the assets of the taxpayer then held minus the indebtedness outstanding at such time. The amount of the money, assets, and indebtedness at such time shall be determined in accordance with regulations of the Commissioner with the approval of the Secretary. The equity invested capital for each day in the taxpayer's base period and for each day after the beginning of the taxpayer's first taxable year shall be determined (under such regulations) using as the basic figure the equity invested capital so determined.

SECTION 722. FOREIGN CORPORATIONS—INVESTED CAPITAL.

In the case of a foreign corporation required to compute its excess-profits credit by the invested-capital method under section 714, the invested capital is based only on the assets of the taxpayer held by it in the United States. The bill provides that the daily invested capital for any day of the taxable year shall be the aggregate of the adjusted basis of each United States asset held by the taxpayer in the United States on the beginning of such day, the determination to be made in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary. For the purpose of reducing the average invested capital by the ratio of inadmissible assets to the sum of admissible and inadmissible assets, the terms "admissible assets" and "inadmissible assets" include only United States assets. The term "United States asset" means an asset held by the taxpayer in the United States, determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary.

If the Commissioner determines that the United States assets of the taxpayer can not satisfactorily be segregated from all its assets, section 722(b) of the bill provides that the invested capital for the taxable year shall be an amount which is the same percentage of the aggregate of the adjusted basis of all assets held by the taxpayer as of the end of the last day of the taxable year which the net income for the taxable year from sources within the United States is of the total net income of the taxpayer for such year.

Foreign corporations subject to the excess-profits tax are allowed the specific exemption of $5,000.

SECTION 723. PERSONAL SERVICE CORPORATIONS.

Section 723 provides special treatment for personal service corporations. Such corporations may elect not to be subject to the excess-profits tax, and in such event the undistributed income of the corporation will be taxed to its shareholders. Section 723(a) defines a personal service corporation as a corporation whose income is attributable primarily to the activities of shareholders who are regularly engaged in the active conduct of the affairs of the corporation and are the owners at all times during the taxable year of at least 80 per cent in value of the stock of the corporation, and in which capital (whether invested or borrowed) is not a material income-producing factor. For the purpose of the stock-ownership requirement an individual is considered as owning, at any time, the stock owned at such time by his spouse or minor child. The term "personal service corporation" does not include any foreign corporation, nor any corporation 50 per cent or more of whose gross income consists of gains, profits, or income derived from trading as a principal.

Subsection (b) of section 723 provides that a personal service corporation may elect in its income-tax return under Chapter 1 for any taxable year not to be subject to the excess-profits tax and in such event it will be exempt from tax for such taxable year. A new election must be made for each taxable year and may be made only in its income-tax return for such year. If the corporation so elects for any taxable year its undistributed net income is required to be included in the gross income of the persons who were shareholders of the corporation on the last day of the corporation's taxable year.

The treatment of the undistributed income of the corporation for tax purposes both with respect to the corporation and its shareholders is prescribed in the new Supplement S. This supplement is explained later in this report.

SECTION 724. CORPORATIONS COMPLETING CONTRACTS UNDER MERCHANT MARINE ACT, 1936.

Under section 505 of the Merchant Marine Act, 1936, as amended, if any contracting party within an income taxable year completes one or more contracts or

subcontracts for the construction of a vessel under such Act, such party is required to pay to the United States Maritime Commission profit in excess of 10 per cent of the total contract prices of such contracts and subcontracts. The excess profit so paid to the Maritime Commission, together with all other receipts of the Commission, are placed in a revolving construction fund and are available for further ship construction.

In view of the fact that such profit-limiting provisions are retained, it is believed that a taxpayer subject thereto should have some relief from the excess-profits tax.

Section 724 is designed to accomplish this purpose. It provides for an alternative tax which is to be paid if it is less than the tax computed under section 710.

As a general rule the amounts received by the contracting party and recaptured by the Maritime Commission would be excluded from net income in computing the excess-profits tax under section 710. In computing the alternative tax provided for by section 724 the taxpayer will be required to increase its excess-profit net income and its normal-tax net income by the amount of the payments to the Maritime Commission. The tax computed upon this basis is then reduced by the amount of the payments to the Maritime Commission, and the remainder constitutes the tax which is to be paid if it is less than the tax computed under section 710.

Section 727(a) makes applicable in respect of the excess-profits tax all provisions of law (including penalties) applicable in respect of the taxes imposed by Chapter 1 which are not inconsistent with the provisions of the bill. Examples of such provisions are provisions relating to the assessment and collection of deficiencies, claims for refund, periods of limitation on the assessment and collection of deficiencies or the allowance of refunds, the jurisdiction, procedure, and powers of the Board of Tax Appeals, closing agreements, etc.

Section 727(b) provides that, although section 52(a), requiring the filing of returns, is made applicable to the excess-profits tax, no excess-profits-tax return need be filed under such section by any taxpayer for any taxable year for which its excess-profits net income computed with the adjustments provided in section 711(a)(2), and placed on an annual basis as provided in section 711(a)(3), is not greater than $5,000.

Section 727. Other Laws Applicable.

Under existing law an American corporation which pays income tax to a foreign country or to a possession of the United States upon its income from such source is allowed (if it claims such credit on its return) a credit for such tax against its United States income tax but only to the extent of the American tax upon the income from such country or possession. Thus, if the United States effective tax rate is 20 per cent, and the foreign effective tax rate is 25 per cent, a part of the foreign tax is not allowed. Since the excess-profits tax proposed in this bill is a tax imposed upon, and measured by, income it is believed that the excess-profits tax should be included in the American tax burden against which is allowed the credit for income taxes paid to foreign countries or possessions of the United States by our domestic corporations. Accordingly, section 727 provides in effect that, where a credit for the tax paid to such foreign country or possession of the United States is allowed under Chapter 1, the portion, if any, of such tax not used as a credit against the tax imposed by Chapter 1 by reason of the limitations of section 131(b), will be available as a credit against the excess-profits tax subject to substantially the same principles of limitation as are applicable for normal tax purposes.

PART II. EXCESS-PROFITS CREDIT IN CONNECTION WITH CERTAIN EXCHANGES.

Supplement A. Credit Based on Income.

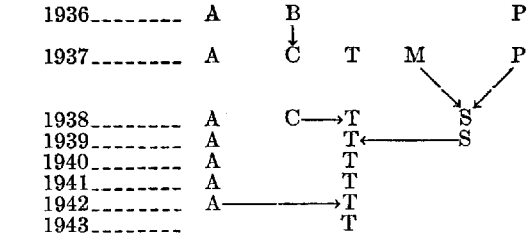
In general, this supplement has two fundamental purposes. The first is to allow a domestic corporation which was not in existence at the beginning of its base period to elect to compute its excess-profits credit under the average-earnings method provided by section 713, if it acquired, or resulted from the coalescing of, another corporation through certain tax-free exchanges, where the other corporation was in existence at the beginning of the base period or had a predecessor which was in existence at such time; and, having so elected, to use as its excess-profits net income for the taxable years in the base period prior to such acquiring or coalescing, the excess-profits net income of the other corporation. For the

years in the base period subsequent to such acquiring or coalescing, it uses its own excess-profits net income for the purpose of computing the credit.

The second is to permit a domestic corporation which was in existence at the beginning of the base period and which is thereby entitled to elect to compute its excess-profits credit under section 713 by virtue of the provisions of section 712, if it does elect to compute such credit under section 713, to add to its excess-profits net income for the years in the base period the excess-profits net incomes of corporations which it absorbs by a statutory merger or by liquidation under section 112(b)(6), where such merged or liquidated corporation was in existence at the beginning of the base period or had predecessors in existence on such date.

SECTION 740. DEFINITIONS.

The factors defined in this section may be more clearly understood by reference to the following diagram:



Corporations A, B, and P were in existence on January 1, 1936, the beginning of the taxpayer T's base period. Corporations T and M came into existence on January 1, 1937.

In the above example:

C acquired all the assets of B in return for all the stock of C, and is an "acquiring corporation" as defined in section 740(a)(1); and B is a "component corporation" as defined in section 740(b)(1).

C was liquidated by T under section 112(b)(6), and T is an acquiring corporation under section 740(a)(2). C is a component corporation under section 740(b)(2) as well as an acquiring corporation as just pointed out.

S was the result of the consolidation of M and P and is an acquiring corporation under section 740(a)(4). M and P are component corporations under section 740(b)(4).

S was merged into T and, therefore, becomes a component corporation under section 740(b)(3). T (although already an acquiring corporation as above stated) also is an acquiring corporation (under section 740(a)(3)) by reason of the merger.

A was merged into T and is a component corporation under section 740(b)(3), and T is once more considered as an acquiring corporation by reason of the merger.

Under section 740(c), a qualified component corporation must be in existence, either actually or constructively, on the date of the beginning of the taxpayer's base period as defined in subsection (d). Assuming, in the example given, that T, the taxpayer, is on a calendar-year basis, then all qualified component corporations of T must have been in existence, either actually or constructively, on January 1, 1936. Thus M is not a qualified component but T itself, while not in existence on January 1, 1936, is given a hypothetical existence on that date by subsection (f) because it had one or more component corporations which were themselves actually or constructively in existence on such date.

SECTION 741. ELECTION OF INCOME CREDIT.

Thus under section 741, T is permitted to elect the income credit, provided by section 713, although it was not in existence actually on January 1, 1940, and although its component A was subject to excess-profits tax for 1941 and on the part of its year 1942 prior to its merger into T. If neither A, B, nor P had been in existence on January 1, 1936, T would have had no right of election.

SECTION 742. AVERAGE BASE PERIOD NET INCOME.

For the purposes of ascertaining T's average base period net income, T is first given a base period, whether actual or hypothetical under section 740(d), consisting of 4 taxable years of 12 months each, the last of which ends with the beginning of its first taxable year beginning in 1940.

Into these taxable years are placed the excess-profits net incomes (or in the case where the deductions and credit for dividends received exceed the gross income, the amount of such excess) of T's qualified component corporations for their taxable years in the base period ending with or within T's taxable years in such period. If T's actual taxable years do not coincide with its constructive taxable years during the base period, its excess-profits net income (or, in the case where the deductions and credit for dividends received exceed the gross income, such excess) goes into its hypothetical taxable year in, or with, which such actual taxable year ends.

Under subsection (f) T is denied the right to include in its aggregate excess-profits net income for the base period, its own income for the years before it became an acquiring corporation, if it was not actually in existence at the beginning of its base period. Thus, under the example given, T can not count its income for 1937. A similar rule applies to the income of a component corporation, under which the income of M for 1937 can not be used by T.

The excess-profits net incomes of T's component corporations attributable to periods prior to the beginning of T's base period are excluded pro rata from T's aggregate base period net income. The same rule is applicable to T itself where its actual and constructive taxable years do not coincide at the beginning of its base period.

Assuming that the merger of A into T took place in the middle of T's taxable year 1942, under subsection (f)(4), only one-half of A's base period income can be used by T for the purposes of computing its income credit for 1942. Thereafter, T is entitled to A's full base period experience.

Subsection (e) provides that in the computation of the base period income of both T and its component corporations, there shall be excluded any dividends paid by T or any of its components which would otherwise go into the taxpayer's base period net income.

For example, if in the diagram given, C had received a dividend from T in 1937 such dividend is not affected by this subsection as T's income for such year is not taken into account in the computation of the taxpayer's base period income. However, if T in 1938, after it had become an acquiring corporation, had received a dividend from S, such dividend would be excluded since both T's and S's income for such year go into the taxapayer's base period income and if the dividend were not excluded it would be counted twice.

The following example illustrates the computation of T's excess-profits credit for 1942. In the example the amount stated as income is the net income adjusted by the adjustments specified in the bill and excluding the dividends on excluded stock. This assumes that all transactions take place at the beginning of each of the taxable years specified, except that it is assumed that A merged with T in the middle of 1942.

For 1936, A's income is $4,000; B's income is $6,000; and P has a deficit in income of $10,000. T's base period income for 1936 is the sum of $2,000 (one-half of A's $4,000) plus $6,000, or $8,000, minus $10,000, giving a base period income for the year of minus $2,000.

For 1937, A's income is $4,000; C's income is $8,000; T's income is $10,000; M's income is $4,000; and P's income is $6,000. A's income is included at one-half, or $2,000. C's income is included in full, or $8,000. T's income and M's income are not included, for they were not actually in existence on January 1, 1936, and had no component in existence on that date. P's income of $6,000 is included in full, so that for 1937, T's base period income is $2,000 plus $8,000, plus $6,000 or $16,000.

For 1938, A's income is $4,000, T has a deficit in income of $6,000, and S has a deficit in income of $10,000. A's income is included at one-half, or $2,000. T's deficit is subtracted in full, or $6,000. S's deficit is subtracted in full, or $10,000. For the year, T's base period net income is the sum of the plus amounts, or $2,000, minus the sum of the minus amounts, or $16,000, which equals a minus $14,000.

For 1939, A's income is $4,000; T's income is $20,000; and S's income is $8,000. For the year T's base period net income is $2,000, plus $20,000, plus $8,000, or $30,000.

Thus T has a base period net income for each year in the base period as follows:

1936	—$2,000
1937	+16,000
1938	—14,000
1939	+30,000

Under the rule of counting the year of greatest deficit at zero, 1938 is not included, so the aggregate base period income of T is $30,000, plus $16,000, or $46,000, minus $2,000, or $44,000, which, divided by 4, gives a base period net income of $11,000.

SECTION 743. NET CAPITAL CHANGES.

By the provisions of this section, the taxpayer is allowed to add the net additions to capital of its component corporations accumulated after the beginning of the first taxable year under the bill and prior to the acquiring transaction. Conversely it must take the net capital reductions of such component corporations for the same period.

For example, if the merger of A into T took place in the middle of T's taxable year, assuming that A had net capital additions as of the day of the merger of $100,000, such net capital addition will be used in computing the net capital additions of T for that and subsequent days in the same manner as T's own net capital additions. The same is applicable with respect to net capital reductions.

SECTION 784. FOREIGN CORPORATIONS.

Foreign corporations are not permitted the use of this supplement and are not included as acquiring, component, or qualified component corporations.

SUPPLEMENT B. EXCHANGES.

Supplement B contains provisions relative to the effect of certain tax-free exchanges upon the computation of the excess-profits credit based on income and invested capital. Such provisions are designed (1) to permit the base period experience of all corporations which coalesced during the base period to be used in computing the base period experience of the successor corporation, (2) to prevent large corporations from obtaining undue advantage from reorganizing, by means of tax-free transactions, into groups of small corporations, (3) to prevent invested capital acquired in certain tax-free exchanges from being treated as new capital to any greater extent than it was so treated in the hands of the corporation from which it was acquired, (4) to prevent step-ups of base period percentages, and (5) to prevent a corporation, the proportion of whose borrowed capital which may be included in invested capital at 100 per cent or 66⅔ per cent or the proportion of whose invested capital which is given favorable base period percentage or new capital treatment has been adjusted because of previous reorganizations, from undoing the effects of such adjustments through transferring its assets, tax-free, to another corporation which is little more than a dummy.

The nontaxable exchanges covered by Supplement B fall into two general classes: (*a*) Whereby one corporation becomes several corporations, and (*b*) whereby several corporations become one corporation. The treatment accorded to such exchanges by Supplement B is in general as follows:

Exchanges occurring after base period.—In cases of corporate split-ups the equity invested capital, the lowest invested capital, the amounts representing the point at which borrowed capital may be included in invested capital at 100 per cent, 66⅔ per cent, or 33⅓ per cent, the amount of lowest invested capital to which a minimum base period percentage of 7 per cent is applicable if the base period percentage is lower, and the amount representing the point at which new capital is subject to the 8 per cent instead of the 10 per cent rate, of the original corporation, are divided between it and the new corporations and each subsidiary is given the same base period percentage as that possessed by the parent corporation. Stock of the subsidiaries acquired by the parent is eliminated from consideration by being treated as neither an admissible nor an inadmissable asset. In addition, securities other than stock issued by the subsidiaries upon the exchange are excluded from the borrowed capital of the subsidiaries unless issued in connection with an assumption of the liabilities of the parent. The result is that the sum of the excess-profits credits of all such corporations is exactly the same

as the excess-profits credit of the parent corporation would have been if the split-up had not taken place.

Where the A Corporation merely reorganizes itself into the B Corporation, transferring all its assets to the B Corporation for all the B Corporation's stock, the B Corporation acquires the status of the A Corporation.

In cases where several corporations become one corporation the equity invested capital, the borrowed capital, and the lowest invested capital of the resulting corporation are the sum of the equity invested capitals, the borrowed capitals, and the lowest invested capitals, respectively, of the constituent companies. The amounts representing the point at which borrowed capital may be included in invested capital by the resulting corporation at 100 per cent, 66⅔ per cent, or 33⅓ per cent, the amount of lowest invested capital of the resulting corporation to which a minimum base period percentage of 7 per cent is applicable if the base period percentage is lower, and the amount representing the point at which new capital is subject to the 8 per cent instead of the 10 per cent rate are the sum of such amounts in the case of the constituent corporations, except that they may not exceed the amounts otherwise allowed by Subchapter E. The base period percentage of the resulting corporation is the weighted average of the base period percentages of the constituent corporations. The result is that the status of constituent corporations is attributed to the resulting corporation except for the consequences which flow from increased size.

Since corporate split-ups may sometimes be disguised as transactions whereby one corporation acquires assets of another, as, for example, where the A Corporation transfers a portion of its assets to an already existing B Corporation which it or its shareholders, or both, afterward control, it is necessary that such transactions be treated in the same manner as corporate split-ups. The status of the acquiring corporation before the exchange is therefore ignored except to the extent that its equity invested capital, its borrowed capital, its lowest invested capital, and its base period percentage are taken into account in the computation. For this purpose "control" is defined as ownership of stock possessing at least 90 per cent of the total combined voting power of all classes of stock entitled to vote and at least 90 per cent of the total value of shares of all classes of stock of a corporation. Similarly and to the same extent, where the shareholders of an acquiring corporation immediately before the acquisition by such corporation of the assets of another corporation are also in control after such acquisition the status of the corporation whose assets are acquired is ignored in determining the future status of the acquiring corporation. An exception to the latter rule is where corporations which resulted from a previous split-up subject to the adjustments provided by Supplement B later reunite.

Exchanges involving several transferors are treated as a series of separate exchanges except where the exchange is one described in section 112(b)(5) or so much of section 112(c) and (e) as refers to section 112(b)(5). In the latter case the acquiring corporation is given a status reflecting the status of each of the transferor corporations, except where one transferor by itself is in control of the acquiring corporation after the transfer, in which case the transaction is treated as a split-up of such corporation alone. In section 112(b)(5) cases where the acquiring corporation is controlled after the exchange by noncorporate transferors, it is treated as a new corporation except as regards lowest invested capital and the base period percentages applicable thereto.

The rules provided by Supplement B relative to the computation of equity invested capital and admissible and inadmissible assets upon tax-free exchanges apply regardless of control and regardless of whether the exchange took place before, after, or during the base period.

Exchanges in base period.—Exchanges occurring in the base period are treated in the same manner as exchanges occurring after the base period insofar as the computation of equity invested capital and admissible and inadmissible assets and the exclusion of certain securities from borrowed capital are concerned. It has been thought unnecessary to require adjustment with respect to the amounts of borrowed capital which may be included in invested capital at 109 per cent, 66⅔ per cent, and 33⅓ per cent. Other adjustments which would be made if the exchange took place after the base period have no application to the base period.

In the case of corporations which have acquired substantially all the assets of one or more other corporations during the base period, the base period experience of such other corporations, both as respects invested capital and as respects base period income, is included in the base period experience of the acquiring corporation. Only actual amounts of invested capital and income

are included for any part of the acquiring corporation's base period during which the acquiring corporation or any one of such other corporations was in existence. For any portion of such base period during which neither the acquiring corporation nor any one of such other corporations was in existence, invested capital and income are constructed on the basis of the acquiring corporation's invested capital for the first day of its first taxable year under Subchapter E.

In computing the base period net income of the acquiring corporation the income for each taxable year of each corporation is taken into account, and from the sum of such amounts is deducted the sum of the deficits for each taxable year of each corporation. If, however, for one or more of the four 12-month periods preceding the beginning of the first taxable year of the acquiring corporation, the combined deficit of the acquiring corporation and the other corporations is greater than the combined income, the incomes and deficits allocated to the 12-month period in which falls the largest excess of deficits over incomes are to be omitted from the computation.

EXAMPLE OF SPLIT-UP.

The A Corporation which is on a calendar-year basis has for each day of 1941 equity invested capital of $1,000,000 and borrowed capital of $1,500,000. It has a base period percentage of 5 per cent and lowest invested capital of $300,000. Not having been through a prior tax-free exchange, it has a second borrowed capital base (i. e., the point at which any future borrowed capital may be included in invested capital at only 33⅓ per cent instead of 66⅔ per cent) of $1,000,000, a first borrowed capital base (i. e., the point at which borrowed capital is includible at 66⅔ per cent instead of 100 per cent) of $100,000, and preferential rate amount (the point at which the rate applicable to new capital becomes 8 per cent instead of 10 per cent and the point at which the rate applicable to lowest invested capital is the base period percentage even though lower than 7 per cent) of $500,000. On December 31, 1941, the adjusted basis of all its assets is $2,500,000. On such date it organizes the B Corporation, transferring to it assets with an adjusted basis of $1,250,000 for all the stock of the B Corporation and the assumption by the B Corporation of $750,000 of the A Corporation's indebtedness represented by borrowed capital. Assuming that the B Corporation also files its returns on the calendar-year basis and that no further changes occurred during the year 1942, the excess-profits credit of the A and the B Corporations for such year will each be $60,500, computed as follows:

	A Corporation.	B Corporation.
Equity invested capital	$500,000	$500,000
Borrowed capital	750,000	750,000
Second borrowed capital base	500,000	500,000
First borrowed capital base	50,000	50,000
Invested capital	750,000	750,000
Lowest invested capital	150,000	150,000
Preferential rate amount	250,000	250,000
Base period percentage (per cent)	5	5
Excess profits credit	$60,500	$60,500

The excess-profits credit of the A Corporation for 1941 was $121,000, computed as follows:

Equity invested capital	$1,000,000
Borrowed capital	$1,500,000
Second borrowed capital base	$1,000,000
First borrowed capital base	$100,000
Invested capital	$1,500,000
Lowest invested capital	$300,000
Preferential rate amount	$500,000
Base period percentage	5
Excess-profits credit	$121,000

On the basis of this example it will be seen that the sum of the credits of the A Corporation after the split-up and the B Corporation is exactly equal to the credit of the A Corporation before the split-up.

EXAMPLE OF ACQUISITION.

The X Corporation and the Y Corporation, both of which file their returns on a calendar-year basis, for each day of the calendar year 1941 and on December 31, 1941, find themselves in the following situation:

	X Corporation.	Y Corporation.
Equity invested capital	$500,000	$900,000
Borrowed capital	$600,000	$750,000
Second borrowed capital base	$800,000	$600,000
First borrowed capital base	$80,000	$60,000
Invested capital	$800,000	$1,150,000
Lowest invested capital	$200,000	$800,000
Preferential rate amount	$350,000	$400,000
Base period percentage (per cent)	8	7
Excess-profits credit	$67,000	$84,000

On December 31, 1941, the X Corporation and the Y Corporation organized the Z Corporation, to which they transfer all their assets in exchange for all the Z Corporation's stock plus the assumption of all their liabilities. Assuming that the adjusted basis of the assets transferred is $2,750,000, that the Z Corporation also files its return on the calendar-year basis, and that no changes occurred during the year 1942, the excess profits credit of the Z Corporation will be $140,000, computed as follows:

	Z Corporation.
Equity invested capital	$1,400,000
Borrowed capital	1,350,000
Second borrowed capital base	1,000,000
First borrowed capital base	100,000
Invested capital	1,850,000
Lowest invested capital	1,000,000
Preferential rate amount	500,000
Base period percentage (per cent)	7.2
Excess-profits credit	$140,000

If instead of consolidating into the Z Corporation either the X Corporation or the Y Corporation had acquired all the assets of the other in exchange for stock and an assumption of liabilities, the status of the acquiring corporation after the exchange would be the same as that of the Z Corporation in the above example.

TITLE II. AMORTIZATION DEDUCTIONS.

Title II of the bill adds to the Internal Revenue Code a new section to be designated as section 124 and a new subsection designed section 23(t) to authorize the allowance of a deduction for the cost of certain facilities necessary in the interest of national defense during the present emergency. Section 124 provides that a corporation shall be allowed a deduction for income and excess-profits tax purposes for the amortization of certain facilities which the Advisory Commission to the Council of National Defense and either the Secretary of War or the Secretary of the Navy certify as necessary in the interest of national defense during the present emergency. Such facilities are land, buildings, machinery and equipment or parts thereof acquired after July 10, 1940, or the construction, reconstruction, erection, or installation of which was completed after July 10, 1940. In order to be effective for the purpose of the amortization allowance, such certification must have been made before (1) the beginning of such construction, reconstruction, erection, or installation, or the date of such acquisition, or (2) the sixtieth day after the date of the enactment of the bill, whichever of such dates is the later. Although a facility may be an emergency facility even though its construction was begun on or before July 10, 1940, only so much of its adjusted basis as is attributable to certified construction taking place after July 10, 1940, is subject to amortization. The remainder of the adjusted basis is subject to depreciation. Capital additions, whether or not the cost thereof is covered by a certificate, may not be added to the adjusted basis for amortization as determined under a prior certificate. If certified, a new amortization period begins relative to the cost of such capital additions.

The amortization of the adjusted basis of such facilities is to be spread over a period of 60 months, the deduction to be in lieu of the present deduction for exhaustion, wear, and tear, and obsolescence provided for in section 23(l) of the Internal Revenue Code. The 60-month period shall begin as to any emergency facility, at the election of the taxpayer, with the month following the month in which the facility was completed or acquired, or with the succeeding taxable year.

The bill provides that an election to take the amortization deduction and to begin the 60-month period for such amortization with the month following the month in which the facility was completed or acquired shall be made only by a statement to that effect in the return for the taxable year in which the facility was so completed or acquired. An election to take the amortization deduction and to begin such period with the taxable year succeeding such year shall be made only by a statement to that effect in its return for such succeeding taxable year.

If, after having elected the amortization deduction, the taxpayer desires to terminate such deduction and use the deduction provided by section 23(l) of the Internal Revenue Code with respect to the remainder of the adjusted basis of the facility, it may be permitted to do so upon notice to the Commissioner at any time prior to the termination of the 60-month period and the taxpayer shall not be entitled to any further amortization deduction with respect to such emergency facility except in the case of a new election authorized by reason of the termination of the emergency period by a proclamation of the President, or by reason of a certificate of the Secretary of War, or the Secretary of the Navy that the emergency facility is no longer necessary in the interest of national defense.

If the President has proclaimed the ending of the emergency, or the Secretary of War or the Secretary of the Navy has certified to the Commissioner of Internal Revenue that, on a date specified in the certificate, the facility ceased to be necessary in the interest of national defense during the emergency and the date of such proclamation or the date specified in such certificate falls before the end of the 60-month period, the taxpayer may elect to terminate the amortization period as of the end of the month in which falls the date of the proclamation or the date specified in the certificate, whichever is the earlier, and to recompute the amortization deduction on the basis of such period in lieu of the 60-month period. The benefits of this election are accorded regardless of whether the taxpayer has in the past elected the amortization deduction with respect to the facilities involved and regardless of the fact that the taxpayer had previously elected to terminate the amortization deduction and use the depreciation deduction provided by section 23(l), but in the latter case only if the date of the proclamation or the date specified in the certification occurs after the beginning of the month which the taxpayer had previously fixed for the taking of the deduction allowed by section 23(l) in lieu of the amortization deduction.

Subsection (h) of section 124 provides that, at the election of the taxpayer, the amortization deduction for any month in which certain payments received from the United States with respect to such facility are required to be included in gross income shall be the amount of such payments in lieu of the amortization deduction otherwise provided for such month. The payments referred to consist only of amounts certified by either the Secretary of War or the Secretary of the Navy as compensation to the taxpayer for the unamortized cost of the facility, made because a contract with the United States involving the use of the facility has been terminated or because the taxpayer had reasonable grounds to anticipate further contracts with the United States involving the use of the facility and such contracts were not made.

The deduction for amortization in the amount of the payment described in subsection (h) is allowable only for the month in which such payment is includible in income and shall be taken in lieu of the amortization deduction otherwise allowable in respect of such month. The deduction may not in any case exceed the adjusted basis of the emergency facility as of the end of such month, computed without regard to any amortization deduction for such month.

If the taxpayer is taking depreciation rather than amortization in the month any such payment is includible in gross income, the depreciation deduction for such month is increased by the amount of such payment, but the total deduction for such month shall not exceed the adjusted basis of the emergency facility.

Paragraph (4) of section 124(d) provides that if, by reason of the President's proclamation, or the certificate of the Secretary of War, or the Secretary of the Navy, the taxpayer elects to have his amortization period terminated and the amortization deductions computed upon the basis of such commuted period, in

lieu of the 60-month period otherwise provided, all taxes for all taxable years, beginning with the taxable year in which the amortization period began, shall be recomputed to give effect to the revised allowance for amortization. In any such case any deficiency or overpayment of income or excess-profits taxes for any taxable year resulting directly or indirectly from such revision shall be assessed and collected or refunded or credited, as the case may be, within the period of limitations properly applicable thereto.

Subsection (d)(5) provides that if an adjustment of the tax liability for any taxable year to give effect to the revised amortization deduction is prevented (1) on the date of the certificate of the Secretary of War or the Secretary of the Navy or the date of the President's proclamation, whichever is the basis of the taxpayer's election under the subsection, or (2) within one year from such date, by any provision of law (other than section 3761 of the Internal Revenue Code and other than this section) or by any rule of law including the doctrine of res judicata, an adjustment shall nevertheless be made if a claim for refund or credit is filed, or a notice of deficiency is mailed, as the case may be, within one year from such date. If, at the time of filing such claim for refund or credit or the mailing of such notice of deficiency, as the case may be, an adjustment of the tax liability would be so prevented, the amount of the adjustment in this situation is limited to the increase or decrease in the tax previously determined for such taxable year which results solely from the revision of the amortization deduction and the collateral effects of such revision. For the purpose of such recomputation, the tax previously determined for any taxable year is to be ascertained in accordance with the method prescribed in section 3801(d) of the Internal Revenue Code.

The amount of such adjustment is to be treated in the same manner as if it were a deficiency or an overpayment, as the case may be, for the taxable year. Subject to certain limitations hereinafter described, such amount may thus be assessed and collected under the law and regulations applicable to the assessment and collection of deficiencies, or may be refunded or credited under the law and regulations applicable to overpayments as the case may be. Such adjustment will bear interest and be subject to additions to the tax to the extent provided by the internal-revenue laws applicable to deficiencies and overpayments for the taxable year with respect to which the adjustment was made. The amount of such adjustment may not be diminished by any credit or set-off based upon any item, inclusion, deduction, credit, exemption, or gain or loss with respect to the year as to which the adjustment was made, other than one resulting from the revision of the amortization allowance. If the Commissioner has refunded the amoufnt of such adjustment, the amount so refunded may not subsequently be recovered in a suit for erroneous refund based upon any item, inclusion, deduction, credit, exemption, gain, or loss with respect to the year for which the adjustment is made other than one resulting from the revision of the amortization allowance. If the Commissioner has assessed and collected the amount of the adjustment, no part thereof may be recovered by the taxpayer in any suit for refund based upon any item, inclusion, deduction, credit, exemption, gain or loss with respect to the year for which the adjustment is made, other than one resulting from the revision of the amortization allowance. The amount of any such adjustment which is to be treated as an overpayment may be credited, under the applicable law and regulations thereunder, against any income, or excess-profits tax, or installment thereof, due from the taxpayer. Likewise, if the amount of the adjustment is to be treated as a deficiency, any overpayment by the taxpayer of income or excess-profits tax may be credited against the amount of such adjustment in accordance with the applicable law and regulations thereunder.

Subsection (i) provides that an emergency facility may not be destroyed, demolished, impaired, or substantially altered without the consent in writing of the Secretary of War or the Secretary of the Navy. If such consent is not given within 90 days after consent has been requested, the Secretary of War or the Secretary of the Navy is directed to purchase such facility at a price not to exceed the adjusted basis but not to be less than $1. In the event that the facility is so purchased and if it consists of buildings or fixtures not removable without substantially affecting the structure to which they are affixed, the taxpayer is given an option, before the facility is resold, to repurchase the facility at the price which he was paid therefor.

Subsection (j) provides that the special deduction for amortization of emergency facilities shall not be allowed in any case unless the taxpayer files with the Commissioner a sworn statement accepting the restrictions imposed under subsection (i).

Subsection (k) imposes a penalty for the willful destruction, demolition, impairment, or substantial alteration of any emergency facility without having first obtained the written consent of the Secretary of War or the Secretary of the Navy. Such penalty is imposed in an amount equal to the unadjusted basis of the facility in the hands of the taxpayer and is to be assessed, collected, and paid in the same manner as the tax imposed by the bill.

TITLE IV.

SECTION 401. EARNINGS AND PROFITS OF CORPORATIONS.

The purpose of this amendment is to clarify the law with respect to what constitutes earnings and profits of a corporation. This is important not only for the purpose of determining whether distributions are taxable dividends but also in determining equity invested capital for excess-profits-tax purposes.

