Treasury Department : : : : Bureau of Internal Revenue

Internal Revenue Bulletin

Cumulative Bulletin XII-1

JANUARY–JUNE, 1933

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

Internal Revenue Bulletin

Cumulative Bulletin XII

JANUARY–JUNE, 1933

IN THIS ISSUE

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

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

In addition to publishing all Internal Revenue Treasury Decisions, it is the policy of the Bureau of Internal Revenue to publish all rulings and decisions, including opinions of the General 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 General 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 General 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 General Counsel for the Bureau of Internal Revenue.

UNITED STATES GOVERNMENT PRINTING OFFICE, WASHINGTON : 1933

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

The Internal Revenue Bulletin service for 1933 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 $2 per year. 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, 80 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, 1923, 1924, 1925, 1926, 1927, 1928, 1929, 1930, 1931, 1932, and 1933 may do so at prices as follows:

Cumulative Bulletin I-1 (January–June, 1922)	40 cents
Cumulative Bulletin I-2 (July–December, 1922)	30 cents
Cumulative Bulletin II-1 (January–June, 1923)	30 cents
Cumulative Bulletin II-2 (July–December, 1923)	40 cents
Cumulative Bulletin III-1 (January–June, 1924)	50 cents
Cumulative Bulletin III-2 (July–December, 1924)	50 cents
Digest No. 13 (January, 1922–December, 1924)	60 cents
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Cumulative Bulletin IV-2 (July–December, 1925)	35 cents
Digest No. 17 (January–December, 1925)	25 cents
Cumulative Bulletin V-1 (January–June, 1926)	40 cents
Cumulative Bulletin V-2 (July–December, 1926)	30 cents
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Cumulative Bulletin VI-1 (January–June, 1927)	40 cents
Cumulative Bulletin VI-2 (July–December, 1927)	40 cents
Digest No. 22 (January, 1925–December, 1927)	35 cents
Cumulative Bulletin VII-1 (January–June, 1928)	35 cents
Cumulative Bulletin VII 2 (July–December, 1928)	50 cents
Cumulative Bulletin VIII-1 (January–June, 1929)	50 cents
Cumulative Bulletin VIII-2 (July–December, 1929)	55 cents
Cumulative Bulletin IX-1 (January–June, 1930)	50 cents
Cumulative Bulletin IX-2 (July–December, 1930)	50 cents
Cumulative Bulletin X-1 (January–June, 1931)	65 cents
Cumulative Bulletin X-2 (July–December, 1931)	80 cents
Cumulative Bulletin XI-1 (January–June, 1932)	30 cents
Cumulative Bulletin XI-2 (July–December, 1932)	30 cents
Cumulative Bulletin XII-1 (January–June, 1933)	30 cents
Digest A (income tax rulings only, April, 1919, to December, 1930, inclusive)	$1.50

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

INTRODUCTORY NOTES.

The Internal Revenue Cumulative Bulletin XII-1, in addition to all decisions of the Treasury Department (called Treasury decisions) pertaining to Internal Revenue matters, contains General Counsel's opinions, and rulings and decisions pertaining to income, estate, sales, and capital stock taxes, as indicated on the title-page of this Bulletin, published in the weekly Bulletins (Volume XII, Nos. 1 to 26, inclusive) for the period January 1 to June 30, 1933. 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, 1932, to June 30, 1933.

Income Tax rulings are printed in three parts. Rulings under the Revenue Act of 1932 are published as Part I, the section headings corresponding with the sections of that law and the article headings corresponding with the article headings of Regulations 77. Rulings under the Revenue Act of 1928 are published as Part II, the section and article headings corresponding with the section and article headings of the Revenue Act of 1928 and Regulations 74. Rulings under the Revenue Act of 1926 and prior Acts are printed as Part III, the section and article headings corresponding with the section and article headings of the Revenue Act of 1926 and Regulations 69.

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.
B. T. A.—Board of Tax Appeals.
C. B.—Cumulative Bulletin.
Ct. D.—Court decision.
C. S. T.—Capital Stock Tax Division.
D. C.—Treasury Department circular.
E. T.—Estate Tax Division.
G. C. M.—General Counsel's memorandum.
I. T.—Income Tax Unit.
M, N, X, Y, Z, etc.—The names of corporations, places, or businesses, according to content.
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
S. T.—Sales Tax Division.

S. M.—Solicitor's memorandum.
Sol. Op.—Solicitor's opinion.
S. R.—Solicitor's recommendation.
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 Court of Appeals of 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.

For additional information which will be of assistance in the use of the Internal Revenue Bulletin service read the Introductory Notes to the latest Digest.

CONTENTS.

CONTENTS OF CUMULATIVE BULLETINS (I. T.) 1 TO 5; S. T. FOR 1920 AND 1921; INTERNAL REVENUE I-1, I-2, II-1, II-2, III-1, III-2, IV-1, IV-2, V-1, V-2, VI-1, VI-2, VII-1, VII-2, VIII-1, VIII-2, IX-1, IX-2, X-1, X-2, XI-1, XI-2, AND XII-1.

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, 1932, TO JUNE 30, 1933, 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 Bulletin, from December 22, 1924, to December 31, 1931, inclusive, are printed in Cumulative Bulletin X-2, pages 1-106. The list below, therefore, contains only such announcements published in the weekly Bulletins from January 1, 1932, to June 30, 1933, inclusive.]

[4] XII-26-6246

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.			
Abeles, Charles T	40546	24	435
Abeles, Clifford	37695	24	435
Abeles, Francis, estate of	37693	24	435
Abeles, John T	37694	24	435
Abeles, Katherine	37696	24	435
Abeles, Williemene H	41034	24	435
Acme Manifolding Co., Inc	25194 38687	24	429
Adelaide Park Land et al., trustees	39980	25	211
Afremow, David, estate of	39593	25	1246
Afremow, Sarah, executrix	39593	25	1246
Albert Lea Packing Co., Inc	20765	24	376
Albrecht et al., Katherine B., executrices (April 6, 1933) [1,2]	41295	27	
Alexander, J. F., estate of (April 26, 1933) [2]	39019	27	
Allen, Irene C	25414	25	834
Allied American Corporation	31704	25	1276
American Cigar Co	16229	21	464
American Feature Film Co	27623	24	18
American Security & Trust Co. et al., executors [1]	39167	24	334

[1] Estate tax decision; acquiescence relates to deduction of $133,000.
[2] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[3] Estate tax decision.
[4] Ruling No. 6246 includes all acquiescence and nonacquiescence notices published in the Internal Revenue Bulletin service from January 1, 1932, to June 30, 1933.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Anderson, Gustave	36224	26	1208
Ashforth, Albert B., estate of [1]	47190 48009 49354	26	1188
Ashforth et al., Mabel A., executors [1]	47190 48009 49354	26	1188
B.			
Baldwin, Florence G	32387	23	512
Balfour, Sir Robert	40230	25	154
Bankers Dairy Credit Corporation	48329	26	886
Barber, Arthur	26747	25	513
Barber, Philip C	26755	25	513
Barber, St. George	26757	25	513
Barber Trusts, Sarah P	26747– 26757	25	513
Barclay, W. L	8743	26	970
B & B Ice & Coal Co. (April 28, 1933)[2]	67637	27	----------
Beaumont, Louis D	31931 46569 49422	25	474
Bebb, Richard E., estate of (April 6, 1933)[2, 3]	41295	27	----------
Bell, Ivor B.[4]	22335	27	377
Bellows Falls Power Co	18592 29104	25	195
Bent Co., R. G	57312 59796	26	1369
Best, Frank E	36746	26	1070
Bingham, Robert W	51051	27	186
Birdneck Realty Corporation	46079	25	1084
Biscayne Bay Islands Co	27616 35098 40147	23	731
Bloodgood, Edith B	26750	25	513
Blum, Julius, trustee	39242 40939 45741 51507	25	119
Boos Bros. Cafeteria Co	39200	25	651
Borg & Beck Co	24223 34964	24	995
Bowden, Paul Akers	54923	26	1410
Brown, Berenice	24667 36637	25	814
Bryan et ux., C. A	24036	19	111
Bryan et ux., L. J	24037	19	111
Buck, John A., estate of [5]	32584 44153 44684	25	780
Buck et al., Mary M., executors [5]	32584 44153 44684	25	780

[1] Nonacquiescence published in Bulletin XII–1, page 1, withdrawn.
[2] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[3] Estate tax decision; acquiescence relates to deduction of $133,000.
[4] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.
[5] Estate tax decision; acquiescence relates to value of certain real estate in San Francisco and value of stock of Langendorf Baking Co. for estate tax purposes; and reasonableness of Commissioner's allowance for support of the widow.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Buena Vista Land & Development Co	2025	13	895
Buffalo Union Iron Furnace Co.[1]	16075 16076	23	439
Bullock, George [2]	31209	23	710
Butler, U. H	46055	24	506
C.			
California Coast Oil Co	25018	25	902
Camp Manufacturing Co	35955	25	537
Carman, F. J	44321 44939 50178	25	162
Carnie-Goudie Manufacturing Co	20074 27095	24	679
Cathey, George	46056	24	506
Cathey, Luke	46057	24	506
Catlin, Daniel K	25421	25	834
Catlin, Theron E	25413	25	834
Central Market Street Co.[3]	24837	25	499
Central National Bank, trustee	28701	25	1123
Central Rendering Corporation	20776	24	376
Champion, David J. (April 27, 1933)[4, 5]	55569 63818	27	-------
Champion, T. Pierre (April 27, 1933)[4, 5]	55568	27	-------
Chapman & Dewey Land Co	37403 51059	25	1166
Chapman & Dewey Lumber Co	33466 37402 47130 50196 51058	25	1166
Christopher, Rachel S. [6]	47704	26	292
City Bank Farmers Trust Co. et al., executors [6]	31869	23	663
Clark et al., James, executors	34499	24	1235
Clements, W. L	46058	24	506
Clinchfield Securities Co	40554	25	446
Cochrane, David K	60428	26	1167
Colgate, Mary	61882	27	506
Colorado & Utah Coal Co	53799	26	588
Columbian Carbon Co.[7]	42743	25	456
Connecticut River Power Co	18591 29106	25	195
Cook, Elizabeth E. [8]	38579	25	1351
Cook, M. M., estate of	53044	27	33
Cooke, Beatrice B	26751	25	513
Coombs, Elizabeth M	44768	25	1320
Coombs, J. Howard	44769	25	1320
Cooper, John I	32610 40115	24	216

[1] Acquiescence relates to issue regarding deductions for obsolescence of blast furnaces.
[2] Acquiescence relates to issue 2 of decision.
[3] Acquiescence relates to issue regarding apportionment of taxes among affiliated corporations.
[4] Acquiescence relates to basis upon which gain or loss upon redemption of stock should be computed.
[5] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after taxpayer's name.
[6] Estate tax decision.
[7] Nonacquiescence published in Bulletin XI-14, page 1, revoked.
[8] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
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Cornwell, F. L.	30303	24	915
Costello, Joseph [1]	22640	27	377
Cotton, G. E.	59655	25	866
Croker, Bula E. (January 31, 1933) [2]	41121	27	----
Cromwell et al., William Nelson, executors [3]	42619	24	461
Crouse, George N.	43446 51419	26	477
Crowley, Joseph J., estate of [4]	35472	25	340
Crowninshield Shipbuilding Co.	18987	24	925
Culver, Wilmer T.	37574	24	1013
Cunard Coal Co.[5]	26874 26875 28792	26	234
D.			
Dahl, Andrew H., estate of	44845	24	1167
Dahl et al., Julia, executors	44845	24	1167
Daley, Eugene S., executor	26645	25	949
Davis, John A.	20703	24	36
De Forest, Kate R.[6]	37284	27	373
Delaware & Hudson Co.[7]	50553 50629	26	520
Dennis, Frank H., estate of [4]	50263	26	1120
Dennis, Merry M., executrix [4]	50263	26	1120
Detroit Trust Co. et al., executors [4]	35472	25	340
Dickinson, Albert G.	35015 43176	23	1211
Dirksen, Anna L., executrix	17717	24	1152
Dirksen, Theodore H., estate of	17717	24	1152
Dome Co.	41887	26	967
Dominion National Bank	52165	26	421
Douglas Co., John	38726	23	1307
Drexel Packing Co.	20775	24	876
Duff, Robert C.[8]	37552	23	1342
Dunham, Walter E. (April 6, 1933)[2]	66308	27	----
E.			
Eagle Pass & Piedras Negras Bridge Co.	42460	23	1337
Elkins, Hallie D.[9]	39255	24	572
Elliott-Granite Linen Corporation	48212	26	936
Elmore Milling Co.	46768 52972	27	84
Emery, Mary M., estate of [9]	40899	25	585
Enameled Metals Co.	19011	25	186

[1] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.
[2] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[3] Estate tax decision; nonacquiescence published in Cumulative Bulletin X-2, page 84, revoked.
[4] Estate tax decision.
[5] Acquiescence relates to deductions for additional royalties and officers' salaries and directors' fees.
[6] Gift tax decision.
[7] Nonacquiescence published in Cumulative Bulletin XI-2, page 12, withdrawn.
[8] Acquiescence relates to issue 1 of decision.
[9] Nonacquiescence published in Cumulative Bulletin XI-1, page 9, revoked.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Ennis Ice Co	22021, 22022, 26259, 42184	24	40
Evergreen Cemetery Association	30726	25	544
F.			
Falck, Alexander D	20452	26	1359
Falls City Ice & Beverage Co. (April 28, 1933) [1]	67636	27	
Fame Canning Co	20774	24	376
Farmers Life Insurance Co.[2]	43317	27	423
Farmers' Loan & Trust Co., trustee	29465	26	1359
Federal Street & Pleasant Valley Passenger Ry. Co	29758	24	262
Fidelity Savings & Loan Association	14862, 31801, 39406, 45215	23	1059
First National Bank of Boston, administrator	36438, 46583	25	252
First National Bank of Key West	45186	26	370
Florence Manufacturing Co	15383, 26079	25	676
Folk, H. B	28396, 31018	25	599
Forest Products Chemical Co. (January 31, 1933) [1]	46621	27	
Forres, Lord	40229, 43973	25	154
Foster, L. B.[3]	43086	26	1328
Foster, N. C., estate of [4]	32984	25	414
Foster et al., Willard, executor [4]	32984	25	414
Frank Emil (April 11, 1933) [1]	50224	27	
G.			
Gambill, A. A	47902	26	995
Gardner, Charles E.[5]	38575	25	1351
Garron et al., Isabel K. J., executors [4]	47705	26	292
George, Jerome R. (February 20, 1933) [1]	45240	27	
George Machinery Co., R. B	61218	26	594
Ginsberg, Albert A	27628	24	18
Ginsberg, Nathan A	27629	24	18
Globe Construction Co	43438, 51694, 53310	25	146
Golden, Edward A	27625	24	18
Goldman, Maxwell	30302	24	915
Gordon, Kizzie [6]	22332	27	377
Gordon, Max L.[6]	22333	27	377
Graeper, W. A. (January 31, 1933) [1]	46619	27	
Grand River Gravel Co	23085	22	1124
Green, Robert D.[7]	53647	24	719

[1] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[2] Acquiescence relates to issue in connection with option payment received for purchase of land.
[3] Acquiescence relates to issue regarding filing of separate return for 1925.
[4] Estate tax decision.
[5] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.
[6] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.
[7] Acquiescence relates to transactions 1, 2, 3, and 4.

ACQUIESCENCES—Continued.

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Green, W. S.	43786, 46373, 63487	26	1017
Grey Bull Corporation (March 7, 1933) [1]	47376	27	
Griffis, Stanton [2]	38577	25	1351
Griffiths, George W	42498	25	1292
Griffiths, John	43074	25	1292
Guaranty Building & Loan Co. (February 20, 1933)[1]	55352	27	
Gulf Coast Irrigation Co.[3]	33694, 40081, 41343	24	958
Gurnee, Augustus Coe, estate of [4]	42619	24	461
H.			
Haberland, Paul	29289	25	1370
Hailey-Ola Coal Co	30962	24	895
Halladay, Sarah P	26754	25	513
Hamburg, jr., Sam	30304	24	915
Hanscom, Edward E., estate of [5]	44992	24	173
Hanscom et al., Melville, executors [5]	44992	24	173
Harbeson Lumber Co., W. B	33076, 51012	24	542
Harbison, Ralph W	54346	26	896
Harbison, William Albert	54347	26	896
Hartford-Empire Co	29958, 41736, 53600	26	134
Havard, Charles	32841	25	1161
Hay, W. H	37499	25	96
Hayman Co., B	16552	25	736
Hemphill, Clifford [3]	38573	25	1351
Hervey, W. R	46806	25	1282
Hess, Nathaniel J	33279	24	475
Hettman, Walter E.[6]	22341	27	377
Hickman, Fannie Snyder	16253	24	438
Himelhoch Bros. & Co	41728, 42769, 45663	26	541
Hires Co., Charles E	47781	26	1351
Hobbs, Henry	27352	26	241
Hobbs, Teck	27351	26	241
Hoffer, Anita Owens	33374	24	22
Hoffer, T. B	33375	24	22
Hollingsworth, A. E. (January 31, 1933) [1]	54282	27	
Hollister, George Buell	29461	26	1359
Houghton, Alanson B	29445	26	1359
Houghton, jr., Amory, estate of	29444	26	1359
Houghton, Arthur A	29446	26	1359
Houghton, Charles F., estate of	29465	26	1359

[1] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[2] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.
[3] Acquiescence relates to all issues except affiliation issue.
[4] Estate tax decision; nonacquiescence published in Cumulative Bulletin X-2, page 88, revoked.
[5] Estate tax decision.
[6] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee, and to limitation issue.

ACQUIESCENCES—Continued.

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Houston, Philip D.[1]	22007	22	51
Hunter, C. W., executor	45417	26	417
Hunter, George H., estate of	45417	26	417
Huyler's, Inc	28369, 29154, 39841	24	425
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Independent Ice & Coal Co. (April 28, 1933) [2]	67639	27	
Ingalls, Charles C., estate of [3]	57835	25	773
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Iten Biscuit Co	16429, 20899	25	880
K.			
Kammerdiner, J	41643, 46555	25	495
Kansas City Leasehold & Improvement Co.[4]	35718	17	213
Kansas City & Memphis Farms Co	51060	25	1166
Kasch, Ed	48293	25	284
Kasch, Theodora	48293	25	284
Kelley, John P	38233	26	212
Kent, Everett E	39576, 42589, 46064	26	482
Kibele, O. B.[5]	24882	27	377
Kinney Co., Inc., G. R	31397, 32980	26	1091
Kraemer, Samuel	37822	25	686
Kuhn, Ida L	32609, 40267	24	216
Kunau et al., Oscar F. C., trustees	64815	27	509
L.			
Lake Charles Naval Stores	34630, 36940	25	173
Landers, Douglas J., estate of [3]	35443	21	1347
Lawson, John	40232	25	154
Leamington Hotel Co	48413	26	1004
Leidesdorf, Samuel D	48305	26	881
Leonard Holding Corporation, George B., estate of	48871	26	46
Ley, George W.[5]	22336	27	377
Ley, Mary C.[5]	22337	27	377
Liberty Farms Co	26717, 29899	22	1298

[1] Acquiescence relates only to deduction for business expenses in 1920 and to number of feet of timber cut during 1919.

[2] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.

[3] Estate tax decision.

[4] Acquiescence relates to March 1, 1913, value, for purposes of calculating gain or loss upon sale of land at Versailles, Mo.; whether the invested capital of the Simcoe Realty Co. should be increased for 1918; and the March 1, 1913, value for amortization purposes of a leasehold belonging to Kansas City Leasehold & Improvement Co.

[5] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Lincoln, Robert Todd, estate of [1]	39167	24	334
Lippincott et al., J. Bertram, executors (February 11, 1933) [1,2]	49233	27	-------
Lippincott, Walter, estate of (February 11, 1933) [1,2]	49233	27	-------
Littauer, Eugene, estate of [3]	51858	25	21
Littauer et al., Lucius N., executors [3]	51858	25	21
Little, C. B. (March 24, 1933) [3]	61821	27	-------
Livingood, Charles J., executor [4]	40899	25	585
Loeb, jr., et al., William, trustees	34161	26	635
Logel, Joseph F	37762	24	798
	40071		
Longyear, Mary B., estate of	36438	25	252
	46583		
Lourie, David A	27630	24	18
Luhrig Collieries Co	40048	26	194
M.			
Markham Irrigation Co. [5]	41344	24	958
Martin Hotel Co. and affiliated corporations	16275	24	899
Martin et al., J. Earle, trustees	44583	24	862
Martin, T. S., estate of	44583	24	862
Martins, Andy [6]	22334	27	377
Marvin, Walter S. [7]	38578	25	1351
Matagarda Canal Co. [5]	40082	24	958
	41345		
Matthews, J. P	26250	22	858
Mauldin, I. M	26239	22	858
McCall, Florence [1]	47702	26	292
McCool, Bess	46059	24	506
McEwan, Anna B	25996	26	727
McEwan et al., Anna B., executors	25997	26	727
McEwan, A. F	25995	26	727
McEwan, Lillian G	25994	26	727
McEwan, W. H., estate of	25997	26	727
McGrew, Elizabeth W	26753	25	513
McLennan, A. R	26730	25	1052
McMillan, William Northrup, estate of [8]	45966	27	318
Mercantile-Commerce National Bank in St. Louis et al., executors and trustees [1]	35443	21	1347
Messer, Richard B., estate of (January 31, 1933) [1, 2]	42513	27	-------
Metropolitan Properties Corporation	45032	24	220
Michigan Trust Co. et al., executors (January 31, 1933) [1, 2]	42513	27	-------
Milby & Dow Coal & Mining Co	22021	24	40
	22022		
	26259		
	42184		

[1] Estate tax decision.
[2] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[3] Estate tax decision; acquiescence relates to issues 4, 5, and 7 of decision.
[4] Nonacquiescence published in Cumulative Bulletin XI-1, page 10, revoked.
[5] Acquiescence relates to all issues except affiliation issue.
[6] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.
[7] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.
[8] Estate tax decision; acquiescence, except in so far as concerns the question of situs.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No	Board of Tax Appeals.	
		Volume.	Page.
Milgrim & Bros., Inc., H.[1]	33177	24	853
Mississippi Packing Co., Inc	20772	24	376
Mitchell, Oscar [2]	41680 41874 54673	27	101
Mobile Light & Railroad Co.[3]	41026 42062	23	543
Moorehead, William A	25853	22	858
Murphy, Mae A. Kelley	38222	26	212
Murtha & Schmohl Co	17911	17	442
Musgrove, Floyd L (January 31, 1933)[4]	42591	27	-------
Mutual Assurance Society of Virginia	43911	24	1102
N.			
Nail et al., R. E., executors	53044	27	33
National Contracting Co.[5]	24520	25	407
National Mill Supply Co	37001	23	1362
National Packing Corporation	31668 33971	24	952
Netcher, Charles, estate of	38053	26	101
Netcher, Gladys Oliver, executrix	38053	26	101
Netcher, Irving	38052	26	101
Netcher, Townsend	38050	26	101
Newaygo Portland Cement Co. (April 6, 1933)[4]	36319	27	-------
Newblock Oil Co. of Texas [6]	28045	26	696
Newbury, Mollie Netcher	38049	26	101
Newbury, Mollie Netcher, trustee	38052	26	101
Newell et al., Sterling, executors [7]	57835	25	773
New England Power Co	18593 29105	25	195
New Market Investment Co.[8]	35719	17	213
Newton, Elizabeth K.[7]	47703	26	292
Newton, Joseph R., estate of [7]	47705	26	292
New York, Chicago & St. Louis R. R. Co	21047	23	177
North Side Lumber & Timber Co. (April 14, 1933)[4]	34924	27	-------
Northern Coal Co.[9]	34945	24	307
Noyes, Jansen [10]	38574	25	1351
O.			
Oakley, Richard H	45778	24	1082
Ontario Realty Co.[8]	35721	17	213

[1] Acquiescence relates to issue 1 of decision.

[2] Acquiescence relates to issues regarding assignment of earnings of iron mines in payment of legal services, and deduction of amount paid to son for alleged services rendered.

[3] Acquiescence relates to following issues: 1. Whether payments received by a trustee on behalf of petitioner in the taxable years in accordance with a written agreement entered into by and between petitioner and another in 1906 constitute taxable payments of rent or nontaxable payments on the selling price of assets. 2. Whether petitioner sustained statutory net losses for 1924 and 1926 which can be deducted from its income for 1925 and 1926, respectively.

[4] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.

[5] Acquiescence in Board's decision that petitioner had the right to allocate overhead expenses to each contract on completed basis and that formula used by petitioner was permissible; and issue relative to negligence.

[6] Nonacquiescence published in Cumulative Bulletin XI-2, page 15, revoked.

[7] Estate tax decision.

[8] Acquiescence relates to March 1, 1913, value, for purposes of calculating gain or loss upon sale of land at Versailles, Mo.; whether the invested capital of the Simcoe Realty Co. should be increased for 1918; and the March 1, 1913, value for amortization purposes of a leasehold belonging to Kansas City Leasehold & Improvement Co.

[9] Acquiescence relates to inventory issue.

[10] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
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P.			
Paine et al., Francis Ward, executors	34113	25	764
Paine, William A., estate of	34113	25	764
Palm Beach Mather Co	43850	24	536
Parkland Ice & Coal Storage Co. (April 28, 1933)[1]	67640	27	
Peavy-Byrnes Lumber Co	15824 16354 25984	25	223
Peavy-Moore Lumber Co	15823 16355 25986	25	223
Peavy-Wilson Lumber Co	15822 16356 25985	25	223
Pegg, Albert O.[2]	22338	27	377
Pennsylvania Investors Co	20766	24	376
Perkins et al., Jacob	28701	25	1123
Pershouse, Alice E	26749	25	513
Pershouse, Mabel B	26748	25	513
Phillips, C. J	47901	26	995
Pictorial Review Co	43995	26	472
Pizitz Dry Goods Co., Louis	46585	22	161
P-M-K Petroleum Co.[3]	50576 54779	24	360
Polar Ice & Coal Co. (April 28, 1933)[1]	67638	27	
Pope, Olive R	29274	25	1161
Powell, Benjamin I	50380	26	509
Price, Laura M	40659	24	216
Price, W. E	41072	24	216
Prophylactic Brush Co	32996 47845 47846	25	676
Prosser, Constance B	26752	25	513
Putnam Trust Co	34743	26	655
Q.			
Quinn, Evan V	8544	26	970
Quinn, Martin M	8598	26	970
Quinn, Paul H	8574	26	970
R.			
Rapp, John W., estate of	28618	24	1061
Rauh Realty Co	32822	26	48
Reardon & Sons Co., John	20773	24	376
Rialto Mining Corporation	48692 56877	25	980
Richards & Hirschfeld, Inc	21715	24	1289
Robson, Clara P., estate of	26645	25	949
Rodeo-Vallejo Ferry Co.[4]	36411 48528	24	936
Rosenberg, Louis	27626	24	18

[1] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[2] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.
[3] Acquiescence relates to third issue of decision.
[4] Acquiescence relates to deduction of contribution to Victory Highway Association.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
Rosenbloom Finance Corporation [1]	35778, 40903	24	763
Roth, Gorton	22568	26	631
Roy & Titcomb, Inc	29138	24	969
Russell, C. C	46060	24	506
Russell, Mrs. C. C	46061	24	506
S.			
St. Louis Union Trust Co., executor [2]	45966	27	818
Sanders, W. C	26651	25	949
San Martinez Oil Co	37447, 43121	25	218
Sappington, G. Ridgely	51944	25	1385
Schepp Co., L	42908	25	419
Schermerhorn, Harriet Pullman	43145	26	1031
Scovill Manufacturing Co	29854, 30238	25	265
Scruggs, Gross R	33610	24	1174
Scruggs Investment Co	46270	24	1174
Scruggs, Marian P	38711	24	1174
Seaconnet Coal Co.[3]	18089	24	307
Searles Real Estate Trust	24489	25	1115
Securities Co	40553	25	446
Sells Sporting Goods Co	20771	24	376
Shand, Gadsden	26238	22	858
Shaw, David, estate of	34499	24	1235
Shea, R. P	37835, 40034	24	798
Simcoe Realty Co.[4]	35720	17	213
Sinclaire et al., Helen B., executors	37703	26	1359
Sinclaire, Henry P., estate of	29252	26	1359
Sinclaire, jr., Henry P., estate of	37520	26	1359
Sinclaire et al., Murray, executors	37520	26	1359
Sinclaire, Reginald	37864	26	1359
Sinclaire, William, estate of	37703	26	1359
Sioux Falls Metal Culvert Co	41070	26	1324
Smith et al., Elizabeth D., executors	39291, 49668	25	291
Smith, I. N., estate of	39291, 49668	25	291
Smith, Jessie, executrix	18876	24	807
Smith, Mrs. Jessie	22313	24	807
Smith, Louis, estate of	18876	24	807
Smoot, Lewis E	32578	25	1038
South Memphis Land Co. (March 7, 1933)[5]	44500	27	-------
Southard, Jennie (January 31, 1933)[5]	42592	27	-------

[1] Acquiescence relates to holding of Board that distributions received from Joseph H. Finch & Co. were not partial liquidating dividends.
[2] Estate tax decision; acquiescence, except in so far as concerns the question of situs.
[3] Acquiescence relates to inventory issue.
[4] Acquiescence relates to March 1, 1913, value, for purposes of calculating gain or loss upon sale of land at Versailles, Mo.; whether the invested capital of the Simcoe Realty Co. should be increased for 1918; and the March 1, 1913, value for amortization purposes of a leasehold belonging to Kansas City Leasehold & Improvement Co.
[5] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
Sprague & Son Co., C. H.[1]	34946	24	307
Sprunt & Son, Inc., Alexander	38408	24	599
Standard Beef Co	20770	24	376
Standard Conveyor Co	33159 36393 40873	25	281
Stauffen, Theodora B	26756	25	513
Stearns, Robert L	37573	24	1013
Stegeman, A. V	26643	25	949
Stegeman, jr., Albert V	26650	25	949
Stegeman, Fannie L	26644	25	949
Stegeman, H. M	26647	25	949
Stegeman, H. R	26646	25	949
Stegeman, Mabel K	26649	25	949
Stegeman, William L	26648	25	949
Stevens, John H	29685	24	52
Stevenson Consolidated Oil Co.[2]	43416	23	610
Stock Yards Bank of Cincinnati	41085	25	964
Stockham, Elijah	22569	26	631
Stone et al., Irving K., executors and trustees [3]	43830	26	1
Stone, Irving Lee, estate of [3]	43830	26	1
Stoneman, David	27627	24	18
Strong, Harold C.[4]	38576	25	1351
Sullivan, Eugene C	29389	26	1359
Sunburst Oil & Refining Co	45979	23	829
T.			
Talbot, J. A.[5]	36191	23	792
Texas Irrigation Co.[6]	40083 41346	24	958
Tifft, Charles	31029 33464 42340 45957	25	986
Tifft, Lewis E	31030 33465 42341 45958	25	986
Times-Picayune Publishing Co	48892 49539	27	277
Tobey, Maurice	27624	24	18
Tolerton & Warfield Co.[7]	45320	23	892
Tracy, William R	45513	25	1055
Tricou, Sallie S	28093 40258	25	713
Trout, H. W. (April 26, 1933) [8]	39020	27	.....
Turner, Kathleen M.[9]	22340	27	877

[1] Acquiescence relates to inventory issue.

[2] Acquiescence relates to issues regarding reduction of income for fiscal year ending November 30, 1924, by loss sustained for 11 months ending November 30, 1922, and inclusion in income for all years of $1 par value of capital stock of Sunburst Oil & Gas Co. received by petitioner as a premium.

[3] Estate tax decision; acquiescence relates to issue involving deductions from gross estate.

[4] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.

[5] Acquiescence relates to loss incurred in sale of a boat.

[6] Acquiescence relates to all issues except affiliation issue.

[7] Acquiescence relates to issue regarding deduction of loss sustained by petitioner during nonaffiliated period.

[8] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.

[9] Acquiescence relates to that part of decision holding that Walter E. Hettman is not liable as a transferee; and to limitation issue.

ACQUIESCENCES—Continued.

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Twin Bell Oil Syndicate	29518	26	165
U.			
Ulster & Delaware R. R. Co	28927	25	109
Union Lard Corporation	20769	24	376
Union Pacific R. R. Co. et al [1]	35639–35649, 35684, 35685, 40060, 40061, 40062	26	1126
United Autographic Register Co	30384	27	433
United States Trust Co. of New York, trustee	26747–26757	25	513
V.			
Vaillant, Ethel Netcher	38051	26	101
W.			
Walker, George H., estate of [2]	31869	23	663
Ward Bros. Co	30992	24	989
Washington Market Co	43912	25	576
Watson, jr., John H	53414	27	463
White Oak Transportation Co.[3]	18088	24	307
Whitney, Williard M	37927	26	212
Whitson, Thomas J	40233	25	154
Wilcox, C. B. (January 31, 1933) [4]	46371	27	-------
Williams, Ella J	29273	25	1161
Williams, W. W	46062	24	506
Williamson, Alexander B	40231, 43972	25	154
Williamson, Archibald (Lord Forres)	40229, 43973	25	154
Wilson & Co., Inc., of California	20768	24	376
Wilson Commission Co	20767	24	376
Wilson & Co., Lee	33826	25	840
Wilson Shipbuilding Co.[3]	34337	25	182
Winne, Walter G	60900	27	369
Wood, Fred T	38808	27	162
Wood Lumber Co., E. K	23605, 24156	25	1013
Wray, Eliza J	25881	24	94
Wright, George M	25854	22	858
Wright, Leonard Marshall	45508	26	21
Y.			
Young, Ethel P	38868	24	815
Yukon Alaska Trust	34161	26	635
Z.			
Zinsser & Co	5242	21	152

[1] Acquiescence relates to donations issue; amortization of discount on bonds issued prior to 1913; computation of tax for 1920.
[2] Estate tax decision.
[3] Acquiescence relates to inventory issue.
[4] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[5] Acquiescence does not relate to issue 5 of decision.

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.			
Abelson Realty Co., Inc	53792	24	686
Abelson's, Inc	53793	24	686
Ackerman, Irving C	30311, 31634, 40948, 40949	24	512
Alameda Park Co	8355	25	850
Albrecht et al., Katherine B., executrices (April 6, 1933)[1, 2]	41295	27	----
Alker, Vera M. Kohler	36116	25	243
Allied Furriers Corporation	50059	24	457
American Brick & Tile Corporation	29994	22	1121
Ames, jr., Ward (January 31, 1933)[3]	49817	27	----
Apartment Corporation	42024	26	849
Arabol Manufacturing Co	50489	26	1068
Archbald, Edward B. (February 28, 1933)[3]	61660, 65064	27	----
Archbald, Joseph A. (February 28, 1933)[3]	61661, 65062	27	----
Archbald, jr., Joseph A. (February 28, 1933)[3]	61673, 65063	27	----
Armstrong, William M	40419	25	928
B.			
Babson, Fred K. (March 7, 1933)[3]	52224	27	----
Babson, Gustavus (March 7, 1933)[3]	52223	27	----
Babson, Henry B. (March 7, 1933)[3]	52222	27	----
Ballinger, Bessie M., executrix [3]	32177	23	1311
Ballinger, Walter F., estate of [3]	32177	23	1311
Bankers Trust Co., trustee	32459	24	10
Bebb, Richard E., estate of (April 6, 1933)[1, 3]	41295	27	----
Beebe, Junius, trustee	52707	26	190
Beebe, Marcus, estate of	52707	26	190
Belfast Investment Co.[4]	19128	17	213
Bell & Sons, Samuel	38056, 41647, 45616	22	793
Bliss, Sydney R	55902	26	962
Bliss, Valentine	53422	26	732
Board of Fire Underwriters of the City of Duluth	43150	26	860
Boca Ceiga Development Co	40446	25	941
Brackman, J. W	45714	24	259
Bradbury, I. C	45780	23	1351
British-American Tobacco Co., Ltd	41224	27	226
Brooklyn City R. R. Co	20353	27	77
Brooklyn & Queens Transit Corporation	20353	27	77
Brown, Frank A., estate of	47677	26	901
Brown, H. C	33343	25	631
Brown, Harry A	48136	26	901
Brown, Pearl B., executrix	47677	26	901

[1] Estate tax decision; nonacquiescence relates to State inheritance tax issue.
[2] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[3] Estate tax decision.
[4] Nonacquiescence in issue as to whether petitioner is entitled to deduction for amortization of the Lee tract warehouse for 1918.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
Buck, John A., estate of [1]	32584 44153 44684	25	780
Buck et al., Mary M., executors [1]	32584 44153 44684	25	780
Buffalo Union Iron Furnace Co.[2]	16075 16076	23	439
Bullock, George [3]	31209	23	710
Bunge North American Grain Corporation	47800	27	150
Burdette, Clara	37321	25	692
Burley, Blanche B., executrix	44909	26	615
Burrill, Edward L	58795	26	1401
Busche, F. C.[4]	9447 10202 10755	10	1345
Business Real Estate Trust of Boston	33469 42684 50305	25	191
Butler-Veitch Co	45169 45170	23	953
C.			
Carey Fibre Products Co., Emerson	36381	26	675
Carey Salt Co	36382	26	675
Carroll, J. J	51880	27	65
Carroll, Lena Carter	51881	27	65
Carter, A. L	51882	27	65
Carter, A. L., administrator	47669	27	65
Carter, Mrs. A. L	51883	27	65
Carter, E. A	51884	27	65
Carter, Lillie N	51885	27	65
Carter, Maude H., estate of	47669	27	65
Carter, jr., W. T	51886	27	65
Cassels, Robert	58793	26	1401
Central Market Street Co.[5]	24837	25	499
Central Union Trust Co. of New York, executor	31736	25	757
Champion, David J. (April 27, 1933)[6, 7]	55569 63818	27	----------
Champion, T. Pierre (April 27, 1933)[6, 7]	55568	27	----------
Chenowith, H. C	38349	26	301
Cobleigh, Margaret Edwards, estate of [8]	40765	24	176
Commercial Garage Co	41646	22	793
Community Bond & Mortgage Corporation	43784	27	480
Cone, Edward K	58777	26	1401
Cook, Elizabeth E.[9]	38579	25	1351

[1] Estate tax decision; nonacquiescence relates to deduction of amount of a claim filed against the estate and allowed by probate court.
[2] Nonacquiescence relates to issue regarding deduction from gross income of fiscal year ended April 30, 1919, of reserve for relining blast furnaces.
[3] Nonacquiescence relates to issue 1 of decision.
[4] Acquiescence published in Cumulative Bulletin X-1, page 10, withdrawn.
[5] Nonacquiescence relates to issue regarding Board's jurisdiction of subsidiaries.
[6] Nonacquiescence relates to issue whether redemption of stock was equivalent to taxable dividend.
[7] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[8] Estate tax decision.
[9] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
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Cooper, A. T.[1]	3144	7	798
Crile, Grace McBride	43136	26	1020
Cross, Maurice	32735	24	1079
Cunard Coal Co.[2]	26874 26875 28792	26	234
Cuppia, Jerome C	58545	26	1401
D.			
Davidson, Watson P	46486	27	158
Davis, C. R.[3]	10299	10	1233
	32950	20	931
Davis, Frederick H	37324	24	405
Davis, Thomas L	37395	24	405
Degener, John F., estate of [4]	38500	26	185
Degener, jr., et al., John F., executors [4]	38500	26	185
De Lisser, Horace, estate of [5]	2459	2	102
Depew, Ganson	50860	27	515
Dohrmann, Andrew B. C	20658	19	507
	23969	19	466
Dort, J. Dallas, estate of [4]	44735	26	1321
Drumheller, George	41515 45752	27	209
Duff, Robert C.[6]	37552	23	1342
E.			
Eifert, Earl C	45781	23	1351
Ethel D. Co	32032	27	25
Everhart, James William	26675	26	318
F.			
Fairmount Cemetery Association	30925 42811	25	1272
Farmers Cotton Oil Co	42679	27	105
Farmers Life Insurance Co.[7]	43317	27	423
Field, Marshall	36908	26	116
Fifth Street Building	16627 29264 45537	24	876
First National Bank in St. Louis [8]	44278 48078	23	1124
First National Bank of Boston, administrator [4]	44746	25	612
First Peoples Trust	45403	26	551
Fleitmann, William M., estate of [8]	28449	22	1291
Fleitmann, jr., et al., William M., executors [8]	28449	22	1291
Fletcher, Salathiel R	33041	24	75
Folger & Co., J. A	22212 30721	27	1
Folger Estate Co	31200 35147	27	1

[1] Acquiescence published in Cumulative Bulletin VII–1, page 1, withdrawn.
[2] Nonacquiescence relates to expenditures for mine equipment.
[3] Acquiescence published in Cumulative Bulletin X–1, page 17, withdrawn.
[4] Estate tax decision.
[5] Estate tax decision; acquiescence published in Cumulative Bulletin X–2, page 18, recalled.
[6] Nonacquiescence relates to issue 2 of decision.
[7] Nonacquiescence does not relate to issue in connection with option payment received for purchase of land.
[8] Acquiescence notice published in Cumulative Bulletin X–2, pages 23 and 24, recalled.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Foster, Caroline B., estate of [1]	46672	26	708
Foster et al., Charles H. W., executors [1]	46672	26	708
Foster, L. B.[2]	43086	26	1328
G.			
Gale, Emily A. (February 28, 1933) [3]	61672	27	----
Garcin, Edward H	21657	22	1027
Gardner, Charles E.[4]	38575	25	1351
Garrie, Daniel T., estate of	31736	25	757
Garvan, John Joseph, estate of [5]	44746	25	612
Gassner, Louis [6]	4017	4	1071
Gerlach, Theodore R. (January 31, 1933) [3]	38042 41641	27	----
Gladding, Mary D., estate of [6]	31435	27	385
G. M. & S. Co	16383	26	223
Goetjen & Metson Co	17875	26	223
Goldberg, Harry S.[6]	5389	4	1073
Goldschmidt et al., Georgette, executors [7]	16138	14	1010
Goldschmidt, Henry P., estate of [7]	16138	14	1010
Graham, M. H	38335	26	301
Green, Robert D.[8]	53647	24	719
Greenleaf Textile Corporation	46746	26	737
Griffis, Stanton [4]	38577	25	1351
Guitar Trust Estate	35102	25	1213
Gulf Coast Irrigation Co.[9]	33694 40081 41343	24	958
Gulf, Mobile & Northern R. R. Co.[10, 11]	24887 42150	22	233
Gummey, Frank B	61056	26	894
H.			
Hancock, G. Allan	36867	25	607
Hanson, Charles C	15398	23	590
Harris, Allen [6]	10980	10	1374
Harris, Simon	31632	24	512
Hart, John H	52795 60115	27	528
Hartley, Cavour, executor (March 16, 1933) [3]	42343	27	----
Hartley, G. G., estate of (March 16, 1933) [3]	42343	27	----
Hauser, W. E	43301 43302	26	1178

[1] Estate tax decision.
[2] Nonacquiescence relates to deductions in 1924 and 1925 on account of losses resulting from alleged sales of securities.
[3] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[4] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.
[5] Estate tax decision.
[6] Acquiescence published in Cumulative Bulletin X-1, pages 24, 27, withdrawn.
[7] Estate tax decision; acquiescence published in Cumulative Bulletin X-2, page 27, recalled.
[8] Nonacquiescence relates to transaction 5.
[9] Nonacquiescence relates to affiliation issue.
[10] Nonacquiescence relates to issues involving award of Interstate Commerce Commission in 1920 for transportation of United States mails in 1916 and 1917; and deduction in 1926 for depreciation on ways and structures.
[11] Nonacquiescence applies to the entire decision of the Board insofar as it is adverse to the Commissioner Partial acquiescence published in Bulletin XI-28, page 1, revoked.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Hawley Investment Co	45169, 45170	23	953
Hedrick, J. T	33533	24	444
Heller, B. G	40634	25	259
Hemphill, Clifford [1]	38573	25	1351
Henn, A. W	37102	20	1133
Hermann, John C	51959	27	409
Hickman, Howard C. (February 27, 1933) [2]	37369	27	
Hieronymus, Carl Richard, estate of	48930	24	269
Higley & Co., E. B	51003	25	127
Hill, D. F., estate of [3]	29399	24	1144
Hill et al., Paul F., executors [3]	29399	24	1144
Hodges, Agnes Wiley, executrix	38336	26	301
Hodges, W. L., estate of	38336	26	301
Hodges, W. L., trustee	38337	26	301
Holmes, Carl F. (January 31, 1933) [2]	51473, 53395, 48631	27	
Holmes, Margaret A. (January 31, 1933) [2]	51570, 53394	27	
Household Products, Inc	44809	24	594
Housman, Clarence J	58798	26	1401
Housman, Frederick	58774	26	1401
Houston Baseball Association	43985, 45430	24	69
Houston Bros. [4]	12052	22	51
Houston, George T. [4]	13104, 22008	22	51
Houston, Horace K. [4]	22009	22	51
Houston, Philip D. [4]	22007	22	51
Hulburd, Charles H., estate of (April 7, 1933) [2]	22028	27	
Hulburd, De Forest, individually and as executor and trustee (April 7, 1933) [2]	22028	27	
Hunter, G. W., estate of [3]	33564	25	1078
Hutchison Coal Co	34939	24	978
I.			
Imperial Elevator Co	35688	25	234
Imperial Investment Co	29291	23	1281
Indianapolis, Crawfordsville & Danville Electric Ry. Co	33859	24	197
Indianapolis & Northwestern Traction Co	33861	24	197
Iten Biscuit Co	43667, 45164	25	870
Ives Dairy, Inc	39873	23	579
J.			
Jackson & Eastern Ry. Co	38295, [5] 42149	22	233
Jackson, Wernich Trust	32307	24	150

[1] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.

[2] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.

[3] Estate tax decision

[4] Nonacquiescence relates to March 1, 1913, value, and to the basis for the deduction for depletion and for the computation of gain or loss upon subsequent sale of the timber.

[5] Nonacquiescence relates to issue involving deduction for depreciation on ways and structures.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
Jamison Coal & Coke Co	31690 34088	24	554
Jefferson Standard Life Insurance Co	43149	25	1335
Johnston, Hugh McBirney, individually and as executor and trustee (April 7, 1933) [1]	22028	27	
Jones, Bessie R	58285	27	171
K.			
Kerrigan, Arthur L	58794	26	1401
King, John M	41549	26	1158
Knapp, Kittie A.[2]	2775	7	790
Koch, Harry A	55318	26	1025
Kountze, Charles T	37323	24	405
Kountze, et al., Charles T., executors	37535	24	405
Kountze Luther L., estate of	37535	24	405
Krull, Francis [3]	16985	10	1096
L.			
Lafayette Life Insurance Co	41721 42663	26	946
Laun, Alfred A	45347	26	764
Laun, J. B	45348	26	764
Leetonia Furnace Co	32272	23	979
Levine, Hyman [3]	7435	8	298
Liebes & Co., H	28544 35038	23	787
Littauer, Eugene, estate of [4]	51858	25	21
Littauer et al., Lucius N., executors [4]	51858	25	21
M.			
Manchester Coal Co	33392	24	577
Margay Oil Corporation	44891	26	199
Markham Irrigation Co.[5]	41344	24	958
Marvin, Walter S.[6]	38578	25	1351
Matagarda Canal Co.[5]	40082 41345	24	958
McCormick et al., Cyrus H., trustees	44139	26	1172
McCrory, Luke W., trustee	32444	25	994
McLister, Frank	48562	27	155
McMillan, William Northrup, estate of [7]	45966	27	318
Meyer, Robert R	44032	27	44
Miglietta, Olga K	36379	25	243
Mills, J. H. Goadby	58797	26	1401
Mitchell, Oscar [8]	41680 41874 54673	27	101
Mitchell, William	58799	26	1401
Moore Bread Co	41645	22	793

[1] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[2] Acquiescence published in Cumulative Bulletin VII-1, page 17, withdrawn.
[3] Acquiescence published in Cumulative Bulletin X-1, pages 36, 38, withdrawn.
[4] Estate tax decision; nonacquiescence in respect to that part of decision which holds that accrued interest paid on Federal income taxes for 1927 and 1928 from date of decedent's death to November 5, 1930, is a proper allowable administrative expense.
[5] Nonacquiescence relates to affiliation issue.
[6] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.
[7] Estate tax decision; nonacquiescence as to question of situs.
[8] Nonacquiescence relates to issue regarding deduction from income of sprinkling tax.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Moore, G. H	38351	26	301
Morganite Brush Co., Inc	26369	24	776
Moro Realty Holding Corporation	37406 44759 50490	25	1135
Morriss et al., Julia L	41023 41024 45863 45864	23	1076
Morriss Realty Co. Trust No. 1	41023 45863	23	1076
Morriss Realty Co. Trust No. 2	41024 45864	23	1076
Mosser, Charles F	55399	27	513
Murphy et al., Fred T., trustees	43795	25	724
Murphy Personal Property Trust	43795	25	724
Mutual Life Insurance Co. of New York	9764	23	749
N.			
Nashville, Chattanooga & St. Louis Ry	33799	24	856
National Contracting Co.[1]	24520	25	407
National Land & Construction Co	40126	25	562
National Pipe & Foundry Co.[2]	32997	19	242
Neal et al., J. Henry, trustees	45403	26	551
Neill, James[3]	9290	8	299
Nelms, Frank Haywood	51887	27	65
Nelms, Mrs. Frank Haywood	51888	27	65
Newport Co	35431	24	1246
New York Life Insurance Co	38880	24	1217
Nibley-Mimnaugh Lumber Co	17527	26	978
Nichols & Cox Lumber Co	23601	24	54
Nicodemus, jr., F. C	52326 62569	26	125
Nielsen Co., E. H	8899	26	223
North American Investment Co	30183	24	419
Northern Coal Co.[4]	34945	24	307
Noyes, Jansen[5]	38574	25	1351
O.			
Oakman et al., Mamie R	42917	24	84
Ogden, Hugh W	23943	24	1239
Old Mission Portland Cement Co	38853	25	305
Olinger Mortuary Association	36502	23	1281
Omaha Coca-Cola Bottling Co	52641	26	1123
Oswego Falls Corporation	28301 32673 34352	26	60
Owens, J. T	63149	27	469
Owens, Mrs. J. T	63150	27	469
Owens, O. O	31986	26	1147

[1] Nonacquiescence relates to issue 1 of decision and issue regarding deductibility of overhead costs in 1928.

[2] Acquiescence published in Cumulative Bulletin IX-2, page 43, revoked. Revocation of prior acquiescence and present nonacquiescence are due to the failure of the Board's decision to limit the word "distributed" to the cash distributions made to the stockholders.

[3] Acquiescence published in Cumulative Bulletin X-1, page 46, withdrawn.

[4] Nonacquiescence relates to statute of limitations issue.

[5] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
P.			
Pacific Nash Motor Co	45169, 45170	23	953
Pacific Rock & Gravel Co	28776	26	296
Peabody, Cornelia Haven, estate of [1]	39647	24	787
Peabody et al., Stephen, executors [1]	39647	24	787
Petaluma & Santa Rosa R. R. Co.[2]	13830	11	541
Phillips, William S	24446, 31769	24	98
Pierce, Edward A	58796	26	1401
Plettner, Maude Brown	33345	25	631
P-M-K Petroleum Co.[3]	50576, 54779	24	360
Powel, T. I. Hare	64464	27	55
Pryor & Lockhart Development Co	38872, 45668, 51326	26	1054
Purse, James N. (February 11, 1933)[4]	54124	27	----
R.			
Randolph, Frankie Carter	51890	27	65
Randolph, R. D	51889	27	65
Raymond, Howard W	58544	26	1401
Realty Associates, as syndicate manager [5]	27921	17	1173
Reed, Latham R	58800	26	1401
Richfield Oil Co	42921	25	101
Riffel, Henry [6]	3576	3	436
Riley, Stoker Corporation	36584	26	749
Roberts, Walter B	37534	24	405
Rodeo-Vallejo Ferry Co.[7]	36411, 48528	24	936
Rorimer, Louis (March 7, 1933)[4]	58850	27	----
Rosenbloom Finance Corporation [8]	35778, 40903	24	763
Rosser, E. M., executor [1]	40765	24	176
Roth, W. A.[9]	45065	22	587
S.			
St. Louis Southwestern Ry. Co	13319, 27768, 33938	24	917
St. Louis Union Trust Co., executor [10]	45966	27	318
Salomon, Leon [9]	3725, 12231	4, 8	1109, 979

[1] Estate tax decision.
[2] Nonacquiescence relates to that part of decision concerning purchase of taxpayer's own bonds at less than par which were held as an investment. Acquiescence notice as to this issue published in Cumulative Bulletin VII-2, page 31, revoked.
[3] Nonacquiescence relates to first issue of decision.
[4] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[5] Acquiescence published in Cumulative Bulletin X-2, page 59, withdrawn.
[6] Estate tax decision; acquiescence published in Cumulative Bulletin X-2, page 60, recalled.
[7] Nonacquiescence relates to first issue of decision.
[8] Nonacquiescence does not relate to the Board's holding that distributions received from Joseph H. Finch & Co. were not partial liquidating dividends.
[9] Acquiescence published in Cumulative Bulletin X-1, pages 56, 57, withdrawn.
[10] Estate tax decision; nonacquiescence as to question of situs.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
San Carlos Milling Co., Ltd.[1]	39525	24	1132
Sand Springs Ry. Co	32438 32439	21	1291
Sather Lease—Thomas Sather & Co	31979	26	86
Schwartz-Kasser Improvement Co	36876	26	322
Seaconnet Coal Co.[2]	18089	24	307
Seatree, William Ernest	22094 33640	25	396
Selwyn Eddy Co	21612	25	1341
Sheaffer Pen Co., W. A. (April 3, 1933)[3]	36604	27	----
Shepherd Syndicate	48332 51327	26	1062
Shlenker, Simon J	58801	26	1401
Small's, Inc	53791	24	686
Smith, Mrs. Grant	43300 43305 43306	26	1178
Snyder, Inc., H. S. & M. W	36686	26	692
Southern California Rock & Gravel Co	30898	26	296
Sprague & Son Co., C. H.[2]	34946	24	307
Spring City Foundry Co	21169	25	822
Stanley Co. of America	31516 33142 40023	26	705
Stearns, Marshall, administrator	48930	24	269
Stern et al., Samuel E. A., executors[4]	2459	2	102
Stetson, Iola Wise	41743	26 27	390 173
Stevenson Consolidated Oil Co.[5]	43416	23	610
Stockholms Enskilda Bank	55755	25	1328
Stone, H. C., estate of	38336	26	301
Stone, Mrs. H. C., executrix	38336	26	301
Stone et al., Irving K., executors and trustees[6]	43830	26	1
Stone, Irving Lee, estate of[6]	43830	26	1
Straus, Aaron (April 6, 1933)[3]	65091	27	----
Strayer, Walter A	48564	27	155
Strong, Harold C.[7]	38576	25	1351
Sturgeon-Hubbard Trust	37095	25	368
Sturgeon et al., Rollin S., trustees	37095	25	368
Sunerest Lumber Co	33214	25	375
Swartz, Inc., Edward G	36650	25	1065
Swift, Mary Dodson, estate of	44909	26	615
Swisky, Toby W	42032	25	259

[1] Acquiescence as to issue 2 published in Cumulative Bulletin XI-1, page 6, and nonacquiescence as to issue 1 published in Cumulative Bulletin XI-1, page 11, withdrawn.
[2] Nonacquiescence relates to statute of limitations issue.
[3] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[4] Estate tax decision; acquiescence published in Cumulative Bulletin X-2, page 67, recalled.
[5] Nonacquiescence relates to issue regarding inclusion in income for 1928 of $180,823.25 received upon exchange by petitioner of 250,000 shares of Sunburst Oil & Gas Co. stock with that corporation.
[6] Estate tax decision; nonacquiescence relates to issue involving property transferred by trust agreement.
[7] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.

NONACQUIESCENCES—Continued.

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T.			
Talbot, Frederick C., estate of (February 28, 1933) [1]	20411	27	
Talbot, J. A.[2]	36191	23	792
Talbot et al., Susan D., executors (February 28, 1933) [1]	20409	27	
Talbot, William H., estate of (February 28, 1933) [1]	20409	27	
Taylor, H. Seldon, estate of [3]	64444	27	220
Taylor, jr., H. Seldon, et al., executors[3]	64444	27	220
Taylor, Jessie Carter	51891	27	65
Taylor, Judson L	51892	27	65
Tennessee Consolidated Coal Co	33383	24	369
Terre Haute, Indianapolis & Eastern Traction Co	33858	24	197
Terre Haute Traction & Light Co	33860	24	197
Terry, Anna Davis	45446	26	1418
Texas Irrigation Co.[4]	40083 41346	24	958
The Hub, Inc	46298	26	1201
353 Lexington Avenue Corporation (February 20, 1933) [1]	65089	27	
Tillotson Manufacturing Co. (March 11, 1933) [1]	44167	27	
Titus, C. Dickson	20705	24	36
Todd, Willis	37536	24	405
Tolerton & Warfield Co.[5]	45320	23	892
Towers & Sullivan Manufacturing Co	40508	25	922
Trojan Oil Co	33757	26	659
Twin Bell Oil Syndicate	45052	26	172
U.			
Union Guardian Trust Co., executor [3]	44735	26	1321
Union Pacific R. R. Co. et al.[6]	35639- 35649 35684 35685 40060 40061 40062	26	1401
Union Trust Co., trustee	42917	24	84
United Oil Co	38082 42922 51622	25	101
V.			
Van Camp Packing Co., Inc	46131	26	256
Voelbel, Jacob, estate of [7]	6009	7	276
Voelbel, Walter W., executor [7]	6009	7	276
Volunteer State Life Insurance Co. (April 10, 1933) [1]	54176	27	

[1] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[2] Nonacquiescence relates to depreciation allowance in computing loss in sale of a boat.
[3] Estate tax decision.
[4] Nonacquiescence relates to affiliation issue.
[5] Nonacquiescence relates to issue regarding deduction of loss sustained by two affiliated companies during fiscal year ended January 31, 1924, and the taxable period February 1 to April 25, 1924, in computing the consolidated net income for taxable period April 26 to December 31, 1924, and the year 1925.
[6] Nonacquiescence relates to issue regarding rental interest and issue concerning net loss of Los Angeles & Salt Lake R. R. Co. for period January 1 to April 30, 1921.
[7] Estate tax decision; acquiescence published in Cumulative Bulletin X-2, page 73, recalled.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
W.			
Waggoner, Ella	33517	24	657
Waggoner, W. T	33516	24	657
Walker, Talbot C. (February 28, 1933) [1]	20407	27	-------
Wall, Frank E.[2]	7359	4	915
Wardman, Harry	22348	24	102
Warner Co	53039, 53040, 59190	26	1225
Warner Collieries Co. of Delaware	34679	26	1047
Watab Paper Co	24773, 28082, 38685, 41733, 46076, 51387	27	488
Wayne County & Home Savings Bank	49144	26	761
Wells Fargo Bank & Union Trust Co., administrator (February 28, 1933)[1]	20411	27	-------
West Virginia-Pittsburgh Coal Co	20337, 25030	24	234
White, Juliet C	58775	26	1401
White Oak Transportation Co.[3]	18088	24	307
White, Rita M. Kohler	36112	25	243
White, Sidney J	58776	26	1401
Williams et al., Frank G., executors	33564	25	1078
Wilson, Luke F., estate of	32444	25	994
Wilson Shipbuilding Co.[4]	34337	25	182
Wobber Bros	36875	26	322
Wobbers, Inc	36874	26	322
Wolpert, Urban F	48563	27	155
Wood Furniture Co., J. A	40565	21	564
Woodward, George [5]	42279	23	1258
Y.			
Youngstown Sheet & Tube Co	28149, 35511	24	1246
Z.			
Ziegler, Albert W	46291	23	1091
Ziegler, Clifford E	46292	23	1091

[1] The page citation of this decision will be supplied in a later Bulletin. For ready reference the date of the decision is shown after the taxpayer's name.
[2] Acquiescence published in Cumulative Bulletin X-1, page 68, withdrawn.
[3] Nonacquiescence relates to statute of limitations issue.
[4] Nonacquiescence relates to issue 5 of decision.
[5] Acquiescence published in Cumulative Bulletin X-2, page 78, withdrawn.