Section 401 of the bill inserts subsection (l) in section 115 of the Internal Revenue Code and correspondingly amends prior Revenue Acts. The rule, applied by the Treasury under existing law, is that while gains or losses which are not recognized by reason of the provisions of section 112 neither increase nor diminish the earnings or profits, the earnings or profits are increased or diminished by the entire amount of the recognized gain or loss, computed in accordance with the provisions of sections 111, 112, and 113. Together with the provisions of section 115(h) of the Internal Revenue Code, and the principles established in *Commissioner* v. *Sansome* (60 Fed. (2d), 931) and following decisions, the rule effectuates the provisions of section 112. While taxpayers generally have concurred in the rule applied by the Treasury, the Board of Tax Appeals and some of the courts have not agreed but have followed the theory that gain or loss, even though not recognized in computing net income, nevertheless affects earnings and profits. For example, on January 1, 1930, the X Corporation owned stock in the Y Corporation which it had acquired in 1929 in a transaction wherein no gain or loss was recognized. The adjusted basis to the X Corporation of the property exchanged by it for the stock in the Y Corporation was $100. The fair market value of the stock in the Y Corporation received by the X Corporation was $1,000. On April 9, 1930, the X Corporation declared a cash dividend of $900 and, except for the possible effect of the transaction in 1929, had no accumulated earnings or profits as of that date. Under the interpretation of the Board and some of the courts, the excess of the fair market value of the stock of the Y Corporation over the basis, $900, would represent earnings or profits, and the cash distribution would be a taxable dividend (*Commissioner* v. *F. J. Young Corporation*, 103 Fed. (2d), 137). Under the proposed legislation and Treasury practice, the $900 would not represent earnings or profits, and the cash distribution would not be a taxable dividend. The need for certainty, not only with respect to the determination of when dividends are taxable but also in the computation of the excess profits tax credit, makes it desirable to clarify existing law.

Provision is made for cases in which the adjustment to the basis prescribed by section 113 is different from the adjustment to such basis proper for the purpose of determining earnings or profits. Thus, section 113(b)(1)(B) requires adjustment for depletion, to the extent allowed (but not less than the amount allowable). Since the only depletion deductions to be considered in the computation of earnings or profits are those based on (1) the cost or other basis prescribed by section 113, if the depletable asset was acquired subsequent to February 28, 1913, or (2) the basis prescribed by section 113, or March 1, 1913, value, whichever is higher, if the depletable asset was acquired prior to March 1, 1913, the adjustment to the basis in such a case is of such depletion deductions, and not "depletion, to the extent allowed (but not less than the amount allowable)."

Certain tax-free distributions when received have uniformly been treated by the Treasury as not increasing the earnings or profits of the distributee for the period after February 28, 1913, of the distributee. Thus, distributions out of earnings or profits accumulated prior to March 1, 1913, or out of increase in value of property accrued prior to March 1, 1913, or otherwise than out of earnings or profits accumulated since 1913 or the earnings or profits of the taxable year, have, to the extent to which they do not exceed the adjusted basis of the stock in respect of which the distribution was made, been applied in reduction of the basis of such stock, with the result that earnings or profits are increased, upon the sale of such stock, by the entire amount of the recognized gain computed upon

the basis so reduced. Tax-free distributions in stock or in rights, whether not constituting income within the meaning of the sixteenth amendment or exempt to the distributee under section 115(f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act, and tax-free distributions of stock or securities in a corporation a party to a reorganization, have consistently been treated by the Treasury as not resulting upon receipt in an increase in earnings or profits, but as causing the basis of the stock in respect of which the distribution was made to be allocated between such stock and the stock securities received, with the result that earnings or profits are increased, upon the sale of such stock or property, by the entire amount of the recognized gain computed upon the basis so determined by allocation. In order that the confusion which occasioned the enactment of section 214(a) of the Revenue Act of 1939 may not reappear in the computation of earnings or profits, section 401 explicitly states the rules heretofore applied by the Treasury.

It should be noted that the provisions of section 401 are applicable only in determining the earnings or profits for periods beginning after February 28, 1913. In the case of a corporation organized before March 1, 1913, its entire accumulated earnings or profits as of any date after February 28, 1913, consists of its earnings or profits accumulated after February 28, 1913, its earnings or profits accumulated prior to March 1, 1913, and its increase in value of property accrued prior to March 1, 1913, which has been after February 28, 1913, realized by a sale, or has otherwise been brought into account in computing its earnings or profits accumulated after February 28, 1913. With respect to earnings or profits accumulated after February 28, 1913, section 401 does not purport to prescribe rules for anything other than certain exceptional cases, namely, the nonrecognition provisions of section 112, use of value as of March 1, 1913, as the basis for determining gain or loss, and depreciation and depletion, and tax-free distributions which either are applied in reduction of the basis or cause the basis to be allocated.

While prescribing rules for certain cases (which apply not only in determining earnings or profits for periods beginning after February 28, 1913, but also, to the extent to which such earnings are a factor, in determining the entire accumulated earnings or profits of a corporation), section 401 contemplates that consistently with these rules the computation shall be made conformably to the best accounting practice.

SUPPLEMENT S.

Tax of shareholders of personal service corporations.—Section 402 of the bill amends the Internal Revenue Code by inserting after section 373 a new supplement, designated Supplement S and made up of sections 391 to 396, inclusive.

Supplement S is applicable to the shareholders of a personal service corporation which has elected to be exempt from the excess-profits tax imposed under Subchapter E and prescribes rules for the determination and taxation of the undistributed income of such corporations to shareholders.

The undistributed net income of a personal service corporation for a taxable year in which such corporation is exempt from the excess-profits tax is includible in the gross income of such as its shareholders as were shareholders on the last day of the taxable year of the corporation. The amount to be included in the gross income of the shareholders is termed the "undistributed Supplement S net income" which is defined in section 392 to mean the "Supplement S net income" minus the dividends paid during the taxable year. For the purpose of determining the amount of dividends paid during the taxable year, the provisions of subsections (d), (e), (f), (g), (h), and (i) of section 27 are made applicable.

The "Supplement S net income" is the net income of the personal service corporation, as defined in section 21 of the Internal Revenue Code, with the following adjustments:

(1) An additional deduction is allowed in the amount of the income tax under Chapter 1 payable for such year; and

(2) The limitation on the deduction allowed for gifts or contributions to charitable, etc., organizations is raised from 5 per cent to 15 per cent of the net income computed without the benefit of such deduction.

Section 394 provides that each shareholder of the corporation who was a shareholder on the last day of the taxable year of the corporation shall include in his return, for the taxable year in which or with which the taxable year of the corporation ends, his pro rata share of the undistributed Supplement S net income of the corporation. The amount to be included is the amount the shareholder would have received as a dividend if on such last day there had

been distributed by the corporation, and received by the shareholders, an amount equal to the undistributed Supplement S net income of the corporation for its taxable year.

For the purposes of the tax imposed by sections 11, 13, 14, 201, 204, 207, or 362, each shareholder required to include in gross income his proportionate share of the income of a personal service corporation is allowed to credit against net income his proportionate share of the interest specified in section 25(a) (1) or (2) which is included in the gross income of the corporation. Section 25(a) (1) and (2) relates to interest on obligations of the United States and instrumentalities of the United States.

Section 394(d) provides that the amount of the undistributed Supplement S net income of a personal service corporation which is required to be included as a dividend in the gross income of the shareholders shall for income and excess-profits tax purposes be considered as paid-in surplus or as a contribution to the capital of the corporation. The accumulated earnings and profits of the corporation as of the close of such taxable year shall be reduced by a corresponding amount.

Under section 394(e), the amount of the undistributed Supplement S net income of a personal service corporation which is required to be included in the gross income of the shareholder shall, for the purpose of adjusting the basis of the stock owned by him on the last day of the corporation's taxable year, be treated as having been reinvested by the shareholder as a contribution to the capital of the corporation. This provision is applicable only to the extent of the amount of the Supplement S net income of the corporation included in the shareholder's gross income subject to any adjustment to such amount which may be made in the determination of the shareholder's tax liability at any time before the expiration of seven years after the date prescribed by law for filing a return.

Section 395 includes in the taxable income of nonresident alien individuals and foreign corporations their distributive shares of the undistributed Supplement S net income of a personal service corporation.

Section 396 requires a personal service corporation which is exempt from excess-profits tax to pay to the collector an amount equal to an amount which it would have been required to withhold under section 143(b) or 144 if the constructive dividend had been an actual dividend.

Section 275(d) of the Internal Revenue Code, as amended by section 403 of the bill, provides that in the case of failure to include in gross income the amount of Supplement S net income properly includible therein the tax may be assessed or a proceeding in court for the collecting of such tax may be begun without assessment at any time within seven years after the return was filed.

1940–43–10462

THE SECOND REVENUE BILL OF 1940.

[Senate Report No. 2114, Seventy-sixth Congress, Third Session.]

[September 11 (legislative day, August 5), 1940.]

Mr. Harrison, from the Committee on Finance, submitted the following report [to accompany H. R. 10413]:

The Committee on Finance, to whom was referred the bill (H. R. 10413) to provide revenue, and for other purposes, having had the same under consideration, report favorably thereon, with certain amendments, and, as amended, recommend that the bill do pass.

ESTIMATES OF REVENUE.

The amendments recommended by your committee increase substantially the estimated yield of revenue from the bill, as compared with the Treasury estimates under the House bill of a gross yield of $305,000,000 for the calendar year 1940 and a net yield of $260,000,000.

There are two estimates of yield under your committee bill, one by the Treasury showing a net yield of $305,000,000 for the calendar year 1940, and the other by the staff of the Joint Committee on Internal Revenue Taxation, showing a net yield for that year of $432,500,000. That the estimates of the staff of the Joint Committee are conservative is evidenced by the fact that the staff computed the excess-profits tax on estimated earnings for the calendar year

1940 of 27 corporations representing a cross section of industrial and mercantile establishments and that computation disclosed an excess-profits tax liability of $102,000,000.

The estimates furnished the committee are as follows:

	Treasury.	Joint Committee staff.
1940:		
From normal tax	$240, 000, 000	$232, 500, 000
From excess-profits	115, 000, 000	250, 000, 000
Gross revenue	355, 000, 000	482, 500, 000
Net revenue	305, 000, 000	432, 500, 000
1941:		
From normal tax	(1)	282, 500, 000
From excess-profits	(1)	600, 000, 000
Gross revenue	(1)	882, 500, 000

[1] No estimate.

In the opinion of your committee, the changes in the bill to provide this additional revenue are justified by current fiscal requirements and will accomplish the equitable distribution of an additional tax burden well within the power of corporate enterprise to sustain in a period of vast governmental expenditure for national defense.

MEASURE OF EXCESS PROFITS.

The bill as passed by the House combined two fundamental methods of measuring excess profits: (1) A comparison of the average earnings of a corporation with its earnings for the taxable year; (2) a comparison of the ratio of earnings to invested capital during the base period with such ratio for the taxable year. These methods of measurement were alternative but only corporations which were in existence for the entire base period (the years 1936 to 1939, inclusive) were allowed to elect. Corporations not in existence for this required period, except in the case of certain tax-free exchanges and reorganizations, were compelled to use the invested capital method of measuring their excess profits.

In order to afford relief to small corporations, the House bill contained three factors relating to the computation of the invested capital credit, varying with the size of the corporation:

(1) A tax-free return of 7 per cent was allowed upon the first $500,000 of the invested capital, while the minimum tax-free return on capital in excess of $500,000 was limited to 5 per cent.

(2) A minimum tax-free return upon new capital was allowed at 10 per cent upon that portion of the new capital which did not cause the invested capital to exceed $500,000 and 8 per cent upon new capital in excess of that figure.

(3) Varying percentages (100, 66⅔, and 33⅓) of borrowed capital were permitted to be included in invested capital depending upon the size of the equity invested capital.

These variable factors, while they did afford substantial relief to small corporations, were the cause of considerable complexity which your committee do not consider necessary in obtaining the desired result. It is felt that substantially the same result is achieved by replacing the varying percentages of minimum tax-free return for both old and new capital by the flat rate of 8 per cent, and the varying percentages of borrowed capital allowed to be included in invested capital, by a flat 50 per cent, regardless of the size of the corporation, and by raising the specific exemption, applicable to all corporations, from $5,000 to $10,000.

Another feature of the House bill, which required a number of pages of highly technical and complicated language, was that providing for the computation of the excess-profits credit by the invested-capital method. Under these provisions it was necessary for the taxpayer to determine both its invested capital for each of the years of the base period and its excess-profits net income for each of such years. This requirement, with respect to the years in the base period, has been eliminated. Taxpayers using the invested-capital method under the bill reported by your committee need only determine their invested capital for the taxable year and upon that they are allowed a tax-free return of 8 per cent.

SUMMARY OF PRINCIPAL CHANGES.

I. INCREASE IN NORMAL CORPORATE INCOME TAX.

The House bill required corporations using the average-earnings method of computing the excess-profits credit to pay as a part of their excess-profits tax an amount equal to 4$\frac{1}{10}$ per cent on the normal tax net income. Your committee substituted for this provision a general increase of 3$\frac{1}{10}$ per cent in the normal tax payable by all corporations regardless of their liability for excess-profits tax.

The following table shows the normal corporate income-tax rate under existing law, the additional normal tax rate under the committee bill, and the total rate:

Corporate net incomes.	Rate under existing law.		Additional rate under the committee bill.	Total normal tax rate.
	Permanent rate.	Temporary additional rate (defense tax).		
Not over $25,000:	*Per cent.*	*Per cent.*	*Per cent.*	*Per cent.*
Up to $5,000	13.50	1.35	3.1	17.95
$5,000 to $20,000	15.00	1.50	3.1	19.60
$20,000 to $25,000	17.00	1.70	3.1	21.80
Over $25,000	19.00	1.90	3.1	24.00

II. EXCESS-PROFITS TAX.

In order that the features of the excess-profits tax as contained in the committee bill may be readily compared with similar provisions in the House bill, the discussion in this report follows the arrangement used in the report of the Committee on Ways and Means.

1. TAXABLE YEARS.

As under the House bill, the tax imposed by the committee bill is applicable to all taxable years beginning after December 31, 1939.

2. CORPORATIONS TAXABLE.

Under the House bill, corporations with excess-profits net incomes of not more than the specific exemption were not subjected to tax and were not required to file excess-profits tax returns. Your committee, having increased the specific exemption, correspondingly modified the requirement for the filing of returns. Increasing the specific exemption to $10,000 has the effect of limiting the application of the excess-profits tax to less than 46,000 corporations, since of the almost 500,000 active corporations in the United States, only about 46,000 have normal-tax net incomes exceeding $10,000.

It will be noted that the Ways and Means Committee amendments adopted by the House after the bill was reported, and therefore not mentioned in the Ways and Means Committee report, added to the exempt category two classes of corporations, namely:

(1) Domestic corporations with incomes largely derived from sources outside of the United States, and

(2) Certain air-mail carriers.

3. BASE PERIOD.

The base period under the House bill, the years 1936 to 1939, inclusive, is retained for the purposes of the income method of computing the excess-profits credit. Under the committee bill, however, the invested capital method of computing the credit requires no reference to the invested capital or income of the base period. Those foreign corporations, further, which under the House bill were confined to the use of the income credit are, under your committee bill, permitted to use the income or the invested capital credit.

4. MEASURE OF EXCESS PROFITS.

Corporations which may elect.—Under the House bill the privilege of electing the average earnings in the base period as the standard of measurement of excess profits was restricted to corporations actually or constructively in existence during the entire base period. Your committee bill also extends this privilege to corporations in existence during any part of the base period. Such a corporation is deemed to have had, in that portion of the base period when it was not in existence, earnings equal in amount to 8 per cent of its invested capital at the beginning of its first taxable year in 1940.

The provisions of the House bill extending the privilege of election of the average earnings method of computing the excess-profits tax to corporations not in existence during the base period but considered to have been so in existence by reason of having acquired, or having resulted from the coalescing of, other corporations, have not been materially changed.

The election privilege has also been extended to foreign corporations engaged in trade or business within the United States at some time during each of the years in the base period.

The House bill provided two methods of computing the excess-profits credit, the use of either of which was at the election of the taxpayer as above-outlined. The committee bill continues this principle with the changes described under the following heading:

5. COMPUTATION OF THE EXCESS-PROFITS CREDIT.

First method—Based on income.—Under the bill reported by your committee, corporations in existence during any part of the base period may use this method and for that purpose are allowed, for the part of the base period during which they were not in existence, a hypothetical income equal to 8 per cent of their invested capital at the beginning of their first taxable year in 1940.

Second method—Based on invested capital.—Under the House bill the credit allowed under this method was that percentage of the invested capital for the taxable year which the average earnings during the base period were of the average invested capital in that period. The base period percentage so determined, however, was confined within fixed limits; namely, a minimum of 5 per cent and a maximum of 10 per cent, except that on the first $500,000 of invested capital the minimum was 7 per cent. In addition, the House bill provided a 10 per cent tax-free return on new capital to the extent that it would not cause the invested capital to exceed $500,000, and 8 per cent on new capital in excess of that figure. In the opinion of your committee, the allowance of a flat credit of 8 per cent of the invested capital for the taxable year, in lieu of these varying percentages, and the elimination of computations of base period invested capital and earnings remove complexities of language and obviate difficulties of administration which appear incommensurate with the revenue involved as well as with the benefits sought to be obtained for the taxpayer.

6. EXCESS-PROFITS NET INCOME.

To the adjustments provided in the House bill for the purpose of determining excess profits net income, your committee has added the following:

(1) Uninsured losses resulting from the demolition, abandonment, or loss of useful value of property. This adjustment applies only to years in the base period and the effect of it is to increase net income by the amount then allowed as a deduction from gross income.

(2) Losses and expenses resulting from the retirement or discharge by the taxpayer certain indebtedness outstanding for more than 18 months. This adjustment is applicable with respect to both the base period and taxable years thereafter, whichever method of computing the excess-profits credit is used, and has the effect of restoring these losses and expenses to net income.

(3) Refunds of processing taxes, including interest thereon. This adjustment applies to the taxable years after the base period, whichever method of computing the excess-profits credit is used, and reduces gross income by the amount of such refunds and interest.

(4) Interest on tax-exempt securities. Interest on Federal securities subject to excess-profits tax is included in gross income and such securities are treated

as admissible assets. If the taxpayer elects to treat other tax-exempt securities as admissible assets, he must include the interest therefrom in his gross income. This adjustment is applicable only to taxable years after the base period and to cases where the excess-profits credit is computed under the invested capital method.

(5) Unusual and nonrecurring claims, judgments, awards, and decrees. Unusual or abnormal amounts paid out because of claims, judgments, awards, and decrees are not deducted from the gross income of years in the base period.

7. SPECIFIC EXEMPTION.

The specific exemption of $5,000 provided in the House bill has been increased to $10,000. It is the opinion of your committee that the allowance of this increased exemption and the uniform 8 per cent credit are adequate compensation for the discontinuance of the preferential treatment applied to the first $500,000 of invested capital under the House bill.

8. RATES OF TAX.

Under the House bill, the excess-profits tax included as a part an amount equal to 4⅒ per cent of the normal-tax net income in the case of corporations electing to use the average-earnings method of computing their excess-profits credit. This penalty tax has been eliminated by your committee. The 3⅒ per cent increase in the normal corporate income-tax rate, adopted by your committee, applies to corporations generally regardless of the method employed in computing the excess-profits credit.

In addition, your committee has removed the 5 per cent differential in the graduated excess-profits tax rate schedule which favored corporations electing to compute their excess-profits credit on the invested-capital method.

The bill reported by your committee contains one such schedule, which is the higher of the two provided in the House bill. This schedule is as follows:

Amount of excess profits:	*Rate of tax, per cent.*
First $20,000	25
Next $30,000	30
Next $50,000	35
Next $150,000	40
Next $250,000	45
Over $500,000	50

9. INVESTED CAPITAL.

Your committee has made no change in the determination of equity invested capital except to clarify the provisions which were designed to avoid any overstatement of invested capital as the result of duplicating amounts in the items of earnings and profits and property paid in. Such a duplication might otherwise arise in the computation of invested capital in cases of reorganization and other tax-free exchanges.

With respect to the portion of borrowed capital which is includible in invested capital your committee has provided a flat 50 per cent in lieu of the graduated percentages of 100, 66⅔, and 33⅓, provided in the House bill

10. ADMISSIBLE AND INADMISSIBLE ASSETS.

Under the House bill all State and local securities, obligations of corporate agencies of the United States, and obligations of the United States or its possessions were "inadmissible assets." The committee bill provides that such assets which, under their terms, are not exempt from excess-profits tax shall be classed as "admissible assets." With respect to such securities which are exempt from excess-profits tax, the taxpayer may, if he so elects, treat them as "admissible assets," in which case the interest thereon is included in gross income.

11. PERSONAL SERVICE CORPORATIONS.

No change is made by your committee in the provisions of the House bill relating to personal service corporations.

12. FOREIGN CORPORATIONS.

Your committee has extended to foreign corporations engaged in trade or business within the United States at some time in all the years in the base period the same right of election of the method of computing excess-profits credit as is allowed domestic corporations.

13. CREDIT FOR FOREIGN TAXES.

No change has been made in the allowance of the credit for foreign taxes provided in the House bill.

14. EXCESS PROFITS CREDIT IN CONNECTION WITH CERTAIN EXCHANGES.

First method—Based on income.—The privileges allowed under the House bill to corporations resulting from statutory mergers or consolidations are extended in your committee bill to similar reorganizations in States in which mergers or consolidations are not defined by statute.

Second method—Based on invested capital.—Your committee has replaced the varying percentages of tax-free return allowed with respect to the first $500,000 of invested capital in the House bill by a flat 8 per cent. In addition, it has substituted a flat 50 per cent allowance of borrowed capital to be included in invested capital in lieu of the graduated percentages of 100, 66⅔, and 33⅓, provided in the House bill. While these preferential methods of treatment for small corporations were in the bill it was necessary to guard against the serious loophole open to large corporations which, by splitting up into smaller entities, could obtain undue advantages and accomplish substantial tax avoidance. The action of your committee has removed the necessity for many of the extremely technical and complicated provisions of Supplement B.

15. SPECIAL RELIEF PROVISIONS.

The House bill contained a number of special relief provisions, generally in the form of adjustments in arriving at the excess-profits net income. To these, your committee has added further adjustments to take care of some unusual cases of hardship. These further adjustments are described in the discussion of excess-profits net income.

In addition, your committee has provided a relief provision of much wider and more general application. This provision allows relief in the taxable period where abnormalities in income occur because of amounts of income (*a*) arising out of claims and judgments; (*b*) resulting on long-term contracts; (*c*) resulting from long-term exploration, discovery, prospecting, research, or development of property, patents, or processes; (*d*) falling into one taxable year rather than another because of a change in accounting periods or methods; or (*e*) arising upon the termination of a lease from improvements on the leased property.

To be entitled to relief in such cases, the type of income must be abnormal in the case of the particular taxpayer, in the light of its business, or if of a type normally received by it, must be grossly disproportionate to its income of the same class in the four preceding taxable years.

Where, with respect to any particular item of income the taxpayer is entitled to relief under this provision, such item of income will be allocated to the years in which it is properly attributable and the taxpayer's income for the taxable year in which such item would otherwise fall is correspondingly reduced.

In addition, taxpayers, 80 per cent or more of whose gross income is derived from processing, canning, or otherwise preparing for market any seasonal fruit or vegetable or any fish or other marine life, are allowed to carry over for two years the unused excess-profits credit for any taxable year subject to the excess-profits tax.

16. CONSOLIDATED RETURN.

Your committee has provided that an affiliated group of corporations may file a consolidated return in lieu of separate returns. This privilege is conditioned upon the consent by each of the corporations of the group to the regulations prescribed by the Commissioner with respect to such returns. When a consolidated return is filed, only one specific exemption of $10,000 is allowed.

III. Suspension of the Vinson-Trammell Act.

Under the House bill the provisions of the Vinson-Trammell Act were suspended so far as applicable to contracts entered into or completed in any taxable year subject to the excess-profits tax.

Your committee extends such suspension to contracts entered into but not completed before the date of the beginning of the taxpayer's first excess-profits tax taxable year beginning in 1940.

IV. Amortization of Emergency Facilities.

Your committee extended the amortization deduction benefits to certified construction after January 1, 1940, in place of July 10, 1940, as provided in the House bill.

In addition, subsections (i), (j), and (k) of section 201 of the House bill (section 301 of the committee bill) have been eliminated. In lieu thereof, your committee has inserted a new subsection (i) providing that if a taxpayer has been or will be substantially reimbursed by the Government for all or a part of the cost of any emergency facility pursuant to a Government contract relative to such facility or for the purchase of supplies, or otherwise, the taxpayer will not be allowed amortization with respect to such facility unless the Advisory Commission to the Council for National Defense and either the Secretary of War or the Secretary of the Navy certify that the contract contains provisions adequately protecting the public interest with reference to the use and disposition of the facility.

The methods of procuring new defense facilities were described before your committee by a member of the Advisory Commission to the Council of National Defense in the hearings before your committee as follows:

Recommended Methods of Procuring New Facilities.

PLAN I. PRIVATE OWNERSHIP WITH NO GOVERNMENT INTEREST.

Purpose: When manufacturer desires to own the facilities at all times and does not include in the product price an abnormal amount for depreciation or amortization.

Financing: Private, including Reconstruction Finance Corporation loans.

Title: Vested in manufacturer.

Methods of operation: By manufacturer in the normal way.

Reimbursement: None other than by way of normal depreciation.

Amortization: Certified for tax purposes as needed for national defense.

Termination: No protection for contractor.

Provision for subsequent use by manufacturer: Continued use by the contractor.

PLAN II. PRIVATE OWNERSHIP WITH GOVERNMENT INTEREST.

Purpose: For plants in which the manufacturer desires to preserve a future interest.

Financing: Private, including Reconstruction Finance Corporation loan.

Title: Vested in the manufacturer.

Method of operation: By manufacturer.

Reimbursement: Cost to be repaid to manufacturer in five equal annual installments. Payments to be subject to acceleration if supply contracts run out.

Amortization: Certified for tax purposes as required for national defense.

Termination: At end of 5-year period, or earlier termination of the emergency, the manufacturer may continue to use the facilities if he pays to the Government the then fair value thereof as determined by arbitrators; otherwise contractor transfers title to the new facilities to the Government.

Provision for subsequent use by manufacturer: No right to use unless payment made as set forth under heading "Termination" above.

PLAN III.—GOVERNMENT OWNERSHIP.

Purpose: For plant in which Government desires to have permanent interest or in which the manufacturer has no future interest.

Financing: Government funds, either Reconstruction Finance Corporation, Defense Corporation, Army or Navy.

Title: Vested in the Government.
Method of operation: Leased to the manufacturer.
Reimbursement: Not applicable (Government owned).
Amortization for tax purposes: Not applicable (Government owned).
Termination: Government will take over facilities whenever lease terminates.
Provision for subsequent use by manufacturer: None.

DESIGN OF FACILITIES AND SUPERVISION OF THEIR CONSTRUCTION.

To insure proper facilities for the work and expedite placing such facilities in production, the manufacture should supervise their design and construction, even in case plan III is followed. In connection with plans II and III, the Government departments concerned should review the building plans and the cost estimates to determine whether the facilities proposed and the cost of the same are reasonable for the purpose prior to any commitments.

COMBINATION OF PLANS.

Machinery, for instance, may be Government furnished by plan III, while the plant may be provided by plans I or II should this be desired.

The variations in these methods used by the Government in dealing with producers of articles necessary for the national defense demonstrate the inadvisability of attempting to cover all of these cases with a rigidly uniform statutory rule.

DETAILED EXPLANATION OF THE CHANGES IN THE HOUSE BILL.

TITLE I. CORPORATION INCOME TAX.

Title I of the committee amendment consists of one section increasing by 3⅓ per cent the ordinary taxes imposed by Chapter I of the Internal Revenue Code upon corporations. Such increase applies to the entire rate schedule contained in sections 13 and 14. This provision is new and was not contained in the House bill. Section 710 of the excess-profits tax as passed by the House did, however, provide as a part of the excess-profits tax in the case of corporations which elected to compute their excess-profits credit on the average-earnings plan for the payment of an additional amount equal to 4⅓ per cent of the normal tax net income. As indicated below, your committee recommends that such provision be eliminated.

Under the proposed amendment the permanent general corporate tax rate will be 22⅓ per cent. It is provided, however, that in computing the 10 per cent increase in tax imposed by section 15 of the Internal Revenue Code, added to such Code by section 201 of the Revenue Act of 1940, the corporate tax prior to the 3⅓ per cent increase proposed by the bill is to be used as the basis for such computation. Thus, the general effective rate applicable to corporations so long as the defense-tax provisions of section 15 are in force will be 24 per cent, computed as follows:

	Per cent.
Tax under permanent provisions	22⅓
Plus 10 per cent of 19 per cent (the rate applicable under the permanent provisions prior to their amendment by the bill)	1⅔
Total	24

TITLE II. EXCESS-PROFITS TAX.

SECTION 710. IMPOSITION OF TAX.

Under the House bill the excess-profits tax imposed upon corporations which elected to compute their excess-profits credit on the average-earnings method consisted of 4⅓ per cent of the corporation's normal-tax net income plus a graduated tax of from 25 to 50 per cent of the corporation's adjusted excess-profits net income. The excess-profits tax imposed upon corporations which elected to compute their excess-profits credit on the income and invested capital method consisted solely of a graduated tax of from 20 to 45 per cent of the corporation's adjusted excess-profits net income. In the case of any corporations which had been through certain types of tax-free exchanges, it was provided that

adjustments were to be made in the dollar amounts constituting the dividing lines between the various brackets on the basis of the relationship of the taxpayer's preferential rate amount to $500,000. The House bill defines the term "adjusted excess-profits net income," which constituted the measure of the graduated tax, as the excess-profits net income less a specific exemption of $5,000 and the amount of the taxpayer's excess-profits credit for the taxable year.

In the bill as reported by your committee the additional 4$\frac{1}{10}$ per cent of the normal tax net income of corporations electing the excess-profits tax based on average earnings has been eliminated. The graduated rate schedule applicable under the House bill to such corporations has been made applicable to all corporations whether computing their excess-profits credit on the average-earnings method or on the invested-capital method. The excess-profits tax of any corporation, therefore, is based on the following rate schedule:

Amount of adjusted excess-profits net income:	*Rate of tax, per cent.*
First $20,000	25
Next $30,000	30
Next $50,000	35
Next $150,000	40
Next $250,000	45
Over $500,000	50

The adjustments made to the dollar amounts in the above rate schedule in the House bill, on account of certain tax-free exchanges, are retained, except that the term "preferential rate amount" has been changed to "highest bracket amount." The computation of the highest bracket amount is contained in section 752 and is substantially the same as the computation of the preferential rate amount contained in section 759 of the House bill. Such adjustment is necessary to prevent corporations from obtaining undue advantage by breaking up into several smaller corporations by means of tax-free transactions.

The definition of adjusted excess-profits net income contained in the House bill is retained except that the specific exemption deductible in computing such adjusted excess-profits net income is increased from $5,000 to $10,000.

SECTION 711. EXCESS-PROFITS NET INCOME.

Under the House bill the excess-profits net income was the normal-tax net income with certain adjustments. If the excess-profits credit was computed on the average-earnings plan, the normal-tax net income was adjusted by the exclusion of gain or loss from the sale or exchange of capital assets (whether depreciable or nondepreciable) held for more than 18 months, the deduction of the normal corporate income tax, and the exclusion of income arising from the retirement or discharge of the taxpayer's own indebtedness.

If the excess-profits credit was computed on the invested-capital plan, the normal-tax net income was further adjusted by increasing the credit for dividends received to 100 per cent and making it applicable to dividends on the stock of all corporations, whether domestic or foreign, except dividends (actual or constructive) on stock of foreign personal holding companies; and by reducing the deduction for interest paid or accrued by an amount which was the same percentage of the interest on borrowed capital as the borrowed invested capital was of the total borrowed capital.

The above adjustments applied whether the computation was made for the base period or the taxable year. Relative to the base period the normal-tax net income (or its equivalent) was to be further adjusted by disallowing certain casualty losses and certain deductions on account of repayments of Agricultural Adjustment Act taxes to vendees.

Under the bill, as reported by your committee, the adjustments to normal-tax net income in computing the excess profits net income which were provided in the House bill are retained, but certain changes have been made therein and certain additions made thereto, as follows:

(1) The treatment of gains and losses on depreciable assets held for more than 18 months as long-term capital gains and losses has been eliminated. In lieu thereof a provision has been inserted providing that only the excess of gains arising from the sale or exchange of such assets over any losses arising from the sale or exchange of such assets shall be excluded from the computation. The effect of this provision is to allow losses from the sale or exchange of depreciable assets held for more than 18 months to be deducted from ordinary income to the extent such losses exceed the gains from similar transactions.

(2) The adjustment on account of income derived from the retirement or discharge of bonds, etc., has been rewritten to make certain that amounts which would be otherwise includible upon such retirement or discharge on account of any premium received upon issuance shall be left out of the computation, and that the adjustment shall apply although the indebtedness retired or discharged is indebtedness which has been assumed by the taxpayer and, although it is evidenced, so far as the taxpayer is concerned, only by a contract with the person whose liabilities have been assumed.

(3) A new adjustment has been added, applicable whether the excess-profits credit is computed under the income or invested capital plan and to taxable years in the base period as well as to taxable years under the excess-profits tax, requiring that any deductions otherwise allowable on account of the retirement or discharge of indebtedness shall be disallowed if the taxpayer's obligation has been outstanding for more than 18 months. The amounts so to be disallowed include the deduction otherwise allowable under section 23(a) for expenses paid or incurred in connection with such retirement or discharge (including any premium paid upon any such retirement or discharge), the deduction for losses otherwise allowable in such connection, and the deduction otherwise allowable on account of the issuance of the bonds or other evidence of indebtedness at a discount.

(4) A new adjustment has been added applicable only to taxable years under the excess-profits tax requiring the exclusion of income attributable to refunds of Agricultural Adjustment Act taxes and interest upon such refunds.

(5) The adjustment applicable to the invested capital method on account of interest has been simplified on account of the substitution of a flat 50 per cent rule for the inclusion of borrowed capital in invested capital in lieu of the varying percentages contained in the House bill.