INCOME TAX RULINGS.—PART I.

REVENUE ACT OF 1932.

SUBTITLE B.—GENERAL PROVISIONS.

PART II.—COMPUTATION OF NET INCOME.

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

ARTICLE 51: What included in gross income. XII-21-6188
Mim. 4022

Certificates of deposit in a closed bank purchased at a discount and applied at face value as payment on indebtedness to such bank.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., May 3, 1933.

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

It has been brought to the attention of the Bureau that in a number of instances taxpayers indebted to a bank which has been closed have purchased from depositors at a substantial discount certificates of deposit issued by such bank and have applied the certificates at face value in payment upon their indebtedness to the bank. Under these circumstances taxable gain was derived by the purchaser to the extent that the face value of the certificates of deposit thus applied in payment upon the bank indebtedness exceeded the cost of the certificates to the purchaser.

Inquiries and correspondence regarding this mimeograph should refer to the number and symbols IT:E:RR.

P. R. BALDRIDGE,
Acting Commissioner.

ARTICLE 52: Compensation for personal services. XII-4-5998
Mim. 3995

Taxability of the compensation of officers and employees in the civil service of the United States.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., January 3, 1933.

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

On account of the numerous inquiries received in regard to the amount of compensation required to be reported by employees in

the civil service of the United States in their income tax returns for the taxable year 1932, it is deemed advisable to issue instructions on this point.

Since the effective date of the Act approved May 22, 1920, officers and employees in the civil service of the United States have been required to report as taxable income the amount of the compensation received by them for their services, plus the amount deducted for retirement pay (T. D. 3112, C. B. 4, 76).

There is no change in the procedure to be followed for the taxable year 1932, during which the compensation of certain officers and employees in the civil service was decreased in accordance with the provisions of the Act approved June 30, 1932 (Public, No. 212—Seventy-second Congress, H. R. 11267, 47 Stat., 382). Under section 205 of that Act the retirement deduction authorized by law to be made from the salary, pay, or compensation of officers and employees is based on the regular rate of salary, pay, or compensation instead of on the rate as temporarily reduced under the provisions of that Act.

Accordingly, for the taxable year 1932 officers and employees in the civil service of the United States shall report in their income tax returns the actual amount of the reduced compensation received, plus the amount deducted for retirement purposes.

All inquiries concerning this mimeograph should refer to the number thereof and be marked for the attention of IT:E:RR.

DAVID BURNET, *Commissioner.*

ARTICLE 53: Compensation paid other than in cash. XII-8-6035 G. C. M. 11453

REVENUE ACT OF 1932.

In the case of a taxpayer employed abroad by the United States Government, the nature of the services not requiring that the Government furnish a house or living quarters, there must be included in gross income the allowance received for living quarters.

An opinion is requested with respect to the taxability of an allowance for living quarters in the case of a taxpayer, employed by the United States and stationed abroad, in view of the decision in *Clifford Jones* v. *United States* (60 Ct. Cls., 552 [T. D. 3724, C. B. IV-2, 136]). The Act of Congress on which the allowance is based is contained in 46 Statutes at Large, page 818, and reads as follows:

That under such regulations as the heads of the respective departments concerned may prescribe and the President approve, civilian officers and employees of the Government having permanent station in a foreign country may be furnished, without cost to them, living quarters, including heat, fuel, and light, in Government-owned or rented buildings and, where such quarters are not available, may be granted an allowance for living quarters, including heat, fuel, and light, notwithstanding the provisions of section 1765 of the Revised Statutes (U. S. C., title 5, section 70): *Provided*, That said rented quarters or allowances in lieu thereof may be furnished only within the limits of such appropriations as may be made therefor, which appropriations are hereby authorized: *Provided further*, That the provisions of this Act shall apply only to those civilian officers and employees who are citizens of the United States.

Article 53 of Regulations 74 provides that when living quarters such as camps are furnished to employees for the convenience of the

employer, the ratable value need not be added to the cash compensation of the employees, but where a person receives as compensation for services rendered a salary and in addition thereto living quarters, the value to such person of the quarters furnished constitutes income subject to tax. An allowance for living quarters would, of course, fall within the same general rule. It is also pointed out in that article of the regulations that the value of quarters furnished Army and Navy officers does not constitute taxable income. The latter provision was based on *Clifford Jones* v. *United States*, supra. Several rulings have been issued by the Bureau which follow the general rule that where living quarters, or an allowance for living quarters, are furnished for the convenience of the employer, the value thereof or the allowance therefor is not income to the employee. (See O. D. 265, C. B. 1, 71; O. D. 814, C. B. 4, 84; O. D. 915, C. B. 4, 85; and I. T. 2253, C. B. V–1, 32.)

On the other hand, rulings have been issued which recognize the general principle that where a person receives living quarters, or an allowance therefor, not for the convenience of the employer but as a part of his compensation for services rendered, the value to such person of the quarters furnished, or the allowance for quarters, constitutes income subject to tax. (See O. D. 862, C. B. 4, 85; O. D. 874, C. B. 4, 348; and O. D. 997, C. B. 5, 84.) The Board of Tax Appeals has held, in the case of *Ralph Kitchen* v. *Commissioner* (11 B. T. A., 855), that the value of meals and lodging supplied to the president and general manager of the hotel for himself and wife constitutes taxable income, in the absence of evidence that the meals and lodging were furnished for the convenience of the employer. This office is of the opinion that the decision of the Court of Claims in *Clifford Jones* v. *United States*, supra, is not applicable to a case such as the one here under consideration where the taxpayer, an employee of the United States stationed abroad, receives an allowance for living quarters under the Act quoted above. The situation of an Army officer is entirely different, as indicated by the following extract from the opinion rendered by the Court of Claims in the Jones case:

> * * * The line of demarcation runs parallel with the services one engages to perform. If the nature of the services require the furnishing of a house for their proper performance, and without it the service may not properly be rendered, the house so furnished is part of the maintenance of the general enterprise, an overhead expense, so to speak, and forms no part of the individual income of the laborer. * * *
>
> * * * an officer of the Army must remain in the quarters assigned * * * as an inseparable part of * * * prescribed duties. * * * The public quarters of the officer is his office as well as his temporary home. * * * The Army officer may not provide himself with his own quarters. * * * On the contrary, the Government furnishes the quarters as a part of the Military Establishment itself.

Here there is no evidence that the nature of the services requires that the Government furnish a house, or living quarters, for their performance. On the contrary, it appears from information received that the taxpayer's duties require considerable traveling, and he is not required to remain on duty at any particular post subject to call 24 hours of the day, as in the case of an Army officer. It can not be said that he must remain in quarters as an inseparable part of his prescribed duties. It must be held, therefore, that the allowance paid

by the United States in the instant case is not for quarters furnished for the convenience of the employer but forms a part of the employee's compensation, and is paid by reason of the fact that the employee is stationed abroad. It is an added inducement for foreign service. To exclude it from gross income would have the effect of permitting a deduction for personal or living expenses, which is prohibited by section 24(a) of the Revenue Act of 1932.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 53: Compensation paid other than in cash. XII-19-6163
I. T. 2692

REVENUE ACT OF 1932.

The value of quarters, subsistence, heat, light, and laundry furnished to employees of the Veterans Administration homes and hospitals throughout the country is part of the employees' compensation for services rendered. The value of such quarters, subsistence, etc., must, therefore, be included in gross income for Federal income tax purposes.

Information is requested whether Veterans Administration employees in the various hospitals and homes must, for Federal income tax purposes, report as taxable income the value of quarters, subsistence, heat, light, and laundry furnished them in connection with their employment.

It has been the practice of the Veterans Administration to furnish quarters, subsistence, heat, light, etc., to all employees whose salaries are paid from the appropriation "Salaries and expenses at the Veterans Administration homes and hospitals." The monetary value of such allowances is included in the contract of employment. In cases where these allowances are furnished the amount of cash payable is reduced to an amount which, together with the value of allowances furnished, equals the aggregate salary rate for the position, as established by the Classification Act, in the grade to which the position was allocated by the administrative office. In the event that allowances are not furnished, the established salary rate is paid in full, less such amounts as are deducted for the purpose of retirement.

Section 3 of the Act of March 5, 1928 (45 Stat., 162, 193), under which quarters, heat, light, subsistence, etc., are furnished to civilian employees, provides as follows:

SEC. 3. The head of an executive department or independent establishment, where, in his judgment, conditions of employment require it, may continue to furnish civilians employed in the field service with quarters, heat, light, household equipment, subsistence, and laundry service; and appropriations for the fiscal year 1929 and thereafter of the character heretofore used for such purposes are hereby made available therefor: *Provided*, That the reasonable value of such allowances shall be determined and considered *as part of the compensation* in fixing the salary rate of such civilians. [Italics supplied.]

The Comptroller General, in a decision relating to this section of the statute and which is found in volume 8, page 628, Decisions of the Comptroller General, A-26426, holds that the above-quoted statute is applicable to all classes of civilian employees entitled by

law or regulation to allowances in kind from the Government, irrespective of the Act under which their salaries are fixed or the branch of the service in which employed. It is also stated in the opinion that the requirements of the proviso of the statute, that the reasonable value of the allowances furnished in kind shall be determined and considered as a part of the compensation, are mandatory whenever and wherever allowances in kind, including quarters, heat, light, etc., are furnished to civilian employees. The Comptroller General reached the conclusion that the retirement deductions must be computed on the "total salary rate, including both the cash paid and the determined value of allowances furnished in kind."

Article 53 of Regulations 77 provides that where services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included in income. It is specifically stated in that article that where a person receives "as compensation" for services rendered, a salary and in addition thereto living quarters, the value to such person of the quarters furnished constitutes income subject to tax.

In view of the foregoing, it is the opinion of this office that the value of quarters, subsistence, heat, light, and laundry furnished to employees of the Veterans Administration homes and hospitals throughout the country is part of the employees' compensation for services rendered. The value of such quarters, subsistence, etc., must, therefore, be included in gross income for Federal income tax purposes.

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

ARTICLE 121: Business expenses. XII-1-5965
G. C. M. 11358

REVENUE ACT OF 1932 AND PRIOR REVENUE ACTS.

Penalty payments, whether on account of negligence, delinquency, or fraud, are not deductible from gross income as business expenses. Solicitor's Law Opinion 926 (C. B. 1, 241) modified.

In view of the position taken by the Bureau and successfully maintained before the courts in *Great Northern Railway Co.* v. *Commissioner* (40 Fed. (2d), 372, certiorari denied, 282 U. S., 855), *Burroughs Building Material Co.* v. *Commissioner* (47 Fed. (2d), 178, C. D. 297, C. B. X-1, 397), and *Chicago, Rock Island & Pacific Railway Co.* v. *Commissioner* (47 Fed. (2d), 990, certiorari denied, 284 U. S., 618), it is the opinion of this office that penalty payments, whether on account of negligence, delinquency, or fraud, are not deductible from gross income on the theory that they constitute business expenses. Solicitor's Law Opinion 926 (C. B. 1, 241) is accordingly modified to the extent that it holds that penalties imposed for negligence or delinquency are ordinary and necessary business expenses which may legally be deducted from gross income.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

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

ARTICLE 151: Taxes.

XII-11-6067
I. T. 2682

REVENUE ACT OF 1932.

The tax imposed by the emergency relief sales tax act enacted by the State of Pennsylvania on August 19, 1932, constitutes an allowable deduction from the gross income of the vendor upon whom the tax is imposed and who is liable for the payment thereof.

Advice has been requested on the following questions arising under the Pennsylvania emergency relief sales tax act approved August 19, 1932:

(1) May this State tax be deducted as an expense item in the Federal income tax return?

(2) If deductible, is it permissible to include the entire accrued State tax on sales made prior to December 31, 1932?

The provisions of the Pennsylvania emergency relief sales tax act, so far as pertinent to the discussion of the questions presented, read as follows:

SEC. 3. *Imposition and rate of tax.*—A State tax is hereby imposed and assessed upon sales of tangible personal property, at the rate of 1 per centum upon each dollar of the gross income derived from the sales of such property, during the six months' period ending February 28, 1933, or any part of such period, except such sales of tangible personal property made to the United States Government upon evidence satisfactory to the department, and except such sales as are not within the taxing power of this Commonwealth under the commerce clause of the Constitution of the United States. Such tax shall be paid at the time and in the manner hereinafter provided.

* * * * * * *

SEC. 5. *Assessment and payment of tax.*—Every vendor, at the time of making the return required under section 4, shall compute and pay to the department the tax due to the Commonwealth by him for the preceding six months' period. The amount of all taxes imposed under the provisions of this act shall be due and payable at the time the return for such six months' period is required to be filed with the department by this act.

* * * * * * *

SEC. 7. *Additional assessment.*—If the department is not satisfied with the return and payment of tax made by any vendor under the provisions of this act, it is hereby authorized and empowered to make an additional assessment of the tax due by such taxpayer, based upon the facts contained in the return or upon any information within its possession or that shall come into its possession. Promptly after the date of such additional assessment, the department shall give or send, by mail or otherwise, a notice thereof to the vendor, together with written notice of the time when and the place where the vendor may be heard on a petition for reassessment as hereinafter provided.

* * * * * * *

SEC. 21. *Vendors may add price of tax to retail price of property sold.*—Vendors may add to the retail price of any tangible personal property, the sale of which is subject to a tax hereunder, 1 per centum of the retail price, provided the retail price and the 1 per centum, representing the tax imposed by this act, be separately stated on price display signs, tickets and tags, and bills rendered in connection with the sale of such property.

As the tax is by law imposed upon the vendor he may deduct the amount paid or accrued as a tax under section 23(c) of the Revenue Act of 1932, in determining his net income for Federal income tax purposes, but where the vendor collects the tax from the vendee he

must include the amount so collected in his gross income for Federal income tax purposes. The vendee may not deduct this amount as a tax notwithstanding it is passed on to him by the vendor. However, where an amount equal to the tax is paid by the vendee with respect to goods purchased for consumption in his trade or business, such amount may be deducted as a business expense or it may be treated as a capital item where such costs are properly capitalized rather than deducted as expenses.

In the case of a vendor whose books are kept on an accrual basis, the amount of the tax actually accruing during the period covered by his Federal income tax return may be deducted in determining his net income. Where the vendor's books are kept on the cash receipts and disbursements basis, only the amount of the tax actually paid during the period covered by his Federal income tax return may be deducted in determining his net income.

ARTICLE 151: Taxes.

XII-13-6094
G. C. M. 11635

REVENUE ACTS OF 1928 AND 1932.

The gasoline tax imposed by the State of Connecticut under the provisions of section 315(a) of the Public Acts of Connecticut, January session, 1931 (Cumulative Supplement to the General Statutes), is deductible by the purchaser or consumer, for Federal income tax purposes. If, however, the tax is added to or is made a part of the business expense of such purchaser or consumer, it can not be deducted separately as a tax.

Recommended that I. T. 2471 (C. B. VIII-1, 73) be limited in its application to years prior to 1931.

An opinion is requested relative to the deductibility for Federal income tax purposes of the gasoline or motor fuel tax imposed by the laws of the State of Connecticut, in view of a statute passed in 1931 by the Legislature of Connecticut relative to the tax on motor fuel.

In I. T. 2471 it was stated that under section 4 of the act of 1925, Public Acts of Connecticut, chapter 145, as amended by chapter 62 of the Public Acts of Connecticut, 1927, the tax on gasoline was imposed upon and deductible by the distributor. It was also held that under the circumstances provided in section 5 of the act of 1925 the tax was imposed upon and deductible by the purchaser.

It now appears that in the 1931 session of the General Assembly of Connecticut, section 4 of the act of 1925, as amended, was superseded and, in effect, repealed by section 315(a) of the Public Acts of Connecticut, January session, 1931 (Cumulative Supplement to the General Statutes, page 134), which reads as follows:

SEC. 315a. *Two-cent tax.* Each distributor shall, on or before the 15th day of each month, render a report to the commissioner of motor vehicles, which shall state the number of gallons of fuels sold or used in this State by him during the preceding calendar month, on forms to be furnished by said commissioner, and such report shall contain such further information as the commissioner shall prescribe. On or before the 1st day of the calendar month succeeding the filing of such report, each distributor shall pay to the treasurer of the State *for the account of the purchaser or consumer* a tax of 2 cents upon each gallon of such fuels sold or used in this State during the preceding calendar month. On or before the 1st day of each calendar month, the commissioner shall transmit to the treasurer of the State such information as shall show all taxes due from each distributor under the provisions of this chapter. [Italics supplied.]

From a consideration of this new enactment in 1931, it is evident that the General Assembly of the State of Connecticut intended, by the use of the words " for the account of the purchaser or consumer," that the tax should be paid to the State by the purchaser or consumer through, or by means of, the distributor. It follows that the tax so paid to the State is deductible by the purchaser or consumer, for Federal income tax purposes, under the provisions of section 23(c) of the Revenue Act of 1932 and article 151 of Regulations 77. If, however, the tax in question is added to or is made a part of the business expense of such purchaser or consumer, it can not be deducted separately as a tax.

Because of the change in the State law it is recommended that I. T. 2471 be limited in its application to years prior to 1931, and that the conclusion reached in this memorandum be followed for the year 1931 and subsequent years.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 151: Taxes. XII-14-6109
I. T. 2687

REVENUE ACT OF 1932.

The gasoline tax imposed under the provisions of an act of the Forty-second Legislature of the State of Texas, chapter 98, General Laws of Texas, 1931, is deductible for Federal income tax purposes by the consumer who pays it and to whom it is not refunded. If, however, such tax is added to or made a part of the business expenses of such consumer, it can not be deducted by him separately as a tax.

A ruling is requested in regard to the deductibility for Federal income tax purposes of the gasoline tax imposed by the State of Texas.

The gasoline tax of the State of Texas is imposed under the provisions of an act of the forty-second legislature of that State, chapter 98, General Laws of Texas, 1931, which became effective May 5, 1931. The following are pertinent provisions of that act:

SECTION 1. That article 7065, section 17, chapter 88, Acts of the second called session of the Forty-first Legislature, be, and the same is, hereby in all things repealed.

SEC. 2. That article 7065-a, section 17, chapter 88, Acts of the second called session of the Forty-first Legislature, be, and the same is, hereby amended so as to hereafter read as follows:

"ART. 7065-a. (1) There is hereby imposed an occupation or excise tax of four (4) cents on each gallon of gasoline or fractional part thereof, on every 'wholesale sale,' or 'sale at wholesale,' as defined herein, and 'wholesale sale' shall mean:

"(a) The first distribution, sale or use in intrastate commerce of gasoline refined, blended, imported into, or otherwise produced in or brought into this State.

"(b) The first distribution, sale or use in intrastate commerce of gasoline upon which no tax has previously accrued under subdivision (a) hereof.

* * * * * * *

"(7) Every distributor selling gasoline at 'wholesale,' as defined herein, shall pay to the State of Texas an occupation tax equal to four (4) cents per gallon or fractional part thereof so distributed, sold or used, and such tax shall be due and payable at the office of the comptroller of public accounts at Austin, Tex., on the 25th day of each month, except the first month such distributor shall do business, and, in that event, the report and tax shall be due on the 10th

of the month, the same to be based on such sales made during the calendar month next preceding, and at the same time such distributor shall make and deliver to the comptroller of public accounts, a report properly sworn to and executed by such distributor or his representative in charge, on such forms as the comptroller shall prescribe, which, among other things, shall give the number of gallons of gasoline sold at 'wholesale,' in interstate and intrastate commerce, and exported during the preceding calendar month, and the number of gallons of gasoline used, distributed or lost by evaporation, or otherwise, upon which no tax is paid.

"(8) Provided, however, that the tax on one per cent (1%) of the taxable gallonage shall be deducted by the distributor to cover the expense of complying with the provisions hereof, and to take care of any loss by evaporation.

* * * * * * *

"(10) The tax herein imposed shall be posted separately from the price of the gasoline, wherever sold in this State, and such tax shall be collected by each person upon the sale of each gallon of gasoline in this State, *so that the tax will be paid by the ultimate consumer* to the distributor.

"(11) 'Gasoline,' as used herein, shall include any derivative of petroleum or any other inflammable liquid that will flash at 110° Fahrenheit or less, in the official closed testing cup method of the United States Bureau of Mines; and provided, further, that any other product which may be ordinarily, practically and commercially usable in internal combustion engines, used for the generation of power in propelling a motor vehicle over the highways of this State, shall be included in said definition." [Italics supplied.]

Chapter 104, General Laws of Texas, 1931, contains, among other things, a provision for refund where the gasoline purchased is used for purposes other than in propelling motor vehicles over the highways of the State.

Section 23(c) of the Revenue Act of 1932 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. Article 151 of Regulations 77, promulgated under the Revenue Act of 1932, provides that in general taxes are deductible only by the person upon whom they are imposed.

From an examination of the pertinent provisions of the statute quoted above, under which the tax is collected, it clearly appears that it was the intention of the Legislature of the State of Texas to impose the gasoline tax upon the ultimate consumers. It is held, therefore, in accordance with the provisions of section 23(c) of the Revenue Act of 1932 and article 151 of Regulations 77, that the gasoline tax imposed by the State of Texas is deductible for Federal income tax purposes by the consumer who pays it and to whom it is not refunded. If, however, the tax is added to or made a part of the business expenses of such consumer, it can not be deducted by him separately as a tax.

ARTICLE 151: Taxes. XII-24-6222
I. T. 2696

REVENUE ACT OF 1932.

> The motor vehicle fuels tax imposed by the laws of the State of New Jersey, 1931 and 1932, relating to such tax, is deductible in the Federal income tax return of the consumer who pays it and to whom it is not refunded. If, however, the tax is added to or made a part of the business expense of such consumer, it can not be deducted by him separately as a tax.

A ruling is requested in regard to the deductibility, for Federal income tax purposes, of the motor vehicle fuels tax imposed by the laws of the State of New Jersey.

Chapter 357, Laws of New Jersey, 1931, reads in part as follows:

1. Section 1 of the act of which this act is an amendment be and the same is hereby amended to read as follows:

* * * * * * *

"1. The term 'motor vehicle' shall include any vehicle propelled or drawn along by any power other than muscular, and motor boats or any boat or scow propelled wholly or in part from power derived from a gasoline engine, except road rollers, street sprinklers, fire engines or fire department apparatus, ambulances owned by municipalities or hospitals, motor vehicles of the United States Government, the State government and all political subdivisions thereof, rural free delivery carriers in the dispatch of their official business, auto buses, commonly called jitneys, which now pay a municipal or franchise tax on their gross receipts, agricultural tractors, aircraft, and such vehicles as run only on rails or tracks or which operate exclusively on private property.

"2. The term 'fuels' shall include gasoline, benzol, or other products which are or can be used as fuels for combustible type engines."

* * * * * * *

3. Section 3 of the act of which this act is an amendment be and the same is hereby amended to read as follows:

"3. Every such distributor shall keep a record of all such fuels sold or used which shall include the name of the purchaser, the number of gallons used or sold and the date of the sale or use. Every such distributor shall also deliver with every consignment of such fuel to a purchaser within the State a written statement containing the date and the number of gallons delivered and the names of the purchaser and seller, and which statement shall show a separate charge for the tax on every gallon. Said records and said written statements shall be preserved by said distributor and said purchaser respectively for a period of one year and shall be offered for inspection upon the verbal or written demand of the State tax commissioner or any of his duly authorized assistants."

4. Section 4 of the act of which this act is amendatory be and the same is hereby amended to read as follows:

"4. Every distributor shall, on or before the last business day of each month, render a report to the State tax commissioner, stating the number of gallons of such fuel sold or used in the State by him during the preceding calendar month * * *. On or before the 1st day of the calendar month succeeding the filing of said report each distributor shall pay to the State tax commissioner a tax of 3 cents per gallon upon each gallon so reported * * *."

Chapter 213 of the Laws of New Jersey, 1931, reads in part as follows:

3. Any person, firm or corporation using such fuel for the purpose of propelling motor boats or motor vessels shall be entitled to a refund of 1 cent per gallon of the tax paid under section 4 of this act, as amended, upon filing with the State tax commissioner a certification, under oath of such person, or a member of such firm, or an officer of such corporation, on forms furnished for such purpose by the State tax commissioner, showing the number of gallons of such fuels used for such purpose.

In addition to the foregoing provisions of law the following provisions of chapter 223, Laws of New Jersey, 1932, approved June 14, 1932, which is a supplement to the original act of April 1, 1927, imposing a tax on gasoline, are pertinent:

1. In addition to the exemptions provided by the provisions of the act to which this act is a supplement [act of April 1, 1927], all motor boats or motor vessels used exclusively for and/or in the propagation, planting, preservation, and gathering of clams and oysters in the tidal waters of this State, and all motor boats, and/or motor vessels used exclusively for commercial fishing, shall be exempted from the payment of the tax, assessed, levied and collected pursuant to the provisions of the act to which this act is a supplement, when used for said purposes.

2. This act shall take effect immediately.

Section 23(c) of the Revenue Act of 1932 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. Article 151 of Regulations 77, promulgated under the Revenue Act of 1932, provides that in general taxes are deductible only by the person upon whom they are imposed. It appears from an examination of the Laws of New Jersey, 1931 and 1932, relating to the imposition of the motor vehicle fuels tax, that it was the purpose of the legislature of that State to impose the tax in question upon the consumer. It is held, therefore, in accordance with the provisions of section 23(c) of the Revenue Act of 1932 and article 151 of Regulations 77, that the motor vehicle fuels tax imposed by the laws of the State of New Jersey, referred to above, is deductible in the Federal income tax return of the consumer who pays it and to whom it is not refunded. If, however, such tax is added to or made a part of the business expense of such consumer, it may not be deducted by him separately as a tax. (See I. T. 2588, C. B. X–2, 135, relative to motor vehicle fuels tax imposed by chapter 239, Laws of New Jersey, 1930.)

ARTICLE 151: Taxes.

XII–25–6236
G. C. M. 11874

REVENUE ACT OF 1932.

The tax imposed by chapter 11, article 14, of the Official Code of West Virginia, 1931, on gasoline used in the propelling of motor vehicles is deductible in the income tax return of the consumer who pays it and to whom it is not refunded. If, however, the tax is added to or made a part of the business expense of the consumer, it can not be deducted by him separately as a tax.

An opinion is requested whether the tax imposed by the State of West Virginia on gasoline is deductible for Federal income tax purposes by the distributor or the consumer.

The tax in question is imposed in accordance with the provisions of chapter 11, article 14, of the Official Code of West Virginia, 1931.

Section 3 of that article contains the following provisions:

There is hereby imposed, upon every person who is a distributor, retail dealer or importer under the terms of this article, an excise tax based on the quantities of all gasoline sold, purchased or used in this State on and after the 1st day of January, 1931 (except as herein provided), which tax shall be equivalent to 4 cents per gallon thereof and shall be paid as hereinafter provided. A distributor shall use as the measure of the tax the gallonage sold for whatever use in this State (as provided in section 4 hereof) and the gallonage used by him in motor vehicles operated in this State; a retail dealer shall use as the measure of the tax the gallonage purchased or obtained by him, and an importer shall use as the measure of the tax the gallonage purchased by him for use in motor vehicles to be operated in this State.

The special excise tax imposed by this article shall be paid by the person first selling, or using in this State the gallonage of gasoline which under this article shall form the measure of such tax; but in no case shall any such gallonage be used more than once in determining taxes due hereunder. The taxes imposed by this article are in addition to all other taxes now imposed or prescribed by law.

Section 20 of the same article contains the following:

Refund of tax on gasoline used for certain purposes; penalty for false claim.—Any person who shall buy, in quantities of 25 gallons or more at any one time, any gasoline as defined in this article, for the purpose of, and the same is actually used for, operating and propelling boats, aeroplanes, tractors used for

agricultural or other purposes, road rollers, steam shovels, compressors, pumps, stationary gas engines, threshing machines or other gasoline-operated machinery, except motor vehicles; or who shall purchase and use such gasoline for cleaning and dyeing or for manufacturing or other commercial uses, except in motor vehicles, which gasoline shall have been previously included in the measure by which the excise tax imposed by this article is determined, shall be reimbursed and repaid a sum equal to the amount of such tax, upon presenting to the tax commissioner an affidavit accompanied by a ticket or invoice from the distributor or retail dealer, showing such purchase, which affidavit shall set forth the total amount of such gasoline purchased and used by such consumer, other than in motor vehicles operated in this State, and how used; and the tax commissioner upon the receipt of such affidavit and ticket or invoice *shall cause to be refunded to such consumer such tax paid* on gasoline purchased and used other than for motor vehicles as aforesaid * * *. [Italics supplied.]

Section 23(c) of the Revenue Act of 1932 provides that in computing net income there shall be allowed as a deduction taxes paid or accrued within the taxable year, with certain exceptions not here material.

From the provisions of the laws of the State of West Virginia, quoted above, it appears that the tax on gasoline is actually imposed upon the consumer who purchases and uses it in operating or propelling motor vehicles. This is evident from an examination of section 20, article 14, of the Official Code of West Virginia, 1931, which section specifically provides for a refund of the tax to the consumer in those cases where the gasoline purchased was used by the consumer "other than in motor vehicles" operated in the State. It is held, therefore, in accordance with the provisions of section 23(c) of the Revenue Act of 1932, and article 151 of Regulations 77, that the tax imposed by the State of West Virginia on gasoline used in the propelling of motor vehicles, is deductible in the income tax return of the consumer who pays it and to whom it is not refunded. If, however, the tax in question is added to or made a part of the business expense of the consumer, it can not be deducted by him separately as a tax.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 151: Taxes.

XII-26-6247
I. T. 2699

REVENUE ACT OF 1932.

The tax paid on motor fuel under the act of March 9, 1933, of the General Assembly of the State of Vermont, effective June 1, 1933, is deductible for Federal income tax purposes by the purchaser or consumer. If, however, the tax is added to or is made a part of the business expenses of such purchaser or consumer, it can not be deducted separately as a tax.

Advice is requested in regard to what effect, if any, the amendment passed by the General Assembly of the State of Vermont to the gasoline tax law of the State, which was approved March 9, 1933, effective June 1, 1933, will have on I. T. 2531 (C. B. IX 1, 105) holding that the tax paid on motor fuel imposed by the law of the State of Vermont under the provisions of No. 30 of the Acts of 1929, Laws of Vermont, 1929, is deductible for Federal income tax purposes only by the distributor.

The gasoline tax of the State of Vermont is imposed in accordance with the provisions of Part I of the general revenue act of that State, approved March 15, 1929 (No. 30 of the Acts of 1929, Laws of Vermont, 1929, page 38), as amended by Nos. 14, 15, and 16 of the Acts of 1931, Laws of Vermont, 1931, pages 15, 16, and 17, and by the act passed by the General Assembly of that State (S. 24) which was approved March 9, 1933, effective June 1, 1933. The latter act reads as follows:

An act to amend the second paragraph of section 5 of Part I of No. 30 of the Acts of 1929, as amended by section 1 of No. 14 of the Acts of 1931, which appears in section 1082 of the Public Laws, as proposed, relating to the collection of the tax on gasoline.

SECTION 1. The second paragraph of section 5 of Part I of No. 30 of the Acts of 1929, as amended by section 1 of No. 14 of the Acts of 1931, which appears in section 1082 of the Public Laws, as proposed, is hereby amended so as to read as follows:

"(1082 P. L.) At the time of filing said report each distributor, in all cases not exempt from such tax under the laws of the United States, shall pay to the commissioner of motor vehicles a tax of 4 cents per gallon upon each gallon of such motor fuel sold by said distributor, *the distributor to collect from the dealer and the dealer from the consumer*, and shall also pay to the said commissioner a tax of 4 cents per gallon upon each gallon of such motor fuel used within the State by said distributor. If any distributor shall neglect or refuse to make said statement or return as herein required an addition of 5 per centum of the amount of the tax shall be added and collected and become a part of the tax due."

Section 23(c) of the Revenue Act of 1932 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. Article 151 of Regulations 77, promulgated under the Revenue Act of 1932, provides that in general taxes are deductible only by the person upon whom they are imposed.

It appears from the use of the words "the distributor to collect from the dealer and the dealer from the consumer" in the act approved March 9, 1933, supra, that the General Assembly of the State of Vermont intended the tax on gasoline imposed by that act to be paid by the purchaser or consumer through or by means of the distributor. It is held, therefore, that the gasoline tax collected in Vermont after the effective date of the act, namely, June 1, 1933, is deductible, for Federal income tax purposes, by the purchaser or consumer. If, however, the tax is added to or is made a part of the business expenses of such purchaser or consumer, it can not be deducted separately as a tax.

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

ARTICLE 206: Obsolescence. XII–6–6016
G. C. M. 10860

REVENUE ACTS OF 1928 AND 1932.

A mere diminution of profits resulting from competition even when changes in the art, etc., are involved, does not give rise to an obsolescence deduction, where there is no reasonable probability that the assets will not be continued in service during their normal useful life in the business or trade for which they were originally designed.

An opinion is requested whether in computing net income a deduction for obsolescence may be allowed with respect to ferryboats owned by the taxpayer, on the theory that it is known that no further profit will be derived from their use. It is admitted that the use of these boats may continue throughout the term of their normal physical life, and that they will be operated for the same purpose for which they were originally acquired.

The provision, permitting a deduction for obsolescence, which appears in section 23(k) of the Revenue Act of 1928 is repeated in section 23(k) of the Revenue Act of 1932 and reads as follows:

In computing net income there shall be allowed as deductions:

* * * * * * *

(k) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *

Article 206 of Regulations 74 reads as follows:

ART. 206. *Obsolescence.*—With respect to physical property the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a future date prior to the end of its normal useful life, so that depreciation deductions alone are insufficient to return the cost (or other basis) at the end of its economic term of usefulness, a reasonable deduction for obsolescence, in addition to depreciation, may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. No deduction for obsolescence will be permitted merely because, in the opinion of a taxpayer, the property may become obsolete at some later date. This allowance will be confined to such portion of the property on which obsolescence is definitely shown to be sustained and can not be held applicable to an entire property unless all portions thereof are affected by the conditions to which obsolescence is found to be due.

The file in the instant case and conferences with the representative of the taxpayer disclose that the ferryboats in question have remained in operation although there has been a loss of trade in the particular branch of the business of the taxpayer which has to do with the transportation of vehicles and pedestrians between two cities. The taxpayer has fixed upon no definite date for the abandonment of the equipment upon which allowances for obsolescence are sought. It appears that the ferryboats are representative of the present standard of ferryboat building, and that since their acquisition the construction and equipment of the art and science of ferryboat building have undergone no radical innovation. However, the building of a bridge connecting the two cities has so affected the business of transporting vehicles and pedestrians between the two cities that the taxpayer has suffered a loss in trade and it is possible that at some future date, before the cost or other basis is returned by ordinary depreciation, the boats of the taxpayer will be retired from service as ferryboats.

The taxpayer relies upon certain cases where obsolescence deductions were allowed on equipment of brewing companies on the basis that the advent of national prohibition rendered obsolete such equipment, notwithstanding that such equipment continued in use. The taxpayer relies particularly on the decision in the case of *Burnet* v. *Niagara Falls Brewing Co.* (282 U. S., 648, Ct. D. 315, C. B. X-1, 403). An examination of the case cited clearly indicates that the court, in determining that the taxpayer was entitled to a deduction

for obsolescence, considered the equipment which had been continued in use after prohibition to be equipment used for the making of nonalcoholic beverages and not for beer-making purposes. After prohibition became a certainty beer-making machinery as such became obsolete and the value of the machinery which would be devoted to the manufacturing of nonalcoholic beverages was determined to be salvage value and that value established a norm by which the quanta of obsolescence allowances were reached.

However, the court used some very broad language, as is shown by the following quotation from its opinion:

> The Government argues that obsolescence is the state of becoming obsolete, that property is obsolete when it is no longer useful for the purpose for which it was acquired and can not be used for any other purpose and that obsolescence begins only when there is a reasonable certainty that the property will become obsolete. And further, that there is no finding that at any time during the taxable years in question it became apparent that the property would become obsolete and that no inference to that effect can properly be drawn from the facts found.
>
> In the solution of the problems here presented, no general or comprehensive definition of "obsolescence" is necessary. The word is much used and its meaning depends upon and varies with the connections in which it is employed. It has been said to be "the condition or process by which units gradually cease to be useful or profitable as a part of the property, on account of changed conditions." Obsolescence is not necessarily confined to particular elements or parts of a plant; the whole may become obsolete. Obsolescence may arise as the result of laws regulating or forbidding the particular use of the property as well as from changes in the art, the shifting of business centers, loss of trade, inadequacy or other causes.

Since the case before the court did not involve changes in the art, the shifting of business centers, loss of trade (except as a result of legislation existing or pending), or inadequacy, the last sentence above quoted is largely obiter dictum. It may be assumed, for purposes of argument, that the Supreme Court would follow its dictum in a subsequent obsolescence case involving any of the elements mentioned in the sentence just referred to, provided the taxpayer met the other conditions laid down by the court.

The taxpayer in the instant case is engaged in the business of transporting passengers and certain freight by water in boats specially designed for ferrying purposes. A bridge recently completed affords the public a different form of transportation which may be more satisfactory, or at a lower price. The situation is quite analogous to "changes in the art," which falls within the scope of the court's opinion and is clearly recognized by the regulations. The change might have resulted in such a condition that the taxpayer would be forced to convert all of its boats to another use, or offer them for sale, or possibly scrap them, in which case an obsolescence allowance might be permissible. Such condition, however, does not exist with respect to the boats here under discussion.

The court, in *Burnet* v. *Niagara Falls Brewing Co.*, supra, laid down the following rule for determining the amount of the allowance:

> * * * A reasonable approximation of the amount that fairly may be included in the accounts of any year is all that is required. In determining the proper deduction for obsolescence there is to be taken into consideration the amount probably recoverable, at the end of its service, by putting the property to another use or by selling it as scrap or otherwise. There is no

hard and fast rule, as suggested by the Government, that a taxpayer must show that his property will be scrapped or cease to be used or useful for any purpose, before any allowance may be made for obsolescence.

The taxpayer is unable to show that the ferryboats here involved will reach "the end of its [their] service" as ferryboats prior to the expiration of the normal useful life of the boats.

It is the opinion of this office that on the facts submitted the taxpayer is not entitled to a deduction for obsolescence with respect to the boats continued in service as ferryboats, although the profits from such service may be less than they were prior to the construction of the bridge.

There is no intimation in the court's decision, referred to above, that a mere diminution of profits resulting from competition, even when changes in the art, etc., are involved, gives rise to an obsolescence deduction, where there is no reasonable probability that the assets will not be continued in service during their normal life in the business or trade for which they were originally designed.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

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

ARTICLE 261: Contributions or gifts by individuals.

REVENUE ACT OF 1932.

Contributions to the Military Training Camps Association. (See G. C. M. 11705, page 57.)

SECTION 23(r). DEDUCTIONS FROM GROSS INCOME: LIMITATION ON STOCK LOSSES.

ARTICLE 272: Limitations on deductions for losses from sales and exchanges of stocks and bonds. XII-1-5966 I. T. 2670

REVENUE ACT OF 1932.

The taxpayer sustained losses from the sale in April, 1932, of certain securities held for two years or less. The taxpayer filed its return on the basis of a fiscal year ended April 30, 1932.

Held, the entire amount of these losses disallowed as a deduction by section 23(r)1 of the Revenue Act of 1932 for the fiscal year ended April 30, 1932, shall, in accordance with section 23(r)2 of the Revenue Act of 1932, be considered as losses sustained in the taxable year 1933 from the sale or exchange of stocks and bonds which are not capital assets, to the extent of the net income for the fiscal year ended April 30, 1932, such net income being computed under the Revenue Act of 1932.

Advice is requested with respect to the application of section 23(r)2 of the Revenue Act of 1932 in the case of the losses sustained from the sale in April, 1932, of certain securities held for two years or less. The taxpayer filed its return on the basis of a fiscal year ended April 30, 1932.

Section 23(r)1 provides that losses from sales or exchanges of stocks and bonds which are not capital assets (as defined in section 101) are deductible 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). Under section 23(r)2 if the losses from sales or exchanges of stocks and bonds which are not capital assets exceed the gains from such transactions, such excess losses may be carried forward and applied against the gains from similar transactions in the succeeding taxable year, provided, first, that there is subtracted from such excess the amount of any losses brought forward from the preceding taxable year, and, second, that the remainder may not be carried forward in an amount exceeding the net income of the taxpayer for the taxable year. The entire amount of the losses in question disallowed as a deduction by section 23(r)1 of the Revenue Act of 1932 for the fiscal year ended April 30, 1932, shall, in accordance with section 23(r)2 of the Revenue Act of 1932, be considered as losses sustained in the taxable year 1933 from the sale or exchange of stocks and bonds which are not capital assets, to the extent of the net income for the fiscal year ended April 30, 1932, such net income being computed under the Revenue Act of 1932. (See also I. T. 2641 [C. B. XI-2, 31] and I. T. 2656 [C. B. XI-2, 32].)

ARTICLE 272: Limitations on deductions for losses from sales and exchanges of stocks and bonds. XII-2-5976 I. T. 2671

Limitations on deductions for Federal income tax purposes of losses from sales or exchanges of stocks and bonds.

The Bureau of Internal Revenue has received numerous inquiries regarding the provisions of the Revenue Act of 1932 pertaining to the limitations on deductions for losses from sales or exchanges of stocks and bonds for income tax purposes. The new provisions in the law are contained in section 23 (r), (s), and (t). Under these provisions deductions may be taken in income tax returns for the year 1932 (and subsequent years) for losses sustained from the sale or exchange of stocks and bonds which had been held by the taxpayer for two years or less prior to date of sale or exchange only to the extent of the gains from such sales or exchanges.

The limitation provided by section 23(r) does not apply to losses sustained from the sale or exchange of stocks and bonds which have been held for a period of more than two years so as to constitute capital assets within the meaning of section 101 of the law, and the treatment of losses sustained on the sale or exchange of such capital assets remains the same as it was under the Revenue Act of 1928.

In defining stocks and bonds for the purpose of the limitation, the statute specifically excludes therefrom bonds issued by a government or one of its political subdivisions. Such exclusion, therefore, not only includes bonds issued by the Government of the United States or a State or political subdivision thereof but also bonds issued by a foreign country or foreign municipality. It therefore follows that the deduction for losses sustained from the sale or exchange of such bonds is not subject to the limitation. Subject

to the exception noted in this paragraph, the term "stocks and bonds" includes not only the usual shares of stock issued by corporations and the usual bonds, debentures, notes, or certificates or other evidences of indebtedness issued by corporations, but also certificates of profit or of interest in property or accumulations in an investment trust or similar organization, regardless of whether or not such investment trust or similar organization constitutes a corporation within the meaning of the Act. The term also includes rights to subscribe for or to receive shares of corporate stock.

The limitation is in general applicable to both corporations and individuals as well as other taxpayers. By the express terms of the statute, however, it does not apply to dealers in securities as to stocks and bonds acquired for resale to customers in respect of transactions in the ordinary course of business, or to banks or trust companies incorporated under the laws of the United States or of any State or Territory.

Although losses in excess of gains from such sales or exchanges during the year 1932 affect the year 1933 by reason of the provision for carrying forward such excess to the latter year, the immediate concern is for the year 1932 and the chief emphasis at the present time is therefore devoted to outlining the method of handling such losses for the year 1932. The application of the limitation calls for the segregation of the gains and losses from such transactions from the gains and losses from other transactions. When such gains or losses are thus segregated the aggregate of the losses is merely offset against the gains, thus giving effect to the provisions of the statute that such losses are to be allowed as deductions only to the extent of the gains from such transactions.

In case the amount of the gains is in excess of the amount of the losses from such transactions, such excess enters into the taxpayer's ordinary income and is subject to tax at the regular rates for computing the normal tax and surtax. In case the amount of losses is in excess of the amount of gains from such transactions for the year 1932, such excess may not be availed of by the taxpayer as a deduction for the year 1932 but may be carried forward to the year 1933, to the extent of his net income for the year 1932, and taken as a deduction against gains from similar transactions for the year 1933.

The application of the statute may be illustrated as follows:

For the taxable year 1932 John Doe (who was not a dealer in securities) had a net income from salaries, dividends, and rents of $50,000. He had gains and losses from sales of stocks and bonds during 1932 as follows:

Gains from sales of stocks and bonds held for two years or less	$100,000
Losses from sales of stocks and bonds held for two years or less	200,000
Excess of losses over gains	100,000

The amount allowable as a deduction for the taxable year 1932 for the losses from the sale of stocks and bonds is limited to $100,000. The excess of the losses over the gains ($100,000) is not deductible, but the amount of such excess not exceeding the net income of John Doe for the taxable year 1932 ($50,000) may be carried forward

and applied against the gains from similar transactions for the taxable year 1933.

As losses from such transactions may be availed of by the taxpayer as a deduction for the year 1932 only in the manner and to the extent above specified, such losses may not be applied as a deduction against income from other sources, such as salary or other compensation received for services, and similarly, such losses may not be applied as a deduction against gains from the sale or exchange of property (including stocks and bonds) held for more than two years.

It is to be observed that section 23(r) does not affect in any way the treatment of transactions in real or personal property (other than stocks and bonds). Such transactions are treated in the same manner as they were under the prior Revenue Act. Stocks and bonds held for over two years are in all cases treated in the same manner under the Revenue Act of 1932 as in the prior Act. It is necessary, under the Revenue Act of 1932, for all taxpayers, regardless of the size of their net income, to keep a record of their transactions in stocks and bonds so that they may determine how long such securities have been held on the date of sale. This is necessary to determine the amount of loss allowable, because stocks and bonds held for less than two years are subject to the special limitations.

ARTICLE 272: Limitations on deductions for losses from sales and exchanges of stocks and bonds.

REVENUE ACT OF 1932.

Bonds issued by a municipality. (See I. T. 2672, page 72.)

SECTION 23(s).—DEDUCTIONS FROM GROSS INCOME; [LIMITATION ON STOCK LOSSES] SHORT SALES.

ARTICLE 272: Limitations on deductions for losses from sales and exchanges of stocks and bonds. XII-12-6079 I. T. 2683

REVENUE ACT OF 1932.

The taxpayer pledged with a bank, as collateral for loans, securities, some of which had been held for a period of more than two years. In order to liquidate the loans, the taxpayer sold such securities through a broker. As delivery of the securities was not made at the time of sale, the sales were treated as short sales.

The sales in question are properly classed as short sales and the gain or loss is to be treated as resulting from sales of securities which were not capital assets, in accordance with section 23(s) of the Revenue Act of 1932, regardless of the fact that the securities which were later delivered may have been held more than two years.

The question is presented relative to the applicability of section 23(s) of the Revenue Act of 1932 in the case of the sale of certain stocks and securities under the circumstances set out below.

The stocks and securities, herein referred to for convenience as securities, had been pledged with a bank as collateral for loans and

in most instances they had been held for a period of more than two years. It was decided in 1932 to liquidate such loans through the sale of securities pledged as collateral. The sales were made through a broker over a period of several weeks, and as delivery of the securities so held as collateral was not made at the time of sale the sales were treated as short sales at the time, although the securities have since been delivered to the broker to cover the sales so made. The question involved is whether the sales are properly to be classed as "short sales" so as to preclude such securities from being treated as capital assets, even though they had been held for a period of more than two years, within the meaning of section 23(s) of the Revenue Act of 1932. That section provides as follows:

> For the purposes of this title, gains or losses (A) from short sales of stocks and bonds, or (B) attributable to privileges or options to buy or sell such stocks and bonds, or (C) from sales or exchanges of such privileges or options, shall be considered as gains or losses from sales or exchanges of stocks or bonds which are not capital assets.

The essence of a short sale is that delivery is made with borrowed stock. As to the legal aspects of so-called "intraoffice borrowings" and "intraoffice loans" where the seller lives beyond the 24-hour limit for making delivery, attention is invited to General Counsel's Memorandum 11096 [C. B. XI-2, 524]. The mechanics of a typical short sale are fully set out in Solicitor's Memorandum 1179 (C. B. 1, 60) and the decision rendered by the Supreme Court in the case of *Provost* v. *United States* (269 U. S., 443), published as Treasury Decision 3811 (C. B. V-1, 417). The Supreme Court in that decision defined an ordinary short sale as follows:

> The loan of stock is usually, though not necessarily, incidental to a short sale. As the phrase indicates, a short sale is a contract for the sale of shares which the seller does not own or the certificates for which are not within his control so as to be available for delivery at the time when, under the rules of the exchange, delivery must be made. • • •

There is nothing to indicate that the foregoing definition was considered to be exclusive but on the contrary it was recognized that a short sale can be made even though the seller owns stock of the same kind at the same time, and as delivery of the stock sold in such case is made with borrowed stock, the sale is what is generally known as a short sale. This is shown by the following statement, which is quoted from the decision:

> • • • The stock for this purpose, if not provided by the customer, must be obtained by borrowing stock of like kind and amount from other brokers, or by purchasing the stock in the open market and charging the customer for whose account the sale was originally made, with the purchase price. • • •

The foregoing conclusion is supported by the decision rendered by the United States Board of Tax Appeals on November 29, 1932, in the case of *Robert W. Bingham* v. *Commissioner* (27 B. T. A., 186, page 2, this Bulletin). It was held in that decision that in the case of short sales gain or loss is to be ascertained by matching the short sale price against the cost of the covering purchase, even though the taxpayer at the same time maintains with the same broker a margin account containing similar shares previously purchased. In that case the taxpayer, in addition to an investment account, maintained with his broker two margin accounts referred to respectively as "long" and "short" trading accounts. The transactions in-

volved the purchase and sale of stock of the Victor Talking Machine Co. Such stock had been sold "short" and the taxpayer was "long" on such stock at the time that a covering purchase was made. In determining the profit from such short transactions the taxpayer matched the cost of the covering purchase against the sale price, while the Bureau attempted to apply against the selling price the cost of the "long" stock previously purchased. In sustaining the taxpayer's contention the Board said in part:

We think that the respondent's position can not be sustained. It loses sight of the nature of a short sale and treats it like an ordinary sale. But the essence of a short sale is that what is sold has not yet been acquired by the seller. (Cf. *Provost* v. *United States*, 269 U. S., 443; *Cook* v. *Flagg*, 251 Fed., 5.) A short sale of property already on hand is an anomaly. An instruction by a broker's customer to sell short puts into operation a machinery which is entirely inconsistent with a simple sale of shares already held in the customer's account. (*Provost* v. *United States*, supra.) While the specific question has not, so far as we have been able to ascertain, been determined, enough has been said in the extensive discussion of cognate questions to indicate at least a doubt whether a broker instructed by his customer to make a short sale is authorized without specific permission to consummate such sale by the use of the shares in the customer's long account. Clearly he could not do so before giving the customer a reasonable time and opportunity to make a profitable purchase to cover. (*Campbell* v. *Wright*, 118 N. Y., 594; 23 N. E., 914; *Rosenthal* v. *Brown*, 247 N. Y., 479; 160 N. E., 921; Ingraham, J., in *In re Mills*, 139 App. Div., 54; 123 N. Y. S., 671.)

In the present case the stipulation suggests that the broker was given a wide freedom in the use of petitioner's shares. The brokerage contracts are not in evidence and, hence, the extent of the broker's powers in this respect is not entirely clear. It would seem, however, that he has no right to close out the petitioner's long account by using the long shares to make an immediate delivery under a short sale. Even if the broker had the right to borrow the customer's long shares for delivery under his short sale (cf. *Jones* v. *DeRonde*, 255 N. Y. S., 505), this would be less than saying, as the respondent does, that the long shares were sold for the petitioner.

A short sale imports a subsequent covering purchase. It leaves open the accounts of both the customer and the broker. No profit or loss exists until by the covering purchase the obligation of the short sale is discharged. (*Brown* v. *Carpenter*, 182 App. Div., 650; 168 N. Y. S., 921; see S. 1179, C. B. 1 (1919), 60; I. T. 2187, C. B. IV-2, 25.) It is in this respect unlike an ordinary sale. While some attributes are present in both transactions, the more important attributes of a short sale are those which entirely distinguish it from the ordinary sale.

While, therefore, it may be that article 58 is applicable on occasions to short sales, so, for instance, as to justify the use of a first out-first in rule to successive unidentified short sales of the same class of stock, this would be quite different from applying the rule indiscriminately to a congeries of short sales and long purchases. The respondent's application of the rule to the facts here finds less support either in law or administrative convenience than its application to stock bought by a single customer through several brokers. (*Christian F. Leng*, 22 B. T. A., 149.)

In our opinion, the gain or loss in respect of a short sale is to be ascertained by matching it against the covering purchase, and this requires that the respondent's determination be reversed. This is in accordance with the respondent's rulings (G. C. M. 7451, C. B. IX-1, 81; G. C. M. 8426, C. B. IX-2, 92; and I. T. 2187, C. B. IV 2, 25).

In accordance with the foregoing, it is held that the sales here in question are properly classed as short sales. The resulting gain or loss is, therefore, to be treated as gain or loss from the sale of securities which were not capital assets in accordance with section 23(s) of the Revenue Act of 1932, regardless of the fact that the securities which were later delivered in connection with such sales may have been held for a period of more than two years.

SECTION 25.—CREDITS OF INDIVIDUAL AGAINST NET INCOME.

ARTICLE 295: Personal exemption and credit for dependents where status changes. XII-9-6055 I. T. 2680

REVENUE ACT OF 1932.

Examples of apportionment of the personal exemption and credit for dependents, under the Revenue Act of 1932, where a taxpayer dies during the taxable year.

A ruling is requested relative to the provisions of the Revenue Act of 1932 with respect to the apportionment of the personal exemption and credit for dependents in the case of a taxpayer who dies during the taxable year.

Section 25 of the Revenue Act of 1932 provides in part:

> There shall be allowed for the purpose of the normal tax, but not for the surtax, the following credits against the net income:
>
> * * * * * * *
>
> (c) *Personal exemption.*— In the case of a single person, a personal exemption of $1,000; or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $2,500. A husband and wife living together shall receive but one personal exemption. The amount of such personal exemption shall be $2,500. If such husband and wife make separate returns, the personal exemption may be taken by either or divided between them.
>
> (d) *Credit for dependents.*— $400 for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer if such dependent person is under 18 years of age or is incapable of self-support because mentally or physically defective.
>
> (e) *Change of status.*—If the status of the taxpayer, in so far as it affects the personal exemption or credit for dependents, changes during the taxable year, the personal exemption and credit shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, in accordance with the number of months before and after such change. For the purpose of such apportionment a fractional part of a month shall be disregarded unless it amounts to more than half a month in which case it shall be considered as a month.

If the status of the taxpayer changes during the taxable year, the personal exemption allowed by section 25(c) to a single person, a head of a family, or a married person living with husband or wife, and the credit for dependents allowed by section 25(d) will be apportioned according to the number of months during which the taxpayer occupied each status. A taxpayer not having the status of a head of a family or the status of a married person living with husband or wife shall be considered as having the status of a single person. For the purpose of the apportionment of the personal exemption and credit for dependents a fractional part of a month shall be disregarded unless it amounts to more than half a month, in which case it shall be considered as a month. In general the personal exemption and credit for dependents allowable to any taxpayer will be the sum of the amounts apportioned to the several periods of the taxable year during which each status was occupied. According to the decision of the Circuit Court of Appeals for the Second Circuit in the case of the *Bankers Trust Co.* v. *Bowers* (295 Fed., 89, T. D. 3547, C. B. III-1, 237) a return filed in behalf of a decedent reporting the income from the beginning of the taxable year

to the date of the decedent's death is a return for a taxable year of 12 months.

The foregoing principles may be illustrated by the following examples:

Example (1): A, who was a single person without dependents and whose accounting period was the calendar year, died on June 20, 1932. The executor or administrator in making a return for A may claim a personal exemption of $1,000, that is, one-half of $1,000, or $500, for the period from the beginning of the taxable year to the date of the decedent's death, plus one-half of $1,000, or $500, for the period from the date of the decedent's death to the close of the taxable year.

Example (2): A and B were married and living together until November 30, 1932, when B, the wife, died. They had no dependents. B's accounting period was the calendar year. The executor or administrator, in making a return for B, may claim a personal exemption of $1,229.16, that is, one-half of eleven-twelfths of $2,500, or $1,145.83, for the period from the beginning of the taxable year to the date of the decedent's death, plus one-twelfth of $1,000, or $83.33, for the period from the date of the decedent's death to the close of the taxable year. If A, the surviving spouse, makes a return for 1932 on the calendar year basis, he may claim a personal exemption of $1,229.16, that is, one-half of eleven-twelfths of $2,500, or $1,145.83, plus one-twelfth of $1,000, or $83.33. However, the combined personal exemption of A and B for the period during which they were married and living together, that is, eleven-twelfths of $2,500, or $2,291.67, may by agreement be taken either by A, or by B's executor or administrator in behalf of B, or divided between them in any proportion. If the surviving spouse is willing to agree that any portion of the $1,145.83 personal exemption to which he is entitled for that period may be used by the executor or administrator in behalf of the decedent, a statement from the surviving spouse should be attached to the return filed for the decedent showing the amount of such portion which may be so used. In the absence of such a statement only one-half of the combined personal exemption for the period during which A and B were married and living together (in addition to the personal exemption of $83.33 for the period from the date of the decedent's death to the close of the taxable year) may be claimed by the executor or administrator in behalf of the decedent.

Example (3): A furnished the chief support of a child under 18 years of age until the death of the child on June 20, 1932. If A files a return on the calendar year basis for 1932, he is entitled, in addition to the personal exemption allowed under section 25(c), to a credit for dependents in the amount of $200; that is, six-twelfths of $400.

Example (4): A and B were married and living together until June 30, 1932, when A, the husband, died. A's accounting period was the calendar year. Prior to the date of A's death, he was the chief support of a child 10 years of age. B, the surviving spouse, was the chief support of the child during the remainder of the year. If B makes a return for 1932 on the calendar year basis, she is entitled, in addition to a personal exemption, to a credit for dependents in the amount of $200; that is, six-twelfths of $400. The executor or admin-

istrator in making a return for A is entitled, in addition to a personal exemption, to a credit for dependents in the amount of $200; that is, six-twelfths of $400.

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 (c) and (e) (computed without regard to his status as the head of a family), or if his gross income for the same period was $5,000 or over, the executor or administrator is required to make a return for such decedent. Where one spouse dies prior to the last day of the taxable year, the surviving spouse may not include the income of the deceased spouse in a joint return for such taxable year.

PART III.—CREDITS AGAINST TAX.

SECTION 31.—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

(Also Section 131, Article 693.)

XII-7-6026
I. T. 2676

REVENUE ACT OF 1932.

Basic information required to substantiate credits for foreign taxes taken in Federal income tax returns.