(6) It is provided that, if the excess-profits credit is computed under the invested capital plan, the normal-tax net income shall be increased by an amount equal to the interest on Federal obligations not specifically exempted from excess-profits taxes and in addition thereto, the interest on all other Federal, State, or local obligations, if the taxpayer elects, under section 720(d), to treat all such other obligations as admissible assets for the taxable year.

(7) The adjustment on account of casualty losses has been expanded so as to exclude from the computation of excess-profits net income for taxable years in the base period, losses arising from the demolition, abandonment, and loss of useful value of property.

(8) The adjustment on account of repayment of Agricultural Adjustment Act taxes to vendees has been rewritten to remedy certain technical defects contained in the House bill.

(9) An additional adjustment is provided, applicable only to taxable years in the base period, to the effect that deductions attributable to any claim, award, judgment, or decree against the taxpayer, or interest thereon, will not be required to be taken into account if, in the light of the taxpayer's business, it is abnormal for the taxpayer to incur a liability of such character or, if the taxpayer normally incurs liabilities of such character, the amount of the particular liabilities of such character in the taxable year is grossly disproportionate to the average amount of liabilities of such character in each of the four previous taxable years.

The House provision applying section 117 of the Internal Revenue Code (relative to capital gains and losses) to taxable years in the base period has been retained. Certain changes have been made therein in view of the revised treatment above described in the case of depreciable assets. In addition, section 23 (g) and (k) of the Internal Revenue Code have been made applicable to taxable years in the base period, in order that long-term losses due to securities (stocks and bonds) having become worthless shall be disallowed in computing excess profits net income for taxable years in which such losses were not treated as capital losses under the income-tax law applicable to such years.

SECTION 712. ALLOWANCE OF EXCESS-PROFITS CREDIT.

Domestic corporations.—Under the House bill a domestic corporation was permitted to choose between the income credit and the invested capital credit only if it had been in existence during the entire 48 months prior to the beginning of its first taxable year which began in 1940. All other domestic corporations were required to compute their excess-profits credit on the invested-capital plan.

Under the bill as reported by your committee any domestic corporation which was in existence before January 1, 1940, may choose between the income credit and the invested capital credit. It is further provided that any domestic corporation which for any taxable year does not file a return must compute its excess-profits credit on the invested-capital plan.

Foreign corporations.—Under the House bill a foreign corporation subject to excess-profits tax was required to compute its excess-profits credit on the average-earnings plan if it was in existence during the entire 48 months prior to the beginning of its first excess-profits tax taxable year beginning in 1940 and was engaged in trade or business within the United States or had an office or place of business therein at any time during each of the taxable years in the 48 months prior to such date. All other foreign corporations subject to excess-profits tax were required to compute their excess-profits credit on the invested-capital plan.

Under the bill as reported by your committee the first class of foreign corporations is entitled to choose between the income credit and the invested-capital credit. If the corporation fails to file a return its excess-profits credit for the taxable year is computed under the invested-capital plan. The treatment of other foreign corporations subject to tax is the same under this section as it was under the House bill.

SECTION 713. EXCESS PROFITS CREDIT BASED ON INCOME.

Owing to the fact that section 712 has been changed so as to allow a domestic corporation which was not in existence during the entire base period to choose the income credit, section 713 has been changed by the insertion of additional provisions giving corporations which were not in exstence during the entire base period an excess-profits net income for that portion of the base period during which they were not in existence. For each 12 months of such period the excess-profits net income is deemed to be 8 per cent of the corporation's daily invested capital for the first day of its first taxable year subject to the excess-profits tax reduced on account of inadmissibles by the same ratio as is applicable under section 720 in reduction of the average invested capital of the preceding taxable year. Thus if the ratio of inadmissibles to total assets in the last taxable year of the base period were as 1 to 3, the daily invested capital as of the day following the close of such taxable year would be reduced by one-third thereof, and 8 per cent of such reduced amount would constitute the corporation's excess-profits net income for each period of 12 months in the base period during which it was not in existence. The excess-profits net income for a period of less than 12 months during which it was not so in existence is a proportionate part of such amount.

SECTION 714. EXCESS-PROFITS CREDIT BASED ON INVESTED CAPITAL.

Under the House bill the invested capital credit for any taxable year reflected, in part, the base period experience of the taxpayer. In general, the excess-profits credit consisted of an amount representing the same rate of return (but not less than 7 per cent or more than 10 per cent on the first $500,000 and not less than 5 per cent or more than 10 per cent on the remainder) on so much of the corporation's invested capital for the taxable year as did not exceed its invested capital at the close of the base period, plus 10 per cent of so much of the remaining invested capital as did not bring the total invested capital beyond $500,000, and 8 per cent of the remainder.

Under the bill as reported by your committee the base period experience of a corporation electing the invested-capital credit has been eliminated from consideration. In lieu of the varying percentages contained in the House bill, a flat rate of 8 per cent of the taxpayer's invested capital for the taxable year has been substituted.

SECTIONS 715–717. INVESTED CAPITAL.

These sections are the same as in the House bill except that the references to the taxable years in the base period have been eliminated owing to the fact that base period experience is not taken into account in computing the excess-profits credit based on invested capital.

SECTION 718. EQUITY INVESTED CAPITAL.

This section is substantially as it was in the House bill except for certain clerical and technical changes. The most important of these are as follows:

(1) Section 718(c)(4) of the House bill provided that, in making the computations required by subsections (a) and (b), the earnings and profits of a transferee corporation were not to include the earnings and profits of another corporation which would otherwise be included by reason of property of such other corporation having been paid in for stock, or as a contribution to capital, or as paid-in surplus, of the transferee corporation. This subsection has been inserted as section 718(b)(3) and made an actual step in the computation.

(2) Section 718(d) of the House bill has been omitted because of the treatment of this matter under section 501 (section 401 of the House bill).

SECTION 719. BORROWED INVESTED CAPITAL.

Under the House bill borrowed capital (i. e., indebtedness evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust) was included in invested capital under a graduated limitation at varying percentages (100, $66\frac{2}{3}$, $33\frac{1}{3}$), these percentages depending upon the amount of equity invested capital.

Under the bill as reported by your committee all borrowed capital, as defined in the House bill, is includible in invested capital at 50 per cent.

SECTION 720. ADMISSIBLE AND INADMISSIBLE ASSETS.

Except for technical changes, section 720 of the House bill has been changed in only one respect, as follows: If the excess-profits credit for any taxable year is computed on the invested-capital plan, the following obligations are to be considered as admissible and not as inadmissible assets for such taxable year:

(1) United States obligations and obligations of Federal instrumentalities the interest from which is not exempt from excess-profits taxation; and

(2) All other Federal, State, and local obligations, if the taxpayer so elects in its return for such year. A taxpayer may not make such an election relative to only a portion of such obligations. The election must be made relative to all such obligations, or none of such obligations may be treated as admissible assets.

Under section 711(a)(2)(H)(i) the interest described in paragraph (1) above increases the normal-tax net income for excess-profits tax purposes. Under section 711(a)(2)(H)(ii), if the election described in paragraph (2) is made, then all the interest on all such obligations increases the normal-tax net income.

SECTION 721. ABNORMALITIES IN INCOME IN TAXABLE PERIOD.

Section 721 of the committee amendment is a new section, no comparable provisions having been included in the House bill. Subsection (a) of this section is designed to provide relief in enumerated cases in which the taxpayer's income in any taxable year is abnormally large because of certain special circumstances. The special types of income with respect to which relief may be accorded by this section are as follows:

(1) Income arising out of a claim, award, judgment, or decree, or out of interest on any of the foregoing;

(2) Income received with respect to a contract whose performance required more than one year;

(3) Income resulting from the exploration, discovery, prospecting, research, or development of tangible property, patents, formulas, or processes, providing that such exploration, etc., extended over a period of more than one year;

(4) Income which is required to be included for the taxable year as a result of a change in the taxpayer's accounting period or method of accounting;

(5) Income received by the lessor of real property on the termination of the lease as a result of improvements on the property during the lease.

If the taxpayer receives income of any of the above classes, the section provides that relief shall be accorded if either (1) in the light of the taxpayer's business it is abnormal for it to receive such income or (2) although the receipt of such income may be normal, the income so received for the taxable year is grossly disproportionate to the amounts of such income received by the taxpayer

in the four previous taxable years. If either of these conditions is satisfied with respect to income falling in an enumerated class, the relief accorded by the section is as follows: There is first determined the amount of such income received in the taxable year which is attributable to any previous taxable year or years and the amounts so attributable to such years. Such determination is to be made under rules and regulations prescribed by the Commissioner with the approval of the Secretary. It is expected that such regulations will provide general rules prescribing the method by which the taxable years to which the income is to be attributed and the amounts to be attributed may be ascertained. There is then computed the aggregate of the excess-profits taxes which would have been placed on such income had it been received in the taxable years to which it is thus attributed, as described above, including the taxable year in which the income was in fact received. For the taxable year in which the income was received, the excess-profits tax attributable to such income can not exceed the aggregate of the taxes so computed. If it is determined that the income received in the taxable year is attributable to years in the base period, the amount of such income so attributable to such years will have the effect of increasing the base period net income and thus the credit under the average-earnings method.

Subsection (b) provides in limited cases a 2-year carry-over of any excess of the excess-profits credit for any taxable year beginning after December 31, 1939, over the excess-profits net income. Such carry-over constitutes an additional subtraction from excess-profits net income in arriving at the adjusted excess-profits net income. Such carry-over is available only to corporations 80 per cent or more of the gross income of which for the taxable year is derived from processing or otherwise preparing for market any seasonable fruit or vegetable, or any fish or other marine life.

SECTIONS 722–724 (SECTIONS 721–723 OF THE HOUSE BILL). EQUITY INVESTED CAPITAL IN SPECIAL CASES—FOREIGN CORPORATIONS, INVESTED CAPITAL—PERSONAL SERVICE CORPORATIONS.

There have been no changes in these sections as contained in the House bill except for the elimination of a reference to the base period in section 722.

SECTION 725. CORPORATIONS COMPLETING CONTRACTS UNDER MERCHANT MARINE ACT, 1936.

This section is the same as section 724 of the House bill except for a clarifying change.

SECTIONS 726–728 (SECTIONS 725–727 OF THE HOUSE BILL). EXEMPT CORPORATIONS—MEANING OF TERMS USED—LAWS APPLICABLE.

No change has been made in these sections as contained in the House bill except the following:

(1) Section 726(d) relating to investment companies registered as diversified companies under the Investment Company Act of 1940 is amended to allow such companies until July 1, 1941, to so register and thereby obtain exemption from the excess-profits tax, instead of December 1, 1940, as under the House bill.

(2) Section 727(b) of the House bill provided that no return need be filed by a corporation whose excess-profits net income (placed on an annual basis in the case of a taxable period of less than one year) was not greater than $5,000. In view of the fact that the specific exemption has been raised from $5,000 to $10,000, this provision has been changed to provide that no return need be filed unless the corporation's excess-profits net income is in excess of $10,000.

SECTION 729. CONSOLIDATED RETURNS.

This section was not in the House bill. It permits consolidated returns to be filed by affiliated groups of corporations under certain circumstances, among which is the requirement that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made must consent to regulations prescribed by the Commissioner, with the approval of the Secretary, prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent.

The regulations which the Commissioner is authorized to prescribe are such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the excess-profits tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability in addition to the matters which, in the light of current and previous consolidated returns regulations, are expected to be covered in detail in the regulations to be issued by the Commissioner, are the extent to which and the manner in which the following items, among others, will be computed and given effect in determining the excess-profits-tax liability of an affiliated group: (*a*) Equity invested capital, borrowed capital, and invested capital, (*b*) admissible and inadmissible assets, and excluded capital, (*c*) net capital additions and reductions, (*d*) consolidated net operating losses, net operating losses incurred by members of the group in taxable years prior to that for which the consolidated return is filed, and the net operating loss deduction of members of the group in taxable years following that for which the consolidated return was filed, and (*e*) excess-profits net income and adjusted excess-profits net income.

If a consolidated return is filed, only one specific exemption of $10,000 is allowable for the year for the entire affiliated group.

The term "affiliated group" is defined to mean one or more chains of corporations connected through stock ownership with a common parent corporation if—

(1) At least 95 per cent of each class of the stock of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

(2) The common parent corporation owns directly at least 95 per cent of each class of the stock of at least one of the other corporations.

Foreign corporations, China Trade Act corporations, and corporations entitled to the benefits of section 251 by reason of receiving a large percentage of their income from possessions of the United States are not to be deemed to be affiliated with any other corporation within the meaning of section 729. For the purpose of this limitation, a 100 per cent owned foreign subsidiary of a domestic corporation, organized under the laws of a contiguous foreign country and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, may, at the option of the domestic parent corporation, be treated as a domestic corporation.

It is also provided that a notice of deficiency for any taxable year mailed to a corporation shall suspend the running of the statute of limitations as to all corporations with which such corporation made a consolidated return for such taxable year.

SUPPLEMENT A. EXCHANGES: EXCESS-PROFITS CREDIT BASED ON INCOME.

Except for technical changes and the changes indicated below, this supplement is the same as the House bill.

SECTION 740. DEFINITIONS.

This section is the same as it was in the House bill except for the definition of "acquiring corporation," which has been expanded to take into account certain types of transfers not covered by the House bill. Subsection (a)(1) has been rewritten.

Subparagraph (A) is substantially the equivalent of the entire subsection (a)(1) as it appeared in the House bill.

Subparagraph (B) covers exchanges described in section 112(g)(1)(C), that is, the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, the assumption by the acquiring corporation of a liability of the other or the fact that property acquired is subject to a liability being disregarded in the determination of whether the exchange is solely for voting stock. This makes it possible for certain types of mergers and consolidations to qualify under the bill, though they are not statutory mergers and consolidations, owing to the absence of any State laws on the subject. Your committee is informed that there are approximately 12 States which have no statutory provisions relative to corporate mergers and consolidations.

Subparagraph (C) covers transfers before October 1, 1940, by one corporation of property to another corporation solely as paid-in surplus or a contribution to capital in respect of voting stock owned by such other corporation. Since the property transferred must be received solely as paid-in surplus or a contribution to capital made solely in respect of voting stock, it is necessary that (1) the transferor corporation receive nothing upon the exchange and (2) that, at the time the transfer takes place, the transferor own no stock of the transferee other than voting stock of the transferee.

Subparagraph (B) or (C) shall apply only if the corporation transferring such properties is forthwith completely liquidated in pursuance of the plan under which the acquisition is made, and the transaction of which the acquisition is a part has in all respects the effect of a statutory merger or consolidation.

SECTION 742. AVERAGE BASE PERIOD NET INCOME.

This section is the same as in the House bill except for a technical change and for the addition of a new sentence to subsection (b) to prevent too great a reduction of the average base period net income of an acquiring corporation in cases where such corporation became an acquiring corporation in a taxable year beginning after December 31, 1939, and the component corporations involved in the transaction were at least 75 per cent owned by the acquiring corporation. Such 75 per cent ownership must have existed prior to the enactment of the bill and have been present at all times thereafter until the transaction. In such cases the average base period net income of the acquiring corporation shall not be less than either (1) its average base period net income computed without reference to the base period experience of the component corporations involved in the transaction, or (2) the average base period net income of that component corporation which possesses the highest average base period net income.

SUPPLEMENT B. EXCHANGES: HIGHEST BRACKET AMOUNT AND INVESTED CAPITAL.

SECTION 750. DEFINITIONS.

Under the House bill the term "exchange" was defined to mean certain exchanges "described in section 112(b) (4) or (5)" and related sections and certain transfers of property by one corporation to another corporation the basis of which in the hands of the acquiring corporation is or was determined under section 113(a) (8) (B), or would have been so determined had such section been in effect. The type of exchanges or transfers described would therefore have been included regardless of whether they were controlled by corresponding provisions of the revenue laws in force at the time when made. This definition has been changed so as, in effect, to include only exchanges and transfers occurring after December 31, 1917. Broadly speaking, the tax-free exchange provisions did not appear in the income-tax law until after such date.

The definitions of transferor upon an exchange and transferee upon an exchange contained in section 750(b) (c) of the House bill have been brought into conformity with the changed definition of exchange.

The definitions of "predecessor," "successor," "first borrowed capital base," and "second borrowed capital base," contained in section 750(e), (f), (h), and (i) of the House bill have been eliminated as no longer necessary in view of the elimination of the sections in which such terms were used.

The definition of "preferential rate amount," contained in section 750(g) of the House bill, has been moved to section 750(e) and as so transferred has been retained except that the term "preferential rate amount" has been changed to "highest bracket amount."

SECTION 751. DETERMINATION OF PROPERTY PAID IN FOR STOCK AND OF BORROWED CAPITAL IN CONNECTION WITH CERTAIN EXCHANGES.

The only change made in this section of the House bill is the elimination of the matter in parentheses in subsection (a) thereof, which excluded from the computation stock received which was neither an admissible nor inadmissible asset in the hands of the transferor. Section 752 of the House bill, which made such stock neither admissible nor inadmissible in the hands of the transferor, has been eliminated.

SECTIONS 752–758 AND SECTION 759 (OF THE HOUSE BILL). EXCHANGES: EQUITY INVESTED CAPITAL—ADMISSIBLE AND INADMISSIBLE ASSETS—BASE PERIOD OF SUCCESSOR—SUCCESSOR BASE PERIOD NET INCOME—SUCCESSOR BASE PERIOD INVESTED CAPITAL—LOWEST INVESTED CAPITAL—BASE PERIOD PERCENTAGE—BORROWED CAPITAL BASES.

These sections in the House bill required computations in the determination of certain factors employed in the computation of the invested capital credit under the House bill, necessary in order to prevent tax avoidance through tax-free exchanges. Because of the change recommended by your committee in the computation of the invested capital credit, the necessity for these sections disappears and they have, therefore, been eliminated.

SECTION 752. HIGHEST BRACKET AMOUNT.

(Section 759 of the House bill. Preferential rate amount.)

Section 759 of the House bill provided rules for the computation of the preferential rate amount of a corporation following certain tax-free exchanges. The preferential rate amount was the point at which, in computing the invested capital credit, there was a shift from 10 to 8 per cent in the rates applicable to new capital, and the point at which the corporation was compelled to use its base period percentage even though such percentage was less than 7 per cent. For example, in the case of a corporation which had not been through a prior tax-free exchange, new capital which would not produce a total invested capital in excess of $500,000 was entitled to a rate of 10 per cent and any new capital in excess of such amount was entitled to a rate of only 8 per cent. The $500,000 amount which constituted this dividing line was the corporation's preferential rate amount. If such corporation split up in a tax-free exchange it was necessary to divide this amount between the two resulting corporations in order that the two together might not have the benefit of the 10 per cent rate on a larger amount of new capital than the original corporation was entitled to in the first place. Section 759 of the House bill provided the rules pursuant to which such adjustment was to be made.

Under the House bill the relationship of the preferential rate amount to $500,000 was also used in the adjustment of the rate schedules contained in section 710 to prevent a corporation from obtaining an undue advantage in connection with such rate schedules as a result of a tax-free reorganization.

Under the bill as reported by your committee it is unnecessary to retain the preferential rate amount for the purpose of determining the rates applicable to old and new capital, owing to the changes which have been made in the computation of the invested capital credit. It is still necessary, however, to make adjustments in the dollar amounts of the rate schedules contained in section 710 similar to those made in the House bill. Section 759 of the House bill has, therefore, been retained, but it has been made section 752. Since the computation is applicable only for the purpose of adjusting the rate schedules, however, the term "preferential rate amount" has been given the more appropriate title of "highest bracket amount."

Owing to the fact that section 752 of the House bill has been eliminated and the adjustment on account of inadmissibles is not made until the close of a taxable year, it has been necessary to insert a new subsection preserving, for the purposes of the computation of the "highest bracket amount," the adjustment formerly required by section 752(a) in the House bill.

The only change made in the actual computation under new section 752 is in subsection (c)(1)(A) [section 759(b)(1)(A) in the House bill]. In order to prevent a corporation from deriving undue advantage, in the taxable year in which an exchange took place, from any increase in capital in that portion of such year following the exchange, the House bill provided that the corporation's invested capital, if lower than the highest bracket amount, for that portion of the taxable year which preceded the exchange, should be used in the computation rather than the highest bracket amount. The limited use to which the highest bracket amount will be put under the bill as reported by your committee makes this restriction no longer necessary and subsection (c)(1)(A), therefore, provides for the use of the highest bracket amount in all cases.

TITLE III (TITLE II OF THE HOUSE BILL). AMORTIZATION DEDUCTION.

The provisions of this title as they appear in the House bill (Title II) have been changed in only the following respects:

(1) The dividing line for the application of the amortization provisions with respect to facilities has been changed from the date July 10, 1940, as provided in the House bill, to January 1, 1940.

(2) Subsection (i) of the House bill provided that emergency facilities with respect to which amortization deductions had been taken were not to be destroyed, demolished, impaired, or substantially altered without the written consent of the Secretary of War or the Secretary of the Navy, that if such consent was not given within 90 days after request the Secretary concerned was to purchase such facility for not more than its adjusted basis or less than $1, and that the taxpayer could repurchase any such emergency facility under certain circumstances. Subsection (j) provided that no deduction for amortization was to be allowed unless the taxpayer consented in writing to the provisions of subsection (i). Subsection (k) imposed a penalty for violation which was to consist of an amount equal to the adjusted basis of the facility in the hands of the taxpayer, to be assessed, collected, and paid in the same manner as the corporate income tax.

Under the bill as reported by your committee these provisions have been eliminated and in lieu thereof a new subsection (i) has been inserted. Such new subsection provides that if the taxpayer has been or will be paid or substantially reimbursed, directly or indirectly, by the Government for all or a part of the cost of any emergency facility pursuant to a Government contract relative to such facility or for the purchase of supplies, or otherwise, the taxpayer will not be allowed amortization with respect to such facility unless the Advisory Commission to the Council for National Defense and either the Secretary of War or the Secretary of the Navy certify to the Commissioner of Internal Revenue that the contract contains provisions, adequately protecting the public interest, with reference to the future use and disposition of the facility. Such certificate, to be valid, must be made within 30 days after the making of the contract above referred to or within 60 days after the date of enactment of the bill, whichever period expires the later. It is also provided that, if such reimbursement occurs after the beginning of the amortization period with respect to such facility and the prescribed certificate is not made, the tax liability for the preceding taxable years shall be recomputed disallowing the amortization deduction previously taken. The terms and conditions of all reimbursements and payments of cost, including the terms and conditions with respect to the protection of the Government's interest, are to be made available to the public.

(3) Subsection (d)(5) of the House bill provided for reopening of the statute of limitations for the purpose of making certain adjustments on account of a change in prior amortization or depreciation deductions taken with respect to an emergency facility. This provision has been retained but it has been expanded so as to cover the recomputation required by new subsection (i) discussed in (2) above.

TITLE IV (TITLE III OF THE HOUSE BILL). SUSPENSION OF VINSON-TRAMMELL ACT AND CERTAIN PROVISIONS OF THE MERCHANT MARINE ACT, 1936.

In the House bill this was Title III and contained only one section (301) suspending the profit-limiting provisions of the Vinson Act in the case of contracts or subcontracts entered into or completed in any taxable year subject to the excess-profits tax (or which would have been subject to the excess-profits tax if the contractor or subcontractor had been a corporation). This section has been renumbered section 401 and has been retained. A new sentence has been added at the end thereof extending the same treatment to contracts or subcontracts entered into before the beginning of the taxpayer's first excess-profits tax year, if they were not completed at the time such year began. Such contracts or subcontracts, like contracts or subcontracts entered into in a taxable year subject to the excess-profits tax, will not be subject to the Vinson Act even though, at the time they are completed, no excess-profits tax is in effect.

Your committee has also added a new section 402 suspending the profit-limiting provisions of the Merchant Marine Act, 1936, as to subcontracts, which would otherwise be subject to such Act, entered into by a corporate contractor with a corporate subcontractor in any taxable year of the subcontractor subject to the excess-profits tax, unless at the time such subcontract was entered into or at any time thereafter up to and including the date of its completion, the principal

contractor and the subcontractor were affiliated. The definition of "affiliated" applicable to this section is substantially the same as that contained in section 2704(b)(1) of the Internal Revenue Code; i. e., two or more corporations shall be deemed to be affiliated (1) if one corporation owns at least 95 per cent of the stock of the other or others, or (2) if at least 95 per cent of the stock of two or more corporations is owned by the same interests. For the purposes of such rule the term "stock" is not to include nonvoting stock which is limited and preferred as to dividends.

TITLE V (TITLE IV OF THE HOUSE BILL). AMENDMENTS TO THE INTERNAL REVENUE CODE.

SECTION 501. EARNINGS AND PROFITS OF CORPORATIONS.

The committee amendment rearranges section 401 of the House bill but otherwise makes no substantial change. Three new subsections are added to section 115 of the Internal Revenue Code relating to distributions by corporations. Subsection (l) defines earnings and profits of a corporation as the sum of (1) its earnings and profits accumulated after February 28, 1913, (2) its earnings and profits accumulated before March 1, 1913, plus (3) the increase (to the extent provided in subsection (n)) in value of its property accrued before March 1, 1913, but realized on or after such date.

Subsection (m) prescribes rules for the computation of earnings and profits accumulated after February 28, 1913, and earnings and profits of the taxable year or other period after February 28, 1913. It deals with the following matters:

1. The basis upon which gain or loss, for the purposes of determining such earnings and profits, is to be computed.
2. The adjustments to be made to such basis in such computation.
3. The effect upon such earnings and profits of the application of the nonrecognition provisions of law to the gain or loss so computed.
4. The effect upon such earnings and profits of distributions from another corporation if such distributions actually reduce the basis of the stock in respect of which the distribution is made, or cause such basis to be allocated.

The subsection provides that the gain or loss realized from the sale or other disposition (after February 28, 1913) of property shall, for the purpose of computing the earnings and profits (for any period beginning after February 28, 1913), be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain. For example, stock in the X Corporation was acquired by the Y Corporation prior to March 1, 1913, at a cost of $90, its March 1, 1913, value was $120, and in 1939 it was sold for $100. The basis (under the law applicable to the year 1939) for determining gain is the cost on March 1, 1913, value, whichever is higher. As the Y Corporation received $100 for the stock of the X Corporation, and its value on March 1, 1913, $120, exceeded its cost, $90 (assuming that there are no adjustments to be made to the basis), the Y Corporation realized a loss under the provisions of this subsection of $20. If such a loss is recognized under section 112, the decrease in the earnings and profits accumulated by the Y Corporation after February 28, 1913, as the result of this transaction in 1939 was $20 notwithstanding provisions of the Code to the effect that no deduction was allowable in computing net income.

The subsection also provides that the realized gain or loss shall increase or decrease the earnings and profits (for any period beginning after February 28, 1913) to, but not beyond, the extent to which such a realized gain or loss was recognized in computing net income under the law applicable to the year in which such sale or disposition was made. This provision relates to gains or losses which are recognized, pursuant to the provisions of law, for instance, by reason of the provisions of section 112 of the Internal Revenue Code. It does not relate to losses disallowed or not taken into account such as those under section 24(b), section 118, and section 117 of the Code. For example, on January 1, 1939, the X Corporation owned stock in the Y Corporation which it had acquired in 1938 in an exchange transaction in which no gain or loss was recognized. The adjusted basis to the X Corporation of the property exchanged by it for the stock in the Y Corporation was $100. The fair market value of the stock in the Y Corporation when received by the X Corporation was $1,000. On April 9, 1939, the X Corporation declared a cash dividend of $900 and, except for the possible effect of the transaction in 1938, had no accumulated earnings or profits. The excess of the fair market value of the stock of the Y Corporation over the basis,

$900, was not recognized gain under the provisions of section 112 of the Revenue Act of 1938. Accordingly, its earnings and profits are not increased by $900 and the distribution was not out of earnings and profits.

The subsection applies regardless of the form taken by the sale or other disposition resulting in the accumulation of earnings and profits. For example, suppose that oil property which X had acquired in 1922 at a cost of $28,000 was transferred to a corporation in 1924 in exchange for all of its capital stock; that the fair market value of the stock and of the property as of the date of the transfer was $247,000; and that the corporation, after three years' operations, effected in 1927 a cash distribution to X in the amount of $165,000. In determining the extent to which the earnings and profits of the corporation available for dividend distributions have been increased as the result of production and sale of oil, it is intended that depletion should be taken into account computed upon the basis of $28,000 established in the nontaxable exchange in 1924 regardless of the fair market value of the property or the stock issued in exchange therefor.

The subsection further provides that where a corporation receives (after February 28, 1913) a distribution from a second corporation which (under the law applicable to the year in which the distribution is made) was not a taxable dividend to the shareholders of the second corporation, the amount of such distribution shall not increase the earnings and profits (for any period beginning after February 28, 1913) of the first corporation in certain cases of tax-free distributions. For example, if in the illustration in the second preceding paragraph the cash dividend of $900 was received by the Z Corporation, the sole stockholder of the X Corporation, it would be applied (if the adjusted basis of the stock is not in excess of $900) in reduction of the stock in respect of which the distribution was made and would not increase the earnings and profits of the Z Corporation.

Provision is also made for cases in which the adjustment of the basis prescribed by section 113 is different from the adjustment to such basis proper for the purpose of determining earnings or profits. The effect of such provision may be illustrated by the following example: The X Corporation purchased on January 1, 1931, an oil lease at a cost of $10,000. The lease was operated only for the years 1931 and 1932. The deduction allowed for depletion in each of the years 1931 and 1932 amounted to $2,750, of which amount $1,750 represented percentage depletion in excess of depletion based on cost. The lease was sold in 1940 for $15,000. Section 113(b)(1)(B) of the Internal Revenue Code provides that in determining the gain or loss from the sale of the property the basis must be adjusted for cost depletion of $1,000 in 1931 and percentage depletion of $2,750 in 1932. However, the adjustment of such basis, proper for the determination of earnings and profits, is $1,000 for each year, or $2,000. Hence, the cost will be adjusted only to the extent of $2,000, leaving an adjusted basis of $8,000 and the earnings and profits would be increased by the realized gain of $7,000 and not by the taxable gain of $8,750, the difference having previously been taken into account in computing earnings and profits.

If in the preceding example the property, instead of being sold, was exchanged in a transaction described in section 112 (b) or (c) for other like property having a value of $7,750 and cash of $7,250, then the gain for earnings and profits purposes amounts to $7,000, that is, $15,000 ($7,750 plus $7,250) minus the base of $8,000. However, for net income purposes the gain is $8,750, that is, $15,000 minus $10,000 (less depletion of $3,750) of which only $7,250 is recognized for net income purposes because such gain can not exceed the sum of money received in the transaction. Section 112(c)(1), Internal Revenue Code and corresponding provisions of prior revenue laws. If, however, the cash received was only $2,250 and the value of the property received was $12,750, then the gain for earnings and profits purposes would be $2,250, that amount being the gain recognized under section 112.

Of course, mere increase or decrease in value (after February 28, 1913) of property while owned by a corporation does not increase its earnings and profits.

Under various provisions of the Internal Revenue Code dealing with exchanges and liquidations, the transfer of the property by a corporation to another corporation results in the nonrecognition, in whole or in part, of the gain or loss realized by the transferor upon such transfer. In such cases well established principles of income tax law require that the earnings and profits of the transferor shall go over to the transferee and shall be considered to be earnings and profits of the transferee for tax purposes. These principles are to be given

full effect under section 501. The requirement of section 501 that there shall be no increase or decrease in earnings and profits by reason of a wholly unrecognized gain or loss is but another aspect of the principle under which the earnings and profits of the transferor become by reason of the transfer the earnings and profits of the transferee.

Subsection (n) prescribes rules for determining that part of the earnings and profits which is represented by increase in value of property accrued but not realized prior to March 1, 1913. It provides that if any increase or decrease in the earnings and profits (for any period beginning after February 28, 1913), with respect to any matter would be different had the adjusted basis of the property involved been determined without regard to its March 1, 1913, value, then an increase (properly reflecting such difference) shall be made in that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913. The following examples illustrate the application of this subsection:

Example (1): Nondepreciable property was acquired prior to March 1, 1913, at a cost of $8, its March 1, 1913, value was $10, and it was sold thereafter for $12. The increase in earnings and profits based on the March 1, 1913, value is $2. If the basis was determined without regard to the March 1, 1913, value there would be an increase in earnings and profits of $4. The increase to be made in that part of the earnings and profits consisting of the increase in value of property accrued before March 1, 1913, properly reflecting such difference, is $2.

Example (2): Nondepreciable property was acquired prior to March 1, 1913, at a cost of $8, its March 1, 1913, value was $12, and it was sold thereafter for $10. The decrease in earnings and profits based on the March 1, 1913, value is $2. If the basis was determined without regard to the March 1, 1913, value there would be an increase in earnings and profits of $2. The increase to be made in that part of the earnings and profits consisting of the increase in value of property accrued before March 1, 1913, properly reflecting such difference, is $4.

Example (3): Nondepreciable property was acquired prior to March 1, 1913, at a cost of $10, its March 1, 1913, value was $12, and it was sold thereafter for $8. The decrease in earnings and profits based on the March 1, 1913, value is $4. If the basis was determined without regard to the March 1, 1913, value there would be a decrease in earnings and profits of $2. The increase to be made in that part of the earnings and profits consisting of the increase in value of property accrued before March 1, 1913, properly reflecting such difference, is $2.