One of the items which will enter into the computation of tax liability of many taxpayers is the credit allowable under sections 31 and 131 of the Revenue Act of 1932 against income tax due the United States, of income, war-profits, and excess-profits taxes imposed by and paid to foreign countries or possessions of the United States.

In the audit of returns it is found that one of the chief obstacles to prompt and correct consideration of credits for foreign taxes is inability to interpret the evidence in the form of receipts, etc., submitted by the taxpayer in support of claims for credit for taxes paid or accrued to foreign countries.

In some instances the credits claimed are based on evidence furnished in a foreign language which is not accompanied by a certified translation, while in other cases the credit is not supported by such evidence as is required by the regulations. The evidence furnished in the form of receipts, assessment notices, and/or other foreign documents of an explanatory character should contain the information for determining the nature of the tax, date of its accrual, date of payment, and the income upon which the tax is based.

TRANSLATIONS REQUIRED.

The income tax regulations require that "where the receipt or the return is in a foreign language, a certified translation thereof must be furnished by the taxpayer." (Article 693 of Regulations 74.) This translation is *in addition* to copies of the original receipts or returns in the foreign language.

The above requirements must be strictly complied with and where the taxpayer has not submitted translations in connection with the

foreign tax receipts attached to Form 1116 or 1118 filed with its return, such translations must be obtained from the taxpayer, together with translations of any explanatory or supporting statements and documents.

RECEIPTS REQUIRED.

A credit for foreign taxes paid or accrued to a foreign country will not be allowed unless supporting evidence is attached to the return or is filed upon request.

The evidence should be in the form of a receipt and any necessary statement explanatory thereof. If the receipt does not contain information as to the character of the tax, the date of the accrual of the income on which the tax is levied, the amount of such income, and the tax rate applied, the Bureau will require from the taxpayer the assessment notices received from the foreign government and/or any statements furnished to the foreign government which disclose such information. The information will be required both with respect to taxes paid by the taxpayer directly on income resulting from its own operations in foreign countries and to such taxes paid by its controlled foreign subsidiaries.

In general, by "receipt" is meant a receipt issued by a foreign government to one of its taxpayers for taxes paid on the latter's own income or upon income of a distributee where such taxpayer is the distributor. However, in the case of taxes paid at the source upon dividends, interest, or royalties distributed to a domestic shareholder or creditor, as the case may be, or of taxes paid by a foreign partnership in which a domestic taxpayer is a partner, a certified statement by the foreign distributor of the dividend, interest, royalty, or partnership share to which the domestic taxpayer is entitled, showing the gross distribution, the tax withheld, and the net amount credited to the domestic taxpayer, may be considered a receipt for the purpose of credit allowances, provided that in these cases of taxes withheld at a foreign source the domestic taxpayer is unable to secure receipts issued by the foreign government, and provided further that such credits shall be subject to the usual verification of income and application of known foreign tax rates thereto.

FOREIGN INCOME.

Where interest, royalties, and dividends from foreign sources are included in the items shown on the lines under those headings on the face of Form 1120 (corporation return), or Form 1040 (individual return), the foreign items included should be segregated (in schedules attached to the return) into amounts received from different sources to show each separate foreign distributor thereof and the corresponding country of origin. The total income from foreign sources should be combined with the total income from domestic sources and reconciled with the total income from all sources reported on the domestic return with respect to each of the items entered as interest, royalties, or dividends.

Branches.—With respect to the income from foreign branches of a corporation, which income has been included in the total net income reported from all sources on the United States return, such

income must be segregated in separate schedules to show the net income of each branch. If the branch operates in foreign countries other than that in which it is located, the profit which it earns or the loss which it sustains should be shown separately for each such foreign country.

In order to effect reconciliation, under the above circumstances, of total net income from foreign sources shown on the return with (1) the total foreign net income shown by taxpayer's books; (2) with income taxed by the foreign country; and (3) with income claimed on Form 1118 or in any brief, the taxpayer should submit with the receipt for foreign taxes paid or accrued in the taxable year a statement showing the computation of the statutory income taxed by the foreign country, corresponding to such receipt, which income should be reconciled with the book income of the foreign branch.

In determining the correct amount of foreign income to be used in computing the limitation on the credit for foreign taxes, the deductions taken for depreciation, depletion, bad debts, losses, overhead, foreign exchange, etc., reflected in such foreign income shown on Form 1118, should be reconciled by the taxpayer with the same class of deductions shown on Form 1120.

INCOME NOT SUBJECT TO FOREIGN TAX.

Frequently it occurs that in arriving at its total net income from sources without the United States, as shown ordinarily on Form 1116 or 1118, the taxpayer includes income from countries which have laws imposing taxes on net income, yet the taxpayer shows no taxes as having been paid to such countries. In all such cases the computation of net income from each foreign country should be set forth as covered by statements, or returns (if any), filed with the foreign governments. The taxpayer should furnish any additional information necessary to reconcile these statements or returns with the books and with the domestic returns; also full information as to the method of operating in such countries, with a view to determining whether such method does not require allocation of the profit or loss on such operations (under both the laws of the foreign country and the United States) to a country other than the country to which the taxpayer has believed proper to assign it; or, if the reason for nontaxation in the foreign country is because part or all of the income is exempt, the nature and amount of such exempt income should be disclosed.

DIVIDENDS FROM CONTROLLED FOREIGN SUBSIDIARIES.

Under section 131(f) of the Revenue Act of 1932, in the case of a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible from gross income) the domestic corporation is deemed to have paid a portion (determined as provided in that section) of the income and profits taxes paid by such foreign corporation to foreign countries and possessions of the United States upon accumulated profits from which dividends are distributed to the domestic corporation. It is important in establishing the amount of the accumulated profits that it be based as a fundamental principle upon all income of the foreign corporation available for distribution to its shareholders, whether such profits be taxable by the foreign country or not.

Some items are nontaxable because of the class of income which they represent; others are specific credits, comparable with the credit of $3,000 allowed under the provisions of section 26 of the Revenue Act of 1928, which are permitted by the foreign countries in the computation of taxes although they represent nevertheless actual distributable income; still others are special credits against income allowed to taxpayers in some countries as provided by certain features of their laws which, while allowable as deductions in the computation of tax, often in large amounts, in no way reduce distributable income or surplus.

Taxpayers will be required to file in connection with their claims for credit under section 131(f) of the Revenue Act of 1932, a statement or return made by each of such foreign subsidiaries to foreign governments showing the computation of the income taxable by such government, or a statement by the foreign government to the taxpayer showing a corresponding adjusted amount, where such statements are made, together with a reconciliation of the taxable income shown on such return or statement with the income claimed by the taxpayer as a basis for "accumulated profits" within the meaning of section 131(f) of the Revenue Act of 1932, and with book income of the foreign subsidiary.

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

SECTION 41.—GENERAL RULE.

ARTICLE 321: Computation of net income. XII-4-6006
I. T. 2673

REVENUE ACT OF 1932.

The following rates of exchange are accepted by the Bureau of Internal Revenue as the current or market rates of exchange prevailing as of December 31, 1932:

Country or city.	Monetary unit.	Value in terms of United States money.	Country or city.	Monetary unit.	Value in terms of United States money.
Austria	Schilling	$0.139650	Yugoslavia	Dinar	$0.013520
Belgium	Belga	.138426	Hongkong	Dollar	.211250
Bulgaria	Lev	.007200	China	Shanghai tael	.271093
Czechoslovakia	Crown	.029601	China	Mexican dollar	.192500
Denmark	Krone	.172376	China	Yuan dollar	.191875
England	Pound (sterling)	3.328083	India	Rupee	.251800
Finland	Markka	.014433	Japan	Yen	.205100
France	Franc	.039022	Singapore	Dollar	.386312
Germany	Reichsmark	.238050	Canada	Dollar	.883281
Greece	Drachma	.005276	Cuba	Peso	.999237
Hungary	Pengo	.174250	Mexico	Peso	.312000
Italy	Lira	.051199	Argentina	Peso (gold)	.585835
Netherlands	Guilder	.401723	Argentina	Peso (paper)	.257767
Norway	Krone	.171483	Brazil	Milreis	.076400
Poland	Zloty	.111850	Chile	Peso	.060250
Portugal	Escudo	.030250	Colombia	Peso	.952400
Rumania	Leu	.005975	Uruguay	Peso	.473333
Spain	Peseta	.081528	Philippine Islands	Peso	.4980
Sweden	Krona	.181615	Australia	Pound (sterling)	2.663500
Switzerland	Franc	.192391			

SECTION 44.—INSTALLMENT BASIS.

ARTICLE 352: Sale of real property involving deferred payments. XII-18-6152 I. T. 2691

REVENUE ACTS OF 1928 AND 1932.

The sole test, in determining whether the profit derived from the sale of real estate may be reported on the installment plan, is whether the initial payments do not exceed 40 per cent of the selling price.

Advice is requested whether a casual sale of real estate in which the initial payments do not exceed 40 per cent of the selling price may be reported on the installment plan for Federal income tax purposes.

The internal revenue agent recommended the assessment of an additional tax against a taxpayer for the year 1930, which deficiency arose from the denial to the taxpayer of the right to report the proceeds from a sale of real estate on the installment plan. This denial was based on the theory that since no provision was made for the payment of the balance received from the sale of the property in installments, the taxpayer was not entitled to treat the transaction as a sale of real property on the installment plan.

It is held that the sole test, in determining whether a taxpayer may report the profit derived from the sale of real estate on the installment plan, is whether the initial payments (payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale or other disposition has been made) do not exceed 40 per cent of the selling price. This ruling is applicable to the Revenue Acts of 1928 and 1932.

ARTICLE 355: Gain or loss upon disposition of installment obligations. XII-26-6248 G. C. M. 11845

REVENUE ACT OF 1932.

In 1926 the taxpayer sold his residence and for the years 1926 to 1931 paid income taxes on the gain on the installment basis. In 1932 he was obliged to reduce the original consideration, settling for cash on a basis that resulted in a loss.

No refund may be made on account of the income taxes heretofore paid. The settlement constituted a satisfaction of installment obligations under section 44(d) of the Revenue Act of 1932 and article 355 of Regulations 77. Any loss sustained in 1932 is deductible from gross income under section 23(e)2 of that Act.

An opinion is requested relative to the treatment for income tax purposes of a loss sustained from the sale of the taxpayer's personal residence under the following circumstances:

In 1926 he sold his residence under a land contract at a profit and from 1926 to 1931, inclusive, paid income taxes based on the proportionate profit received each year through payments on the contract. In 1932 he reduced the original selling price of the property and the vendee settled with him for cash and received a deed to the property; and instead of the profit anticipated from the sale he sustained a loss. He understands that a loss from the sale of a personal residence is not deductible, and inquires whether adjustment or refund may be made.

Apparently a bona fide transaction was entered into in 1926 for the sale of the taxpayer's residence at a profit which the taxpayer elected to report on the installment basis. The profit on each installment was reported, and the tax paid thereon for the year 1926 and for each subsequent year up to and including 1931. The collector evidently approved the taxpayer's method of reporting the profit from such sale and computed the tax accordingly. The fact that the taxpayer was unable to collect the amount of the original selling price and for that reason reduced that price in 1932 to an amount which was less than the basis, can not correctly be said to have a material bearing on the status of the transaction in 1926.

While it does not appear that the Board of Tax Appeals has passed on the specific question herein presented, its position may be inferred from the language used in the case of *Gilbert W. Lee* v. *Commissioner* (6 B. T. A., 135). The petitioner in that case had reported certain 1916 sales of real estate on the installment basis and desired to make a change in later years. The Board, in holding that he should be required to report on the installment basis previously adopted, stated, in part, as follows:

> In his original income tax returns for several of the years in question the petitioner computed his taxable income from the sale of lots by what he calls the percentage method. The evidence indicates that such computation was in effect the use of the installment basis. It is apparent, therefore, that the petitioner elected to return the income resulting from the sale of lots on the installment basis. This choice must have been considered and doubtless was made because it was deemed to best serve the interests of the petitioner. Having once made his election, the petitioner should not be allowed to change to a different basis merely because subsequent legislation or other events made it to his interest so to do. We are of the opinion that the petitioner's income from the sale of lots, in the circumstances set forth in our findings of fact, should be computed, reported, and taxed on the installment basis.

The reasoning of the Board in that case appears to be applicable to the instant question. The taxpayer chose to report the sale on the installment basis, which was no doubt beneficial to him at that time. It permitted him to report the income as it was received. If on account of subsequent events he was compelled to alter the terms of his 1926 contract, such adjustment should not be treated as affecting the contract as of the year of the sale. Having accepted the benefits flowing from the installment basis of taxation, the taxpayer can not now repudiate that basis by claiming a refund of the taxes paid and retaining the benefits enjoyed for earlier years. (Cf. *Louis Werner Saw Mill Co.* v. *Commissioner*, 26 B. T. A., 141; *Walker* v. *Alamo Foods Co.*, 16 Fed. (2d), 694, T. D. 3984, C. B. VI-1, 274.) To allow a refund of the taxes paid with respect to installments received in prior years the Bureau would sanction such repudiation. Therefore, the taxes on the profit already reported may not be refunded.

The taxpayer and the vendee agreed to a cash settlement of the unpaid balance of the land contract at an amount less than the amount provided for in the contract, so that the anticipated profit did not materialize. The settlement constituted a satisfaction of installment obligations under section 44(d) of the Revenue Act of 1932. Any gain or loss resulting therefrom should be computed in accordance with section 44(d) of the Revenue Act of 1932 and article 355 of Regulations 77. The taxpayer indicates that he was "obliged"

in 1932 to dispose of the installment obligations at an amount less than their face value. If the installment obligations were originally received and held for profit-seeking purposes, and finally disposed of, bona fide, in the ordinary conduct of the taxpayer's business affairs, there would seem no reason to doubt that the money received was derived from a contract entered into for profit and that any loss sustained in 1932, resulting from the satisfaction of the installment obligations, is deductible from the taxpayer's gross income for the taxable year 1932 under the provisions of section 23(e)2 of the Revenue Act of 1932.

PART V.—RETURNS AND PAYMENT OF TAX.

SECTION 53.—TIME AND PLACE FOR FILING RETURNS.

ARTICLE 402: Extensions of time for filing returns. XII-12-6092 T. D. 4363

INCOME TAX.

Extension of time within which to file income tax returns.

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

To Collectors of Internal Revenue and Others Concerned:

In accordance with the provisions of section 53 of the Revenue Act of 1932, an extension of time for filing income tax returns for individuals, fiduciaries, and corporations for the calendar year 1932, is hereby granted up to and including March 31, 1933, and the return when so filed shall be accompanied by at least one-fourth of the tax together with interest on such amount at the rate of 6 per cent per annum from March 15, 1933.

DAVID BURNET, *Commissioner.*

Approved March 13, 1933.

W. H. WOODIN,
Secretary of the Treasury.

ARTICLE 402: Extensions of time for filing returns. XII-13-6106 Mim. 4008

Extension of time for filing income tax returns for calendar year 1932.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., March 20, 1933.

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

Reference is made to Treasury Decision 4363 [see above], approved March 18, 1933, which grants an extension of time for filing income

tax returns for individuals, fiduciaries, and corporations for the calendar year 1932 up to and including March 31, 1933.

Where extensions of time have been granted for filing returns for the calendar year 1932 conditioned upon the filing of a tentative return on or before March 15, 1933, the above-mentioned Treasury decision automatically advances the date for filing the tentative return to March 31, 1933. Where in such cases the tentative return is not filed until after March 15, 1933, one-fourth of the estimated tax shown on the tentative return will bear interest at the rate of 6 per cent per annum from March 15, 1933.

Inquiries and correspondence regarding this mimeograph should refer to the number and the symbols IT:E:RR.

DAVID BURNET, *Commissioner.*

SECTION 56.—PAYMENT OF TAX.

ARTICLE 432: Extension of time for payment of the tax or installment thereof. XII-26-6260 T. D. 4367

INCOME TAX.

Extension of time for payment of the tax or installment thereof.

To Collectors of Internal Revenue and Others Concerned:

Section 56(c) of the Revenue Act of 1932 provides for extending the time for payment of the amount determined as the tax by the taxpayer, or any installment thereof, for a period not to exceed six months from the date prescribed for the payment of the tax or installment. Article 432 of Regulations 77, promulgated under section 56(c), provides in part that an application for an extension of time will not be considered unless such application is made on or before the due date of the tax or installment thereof for which the extension is desired.

In a number of cases the taxpayer filed an income tax return for the calendar year 1932 on or before March 15, 1933, or on or before March 31, 1933, as provided in Treasury Decision 4363 [page 54, this Bulletin], accompanied by a check for the tax or the first installment thereof, together with interest, if any, and because of the closing of the bank upon which the check was drawn as the result of bank holidays, or because of restrictions placed upon the withdrawal of bank deposits, the check was returned not honored.

Where an application for an extension of time is made in such cases and the taxpayer makes a showing that he is unable to make payment of the tax or installment because of the closing of the bank in which his funds are deposited or because of restrictions upon the withdrawal of his bank deposits, the requirement of article 432 that the application be made on or before the due date of the tax or installment will be waived.

GUY T. HELVERING,
Commissioner.

Approved June 14, 1933.

W. H. WOODIN,
Secretary of the Treasury.

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SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A.—RATES OF TAX.

SECTION 103.—EXEMPTIONS FROM TAX ON CORPORATIONS.

ARTICLE 521: Proof of exemption. XII-26-6249
G. C. M. 11817

REVENUE ACT OF 1932 AND PRIOR REVENUE ACTS.

The right to exemption from Federal income tax is not defeated where a holding corporation pays its income to several organizations each of which is entitled to exemption under section 103 of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts.

An opinion is requested relative to the status of the M Corporation under the provisions of section 103(14) of the Revenue Act of 1932 and the corresponding provisions of the prior Revenue Acts.

Section 103(14) exempts from income tax:

(14) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title.

The facts material to the discussion of the question presented are as follows:

The M Corporation was incorporated in 1924 under the laws of the State of T. The purposes for which the corporation was formed are stated in the articles of incorporation as follows:

For the exclusive purpose of holding title to property, collecting the income therefrom and turning over the entire amount thereof, less expenses:

(a) To corporations or any community chest, fund or foundation organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholders or individual.

(b) To business leagues, chambers of commerce, or boards of trade not organized for profit, and no part of the net earnings of which inures to the benefit of any private stockholder or individual.

(c) To civic leagues and organizations not organized for profit, but operated exclusively for the promotion of social welfare.

(d) To 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.

Or to any of the foregoing classes "a," "b," "c," or "d."

In July, 1924, A donated to the corporation several thousand shares of stock which were to be held by the corporation, the income collected therefrom and paid over to the R University to found and endow a school of citizenship and public affairs at that university. In 1924 all the securities held by the "M Fund," a fund created in 1916 by A, B, and others, were turned over to the corporation to be invested and reinvested by it and the income used for the declared purposes of the corporation. In 1928 A made a further gift of [illegible] dollars to the R University for the school of citizenship and public affairs. At the same time the donor guaranteed an income of [illegible] dollars a year. It was a condition of these gifts that title thereto should remain in the M Corporation, which should pay to the said university the stipulated amounts of income thereon in monthly

payments. In 1928 monthly payments were made to the university at the rate of x dollars per year and since that time and during the years 1929 to 1931, inclusive, monthly payments were made to the university at the rate of $1.5x$ dollars a year, which are now being continued.

All of the income of the holding corporation has been paid over periodically to the R University and other organizations which are exempt under the provisions of section 103 of the Revenue Act of 1932 and the corresponding sections of prior Revenue Acts, except amounts used to defray expenses of the corporation.

It is apparent from the foregoing facts that the M Corporation was organized and is operated for the purpose of taking title to property and paying the net income therefrom over to several organizations each of which is entitled to exemption under section 103 of the Revenue Act of 1932.

It would be contrary to the whole spirit and manifest intent of section 103 to hold that because section 103(6) exempts corporations organized and operated exclusively for religious, scientific, or educational purposes, and section 103(8) exempts organizations operated exclusively for the promotion of social welfare, an organization which is neither exclusively the one or the other, but is organized and operated exclusively for the purposes named in both of these paragraphs, is not exempt. Congress surely did not intend to grant exemption to a charitable organization in one paragraph and to a civic organization in another, and at the same time deny exemption to an organization organized and operated for both charitable and civic purposes. It is apparent, therefore, that an organization the activities of which are such as to bring it within the contemplation of two or more paragraphs of section 103 of the Revenue Act of 1932 is entitled to exemption. While the strict letter of that section exempts a holding corporation when it turns the income over to "an organization which itself is exempt," the right to exemption is not, in the opinion of this office, defeated where the holding corporation pays its income to several organizations each of which is entitled to exemption under one or the other of the paragraphs of section 103 of the Revenue Act of 1932.

For the foregoing reasons it is the opinion of this office that the M Corporation is entitled to exemption under section 103(14) of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts.

ARTICLE 527: Religious, charitable, scientific, literary, and educational organizations and community chests. XII-24-6223 G. C. M. 11705

(Also Section 23(n), Article 261.)

REVENUE ACT OF 1932 AND PRIOR REVENUE ACTS.

The Military Training Camps Association is exempt from taxation under section 103(6) of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts, and contributions thereto by individuals are deductible under section 23(n) of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts, subject to the limitations imposed by such Revenue Acts. Recommended that I. T. 2267 (C. B. V-1, 84) be modified.

Reconsideration has been requested of the ruling in I. T. 2267 that the Military Training Camps Association is exempt from taxation under section 231(8) of the Revenue Act of 1924, but not under section 231(6) of that Act, and that contributions to the association are not deductible by individual donors under section 214(a)10 of that Act.

The evidence before the Bureau discloses that in the year 1913 the students attending the first military instruction camps of the United States Army formed an organization for the purpose of perpetuating the system of military instruction camps of the Army of the United States. In 1915 the business and professional men's camps at Plattsburg, N. Y., Fort Sheridan, Ill., and San Francisco, Calif., formed organizations for similar purposes. These various organizations were combined in 1916 to form the organization here under consideration. The purpose of this organization is to promote voluntary military training in the citizens' military training camps and to continue such training and instruction during the winter months when the training camps are not in session. The income of the association is derived from membership fees and contributions, which are expended through the national and local offices of the association to carry on its activities. No part of its income is credited to surplus nor may it inure to the benefit of any private stockholder or individual.

Instruction in military science is a recognized part of the curricula of a majority of the secondary schools, as well as the colleges and universities of the United States. Its purpose is to prepare the young men of the country to discharge the obligations of citizenship in time of war. In General Counsel's Memorandum 443 (C. B. V-2, 66) it was said:

> In countries with small regular or standing armies, such as the United States, reliance must be placed on its able bodied citizens for its defense in time of war. In this connection see United States Compiled Statutes, section 1714 et seq. The immediate effectiveness of such a body obviously is essential to the welfare, if not the continued existence, of the Nation. In recognition of this fact, Congress has through legislation encouraged the establishment, in the schools and colleges of the country, of courses of military science, as well as the establishment of camps for military instruction. * * *
>
> It is accordingly the opinion of this office that an organization which has for its purpose the fostering of an interest, and the training of citizens, in the use of firearms, to the end that they may more ably discharge the obligations of citizenship, is organized and operated for educational purposes within the meaning of section 231(6) of the Revenue Act of 1926 and prior Revenue Acts. It follows that contributions to such an organization by individuals are deductible in the manner and to the extent provided in section 214(a)10 of the Revenue Act of 1926 and the corresponding provisions of prior Revenue Acts.

It is accordingly the opinion of this office that the activities of the Military Training Camps Association entitle it to exemption as an educational organization under section 103(6) of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts, and that contributions to the organization by individuals are deductible under section 23(n) of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts, subject to the limitations imposed by such Revenue Acts.

It is recommended that I. T. 2267 be modified accordingly.

C. M. Charest,
General Counsel, Bureau of Internal Revenue.

ARTICLE 530: Social clubs. XII-19-6164
I. T. 2693

REVENUE ACT OF 1932 AND PRIOR REVENUE ACTS.

The M Club was incorporated with the declared purpose to make trails and roads in the —— Mountains, to erect camps and shelter houses therein, to furnish maps and guidebooks thereof, and in other ways to make these mountains play a larger part in the life of the people. Its income is derived from membership dues and receipts from the sale of maps, guidebooks, and similar publications, no part of which income inures to the benefit of any private shareholder or individual.

Held, the purposes and activities of the club are such as to entitle it to exemption under the provisions of section 103(9) of the Revenue Act of 1932 and corresponding sections of prior Revenue Acts.

The M Club was incorporated in 1917. The purpose for which the club was organized was to make trails and roads in the —— Mountains, to erect camps and shelter houses therein, to furnish maps and guidebooks thereof, and in other ways to make these mountains play a larger part in the life of the people. Its actual activities are in harmony with its declared purposes.

Any person may become a member of the club by making application to, and receiving the approval of, the membership committee.

The club's income is derived from membership dues and receipts from the sale of maps, guidebooks, and similar publications, no part of which income inures to the benefit of any private shareholder or individual.

In view of the foregoing, it is the opinion of this office that the purpose and activities of the M Club are such as to bring it within the principle of General Counsel's Memorandum 3555 (C. B. VII-1, 117) and Office Decision 643 (C. B. 3, 241). The latter ruling reads as follows:

An automobile club organized for the purpose of promoting the improvement of roads and boulevards, and other conditions and matters of benefit to automobile owners and drivers, such as signposting roads and securing legislation of benefit to automobile owners and drivers, its income being derived from membership fees and subscriptions, no part of which inures to the benefit of any private stockholder or individual, is organized for "nonprofitable purposes" and therefore exempt from taxation under the provisions of paragraph 9, section 231 of the Revenue Act of 1918.

It is, therefore, held that the purposes and activities of the M Club are such as to entitle it to exemption from Federal income taxation under the provisions of section 103(9) of the Revenue Act of 1928 and the corresponding sections of prior Revenue Acts, which exempt "clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes * * *." Contributions to this organization are, of course, not deductible in determining the net income of individual donors.

Inasmuch as section 103(9) of the Revenue Act of 1932 is identical with section 103(9) of the Revenue Act of 1928 and the corresponding sections of prior Revenue Acts, this ruling is also applicable to 1932 and subsequent years so long as there is no change in the organization, its purposes, and method of doing business.

SECTION 105.—TAXABLE PERIOD EMBRACING YEARS WITH DIFFERENT LAWS.

ARTICLE 501: Fiscal years ending in 1932.

REVENUE ACT OF 1932.

Computation of credit for foreign taxes. (See I. T. 2695, page 73.)

SUPPLEMENT B.—COMPUTATION OF NET INCOME.

SECTION 113.—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

ARTICLE 605: Adjusted basis for determining gain or loss. XII-26-6250 Mim. 4027

Requirements for the allowance of estimated cost of future improvements to real estate.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., June 10, 1933.

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

In computing the gain or loss resulting from sales of lots or tracts of land forming parts of larger tracts previously acquired, there may be added to the actual cost or other basis of the property sold in any year, the estimated cost of future improvements to such property which the vendor is contractually obligated to make and the cost of which is not properly recoverable through depreciation. However, before any part of such estimated costs are allowed, the vendor will be required to furnish schedules showing the following data and information in order to establish the correctness of the estimated costs:

(1) The actual cost or other basis to the vendor of the entire tract of which the property sold forms a part; together with such facts and data as may be necessary to establish that the cost or other basis of the property sold, as shown by the vendor, is the correct proportion of the total cost or other basis of the whole tract.

(2) An accurate description of each class of the proposed improvements and definite evidence that the vendor is contractually obligated to make all of such improvements to the property sold during the year under consideration, together with an estimate of the maximum period within which the improvements will be completed.

(3) Complete details regarding the method of estimating the total cost of each class of improvements to be made to the entire tract, together with such evidence as may be necessary to establish the correctness of the estimated costs.

(4) A plat or map of the entire tract and a detailed statement showing the portion of the total cost of each class of improvements

allocated to each lot or subdivision of the entire tract, with such information as may be necessary to establish the correctness of that allocation.

(5) If, in the return of any prior year, the estimated cost of improvements to all or any part of the tract of which the property sold during the current year forms a part, was included in the basis upon which gain or loss was computed, the vendor shall be required to furnish (*a*) a detailed statement showing the amounts expended and charged to capital account or improvement reserve each year since acquisition of the tract, on each class of improvements, (*b*) the portion of such expenditures properly allocable to each lot or subdivision of the tract, and (*c*) a list of all lots or subdivisions of the tract sold in each prior year, showing the amount received from each sale, the actual cost of the property sold, and the amount of the estimated cost of future improvements that was included in the basis upon which gain or loss on each sale was computed. Even though all of the information required by paragraphs (1), (2), (3), and (4) is furnished, the inclusion of the estimated cost of future improvements in the basis upon which gain or loss is computed on sales made during the current year will not be approved unless the information required in this paragraph is also furnished.

(6) Where gain is reported on collections or repossessions made during the current year on installment sales made in prior years, and the basis on which such gain is computed includes any amount for the estimated cost of future improvements, the information and data required by paragraphs (1), (2), (3), (4), and (5) must be furnished before the inclusion of such estimated costs will be approved.

If the information required by paragraph (5) above discloses that all of the improvements properly chargeable to any of the lots or subdivisions sold in any prior year have been completed, or if the period within which the vendor expects to make the improvements, or a period of five years, whichever is shorter, has elapsed since the filing of any return by the vendor in which the basis for computing gain or loss on sales in that year included the estimated cost of future improvements and such improvements still remain uncompleted, the tax liability for each of such prior years will be determined upon the basis of the amounts actually expended and charged to capital account or to the reserve. In such event the inclusion of the estimated cost of future improvements in the basis upon which gain or loss on sales made during the current year is computed will not be approved by the Commissioner unless and until such additional tax, if any, as may be determined from the facts shown, for each prior year has been paid. Provided, however, if it is shown that all of the proposed improvements, the cost of which is chargeable against the lots sold during any year, can not for good and sufficient reasons be completed within the estimated period, or the 5-year period, whichever is shorter, and it is shown that the contractual obligations of the vendor permit the deferment of the making of such improvements beyond such period, the Commissioner will consider an application from the vendor to defer taking the above-described action in computing gain or loss, if an acceptable

waiver on Form 921, revised, or Form 921A is executed and filed, in addition to any waiver executed and accepted in respect of the original period, as hereinafter provided.