Example (4): Depreciable property was acquired in 1908 for $100,000. Assuming no additions or betterments, the depreciation sustained prior to March 1, 1913, was $10,000 so that the adjusted cost was $90,000. Its March 1, 1913, value was $94,000 and in 1939 it was sold for $60,000. For the purpose of determining gain from the sale, the basis of the property is the fair market value of $94,000 as of March 1, 1913, adjusted for depreciation for the period subsequent to February 28, 1913, computed on such fair market value. If the amount of the depreciation deduction allowed (not less than the amount allowable) after February 28, 1913, to the sale in 1939 is the aggregate sum of $43,240 the adjusted basis for determining gain in 1939 ($94,000 less $43,240) is $50,760 and the gain would be $9,240 ($60,000 less $50,760). The increase in earnings and profits accumulated since February 28, 1913, by reason of the sale, based on the March 1, 1913, value adjusted for depreciation, is $9,240. If the depreciation since February 28, 1913, had been based on the cost of $100,000 instead of the March 1, 1913, value of $94,000, the depreciation sustained from that date to the date of sale would have been $41,400 instead of $43,240 and the actual gain on the sale based on the cost of $100,000 adjusted by depreciation on such cost to $48,600 ($100,000 less $10,000 less $41,400) would be $11,400 ($60,000 less $48,600). If the adjusted basis of the property was determined without regard to the March 1, 1913, value there would be an increase in earnings and profits of $11,400. The increase to be made in that part of the earnings and profits consisting of the increase in value of property accrued before March 1, 1913, properly reflecting such difference, is $2,160.

The amendments to the Internal Revenue Code made by section 501(a) are by section 501(c) made applicable to all prior Revenue Acts, effective as if they were a part of such Act on the date of its enactment, thus effecting the application of a uniform rule for the determination of the earnings and profits of all corporations for all prior taxable years. The last sentence of the subsection provides that only the actual tax liability of a shareholder taxpayer for a particular year which is now pending before, or heretofore determined by, the

Board of Tax Appeals or any court of the United States, shall remain unaffected by the provisions of section 501. These cases now actually in litigation are left to be determined as the Board or the court may see fit. The result is that the decision in each of these cases will merely determine the tax liability for the particular year of the particular taxpayer, but for every other purpose the determination of the earnings and profits, and of all matters dependent upon such determination the provisions of section 501 govern. Section 501 will therefore control for all purposes as respects the corporation, and as respects the shareholder in litigation for every purpose except that the tax liability for the particular year, as finally determined by the Board or the court, will remain undisturbed.

SECTIONS 502–508 (SECTIONS 402–408 OF THE HOUSE BILL). TAX ON SHAREHOLDERS OF PERSONAL SERVICE CORPORATIONS—STATUTE OF LIMITATIONS IN THE CASE OF CONSTRUCTIVE DIVIDENDS—CREDIT OF NONRESIDENT ALIEN OF TAX AS SHAREHOLDER IN PERSONAL SERVICE CORPORATION—CREDIT OF FOREIGN CORPORATION OF TAX AS SHAREHOLDER IN PERSONAL SERVICE CORPORATION—CHANGE IN NAME OF EXISTING EXCESS-PROFITS TAX—PUBLICITY OF RETURNS OF SUBCHAPTER E EXCESS-PROFITS TAX—TECHNICAL AMENDMENTS.

These sections are the same as sections 402–408 of the House bill.

1940–43–10463

SECOND REVENUE BILL OF 1940.

[House of Representatives Report No. 3002, Seventy-sixth Congress, Third Session.]

[September 30, 1940.]

Mr. Doughton, from the committee of conference, submitted the following conference report [to accompany H. R. 10413]:

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H. R. 10413) to provide revenue, and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

* * * * * * *

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE.

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H. R. 10413) to provide revenue, and for other purposes, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

Amendment No. 1: This amendment strikes out Title I (excess-profits tax) of the House bill and substitutes Title I (corporation income tax) and Title II (excess-profits tax); and the House recedes with an amendment.

Title I of this amendment being new and Title II being in effect Title I of the House bill with amendments, the action on this amendment will be discussed section by section.

TITLE I—CORPORATION INCOME TAX.

House bill.—There is no comparable provision in the House bill. Section 710 of the excess-profits tax as passed by the House did, however, provide, as part of the excess-profits tax in the case of corporations which elected to compute their excess-profits credit on the average earnings plan, for the payment of an additional amount equal to 4⅒ per cent of the normal tax net income.

Senate amendment.—The Senate amendment increased by 3⅒ per cent the corporate income tax of all corporations (except nonresident foreign corporations taxable under section 231(a)). Such increase applied to the entire rate schedule contained in sections 13 and 14, that is, whether or not the corporation's normal tax net income was in excess of $25,000. The permanent corporate tax rate applicable to corporations not entitled to the special treatment provided for small corporations was therefore 22⅒ per cent. It was provided, however, that in computing the 10 per cent increase in tax imposed by section 15 of the Internal Revenue Code, added to such code by section 201 of the First Revenue Act of 1940, the corporate tax prior to the 3⅒ per cent increase contained in

the Senate amendment was to be used as the basis for such computation. Thus, the general effective rate applicable to corporations with normal-tax net incomes in excess of $31,964.30, so long as the defense-tax provisions of section 15 were in force, would be 24 per cent.

Conference agreement.—Under the conference agreement, there is no increase of the Chapter 1 tax of corporations whose normal-tax net income is not in excess of $25,000, if such corporations are entitled to the treatment provided by section 14 of the Internal Revenue Code. In the case of corporations whose normal-tax net income is slightly in excess of $25,000 and which are taxable as provided in section 13, the full 3⅒ per cent increase is not applicable in fact until the normal-tax net income reaches $38,565.89. Like the Senate amendment, the bill as agreed to in conference provides that the additional 10 per cent imposed by the First Revenue Act of 1940 is to be figured on the basis of the permanent rates prior to their increase by the bill. Therefore, in the case of corporations whose normal-tax net income is slightly in excess of $25,000, the 10 per cent increase may be computed on the basis of the tax (at the unincreased rates) under the general rule, even though the corporation may still be subject to the alternative tax under the bill. The applicable rates under the conference agreement are illustrated by the following table:

	Permanent rate.			Temporary additional rate (defense tax).	Total normal tax rate.
	Existing law.	Additional rate under the conference bill.	Total.		
Corporations with normal tax net incomes not in excess of $31,964.30:	*Per cent.*	*Per cent.*	*Per cent.*	*Per cent.*	*Per cent.*
First $5,000	13.50	0	13.50	1.35	14.85
Next $15,000	15.00	0	15.00	1.50	16.50
Next $5,000	17.00	0	17.00	1.70	18.70
Next $6,964.30	33.00	2	35.00	3.30	[1] 38.30
Corporations with normal-tax net incomes in excess of $31,964.30, but not in excess of $38,565.89:					
First $5,000	13.50	0	13.50	1.9	15.4
Next $15,000	15.00	0	15.00	1.9	16.9
Next $5,000	17.00	0	17.00	1.9	18.9
Next $13,565.89	33.00	2	35.00	1.9	[1] 36.9
Corporations with normal-tax net incomes in excess of $38,565.89 [2]	19.00	3.1	22.10	1.9	24.00

[1] This is the "notch provision." The specified rate, coupled with the low rates applicable to the first $25,000, does not produce an effective rate as high as that applicable to large corporations until the normal-tax net income reaches $31,964.30, in the case of existing law, and $38,565.89, under the bill.

[2] In this group would also fall mutual investment companies and foreign corporations not taxable under section 231 (a), regardless of the amount of their income.

TITLE II (TITLE I OF HOUSE BILL)—EXCESS-PROFITS TAX.

SECTION 710. IMPOSITION OF TAX.

House bill.—Under the House bill, the excess-profits tax imposed upon corporations which elected to compute their excess-profits credit on the income plan consisted of 4⅒ per cent of the corporation's normal-tax net income plus a graduated tax of from 25 to 50 per cent of the corporation's adjusted excess-profits net income. The excess-profits tax imposed upon corporations which elected to compute their excess-profits credit on the invested capital method consisted solely of a graduated tax of from 20 to 45 per cent of the corporation's adjusted excess-profits net income. The term "adjusted excess-profits net income," which constituted the measure of the graduated tax, was defined as the excess-profits net income less a specific exemption of $5,000 and the amount of the taxpayer's excess-profits credit for the taxable year.

In the case of any corporations which had been through certain types of tax-free exchanges, adjustments were to be made in the dollar amounts constituting the dividing lines between the various brackets. If, for example, a corporation, in a tax-free transaction, split up into two corporations, the rate schedule was adjusted so that the sum of the amounts of income of both corporations subject to each bracket would not exceed the amount of income which

would have been taxed in such bracket had the original corporation remained intact. The amount in each bracket was divided between the two corporations on the basis of the relationship of its invested capital immediately after the exchange to the invested capital of the original corporation immediately preceding the exchange. To accomplish this result, since section 759 required a similar adjustment to be made in the case of the preferential rate amount, which in the case of corporations which had not been through a prior tax-free exchange was always $500,000, the ratio of the taxpayer's preferential rate amount to $500,000 was, as a matter of convenience, applied in the adjustment of the dollar amounts in the rate schedule provided by section 710.

Senate amendment.—The additional 4⅒ per cent of the normal-tax net income of corporations electing the excess-profits tax based on average earnings was eliminated. The 5 per cent differential in rate between corporations computing their excess-profits credit on the invested-capital plan and corporations computing their excess-profits credit on the income plan was also eliminated and the 25 to 50 per cent graduated rate schedule applicable under the House bill to corporations electing the income credit was made applicable to all corporations. However, such rate schedule was further modified so as to make the dividing line between the brackets depend upon specified dollar amounts of adjusted excess-profits net income only if such specified dollar amounts are greater than alternative amounts representing specified percentages of the excess-profits credit. The rate schedule contained in the Senate amendment is as follows:

"Twenty-five per cent of so much of the adjusted excess-profits net income as does not exceed the greater of $20,000 or 20 per cent of the excess-profits credit;

"Thirty per cent of so much of the adjusted excess-profits net income as exceeds the greater of $20 000 or 20 per cent of the excess-profits credit and does not exceed the greater of $50,000 or 40 per cent of such credit;

"Thirty-five per cent of so much of the adjusted excess-profits net income as exceeds the greater of $50,000 or 40 per cent of the excess-profits credit and does not exceed the greater of $100,000 or 60 per cent of such credit;

"Forty per cent of so much of the adjusted excess-profits net income as exceeds the greater of $100,000 or 60 per cent of the excess-profits credit and does not exceed the greater of $250,000 or 80 per cent of such credit;

"Forty per cent of so much of the adjusted excess-profits net income as exceeds the greater of $250,000 or 80 per cent of the excess-profits credit and does not exceed the greater of $500,000 or 100 per cent of such credit; and

"Fifty per cent of so much of the adjusted excess-profits net income as exceeds the greater of $500,000 or 100 per cent of the excess-profits credit."

The adjustment in the rate schedule required in the case of taxpayers which had been through certain types of tax-free transactions was eliminated.

The definition of "adjusted excess-profits net income" contained in the House bill was retained except that the specific exemption allowable in computing such adjusted excess-profits net income was increased from $5,000 to $10,000.

Conference agreement.—Under the conference agreement, the excess-profits tax of all corporations, whether computing their excess-profits credit on the income or invested-capital plan, is based solely on the following rate schedule:

Amount of adjusted excess-profits net income:	*Rate of tax (per cent).*
First $20,000	25
Next $30,000	30
Next $50,000	35
Next $150,000	40
Next $250,000	45
Over $500,000	50

This was the graduated schedule applicable to corporations computing their excess profit on the income plan under the House bill and was the schedule applicable to all corporations under the amendment as reported by the Senate Finance Committee.

The adjustment in the above rate schedule which was required, under the House bill, in the case of taxpayers which had been through certain types of tax-free transactions has been restored, with clerical changes.

The specific exemption allowable in computing the adjusted excess-profits net income has been restored to $5,000. An additional credit is also allowed, in computing such adjusted excess-profits net income, to corporations whose normal-tax net income for the taxable year is not in excess of $25,000, such additional credit to consist of the amount if any, by which the excess-profits

credit for the preceding taxable year exceeded the excess-profits net income for such year. It is understood that the Treasury and members of the staff of the Joint Committee on Internal Revenue Taxation will study the operation of this limited carry-over, with a view to its possible extension or modification, and will report to the appropriate committees on the subject as soon as possible.

SECTION 711. EXCESS-PROFITS NET INCOME.

House bill.—Under the House bill the excess-profits net income was defined to be the normal-tax net income with certain adjustments.

Senate amendment.—In addition to certain technical amendments, the Senate amendment made the following changes in and additions to the adjustments contained in the House bill:

(1) The additional deduction on account of corporate income taxes was modified so as to exclude the section 102 tax imposed on corporations improperly accumulating surplus. Under both the House and Senate bills, however, the normal corporate income tax (after the allowance of the foreign tax credit) for the taxable year for which the excess-profits net income is being computed is allowable as an additional deduction.

(2) The treatment of gains and losses on depreciable assets held for more than 18 months as long-term capital gains and losses and their consequent exclusion from the computation was eliminated. In lieu thereof a provision was inserted providing that only the excess of gains arising from the sale or exchange of such assets over any losses arising therefrom should be excluded from the computation. The effect of this provision is to allow losses from the sale or exchange of depreciable assets held for more than 18 months to be deducted from ordinary income to the extent such losses exceed the gains from similar transactions.

(3) The adjustment on account of income derived from the retirement or discharge of bonds, etc., was rewritten to make certain that amounts which would be otherwise includible upon such retirement or discharge on account of any premium received upon issuance should be left out of the computation, and that the adjustment should apply although the indebtedness retired or discharged is indebtedness which has been assumed by the taxpayer and although it is evidenced, so far as the taxpayer is concerned, only by a contract with the person whose liabilities have been assumed.

(4) A corresponding adjustment was added requiring that certain deductions otherwise allowable on account of the retirement or discharge of bonds, etc., should be excluded from the computation.

(5) A new adjustment was added, applicable only to taxable years after the base period, requiring the exclusion of income attributable to refunds of Agricultural Adjustment Act taxes and interest upon such refunds.

(6) It was also provided that, if the excess-profits credit is computed under the invested-capital plan, the normal-tax net income should be increased by an amount equal to the interest on United States obligations and the obligations of Federal instrumentalities not specifically exempted from excess-profits taxes and, in addition thereto, the interest on all other Federal, State, or local obligations, if the taxpayer elects, under section 720(d) (added by the Senate amendment), to treat all such other obligations as admissible assets for the taxable year.

(7) Losses arising from the demolition, abandonment, and loss of useful value of property are excluded from the computation of excess-profits net income for taxable years in the base period.

(8) An additional adjustment was provided, applicable only to taxable years in the base period, to the effect that deductions attributable to any claim, award, judgment, or decree against the taxpayer, or interest thereon, would not be required to be taken into account if, in the light of the taxpayer's business, it is abnormal for the taxpayer to incur a liability of such character or, if the taxpayer normally incurs liabilities of such character, the amount of the particular liabilities of such character in the taxable year is grossly disproportionate to the average amount of liabilities of such character in each of the four previous taxable years.

(9) Income attributable to the recovery of a bad debt, if a deduction from gross income was allowed with reference to such debt was allowed from gross income for a taxable year beginning prior to January 1, 1940, is excluded in the case of taxable years after the base period.

(10) A new adjustment, applicable to both the taxable years in the base period and taxable years after the base period in the case of corporations computing their excess-profits credit under the income plan, was added requiring the exclusion of any deductions in connection with exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing.

(11) Corporations computing their excess-profits credit under the income plan are given the same dividends received credit, both for taxable years in the base period and for taxable years after the base period, as is given to corporations computing their excess-profits credit on the invested capital plan, i. e., the full amount of all dividends received, except dividends on stock of a foreign personal holding company.

(12) Amounts received pursuant to an award of the Mixed Claims Commission, United States and Germany, are excluded from income for taxable years after the base period in the case of corporations computing their excess-profits credit under the income plan.

(13) In case of taxable years in the base period, the deduction under section 23(k) for bad debts is decreased by an amount representing unrecovered loans made by a parent corporation to its subsidiary, in so far as such deduction includes an amount representing such unrecovered loans.

In addition to applying section 117 of the Internal Revenue Code (relative to capital gains and losses) to taxable years in the base period, which was done in the House bill, the Senate amendment applies section 23 (g) and (k) to such taxable years in order that long-term losses due to securities (stocks and bonds) having become worthless would be disallowed in computing excess-profits net income for taxable years in which such losses were not treated as capital losses under the income-tax law applicable to such years.

Conference agreement.—With the exceptions and modifications described below, the Senate provision is adopted:

(1) The adjustment relative to income realized upon the retirement or discharge of bonds, etc., has been further redrafted so as to make certain that the excluded income on account of the issuance of the bonds at a premium relates only to premium unamortized on the date of retirement or discharge. There is not to be excluded from income the accrued amortization of bond premium for that portion of the taxable year preceding such retirement or discharge.

(2) The adjustment requiring that certain deductions otherwise allowable on account of the retirement or discharge of bonds, etc., should be excluded from the computation has been eliminated for taxable years after the base period. As retained relative to taxable years in the base period, it has been redrafted so as to make certain that the excluded deduction on account of the issuance of bonds, etc., at a discount relates only to discount unamortized on the date of the retirement or discharge. The ordinary deduction for amortization of bond discount accrued for that portion of the taxable year preceding the retirement or discharge is not to be excluded from the computation.

(3) The adjustment relative to interest on Federal, State, and local obligations has been revised as follows: The distinction between certain United States obligations and obligations of Federal instrumentalities, on the one hand, and all other Federal, State, or local obligations, on the other, has been eliminated, and the treatment of all such obligations has been made optional with the taxpayer. Instead of requiring the taxpayer to elect to treat such obligations as admissible assets and having the taxation of the interest derived therefrom follow as a consequence, however, the conference agreement provides that the taxpayer's election shall be with respect to the inclusion of the interest in income and that, if such an election is made, the obligations from which such interest was derived shall be treated as admissible assets for the taxable year. See discussion under section 720. A taxpayer must elect as to all such interest and may not elect as to only a portion thereof.

(4) The adjustment requiring the exclusion of any deduction in connection with exploration, etc., has been eliminated as to taxable years after the base period. As retained relative to taxable years in the base period, the adjustment has been limited to deductions allowed in respect of expenditures for intangible drilling and development costs paid or incurred in or for the drilling of wells or the preparation of wells for the production of oil or gas, or for development costs in the case of mines. Such deductions are excluded only if and to the extent that in the light of the taxpayer's business it is abnormal for the taxpayer to incur a liability of such character or, if the taxpayer normally incurs such liability,

only to the extent that the amount of such liability in the taxable year in question was grossly disproportionate to the amount of such liability in the four previous taxable years.

(5) Corporations computing their excess-profits credit on the income plan are allowed a dividends received credit of 100 per cent of the dividends received from a domestic corporation, but, unlike corporations on the invested-capital plan, are given no credit for dividends received from a foreign corporation. Such dividends, however, if their receipt constitutes an abnormality, are entitled to the treatment provided by section 721.

(6) The specific adjustment excluding from income awards of the Mixed Claims Commission has been eliminated, since it is already covered by the general provisions of section 721. Such income would be abnormal in kind, and, to the extent it constituted compensation for past losses, would be attributable to the years such losses occurred. Most of these awards of the Mixed Claims Commission were paid many years ago. However, a number of awards to American nationals were rendered by the Commission only recently and have not yet been paid. The conferees were unanimous that such awards when paid, to the extent they do not include current interest, should not and would not be subject to the excess-profits tax. Section 711(a)(1)(I) of Senate amendment has been omitted from the bill as agreed to in conference by reason of the fact that the conferees are convinced (and have the assurances of the Treasury) that section 721 of the bill accomplishes the same result, since the very nature of the award makes any resulting income abnormal, and none of the amounts paid pursuant to such awards will be attributable to any taxable year beginning after December 31, 1939, within the meaning of such section. In so far as such amounts are properly includible in the normal tax net income of the recipients, they will, of course, be subject to the normal tax in the year in which they are accrued or (in the case of recipients upon the cash receipts basis) are actually received.

(7) The adjustment in the base period on account of bad debts representing unrecovered loans made by a parent corporation to a subsidiary has been eliminated.

SECTION 712. ALLOWANCE OF EXCESS-PROFITS CREDIT.

House bill.—Under the House bill a domestic corporation was permitted to choose between the income credit and the invested capital credit only if it had been in existence during the entire 48 months prior to the beginning of its first taxable year which began in 1940. Foreign corporations subject to excess-profits tax were required to compute their excess-profits credit on the income plan if they were in existence during the entire 48 months prior to the beginning of their first excess-profits tax taxable year beginning in 1940 and were engaged in trade or business within the United States or had an office or place of business therein at any time during each of the taxable years in the 48 months prior to such date. All other domestic and foreign corporations subject to excess-profits tax were required to compute their excess-profits credit on the invested-capital plan.

Senate amendment.—Under the Senate amendment all domestic corporations which have been in existence prior to January 1, 1940, and all foreign corporations which, under the House bill, were required to compute their excess-profits credit on the income plan, are permitted to choose between the income and the invested-capital plan. All other corporations, including corporations which for any taxable year do not file returns, must compute their excess-profits credit on the invested-capital plan.

Conference agreement.—The Senate provision is adopted.

SECTION 713. EXCESS-PROFITS CREDIT BASED ON INCOME.

House bill.—Under the House bill all taxable years in the base period, including taxable years for which there were deficits, were taken into account in computing the average base period net income, except that the loss for one deficit year (the largest, if the taxpayer had more than one) was not to be applied in reduction of the aggregate income for other years. In ascertaining the average, however, the period covered by such taxable year was taken into account, i. e., the aggregate for the other years was divided by the total number of years in the base period, not by such total number less one.

Senate amendment.—In lieu of the treatment relative to deficits contained in the House bill, the Senate amendment provides that a taxpayer may entirely exclude one base period taxable year in computing its average earnings. Not only may the excess-profits net income or the deficit for such year be excluded from the computation, but the period embraced by such taxable year is excluded in ascertaining the average base period net income for the base period. Thus, if the base period includes four calendar years and the taxpayer chooses to drop one of such years out of the computation, the aggregate income for the remaining three years is divided by 3, and not by 4, in ascertaining the base period average.

Since under the Senate amendment all domestic corporations which have been in existence prior to January 1, 1940, are permitted to choose between the income and the invested capital plan, even though they may not have been in existence during the entire base period, the Senate amendment also provides for a constructive excess-profits net income in the case of corporations electing the income plan for such portion of the base period as the corporation was not in existence. Such excess-profits net income is to be computed in the same manner as the House bill provided in the case of corporations electing the invested-capital plan, i. e., 8 per cent of the invested capital for the day following the close of the base period, reduced by the same ratio of inadmissibles as is applicable to the last year of the base period.

The adjustment on account of capital additions and reductions was amended so as to treat 100 per cent of the stock of another corporation owned by the taxpayer as excluded capital. This conforms with the change made in the dividends received credit of corporations computing their excess-profits credit on the income plan.

Conference agreement.—The Senate provision permitting the complete exclusion of one year in the computation of average base period net income has been eliminated, and the House provision relative to the treatment of deficit years has been restored. In addition, it is provided that, in computing the income credit, the amount thereof, prior to adjustment on account of capital additions or capital reductions, shall be 95 per cent of the average base period net income instead of 100 per cent of such average base period net income. This 5 per cent reduction of the average base period net income is in lieu of the House provision which included an additional 4½0 per cent of the normal-tax net income in the excess profits tax of corporations electing the income plan and provided a 5 per cent differential in the graduated rate schedule applicable to such corporations.

In view of the conference agreement on sections 711 and 712, the Senate provision relative to a constructive excess profits net income in the case of corporations in existence during part, but not all, of the base period has been retained, and the treatment of corporate stock as excluded capital has been limited to the stock of domestic corporations.

SECTION 714. EXCESS-PROFITS CREDIT BASED ON INVESTED CAPITAL.

House bill.—Under the House bill the invested capital credit for any taxable year reflected, in part, the base period experience of the taxpayer. In general, the excess-profits credit consisted of an amount representing the base period rate of return (but not less than 7 per cent or more than 10 per cent on the first $500,000 and not less than 5 per cent or more than 10 per cent on the remainder) on so much of the corporation's invested capital for the taxable year as did not exceed its invested capital at the close of the base period, plus 10 per cent of so much of the remaining invested capital as did not bring the total invested capital beyond $500,000, and 8 per cent of the remainder.

Senate amendment.—Under the Senate amendment the base period experience of a corporation electing the invested capital credit is eliminated from consideration. The excess-profits credit of any such corporation is 8 per cent of the taxpayer's invested capital for the taxable year, without regard to its earnings record in the base period.

Conference agreement.—The conference agreement adopts the Senate provision.

SECTIONS 715–718. INVESTED CAPITAL.

The only change, other than clerical and technical changes, made by the Senate amendment in these sections of the House bill was the insertion of a new sentence in section 715 authorizing the Commissioner of Internal Revenue, pursuant to

regulations, to permit, in the computation of invested capital, the use of averages or ratios on a monthly, annual, or other appropriate basis, where in his opinion the circumstances do not require daily computation.

Under the conference agreement, the authorization to compute invested capital on some basis other than a daily basis is limited to cases where such other method will not cause the invested capital to vary by more than $1,000 from the invested capital computed on a daily basis. The conference agreement also makes further technical changes in order to eliminate duplications in the computation of equity invested capital. Provisions have been inserted governing the extent to which the equity invested capital of a parent corporation is to be increased or decreased following a liquidation under section 112(b)(6). This provision enables the provisions of section 718(b)(3) to be expanded so as to cover all situations in which, under the doctrine of *Commissioner* v. *Sansome* (60 Fed. (2d), 931), the earnings and profits of one corporation become the earnings and profits of another. A proper application of the provisions of section 718 prevents, it is believed, improper duplications in the case of the merger or consolidation of two or more corporations, one of which owns stock in the other; for the sake of clarity, however, subsection (c)(4) has been inserted dealing with the merger or consolidation of two or more corporations, one of which owns stock in the other. In case the corporation whose stock is owned by the other is merged into the other, no corresponding provision is necessary, since the property transferred in the merger represented by such stock is not within any provision of section 718(a).

SECTION 719. BORROWED INVESTED CAPITAL.

House bill.—Under the House bill borrowed capital (i. e., indebtedness evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust) was included in invested capital under a graduated limitation at varying percentages (100, 66⅔, 33⅓), these percentages depending upon the size of the corporation.

Senate amendment.—Under the Senate amendment all borrowed capital is included in invested capital at 50 per cent, regardless of the size of the corporation. Borrowed capital is defined to mean, in addition to the types of indebtedness described in the House bill, certain amounts received as advance payment in connection with a contract with a foreign government to furnish articles, materials, or supplies, to the extent such amounts would be repayable, pursuant to the terms of the contract, if cancellation by such foreign government occurred at the beginning of the day for which the borrowed capital is being ascertained. Such contract must have been made before the expiration of 30 days after the date of enactment of the bill.

Conference agreement.—The Senate provision has been adopted, except that the clause relative to amounts repayable to a foreign government has been redrafted so as to make certain that the amounts included as borrowed capital thereunder do not include amounts treated as income and therefore reflected in equity invested capital through the accumulated earnings and profits account.

SECTION 720. ADMISSIBLE AND INADMISSIBLE ASSETS.

House bill.—Under the House bill, in addition to corporate stock, all Federal, State, and local obligations were treated as inadmissible assets for the taxable year, and the interest derived therefrom was not included in normal-tax net income, upon the basis of which the excess-profits net income was computed.

Senate amendment.—Under the Senate amendment all United States obligations and obligations of Federal instrumentalities, the interest from which is not exempt from excess-profits taxation, are treated as admissible assets and the interest derived therefrom is subject to tax. In addition, the taxpayer may elect to treat all other Federal, State, and local obligations as admissible assets for the taxable year. If such an election is made, the normal tax net income is increased by the amount of interest derived from such obligations. The taxpayer is required to make a single election relative to all such obligations and may not elect as to only a portion thereof.

Conference agreement.—Under the conference agreement the disinction between certain United States obligations and obligations of Federal instrumentalities, on the one hand, and of other Federal, State, and local obligations, on the other, is eliminated. The taxpayer's election, instead of being an election to treat the

obligations in question as admissible assets, is an election to include the interest derived therefrom in normal tax net income. It is provided that, if such an election is made, the obligations from which such included interest is derived are treated as admissible assets for the taxable year.

SECTION 721. ABNORMALITIES IN INCOME IN TAXABLE PERIOD.

House bill.—There were no comparable provisions in the House bill.

Senate amendment.—Section 721(a) of the Senate amendment was designed to provide relief in the case of—

(1) Income arising out of a claim, award, judgment, or decree, or out of interest on any of the foregoing;

(2) Income received with respect to a contract whose performance required more than one year;

(3) Income resulting from the exploration, discovery, prospecting, research, or development of tangible property, patents, formulas, or processes, or any combination thereof, by the taxpayer or any of its predecessors, providing that such exploration, etc., extended over a period of more than one year;

(4) Income which is required to be included for the taxable year as a result of a change in the taxpayer's accounting period or method of accounting;

(5) Income received by the lessor of real property on the termination of the lease as a result of improvements on the property during the lease.

Any of the above types of income which is abnormal in kind, or which, in the light of the taxpayer's experience in the four previous taxable years, is abnormal in amount, is entitled to the following treatment:

The amount thereof attributable to any previous taxable year or years is to be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary. In the case of income from exploration, etc., the Commissioner is required to allocate in equal amounts so much of such income as is not attributed to the taxable year to each of the preceding years (not exceeding five) during which the exploration, etc., was conducted. The excess-profits tax for the taxable year shall not exceed the excess-profits tax for such taxable year computed without including such income in gross income, plus the aggregate of the additional excess-profits taxes which would have been payable in each of the preceding taxable years (including the current taxable year) to which a portion of such income is attributed if such portion had been included in income in such year.

Section 721(b) provides a 2-year carry-over of the unused excess-profits credit for any taxable year beginning after December 31, 1939, in the case of corporations 80 per cent or more of whose gross income is derived from mining or processing minerals or from processing or otherwise preparing for market any seasonal fruit or vegetable, or any fish or other marine life. The unused excess-profits credit for any taxable year is the amount by which the excess-profits credit for such taxable year exceeds the excess-profits net income for such taxable year.

Conference agreement.—The conference agreement retains section 721 with the following modifications:

(1) The item relative to income resulting from explorations, etc., has been rewritten. The exploration, etc., from which the income is derived must be the taxpayer's own exploration. Income resulting from activities of such a character carried on by a predecessor corporation is not entitled to the treatment provided in section 721.

(2) The item relative to income arising from the termination of a lease has been broadened so as to include all income arising from such source and not merely income occasioned by improvements on the property during the term of the lease.

(3) A new category of potentially abnormal income has been added, consisting of dividends on stock of foreign corporations, except foreign personal holding companies. This is part of the conference agreement relative to the dividends received credit of corporations computing their excess-profits credit on the income plan. See section 710.

(4) The fixed rule of allocation applicable to income resulting from exploration, etc., has been eliminated.

(5) A new provision is inserted making certain that income attributed to any future year or years will be included in excess-profits net income for such future year or years and subjected to excess-profits tax.

(6) Subsections (b) and (c), providing for a special 2-year carry-over of the unused excess-profits credit in the case of certain businesses, are eliminated.

SECTION 722 (SECTION 721½ OF THE SENATE AMENDMENT). ADJUSTMENT OF ABNORMALITIES IN INCOME AND CAPITAL.

Section 721½ of the Senate amendment provides that the Commissioner shall have authority to make any adjustments which abnormally affect income or capital, and that his decision shall be subject to review by the Board of Tax Appeals.

Conference agreement.—Under the conference agreement section 721½ is renumbered section 722 and given the heading "Adjustment of Abnormalities of Income and Capital." It grants the Commissioner authority to adjust any items which abnormally affect income or capital, and provides that the Commissioner's decision shall be subject to review by the Board of Tax Appeals. It is understood that the Treasury and members of the staff of the Joint Committee on Internal Revenue Taxation will give further study to the entire problem covered by this section and will report to the appropriate committees on the subject as soon as possible.

SECTIONS 723 AND 724 (SECTIONS 722 AND 723 OF THE SENATE AMENDMENT AND SECTIONS 721 AND 722 OF THE HOUSE BILL). EQUITY INVESTED CAPITAL IN SPECIAL CASES—FOREIGN CORPORATIONS, INVESTED CAPITAL.

In addition to changes in section numbers, a clerical change was made by the Senate amendment because of the changes made in section 714. The Senate provision is adopted with a further change in section number.

SECTION 724 (SECTION 723 OF THE HOUSE BILL). PERSONAL SERVICE CORPORATIONS.

House bill.—The House bill allowed a personal service corporation an election to have its income taxed in the hands of its shareholders in lieu of paying an excess-profits tax. A personal service corporation was defined to mean a corporation whose income is attributable primarily to the activities of shareholders who are regularly engaged in the active conduct of the affairs of the corporation and are owners at all times during the taxable year of at least 80 per cent in value of the stock of the corporation, and in which capital (whether invested or borrowed) is not a material income-producing factor. Foreign corporations and any corporation 50 per cent or more of whose gross income consisted of gains, profits, or income derived from trading as a principal were excluded. For the purposes of the stock-ownership test, an individual was considered as owning stock owned by his spouse or minor child.

Senate amendment.—The Senate amendment contains, in effect, three alternative definitions of a personal service corporation. The first is that contained in the House bill. The second defines a personal service corporation as a corporation (in which capital is not an income-producing factor) at least 80 per cent in value of whose stock is owned at all times during the taxable year by shareholders who are regularly engaged in the active conduct of the corporation's affairs. This definition differs from the House definition in that it does not require the corporation's income to be ascribed primarily to the activities of such shareholders. The third alternative contained in the Senate amendment defines a personal service corporation as a corporation (in which capital is not an income-producing factor) the income of which is to be ascribed primarily to the activities of shareholders who are actively engaged in the conduct of the corporation's affairs and all of the stock of which is owned at all times during the taxable year by or for not more than 20 individuals. The effect of this alternative is to include corporations which have so-called silent partners who own more than 20 per cent of its stock. As to both alternatives added by the Senate amendment, it is provided that an individual shall be considered as owning stock owned not only by his spouse or minor child, but by any guardian or trustee representing them.

Conference agreement.—Under the conference agreement a personal service corporation is defined to mean a corporation whose income is attributable primarily to the activities of shareholders who are regularly engaged in the active conduct of the affairs of the corporation and are owners at all times during the taxable year of at least 70 per cent in value of each class of stock of the corporation, and in which capital (whether invested or borrowed) is not a material income-producing factor. Foreign corporations and any corporation 50 per cent or more of whose gross income consisted of gains, profits, or income derived from trading as a principal are excluded. For the purposes of the stock-ownership test, an individual is considered as owning stock owned by his spouse or minor child or by any guardian or trustee representing them.

SECTION 726 (SECTION 725 OF THE SENATE AMENDMENT AND SECTION 724 OF THE HOUSE BILL). CORPORATIONS COMPLETING CONTRACTS UNDER MERCHANT MARINE ACT, 1936.

In addition to changing the section number, only a clarifying change was made in this section by the Senate amendment. The Senate provision is adopted, with a further change in section number.

SECTION 727 (SECTION 726 OF THE SENATE AMENDMENT AND SECTION 725 OF THE HOUSE BILL). EXEMPT CORPORATIONS.

The Senate amendment made no change in this section as contained in the House bill except to change the section number and to advance from December 1, 1940, to July 1, 1941, the date before which an investment company must register as a diversified company under the Investment Company Act of 1940 in order to qualify for exemption for the taxable years 1940 and 1941. The Senate provision is adopted with a further change in section number.

SECTION 728 (SECTION 727 OF THE SENATE AMENDMENT AND SECTION 726 OF THE HOUSE BILL). MEANING OF TERMS USED.

The Senate amendment and the conference agreement merely change the section number.

SECTION 729 (SECTION 728 OF THE SENATE AMENDMENT AND SECTION 727 OF THE HOUSE BILL). LAWS APPLICABLE.

House bill.—Section 727(b) of the House bill provided that no return need be filed by a corporation whose excess-profits net income (placed on an annual basis in the case of a taxable period of less than one year) was not greater than $5,000, the amount of the specific exemption contained in the House bill.

Senate amendment.—The Senate amendment provides that no return need be filed unless the corporation's excess-profits net income (placed on an annual basis in the case of a taxable period of less than one year) is in excess of $10,000, the amount of the specific exemption provided by the Senate amendment.

Conference agreement.—In view of the conference action restoring the specific exemption to $5,000, the House provision is adopted with a further change in section number.

SECTION 730 (SECTION 729 OF THE SENATE AMENDMENT). CONSOLIDATED RETURNS.

This section was not in the House bill. As added by the Senate amendment it permits consolidated returns to be filed by affiliated groups of corporations under certain circumstances, among which is the requirement that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made must consent to regulations prescribed by the Commissioner, with the approval of the Secretary, prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent.

The term "affiliated group" is defined to mean one or more chains of corporations connected through stock ownership with a common parent corporation if—

(1) At least 95 per cent of each class of the stock of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

(2) The common parent corporation owns directly at least 95 per cent of each class of the stock of at least one of the other corporations.

Foreign corporations (except certain 100 per cent owned foreign subsidiaries of domestic corporations), China Trade Act corporations, and certain corporations deriving income from United States possessions are not to be deemed to be affiliated with any other corporation within the meaning of this provision.

Under the conference agreement—

(1) The class of corporations excluded from membership in an affiliated group is expanded to include certain other corporations in addition to those specified in the Senate amendment. As thus expanded, the class of corporations excluded from the affiliated group includes all those corporations which, by reason of the fact that they are themselves exempt from the excess-profits tax,

or are taxable on a basis different from that used in the case of corporations generally (as in the case of foreign corporations), or are otherwise allowed special treatment (as in the case of China Trade Act corporations, personal service corporations, and corporations doing business in possessions of the United States), can not appropriately be associated for tax purposes with corporations not accorded such special treatment. While insurance companies in general are not includible in an affiliated group, an insurance company may be affiliated with other insurance companies of the same taxable character. For example, an insurance company taxable under section 201 may file a consolidated return with another insurance company taxable under the same section, assuming both companies meet the stock ownership test. An insurance company taxable under section 201 may not, however, file a consolidated return with another insurance company taxable under section 204 or section 207. The conference agreement preserves the exception relative to certain 100 per cent owned foreign subsidiaries of domestic corporations contained in the Senate amendment.

(2) The definition of the term "affiliated group" has been revised so as to speak in terms of includible corporations (all corporations not excluded from membership in an affiliated group being termed includible corporations) and to provide that the type of stock to which the 95 per cent ownership test applies shall not include nonvoting stock which is limited and preferred as to dividends.

The term "affiliated group" is defined to mean one or more chains of includible corporations connected through stock ownership with a common parent corporation which is itself an includible corporation if—

(a) At least 95 per centum of the stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

(b) The common parent corporation owns directly at least 95 per centum of the stock of at least one of the other includible corporations.

In view of the above definition, consolidated returns may not be filed by subsidiary corporations as an affiliated group unless the parent corporation through which such subsidiaries are connected is a member of the group. For instance, there will not be recognized as an affiliated group two industrial corporations the common parent of which is an insurance company or a personal holding company. In addition, no corporation which is connected by stock ownership with an affiliated group of includible corporations only through a nonincludible corporation may be included in a consolidated return. If a common parent which is an includible corporation owns 95 per cent of the stock of a nonincludible corporation and 95 per cent of the stock of an includible corporation, it, and the other includible corporations may, of course, file a consolidated return.

Under section 141 of the Internal Revenue Code and corresponding sections of prior Revenue Acts, the Commissioner has prescribed by regulations the requirement that all corporations falling within the affiliated group at any time during the taxable year shall join in the consolidated return. The section provides that all the members of the group shall consent to such regulations as a condition to the privilege of filing such return. It is contemplated that the Commissioner will prescribe like requirements for the purposes of the consolidated returns authorized by this section and the section provides that such regulations shall be consented to by all of the includible corporations.

SECTION 731. INCOME FROM MINING STRATEGIC METALS (SECTION 730 OF SENATE AMENDMENT).

This section is new in the Senate amendment, no comparable provision having been contained in the House bill. It exempts from excess-profits tax income derived from mining, reduction or beneficiation of tungsten, quicksilver, manganese, platinum, antimony, chromite, and tin, or the ores and material containing such metals. These materials have been declared to be strategic materials by the War Department. The exemption provided in section 730 is intended to encourage their domestic production.

Under the conference agreement, this section is changed to section 731 and it is given a new caption. It exempts from excess-profits tax that portion of the adjusted excess-profits net income of a domestic corporation which is attributable to mining within the United States of tungsten, quicksilver, manganese, platinum, antimony, chromite, or tin. The tax on the remaining portion

of the adjusted excess-profits net income is an amount which bears the same ratio to the tax computed on all the adjusted excess-profits net income as such remaining portion bears to the entire adjusted excess-profits net income.

SUPPLEMENT A. EXCHANGES: EXCESS-PROFITS CREDIT BASED ON INCOME.

Except for technical changes and the changes indicated below, Supplement A of the Senate amendment is the same as Supplement A of the House bill.

House bill.—Supplement A of the House bill contained provisions whereby, in computing the excess-profits credit of a taxpayer on the average earnings plan, the base period experience of corporations, the assets of which had previously been acquired by the taxpayer in certain types of transactions, could be taken into account. This provision was intended not only to enable the base period experience of the enterprise to be more truly reflected but to enable the income credit to be available in certain cases even though the taxpayer had not been in existence during the entire base period. The types of transactions in which the assets of another corporation must have been acquired to entitle the acquiring corporation to these benefits were as follows:

(1) Whereby all the assets of another corporation were acquired in whole or in part for all the stock of the acquiring corporation.

(2) Complete liquidations of subsidiaries under section 112(b)(6).

(3) Statutory mergers or consolidations.

Senate amendment.—Aside from certain technical changes the Senate amendment changed this provision of the House bill only in the following respects:

In addition to the types of transactions covered by the House bill, the Senate amendment added the type of exchange described in section 112(g)(1)(C) of the Internal Revenue Code, that is, the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, the assumption by the acquiring corporation of a liability of the other or the fact that property acquired is subject to a liability being disregarded in the determination of whether the exchange is solely for voting stock. There were also added transfers before October 1, 1940, by one corporation of property to another corporation solely as paid-in surplus or a contribution to capital in respect of voting stock of the transferee corporation owned by the transferor corporation, assumptions of liabilities being disregarded as in the case of section 112(g)(1)(C) reorganizations. Neither of these types of transactions are includible unless the transferor corporation is forthwith completely liquidated in pursuance of the plan under which the acquisition is made, and the transaction of which the acquisition is a part has in all respects the effect of a statutory merger or consolidation.

The Senate amendment also provides that in the case of a taxpayer which became an acquiring corporation in a taxable year after December 31, 1939, if, on September 11, 1940, and at all times thereafter until the taxpayer became an acquiring corporation, either the taxpayer or one of the transferor corporations involved in the transaction in which the taxpayer became an acquiring corporation owned not less than 75 per cent of each class of stock of each of the other corporations involved in the transaction, then the average base period net income of the taxpayer should not be less than either (1) its average base period net income would have been if the transaction had not taken place or (2) the average base period net income of that transferor corporation whose average base period net income is the greatest.

A change, corresponding to that made in section 713, was made in section 742, authorizing the omission of one taxable year in the computation of average base period net income.

Conference agreement.—The Senate provisions are adopted, except to the extent they authorize the complete exclusion of one taxable year in computing average base period net income. (See section 713.) The conference agreement also makes a clarifying change, whereby section 743(c) is stricken out and section 740(g) inserted in lieu thereof. Section 740(g) provides that the term "component corporation" includes a component corporation of a component corporation, except as used in section 742(d) (1) and (2) and section 743(a).

SUPPLEMENT B. EXCHANGES: HIGHEST BRACKET AMOUNT AND INVESTED CAPITAL.

House bill.—In the computation of the invested-capital credit under the House bill, a number of variable factors were employed depending upon the

size of the corporation. The preferential treatment accorded small corporations made it necessary to include provisions to prevent a large corporation from receiving small corporation treatment through breaking itself up into a number of small corporations by means of tax-free transactions. Supplement B of the House bill provided the necessary rules for adjusting the various factors employed in the computation of the invested capital credit following certain tax-free transactions.

Senate amendment.—The Senate amendment eliminates most of Supplement B as no longer necessary in view of the change made in section 714, relative to the computation of the invested-capital credit. Section 751, relative to the determination of property paid in for stock and of borrowed capital in connection with certain exchanges, was retained, however, with a clerical amendment. Section 759, relative to the determination of the preferential rate amount (renumbered section 752 and entitled "Highest Bracket Amount"), was also retained, with technical amendments.

The definitions of "exchange," "transfer or upon exchange," "transferee upon exchange," and "preferential rate amount" (renamed "highest bracket amount"), contained in section 750 of the House bill, were also retained but the term "exchange" was clarified so as to make it clear that only transactions occurring after December 31, 1917, are embraced in the definition. Broadly speaking, the tax-free exchange provisions did not appear in the income-tax law until after such date.

Conference agreement.—The conference agreement adopts the Senate provisions.

Amendments Nos. 2, 3, and 4: These are changes in title and section numbers. The House recedes.

Amendment No. 5: Section 124(d) as added to the Internal Revenue Code by the House bill provided for making certain adjustments on account of changes in prior amortization or depreciation deductions occasioned by the provisions of subsection (d) (1), (2), (3), and (4), which adjustments were to be made without regard to the statute of limitations, closing agreements, or any other final determination of tax liability. This amendment expands such provision so as to cover the recomputation required by subsection (i), added by amendment No. 11. Because of the changes made in subsection (i) in conference, this amendment is no longer necessary; and the Senate recedes.

Amendment No. 6: This is a clarifying amendment expanding the definition of the term "emergency facility" to include any facility which meets the required conditions, as well as land, buildings, machinery, or equipment, in terms of which the definition in the House bill was phrased. This is to make certain that the cost of dry docks, channels, airports, and similar facilities may be amortized. The House recedes.

Amendments Nos. 7, 8, and 9: These amendments substitute January 1, 1940, for July 10, 1940, the date contained in the House bill, as the date (1) after which the construction, reconstruction, erection, or installation of any facility must have been completed or its acquisition have taken place in order that the cost thereof may be subject to amortization, (2) with which the period of national emergency begins during which the facility must have been necessary in the interest of national defense, and (3) in terms of which the portion of the adjusted basis subject to amortization is defined. The House recedes with an amendment fixing June 10, 1940, as such date.

Amendment No. 10: Under the House bill, the certificate entitling the taxpayer to amortization must have been issued before whichever of the following dates was the later: (1) The beginning of the construction, etc., of the facility, or the date of its acquisition, or (2) the sixtieth day after the enactment of the bill. The Senate amendment changed the day specified in (2) to the one hundred and twentieth day after the enactment of the bill. The House recedes.

Amendment No. 11: This amendment substitutes for section 124 (i), (j), and (k) of the House bill a new subsection (i). In general, subsections (i), (j), and (k) of the House bill prohibited the destruction, demolition, etc., of any emergency facility without the consent of the Secretary of War or the Secretary of the Navy, and provided penalties for violations thereof. The substitute provision inserted by the Senate amendment provides that, if the taxpayer has been or will be paid or substantially reimbursed by the Government for all or a part of the cost of any emergency facility pursuant to any Government contract for the construction or acquisition of such facilities, or the purchase of supplies, or otherwise, amortization of the cost of such facility (including any amortization previously taken) will be disallowed unless within 30 days after

making of such contract, or 60 days after the date of the enactment of the bill, whichever of such periods expires the later, the Advisory Commission to the Council of National Defense and either the Secretary of War or the Secretary of the Navy have certified to the Commissioner of Internal Revenue that the contract contains provisions adequately protecting the public interest with respect to the future use and disposition of the facilities. The terms and conditions of such contracts with reference to payment or reimbursement of the cost of such facilities and the protecting of the Government's interest therein shall be made available to the public.

The House recedes with an amendment. Under the conference agreement, reimbursement by the United States must have been either (1) directly, by provision of any contract with the United States dealing expressly with such reimbursement, or (2) indirectly, because the price paid by the United States (in so far as return of cost of the facility is used as a factor in the fixing of such price) is recognized by the contract as including a return of cost greater than the normal exhaustion, wear and tear. In the event of such reimbursement and in the absence of the required certificate, amortization with respect to the facility in question is disallowed, but only for the period following the end of the month in which the contract is made. The time within which the certification that the Government's interest is adequately protected is required to be made has been increased to 90 days after the making of the contract or 120 days after the date of enactment of the bill. It is further provided that a certificate made by the Advisory Commission and either the Secretary of War or the Secretary of the Navy to the Commissioner of Internal Revenue, within 90 days after any contract is made or 120 days after the enactment of the bill, to the effect that, under such contract, reimbursement is not provided for within the meaning of the above provisions, shall be conclusive of such fact for the purposes of this provision.

Under the conference agreement the provision with respect to publicity has been retained.

Amendments Nos. 12, 13, 14, and 15: These are clerical amendments. The House recedes.

Amendments Nos. 16 and 17: The effect of these amendments is to add to the class of contracts or subcontracts relative to which the profit-limiting provisions of the Vinson-Trammell Act are suspended, any contracts or subcontracts which were entered into before the beginning of the contractor's or subcontractor's first taxable year which began in the year 1940 and which are not completed until after the last taxable year to which the excess-profits tax is applicable. The House recedes.

Amendment No. 18: This amendment adds a new section suspending the profit-limiting provisions of the Merchant Marine Act of 1936 as to any subcontract which would otherwise be subject to such Act, if such subcontract was entered into by a corporate contractor with a corporate subcontractor in any taxable year of the subcontractor subject to the excess-profits tax, and if the principal contractor and the subcontractor were not affiliated at the time such subcontract was entered into or at any time thereafter up to and including the date of its completion. The definition of "affiliated" is substantially the same as that contained in section 2704(b)(1) of the Internal Revenue Code, i. e., two or more corporations shall be deemed to be affiliated (1) if one corporation owns at least 95 per cent of the stock of the other or others, or (2) if at least 95 per cent of the stock of two or more corporations is owned by the same interests. For the purposes of such rule the term "stock" is not to include nonvoting stock which is limited and preferred as to dividends. The House recedes.

Amendments Nos. 19 and 20: These are changes in title and certain numbers. The House recedes.

Amendments Nos. 21, 22, 23, and 24:

The House bill provided rules applicable to taxable years beginning after December 31, 1938, for determining the effect on earnings and profits of the sale or other disposition (after February 28, 1913) of property by a corporation or the receipt by it of tax-free distributions. It also provided that such rules should not affect the extent to which accumulated earnings and profits are increased by reason of increase in value of property accrued before March 1, 1913, but realized on or after such date. In order to effect a uniform rule for all prior taxable years, it provided that the stated rules shall be applied for the purpose of the Revenue Act of 1938 or any prior Revenue Act as if such rules were a part of each such Act when it was enacted. The rules apply not only for the purpose of determining when a distribution is a taxable dividend

but also for the purpose of determining accumulated earnings and profits in computing equity invested capital for excess-profits tax purposes.

The Senate amendments rearrange the provisions of the House bill, define earnings and profits, provide a method for determining that part of the earnings and profits consisting of the increase in value of property accrued before March 1, 1913, and, as to prior Acts, provide that the rules for determining earnings and profits shall not affect the tax liability of any taxpayer for a particular year now pending before, or heretofore determined by, the Board of Tax Appeals, or any court of the United States.

The House recedes on amendment No. 23 and with amendments Nos. 21, 22, and 24, which substitute for the Senate provisions two subsections providing as follows:

Subsection (l) provides that the gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation is to be determined for two purposes: (1) The computation of earnings and profits of the corporation as a whole, primarily for invested-capital purposes and (2) the computation of earnings and profits of the corporation for any period beginning after February 28, 1913, for the purpose of determining the character of dividend distributions. In (1) there is used the adjusted basis (under the law applicable to the year in which the sale or other disposition is made) for determining gain, but disregarding value as of March 1, 1913. In (2) there is used such adjusted basis for determining gain, giving effect to the value as of March 1, 1913, whenever applicable. The term "adjusted basis" means adjusted basis specified by the law, for example, see section 113(b) of the Internal Revenue Code, but is subject to the limitations of the third sentence of subsection (l) relative to adjustments proper in determining earnings and profits. The proper adjustments may differ under subsection (l) (1) and (2). Where the operation of subsection (l) results in a loss to be applied in decrease of earnings and profits, such loss may be subject to an adjustment required by subsection (m) (2).

The provisions in the House and Senate bills, that gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent *recognized* in computing net income under the law applicable to the year in which such sale or disposition was made, are retained. As used in this subsection the term "recognized" relates to a realized gain or loss which is recognized pursuant to the provisions of law, for example, see section 112 of the Internal Revenue Code. It does not relate to losses disallowed or not taken into account.

The provision in the House bill and Senate amendment, for cases in which the adjustment, prescribed in section 113, to the basis indicated in paragraph (1) or (2), as the case may be, of subsection (l), differs from the adjustment to such basis proper for the purpose of determining earnings or profits, and the provisions with respect to tax-free distributions, are also retained.

Subsection (m) provides rules for determining, for the purposes of section 115(b) of the Code, that part of the earnings and profits which is represented by increase in value of property accrued prior to March 1, 1913, but realized on or after such date.

Paragraph (1) of subsection (m) sets forth the general rule with respect to computing the increase to be made in that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913. Illustrations of the application of this paragraph are set forth in examples (1) and (4) of the Senate Finance Committee Report No. 2114, pages 25 and 26 [page 547, this Bulletin].

Paragraph (2) of subsection (m) is an exception to the general rule in paragraph (1) of subsection (m) and also operates as a limitation on the application of subsection (l). It provides that, if the application of subsection (l) to a sale or other disposition after February 28, 1913, results in a loss which is to be applied in decrease of earnings and profits for any period beginning after February 28, 1913, then, notwithstanding subsection (l) and in lieu of the rule provided in paragraph (1) of subsection (m), the amount of such loss so to be applied shall be reduced by the amount, if any, by which the adjusted basis of the property used in determining the loss, exceeds the adjusted basis computed without regard to the value of the property on March 1, 1913. If the amount so applied in reduction of the loss exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913. The following examples will show the application of subsection (m) (2):

Example (1). Nondepreciable property was acquired prior to March 1, 1913, at a cost of $8, its value as of March 1, 1913, was $12, and it was sold in 1939 for

$10. Under subsection (1) (2) the adjusted basis would be $12 and there would be a loss of $2. Assuming that such loss is recognized under section 112 of the Internal Revenue Code, the application of subsection (1) (2) would result in a loss from the sale in 1939 to be applied in decrease of earnings and profits for that year. Subsection (m) (2) however, applies and the loss of $2 is reduced by the amount by which the adjusted basis of $12 exceeds the cost of $8, namely, $4. The amount of the loss is, accordingly, reduced from $2 to 0 and there is no decrease in earnings and profits for the year 1939 as the result of the sale. The amount applied in reduction of the decrease, namely, $4, exceeds $2. Accordingly, as a result of the sale the excess of $2 increases that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

Example (2). Nondepreciable property was acquired prior to March 1, 1913, at a cost of $10, its value as of March 1, 1913, was $12, and it was sold in 1939 for $8. Under the subsection (1) (2) the adjusted basis would be $12 and there would be a loss of $4. Assuming that such loss is recognized under section 112 of the Internal Revenue Code, the application of subsection (1) (2) would result in a loss from the sale in 1939 to be applied in decrease of earnings and profits for that year. Subsection (m) (2), however, applies and the loss of $4 is reduced by the amount by which the adjusted basis of $12 exceeds the cost of $10, namely, $2. The amount of the loss is, accordingly, reduced from $4 to $2 and the decrease in earnings and profits for the year 1939 as the result of the sale is $2 instead of $4. The amount applied in reduction of the decrease, namely, $2, does not exceed $4. Accordingly, as the result of the sale there is no increase in that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

The House bill and Senate amendment provided that, in order to effect a uniform rule for all prior years, the stated rules are made applicable to prior Acts, but the Senate amendment added a provision providing that such rules should not affect the tax liability of any taxpayer for any year now pending before, or heretofore determined by, the Board of Tax Appeals, or any court of the United States. The tax liability may be that of the corporation the earnings or profits of which are being determined or the tax liability of a shareholder of such corporation, or of some other taxpayer. These tax liabilities are left to be determined according to such decisions as the Board or courts may make under existing law. As to all matters except such tax liabilities, such stated rules are applicable, and res judicata will not be applicable. The House recedes with an amendment providing that the exception added by the Senate amendment relative to pending or decided cases shall apply only if the tax liability in question was pending before the Board of Tax Appeals or any court of the United States on September 20, 1940, or was determined prior to such date by the Board of Tax Appeals or any court of the United States.

Amendments Nos. 25 to 33, both inclusive: These amendments are changes in section numbers and cross-references. The House recedes on amendments Nos. 25, 28, 29, 30, 31, 32, and 33, and with amendments making further changes in cross-references on amendments Nos. 26 and 27.

Amendment No. 34: This amendment adds at the end of Supplement A of Subchapter C of Chapter 1 of the Internal Revenue Code a new section providing a special rule for the taxation of certain compensation received from the United States for patent infringement. The Senate recedes.

Amendment No. 35: This amendment was inserted by the Senate to carry out the recommendations contained in the President's message of September 14, 1940. Due to the time element, the amendment was written in broad language so that the entire subject matter of such message would be before the conferees for such action as they deemed appropriate to take. As the amendment passed the Senate, it conferred authority on the President (1) to establish a system of allotments and allowances for the dependents of persons serving in the land or naval forces of the United States, (2) to provide a system of insurance for such persons, (3) to provide unemployment allowances for them upon termination of their service, and (4) to preserve and modify their benefit rights under the Social Security Act and the Railroad Retirement Acts. There was no comparable provision in the House bill. The House recedes with an amendment which is divided into two parts.

Part I establishes a new system of insurance, called National Service Life Insurance, for persons in the active service of the land or naval forces (including the Coast Guard) of the United States. Such insurance (1) will be payable

only in the event of death; (2) will carry premium rates based upon the American Experience Table of Mortality and interest at the rate of 3 per centum; (3) will be first issued as 5-year level premium term insurance with the privilege of converting it into ordinary life, 20-payment life, or 30-payment life; (4) will contain provision for waiver of premiums, in the discretion of the Administrator, in the event of the continuous total disability of the insured for six months; (5) will provide that the United States will bear the excess mortality cost and the cost of waiver of premiums on account of total disability, when death or disability is traceable to the extra hazard of military or naval service; (6) will be payable in 240 equal monthly installments if the beneficiary is under 30 years of age, and in 120 equal monthly installments if the beneficiary is 30 years of age or over with payments continuing during the remaining lifetime of such beneficiary; and (7) will provide that unpaid installments remaining at the death of the beneficiary will be paid at the same rate and, unless designated in a different order by the insured, to the persons specified and in the order enumerated in section 602(h)(3) of the amendment.

Persons in the active service may not take out United States Government life insurance after the date of enactment of this Act, but will be limited to National Service Life Insurance as provided in this part. The rights of World War Veterans under existing law with respect to United States Government life insurance is, however, not changed. No person may carry more than $10,000 of National Service Life Insurance nor a combined amount of National Service Life Insurance and United States Government life insurance in excess of $10,000 at any one time. The decision of the Administrator is made final and conclusive on all questions of law and fact, and there is specific provision that such decision shall not be reviewable by any other official or court of the United States, except in the event of suit as provided in section 817. The right to waiver of premiums is the only item which would involve any considerable amount of controversy between the insured or his beneficiaries and the Government, and as the waiver of premiums is an entirely gratuitous feature, it is not believed that suit against the United States to secure such gratuity should be authorized. For this reason section 817 authorizing a suit pursuant to section 19 of the World War Veterans Act specifically makes the decisions of the Administrator as to waiver or nonwaiver of premiums binding on the court.

Part II of the amendment prevents loss of annuity credit under the Railroad Retirement Acts, which occurred by reason of the interruption of service in the railroad industry by military service during periods prior to January 1, 1937, when a Federal Conscription Act was in effect or during periods of war or during periods when members of the National Guard or of other Reserve forces of the United States may have been required by any Act of Congress, or by a call of the President pursuant to such Act, to serve in the armed forces of the United States. In some cases individuals have failed to qualify for annuities because the time they spent in military service during the last World War or in other war periods could not be included in their years of service, and in other cases, although the individuals have qualified for annuities, such annuities were in amounts less than would be the case could such periods of military service have been taken into consideration. To prevent such losses to individuals whose railroad service has been interrupted by military service in such periods as above described, Part II of the amendment provides for the inclusion of such military service, both for eligibility for an annuity and for computing the amount of the annuity. It provides methods for adjudicating again claims which have been adjudicated in the past but in which military service was not considered; and for the adjudication of claims in the future in which military service prior to January 1, 1937, may be a factor. Inasmuch as the additional costs resulting from the payment of benefits under the Railroad Retirement Acts on the basis of military service is not properly chargeable to the railroad industry, provision is made in the amendment for the payment of these costs by specific Government appropriations.

The managers on the part of the House desire to state that they agree with the managers on the part of the Senate that all of the proposals contained in Senate amendment numbered 35 should be given prompt and careful consideration. Inherent in those proposals, however, are broad and important problems of public policy which need intensive study and investigation before intelligent decisions may be reached with respect thereto. It is hoped that a comprehensive study of the subject matter contained in the President's message of September 14, 1940, be made as soon as practicable to the end that the proposals contained therein may be enacted into law with all reasonable dispatch.

Amendment No. 36: This amendment is intended to permit credit against the Federal unemployment tax for the calendar year 1936, 1937, 1938, or 1939, on employers of eight or more employees, for contributions paid by the employer before the sixtieth day after the date of enactment of this Act into an unemployment fund under a State law. If the employer has paid the Federal tax without the benefit of the credit, a refund based on the credit would be permitted. With certain limited exceptions, the time has expired under existing law for paying contributions upon which credit against the tax for such years may be based. The House recedes with an amendment allowing the same extension of time as is provided in the Senate amendment, permitting credit against the tax for the same years, and providing for refunds based on the credit. However, in the case of the tax for 1939 and subsequent years, the provisions of existing law contained in section 1601(a)(3) of the Federal Unemployment Tax Act limit the amount of credit, on account of contributions paid after the due date of the Federal return of the tax against which credit is taken but before July 1 next following such due date, to 90 per cent of the amount which would have been allowable as credit on account of such contributions if they had been paid on or before the due date. The conference agreement retains that limitation on the credit against the tax for 1939 with respect to contributions paid before the sixtieth day after the date of enactment of this Act. No similar limitation is provided with respect to the tax for prior years. In addition to certain clarifying changes from the Senate amendment, the conference agreement permits credit for contributions paid, without regard to the date of payment, if the assets of the taxpayer are at any time during the 59-day period following the date of enactment of this Act, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction.

Amendment No. 37: This amendment adds a new title, entitled "War-Profits Tax," imposing increased income and excess-profits taxes in the event of war. The Senate recedes.

R. L. DOUGHTON,
THOMAS H. CULLEN,
JOHN W. MCCORMACK,
JERE COOPER,
ALLEN T. TREADWAY,
FRANK CROWTHER,
HAROLD KNUTSON,
Managers on the part of the House.

1940–29–10335

THE REVENUE BILL OF 1940.

[House of Representatives Report No. 2491, Seventy-sixth Congress, Third Session.]

[June 10, 1940.]

Mr. Doughton, from the Committee on Ways and Means, submitted the following report [to accompany H. R. 10039]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 10039) to provide for the expenses of national preparedness by raising revenue and issuing bonds, to provide a method for paying for such bonds, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

NEED FOR THE LEGISLATION.

There is a growing concern regarding the state of our national defense. Recent developments in the European war have reminded us forcefully of the inadequacy of our means of defense against modern weapons of aggression. This need has been pointed out by the President upon several occasions; particularly, in his message to the Congress of May 16, 1940.

In this message, and in other requests, the President has requested defense funds for the fiscal year 1941 totaling $3,250,000,000. This sum includes the amounts carried in the Budget for 1941, and the supplementary requests made since January 3, 1940, the date of the Budget message.

As outlined in the President's message of May 16, 1940, the four primary purposes for which the additional appropriations are to be used, are—

First. To procure the essential equipment of all kinds for a larger and thoroughly rounded-out Army;

Second. To replace or modernize all old Army and Navy equipment with the latest type of equipment;

Third. To increase production facilities for everything needed for the Army and Navy for national defense. We require the ability to turn out quickly infinitely greater supplies;

Fourth. To speed up to a 24-hour basis all new contracts to be awarded.

The urgent need for the speedy and effective undertaking and completion of this program can not be doubted.

THE FISCAL SITUATION.

The working balance of the Treasury is at present about $1,300,000,000. The gross public debt is $42,787,000,000, and the face amount of obligations which the Secretary of the Treasury may issue under the limitation of $45,000,000,000 specified in section 21 of the Second Liberty Bond Act, as amended, is $1,973,000,000.

The present deficit will be $260,000,000 less on June 30, 1940, than was estimated on January 1, 1940. The national defense expenditures, including public works for the Army and Navy, were estimated in the Budget submitted to Congress last January at $1,940,000,000 and they are now estimated on the basis of the program submitted to the Congress up to and including June 10 at $3,250,000,000.

These greatly increased necessary expenditures for national defense would, thus, result in the large deficit indicated, except for this tax bill which is designed to raise the revenue to pay for the national defense program.

From these estimates it will be seen that it is highly desirable that Congress take some action at this session to provide the Treasury with the additional taxes levied in the bill and to provide it with the additional borrowing power set forth therein. This will give the Treasury that flexibility in its financing which is so necessary for the effective management of the public finances in times like these and thus obviate the payment of higher interest rates.

THE FISCAL PROGRAM.

Section 21 of the Second Liberty Bond Act, as amended, provides that the face amount of bonds, certificates of indebtedness, Treasury bills and notes issued under that Act, as amended, shall not exceed $45,000,000,000 outstanding at any one time. Section 302 of the bill amends this provision to permit the Treasury to issue, within the framework of current statutes relating to the public debt, $4,000,000,000 of short-term public-debt obligations with maturities not exceeding five years, to be designated "National Defense Series." These obligations will be in addition to the $45,000,000,000 face amount of securities authorized under existing law.

The tax increases provided under the bill are estimated to yield additional revenue of approximately $1,004,000,000 for each full year of operation. The increased taxes may be divided into two categories. Those contained in Title I are permanent in nature and will yield about $322,000,000 annually. Those contained in Title II are temporary in nature, being applicable only for the 5-year period, 1940–1945, and will yield about $682,000,000, annually.

The increased revenue attributable to Title II, with certain minor exceptions, will be placed in a special fund which shall be available only for the retirement of the "National Defense Series" obligations. Because of the difficulty of segregating the additional revenue attributable to the permanent increases contained in Title I, this amount can not be earmarked for this special purpose. However, the total additional revenue attributable to both Titles I and II is intended to insure the retirement of these special obligations issued during the 5-year period for which the temporary taxes are to be effective.

STUDIES OF EXCESS-PROFITS TAXES AND SPECIAL AMORTIZATION.

During the executive sessions, there have been discussed proposals to provide special amortization for national defense industries and to provide for the imposition of excess-profits taxes. These two measures—each in itself requiring a complicated and exhaustive legislative project—must be consid-

ered together. It is the desire of this committee, which is favorably reporting a bill which will enable a larger proportion of our citizens to participate in the responsibility of providing an adequate national defense than has ever been the case before, that there shall not be an opportunity for the creation of new war millionaires or the further substantial enrichment of already wealthy persons because of the rearmament program. Accordingly we have instructed our technical assistants and the appropriate Treasury officials to accelerate their work in these two fields so that bills will be prepared for submission not later than the opening of the next session of Congress, which if passed by the Congress may become retroactive and apply to income earned during the calendar year of 1940, or may become effective upon any other date which Congress, in the light of information it then possesses, may deem advisable.