In the event that all of the data required by paragraphs (1), (2), (3), (4), and (5) have been previously filed with the Bureau, that data need not be again furnished, provided full information regarding all sales and the cost of improvements made subsequent to the filing of such data is supplied.

The final determination of the taxable gain resulting from the sale of lots in each year, upon the basis of actual cost, obviously can not be deferred indefinitely, as might be the result if that determination were to await the sale of all of the lots contained in an entire tract, and unless the requirements stated above are complied with, it will be necessary that the gain on all lots sold in each year be computed on the basis of their actual cost or other basis, including the amounts previously expended for improvements, but without including in that cost or other basis, any part of the estimated cost of contemplated future improvements.

The taxpayer also will be required to execute and file a waiver on Form 921, revised (copy of which is attached), provided, however, if the vendor files a fiduciary return on Form 1041, or a partnership return on Form 1065, a waiver on Form 921A (a copy of which is also attached) will be required to be executed and filed by each beneficiary of the estate or trust or each member of the partnership. The date on which the period covered by the waiver will expire should permit the assessment of a deficiency within one year after the expiration of the estimated period within which the vendor expects to make the improvements, or one year after the expiration of the 5-year period of limitation hereinbefore provided, whichever is shorter, calculated from the date of the filing of the return to which the waiver relates. Where such a waiver is accepted, the Commissioner may on or before the expiration date stated in the waiver, assess any additional tax that may be found to be due computed upon the basis of the actual cost of the improvements that have been made, in either of the following instances:

(a) Where the improvements have been completed, but the estimated reserve exceeds the actual expenditures for the total improvements, or the portion allocable to a particular subdivision.

(b) If for any reason it appears that all of the proposed improvements will not be made by the vendor.

Waivers on Form 921, revised, or Form 921A will be accepted only in those cases in which no deficiency on a basis other than the estimated future expense liability is disclosed, or in which if such a deficiency is disclosed the taxpayer waives the restrictions on the assessment and collection of the deficiency. In the event a deficiency based on other items is disclosed and the taxpayer declines to waive the restrictions on the assessment and collection of the deficiency, it will be necessary to recompute the profits or losses reported from the sales of the real estate on the basis of actual costs of the improvements made.

In all cases involving estimated costs of future improvements to real estate internal revenue agents' reports will be submitted to Washington in duplicate. All the data and documents specified

herein should be attached to the duplicate copy of the report. The letter transmitting these reports to the Commissioner will indicate clearly that the estimated cost of future improvements is involved. This can be accomplished by inserting on the line with the caption "Attention IT:R" the words "Estimated cost of future improvements is involved," as well as any other symbol called for by previous correspondence or the nature of the report.

In Washington the Valuation Division will be furnished with one copy of the agent's report and will cooperate in the review. Arrangements will be made to avoid duplication in forwarding letters of inquiry to internal revenue agents in charge and in planning conferences with taxpayers.

All waivers on Form 921, revised, and Form 921A will be forwarded to Washington for acceptance by the Commissioner. When accepted, the original of the waiver will be transmitted to the central waiver file to be held in a special file and the duplicate copy will be associated with the return.

Inquiries and correspondence regarding this mimeograph should refer to the number and symbols IT:E:RR.

GUY T. HELVERING,
Commissioner.

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[Form 921. Treasury Department. Internal Revenue Service. Revised May, 1933.]

CONSENT FIXING PERIOD OF LIMITATION UPON ASSESSMENT OF INCOME AND PROFITS TAX FOR ALLOWANCE OF ESTIMATED FUTURE EXPENSE LIABILITIES UNDER CONTRACT FOR SALE OF REAL ESTATE.

_____, 193_.

In consideration of the tentative allowance, in whole or in part, by the Commissioner of Internal Revenue for income tax purposes of the estimated cost of future improvements as a part of the cost or other basis of certain real estate sold or otherwise disposed of under contract by _____, a taxpayer of _____, the said taxpayer and the Commissioner of Internal Revenue hereby mutually consent and agree as follows:

That the amount of any income, excess-profits, or war-profits taxes due under any return made by or on behalf of the said taxpayer for the taxable year ____ may be assessed on or before _____, such date being subject to extension as provided by law if a notice of deficiency in tax with respect to the taxable year ____ is sent to said taxpayer by registered mail on or before such date.

_____,
Taxpayer.

By _____

_____,
Commissioner.

By _____

_____
(Date.)

If this consent is executed on behalf of a corporation, it shall be signed with the corporate name, followed by the signature and title of such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition to which, the seal, if any, of the corporation must be affixed. Where the corporation has no seal, the consent must be accompanied by a certified copy of the resolution passed by the board of directors, giving the officer authority to sign the consent.

(This form must be filed in duplicate.)

[Form 921A. Treasury Department. Internal Revenue Service. May, 1933.]

CONSENT FIXING PERIOD OF LIMITATION UPON ASSESSMENT OF INCOME AND PROFITS TAX FOR ALLOWANCE OF ESTIMATED FUTURE EXPENSE LIABILITIES UNDER CONTRACT FOR SALE OF REAL ESTATE.

_____, 193_.

In consideration of the tentative allowance, in whole or in part, by the Commissioner of Internal Revenue for income tax purposes of the estimated cost of future improvements as a part of the cost or other basis of certain real estate sold or otherwise disposed of under contract by _____, a _____ (trust, partnership, syndicate, pool, etc.), whose address is _____, the undersigned taxpayer, a _____ (beneficiary or member) of the said _____ (trust, partnership, syndicate, pool, etc.) and the Commissioner of Internal Revenue hereby mutually consent and agree as follows:

That the amount of any income, excess-profits, or war-profits taxes due under any return made by or on behalf of the undersigned for the taxable year ____ may be assessed on or before _____, such date being subject to extension as provided by law if a notice of deficiency in tax with respect to the taxable year ____ is sent to the undersigned by registered mail on or before such date.

_____
(Signature of Beneficiary or Member.)
By _____
_____
Commissioner.
By _____
_____
(Date.)

(This form must be filed in duplicate.)

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION.

ARTICLE 611: Basis for allowance of depreciation and depletion. XII-3-5988 G. C. M. 11384

REVENUE ACTS OF 1926, 1928, AND 1932.

In the case of a bonus for an oil or gas lease, received before the property covered by the lease became productive of oil or gas, percentage depletion is allowable if at the time the bonus was received the future production of oil or gas from the property was practically assured, or the property became productive during the taxable year.

An opinion is requested relative to the application of the decision of the United States Supreme Court in the case of *Murphy Oil Co. v. Burnet*, December 5, 1932 (53 S. Ct., 161), to certain situations arising in connection with the allowance of percentage depletion in the case of a bonus paid for an oil or gas lease.

Although the United States Supreme Court had before it in the Murphy case a question which arose in connection with an allowance for depletion based on cost, some of the language used by the court appears to be equally applicable to certain situations arising in connection with percentage depletion. The language referred to is as follows:

* * * when the execution of an oil and gas lease is *followed by production of oil*, the bonus and royalties paid to the lessor both involve at least some return of his capital investment in oil in the ground, for which a depletion allowance must be made under section 234. * * * A distinction between royalties and bonus * * * making no provision for a *reasonably anticipated*

production of oil on the leased premises, would deny the "reasonable allowance for depletion" which the statute provides. * * *. [Italics supplied.]

The four situations to which attention is called are as follows:

(1) No oil being produced when the bonus was received, but future production practically assured because of near-by wells and geological indications.

(2) No oil being produced when the bonus was received, but property became productive within the taxable year.

(3) No oil being produced when the bonus was received, and not more than a speculative prospect of future oil production at that time, but property is now known to have become productive after the taxable year.

(4) Property has never become productive.

It is stated in substance that it is the opinion of the Income Tax Unit that a practical application of the law and the regulations in the light of language used in the Murphy Oil Co. case would be to allow depletion in situations (1) and (2) and to deny it in situations (3) and (4).

After consideration of the question, this office is of the opinion that the conclusion reached by the Unit is correct and should be applied in the disposition of future cases involving this issue.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 611: Basis for allowance of depreciation and depletion. XII–16–6133
G. C. M. 11692

REVENUE ACTS OF 1928 AND 1932.

Under the Revenue Act of 1928 the basis for computing the annual allowance for obsolescence for 1931 in connection with bulk-freight vessels of the older types on the Great Lakes should be determined by reducing the cost or other basis of the property by the obsolescence sustained since the basic date, including obsolescence sustained for years prior to 1918.

Under the Revenue Act of 1932 the basis for determining the allowance for obsolescence for 1932 is the adjusted basis of the property, i. e., the basis provided in section 113(a) (in general the cost or March 1, 1913, value, whichever is greater) diminished by exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under the Revenue Act of 1932 or prior income tax laws. As the result of the change in the Revenue Act of 1932 the basis for the obsolescence computation for 1932 will be the cost or other basis of the property without reduction for obsolescence sustained prior to January 1, 1918.

Reference is made to a memorandum of the Income Tax Unit presenting certain questions concerning the obsolescence allowance and the basis for obsolescence for 1931 and subsequent years in connection with certain bulk-freight vessels of the older types on the Great Lakes.

It appears that on the authority of Appeals and Review Recommendation 963 (C. B. I–1, 161) and Solicitor's Opinion 114 (C. B. 5, 148) obsolescence has been allowed for the year 1918 and subsequent years but that obsolescence accruing prior to January 1, 1918, was not allowed. It also appears that conditions have changed in

recent years to such an extent that obsolescence is now accruing over a period different from that previously indicated. It has, therefore, been decided that for 1931 and subsequent years a new computation of obsolescence will be made and the remainder of the total sum allowable as obsolescence spread over the remaining serviceable life of the vessels in question. The Unit submits the following questions:

> * * * whether in the computation of the deduction allowable as depreciation and obsolescence for 1931 and subsequent years, the amount of obsolescence so occurring prior to 1918 should be:
>
> 1. Included in the basis as a part of the cost or allowable value not previously allowed or allowable, and be spread over the remaining serviceable life of the vessel.
>
> 2. Excluded from the basis for computing depreciation and obsolescence and be allowed as a loss when the vessel is sold or scrapped.
>
> 3. Excluded from the basis entirely and held to be now not recoverable in 1931 or in any subsequent year either as depreciation, obsolescence or loss upon sale or scrapping of the vessel.

The Unit also requests that if the obsolescence basis for 1931 is different from that for 1932 and subsequent years the proper basis for each period be indicated.

In *United States* v. *Ludey* (274 U. S., 295, T. D. 4046, C. B. VI-2, 157) the United States Supreme Court had for consideration the question whether in computing the gain or loss from the sale of an oil and gas property the gain or loss basis should be reduced by the amount of the depletion actually sustained for the years 1913 to 1915, inclusive, as contended by the Government, or by the amount of depletion actually claimed as a deduction for those years by the taxpayer, as contended by the taxpayer. The Supreme Court rejected both contentions and decided that the basis for determining the gain or loss from the sale of the property should be reduced by the depletion deductions allowed by law, i. e., by the amount which the taxpayer was entitled to deduct under the different Revenue Acts.

In *Burnet* v. *Thompson Oil & Gas Co.* (283 U. S., 301, Ct. D. 831, C. B. X-1, 390), the question presented was whether in computing the annual depletion allowance the basis for such computation should be reduced by the amount of the depletion actually sustained for the years 1913 to 1915, inclusive, whether allowed by law or not, as contended by the Government, or whether the decision in the Ludey case required the Government to reduce the basis for the allowance only by the amount of depletion allowed by law, as contended by the taxpayer. In that case the Supreme Court agreed with the Government's contention and held in effect that the basis for computing the annual allowance was subject to different adjustments than was the basis for determining gain or loss from a sale of the property. In the course of its opinion the Supreme Court used the following language:

> It is evident that the Act of 1918 did not allow enough to return the capital on exhaustion of the reserve. The deduction permitted by that Act fell some $85,000 short of what was required in 1913-1915 for that purpose. Was it then the intent of the Act of 1918 to permit a deduction from gross income for depletion which would represent not only that year's sustained depletion, but make up for sustained but disallowed depletion in the earlier years? The Government says, and we think rightly, that there is nothing in the terms of the Act to indicate any such purpose. The tax is an income tax for 1918, and

in the absence of express provision to the contrary, it is not to be supposed that the taxpayer is authorized to deduct from that year's income, depreciation, depletion, business losses or other similar items attributable to other years. The very fact that Congress denied deductions equal to the sustained depletion in the earlier years negatives an intent that they should be allowed in later years, as if for depletion then sustained. * * *

The Ludey case involved the year 1917 and the Thompson Oil & Gas Co. case involved the year 1918. The Revenue Acts of 1917 and 1918 contain no provisions similar to those contained in the Revenue Acts of 1924, 1926, and 1928 (section 204(c) of the Revenue Acts of 1924 and 1926 and section 114 of the Revenue Act of 1928), which provide that the basis for determining exhaustion, wear and tear, obsolescence, amortization, and depletion should be the same as the basis provided for determining gain or loss from a sale or other disposition. The provisions of the later Acts, which required that proper adjustment must be made to the basis for exhaustion, wear and tear, obsolescence, amortization, and depletion, were limited by their terms to computations of the amount of gain or loss from the sale or other disposition of the property (section 202(b) of the Revenue Acts of 1924 and 1926 and section 111(b)2 of the Revenue Act of 1928) and did not require the same adjustments to be made to the basis for computing the annual allowance for exhaustion, etc. Accordingly, the Bureau has not regarded the requirements for adjustments to the basis for the purposes of computing gain or loss from the sale or other disposition of the property as being controlling in cases where it was merely necessary to compute the annual allowance for exhaustion, etc. This view of the Bureau is supported by the following language used by the Supreme Court in the Thompson Oil & Gas Co. case:

* * * The court below relied on certain statements in the opinion in the Ludey case which were applicable in the determination of gain on a sale, but which do not apply in this case, for if the sale of each barrel of oil were a partial sale of the reserve (which it is not) to apply the rule which respondent seeks to deduce from the Ludey case would increase the cost or 1913 value of each barrel sold, in determining gain or loss in 1918, beyond its actual cost or 1913 value, taken for barrels sold in prior years. The decision in the Ludey case has been adopted in the later statutes as affecting sales of capital assets [citing section 202(b) of the Revenue Act of 1924, section 202(b)2 of the Revenue Act of 1926, and section 111(b)2 of the Revenue Act of 1928], but the provision for annual depletion allowance has remained substantially unchanged. [Citing section 234(a)8 of the Revenue Act of 1924, section 234(a)8 of the Revenue Act of 1926, and section 23(l) of the Revenue Act of 1928.]

The analogy between the treatment to be afforded in cases involving depletion and in cases involving obsolescence is almost perfect. As pointed out above, under the Revenue Act of 1913 depletion (there termed exhaustion, wear and tear) was limited in the case of mines to 5 per cent of the gross value at the mine of the output for the year for which the computation was made, which resulted in many cases in an allowance materially less than it would have been if based upon the depletion actually sustained. The Revenue Acts prior to the Revenue Act of 1918 made no allowance whatever for obsolescence and as a result the Bureau has consistently denied taxpayers a deduction for obsolescence even though, as in the instant case, obsolescence was actually sustained for years prior to 1918. (See Sol. Op. 114, supra.) Accordingly, upon the authority of the Thompson Oil & Gas Co. decision the basis for computing the annual

allowance for obsolescence for 1931 should be determined by reducing the cost or other basis of the property by the obsolescence sustained since the basic date, including obsolescence sustained for years prior to 1918.

Because of the changes made in the Revenue Act of 1932, however, the situation with respect to the taxable year 1932 and subsequent taxable years is materially different. In drafting the Revenue Act of 1932 Congress rearranged sections 111 and 113 in such a way as to throw the adjustments previously necessary only in cases where a computation of gain or loss from a sale or other disposition was involved over into section 113(b) so that they apply not only to such gain or loss computations but also to the basis for computing the annual allowance for exhaustion, etc. This rearrangement was designed, among other things, to make it clear that henceforth the basis upon which both the gain or loss and exhaustion, etc., was to be computed was the net capital investment at the point of time in question. In this connection see page 19 of the report of the Committee on Ways and Means, revenue bill of 1932 (Rept. No. 708, Seventy-second Congress, first session), and page 25 of the report of the Committee on Finance (Rept. No. 665, Seventy-second Congress, first session), where it is stated:

> Instead of using the term "basis" interchangeably to denote two different concepts, the new bill employs the terms "unadjusted basis" (or, for brevity, "basis") and "adjusted basis." "Basis" means the original capital investment in the property and is provided for in subsection (a) of section 112 [113]. "Adjusted basis" means, in substance, the net capital investment in the property at any point of time when it becomes material to determine gain or loss, *depreciation, etc.* It is the "basis" determined by reference to subsection (a), adjusted in the manner provided in subsection (b). [Italics supplied.]

Clearly, therefore, under the Revenue Act of 1932 the basis for determining the allowance for obsolescence for 1932 is the adjusted basis of the property, i. e., the basis provided in section 113(a) (in general the cost or March 1, 1913, value, which ever is greater) diminished by exhaustion, wear and tear, *obsolescence*, amortization, and depletion, *to the extent allowed* (*but not less than the amount allowable*) under the Revenue Act of 1932 or prior income tax laws. As the result of the change in the Revenue Act of 1932 the basis for the obsolescence computation for 1932 will be the cost or other basis of the property without reduction for obsolescence sustained prior to January 1, 1918.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 116.—EXCLUSIONS FROM GROSS INCOME.

ARTICLE 643: Compensation of State officers and employees. XII-1-5963 I. T. 2669

REVENUE ACT OF 1932.

> Pensions paid by a State to the beneficiary for services rendered by him in connection with the exercise of an essential governmental function of the State, or political subdivision thereof, are exempt from Federal income tax. Pensions paid by a State for other services are subject to that tax.
>
> A pension paid by a State to a beneficiary for services rendered by another person is exempt from income tax as a gift.

Inquiry is made whether State pensions are subject to Federal income tax under the Revenue Act of 1932.

For the purpose of determining their taxable or exempt status, State pensions paid to beneficiaries for services rendered by them are divisible into two classes—(1) pensions paid by a State to a person who, as an officer or employee of the State, or political subdivision thereof, rendered services in connection with the exercise of an essential governmental function of the State, or political subdivision thereof; and (2) pensions paid by a State to persons for other services rendered.

Pensions falling within the first class represent compensation paid for past services rendered, and since the compensation in such cases was exempt from Federal income tax the pensions are also exempt from Federal income tax. Pensions paid by a State to persons for services rendered, other than the services referred to in the first class, are subject to Federal income tax. A pension paid by a State to a beneficiary for services rendered by another person is a gift from the State to the recipient and is, therefore, not subject to Federal income tax.

ARTICLE 643: Compensation of State officers and employees. XII–14–6110 G. C. M. 11625

REVENUE ACT OF 1932.

The fees received by special masters in chancery, appointed under the provisions of section 5 of chapter 90 of Illinois Revised Statutes, are not subject to Federal income tax.

An opinion is requested whether the decision of the Board of Tax Appeals in *David K. Cochrane* v. *Commissioner* (26 B. T. A., 1167, page 3, this Bulletin) should be applied to fees of special masters in chancery in Illinois, as well as to regular officers appointed for a definite term.

The Board of Tax Appeals held in *David K. Cochrane* v. *Commissioner*, supra, that fees received by a master in chancery of the Superior Court of Cook County, Ill., a statutory office, are not subject to Federal income tax. The appointment of masters in chancery is authorized by the Statutes of Illinois (ch. 90, Smith-Hurd, Illinois Revised Statutes, 1925). Section 5 of chapter 90, providing for the appointment of special masters, reads as follows:

5. *Master interested—Special master.*—Whenever it shall happen that there is no master in chancery in any county, or when such master shall be of counsel or of kin to either party interested, or otherwise disqualified or unable to act in any suit or matter, the court may appoint a special master to perform the duties of the office in all things concerning such suit or matter; and every special master in chancery so appointed, before entering on the duties of his appointment, shall give bond, with security to be approved by the court, and take and subscribe an oath of office in such suit or matter, which bond and oath shall be filed with the clerk of the court making the appointment and spread upon the records thereof; *Provided, however,* That said special master shall not be required to give said bond if no funds shall be paid to him in said cause.

It is the opinion of this office that a special master in chancery, appointed by the court under the above-quoted statute to perform all duties of the office of master in a particular case becomes an officer of the State for the period during which he holds the statutory office. He must take an oath of office, give bond if any funds are paid

to him in the cause, his tenure is for a definite period, that is, the duration of the particular case in which he is acting, and his duties are fixed by law. It appears that it may properly be said that the office of special master in chancery was created by State statute which prescribes the incidents of such office. The appointment can not properly be classed as a nonstatutory one.

The Board of Tax Appeals in the Cochrane case pointed out that a master in chancery was an integral part of the judicial system of the State of Illinois. A like statement was made by the Board in its decision in *Walter G. Winne* v. *Commissioner* (27 B. T. A., 869, page 13, this Bulletin), in which it was held that compensation received by the petitioner as master or special master in chancery in the State of New Jersey is exempt from Federal income tax.

Accordingly, it is the opinion of this office that the fees received by special masters in chancery, appointed under the provisions of section 5 of chapter 90 of Illinois Revised Statutes, are not subject to Federal income tax.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 643: Compensation of State officers and employees. XII-25-6237 I. T. 2698

REVENUE ACT OF 1932.

The taxpayer was continuously employed in 1932 by the public health department of the State of R, and in that capacity was also an appointee through the Secretary of the Treasury and compensated directly by the Federal Government as its employee.

Held, the taxpayer's compensation from the State is exempt from Federal income tax, but his compensation from the Federal Government is subject to tax.

Advice is requested relative to the taxable status, for Federal income tax purposes, of the compensation received by the taxpayer as a field agent of the United States Public Health Service and as director of S County health unit.

During the year 1932 the taxpayer's total compensation for services rendered to the S County health unit amounted to $144x$ dollars, of which $81x$ dollars was paid by the United States Public Health Service, $51x$ dollars by the State of R, and $12x$ dollars by S County. The question has arisen as to what part of this income, if any, is exempt from Federal income tax.

The compensation received by an individual from a State or any political subdivision thereof must be included in gross income unless it was received by him as an officer or employee of a State or political subdivision engaged in the exercise of an essential governmental function. (Article 643 of Regulations 77.) An officer is a person who occupies a position in the service of the State or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not the accomplishment of specific objects, and whose services are continuous, not occasional or temporary.

The activities of the public health department of a State have been held to constitute the exercise of an essential governmental function. (*Chafor* v. *City of Long Beach*, 174 Cal., 478, 163 Pac., 670; *City of Kokomo* v. *Loy*, 185 Ind., 18, 112 N.E., 994.) Since the taxpayer was continuously employed during the year 1932 by the public health department of the State of R as director of S County health unit, he was an officer or employee of the State or a political subdivision engaged in the exercise of an essential governmental function. Accordingly, the compensation received by him from the State of R, 51*x* dollars, and from S County, 12*x* dollars, is exempt from Federal income tax.

In regard to the compensation paid to the taxpayer by the Federal Government, the following provision of the annual appropriation Act provides for the employment by the United States Public Health Service of the field agents herein referred to:

> Rural sanitation: For special studies of, and demonstration work in, rural sanitation, including personal services, and including the maintenance, repair, and operation of motor-propelled passenger-carrying vehicles for official use in field work, $300,000: *Provided*, That no part of this appropriation shall be available for demonstration work in rural sanitation in any community unless the State, county, or municipality in which the community is located agrees to pay one-half the expenses of such demonstration work. (See 47 Stat., 501.)

The field agents of the United States Public Health Service employed in the county health units are formally appointed by the Secretary of the Treasury and receive compensation direct from the United States Public Health Service on the basis of regular pay rolls submitted in the same manner as are pay rolls for other Federal employees. These appointments are made to facilitate the contribution of Federal funds to the local rural sanitation demonstration projects in the States, and to establish the official connection of the United States Public Health Service with those demonstrations. It appears that the names of the agents are submitted by the health officer of the State and that the agents are subject to the general supervision of the public health department of the State.

Inasmuch as the taxpayer received his appointment from the Federal Government and his compensation from that source was received in the same manner as that of other Federal employees, he was, in the opinion of this office, an employee of the Federal Government in so far as his compensation received from it is concerned. The fact that the taxpayer was assisting a county health unit in demonstration work and was primarily under its control and supervision, does not, of itself, justify the conclusion that all of his compensation was received as an employee of the State or a political subdivision thereof.

The facts in this case are such as to distinguish it from the case of employees of universities receiving compensation under the Smith-Lever Act of May 8, 1914, which compensation is specifically exempted from Federal income tax under the regulations of the Bureau. (Article 643, Regulations 77, and the corresponding articles of prior regulations.) In the case of employees receiving compensation under the Smith-Lever Act the funds appropriated by the Federal Government are paid into the State treasuries and lose their identity as funds of the United States. The officers or employees in those cases who qualify as State officers or employees receive no appointment

from the Federal Government and are paid no compensation directly by it. In the instant case the funds appropriated by the Federal Government are disbursed directly to employees appointed by it instead of such funds being paid into the State treasuries.

Accordingly, the taxpayer's compensation of $81x dollars received from the Federal Government is subject to Federal income tax.

SECTION 118.—LOSS FROM WASH SALES OF STOCK OR SECURITIES.

ARTICLE 661: Losses from wash sales of stock or securities. XII-2-5977 I. T. 2672

(Also Section 23(r), Article 272.)

REVENUE ACT OF 1932.

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" within the meaning of section 118 of the Revenue Act of 1932.

The definition in section 23(t) of stocks and bonds excludes a loss on the sale of a municipal bond from the limitation on deductibility imposed by section 23(r) of the Revenue Act of 1932.

Two questions are presented relative to the deductibility of the loss resulting from the sale by a corporation subsequent to June 6, 1932, of a bond of the face value of $1,000 issued by a municipality, namely, whether under the circumstances of this case a deduction for the loss should be disallowed because of section 118 of the Revenue Act of 1932, relating to losses from wash sales of stock or securities, and whether the loss is subject to the limitations on deductions for losses from sales and exchanges of stocks and bonds under section 23 (r), (s), and (t) of the Revenue Act of 1932.

The bond sold is of the issue of 1927, bearing 4 per cent interest, and matures in 1977. The interest on this issue is payable on May 1 and November 1 of each year. The sale was made at a price of $770 and accrued interest, and a substantial loss resulted from the sale at that price. This bond had been held for a period of more than two years.

On the same date the taxpayer corporation purchased another bond of the face value of $1,000 issued by the same municipality. This bond is of the issue of 1930 and matures in 1980. The interest on this issue is payable on October 1 and April 1 of each year. The purchase was made at a price of $777.50 and accrued interest.

Although the two bonds in question were both issued by the same municipality, and both bear interest at the annual rate of 4 per cent, one of them was issued more than three years after the other. The interest on the two bonds is payable on different dates and the two bonds have different maturity dates as shown above. It is, therefore, held that the two bonds do not come within the meaning of "substantially identical stock or securities" as used in section 118 of the Revenue Act of 1932. This accords with I. T. 1305 (C. B. I-1, 151), which was promulgated under the corresponding provisions of the Revenue Act of 1921. The taxpayer is accordingly not

prohibited from taking such loss as a deduction by section 118 of the Revenue Act of 1932.

The second question relates to the applicability of section 23(r) and section 23(t) of the Revenue Act of 1932 pertaining to "limitation on stock losses." Such limitation applies to losses sustained from sales or exchanges of stocks and bonds unless the transactions are excepted from the limitation. The definition of stocks and bonds for the purpose of such limitation is contained in section 23(t), and for that purpose the term "bonds" is defined as meaning "* * * bonds, debentures, notes, or certificates or other evidences of indebtedness, issued by any corporation (other than a government or political subdivision thereof) * * *." Accordingly, Federal, State, and municipal bonds are excepted from the limitation relative to the deductibility of such losses. In view of the foregoing, the length of time the municipal bond involved in this case was held by the corporation is immaterial from the standpoint of section 23(r). Furthermore, since the taxpayer is a corporation, the provisions of section 101(b) of the Revenue Act of 1932, relating to the computation of the tax in the case of capital net losses, are not applicable.

The corporation is, therefore, entitled to deduct from its gross income the full amount of the loss resulting from the sale of the bond in the instant case.

SUPPLEMENT C.—CREDITS AGAINST TAX.

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

ARTICLE 691: Analysis of credit for taxes. XII-21-6189
(Also Section 105, Article 551.) I. T. 2695

REVENUE ACT OF 1932.

The Revenue Act of 1932 makes no provision for computing the credit for foreign taxes in the same manner as the tax is computed under section 105 of that Act.

Where a taxpayer files a return for a fiscal year ending in 1932 he is required to elect whether he will deduct from gross income under section 23(c) of the Revenue Act of 1932 the total amount of the foreign income taxes paid or accrued within the taxable year, or whether he will take as a credit against the United States income tax the amount of such foreign taxes allowable under section 131(b) (1) and (2) of the Revenue Act of 1932.

Advice is requested whether credit for taxes paid to foreign countries by a corporation having a fiscal year ending in 1932 should be computed under the Revenue Act of 1928 as well as the Revenue Act of 1932, and apportioned under section 105 of the Revenue Act of 1932 on the basis of the number of months falling within the taxable periods covered by each Act.

This question has arisen in connection with the credit for foreign taxes allowable to the M Corporation and affiliated corporations on its fiscal year return for the taxable year March 1, 1931, to February 29, 1932. The taxes actually paid by the taxpayer to foreign coun-

tries are $7x$ dollars, while the taxes deemed to have been paid by the taxpayer amount to x dollars, making a possible credit of $8x$ dollars.