REVENUE ESTIMATES.

The following table, prepared by the Treasury Department, shows the additional revenue under the taxing provisions of the bill:

Estimated additional revenue [1] *attributable to the proposed Revenue Act of 1940.*[2]

Source of revenue.		*Millions of dollars.*	
Title I:			
Income tax—			
Corporation income tax		70	
Individual income tax		252	
Total increase, Title I			322
Title II:			
Corporation super income tax		135	
Individual super income tax		123	
Capital stock and excess-profits taxes		12	
Estate tax		29	
Gift tax		3	
Alcoholic beverage taxes—			
Distilled spirits	76		
Fermented malt liquors	46		
Other	3		
Total increase, alcoholic beverage taxes		125	
Tobacco taxes:			
Cigarettes	67		
Other	12		
Total increase, tobacco taxes		79	
Stamp taxes		7	
Manufacturers' excise taxes:			
Gasoline	112		
Other	30		
Total increase, manufacturers' excise taxes		142	
Miscellaneous taxes		27	
Total increase, Title II			682
Total increase, Titles I and II			1,004

Treasury Department, Division of Research and Statistics, June 10, 1940.

[1] Excluding (*a*) the nonrecurring collections of floor taxes on alcoholic beverages and tobacco, estimated for fiscal year 1941 at $26,000,000, and (*b*) revenues resulting from the extension of certain excise taxes as provided in Title II "SEC. 209. Continuation of Excise Taxes," but including the super-tax on such excise taxes.

[2] As introduced by Mr. Doughton, June 10, 1940.

SUMMARY OF CHANGES IN TAX STRUCTURE.

TITLE I—PERMANENT CHANGES.

These changes apply to income taxes for taxable years beginning after December 31, 1939. They are, therefore, applicable to 1940 incomes.

(1) The personal exemptions allowed individuals for income tax purposes under the existing law have been reduced from $2,500 to $2,000 in the case

of married persons and heads of families and from $1,000 to $800 in the case of single persons. The bill does not affect the $400 credit for dependents allowed under existing law. This credit is allowed if the dependent receives his chief support from the taxpayer and is under 18 years of age or incapable of self-support because mentally or physically defective.

(2) The surtaxes are increased on surtax net incomes in excess of $6,000 and the increases continue up to surtax net incomes not in excess of $100,000, and from that point the rates of existing law are retained. Under the present law, the rate on surtax net incomes in excess of $100,000 and not in excess of $150,000 is 58 per cent. While the rates applicable to surtax net incomes in excess of $100,000 are not increased, the surtaxes payable by taxpayers in these upper brackets are increased by reason of the higher rates in the lower brackets.

(3) The requirement as to filing income tax returns in the case of individuals has been changed. Under the existing law, an individual is required to file a return if his net income amounts to $1,000 or more in the case of a single person, or $2,500 or more in the case of a married person, and in either case if his gross income is $5,000 or more. The bill requires a return from a single person if his gross income is $800 or more and from married persons if either their aggregate or separate gross income is $2,000 or more.

(4) Nonresident aliens: Under existing law, a nonresident alien individual not engaged in business within the United States or not having an office or place of business therein, is taxed only upon dividends, interest, or other fixed or determinable annual or periodical income at the rate of 10 per cent. This rate may be reduced to 5 per cent in the case of a resident of a contiguous country if so provided by treaty. Subject to treaty provisions with foreign countries, the 10 per cent rate has been increased to 15 per cent, which corresponds to the proportionate increase in burden imposed upon American citizens and residents by the increases in income and excise taxes under the bill. Under existing law, if such a nonresident alien individual has a gross income of more than $21,600, which is the level at which the average effective rate equals 10 per cent, he is subject to the full normal and sur tax on his fixed or determinable annual or periodical income. The bill raises this level to $24,000 which, under the increased rates, is the point which equals an effective rate of approximately 15 per cent. Nonresident aliens engaged in business in the United States or having an office or place of business therein are subject to the same rates as apply to American citizens with respect to income from United States sources. They will, therefore, be subject to the increase in tax applicable to American citizens.

CORPORATIONS.

(1) *Domestic corporations.*—Your committee increased the rate of tax on corporations by 1 per cent. In view of the increase in the tax burden imposed upon individuals under the bill, it was believed that corporations should bear some part of the increased burden.

The rates under the proposed bill and under the existing law are as follows:

Normal tax net incomes.	Existing law.	Bill.
	Per cent.	*Per cent.*
Not in excess of $5,000	12½	13½
In excess of $5,000 and not in excess of $20,000	14	15
In excess of $20,000 and not in excess of $25,000	16	17
In excess of $25,000	18	19

(2) *Foreign corporations.*—Since the tax on domestic corporations is increased, your committee also deemed it advisable to make the same proportionate increase in the tax on foreign corporations deriving income from American sources. Under existing law, foreign corporations having an office or place of business in the United States are subject to a flat rate of 18 per cent. This has been increased under the bill to 19 per cent. Foreign corporations not engaged in trade or business within the United States or not having an office or place of business therein are taxable only upon their dividends, interest, or other fixed or deter-

minable periodical or annual income, and they are subject to a tax of 15 per cent on such income. In the case of dividends, the rate is 10 per cent unless received by a corporation organized under the laws of a contiguous country, in which case the rate may by treaty be reduced to not less than 5 per cent. The rate of 15 per cent is increased under the bill to 16 per cent and the rate of 10 per cent is increased to 11 per cent. No increase in taxes will apply where its application will be contrary to any treaty obligation of the United States.

TITLE II.—TEMPORARY CHANGES.

The bill makes certain temporary increases in the internal-revenue laws for a period of five years. These changes are briefly as follows:

(1) INCOME TAX.

For taxable years beginning after December 31, 1939, and before January 1, 1945, the tax computed in accordance with the changes made in Title I of the bill is increased by 10 per cent thereof. To prevent the rate in the higher brackets from being confiscatory, a cushion is inserted which prevents such increase from being greater than 10 per cent of the net income in excess of the tax computed under existing law, as amended by Title I. This cushion begins to operate where the tax so computed is in excess of 50 per cent of the net income, which in the case of a married person is around $200,000. The following examples will show the result of the operation of the tax and the cushion:

Net income.	Tax under existing law as amended by Title I.	Supertax.	Net income.	Tax under existing law as amended by Title I.	Supertax.
$3,000	$28	$2.80	$100,000	$39,524	$3,952.40
$5,000	100	10.00	$300,000	169,364	13,063.60
$10,000	480	48.00	$1,000,000	686,204	31,379.60

It will be seen from the above examples that in the case of a married man without dependents with $5,000 net income, the supertax is determined by increasing the ordinary tax of $100 by 10 per cent, or $10, making a total tax of $110. The cushion will not operate in this case because the ordinary tax is not in excess of 50 per cent of the net income. In the case of a married man with $300,000 net income the 10 per cent supertax if applied without the cushion, would amount to $16,936.40, but since the ordinary tax is in excess of 50 per cent of the net income the cushion applies. Accordingly, the supertax in this last example is computed by applying the 10 per cent against $130,636 (the amount of the net income less ordinary tax) instead of against the tax of $169,364. This makes the supertax $13,063.60 instead of $16,936.40.

(2) EXCESS-PROFITS TAX.

The amount of the excess-profits tax payable for any taxable year ending after June 30, 1940, and before July 1, 1945, is increased by 10 per cent. Thus, a corporation with an excess-profits tax year ending July 31, 1940, will be subject to the 10 per cent increase. If the excess-profits tax payable is $1,000, the supertax will be $100, and the corporation will pay a total excess-profits tax of $1,100.

(3) CAPITAL STOCK TAX.

The capital stock tax is increased for the year ending June 30, 1940, and for the four succeeding years ending June 30, from $1 per thousand of adjusted declared value to $1.10 per thousand of adjusted declared value.

(4) ESTATE TAX.

In the case of a decedent dying after the enactment of this bill and before the expiration of five years after such date, the estate tax payable (after application of the credits provided for State death taxes and Federal gift taxes), is increased by 10 per cent.

(5) GIFT TAX.

The gift tax is also increased by .10 per cent, effective for the calendar year 1940 and subsequent calendar years up to and including the calendar year 1945.

For the calendar year 1940, the increase is in effect applied only to gifts made after the date of the enactment of this bill. This is accomplished by determining the gift tax for the entire year at the existing rates and adding thereto an amount which bears the same ratio to 10 per cent of the tax so computed as the amount of gifts made after the enactment of the bill bears to the total amount of gifts made during the year.

(6) TRANSFERS TO AVOID INCOME TAX.

Under the existing law, an excise is imposed upon the transfer of stock or securities by a citizen or resident of the United States, or by a domestic corporation or partnership, or by a trust which is not a foreign trust, to a foreign corporation, as paid-in surplus or as a contribution to capital. The rate under existing law is 25 per cent and this has been increased to 27½ per cent in the case of any transfer made during the period after the date of the enactment of this bill and before July 1, 1945.

(7) TOBACCO TAXES.

The bill makes the following changes in the taxes on tobacco and tobacco products:

Tobacco, snuff, cigars, and cigarettes.

Description of tax.	Old rate.	New rate.	Percentage of increase.
Snuff and snuff flour	18 cents	21 cents	16⅔
Tobacco, except chewing tobacco	do	do	16⅔
Cigars	75 cents	87½ cents	16⅔
Do	$2	$2.33⅓	16⅔
Do	$3	$3.50	16⅔
Do	$5	$5.83⅓	16⅔
Do	$10.50	$12.25	15⅐
Do	$13.50	$15.75	16⅔
Cigarettes	$3	$3.50	16⅔
Do	$7.20	$8.40	16⅔
Cigarette paper	½ cent	7/12 cent	16⅔
Do	1 cent	1⅙ cents	16⅔

A floor stocks tax is imposed upon all the products listed above to which the increased rates apply, with the exception of cigarette papers. This tax is equal to the difference between the old rate and the new rate and is imposed with respect to such products held by any person for sale otherwise than in retail stock. The tax on chewing tobacco was not increased, due to the declining consumption of this product and the small amount of revenue involved.

DISTILLED SPIRITS.

Your committee increased the taxes on distilled spirits at the following rates:

Distilled spirits.	Old rates.	New rates.	Percentage of increase.
Distilled spirits generally	$2.25	$3.00	33⅓
Brandy	2.00	2.75	37½
Imported perfumes	2.25	3.00	33⅓

Floor stocks taxes are imposed upon distilled spirits which on July 1, 1940, are held by any person and intended for sale or for use in the manufacture and production of any article intended for sale. The rate is 75 cents, which is the increased rate imposed upon liquor. An exemption of 100 gallons is allowed in the case of a retailer. Your committee did not increase the tax on rectified spirits which are also subject to increased tax on distilled spirits.

BEER.

Your committee increased the tax on fermented liquors from $5 a barrel to $6 a barrel, effective July 1, 1940. This amounts to a 20 per cent increase in the rate of tax. In addition, a floor stocks tax is imposed upon stocks held by manufacturers or wholesalers at the rate of $1 per barrel.

WINES.

The taxes on wines were increased at the following rates:

	Old rate.	New rate.	Percentage of increase.
	Cents.	*Cents.*	*Per cent.*
Still wines	5	6	20
Do	10	12	20
Do	20	24	20
Sparkling wines	2½	3	20
Do	1¼	1½	20
Fortification of wines	10	12	20

ADMISSIONS TAXES.

Under existing law, an admissions tax of 10 per cent is imposed except where the amount paid for admission is less than 41 cents. Instead of raising the rate of tax, your committee deemed it much simpler and more feasible from an administrative point of view to decrease the exemption from 40 to 30 cents.

OTHER MISCELLANEOUS TAXES.

The following table shows the increases in other miscellaneous taxes:

Description of tax.	Old rate.	New rate.	Percentage of increase.
Box seats	10 per cent	11 per cent	10
Sales outside of box office	do	do	10
Cabarets, roof gardens, etc	1½ cents	2 cents	33⅓
Club dues	10 per cent	11 per cent	10
Corporate securities	10 cents	11 cents	10
Capital stock	do	do	10
Do	2 cents	3 cents	50
Do	4 cents	5 cents	25
Do	5 cents	6 cents	20
Insurance policies	3 cents	4 cents	33⅓
Passage tickets	$1	$1.10	10
Do	$3	$3.30	10
Do	$5	$5.50	10
Safe-deposit boxes	10 per cent	11 per cent	10
Pistols and revolvers	do	do	10
Wholesalers in liquor	$100	$110	10
Retailers in liquor	$25	$27.50	10
Brewers (more than 500 barrels)	$100	$110	10
Brewers (less than 500 barrels)	$50	$55	10
Wholesalers in malt liquors	do	do	10
Retailers in malt liquors	$20	$22	10
Special cases	$2	$2.20	10
Rectifiers	$200	$220	10
Do	$100	$110	10
Stills	$50	$55	10
Do	$20	$22	10
Tires	2¼ cents	2½ cents	11
Tubes	4 cents	4½ cents	12½
Toilet preparations	10 per cent	11 per cent	10
Automobiles	2 per cent	2½ per cent	25
Other automobiles	3 per cent	3½ per cent	16⅔
Auto parts	2 per cent	2½ per cent	25
Radios	5 per cent	5½ per cent	10
Mechanical refrigerators	do	do	10
Firearms	10 per cent	11 per cent	10
Matches	5 cents	5½ cents	10
Electrical energy	3 per cent	3⅓ per cent	11⅑
Gasoline	1 cent	1½ cents	50
Lubricating oils	4 cents	4½ cents	12½
Transportation of oil by pipe line	4 per cent	4½ per cent	12½
Transfers of bonds	4 cents	5 cents	25
Conveyances	50 cents	55 cents	10
Playing cards	10 cents	11 cents	10

CONTINUATION OF TEMPORARY EXCISE TAXES.

The bill also provides for the continuation of the temporary import and excise taxes which either expire or have their rates reduced in 1941. Under the bill these taxes will not expire or have their rates reduced until 1945.

TAXES NOT INCREASED.

(1) No increase is provided in the case of certain taxes of a regulatory nature, such as the taxes on white phosphorus matches, mixed flour, filled cheese, narcotics, sugar, bituminous coal, and certain types of firearms. Likewise, the bill does not increase certain excise taxes on imports such as those levied with respect to coal, lumber, copper, petroleum products, and certain vegetable oils. The revenue from these taxes is small, and since they are designed for a particular function which an increase in their rates might impair, your committee feel they should not be increased and some of them are affected by reciprocal trade agreements.

(2) The bill makes no changes in the taxes levied under the social security program. These taxes are directed to a special purpose and it is not felt that they should be increased for the defense program.

(3) In the case of the taxes on communication facilities (telephone, telegraph, radio and cable), severe administrative difficulties convince your committee of the inadvisability of increase in rates.

DISCUSSION OF PRINCIPAL INCOME TAX CHANGES.

(*a*) *Lowering of personal exemptions.*—Title I of the bill lowers the personal exemption from $1,000 to $800 in the case of single persons and from $2,500 to $2,000 in the case of married persons or heads of families. This will make approximately 2,190,000 new taxpayers. Of the additional revenue to be derived from this source approximately $14,000,000 will be derived from new taxpayers. This is a permanent change and first goes into effect with respect to taxable years beginning after December 31, 1939.

(*b*) Title I of the bill also increases permanently the surtax rates with respect to taxable years beginning after December 31, 1939. The normal tax rate, which is 4 per cent under existing law, is not changed in the bill. The following table shows the surtax rates under the existing law and under the bill:

TABLE I.—*Comparison of surtax rates, existing law, and proposed bill.*

Amount of surtax net income.		Existing law rate.	Proposed bill rate.	Amount of rate increase.
Exceeding.	Not exceeding.			
		Per cent.	*Per cent.*	*Per cent.*
$4,000	$6,000	4	4	0
6,000	8,000	5	6	1
8,000	10,000	6	8	2
10,000	12,000	7	10	3
12,000	14,000	8	12	4
14,000	16,000	9	15	6
16,000	18,000	11	18	7
18,000	20,000	13	21	8
20,000	22,000	15	24	9
22,000	26,000	17	27	10
26,000	32,000	19	30	11
32,000	38,000	21	33	12
38,000	44,000	24	36	12
44,000	50,000	27	40	13
50,000	56,000	31	44	13
56,000	60,000	35	44	9
60,000	62,000	35	47	12
62,000	68,000	39	47	8
68,000	70,000	43	47	4
70,000	74,000	43	50	7
74,000	80,000	47	50	3
80,000	90,000	51	53	2
90,000	100,000	55	56	1
100,000	150,000	58	58	0
150,000	200,000	60	60	0
200,000	250,000	62	62	0
250,000	300,000	64	64	0
300,000	400,000	66	66	0
400,000	500,000	68	68	0
500,000	750,000	70	70	0
750,000	1,000,000	72	72	0
1,000,000	2,000,000	73	73	0
2,000,000	5,000,000	74	74	0
5,000,000 and up	----------	75	75	0

(c) *Total income-tax burden.*—(1) Permanent increases: In order to secure a complete picture of the total income tax burden, the following tables are included with respect to a married man with no dependents. Table II shows the increased normal and surtax rates on a married man with no dependents under existing law and under the bill. While there is no change in the normal tax rate over that of existing law, the normal tax itself is increased by reason of the lowering of the exemptions to $800 for single persons and to $2,000 for married persons.

TABLE II.—*Comparison of normal tax and surtax, existing law and proposed bill, married person, no dependents, all income earned.*

Net income.	Normal tax.		Surtax.		Surtax increase.
	Present law.	Proposed bill.	Present law.	Proposed bill.	
$2,000	0	0	0	0	0
$2,500	0	$10	0	0	0
$3,000	$8	28	0	0	0
$4,000	44	64	0	0	0
$5,000	80	100	0	0	0
$6,000	116	136	0	0	0
$7,000	152	172	$20	$40	$20
$8,000	188	208	60	80	20
$9,000	224	244	105	140	35
$10,000	260	280	155	200	45
$11,000	296	316	210	280	70
$12,000	332	352	270	360	90
$13,000	368	388	335	460	125
$14,000	404	424	405	560	155
$15,000	444	464	480	680	200
$20,000	644	664	945	1,460	515
$25,000	844	864	1,645	2,630	985
$30,000	1,044	1,064	2,525	4,040	1,515
$40,000	1,444	1,464	4,535	7,220	2,685
$50,000	1,844	1,864	7,025	10,980	3,955
$60,000	2,244	2,264	10,085	15,300	5,215
$70,000	2,644	2,664	13,805	19,940	6,135
$80,000	3,044	3,064	18,225	24,880	6,655
$90,000	3,444	3,464	23,225	30,120	6,895
$100,000	3,844	3,864	28,625	35,660	7,035
$150,000	5,844	5,864	57,550	64,620	7,070
$200,000	7,844	7,864	87,500	94,580	7,080
$250,000	9,844	9,864	118,450	125,540	7,090
$300,000	11,844	11,864	150,400	157,500	7,100
$400,000	15,844	15,864	216,350	223,460	7,110
$500,000	19,844	19,864	284,300	291,420	7,120
$750,000	29,844	29,864	459,250	466,380	7,130
$1,000,000	39,844	39,864	639,200	646,340	7,140
$2,000,000	79,844	79,864	1,369,175	1,376,320	7,145
$5,000,000	199,844	199,864	3,589,150	3,596,300	7,150

It will be noted that a married person with a net income of $2,500 pays no tax under existing law. However, under the bill he will pay a normal tax of $10 for each taxable year beginning after December 31, 1939. The same person with a net income of $3,000 will pay for each such taxable year a normal tax of $28. No surtax is imposed either under the bill or under the existing law until the net income of a married man exceeds $6,500 under the present law and $6,000 under the bill. In the case of a single person, no surtax is imposed until the net income exceeds $5,000 under the present law and $4,800 under the bill. The largest increase in the surtax rate over existing law is with respect to married persons with net incomes between $46,000 and $58,000, where the rate is increased 13 per cent. In the case of a single person, the largest increase is with respect to net incomes from $45,000 to $57,000, where the rate is also increased 13 per cent.

(2) Temporary increase: In addition to the permanent increases caused by the change in the exemptions and the surtax rates, Title II of the bill imposes a 10 per cent supertax with respect to taxable years beginning after December 31, 1939, and before January 1, 1945. This is shown in the following table:

TABLE III.—*Comparison of total tax burden, existing law and proposed bill, married person, no dependents, all income earned.*

Net income.	Present law.	Proposed bill excluding super-tax.	Super-tax.	Proposed bill including super-tax.	Effective rate in per cent.		
					Present law.	Proposed bill.	
						Without super-tax.	With super-tax.
$2,000							
$2,500		$10	$1.00	$11.00		0.40	0.44
$3,000	$8	28	2.80	30.80	0.27	.93	1.03
$4,000	44	64	6.40	70.40	1.10	1.60	1.76
$5,000	80	100	10.00	110.00	1.60	2.00	2.20
$6,000	116	136	13.60	149.60	1.93	2.27	2.49
$7,000	172	212	21.20	233.20	2.46	3.03	3.33
$8,000	248	288	28.80	316.80	3.10	3.60	3.96
$9,000	329	384	38.40	422.40	3.66	4.27	4.69
$10,000	415	480	48.00	528.00	4.15	4.80	5.28
$11,000	506	596	59.60	655.60	4.60	5.42	5.96
$12,000	602	712	71.20	783.20	5.02	5.93	6.53
$13,000	703	848	84.80	932.80	5.41	6.52	7.18
$14,000	809	984	98.40	1,082.40	5.78	7.03	7.73
$15,000	924	1,144	114.40	1,258.40	6.16	7.63	8.39
$20,000	1,589	2,124	212.40	2,336.40	7.95	10.62	11.68
$25,000	2,489	3,494	349.40	3,843.40	9.96	13.98	15.37
$30,000	3,569	5,104	510.40	5,614.40	11.90	17.01	18.71
$40,000	5,979	8,684	868.40	9,552.40	14.95	21.71	23.88
$50,000	8,869	12,844	1,284.40	14,128.40	17.74	25.69	28.26
$60,000	12,329	17,564	1,756.40	19,320.40	20.55	29.27	32.20
$70,000	16,449	22,604	2,260.40	24,864.40	23.50	32.29	35.52
$80,000	21,269	27,944	2,794.40	30,738.40	26.59	34.93	38.42
$90,000	26,669	33,584	3,358.40	36,942.40	29.63	37.32	41.05
$100,000	32,469	39,524	3,952.40	43,476.40	32.47	39.52	43.48
$150,000	63,394	70,484	7,048.40	77,532.40	42.26	46.99	51.69
$200,000	95,344	102,444	9,755.60	112,199.60	47.67	51.22	56.10
$250,000	128,294	135,404	11,459.60	146,863.60	51.32	54.16	58.75
$300,000	162,244	169,364	13,063.60	182,427.60	54.08	56.45	60.81
$400,000	232,194	239,324	16,061.60	255,391.60	58.05	59.83	63.85
$500,000	304,144	311,284	18,871.60	330,155.60	60.83	62.26	66.03
$750,000	489,094	496,244	25,375.60	521,619.60	65.21	66.17	69.55
$1,000,000	679,044	686,204	31,379.60	717,583.60	67.90	68.62	71.76
$2,000,000	1,449,019	1,456,184	54,381.60	1,510,565.60	72.45	72.81	75.53
$5,000,000	3,788,994	3,796,164	120,383.60	3,916,547.60	75.78	75.92	78.33

From the above table it will be noted a married man, without dependents, having a net income of $20,000 will pay in permanent taxes $2,124, an increase of $535 over existing law, and in addition he will pay a super-tax, under Title II of the bill, of $212.40 for five years, making a total annual tax for such 5-year period of $2,336.40 or 11.68 per cent of his net income as against 7.95 per cent under existing law. One with $50,000 net income will pay $12,844 in permanent tax, and $1,284.40 super-tax, making a total of $14.128.40 as against $8,869 under existing law, or 28.26 per cent of his net income as against 17.74 per cent under existing law.

(*d*) *Requirement for filing individual income tax returns.*—Under existing law, an individual, if single, is not required to file an income tax return unless his gross income is $5,000 or more or his net income is $1,000 or more. In the case of a married individual, no return is required under existing laws unless his gross income is $5,000 or more, or the net income is $2,500 or more. A return is also required if such individual and his spouse each has a gross income and the aggregate gross income is $5,000 or more. The bill requires a return from a single individual if his gross income is $800 or more and from a married individual if (1) such individual has a gross income of $2,000 or more and the other spouse has no gross income or (2) if such individual and his spouse each has for the taxable year a gross income and the aggregate gross income is $2,000 or over. Many persons have failed to file returns upon the assumption that their income was insufficient, when, in fact, they were liable for the filing of a return and the payment of a tax. This change will require approximately 8,000,000

additional returns, and it is believed will result in the collection of substantial additional taxes. It is estimated that under existing law approximately 7,500,000 individual returns are filed.

ANALYSIS OF BILL BY SECTIONS.

TITLE I.

This title contains permanent amendments to the Internal Revenue Code.

SECTION 1. SHORT TITLE.

This section provides that the Act may be cited as the Revenue Act of 1940.

SECTION 2. SURTAX ON INDIVIDUALS.

This section increases the surtax rates on taxpayers other than corporations. This surtax schedule has been discussed in a previous portion of the report. The increase is effective in the case of taxable years beginning after December 31, 1939.

SECTION 3. CORPORATION TAX.

The rates of income tax on corporations are increased 1 per centum effective with respect to taxable years beginning after December 31, 1939. This section makes the specific rates named in existing law 1 per centum larger regardless of the character of the corporation, whether large or small, or whether of a special class or of a general class. The effect of existing law, together with the amendment, is to subject to the 1 per centum increase corporations, such as banks and insurance companies, whose rate of tax under existing law is the same as the rate on corporations in general.

SECTION 4. NONRESIDENT ALIEN INDIVIDUALS.

This section increases the rate of income tax upon nonresident alien individuals not engaged in trade or business within the United States and not having an office or place of business therein from 10 per centum to 15 per centum, such individuals being taxed under existing law on their receipts from fixed and determinable income from United States sources, such as interest, rents, dividends, royalties, etc.

This section also, in view of this increased rate, makes an adjustment in the figure of $21,600 in existing law, which is the point at which a nonresident alien individual is exempted from the flat 10 per centum tax provided for in existing law and is subjected to tax at normal and sur tax rates on the same items of income as above mentioned. Twenty-one thousand six hundred dollars is changed to $24,000, and the section also increases from 10 per centum to 15 per centum the minimum rate of tax payable by an individual having gross income of such amount.

SECTION 5. WITHHOLDING OF TAX AT SOURCE.

Existing law provides for various rates at which taxes may be withheld at the source in the case of nonresident aliens and foreign corporations. These rates are increased by this section to correspond with the increased rates of tax imposed by other sections of the bill. The new withholding rates are to take effect on June 26, 1940.

SECTION 6. PERSONAL EXEMPTIONS.

This section broadens the base for the imposition of the income tax by lowering the personal exemption of married persons from $2,500 to $2,000, and the personal exemption of single persons from $1,000 to $800. The section also reduces to $800 the personal exemption of nonresident alien individuals, which under existing law is a flat $1,000 regardless of marital status. A similar change is made, in this section, in the case of United States citizens doing business in any possession of the United States.

SECTION 7. RETURNS OF INCOME TAX.

Under existing law, the requirement of filing a return in the case of individuals is based upon the amount of the net income equal to or in excess of the personal exemption, or a gross income of $5,000 or over. This section abandons the net-income test as the basis for the requirement of a return and

substitutes a test of gross income equal to or in excess of the personal exemption. Thus, a return is required from an individual who is single or married and not living with husband or wife if his gross income is $800 or over, and from a married individual living with husband or wife if having a gross income of $2,000 or over if the other spouse has no gross income, or having a gross income together with the spouse of $2,000 or over.

A similar change has been made with respect to fiduciary returns.

This section also reduces from $1,000 to $800 the amount of payments to individuals which requires an information return from the payor of the income.

SECTION 8. CIGARETTE PAPERS.

This section amends section 2000(d) of the Internal Revenue Code to remove the present exemption of packages and books containing 25 papers or less from the existing tax on cigarette papers in packages or books. Packages and books containing 25 papers or less will thus be subject to the tax in the same manner as those containing more than 25 and not more than 50 papers. The amendment made by this section is effective July 1, 1940.

SECTION 9. TREATY OBLIGATIONS.

This section provides that none of the amendments made by this title of the bill shall apply in any case so as to be contrary to any treaty obligation of the United States.

SECTION 10. TAXABLE YEARS TO WHICH TITLE APPLICABLE.

This section provides that the amendments made by this title shall be applicable only with respect to taxable years beginning after December 31, 1939, but an exception is made of the amendments made by section 5, relating to the rates of withholding of tax at the source, which, as has already been pointed out, is effective June 26, 1940, and section 8, relating to the tax on cigarette papers, which is effective July 1, 1940.

TITLE II.

This title contains temporary provisions increasing rates of tax in general for a period of five years, and imposes necessary floor stocks taxes to complement the increases in certain excise taxes. All these provisions, except as specifically pointed out hereinafter, are effective July 1, 1940, to continue until July 1, 1945.

SECTION 201. SUPER-TAX ON INCOMES.

This section adds a new section 15 to Chapter 1 of the Internal Revenue Code providing that for taxable years beginning after December 31, 1939, and before January 1, 1945, each taxpayer's tax (after applying the amendments made in Title I of the bill) shall be increased by 10 per centum of the amount thereof. For the purposes of this 10 per centum increase, the tax which is to be increased is computed before the application of the foreign tax credit and the credit for taxes withheld at source. Suppose, for example, that the net income of the corporate taxpayer is $100,000, of which $60,000 is attributable to a foreign country, to which a tax of $25,000 has been paid. Under existing law the United States tax before applying the credit is $18,000, and the credit is that proportion of $18,000 which $60,000 bears to $100,000, or three-fifths, or $10,800, thus making the tax payable $7,200.

Under the bill the tax will be computed as follows:

Net income	$100,000
Tax (computed without section 15)	19,000
10 per cent increase	1,900
Total	20,900
Foreign tax credit three-fifths of $20,900	12,540
Tax payable under bill	8,360

This section also provides, however, that in no case shall the effect of the section be to increase by more than 10 per centum the amount by which the net income exceeds the tax computed without regard to section 15. This limitation has the effect of affording relief to noncorporate taxpayers whose income tax, computed without regard to the super-tax provisions, amounts to more than 50 per centum of their net income. It is provided that such taxpayers shall pay a super-tax of not more than 10 per centum of their income remaining after deduction of income tax computed without regard to the super-tax provisions. This limitation may be illustrated by the following example:

The net income of an individual entitled to the maximum earned income credit and having no capital gains or losses, after application of the personal exemption and credit for dependents, is $750,000, and his tax liability computed without regard to section 15 is $497,724. The difference between the net income and the tax liability is $252,276. The tax under section 15 is $497,724 plus 10 per centum of $252,276, or $522,951.60. If such a limitation had not been provided for, the tax under section 15 would have been $547,496.40. It should be noted that the effect of this limitation on the 10 per centum increase is to relieve from any increase a taxpayer who under existing law, as amended by Title I, has no net income, because he has a net long-term capital loss, but is subject to tax under section 117(c)2 of the Internal Revenue Code.

The section does not apply in any case where its application would be contrary to the terms of any treaty obligation of the United States.

SECTION 202. RATES OF WITHHOLDING.

Section 202 of the bill inserts a new subsection (h) at the end of section 143 of the Internal Revenue Code. This subsection increases temporarily the 11, 15, and 16 per centum rates of withholding prescribed by sections 143 and 144, as amended by section 5 of Title I, to 12½0, 16⅝0, and 17⅞0 per centum, respectively. The increased rates are to be in effect during the period after June 25, 1940, and before January 1, 1945. The increased rates of withholding correspond to the rates of tax effective for the 5-year period on nonresident alien individuals and foreign corporations not engaged in trade or business in the United States and not having an office or place of business therein. The date June 26 is used to mark the start of the period of the increased rate because it was deemed necessary to have a date as close as reasonably possible to the date of enactment of the Act, but which would provide necessary time for the withholding agents to comply with the law. This subsection does not apply in any case where its application would be contrary to the terms of a treaty obligation of the United States.

SECTION 203. PERSONAL HOLDING COMPANIES.

Section 203 of the bill amends section 500 of the Internal Revenue Code by designating the present section as subsection (a) and adding a new subsection (b) at the end. The new subsection increases by 10 per centum the amount of surtax payable by any personal holding company under the existing law. The total amount of surtax under the amendment is thus obtained by ascertaining the surtax payable and then adding thereto 10 per centum of that figure. The 10 per centum increase is to be in effect for any taxable year beginning after December 31, 1939, and before January 1, 1945.

SECTION 204. EXCESS-PROFITS TAX.

This section amends the Internal Revenue Code to provide for a 10 per centum increase in the amount of excess-profits tax payable for income-tax taxable years ending after June 30, 1940, and before July 1, 1945. The provisions for the increased tax will consequently affect excess-profits tax liability for five income-tax taxable years.

SECTION 205. CAPITAL STOCK TAX.

Section 1200 of the Internal Revenue Code is amended by increasing the rate of capital stock tax from $1 for each $1,000 of the adjusted declared value of capital stock to $1.10 for each such $1,000 of value. This shall apply for the year ending June 30, 1940, and for the next four succeeding years ending June 30.

SECTION 206. ESTATE TAX.

A 10 per centum increase is proposed in the amount of estate tax payable in the case of estates of decedents dying within a period of five years after the date of the enactment of the proposed Act. Such increase will be computed upon the amount of tax as determined by the rate schedule or schedules of existing law after subtracting from the amount so obtained the amount of credit for gift taxes paid, as provided for in sections 813(a) and 936(b) of the Internal Revenue Code, and also the amount of any State, inheritance, legacy, or succession taxes paid to any State, Territory, the District of Columbia, or possession of the United States (not exceeding 80 per centum of the basic estate tax of 1926—Subchapter A of Chapter 3 of the Internal Revenue Code), as provided for in section 813(b).

Thus, if the basic estate tax (Subchapter A of Chapter 3), computed in accordance with the rate schedule set out in section 810, amounts to $1,500, and the additional estate tax (Subchapter B of Chapter 3), computed as prescribed in section 935, amounts to $8,100, and the credit against the amount of basic estate tax on account of the payment of any such estate, inheritance, legacy, or succession taxes amounts to $1,200, and the gift tax credit amounts to $100, the operation of the proposed super-tax is illustrated in the following table:

Basic estate tax (Chapter 3A of Code)		$1,500
Additional estate tax (Chapter 3B of Code)		8,100
Total tax under existing law before credits		9,600
Credits under existing law:		
Gift tax credit	$100	
Credit for State taxes	1,200	
Total		1,300
Total estate tax under existing law		8,300
10 per centum of $8,300		830
Total estate tax under bill		9,130

SECTION 207. GIFT TAX.

This section provides for each of the calendar years 1941 to 1945, both inclusive, an increase of 10 per centum in the gift tax computed according to the rate schedule set forth in section 1001 of the Code.

The following example illustrates the computation of the tax for the year 1943. Assume the taxpayer made net gifts of $50,000 in 1943, and aggregate net gifts of $100,000 for preceding calendar years, and that no specific exemption has been claimed, or is claimed for 1943.

Gift tax under existing law.

1942 and prior year gifts	$100,000
1943 gifts	50,000
Total	150,000
Tax under section 1001(a)1	13,575
Tax under section 1001(a)2	7,200
1943 gift tax payable under existing law	6,375

Tax under bill.

110 per centum of tax under 1001(a)1, or $13,575	$14,932.50
110 per centum of tax under 1001(a)2, or $7,200	7,920.00
Total 1943 gift tax	7,012.50

For the calendar year 1940, in order to prevent the injustice that would be caused by applying the increase over the whole year if some of the gifts were made before the enactment of the Act, it is provided that only that portion of

the 10 per centum increase shall be applied which corresponds to the ratio which the amount of the 1940 gifts made after the enactment of the Act bears to the total amount of 1940 gifts. For the purpose of this proration the first $4,000 of gifts to each donee is not counted as a gift, and charitable, etc., gifts allowed as a deduction under existing law are not counted. The specific exemption of $40,000 granted by section 1004(a)1 is not to be taken into account (whether claimed in whole or in part for 1940) in ascertaining the ratio to be applied.

The following example will illustrate the computation of the tax for 1940. Assume the taxpayer has made (from 1932 to 1939, inclusive) net gifts of $1,040,000 and before 1940 has claimed no part of the specific exemption of $40,000. In 1940 he makes gifts to charity: $100,000 to X charity in March, and $75,000 to Y charity in August. He also gives $60,000 to John Smith in April and $40,000 to him in September. The tax will be computed as follows:

1939 and prior year gifts	$1,040,000
1940 gifts before enactment of Act:	
(1) Gifts to John Smith	60,000
(2) Gifts to X charity	100,000
1940 gifts after enactment of Act:	
(1) Gifts to John Smith	40,000
(2) Gifts to Y charity	75,000

Gift tax under existing law.

1939 and prior year gifts	$1,040,000
1940 gifts to John Smith ($100,000 minus first $4,000)	96,000
1940 gifts to charity	175,000
Total	1,311,000
Deduct gifts to charity	175,000
	1,136,000
Deduct $40,000 specific exemption claimed	40,000
	1,096,000
Tax under section 1001(a)1	189,990
Tax under section 1001(a)2	176,550
Gift tax payable for 1940 under existing law	13,440

Tax under bill.

Ratio of 1940 taxable gifts after enactment to total 1940 taxable gifts $= \frac{40,000}{96,000}$ or $\frac{5}{12}$	
10 per centum of $13,440	$1,344
$\frac{5}{12}$ of $1,344	560
Plus regular 1940 tax	13,440
Total 1940 gift tax	14,000

SECTION 208. TAX ON TRANSFERS TO AVOID INCOME TAX.

This section amends section 1250 of the Internal Revenue Code by increasing the excise-tax rate therein provided from 25 per centum to 27½ per centum. Section 1250 provides for an excise tax on transfers made by citizens or residents of the United States or domestic corporations and partnerships to foreign corporations, unless under section 1251 prior to the transfer it is established to the satisfaction of the Commissioner that the transfer is not to avoid Federal income taxes. The increase in tax rate is to be effective for the period after the date of the enactment of the Act and ending before July 1, 1945.

SECTION 209. CONTINUATION OF EXCISE TAXES.

Certain excise taxes and increased rates of excise taxes under existing law are due to expire in 1941. Since the bill proposes to increase the rates of such taxes (the increases are specified in section 210) until July 1, 1945, it is neces-

sary to extend the temporary provisions. Section 209 of the bill therefore provides for such continuation. The taxes so extended or increased by this section are as follows:

Stamp taxes:
- Issues of securities, bond transfers, and deeds of conveyance.
- Stock transfers.

Manufacturers' excise taxes:
- Lubricating oils.
- Gasoline.
- Electrical energy.
- Tires and inner tubes.
- Toilet preparations.
- Automobile trucks.
- Passenger automobiles and motorcycles.
- Parts and accessories for automobiles.
- Radio sets.
- Mechanical refrigerators.
- Matches.

Miscellaneous taxes:
- Telegraph, telephone, radio, and cable facilities, leased wires, etc.
- Transportation of oil by pipe line.
- Admissions to theaters, concerts, cabarets, etc.
- Import taxes on petroleum, coal, lumber, and copper.

The admissions tax, in so far as the exemption is concerned, is treated in section 211.

SECTION 210. MISCELLANEOUS EXCISES.

Section 210 of the bill inserts a new Chapter 9A in the Internal Revenue Code, to be entitled "Super-tax For Five Years." Section 1650 of such new chapter provides for an increase in the rates of tax now applicable with respect to most of the miscellaneous excises and occupational taxes. The excises affected, and the increased rates, called super-tax rates, are specified in the schedule contained in section 1650. The amount of the increase in each case has been stated previously in this report. The increased rates are effective for the period after June 30, 1940, and before July 1, 1945. Thus, if the tax is on the sale of an article, as in the case of the manufacturer's excise on radio parts, and such sale occurs after June 30, 1940, it is taxable at the increased or super-tax rate. If the tax is on transportation, as in the case of the transportation of crude petroleum by pipe line, and such transportation originates after June 30, 1940, it is taxable at the increased or super-tax rate. If the tax is occupational tax, the increased rate applies for the fiscal year beginning July 1, 1940, or part thereof during which the occupation is carried on, and continues for four more years.

SECTION 211. ADMISSIONS TAX.

The present law exempts from admissions tax admissions of less than 41 cents until July 1, 1941, and thereafter admissions of $3 or less. The bill, in section 211, exempts only admissions of less than 31 cents until July 1, 1945, after which time admissions of $3 or less will be exempt.

SECTION 212. TOBACCO, SNUFF, CIGARS, CIGARETTES, AND CIGARETTE PAPERS.

This section amends the Internal Revenue Code to increase the rates of tax applicable to tobacco (other than chewing tobacco), snuff, cigars, cigarettes, and cigarette papers and to impose a floor stocks tax on all these articles except cigarette papers. Subchapter A of Chapter 15 of the Internal Revenue Code is amended by adding a new section 2004 which, for the period beginning July 1, 1940, and before July 1, 1945, increases all rates of tax with respect to the articles named by 16⅔ per centum.

While the tax rates with respect to cigarette papers are increased to 7/12, 1⅙ and 7/12 cents, respectively, no increase of the rate of tax with respect to cigarette tubes is made. The tax on cigarette tubes returns very little revenue and is collectible by stamp. It was thought impracticable to provide for an increase of ⅙ of a cent because the administrative difficulties involved in issuing new stamps would be out of all proportion to the very small increased revenue that would result from an increased rate of tax.

Because of the increase in the rates of tobacco tax provided for in the proposed new section 2004, it is proposed to add to the Internal Revenue Code a new section 2005 which will impose a floor stocks tax on tobacco products (other than chewing tobacco) held on July 1, 1940, by any person for sale otherwise than in retail stocks. The rate of the floor stocks tax is the difference between the rates of tax imposed by existing law and the increased rates contained in the proposed new section 2004. As a result of the floor stocks tax, all such articles on which tax must be paid which are removed for sale or consumption after June 30, 1940, will bear a total tax equal to the increased rates of tax imposed by section 2004 on articles manufactured after June 30, 1940.

The proposed new subsection 2005(b) provides that every person required to pay the floor stocks tax shall, on or before August 1, 1940, make a return and pay such tax. A special provision has been included in subsection (b) designed to simplify the collection of floor stocks tax with respect to articles held by manufacturers and importers. It is recognized that many such taxpayers will, on July 1, 1940, have on hand (*a*) articles to which no tax stamps have been affixed; (*b*) articles to which tax stamps have been affixed; and (*c*) unattached tax stamps purchased at the old rates of tax.

Under section 2005(b) the Commissioner will have authority in the case of manufacturers and importers to dispense with the requirement of a floor stocks tax return with respect to articles subject to tax held on July 1, 1940, to which tax stamps have not been affixed. The floor stocks tax payable with respect to such articles would then be paid by the taxpayers affixing the usual tax stamps, purchased however at the increased rates of tax rather than the old rates of tax. For example, the manufacturers' tax due with respect to a package of 20 small cigarettes at the old rate would be 6 cents; the floor stocks tax, 1 cent. Instead of affixing a stamp purchased for 6 cents on the package of cigarettes and filing a floor stocks tax return with respect to the 1-cent floor stocks tax, the taxpayer could affix a stamp purchased for 7 cents altogether. In order to make this simplified procedure possible, provision is made in section 2005(b) to give the Commissioner authority to make an assessment against taxpayers with respect to unattached tax stamps on hand July 1, 1940, for the difference between the amount paid for such stamps and the increased rates of tax. This provision of law is similar to one contained in section 1006 of the Revenue Act of 1917 and section 1311 of the Revenue Act of 1918.

As to articles to which tax stamps have already been affixed, this procedure could only be followed if taxpayers affixed to stamped articles an additional stamp to cover the floor stocks tax. With respect to such stamped articles, it would be simpler to have the floor stocks tax paid by means of return and dispense with the necessity of affixing an extra stamp.

SECTION 213. DISTILLED SPIRITS.

This section increases the rates of tax on distilled spirits, brandy, high-proof wines, liqueurs, etc., which are classified as distilled spirits, and imported perfumes containing distilled spirits, by 75 cents per proof gallon or, in some cases, wine gallon when below proof. The increase applies to distilled spirits, articles classified as distilled spirits, and brandy withdrawn from bond after June 30, 1940, and before July 1, 1945, and to such perfumes imported during such period.

A floor stocks tax is imposed on distilled spirits, articles so classified, and brandy held by any person for sale or for use in the manufacture or production of an article intended for sale. This tax is at a rate of 75 cents per proof gallon. An exemption of 100 wine gallons is accorded to retail dealers. The floor stocks tax is imposed only on distilled spirits upon which the internal revenue tax has been paid, in order not to impose a floor stocks tax on distilled spirits aging in warehouses and not yet withdrawn. This corresponds to the taxation, at the increased rate, of spirits, etc., removed after June 30, 1940, and before July 1, 1945.

Returns and payment of the floor stocks tax must be made on or before August 1, 1940, but the Commissioner may extend the payment to a date not later than February 1, 1941. Administrative provisions and penalties applicable to the regular distilled spirits taxes are incorporated by reference.

A technical amendment to the provisions relating to drawback of tax increases the rates of drawback to $3 and $2.75 where the tax has been paid at such rates.

SECTION 214. WINES AND FERMENTED MALT LIQUORS.

This section increases by 20 per centum the rates of tax on wines produced in or imported into the United States. The increase applies to such wines sold or removed for consumption or sale after June 30, 1940, and before July 1, 1945. This increase is effectuated by an increase in the specific rate in the schedules under the wine tax.

A similar increase is made in the rate of tax on fermented malt liquors (beer, lager beer, ale, porter, and similar malt beverages) sold or removed for consumption or sale during such period. The rate is increased from $5 per barrel to $6 per barrel. A floor stocks tax is imposed on fermented malt liquors, at a rate equal to the increase in rate of tax made applicable to such articles by section 3190, held on July 1, 1940, by any person, other than a retail dealer, and intended for sale.

SECTION 215. PLAYING CARDS.

This section increases from 10 cents to 11 cents the rate of tax on each pack of playing cards manufactured or imported and sold, or removed for consumption or sale, in the case of articles manufactured, etc., after June 30, 1940, and before July 1, 1945

SECTION 216. CREDITS OF TAX ON AUTOMOBILES, ETC.

Section 3403(e) of the Internal Revenue Code allows a credit against the automobile, truck, and motorcycle tax on account of the sale in connection with the vehicle of tires and tubes with respect to which the tax on tires or tubes has been paid. This credit under existing law is 2 per centum, in the case of automobile trucks, and 3 per centum in the case of automobiles and motorcycles, of the purchase price or sales price of similar tires and tubes.

This section of the bill increases the credit to 2½ per centum and 3½ per centum, respectively, with respect to such vehicles sold after June 30, 1940, and before July 1, 1945. These increases correspond to the increase made by section 210 of the bill in the rates of tax on automobiles, etc. The credit is allowable at 2½ per centum and 3½ per centum regardless of the rate of the tax paid on the tires and tubes or their date of acquisition.

TITLE III.

SECTION 301. SPECIAL FUND.

This section provides that the Secretary of the Treasury shall as soon as practicable after the end of each quarter determine the additional amount of taxes collected attributable to the increases in taxes made, and to the floor stocks taxes imposed, by the amendments to the Internal Revenue Code in Title II of the bill, and the amounts so determined shall be set aside as a special fund which shall be available only for the retirement of any of the National Defense Series obligations authorized by section 302 of the bill. In the amount to be set aside in the special fund there is not to be included the amount of taxes attributable solely to the extension of excise taxes and rates of excise taxes contained in section 209 of the bill, nor any amount collected under admissions taxes attributable to a basic admission charge of more than 40 cents. If at any time the amounts in the fund are not sufficient for the retirement of the obligations of the National Defense Series, the Secretary of the Treasury is authorized and directed to transfer to the fund moneys out of the general fund of the Treasury. Any amounts in the special fund not necessary for the retirement of the obligations shall be deposited in the general fund of the Treasury.

The revenues attributable to Title II of the bill will be collected and paid into the Treasury in accordance with established procedures. Shortly after each quarter the Secretary of the Treasury, acting upon information obtained by the Bureau of Internal Revenue from the offices of collectors of internal revenue, will determine the amounts collected during the preceding quarter which under this section are required to be set aside in the special fund, and on the basis of such determination he will transfer the amount thereof to the special fund for the retirement of the national defense obligations outstanding.

It will be obligatory upon the Treasury, beginning July 1, 1940, to retire the national defense obligations and charge the amount so retired to the special fund. The Secretary of the Treasury has stated before this committee that it is his intention to arrange the maturities of any national defense obligations issued under the authority contained in this bill so as to insure as nearly as possible the application of the increased revenue from the enactment of Title II to the retirement of national defense obligations during the year in which such revenue is received.

SECTION 802. NATIONAL DEFENSE OBLIGATIONS.

This section amends section 21 of the Second Liberty Bond Act, as amended. That section now provides that the face amount of bonds, certificates of indebtedness, Treasury bills and notes issued under the Second Liberty Bond Act, as amended, shall not exceed $45,000,000,000 outstanding at any one time. On June 30, 1940, there will be a margin under this limitation of only $1,700,000,000 which can be availed of by the Treasury to issue additional public-debt obligations for the purpose of obtaining funds in addition to $700,000,000 to be recovered from governmental corporations, to meet the increased deficit in the fiscal year 1941 if the President's defense recommendations are adopted by the Congress. More than $1,600,000,000 of this deficit will be due to additional emergency national defense expenditures. On the basis of present recommendations, total national defense expenditures will amount to about $3,250,000,000, the highest amount spent for this purpose in any year in our history, except for the two fiscal years when this country participated in the World War.

In order to finance national defense expenditures after June 30, 1940, it is proposed to permit the Treasury to issue within the framework of current statutes relating to the public debt, $4,000,000,000 of short-term public-debt obligations with maturities not exceeding five years, to be designated "National Defense Series." These obligations will be in addition to the $45,000,000,000 face amount of public-debt obligations permitted to be outstanding under the Second Liberty Bond Act, as amended. This additional $4,000,000,000 authorization for national defense obligations permits only a temporary increase in the limitation on outstanding public-debt obligations because, to the extent that such national defense obligations are retired under the provisions of section 801, the authorization will be reduced.

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1940–29–10336

REVENUE ACT OF 1940.

[Senate Report No. 1856, Seventy-sixth Congress, Third Session. Calendar No. 1945.]

[JUNE 15, 1940.]

Mr. Harrison, from the Committee on Finance, submitted the following report [to accompany H. R. 10039]:

The Committee on Finance, to whom was referred the bill (H. R. 10039) to provide for the expenses of national preparedness by raising revenue and issuing bonds, to provide a method for paying for such bonds, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

Your committee concurs in the provisions of the House bill with the following changes:

(1) All increases on tobacco and tobacco products under the House bill have been eliminated. Your committee is of the opinion that the tax on tobacco and tobacco products is already very high and that any increase in this tax would have a tendency to injure the tobacco farmer and decrease the consumption of tobacco products. Under the committee amendment the rates of existing law now applicable to snuff, snuff flour, manufactured tobacco, cigars, cigarettes, and cigarette papers are continued.

(2) Under existing law packages and books containing 25 papers or less are exempt from the tax on cigarette papers. Your committee believes that this exemption should be continued for the reason that its elimination would result in considerably curtailing the consumption of smoking tobacco. The

committee amendment, therefore, restores this exemption, which had been eliminated in the House bill.

(3) The provisions of the House bill affecting distilled spirits, wines, and fermented malt liquors were agreed to with the following exceptions:

(*a*) The House bill did not increase the tax on rectified spirits. Your committee believes that some increase should be made in this tax. Accordingly, the rate has been increased from 30 cents on each proof gallon to 40 cents on each proof gallon. A corresponding floor stocks tax of 10 cents is imposed on account of the increased rate.

(*b*) Under the House bill an exemption of 100 wine gallons is allowed retail dealers in the case of floor stocks taxes imposed upon distilled spirits. Your committee is of the opinion that no exemption should be allowed. The allowance of an exemption would give an opportunity for the retail trade to stock up with tax-paid liquor prior to the time the increased rates were effective.

(4) Your committee has changed the tax with respect to admissions. Under existing law admissions of 40 cents or less are exempt from tax. Admissions of over 40 cents are subject to a tax at the rate of 1 cent on each 10 cents or fraction thereof. While the House bill did not change the rate of tax under existing law, it exempted only admissions of less than 31 cents. Your committee has provided the following rates for taxing admissions, which will considerably increase the revenue derived from this source over that produced by the House bill:

Admissions up to and including 9 cents	No tax.
Admissions of more than 9 cents and less than 20 cents	1 cent.
Admissions of 20 cents or more	1 cent on each 10 cents or fraction thereof.

The 1-cent tax will apply to admissions from 10 to 19 cents, both inclusive. An admission of 20 cents will be taxed at 2 cents. Admissions from 21 to 30 cents will be taxed at 3 cents; admissions from 31 to 40 cents will be taxed at 4 cents; and admissions from 41 to 50 cents will be taxed at 5 cents. Admissions over that amount will be taxed at 1 cent for each 10 cents or fraction thereof.

(5) A few minor changes were made in the income tax provisions.

(*a*) The rate of tax on foreign corporations not engaged in trade or business in the United States and not having an office or place of business therein, which in the case of dividends is 10 per cent under existing law, was changed to 15 per cent instead of 11 per cent as provided in the House bill and the rate of tax on other fixed or determinable income, which under the existing law is 15 per cent and under the House bill was changed to 16 per cent, is left at 15 per cent. These changes were deemed necessary so that the same rate of tax will apply to foreign corporations not engaged in trade or business within the United States and not having an office or place of business therein as applicable to nonresident alien individuals of like character. The temporary defense tax increases this 15 per cent rate for the 5-year period to 16½ per cent.

Since these taxes are withheld at the source, it is impossible for the withholding agent to determine in many cases whether the actual recipient of the income is a corporation or an individual. Any differential between the corporate rate and the individual rate can be easily avoided and will cause substantial administrative difficulty. For these reasons the House bill was changed in this respect. Corresponding changes are made with respect to the rate of withholding.

(*b*) Under the House bill a trust was required to file an income tax return if the gross income for the taxable year was $100 or over. Your committee believes that this puts an undue burden upon the fiduciary and will result in the filing of unnecessary returns. Accordingly the bill is changed so that a trust is only required to file a return where its net income for the taxable year is $100 or over or its gross income is $800 or over. An individual is not required to file a return unless his gross income is $800 or over.

(6) Your committee has added to the House bill a provision to the effect that articles subject to the manufacturers' excise taxes which prior to July 1, 1940, were delivered under leases, contracts of sale, or conditional sales, shall be subject to tax with respect to payments made after June 30, 1940, on the basis of the rates in effect prior to July 1, 1940, and not at the increased rates.

(7) The temporary taxes, imposed for the 5-year period, are referred to in the House bill as "supertaxes." Your committee has amended the bill so that these taxes will be designated as "defense taxes" instead of "supertaxes."

REVENUE ESTIMATES.

The following table prepared by the Treasury Department shows the additional revenue under the committee bill:

Estimated additional revenue[1] *attributable to the proposed Revenue Act of 1940.*[2]

SOURCE OF REVENUE.	
Title I:	
Income tax—	
Corporation income tax	$70,000,000
Individual income tax	252,000,000
Total increase, Title I	322,000,000
Title II (defense taxes):	
Corporation income tax	135,000,000
Individual income tax	123,000,000
Capital stock and excess-profits taxes	12,000,000
Estate tax	29,000,000
Gift tax	3,000,000
Alcoholic beverage taxes—	
Distilled spirits	76,000,000
Fermented malt liquors	46,000,000
Other	7,000,000
Total increase, alcoholic beverage taxes	129,000,000
Stamp taxes	7,000,000
Manufacturers' excise taxes—	
Gasoline	112,000,000
Other	30,000,000
Total increase, manufacturers' excise taxes	142,000,000
Miscellaneous taxes	105,000,000
Total increase, Title II	685,000,000
Total increase, Titles I and II	1,007,000,000

Treasury Department, Division of Research and Statistics, June 17, 1940.

[1] Excluding (*a*) the nonrecurring collections of floor taxes on alcoholic beverages, estimated for fiscal year 1941 at $27,000,000, and (*b*) revenues resulting from the extension of certain excise taxes as provided in Title II, "SEC. 209. Continuation of Excise Taxes," but including the defense tax on such excise taxes.

[2] As reported by the Senate Finance Committee June 17, 1940.

It will be noted that despite the elimination of the tax on tobacco and tobacco products, your committee bill raises about $3,000,000 more than the House bill. This is due to the change in the admissions tax, and the increased tax on rectified spirits.

(8) Your committee has amended the House bill to provide that the President is hereby authorized and directed to reduce appropriations for the executive branch of the Government for the fiscal year ending June 30, 1941 (except appropriations for national defense, fixed charges, and trust funds), in such manner that the total amount of such reductions shall not be less than 10 per cent of the total amount of the appropriations affected. Such reductions in appropriations shall be impounded and returned to the Treasury.

(9) Your committee added an amendment terminating on the date of the enactment of the Revenue Act of 1940 the power and authority of the President and the Secretary of the Treasury under the Silver Purchase Act of 1934, with respect to the acquisition of foreign silver, and also repealing the internal revenue tax on transfers of any interest in silver bullion contained in section 1805 of the Internal Revenue Code.

TITLE I—PERMANENT CHANGES.

These changes apply to income taxes for taxable years beginning after December 31, 1939. They are, therefore, applicable to 1940 incomes.

(1) The personal exemptions allowed individuals for income tax purposes under the existing law have been reduced from $2,500 to $2,000 in the case of married persons and heads of families and from $1,000 to $800 in the case of single persons. The bill does not affect the $400 credit for dependents allowed under existing law. This credit is allowed if the dependent receives his chief support from the taxpayer and is under 18 years of age or incapable of self-support because mentally or physically defective.

(2) The surtaxes are increased on surtax net incomes in excess of $6,000 and the increases continue up to surtax net incomes not in excess of $100,000, and from that point the rates of existing law are retained. Under the present law, the rate on surtax net incomes in excess of $100,000 and not in excess of $150,000 is 58 per cent. While the rates applicable to surtax net incomes in excess of $100,000 are not increased, the surtaxes payable by taxpayers in these upper brackets are increased by reason of the higher rates in the lower brackets.

(3) The requirement as to filing income tax returns in the case of individuals has been changed. Under the existing law, an individual is required to file a return if his net income amounts to $1,000 or more in the case of a single person, or $2,500 or more in the case of a married person, and in either case if his gross income is $5,000 or more. The bill requires a return from a single person if his gross income is $800 or more and from married persons if either their aggregate or separate gross income is $2,000 or more.

(4) Nonresident aliens: Under existing law, a nonresident alien individual not engaged in business within the United States or not having an office or place of business therein, is taxed only upon dividends, interest, or other fixed or determinable annual or periodical income at the rate of 10 per cent. This rate may be reduced to 5 per cent in the case of a resident of a contiguous country if so provided by treaty. Subject to treaty provisions with foreign countries, the 10 per cent rate has been increased to 15 per cent, which corresponds to the proportionate increase in burden imposed upon American citizens and residents by the increases in income and excise taxes under the bill. Under existing law, if such a nonresident alien individual has a gross income of more than $21,600, which is the level at which the average effective rate equals 10 per cent, he is subject to the full normal and sur tax on his fixed or determinable annual or periodical income. The bill raises this level to $24,000 which, under the increased rates, is the point which equals an effective rate of approximately 15 per cent. Nonresident aliens engaged in business in the United States or having an office or place of business therein are subject to the same rates as apply to American citizens with respect to income from United States sources. They will, therefore, be subject to the increase in tax applicable to American citizens.

CORPORATIONS.

(1) *Domestic corporations.*—Your committee increased the rate of tax on corporations by 1 per cent. In view of the increase in the tax burden imposed upon individuals under the bill, it was believed that corporations should bear some part of the increased burden.

The rates under the proposed bill and under the existing law are as follows:

Normal tax net incomes.	Existing law.	Bill.
	Per cent.	*Per cent.*
Not in excess of $5,000	12½	13½
In excess of $5,000 and not in excess of $20,000	14	15
In excess of $20,000 and not in excess of $25,000	16	17
In excess of $25,000	18	19

(2) *Foreign corporations.*—Since the tax on domestic corporations is increased, your committee also deemed it advisable to make the same proportionate increase in the tax on foreign corporations deriving income from American sources. Under existing law, foreign corporations having an office or place of business in the United States are subject to a flat rate of 18 per cent. This has been in-

creased under the bill to 19 per cent. Foreign corporations not engaged in trade or business within the United States or not having an office or place of business therein are taxable only upon their dividends, interest, or other fixed or determinable periodical or annual income, and they are subject to a tax of 15 per cent on such income. In the case of dividends, the rate is 10 per cent unless received by a corporation organized under the laws of a contiguous country, in which case the rate may by treaty be reduced to not less than 5 per cent. The rate of 10 per cent is increased to 15 per cent and under the defense tax, to 16½ per cent. No increase in taxes will apply where its application will be contrary to any treaty of the United States.

TITLE II.—TEMPORARY CHANGES.

The bill makes certain temporary increases in the internal-revenue laws for a period of five years. These changes are briefly as follows:

(1) INCOME TAX.

For taxable years beginning after December 31, 1939, and before January 1, 1945, the tax computed in accordance with the changes made in Title I of the bill is increased by 10 per cent thereof. To prevent the rate in the higher brackets from being confiscatory, a cushion is inserted which prevents such increase from being greater than 10 per cent of the net income in excess of the tax computed under existing law, as amended by Title I. This cushion begins to operate where the tax so computed is in excess of 50 per cent of the net income, which in the case of a married person is around $200,000. The following examples will show the result of the operation of the tax and the cushion:

Net income.	Tax under existing law as amended by Title I.	Super-tax.	Net income.	Tax under existing law as amended by Title I.	Super-tax.
$3,000	$28	$2.80	$100,000	$39,524	$3,952.40
$5,000	100	10.00	$300,000	169,364	13,063.60
$10,000	480	48.00	$1,000,000	686,204	31,379.60

It will be seen from the above examples that in the case of a married man without dependents with $5,000 net income, the defense tax is determined by increasing the ordinary tax of $100 by 10 per cent, or $10, making a total tax of $110. The cushion will not operate in this case because the ordinary tax is not in excess of 50 per cent of the net income. In the case of a married man with $300,000 net income the 10 per cent defense tax if applied without the cushion, would amount to $16,936.40, but since the ordinary tax is in excess of 50 per cent of the net income the cushion applies. Accordingly, the defense tax in this last example is computed by applying the 10 per cent against $130,636 (the amount of the net income less ordinary tax) instead of against the tax of $169,364. This makes the defense tax $13,063.60 instead of $16,936.40.

(2) EXCESS-PROFITS TAX.

The amount of the excess-profits tax payable for any taxable year ending after June 30, 1940, and before July 1, 1945, is increased by 10 per cent. Thus, a corporation with an excess-profits tax year ending July 31, 1940, will be subject to the 10 per cent increase. If the excess-profits tax payable is $1,000, the defense tax will be $100, and the corporation will pay a total excess-profits tax of $1,100.

(3) CAPITAL STOCK TAX.

The capital stock tax is increased for the year ending June 30, 1940, and for the four succeeding years ending June 30, from $1 per thousand of adjusted declared value to $1.10 per thousand of adjusted declared value.

(4) ESTATE TAX.

In the case of a decedent dying after the enactment of this bill and before the expiration of five years after such date, the estate tax payable (after application of the credits provided for State death taxes and Federal gift taxes), is increased by 10 per cent.

(5) GIFT TAX.

The gift tax is also increased by 10 per cent, effective for the calendar year 1940 and subsequent calendar years up to and including the calendar year 1945.

For the calendar year 1940, the increase is in effect applied only to gifts made after the date of the enactment of this bill. This is accomplished by determining the gift tax for the entire year at the existing rates and adding thereto an amount which bears the same ratio to 10 per cent of the tax so computed as the amount of gifts made after the enactment of the bill bears to the total amount of gifts made during the year.

(6) TRANSFERS TO AVOID INCOME TAX.

Under the existing law, an excise is imposed upon the transfer of stock or securities by a citizen or resident of the United States, or by a domestic corporation or partnership, or by a trust which is not a foreign trust, to a foreign corporation as paid-in surplus or as a contribution to capital. The rate under existing law is 25 per cent and this has been increased to 27½ per cent in the case of any transfer made during the period after the date of the enactment of this bill and before July 1, 1945.

(7) DISTILLED SPIRITS.

Your committee increased the taxes on distilled spirits at the following rates:

Distilled spirits.	Old rates.	New rates.	Percentage of increase.
Distilled spirits generally	$2.25	$3.00	33⅓
Brandy	2.00	2.75	37½
Imported perfumes	2.25	3.00	33⅓
Rectified spirits	.30	.40	33⅓

Floor stocks taxes are imposed upon distilled spirits which on July 1, 1940, are held by any person and intended for sale or for use in the manufacture and production of any article intended for sale. The rate is 75 cents, which is the increased rate imposed upon liquor. Your committee also increased the tax on rectified spirits from 30 cents per gallon under existing law to 40 cents. In addition a floor stocks tax of 10 cents per gallon is provided.

(8) BEER.

Your committee increased the tax on fermented liquors from $5 a barrel to $6 a barrel, effective July 1, 1940. This amounts to a 20 per cent increase in the rate of tax. In addition, a floor stocks tax is imposed upon stocks held by manufacturers or wholesalers at the rate of $1 per barrel.

(9) WINES.

The taxes on wines were increased at the following rates:

	Old rate.	New rate.	Percentage of increase.
	Cents.	*Cents.*	*Per cent.*
Still wines	5	6	20
Do	15	18	20
Do	25	30	20
Sparkling wines	2½	3	20
Do	1¼	1½	20

The reasons for the change in the rates on still wines in section 214 and for the striking out of any reference to the fortification tax, is that it is anticipated that H. R. 9117 will become law before this bill. The changes here made in the rates will incorporate the basic rates provided in H. R. 9117, which rates are increased by the bill for the 5-year period.

(10) ADMISSIONS TAXES.

Under exisiting law, an admissions tax of 10 per cent is imposed except where the amount paid for admission is less than 41 cents. Instead of raising the rate of tax, your committee deemed it much simpler and more feasible from an administrative point of view to decrease the exemption from 40 to 9 cents. Upon admissions of from 10 to 19 cents, inclusive, your committee placed a tax of 1 cent. Upon admissions of 20 cents or more the rate is 1 cent for each 10 cents, or fraction thereof.

(11) OTHER MISCELLANEOUS TAXES.