The taxpayer in computing its net income under the Revenue Act of 1928 (as provided in section 105 of the Revenue Act of 1932) deducted from its gross income that portion of the amount of foreign taxes paid which was not claimed as a credit against the tax. The taxpayer computed the amount of the credit allowable under the Revenue Act of 1928 and took ten-twelfths of that amount as allowable under that Act. The amount of credit allowable under the Revenue Act of 1932 was also computed, and of that amount the taxpayer took as a credit two-twelfths.

Section 131 of the Revenue Act of 1932 provides in part as follows:

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

The phrase "the tax imposed by this title," as used in the above-quoted provision, means the tax computed under Title I (Income tax) of the Revenue Act of 1932.

Section 105 of the Revenue Act of 1932 provides as follows:

SEC. 105. *Taxable period embracing years with different laws.*

If it is necessary to compute the tax for a period beginning in one calendar year (hereinafter in this section called "first calendar year") and ending in the following calendar year (hereinafter in this section called "second calendar year") and the law applicable to the second calendar year is different from the law applicable to the first calendar year, then the tax under this title for the period ending during the second calendar year shall be in the sum of: (1) the same proportion of a tax for the entire period, determined under the law applicable to the first calendar year and at the rates for such year, which the portion of such period falling within the first calendar year is of the entire period; and (2) the same proportion of a tax for the entire period, determined under the law applicable to the second calendar year and at the rates for such year, which the portion of such period falling within the second calendar year is of the entire period.

The Revenue Act of 1932 makes no provision for computing the credit for foreign taxes in the same manner as the tax is computed under section 105 of that Act.

In computing net income under the Revenue Act of 1932 section 23(c) provides that there shall be allowed as deductions from gross income:

Taxes generally.—Taxes paid or accrued within the taxable year, except—

(1) Income, war-profits, and excess-profits taxes imposed by the authority of the United States;

(2) Income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States; but this deduction shall be allowed in the case of a taxpayer who does not signify in his return his desire to have to any extent the benefits of section 131 (relating to credit for taxes of foreign countries and possessions of the United States) * * *.

The taxable year 1932 means the calendar year 1932 or a fiscal year ending during such calendar year. Consequently, where a taxpayer files a return for a fiscal year ending in 1932, he is required to elect whether he will deduct from gross income under section 23(c) of the Revenue Act of 1932 the total amount of the foreign income taxes paid or accrued within the taxable year, or whether he will take as a credit against the United States income tax the amount of such foreign taxes allowable under section

131(b) (1) and (2) of the Revenue Act of 1932. A deduction from gross income of foreign taxes will not be allowed to a taxpayer who signifies in his return his desire to have "to any extent" the benefits of section 131, relating to the credit for foreign taxes.

Since the M Corporation deducted a part of the foreign taxes from its gross income and computed the credit for foreign taxes in the same manner as it computed its tax under section 105 of the Revenue Act of 1932, the taxpayer's method of computation is erroneous.

If the amount of the foreign taxes allowable as a credit under the provisions of section 131(b) (1) and (2) of the Revenue Act of 1932 is determined to be $4.5x$ dollars, based upon the data submitted by the taxpayer, it may claim that amount as a credit against the total amount of United States income tax computed under section 105 of the Revenue Act of 1932. The balance of the foreign tax paid, or deemed to have been paid, by the taxpayer which is not allowed as a credit may not be deducted from gross income.

ARTICLE 693: Conditions of allowance of credit.

REVENUE ACT OF 1932.

Information required to substantiate credits for foreign taxes. (See I. T. 2676, page 48.)

SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX.

SECTION 141.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 711: Consolidated returns of affiliated corporations for 1932 and subsequent taxable years. XII-17-6142 G. C. M. 11676

REVENUE ACTS OF 1917, 1918, 1921, 1924, 1926, 1928, AND 1932.

1. (a) On the sale of a subsidiary company's stock to outside interests, the gain to the parent company should be taxed without adjustment for the subsidiary's earnings or gains which were taxed in a consolidated return; and (b) the gain or loss of the parent company should be adjusted on account of the subsidiary's losses used in consolidated returns to offset the parent company's income, as provided in General Counsel's Memorandum 7765 (C. B. IX-1, 223). This rule should be applied for all taxable years. General Counsel's Memorandum 8889 (C. B. IX-2, 236) revoked.

2. For taxable years prior to 1929 the liquidation of a subsidiary during the consolidated return period will not be considered as an intercompany transaction.

To the extent that they are inconsistent herewith the following rulings are modified: Solicitor's Opinion 131 (C. B. I-1, 18), General Counsel's Memorandum 1501 (C. B. VI-1, 260), and General Counsel's Memorandum 2774 (C. B. VII-1, 196).

An opinion is requested whether, in view of *Burnet* v. *Riggs National Bank* (57 Fed. (2d), 980), which affirmed the opinion of the Board of Tax Appeals in *Riggs National Bank* v. *Commissioner*

(17 B. T. A., 615), the Bureau should continue to follow General Counsel's Memorandum 8889. The scope of the request for an opinion includes the view to be taken of the liquidation of a subsidiary company as an incident to the dissolution thereof, as well as the position to be taken in the case of the sale of the stock of the subsidiary to outside interests.

In General Counsel's Memorandum 7765 (C. B. IX–1, 223) the conclusion was reached that no adjustment to the gain or loss basis of a subsidiary corporation's stock in the hands of the parent corporation is permissible on account of the prior gains of the subsidiary, whether such gains are reported in a consolidated return or in a separate return, or on account of the prior losses of the subsidiary where the losses are reported in a separate return, but that an adjustment to the gain or loss basis of a subsidiary corporation's stock in the hands of the parent corporation is necessary where the losses of the subsidiary are reported in a consolidated return and used as an offset against the income of the parent corporation and it appears that the losses could not have been availed of by the subsidiary as net losses or otherwise had its income been reported in separate returns instead of being reported in a consolidated return. Later this conclusion was modified by General Counsel's Memorandum 8889, supra, so as to provide that no adjustment to the gain or loss basis of the stock of the subsidiary in the hands of the parent company is permissible on account of the prior losses of the subsidiary, whether such losses are reported in a consolidated return or a separate return.

In *Remington Rand, Inc.*, v. *Commissioner* (33 Fed. (2d), 77, Ct. D. 149, C. B. IX–1, 268, certiorari denied, 280 U. S., 591) it was held, in conformity with the Government's contention, that a parent company realizes a gain on the sale to outside interests of all of the stock of a subsidiary company, that the sale breaks the affiliation and occurs outside thereof, and that the parent company's gain should not be adjusted on account of the subsidiary's accumulated earnings included and taxed in consolidated returns filed by the companies. In *Riggs National Bank* v. *Commissioner*, supra, the Board held that upon surrender and cancellation of the stock in complete liquidation of a subsidiary a loss was sustained by the parent company, that the liquidation occurred after the termination of affiliation, and that the loss thus sustained was deductible in the separate return of the parent company for the taxable year immediately following the termination of affiliation. The Board also held that the deductible loss was the difference between the investment in the stock and the value of the assets received on the liquidation, less the amount of the subsidiary's operating loss used in the preceding consolidated return to offset the income of the parent company. The Board stated that as it was not to be assumed that Congress intended to grant a double deduction to a taxpayer (*Goodrich* v. *Edwards*, 255 U. S., 527, T. D. 3174, C. B. 4, 40, and *U. S.* v. *Luley*, 274 U. S., 295, T. D. 4046, C. B. VI–2, 157), it was necessary that such adjustment should be made of the parent company's loss on the winding up of the subsidiary.

It seemed, therefore, on the basis of those decisions, if gain or loss is to be determined for tax purposes on the liquidation of a subsidiary, as well as on the sale of the subsidiary's stock to outside

interests, that in either case the parent company's gain should be taxed without adjustment for the subsidiary's earnings or gains included and taxed in consolidated returns filed by the companies, but that the parent company's gain should be increased or its deductible loss should be reduced on account of the subsidiary's losses used in consolidated returns to offset the parent company's income. The taxation of the subsidiary's earnings or gains in a consolidated return does not impose any additional tax liability upon the parent company, for its own tax liability is not thereby increased (compare *Obenchain-Boyer Co.* v. *Commissioner*, 18 B. T. A., 293, and see *Southwestern Ice & Cold Storage Co.* v. *Commissioner*, 27 B. T. A., 190), whereas the use of the subsidiary company's losses in a consolidated return to reduce the parent company's taxable income does reduce the parent company's own tax liability, and in actual effect is pro tanto an allowance for a return of capital out of the subsidiary which for tax purposes should be applied against the parent company's investment or against its advances to the subsidiary.

Thereafter, the District Court for the Southern District of New York rendered its decision in *United Publishers' Corporation* v. *Anderson* (42 Fed. (2d), 781), in a case involving the sale of a subsidiary's stock to outside interests, wherein it was held that the capital loss of the parent company, consisting of the difference between the proceeds of sale and the aggregate amount of the parent company's advances to and its investment in the stock of the subsidiary, should not be adjusted by reduction on account of the subsidiary's losses which were used to reduce the parent company's income in consolidated returns filed by the companies. The court was of the opinion that the case before it was the exact converse of *Remington Rand, Inc.*, v. *Commissioner*, supra, and that in either case no adjustment was required. No appeal was taken from the decision in *United Publishers' Corporation* v. *Anderson*, supra.

After the decision in *United Publishers' Corporation* v. *Anderson*, supra, General Counsel's Memorandum 8889, supra, was issued, by which General Counsel's Memorandum 7765, supra, was modified. This modification was limited, however, to the sale of a subsidiary company's stock to outside interests, as to which it was ruled that no adjustment of the parent company's gain or loss should be made on account of the subsidiary's losses used to offset the parent company's income in consolidated returns. It follows that there was left in effect so much of General Counsel's Memorandum 7765, supra, as had to do with the adjustment of the basis in the case of the liquidation of a subsidiary after the termination of the consolidated return period. General Counsel's Memorandum 8889, supra, did not give any effect to either of the two points involved in the decision of the Board in the Riggs National Bank case, because the Commissioner had appealed the case to the Circuit Court of Appeals for the Fourth Circuit on the ground that the liquidation of the subsidiary arose out of the affiliated status and for that reason did not result in a deductible loss.

In its opinion in *Burnet* v. *Aluminum Goods Manufacturing Co.* (287 U. S., 544, C. B. 631, page 283, this Bulletin), decided January 9, 1933, the Supreme Court held that the parent company sustained a deductible loss upon the complete liquidation of the subsidiary, even

though the liquidation occurred during the continuation of affiliation. It thus appears to be established that a deductible loss may be sustained, and, a fortiori, that a taxable gain may be realized by a parent company on the liquidation of a subsidiary company, whether before or after the termination of affiliation. Such deductible loss may be used by the parent company in computing its net income for the purposes of the consolidated return. (Compare *American Paper Exports, Inc.*, v. *Bowers* (C. C. A. 2), 54 Fed. (2d), 508.) The Supreme Court also commented with approval upon the adjustment of the parent company's deductible loss by the amount of the subsidiary's loss used in the consolidated return to offset the parent company's income.

In view of *Burnet* v. *Aluminum Goods Manufacturing Co.*, supra, and *Burnet* v. *Riggs National Bank*, supra, this office is of the opinion that the ruling in General Counsel's Memorandum 7765, supra, should now be reinstated and extended to cover the case of a complete liquidation of a subsidiary during the continuance of the affiliation, except as the matter is affected by article 37 of Regulations 75 and 78.

It has been suggested the effect of the Supreme Court's opinion in *Burnet* v. *Aluminum Goods Manufacturing Co.*, supra, may be limited to cases arising under the Revenue Act of 1917, and that it may still be contended for 1918 and later years that the results of the liquidation of a subsidiary during the continuation of affiliation should be eliminated in the computation of the parent company's income for the purposes of the consolidated return. In such case the question of the adjustment of the parent company's gain or loss by the subsidiary's losses used in consolidated returns to offset the parent company's income would become unimportant.

The Aluminum Goods Manufacturing Co. case was governed by the Revenue Act of 1917, by section 1331 of the Revenue Act of 1921, and by Regulations 41. The Supreme Court stated that it was not necessary in the disposition of the case to decide whether the loss resulted from an intercompany transaction within the meaning of the regulations under later statutes, "which broadly exclude from the consolidated returns profit or loss upon all such transactions," because, it was pointed out, neither the law nor the regulations in effect for 1917 require the elimination of the results of all intercompany transactions in the computation of consolidated income, but provide only that the effect of intercorporate relationships shall be determined upon the basis of an "equitable and lawful accounting." This difference between the regulations issued under the Revenue Act of 1917 and the regulations issued under later Revenue Acts, and the fact that the Supreme Court did not directly express its opinion whether a liquidation of a subsidiary during the continuance of the affiliation does or does not constitute an intercompany transaction, has given rise to speculation, as above indicated, whether the Bureau should not continue to hold under Regulations 45, 62, 65, and 69 that a liquidation of a subsidiary under such circumstances is an intercompany transaction which must be eliminated in computing consolidated net income.

Under article 37 of Regulations 75 and 78, it is expressly provided that such a liquidation is to be considered an intercompany transaction on which gain or loss must be eliminated. Inasmuch

as these regulations rest upon a broader authority to make rules governing consolidated returns, and, since taxpayers are required to consent to such regulations as a condition to being permitted to file consolidated returns, the question of the effect of the Supreme Court's decision in the Aluminum Goods Manufacturing Co. case should be taken to have no application to Regulations 75 and 78.

Article 637 of Regulations 45 (1920 edition) provides that intercompany transactions shall be eliminated. Article 636 of Regulations 62 and 65 and article 635 of Regulations 69 also provide for the elimination of "intercompany transactions (whether or not resulting in any profit or loss to the separate corporations) * * *." None of these regulations expressly define an "intercompany transaction," but in practice the Bureau has proceeded on the theory that the liquidation of a subsidiary, whether before or after the termination of the affiliation, is such a transaction, and so contended in *Burnet* v. *Riggs National Bank*, supra, and in the more recent case of *Canal-Commercial National Bank* v. *Commissioner* (22 B. T. A., 541), affirmed February 21, 1933, by the Circuit Court of Appeals for the Fifth Circuit. These cases arose under the 1921 and 1918 Acts, respectively, and in both cases the Board and courts held that gain or loss resulted from the liquidation of a subsidiary.

While the Supreme Court in *Burnet* v. *Aluminum Goods Manufacturing Co.*, supra, pointed out the difference between the 1917 and later regulations and did not comment on what constitutes an intercompany transaction, it went on to state that "no method of accounting, in calculating taxable income upon the consolidated return can be upheld which would withhold from the taxpayer all benefit of deduction for losses actually sustained and deductible under the sections governing the computation of taxable income, and which at the same time would not further, in some way, the very purpose for which consolidated returns are required." The court was impressed with the fact that on the liquidation there involved the subsidiary was completely divested of assets during the taxable year, that there was nothing left out of which the parent company could secure reimbursement for the balance of its advances to the subsidiary and for its investment in the stock, and that for these reasons the items mentioned had become worthless and were deductible in the year 1917, if at all. The court stated that the loss was a real one, suffered by the parent company as a separate corporate entity, and it was equally a loss suffered by the single business carried on by the two corporations during the period of their affiliation. From such statement it may be doubted that a loss due to the ascertainment, upon complete liquidation, of the worthlessness of the stock investment and the parent company's claims for advances would be held by the court to be a part of an intercompany transaction under any of the regulations, at least prior to Regulations 75. It is believed that a deduction for a loss would be allowed by the court, under similar circumstances for any year to and including the taxable year 1928.

This office is of the opinion that the question whether gain or deductible loss results to a parent company from the complete liquidation of a subsidiary is settled by *Burnet* v. *Aluminum Goods Manufacturing Co.*, supra, *Burnet* v. *Riggs National Bank*, supra, and *Canal-Commercial National Bank* v. *Commissioner*, supra.

The conclusions of this office are as follows:

1. (a) On the sale of a subsidiary company's stock to outside interests, the gain to the parent company should be taxed without adjustment for the subsidiary's earnings or gains which were taxed in a consolidated return (*Remington Rand, Inc.*, v. *Commissioner*, supra); and (b) the gain or loss of the parent company should be adjusted on account of the subsidiary's losses used in consolidated returns to offset the parent company's income, as provided in General Counsel's Memorandum 7765, supra. (*Burnet* v. *Riggs National Bank*, supra, and *Burnet* v. *Aluminum Goods Manufacturing Co.*, supra.) This rule should be applied for all taxable years. General Counsel's Memorandum 8889 is hereby revoked.

2. For taxable years prior to 1929 the liquidation of a subsidiary during the consolidated return period will not be considered as an intercompany transaction.

To the extent that they are inconsistent herewith the following rulings are hereby modified: Solicitor's Opinion 131, General Counsel's Memorandum 1501, and General Counsel's Memorandum 2774.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 143.—WITHHOLDING OF TAX AT SOURCE.

ARTICLE 761: Withholding tax at source. XII-9-6045
Mim. 4001

Withholding under the Revenue Act of 1932 from compensation received for services rendered within the United States by nonresident alien individuals.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., February 9, 1933.

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

This Bureau has received a number of inquiries concerning the application of the withholding provisions of the Revenue Act of 1932 to compensation paid for services rendered in the United States by nonresident alien individuals.

Section 143(b) of the Revenue Act of 1932 requires an employer to withhold a tax of 8 per cent from the compensation paid to nonresident alien individuals for services rendered in the United States.

Section 211(b) of the Revenue Act of 1932 provides that in the case of an alien individual resident in a contiguous country (Canada or Mexico), the normal tax shall be an amount equal to the sum of the following:

(1) 4 per cent of the amount by which the part of the net income attributable to wages, salaries, professional fees, or other amounts received as compensation for personal services actually performed in the United States, exceeds the personal exemption and credit for dependents: but the amount taxable at such 4 per cent rate shall not exceed $4,000; and

(2) 8 per cent of the amount of the net income in excess of the sum of (A) the amount taxed under paragraph (1) above plus (B) the total credits against net income allowed to such individual.

In section 214 of the Revenue Act of 1932 it is provided that in the case of a nonresident alien individual the personal exemption shall be only $1,000, and the credit for dependents shall not be allowed in the case of a nonresident alien individual unless he is a resident of a contiguous country.

Section 215(b) of the Revenue Act of 1932 provides that the benefit of the personal exemption and credit for dependents and of the reduced rate of tax provided for in section 211(b) of that Act may, in the discretion of the Commissioner and under regulations prescribed by him with the approval of the Secretary, be received by a nonresident alien individual entitled thereto, by filing a claim therefor with the withholding agent.

Under section 143(g) of the Revenue Act of 1932 withholding of the tax in the case of compensation paid prior to the date of the enactment of the Act is at the rate of 5 per cent in lieu of the rate of 8 per cent.

The Revenue Act of 1932 was approved by the President at 5 p. m., eastern standard time, June 6, 1932.

Under the income tax regulations promulgated under the Revenue Act of 1928 and prior Revenue Acts a nonresident alien employee may claim the benefit of the personal exemption by filing with his employer Form 1115 duly filled in and executed under oath. Under the income tax regulations promulgated under the Revenue Acts of 1928, 1926, and 1924, if the alien employee is a resident of Canada or Mexico he may claim, in addition to the benefit of a personal exemption, the benefit of the credit for dependents, as well as the reduced rates of tax applicable to the compensation received by him for services performed within the United States, by filing Form 1115 with his employer. Form 1115 will also be used in connection with income from sources within the United States for the year 1932.

To illustrate the application of the withholding provisions of the statute to cases where employers have or have not withheld tax during 1932 prior to June 6, 1932, at the old rates, and the employee has or has not filed Form 1115 with the employer, the following examples are given:

Example (1): A, who is a citizen and resident of Cuba, while temporarily in the United States received a salary of $1,500 prior to June 6, 1932. If, during the period from January 1 to June 6, 1932, A filed Form 1115 with his employer, claiming the benefit of the personal exemption of $1,500 to which he was entitled under the Revenue Act of 1928, no tax was required to be withheld by the employer. In this case, however, A is required to file an individual income tax return, Form 1040B, for 1932, not later than June 15, 1933, of his total income from all sources within the United States, including his compensation, in order that the normal tax of 8 per cent (new rate) may be properly computed on his income in excess of his personal exemption of $1,000 allowable under the Revenue Act of 1932.

Should A have failed to file Form 1115 with his employer prior to the payment of the salary of $1,500 the employer was required to withhold a tax of 5 per cent (old rate of withholding) from the

salary of $1,500, or $75. If, after such tax had been withheld and not later than February 1, 1933, A files Form 1115 claiming the benefit of the personal exemption of $1,000 allowable under the Revenue Act of 1932, and upon examination of such claim the employer is satisfied that it is in due form, that it contains no statement which to his knowledge is untrue, and that such employee on the face of the claim is entitled to the benefits claimed, the employer may release to the employee the tax withheld in excess of 8 per cent (new rate of withholding) of the amount by which the compensation of $1,500 exceeds $1,000 ($500), that is, the employer in such case may release to the employee $35 of the $75 tax withheld.

Example (2): B, a citizen of Canada residing in Canada and employed in Detroit, Mich., earned $1,300 prior to June 6, 1932. If B filed Form 1115 with his employer prior to June 6, 1932, claiming the benefit of the personal exemption of $1,500 to which he was entitled under the Revenue Act of 1928, no tax was required to be withheld by the employer. B, however, should file an individual income tax return, Form 1040B, not later than June 15, 1933, showing his total income from all sources within the United States, in order that the tax of 4 per cent (new rate) may be properly computed upon his income in excess of his personal exemption of $1,000 allowable under the Revenue Act of 1932.

If B failed to file Form 1115 during the period from January 1 to June 6, 1932, his employer should have withheld a tax at the rate of 5 per cent (old rate of withholding) from the entire amount of the compensation of $1,300, or $65. If B files Form 1115 prior to February 1, 1933, claiming the benefit of the personal exemption of $1,000 to which he is entitled under the Revenue Act of 1932, as well as the new reduced rate of 4 per cent, and upon examination of such claim the employer is satisfied that the claim is in due form, that it contains no statement which to his knowledge is untrue, and that such employee on the face of the claim is entitled to the benefits claimed, the employer may release to the employee the tax withheld in excess of 4 per cent (new rate) of the amount by which the compensation of $1,300 exceeds the personal exemption of $1,000 ($300), that is, in such case the employer may release to the employee $53 of the $65 withheld.

Example (3): C, a citizen of Canada residing in Canada but employed in Buffalo, N. Y., received compensation amounting to $2,000 prior to June 6, 1932. He filed Form 1115 with his employer, January 1, 1932, claiming the benefit of the personal exemption of $1,500 to which he was entitled under the Revenue Act of 1928, as well as the reduced rate of 1½ per cent (old rate of 1½ per cent of the amount by which the part of the net income attributable to compensation for personal services performed in the United States, not in excess of $4,000, exceeds the personal exemption and credit for dependents). In that case the employer should have withheld a tax at the rate of 1½ per cent (old rate) on $500, the amount of the compensation in excess of the personal exemption of $1,500. C should also file an individual income tax return, Form 1040B, not later than June 15, 1933, of his total income from all sources within the United States, in order that the tax of 4 per cent (new rate) may be properly computed upon his income in excess of his personal exemption of $1,000 allowable under the Revenue Act of

1932. The amount of tax withheld by the employer is a proper credit against the tax computed on C's return. If C failed to file Form 1115 prior to June 6, 1932, the employer should have withheld a tax at the rate of 5 per cent (old rate of withholding) on the entire amount of compensation of $2,000, but if C files Form 1115 prior to February 1, 1933, claiming the benefit of the personal exemption of $1,000 to which he is entitled under the Revenue Act of 1932, as well as the new reduced rate of 4 per cent, and upon examination of such claim the employer is satisfied that the claim is in due form, that it contains no statement which to his knowledge is untrue, and that such employee on the face of the claim is entitled to the benefits claimed, the employer may release to the employee the tax withheld in excess of 4 per cent (new reduced rate) of the amount by which the compensation of $2,000 exceeds the personal exemption of $1,000 ($1,000), that is, in such case the employer may release to the employee $60 of the $100 tax withheld.

All inquiries concerning this mimeograph should refer to the number thereof and the symbols IT:E:RR.

DAVID BURNET, *Commissioner.*

Approved February 8, 1933.

OGDEN L. MILLS,
Secretary of the Treasury.

TITLE VII.—TAX ON TRANSFERS TO AVOID INCOME TAX.

SECTION 904.—PAYMENT AND COLLECTION.

ARTICLE 1281: Transfers to avoid income tax. XII-18-6153
Mim. 4016

Determination, assessment, and collection of excise tax on transfers of stock or securities to avoid income tax.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., April 12, 1933.

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

Article 1281 of Regulations 77, relating to excise tax on transfers of stock or securities to avoid income tax, provides that the determination, assessment, and collection of the tax and the examination of returns and claims filed pursuant to Title VII of the Revenue Act of 1932 and that article will be made under such procedure as may be prescribed from time to time by the Commissioner. Pursuant thereto the following procedure is prescribed:

Statements from taxpayers relating to proposed transfers of stock or securities submitted to the Bureau in accordance with the provisions of article 1281 will be routed to the Income Tax Unit, attention of IT:R.

Upon receipt in the records division of the Income Tax Unit of a statement by a taxpayer in respect of a proposed transfer of stock or

securities, submitted to the Bureau in accordance with the provisions of article 1281, an appropriate control record will be made and the file will be forwarded to the section of the audit review division charged with the audit of income tax returns filed in the collection district in which the taxpayer's Federal income tax return would be filed. The audit section will proceed promptly to a determination of the question whether the proposed transfer of stock or securities will render the transferor liable for the excise tax imposed by section 901 of the Revenue Act of 1932. Wherever necessary the taxpayer will be required to furnish further pertinent information in addition to the statement submitted and, if desirable, the matter may be referred to the appropriate internal revenue agent in charge for the purpose of obtaining such information. When the question is determined by the audit section the transferor will be notified thereof, and if it is held that the proposed transfer renders the transferor liable to the tax the transferor will be granted a reasonable time in which to submit a protest and, or appear for a hearing, and advised that if a protest is not submitted or a hearing requested within the time granted the determination will become final and the question will not be reopened by the Bureau.

Letters notifying taxpayers of the Bureau's determination of whether a transfer of stock or securities was made in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax will be prepared for the signature of the Commissioner.

Returns filed under the provisions of article 1281 of Regulations 77 will be listed by collectors for assessment on the miscellaneous tax list in the 400 block. The returns and list will then be transmitted to the Bureau in Washington in the same manner as other returns and lists of miscellaneous taxes.

Upon receipt of the list and returns in the Miscellaneous Tax Unit of the Bureau, the listing will be verified with the returns and the tax assessed in the usual manner. The returns will be recorded, and will then be transmitted by the Miscellaneous Tax Unit to the Income Tax Unit for the attention of the records division. After appropriate control records have been made in the records division the returns will be forwarded to the proper audit sections, which will examine the returns under the usual procedure to determine the correct amount of the tax and, whenever desirable or necessary for a correct determination of the tax, the returns and related papers will be referred to the appropriate internal revenue agent in charge for examination.

The procedure for examining the returns and determining the correct amount of the tax, in both the Income Tax Unit and the field, in general will be the same as provided in Mimeograph 3937 (C. B. XI-1, 61) for the determination of income tax liability, including preliminary notice of determination and an opportunity for the taxpayer to protest and/or appear for a hearing. Closed returns and related papers will be filed in the Miscellaneous Tax Unit.

Taxpayers do not have the privilege of filing a petition with the United States Board of Tax Appeals for a redetermination of additional taxes determined by the Bureau under section 901 of the Revenue Act of 1932. Where, as the result of an examination of a return under Title VII of the Act, additional tax is finally deter-

mined by the Bureau, the taxpayer will be advised thereof and the returns, together with a statement showing how the tax was determined, will be transmitted by the audit review division through the records division to the Miscellaneous Tax Unit for assessment in accordance with the usual procedure for assessment of other miscellaneous taxes.

The procedure for the collection of the taxes assessed under Title VII of the Revenue Act of 1932 will be the same as for the collection of other miscellaneous taxes assessed.

Claims for refund or abatement of the excise tax imposed by section 901 of the Revenue Act of 1932 will be forwarded by collectors to the Bureau in Washington for the attention of the Miscellaneous Tax Unit. Appropriate record will be made in that Unit and the return and related papers will be attached to the claim and forwarded to the Income Tax Unit, marked for the attention of the records division. After making proper notations of the claim on the control record of the return, the claim, return, and related papers will be forwarded by the records division to the proper audit section, which will examine and determine the merits of all claims for abatement or refund of such tax and, wherever necessary, the claim and related papers will be referred to the appropriate internal revenue agent in charge for a field investigation and report. If the claim is disallowed in whole or in part, the usual preliminary letter will be mailed to the taxpayer. Where, in connection with such a claim, a determination is made whether a transfer of stock or securities was in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax, such determination will be made the subject of a memorandum to the Commissioner for his approval.

Claims for abatement or refund, when allowed in whole or in part, will be transmitted by the audit review division of the Income Tax Unit through the records division to the Miscellaneous Tax Unit for scheduling in accordance with the usual procedure relating to the abatement or refund of other miscellaneous taxes assessed. Claims which are rejected in whole will also be transmitted to the Miscellaneous Tax Unit for scheduling in accordance with such procedure. Where a claim for refund is rejected in whole or in part the Miscellaneous Tax Unit will mail to the taxpayer, by registered mail, an appropriate notice of the rejection in accordance with the provisions of section 3226 of the Revised Statutes of the United States, as amended by section 1103 of the Revenue Act of 1932.