The following table shows the increases in other miscellaneous taxes:

Description of tax.	Old rate.	New rate.	Percentage of increase.
Box seats	10 per cent	11 per cent	10
Sales outside of box office	do	do	10
Cabarets, roof gardens, etc	1½ cents	2 cents	33⅓
Club dues	10 per cent	11 per cent	10
Corporate securities	10 cents	11 cents	10
Capital stock	do	do	10
Do	2 cents	3 cents	50
Do	4 cents	5 cents	25
Do	5 cents	6 cents	20
Insurance policies	3 cents	4 cents	33⅓
Passage tickets	$1	$1.10	10
Do	$3	$3.30	10
Do	$5	$5.50	10
Safe-deposit boxes	10 per cent	11 per cent	10
Pistols and revolvers	do	do	10
Wholesalers in liquor	$100	$110	10
Retailers in liquor	$25	$27.50	10
Brewers (more than 500 barrels)	$100	$110	10
Brewers (less than 500 barrels)	$50	$55	10
Wholesalers in malt liquors	do	do	10
Retailers in malt liquors	$20	$22	10
Special cases	$2	$2.20	10
Rectifiers	$200	$220	10
Do	$100	$110	10
Stills	$50	$55	10
Do	$20	$22	10
Tires	2¼ cents	2½ cents	11
Tubes	4 cents	4½ cents	12½
Toilet preparations	10 per cent	11 per cent	10
Automobiles	2 per cent	2½ per cent	25
Other automobiles	3 per cent	3½ per cent	16⅔
Auto parts	2 per cent	2½ per cent	25
Radios	5 per cent	5½ per cent	10
Mechanical refrigerators	do	do	10
Firearms	10 per cent	11 per cent	10
Matches	5 cents	5½ cents	10
Electrical energy	3 per cent	3⅓ per cent	11⅑
Gasoline	1 cent	1½ cents	50
Lubricating oils	4 cents	4½ cents	12½
Transportation of oil by pipe line	4 per cent	4½ per cent	12½
Transfers of bonds	4 cents	5 cents	25
Conveyances	50 cents	55 cents	10
Playing cards	10 cents	11 cents	10

(12) CONTINUATION OF TEMPORARY EXCISE TAXES.

The bill also provides for the continuation of the temporary import and excise taxes which either expire or have their rates reduced in 1941. Under the bill these taxes will not expire or have their rates reduced until 1945. These are as follows:

Stamp taxes:
- Issues of securities, bond transfers, and deeds of conveyance.
- Stock transfers.

Manufacturers' excise taxes:
- Lubricating oils.
- Gasoline.
- Electrical energy.
- Tires and inner tubes.
- Toilet preparations.
- Automobile trucks.
- Passenger automobiles and motorcycles.
- Parts and accessories for automobiles.
- Radio sets.
- Mechanical refrigerators.
- Matches.

Miscellaneous taxes:
- Telegraph, telephone, radio, and cable facilities, leased wires, etc.
- Transportation of oil by pipe line.
- Admissions to theaters, concerts, cabarets, etc.
- Import taxes on petroleum, coal, lumber, and copper.

The admissions tax is discussed in another part of this report.

(13) TAXES NOT INCREASED.

(1) No increase is provided in the case of certain taxes of a regulatory nature, such as the taxes on white phosphorus matches, mixed flour, filled cheese, narcotics, sugar, bituminous coal, and certain types of firearms. Likewise, the bill does not increase certain excise taxes on imports such as those levied with respect to coal, lumber, copper, petroleum products, and certain vegetable oils. The revenue from these taxes is small, and since they are designed for a particular function which an increase in their rates might impair, your committee feel they should not be increased and some of them are affected by reciprocal trade agreements.

(2) The bill makes no changes in the taxes levied under the social security program. These taxes are directed to a special purpose and it is not felt that they should be increased for the defense program.

(3) In the case of the taxes on communication facilities (telephone, telegraph, radio and cable), severe administrative difficulties convince your committee of the inadvisability of increase in rates.

(4) No increases are provided in the case of the taxes on tobacco and tobacco products.

DISCUSSION OF PRINCIPAL INCOME TAX CHANGES.

(*a*) *Lowering of personal exemptions.*—Title I of the bill lowers the personal exemption from $1,000 to $800 in the case of single persons and from $2,500 to $2,000 in the case of married persons or heads of families. This will make approximately 2,190,000 new taxpayers. Of the additional revenue to be derived from this source approximately $14,000,000 will be derived from new taxpayers. This is a permanent change and first goes into effect with respect to taxable years beginning after December 31, 1939.

(*b*) Title I of the bill also increases permanently the surtax rates with respect to taxable years beginning after December 31, 1939. The normal tax rate,

which is 4 per cent under existing law, is not changed in the bill. The following table shows the surtax rates under the existing law and under the bill:

TABLE I.—*Comparison of surtax rates, existing law and proposed bill.*

Amount of surtax net income.		Existing law rate.	Proposed bill rate.	Amount of rate increase.
Exceeding.	Not exceeding.			
		Per cent.	*Per cent.*	*Per cent.*
$4,000	$6,000	4	4	0
6,000	8,000	5	6	1
8,000	10,000	6	8	2
10,000	12,000	7	10	3
12,000	14,000	8	12	4
14,000	16,000	9	15	6
16,000	18,000	11	18	7
18,000	20,000	13	21	8
20,000	22,000	15	24	9
22,000	26,000	17	27	10
26,000	32,000	19	30	11
32,000	38,000	21	33	12
38,000	44,000	24	36	12
44,000	50,000	27	40	13
50,000	56,000	31	44	13
56,000	60,000	35	44	9
60,000	62,000	35	47	12
62,000	68,000	39	47	8
68,000	70,000	43	47	4
70,000	74,000	43	50	7
74,000	80,000	47	50	3
80,000	90,000	51	53	2
90,000	100,000	55	56	1
100,000	150,000	58	58	0
150,000	200,000	60	60	0
200,000	250,000	62	62	0
250,000	300,000	64	64	0
300,000	400,000	66	66	0
400,000	500,000	68	68	0
500,000	750,000	70	70	0
750,000	1,000,000	72	72	0
1,000,000	2,000,000	73	73	0
2,000,000	5,000,000	74	74	0
5,000,000 and up	----------	75	75	0

(c) *Total income tax burden.*—(1) Permanent increases: In order to secure a complete picture of the total income tax burden, the following tables are included with respect to a married man with no dependents. Table II shows the increased normal and sur tax rates on a married man with no dependents under existing law and under the bill. While there is no change in the normal tax rate over that of existing law, the normal tax itself is increased by reason of the lowering of the exemptions to $800 for single persons and to $2,000 for married persons.

TABLE II.—*Comparison of normal tax and surtax, existing law and proposed bill, married person, no dependents, all income earned.*

Net income.	Normal tax.		Surtax.		Surtax increase.
	Present law.	Proposed bill.	Present law.	Proposed bill.	
$2,000	0	0	0	0	0
$2,500	0	$10	0	0	0
$3,000	$8	28	0	0	0
$4,000	44	64	0	0	0
$5,000	80	100	0	0	0
$6,000	116	136	0	0	0
$7,000	152	172	$20	$40	$20
$8,000	188	208	60	80	20
$9,000	224	244	105	140	35
$10,000	260	280	155	200	45
$11,000	296	316	210	280	70

TABLE II.—*Comparison of normal tax and surtax, existing law and proposed bill, married person, no dependents, all income earned*—Continued.

Net income.	Normal tax.		Surtax.		Surtax increase.
	Present law.	Proposed bill.	Present law.	Proposed bill.	
$12,000	$332	$352	$270	$360	$90
$13,000	368	388	335	460	125
$14,000	404	424	405	560	155
$15,000	444	464	480	680	200
$20,000	644	664	945	1,460	515
$25,000	844	864	1,645	2,630	985
$30,000	1,044	1,064	2,525	4,040	1,515
$40,000	1,444	1,464	4,535	7,220	2,685
$50,000	1,844	1,864	7,025	10,980	3,955
$60,000	2,244	2,264	10,085	15,300	5,215
$70,000	2,644	2,664	13,805	19,940	6,135
$80,000	3,044	3,064	18,225	24,880	6,655
$90,000	3,444	3,464	23,225	30,120	6,895
$100,000	3,844	3,864	28,625	35,660	7,035
$150,000	5,844	5,864	57,550	64,620	7,070
$200,000	7,844	7,864	87,500	94,580	7,080
$250,000	9,844	9,864	118,450	125,540	7,090
$300,000	11,844	11,864	150,400	157,500	7,100
$400,000	15,844	15,864	216,350	223,460	7,110
$500,000	19,844	19,864	284,300	291,420	7,120
$750,000	29,844	29,864	459,250	466,380	7,130
$1,000,000	39,844	39,864	639,200	646,340	7,140
$2,000,000	79,844	79,864	1,369,175	1,376,320	7,145
$5,000,000	199,844	199,864	3,589,150	3,596,300	7,150

It will be noted that a married person with a net income of $2,500 pays no tax under existing law. However, under the bill he will pay a normal tax of $10 for each taxable year beginning after December 31, 1939. The same person with a net income of $3,000 will pay for each such taxable year a normal tax of $28. No surtax is imposed either under the bill or under the existing law until the net income of a married man exceeds $6,500 under the present law and $6,000 under the bill. In the case of a single person, no surtax is imposed until the net income exceeds $5,000 under the present law and $4,800 under the bill. The largest increase in the surtax rate over existing law is with respect to married persons with net incomes between $46,000 and $58,000, where the rate is increased 13 per cent. In the case of a single person, the largest increase is with respect to net incomes from $45,000 to $57,000, where the rate is also increased 13 per cent.

(2) Temporary increase: In addition to the permanent increases caused by the change in the exemptions and the surtax rates, Title II of the bill imposes a 10 per cent defense tax with respect to taxable years beginning after December 31, 1939, and before January 1, 1945. This is shown in the following table:

TABLE III.—*Comparison of total tax burden, existing law and proposed bill, married persons, no dependents, all income earned.*

Net income.	Present law.	Proposed bill excluding defense tax.	Defense tax.	Proposed bill including defense tax.	Effective rate in per cent.		
					Present law.	Proposed bill.	
						Without defense tax.	With defense tax.
$2,000							
$2,500		$10	$1.00	$11.00		0.40	0.44
$3,000	$8	28	2.80	30.80	0.27	.93	1.03
$4,000	44	64	6.40	70.40	1.10	1.60	1.76
$5,000	80	100	10.00	110.00	1.60	2.00	2.20
$6,000	116	136	13.60	149.60	1.93	2.27	2.49
$7,000	172	212	21.20	233.20	2.46	3.03	3.33
$8,000	248	288	28.80	316.80	3.10	3.60	3.96

TABLE III.—*Comparison of total tax burden, existing law and proposed bill, married persons, no dependents, all income earned*—Continued.

Net income.	Present law.	Proposed bill excluding defense tax.	Defense tax.	Proposed bill including defense tax.	Effective rate in per cent.		
					Present law.	Proposed bill.	
						Without defense tax.	With defense tax.
$9,000	$329	$384	$38.40	$422.40	3.66	4.27	4.69
$10,000	415	480	48.00	528.00	4.15	4.80	5.28
$11,000	506	596	59.60	655.60	4.60	5.42	5.96
$12,000	602	712	71.20	783.20	5.02	5.93	6.53
$13,000	703	848	84.80	932.80	5.41	6.52	7.18
$14,000	809	984	98.40	1,082.40	5.78	7.03	7.73
$15,000	924	1,144	114.40	1,258.40	6.16	7.63	8.39
$20,000	1,589	2,124	212.40	2,336.40	7.95	10.62	11.68
$25,000	2,489	3,494	349.40	3,843.40	9.96	13.98	15.37
$30,000	3,569	5,104	510.40	5,614.40	11.90	17.01	18.71
$40,000	5,979	8,684	868.40	9,552.40	14.95	21.71	23.88
$50,000	8,869	12,844	1,284.40	14,128.40	17.74	25.69	28.26
$60,000	12,329	17,564	1,756.40	19,320.40	20.55	29.27	32.20
$70,000	16,449	22,604	2,260.40	24,864.40	23.50	32.29	35.52
$80,000	21,269	27,944	2,794.40	30,738.40	26.59	34.93	38.42
$90,000	26,669	33,584	3,358.40	36,942.40	29.63	37.32	41.05
$100,000	32,469	39,524	3,952.40	43,476.40	32.47	39.52	43.48
$150,000	63,394	70,484	7,048.40	77,532.40	42.26	46.99	51.69
$200,000	95,344	102,444	9,755.60	112,199.60	47.67	51.22	56.10
$250,000	128,294	135,404	11,459.60	146,863.60	51.32	54.16	58.75
$300,000	162,244	169,364	13,063.60	182,427.60	54.08	56.45	60.81
$400,000	232,194	239,324	16,067.60	255,391.60	58.05	59.83	63.85
$500,000	304,144	311,284	18,871.60	330,155.60	60.83	62.26	66.03
$750,000	489,094	496,244	25,375.60	521,619.60	65.21	66.17	69.55
$1,000,000	679,044	686,204	31,379.60	717,583.60	67.90	68.62	71.76
$2,000,000	1,449,019	1,456,184	54,381.60	1,510,565.60	72.45	72.81	75.53
$5,000,000	3,788,994	3,796,164	120,383.60	3,916,547.60	75.78	75.92	78.33

From the above table it will be noted a married man, without dependents, having a net income of $20,000 will pay in permanent taxes $2,124, an increase of $535 over existing law, and in addition he will pay a defense tax, under Title II of the bill, of $212.40 for five years, making a total annual tax for such 5-year period of $2,336.40, or 11.68 per cent of his net income as against 7.95 per cent under existing law. One with $50,000 net income will pay $12,844 in permanent tax, and $1,284.40 defense tax, making a total of $14,128.40 as against $8,869 under existing law, or 28.26 per cent of his net income as against 17.74 per cent under existing law.

(*d*) *Requirement for filing individual income tax returns.*—Under existing law, an individual, if single, is not required to file an income tax return unless his gross income is $5,000 or more or his net income is $1,000 or more. In the case of a married individual, no return is required under existing law, unless his gross income is $5,000 or more, or the net income is $2,500 or more. A return is also required if such individual and his spouse each has a gross income, and the aggregate gross income is $5,000 or more. The bill requires a return from a single individual if his gross income is $800 or more and from a married individual if (1) such individual has a gross income of $2,000 or more and the other spouse has no gross income or (2) if such individual and his spouse each has for the taxable year a gross income and the aggregate gross income is $2,000 or over. Many persons have failed to file returns upon the assumption that their income was insufficient, when, in fact, they were liable for the filing of a return and the payment of a tax. This change will require approximately, 8,000,000 additional returns, and it is believed will result in the collection of substantial additional taxes. It is estimated that under existing law approximately 7,500,000 individual returns are filed.

SECTION 301. SPECIAL FUND.

This section provides that the Secretary of the Treasury shall as soon as practicable after the end of each quarter determine the additional amount of taxes collected attributable to the increases in taxes made, and to the floor stocks taxes imposed, by the amendments to the Internal Revenue Code in Title II of the bill, and the amounts so determined shall be set aside as a special fund which shall be available only for the retirement of any of the

National Defense Series obligations authorized by section 302 of the bill. In the amount to be set aside in the special fund there is not to be included the amount of taxes attributable solely to the extension of excise taxes and rates of excise taxes contained in section 209 of the bill, nor any amount collected under admissions taxes attributable to a basic admission charge of more than 40 cents. If at any time the amounts in the fund are not sufficient for the retirement of the obligations of the National Defense Series, the Secretary of the Treasury is authorized and directed to transfer to the fund moneys out of the general fund of the Treasury. Any amounts in the special fund not necessary for the retirement of the obligations shall be deposited in the general fund of the Treasury.

The revenues attributable to Title II of the bill will be collected and paid into the Treasury in accordance with established procedures. Shortly after each quarter the Secretary of the Treasury, acting upon information obtained by the Bureau of Internal Revenue from the offices of collectors of internal revenue, will determine the amounts collected during the preceding quarter which under this section are required to be set aside in the special fund, and on the basis of such determination he will transfer the amount thereof to the special fund for the retirement of the national defense obligations outstanding. It will be obligatory upon the Treasury, beginning July 1, 1940, to retire the national defense obligations and charge the amount so retired to the special fund. The Secretary of the Treasury has stated before this committee that it is his intention to arrange the maturities of any national defense obligations issued under the authority contained in this bill so as to insure as nearly as possible the application of the increased revenue from the enactment of Title II to the retirement of national defense obligations during the year in which such revenue is received.

SECTION 302. NATIONAL DEFENSE OBLIGATIONS.

This section amends section 21 of the Second Liberty Bond Act, as amended. That section now provides that the face amount of bonds, certificates of indebtedness, Treasury bills and notes issued under the Second Liberty Bond Act, as amended, shall not exceed $45,000,000,000 outstanding at any one time. On June 30, 1940, there will be a margin under this limitation of only $1,700,000,000 which can be availed of by the Treasury to issue additional public-debt obligations for the purpose of obtaining funds in addition to $700,000,000 to be recovered from governmental corporations, to meet the increased deficit in the fiscal year 1941 if the President's defense recommendations are adopted by the Congress. More than $1,600,000,000 of this deficit will be due to additional emergency national defense expenditures. On the basis of present recommendations, total national defense expenditures will amount to about $3,250,000,000, the highest amount spent for this purpose in any year in our history, except for the two fiscal years when this country participated in the World War.

In order to finance national defense expenditures after June 30, 1940, it is proposed to permit the Treasury to issue within the framework of current statutes relating to the public debt, $4,000,000,000 of short-term public-debt obligations with maturities not exceeding five years, to be designated "National Defense Series." These obligations will be in addition to the $45,000,000,000 face amount of public-debt obligations permitted to be outstanding under the Second Liberty Bond Act, as amended. This additional $4,000,000,000 authorization for national defense obligations permits only a temporary increase in the limitation on outstanding public-debt obligations because, to the extent that such national defense obligations are retired under the provisions of section 301, the authorization will be reduced.

1940–29–10337

REVENUE ACT OF 1940.

[House of Representatives Report No. 2697, Seventy-sixth Congress, Third Session.]

[June 21, 1940.]

Mr. Doughton, from the committee of conference, submitted the following conference report [to accompany H. R. 10039]:

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H. R. 10039) to provide for the expenses of national preparedness by raising revenue and issuing bonds, to provide

a method for paying for such bonds, and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

* * * * * * *

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE.

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H. R. 10039) to provide for the expenses of national preparedness by raising revenue and issuing bonds, to provide a method for paying for such bonds, and for other purposes, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

Amendment No. 1: The Senate amendment provides that the tax on foreign corporations not engaged in trade or business in the United States and not having an office or place of business therein shall be at a uniform rate of 15 per cent. Under the House bill the rate was 11 per cent in the case of income from dividends, and 16 per cent in the case of all other fixed and determinable receipts. (See amendments Nos. 2, 3, and 10.) The House recedes.

Amendment No. 2: The Senate amendment restores the 15 per cent withholding rate in the case of interest on tax free covenant bonds paid to foreign corporations not engaged in trade or business in the United States and not having an office or place of business therein. Under the House bill the rate was 16 per cent. (See amendments Nos. 1, 3, and 10.) The House recedes.

Amendment No. 3: The Senate amendment provides for withholding of corporation tax at the source in the case of foreign corporations not engaged in trade or business in the United States and not having an office or place of business therein at the uniform rate of 15 per cent rather than the 16 per cent and 11 per cent rates provided in the House bill. (See amendments Nos. 1, 2, and 10.) The House recedes.

Amendment No. 4: The Senate amendment substitutes for the requirement of the House bill that every trust with a gross income of $100 or over file an income tax return, a requirement that every trust with a gross income of $800 or over file a return and every trust with a net income of $100 or over file a return. The House recedes.

Amendment No. 5: The Senate amendment eliminates the provision of the House bill under which cigarette papers in books of 25 papers or less were to be subject to the cigarette paper tax. The House recedes.

Amendments Nos. 6 and 7: These amendments make changes in section numbers. The House recedes.

Amendment No. 8: This amendment makes a change in a cross reference, and the House recedes.

Amendments Nos. 9, 11, 12, 13, 14, 15, 16, 17, 18, 19, 21, 22, 27, 28, 29, 32, 33, 34, 35, and 43: These amendments change the designation in the headings of sections and subsections and of columns in schedules, and references thereto, from "Super-tax" to "Defense tax." The House recedes.

Amendment No. 10: The Senate amendment provides for a uniform withholding rate of 16.5 per cent for the 5-year period rather than the 12½ per cent, 16½ per cent, and 17½ per cent rates provided in the House bill. The amendment also contains a clarifying change to assure the maintenance of treaty obligations in the case of withholding on dividends. (See amendments Nos. 1, 2, and 3.) The House recedes.

Amendments Nos. 20, 23, and 24: The Senate amendments provide that in cases where articles leased or sold with respect to which under section 3441(c) of the Internal Revenue Code payment of the tax is required as the installment payments for the article are received, the increased rates in the bill will not apply if the lease, contract of sale, or conditional sale was made before July 1, 1940, and delivery of the article was made before that date. The House recedes.

Amendment No. 25: The Senate amendment eliminates the House provision under which admissions of more than 30 cents and less than 41 cents were subject to tax, for the 5-year period. It substitutes therefor the following rates:

If the amount paid is 10 cents or more, and less than 20 cents, 1 cent; if the amount paid is 20 cents or more, 1 cent for each 10 cents or fraction thereof; if the amount which would be charged for a single admission is 10 cents or more, 1 cent for each 10 cents or fraction thereof of the amount paid for a season ticket or subscription.

The other provisions of the amendment merely rewrite the provisions of existing law.

The House recedes with an amendment which restores the House provision but reduces the exemption so that admissions of less than 21 cents are exempt.

Amendment No. 26: The Senate amendment eliminates the increased rates of tax on tobacco products provided for the 5-year period by the House bill and the floor stocks tax imposed thereunder.

The House recedes with an amendment which eliminates all increases in tax on tobacco products, except cigarettes, and eliminates the increase in tax on cigarette papers. The conference agreement also substitutes for the House rates on cigarettes of $3.50 per thousand and $8.40 per thousand rates of $3.25 per thousand and $7.80 per thousand. The conference agreement also imposes a floor stocks tax at the increased rates on all cigarettes held on July 1, 1940, for sale.

Amendment No. 30: The Senate amendment increases, for the 5-year period, the rate on rectifying distilled spirits from 30 cents per proof gallon to 40 cents per proof gallon. There is no comparable provision in the House bill. The Senate recedes.

Amendment No. 31: The Senate amendment eliminates the exemption from the floor stocks tax on distilled spirits of 100 wine gallons held by a retail dealer in liquors. Under the amendment floor stocks of rectified distilled spirits are subjected to a rate 10 cents per proof gallon higher than the basic rate of 75 cents. For administrative reasons, this additional rate is not to apply to distilled spirits which are rectified spirits solely by reason of the addition of not more than 2½ per cent by volume of coloring, blending, smoothing, or flavoring materials, and is not to apply to liqueurs, cordials, or similar compounds. Technical changes are made in the provisions relating to return and payment of the floor stocks tax.

The House recedes with an amendment which eliminates the additional 10-cent rate on floor stocks of rectified spirits. The amendment also contains an exemption of 100 wine gallons held by any person on retail stocks on July 1, 1940, on premises as to which he is for any period beginning on that date exclusively engaged in business as a retailer.

Amendments Nos. 36, 37, 38, 39, and 40: These Senate amendments increase the rates on certain still wines and strike out references to the tax on fortification of wine. These amendments are consistent with the recent increase in tax on still wines and the elimination of the tax on fortification of wines. The House recedes.

Amendments Nos. 41 and 42: Amendment No. 41 strikes out the exemption of retail dealers from the floor stocks tax on fermented malt liquors. Amendment No. 42 inserts a modified exemption of retail stocks. This provides that the exemption shall apply only to retail stocks which, on July 1, 1940, are held on retail premises. Such premises are confined to premises with respect to which the dealer is a retail dealer exclusively. If with respect to such premises the dealer is a wholesale dealer or brewer also, the exemption is not allowed as to any of the fermented malt liquor held on the premises. The House recedes.

Amendment No. 44: This amendment inserts a new title number, "Title IV." The House recedes.

Amendment No. 45: The Senate amendment amends the Public Salary Tax Act of 1939 to provide that no income tax shall be assessed or collected after the date of enactment of the bill which is attributable to compensation received prior to January 1, 1939, for personal service as a State officer or employee even though such compensation was paid directly or indirectly by the United States. There is no comparable provision in the House bill. The House recedes with an amendment which provides that, if the amount of deficiency in income tax which is attributable to such compensation is paid with interest on or before March 15, 1941, no civil or criminal penalties shall be imposed on account of failure to pay such amount or make return of such compensation.

Amendment No. 46: This amendment inserts a new section imposing an excess profits tax. The Senate recedes.

Amendment No. 47: This amendment proposes taxes which become effective in the event of war. The Senate recedes.

R. L. DOUGHTON,
THOS. H. CULLEN,
JOHN W. MCCORMACK,
JERE COOPER,
ALLEN T. TREADWAY,
FRANK CROWTHER,
HAROLD KNUTSON,
Managers on the part of the House.

1940–30–10347

PROVISIONS OF BANKRUPTCY ACT WITH RESPECT TO BASIS OF PROPERTY FOR INCOME-TAX PURPOSES.

[House of Representatives Report No. 2372, Seventy-sixth Congress, Third Session.]

[June 4, 1940.]

Mr. McLaughlin, from the Committee on the Judiciary, submitted the following report [to accompany H. R. 9864]:

The Committee on the Judiciary, to whom was referred the bill (H. R. 9864) amending the Bankruptcy Act with respect to the basis of property and excluding certain corporations from the provisions of Chapter XI, after consideration, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Page 2, line 9, strike out "the date as of which the plan became effective" and insert "the date of entry of the order confirming the plan."

Page 3, line 7, strike out "the date as of which the plan became effective" and insert "the date of entry of the order confirming the arrangement."

Page 4, line 5, strike out "the date as of which the plan became effective" and insert "the date of entry of the order confirming the arrangement."

Page 4, line 14, to page 6, line 16, strike out sections 4, 5, 6, and 7.

Amend the title to read:

"A bill amending the Bankruptcy Act with respect to the basis of property."

The bill had two purposes:

1. Sections 1, 2, and 3 provided for identical amendments to sections 270, 396, and 522 of the Bankruptcy Act. Those sections, which are themselves identical, deal with the basis of property for income-tax purposes. Where a proceeding for "corporate reorganization" under Chapter X, for an "arrangement" under Chapter XI, or for a "real-property arrangement" under Chapter XII results in a cancellation or reduction of indebtedness, those three sections require (with limited exceptions) that the basis of the debtor's property for income-tax purposes, State as well as Federal, be decreased by an amount equal to the amount of such cancellation or reduction. The first three sections of the bill amend sections 270, 396, and 522 so as to prevent the basis of the debtor's property from being decreased, as a result of those sections, to an amount less than the fair market value of such property. Your committee's amendments to sections 1, 2, and 3 of the bill are designed to make more definite and certain the time as of which the fair market value of the property in question is to be determined, by fixing such time as the date of entry of the order confirming the plan or the arrangement, as the case may be.

2. Sections 4, 5, 6, and 7 of the bill, which are eliminated by the last of your committee's amendments, provided for amendments to Chapter XI of the Bankruptcy Act which were designed to prevent corporations which are publicly indebted or owned from filing a petition for an arrangement under Chapter XI, rather than a petition for reorganization under Chapter X, the chapter specially designed for the reorganization of such corporations, and to establish a numerical test of such "public" indebtedness or ownership.

Your committee believes that, while the amendments proposed by sections 4, 5, 6, and 7 are desirable, the element of emergency requiring their immediate passage has been eliminated by the decision of the United States Supreme Court in *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.* That decision was rendered on May 27, 1940, after the introduction of the bill. Since immediate action on these proposals does not appear to be necessary, the last of your committee's amendments provides for the striking out of sections 4, 5, 6, and 7. The committee's conclusion is supported by all of the witnesses who testified at the hearings before the committee's Subcommittee on Bankruptcy and Reorganization and also by the report of the Securities and Exchange Commission on the bill.

NECESSITY OF PROMPT ENACTMENT OF BILL AS AMENDED.

With respect to the amendments proposed by sections 1, 2, and 3, however, your committee believes, for the reasons hereinafter set forth, that the present provisions of section 270 are unfair to a substantial number of debtor corpora-

tions heretofore reorganized or now in the process of reorganization under Chapter X; that those provisions are frequently a serious obstacle to the development of a fair and feasible plan; and that sections 396 of Chapter XI and 522 of Chapter XII are open to the same criticisms. So long as sections 270, 396, and 522 continue in their present form, these unfair and undesirable consequences will continue to affect the substantial volume of proceedings under those chapters which are now in the courts or are hereafter instituted. For that reason your committee believes it to be essential that the sections be amended at the earliest practicable date.

The Subcommittee on Bankruptcy and Reorganization of the Committee on the Judiciary held hearings on the bill on the morning and afternoon of June 3. Representatives of the Treasury Department and the Securities and Exchange Commission and members of the National Bankruptcy Conference appeared and testified at those hearings. The National Bankruptcy Conference is an informal group composed of members of bar associations, associations of credit men, and commercial lawyers, the National Association of Referees in Bankruptcy, law school professors, and others which for more than five years cooperated with your committee in the preparation of the 1938 amendments of the Bankruptcy Act.

The amendments proposed by sections 1, 2, and 3 were favorably reported by the Treasury Department and the Securities and Exchange Commission. The Treasury Department said in its report on the bill H. R. 9864:

"* * *, the first three sections of H. R. 9864 would amend sections 270, 396, and 522 to limit any reduction of basis thereunder to an amount not less than the fair market value of the property involved. If the committee is of the opinion that an amendment is desirable at this time, the method adopted meets with the approval of the Treasury Department. The amendment would impose a definite limitation upon the amount of the adjustment provided and would appear to meet adequately the chief criticism urged against the existing law. After careful consideration of various approaches to the problem, the Treasury is of the opinion that the direct approach followed in the bill may prove to be the most satisfactory both from the viewpoint of effectiveness and administration."

All of the other witnesses who testified at the hearings agreed with your committee's conclusion that it is essential that sections 270, 396, and 522 be amended at the earliest practicable date. While two of the witnesses before the subcommittee would have preferred that the amendments take a somewhat different form, even those witnesses agreed that it was preferable to enact at this time the amendments proposed in sections 1, 2, and 3 of the amended bill rather than to defer action on the problem until the next session of the Congress.

The "basis" of property for income-tax purposes is important from at least two points of view: (1) The amount of depreciation (or depletion) which may be claimed annually in future income-tax returns, and (2) the determination of gain or loss resulting from future sales or exchanges of the property in question.

The record of the hearings contains testimony and exhibits with regard to the practical consequences of section 270 as observed by the Securities and Exchange Commission in the exercise of its advisory functions under Chapter X. Up to May 17, 1940, plans of reorganization were confirmed in 38 cases in which the Commission participated as a party pursuant to section 208 of that chapter. Under 6 of these plans the total indebtedness of the debtor corporation was entirely wiped out; under 12 others, it was reduced by more than one-half; and under 4 others it was reduced by at least one-third. In one case the reduction amounted to more than $40,000,000. In addition, as of May 17, 1940, the Commission was participating in 31 other proceedings under Chapter X in which a plan had been filed, but had not yet been confirmed by the court as of that date. Under 6 of these plans it was proposed to wipe out more than half of the indebtedness of the debtor corporation; under 12 others it was to be reduced by more than one-half; and under 5 others it was to be reduced by more than one-third. In one of these cases, the reduction proposed amounted to more than $23,000,000. These figures sufficiently indicate the importance of the provisions of section 270, as applied to corporations heretofore or hereafter reorganized under Chapter X.

It appears likely that in a substantial number of these cases, the application of section 270 will result in a decrease of the "basis" of the debtor's property to a figure substantially below its fair market value, or even to zero. Where the "basis" is reduced to zero, the result is that (i) the reorganized company can not take any deduction for depreciation or depletion in future State or Federal income-tax returns, not even depreciation or depletion based on the

present fair market value of its property, and (ii) if the property should be sold, the entire proceeds would constitute taxable income, even if the sale should be at a figure less than its present fair market value, which of course would be drastically less than its original cost. Where the "basis" is reduced to any other figure below the fair market value of the debtor's property the onerous consequences to the reorganized company are only less severe.

Your committee's conclusions are as follows:

(*a*) To the extent that sections 270, 396, and 522 require, in the case of debtors reorganized under Chapters X, XI, and XII, a decrease of "basis" for taking depreciation or depletion upon their property or for measuring gain or loss on future sales to a figure below the present fair market value of such property, those sections are intrinsically unfair to debtors reorganized under those chapters. This unfairness would be eliminated by the amendments proposed in sections 1, 2, and 3 of the bill. Those amendments provide a fair market value "floor" below which the basis shall not be reduced.

(*b*) The present sections frequently provide an appealing argument for not reducing the outstanding indebtedness of the debtor corporation even though, in the light of present values, a failure to effect such reduction results in an unsound capital structure and a plan which does not meet the test of "feasibility" established by sections 221(2), 366(3), and 472(3), and in most cases with the accompanying risk of recurrent reorganization. In other words, the development of a fair and feasible plan is prejudiced by the injection of an altogether extraneous consideration, that is, the undesirable tax consequences. A similar possibility is avoided under the proposed amendment by the provision which makes clear that a determination of value for reorganization purposes shall not be deemed a determination of value for the purposes of the "tax basis" sections.

(*c*) The present sections may well lead debtors which should reorganize under Chapters X, XI, or XII to resort to another and less appropriate method of reorganization, such as foreclosure, with the accompanying necessity of paying dissenters in cash. This risk would also be minimized by the amendments proposed in the bill.

In order to correct the inequity resulting from the application of sections 270, 396, and 522 to plans or arrangements already confirmed under sections 12, 74, and 77B and Chapters X, XI, and XII, the bill properly proposes to make the amendments effective as of June 22, 1938, the date of approval of the Act which first inserted those sections in the Bankruptcy Act. The amendments will thus take effect as if they were a part of such Act as originally enacted.

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