Particular attention is invited to section 904(a) of the Revenue Act of 1932, which provides that the tax imposed by section 901 shall, without assessment or notice and demand, be due and payable by the transferor at the time of the transfer. Accordingly, the filing of a claim for abatement will not operate as a stay of collection unless the transferor files a bond or makes other arrangements to secure payment of the tax which are satisfactory to the collector.

Attention is also invited to section 904(e) of the Revenue Act of 1932, which provides that all administrative, special, or stamp provisions of law, including penalties and including the law relating to the assessment of taxes, so far as applicable, are extended to and made a part of Title VII. The limitation of four years after the tax becomes due, provided in section 1109 of the Revenue Act of 1926,

is, therefore, applicable to the assessment of the tax under Title VII of the Revenue Act of 1932. The limitation of four years after payment, provided in section 3228 of the Revised Statutes, as amended, and further amended by section 1106 of the Revenue Act of 1932, is applicable to the refund of such tax.

The provisions of section 3176 of the Revised Statutes, as amended by section 1103 of the Revenue Act of 1926 and section 619 of the Revenue Act of 1928, imposing ad valorem penalties for failure to file a return and for the filing of a false or fraudulent return, and the provisions of section 3184 of the Revised Statutes, which impose a penalty of 5 per cent of the tax and interest at the rate of 1 per cent per month for failure to pay the tax when due, are also applicable to the tax imposed by Title VII.

Appropriate statistics of returns filed, original and additional tax assessed and collected, and abatements and refunds allowed under Title VII of the Revenue Act of 1932, will be maintained by the Miscellaneous Tax Unit.

Correspondence and inquiries regarding this mimeograph should refer to the number and the symbols IT:E:WTS.

DAVID BURNET, *Commissioner.*

TITLE IX.—ADMINISTRATIVE AND GENERAL PROVISIONS.

SECTION 1104.—DATE OF ALLOWANCE OF REFUND OR CREDIT.

REVENUE ACT OF 1932.

Effect of section 1104, Revenue Act of 1932, on section 1116, Revenue Act of 1926, with respect to the date of allowance of refund or credit. (See Ct. D. 634, page 349.)

SECTION 1107.—ADJUSTMENTS OF CARRIERS' TAX LIABILITIES TO CONFORM TO RECAPTURE PAYMENTS.

XII–3–5989
G. C. M. 11266

REVENUE ACT OF 1932.

Adjustments of the tax liability of carriers in accordance with section 1107 of the Revenue Act of 1932 to conform with the final action taken by the Interstate Commerce Commission in the determination of "recapture" income under section 15(a)6 of the Interstate Commerce Act as amended by the Transportation Act of 1920.

An opinion is requested concerning the status, for the purposes of suit, of claims for refund or credit filed under section 1107 of the Revenue Act of 1932.

Section 1107 has to do with adjustments of the tax liability of carriers to conform with the final action taken by the Interstate Commerce Commission in the determination of "recapture" income under section 15(a)6 of the Interstate Commerce Act, as amended

by the Transportation Act of 1920 (41 Stat., 456, 489). Section 15(a)6 provides that:

> If * * * any carrier receives for any year a net railway operating income in excess of 6 per centum of the value of the railway property held for and used by it in the service of transportation, one-half of such excess shall be placed in a reserve fund established and maintained by such carrier, and the remaining one-half thereof shall, within the first four months following the close of the period for which such computation is made, be recoverable by and paid to the commission for the purpose of establishing and maintaining a general railroad contingent fund as hereinafter described. * * * The value of such railway property shall be determined by the commission in the manner provided in paragraph (4).

Many carriers have not admitted any liability to the Interstate Commerce Commission for excess income, commonly known as "recapture" income. In such cases the Bureau has not permitted the taxpayers to exclude from gross income the liability for "recapture" amounts which the taxpayers do not admit or refuse to pay. (G. C. M. 4606, C. B. VII–2, 256.) There are a number of carriers which have paid the commission some part of, or all, the amounts determined to be recoverable, but such payments generally have been made under protest. On the final orders of the commission the amounts determined to be recoverable may be more or less than the amounts originally determined. Under these circumstances carriers have been allowed to reduce gross income for income tax purposes by the amounts which they have paid to the commission. In discussing claims for refund or credit which are to be filed under section 1107 of the Revenue Act of 1932, this memorandum will be premised upon the cases of carriers which have not admitted any liability and have made no payments to the commission.

Section 1107 reads as follows:

> The Interstate Commerce Commission shall, as soon as practicable after its order with respect to the amount recoverable from any carrier under the provisions of section 15a of the Interstate Commerce Act, as amended, for any year or portion thereof has become final, and such amount, if any, has been paid, certify to the Commissioner of Internal Revenue the amount so paid. If the amount so paid by such carrier differs from the amount allowed as so recoverable in computing the income or excess profits tax liabilities for any taxable period of such carrier, or of any corporation whose income or excess profits tax liability is affected, the Commissioner of Internal Revenue shall determine any deficiency or overpayment attributable to such difference. Notwithstanding any other provision of law, (1) any such deficiency may be assessed within two years from the date of such certification, and, if so assessed, shall be paid upon notice and demand from the collector, and (2) any such overpayment may be credited or refunded within two years from the date of such certification, but not after unless, before the expiration of such period, a claim therefor is filed. This section shall not be held to affect the provisions of section 1106(b) of the Revenue Act of 1926 or 606 of the Revenue Act of 1928.

The section contemplates a recomputation of tax liability for the year in which the "recapture" income was earned. This is in line with General Counsel's Memorandum 4606, supra. If carriers which have not admitted having "recapture" income for prior years are required hereafter to account to the Interstate Commerce Commission for such income, the redetermination of tax liability by the Bureau for such years will disclose overpayments, and carriers which come within the provisions of section 1107 of the Revenue Act of 1932 will be entitled to have such overpayments credited or refunded

to them. Returns for prior years which have been closed under section 1106(b) of the Revenue Act of 1926 and section 606 of the Revenue Act of 1928 are specifically excluded from the benefits of section 1107 of the Revenue Act of 1932. Also it would seem that the latter section was not designed to limit the action to be taken with respect to returns for prior years which may be pending before the Bureau and the Board of Tax Appeals for adjustment on issues other than "recapture" items, when the certifications of final determination of "recapture" income are received from the Interstate Commerce Commission.

The principal reason for the enactment of section 1107 of the Revenue Act of 1932 was to permit closing for the present those cases in the Bureau, before the Board of Tax Appeals, or in the courts, where all matters affecting the Federal income or profits tax liability have been, or can be, agreed upon, and the only remaining adjustment has to do with the final determination of the amount of "recapture" income. Section 15(a)6 of the Interstate Commerce Act has been in effect since 1920 but at the present time final determinations have not been made of the amounts recoverable by the commission from many carriers, owing to questions of valuation and other difficulties, and it appears that further delay will ensue before final orders can be entered by the commission. Since the audit of income tax returns for prior years can, in many cases, be considered completed except for probable "recapture" adjustments, section 1107 was devised to permit of the disposition of such cases, whether pending before the Bureau, the Board of Tax Appeals, or the courts, subject to a later reopening to the extent only of a recomputation of the tax liability due to any differences attributable to the final determination of "recapture" income, provided, as above indicated, that cases closed by formal closing agreements should not be entitled to such reopening. It appears that there are pending before the Board a number of appeals of carriers which may now be closed by stipulation, if it be understood that such carriers will have the opportunity hereafter of securing the benefit of overpayments which the final determination of "recapture" income may disclose.

In the instant case the taxpayer, in reply to a letter from this office suggesting stipulation of its tax liability before the Board of Tax Appeals, expressed the fear that upon "the refusal of the Commissioner of Internal Revenue to exercise the power conferred upon him and authorizing refund to this company, this company would have no recourse in view of the expiration of the period of five years in which suit would have to be brought." The 5-year period to which the taxpayer refers was contained in section 3226, Revised Statutes, as amended by section 1113 of the Revenue Act of 1926. This provision, limiting the right of suit to five years from the date of payment of the tax where no action was taken on the claim by the Commissioner, is not contained in section 3226, Revised Statutes, as amended by section 1103 of the Revenue Act of 1932, and as the law now stands suit may be brought under a claim for refund at any time after the expiration of six months from the filing date without prior action thereon by the Commissioner, provided that such suit is not brought more than *two years from the date of mailing by registered mail by the Commissioner to the taxpayer notice of the disallowance of the part of the claim to which such suit or proceeding*

relates. The question raised by the taxpayer in this case is, therefore, no longer present.

Section 3226, Revised Statutes, as amended by section 1103 of the Revenue Act of 1932, sets forth the general conditions and limitations on suits for the recovery of taxes alleged to have been erroneously or illegally assessed and collected, and reads:

SEC. 3226. No suit or proceeding shall be maintained in any court for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress. No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim unless the Commissioner renders a decision thereon within that time, nor after the expiration of two years from the date of mailing by registered mail by the Commissioner to the taxpayer of a notice of the disallowance of the part of the claim to which such suit or proceeding relates.

The general rule under section 3226, Revised Statutes, as thus amended, is that a suit in court may be brought on any claim for refund duly filed "* * * according to the provisions of law in that regard * * *." Clearly, a claim for refund filed under the provisions of section 1107 of the Revenue Act of 1932 is duly filed "according to the provisions of law in that regard" as contemplated by section 3226, Revised Statutes, as amended. So filed according to law, the legal incidents of a refund claim attach, one of which is the right to sue for recovery.

The fact that section 1107 makes no provision for the institution of suit on claims filed thereunder, and the further fact that the language authorizing the Commissioner to assess any deficiency, or refund any overpayment, is permissive in form, is not considered as indicative of any intent to preclude the right of suit, or as granting to the Commissioner a mere discretion in the matter of assessing a determined deficiency or of refunding or crediting a determined overpayment.

Under the provisions of section 3220, Revised Statutes, as amended, the Commissioner of Internal Revenue is "authorized" to refund, and under section 3228, Revised Statutes, as amended, a claim, except as otherwise provided by law, must be filed within the time limit therein prescribed. No reference to the right to sue is made in the sections of the Revised Statutes authorizing the Commissioner to refund overpayments of taxes and the filing of claims by the taxpayer, nor in the exceptions thereto as to time limits prescribed in the various Revenue Acts within which claim must be filed.

The use of the word "may" in section 1107, relating to the assessment of taxes due and "refund or credit" of overpayments thereunder, does not appear to be significant. Permissive language in a statute, where power is delegated to public officers for the public interest or where the rights of individuals call for its exercise, though permissive in form, is held to be peremptory. The general rule is stated in the case of *Supervisors* v. *United States ex relatione* (4 Wall., 435), as follows:

The conclusion to be deduced from the authorities is, that where power is given to public officers, in the language of the Act before us, or in equivalent language—whenever the public interest or individual rights call for its exercise—the language used, though permissive in form, is in fact peremptory. • • •

Section 1107 contemplates adjustments with respect to "recapture" income, except in those cases which have been finally closed by agreement under section 1106(b) of the Revenue Act of 1926 and section 606 of the Revenue Act of 1928, "notwithstanding any other provisions of law." That is, notwithstanding the time limitations otherwise applicable within which taxes must be assessed and within which refund claims must be filed, and notwithstanding the prohibition against the determination of any additional deficiency as provided in section 274(f) of the Revenue Act of 1926 and corresponding provisions of other Acts, and likewise the prohibition against the institution of suit for refund as provided in section 284(d) of the Revenue Act of 1926 and similar provisions of other Acts, and the provisions of section 284(b)2 of the Revenue Act of 1926 limiting the amount of a refund or credit to the portion of the tax paid within the time limit for filing a claim. Otherwise the section fails, to a large extent at least, of accomplishing what obviously is its intended purpose.

The following conclusions may therefore be taken to represent the views contained in this memorandum:

(1) No refund or credit may be allowed under section 1107 of the Revenue Act of 1932 for any taxable year which has been finally closed by agreement under section 1106(b) of the Revenue Act of 1926, or section 606 of the Revenue Act of 1928.

(2) A claim for refund or credit properly filed under section 1107 of the Revenue Act of 1932 may be the basis for suit for recovery of an overpayment determined as therein provided;

(a) Where the tax liability for the year involved has not been finally closed by agreement under section 1106(b) of the Revenue Act of 1926, or section 606 of the Revenue Act of 1928;

(b) Where the tax liability for the year involved has been closed in the Board of Tax Appeals, either with or without review by an appellate court; and

(c) Where the tax liability for such year has been closed in the courts.

(3) Where tax liability for a given year is to be closed in the Board of Tax Appeals either with or without review by an appellate court, or where such tax liability is to be closed in the courts as the result of some form of agreement between the Bureau and the taxpayer (one of the elements of which is the proper adjustment for "recapture" income under section 15(a) of the Interstate Commerce Act), such an agreement as to "recapture" liability should be incorporated in a closing agreement under section 606 of the Revenue Act of 1928 prior to the time when the tax liability for the year in question has been finally determined by the Board of Tax Appeals or by the courts, so that no basis for a claim or suit for refund based upon a subsequent redetermination of "recapture" liability by the Interstate Commerce Commission will exist.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

INCOME TAX RULINGS.—PART II.

REVENUE ACT OF 1928.

SUBTITLE B.—GENERAL PROVISIONS.

PART II.—COMPUTATION OF NET INCOME.

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

ARTICLE 51: What included in gross income. XII-9-6046
G. C. M. 11473

REVENUE ACTS OF 1926 AND 1928.

Renewal commissions on insurance premiums received by the estate of a decedent under his contract with the insurance company are not subject to Federal income tax until such time as the amount of such commissions exceeds the value at which the contract was appraised for Federal estate tax purposes.

General Counsel's Memorandum 8826 (C. B. IX-2, 194) modified in so far as inconsistent herewith.

An opinion is requested relative to the proper amount of renewal insurance commissions to be reported as income each year by the estate of A, deceased.

The decedent at the time of his death was general agent for the M Life Insurance Co. for certain counties in the State of R, and under the contract with the company his estate will receive renewal commissions for a period of nine years from the date of the death of the decedent. Examination of the Federal estate tax return discloses that the contract right was valued for estate tax purposes at $3,e$ dollars.

The estate returned a portion of the renewal commissions as income for the year 1931, computed in accordance with General Counsel's Memorandum 8826, in which it was held that renewal commissions on insurance premiums received by a trust created under the will of the decedent were income subject to tax to the extent that the sums received after the taxpayer's death exceeded the fair market value of the contract right at the decedent's death. This office, relying upon *Eldredge* v. *United States* (31 Fed. (2d), 924), stated in that memorandum, however, that it did not follow that nothing was taxable until the trust had received payments in an aggregate amount exceeding the capital value of the contract, and held that income tax was due upon so much of each annual payment as represented approximately a proportionate amount of the profit on the whole transaction looked at from the standpoint of the date of the decedent's death. In the instant case the taxpayer encountered difficulty in arriving at the proper fraction to be used in determining what part of the renewal commissions was capital and what part was income. In answer to an inquiry from the taxpayer relative to the present value of renewal commissions

to be collected under the contract in question, the M Life Insurance Co., on April —, 1931, made the following reply:

The answer to your inquiry is that we have no established practice for making valuations as to the present worth of renewal commissions hereafter payable under terminated contracts. That is to say, we can not set up a clerical unit in an attempt to furnish such information. We have, of course, established factors used as a basis for making such valuations under certain conditions, but the clerical work involved in this case would take considerable time, and, furthermore, results attained are not guaranteed; in other words, the interest in future renewal commissions depends upon lapses and deaths. One or more terminations in larger policies may cause an excessive fluctuation in the termination rates. Lapses also vary widely not only as between agencies, but at different periods. As a consequence the company could not very well accept any responsibility for any basis adopted. We are, of course, disposed to give such assistance as we can which may be of some value in the circumstances.

At the proper time a fair guess could be made, based upon the amount of renewals paid since termination of the contract, but the termination is of such recent date that the present could not be regarded as a proper time. A full year's payments would furnish a working basis and if it can be arranged to defer your request for that length of time, figures will be available upon which to base a rough estimate.

In addition to the contingencies suggested in the letter quoted above, it appears from a reading of the contract that the amount of renewal commissions might be affected by the removal of a policyholder from the territory of the insurance agent.

The actual manner in which the taxpayer computed its income for the year 1931 is disclosed by the following excerpt from a memorandum filed with the return:

Under this ruling, for the purpose of determining the Federal estate tax and State of R inheritance tax, we set the fair value of the contract right at $3x$ dollars. The contract runs for a term of nine years from the date of death, and the commissions for the year following the date of death were $.7077x$ dollars. If all of the insurance written remained in force during the entire 9-year period, we might expect to receive nine times the income for the year 1931, or approximately $6.37x$ dollars. The difference between the $3x$ dollars reported as corpus for tax purposes and the anticipated gross income of $6.37x$ dollars would be the amount we should report as income for income tax purposes.

Under the regulations, we are not allowed to omit the reporting of any of this income until the total of $3x$ dollars has been reached, but, instead, we are required to report so much of the annual receipts as the sum of $3x$ dollars bears to the total of $6.37x$ dollars; therefore, we are reporting for the year 1931

$\frac{3x \text{ dollars}}{6.37x \text{ dollars}} \times .7077x \text{ dollars}$—or $.33x$ dollars.

It must be borne in mind that there will be lapses of insurance written, with a consequent decrease in the amount of annual renewal commissions. Periodic review should be made to determine how the contract is paying out, so that if the receipts actually aggregate less than $3x$ dollars over the entire period, we take a credit to the extent to which we are entitled. A tickler memorandum has been set up to bring this matter to our attention at appropriate times.

This method of computing the reportable income is, of course, subject to approval of the Internal Revenue Department, and the equation may be changed.

In *Burnet* v. *Logan* (283 U. S., 404, Ct. D. 351, C. B. X-1, 345) Mrs. Logan had received under the will of her mother an interest in an annual payment to be made to her mother. The amount of this annual payment depended upon the amount of ore which was to be mined under a lease contract which did not require production of either maximum or minimum tonnage or any definite payments. This

interest in the annual payments was appraised for Federal estate tax purposes at $277,164.50. Mrs. Logan claimed that no part of the annual payments was taxable as income to her until they exceeded the sum of $277,164.50. In disposing of this phase of the case the Supreme Court said:

> From her mother's estate Mrs. Logan obtained the right to share in possible proceeds of a contract thereafter to pay indefinite sums. The value of this was assumed to be $277,164.50 and its transfer was so taxed. Some valuation—speculative or otherwise—was necessary in order to close the estate. It may never yield as much, it may yield more. If a sum equal to the value thus ascertained had been invested in an annuity contract, payments thereunder would have been free from income tax until the owner had recouped his capital investment. We think a like rule should be applied here. The statute definitely excepts bequests from receipts which go to make up taxable income. (See *Burnet* v. *Whitehouse*, 283 U. S., 148.)

In the opinion of this office the instant case falls within the doctrine of *Burnet* v. *Logan*, supra. That decision is authority for the proposition that where a contract right of speculative value has been valued and taxed for Federal estate tax purposes, a taxpayer will not be subject to Federal income tax on amounts received under the contract until such amounts exceed the value at which the contract right was appraised for Federal estate tax purposes. It seems evident that the value of the contract right in the instant case is no less speculative in character than was the value of the contract right in the Logan case. As suggested by the Supreme Court in *Burnet* v. *Logan*, supra, the situation does not demand that an effort be made to place, according to the best available data, some approximate value upon the contract for future payments. In this connection attention is invited to General Counsel's Memorandum 9798 (C. B. X–2, 221), involving a somewhat analogous situation.

It is, accordingly, the opinion of this office that the taxpayer estate is not subject to income tax on any of the renewal commissions received under the above-mentioned contract, until such time as the amount of such commissions exceeds the value at which the contract was appraised for Federal estate tax purposes.

General Counsel's Memorandum 8826, in so far as inconsistent herewith, is hereby modified.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 51: What included in gross income. XII–10–6057
I. T. 2681

REVENUE ACT OF 1928.

> The taxpayer, intending to make a gift of $5,000 in value to each of his children, conveyed to one child in 1931 certain real estate having a fair market value of $8,500, and received a mortgage thereon for $3,500. The basic cost of the property was $4,500.
>
> The transaction represents a gift to the extent of $5,000 of the value of the property and a sale as to $3,500 of such value. Seven-seventeenths ($3,500/$8,500) of the cost ($4,500), or $1,852.94, represents the basis to the taxpayer of that part sold. In the hands of the child the basis of the property is 10/17 ($5,000/$8,500) of the cost to the donor, or $2,647.06, plus $3,500, the amount which the child is obligated to pay for the part purchased.

Pursuant to an intention on the taxpayer's part to make a gift of $5,000 to each of his children, he conveyed to one child in 1931 certain real estate. The basic cost of the real estate to the taxpayer was $4,500, but on the date of transfer the fair market value of the property was $8,500. In order that the gift would not exceed $5,000 the taxpayer received a first mortgage on the property in the amount of $3,500, representing the excess of the fair market value of the property over the gift made by him. Advice is requested as to whether the transfer of the property under the above circumstances resulted in an element of taxable income, and if so, to what extent.

It is the opinion of this office that the transaction referred to represents a gift to the extent of $5,000 of the value of the property and a sale as to $3,500 of such value. The whole of the property cost $4,500 and 7/17 ($3,500 $8,500) of this amount, or $1,852.94, represents the basis to the taxpayer of that part of the property sold to his child. The taxpayer received a mortgage in the amount of $3,500 for that part of the property sold by him, and as the basis of such part sold was $1,852.94, he derived a taxable gain to the extent of the excess of the fair market value of the mortgage over such basis.

The basis of the property in the hands of the child in determining gain or loss on the subsequent sale or other disposition thereof is 10/17 ($5,000 $8,500) of $4,500, the cost of the property to the father, or $2,647.06, plus $3,500, the amount which the child is obligated to pay for that part of the property purchased, or $6,147.06.

ARTICLE 51: What included in gross income. XII-24-0224
Ct. D. 679

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

INCOME — CALIFORNIA COMMUNITY PROPERTY — DIVIDENDS UPON STOCK.

Dividends received in 1928 upon stock owned as community property by taxpayer and his wife, residents of California, some of the stock having been purchased prior and some subsequent to July 29, 1927 (the date of the amendment of section 172a of the Civil Code of California), but all the purchases having been made with funds acquired before that date, were taxable income to the husband, his control over the community property, despite the limitations prescribed in amendments to the code in 1917 and 1923, being such as to require that the income from such property be taxable to him under the Federal income tax law. *United States* v. *Robbins* (269 U. S. 315) followed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Barnard J. Hirsch, appellant, v. *United States of America, appellee.*

Upon appeal from the District Court of the United States for the Northern District of California, Southern Division.

[December 12, 1932.]

OPINION.

WILBUR, Circuit Judge: Appellant brought this suit to recover $185.76 paid by him as income tax. The Government concedes his right to recover $177.45. The judgment of the trial court was in favor of the plaintiff for that amount

with interest. Appellant took an appeal from the judgment in his favor, claiming that it should have been for the full amount claimed. It is suggested on the argument that this is a test case and that other cases involving much larger amounts depend upon the decision herein, which no doubt accounts for the expense which has been incurred in the presentation of this case.

The question involved is with reference to the income derived from dividends upon stock owned by the appellant and his wife as community property. Appellant contends that one-half this amount should be returned by both the husband and wife, separately, while the Government contends that the income on this community property should be returned by the husband as part of his income, in accordance with the decision of the Supreme Court in *United States* v. *Robbins* (269 U. S., 315 [T. D. 3817, C. B. V-1, 188]). It is conceded by the Government that from and after the legislation enacted by the State of California on July 29, 1927, enacting civil code section 172a, that the income of the community property should be returned by the husband and wife separately, one-half each, as decided by the Supreme Court in *United States* v. *Malcolm* (282 U. S., 792). The appellant, however, contends that some time during the evolution of the California law with reference to community property, the wife acquired such an interest in the community property that the act of the Legislature of the State of California in 1927 effectively vested in her one-half of the income received after 1927 derived from community property which was acquired before the enactment of the statute in question.

In order to raise the various questions conceded to be presented by the appeal, plaintiff alleges the time of the acquisition of the stock upon which the dividends were received, and the amount of the dividends received upon these several purchases of stock, as follows:

"Income amounting to $1,353 was derived from stock purchased between July 27, 1917, and August 17, 1923, with funds acquired prior to July 27, 1917; income amounting to $2,542 was derived from stock purchased between August 17, 1923, and July 29, 1927, with funds acquired between July 27, 1917, and August 17, 1923; and income amounting to $1,393 was derived from stocks purchased after July 29, 1927, with funds acquired between August 17, 1923, and July 29, 1927."

The significance of these dates arises from the fact that on July 27, 1917, the amendments to sections 172 and 172a of the Civil Code of California, enacted by the legislature in 1917, became effective. (Civil code, sections 172 and 172a, Cal. Stats., 1917, page 829.) On August 17, 1923, sections 1401, 1402, of the civil code as amended by the legislature in 1923 (Cal. Stats., 1923, page 30) became effective. The amendments of the California Code in 1917 limited the absolute management and control by the husband of the community property with reference to gifts of the community personal property, etc. In the same year, 1917, the Legislature of California, also abolished the inheritance tax upon one-half the community property which went to the surviving wife on the death of the husband. The amendments of 1923 to sections 1401 and 1402 of the California Civil Code provided that one-half the community property is subject to the testamentary disposition of the decedent, whether that decedent be the husband or wife.

The question as to the interest of the wife in the community property arising from these changes in the statutory law of California has been frequently before the courts of California, and it has been definitely decided by the supreme court of that State that up to the year 1923, notwithstanding the amendments of 1917, above referred to, the community property belonged to the husband, and of course the income on that property also belonged to him. We need only cite some of these decisions without further comment: *Spreckels* v. *Spreckels* (116 Cal., 339); *Roberts* v. *Wehmeyer* (191 Cal., 601); *Stewart* v. *Stewart* (199 Cal., 318); *Lahaney* v. *Lahaney* (208 Cal., 323); *Estate of Phillips* (203 Cal., 106); *Osuske* v. *Kalinowsky* (209 Cal., 46, 51); *Blethen* v. *Pacific Mutual Life Ins. Co.* (198 Cal., 91).

The interest of the husband in the community property is such that the legislature can not vest any part thereof in the wife by legislation enacted subsequent to the acquisition of the community property. (*Spreckels* v. *Spreckels*, 116 Cal., 339; *McKay* v. *Lauriston*, 204 Cal., 557; *Estate of Phillips*, 203 Cal., 106, 110; *Estate of Bruggemeyer*, 115 Cal. App., 525; *Lovell* v. *Metropolitan Life Ins. Co.*, 118 Cal. App., 426.)

It seems too clear for discussion that if the Legislature of California was powerless to shift the title to a portion of the community property from the husband to the wife, it is equally powerless to change their relationship to in-

come derived from the community property vested in the husband. (See *George* v. *Ransom*, 15 Cal., 322; *Spear* v. *Ward*, 20 Cal., 659; *Lewis* v. *Johns*, 24 Cal., 98, 1930 Sup. to Cal. Jur., section 39; *Pac. Southwest Tr. & Sav. Bk.* v. *Ross*, 81 Cal. App., 204.) The extent to which the amendments of sections 1401, 1402 of the civil code in 1923 affected the ownership of the wife in the community property has not been directly decided by the Supreme Court of California. See discussion sections 117, 118, 1930 Supp., Cal. Jur. It was held in *Estate of Phillips* (supra) that it had no retroactive effect. That court, as to property acquired after the amendments of 1923, said:

"As applying to community property acquired after the adoption of said amendment it is, in our opinion, a valid and binding legislative enactment."

We entertain no doubt that after the amendment to the Code of California in 1923 as well as before, the husband's control over the community property was such as to require that the income from such property was taxable under the Federal income tax law as held by the Supreme Court in *United States* v. *Robbins* (269 U. S., 315), supra. The appellant seems to be of the opinion that the Robbins case was modified or overruled by the Supreme Court in *Poe* v. *Seaborn* [*Seaborn*] (282 U. S. 101 [Ct. D. 259, C. B. IX-2, 202]), dealing with the question of taxation of the community property in the State of Washington. We think there is nothing inconsistent between the two cases as was pointed out by the Supreme Court in the latter case. The point is too clear for extended discussion.

Judgment affirmed.

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

ARTICLE 84: Interest upon State obligations. XII-6-6017
I. T. 2674

REVENUE ACT OF 1928.

Where property is sold on a deferred payment plan and the contract of sale does not provide that any part of the deferred payments is interest, no part of such payments may be considered as interest. The difference between the cash price and the deferred payment price of an article is not interest or discount.

Advice is requested relative to the taxability, for Federal income tax purposes, of amounts received under a conditional sales contract which is designated as a municipal lease.

It is contended that the contract is a municipal obligation of the city of R, issued for the purpose of carrying on an essential governmental function; that the difference between the cash value of the apparatus at the time it was transferred to the city (5.3x dollars) and the sum of the several installments which the city agreed to pay under the contract (6.09x dollars), or .79x dollars, is the discount at which the obligation was issued; and that such discount is exempt from income tax under General Counsel's Memorandum 10452 (C. B. XI-1, 18), it being immaterial whether interest is specifically mentioned in the contract, and even though such mention is material, interest was specifically provided for by the provisions of the contract which in effect allowed a discount at the rate of 6 per cent if the installments were paid before their date. The only mention of interest made in the contract is contained in the "ninth" paragraph, which provides as follows:

Ninth. It is mutually understood and agreed by and between the parties hereto that the city of R, party of the second part, shall at any time during the term of this lease have the privilege and option of purchasing said apparatus and appurtenances for the sum of 5.3x dollars and interest thereon at the rate of

6 per cent per annum from the date of acceptance of said apparatus by the party of the second part to the date of purchase, and that the rental payments made by the party of the second part prior to the date of purchase shall be considered as applying against this stated price and the party of the first part will allow the party of the second part credit for such payments to apply against said price and in addition, credit for an amount representing interest on such rental payments from the date said payments were made to the date of purchase.

In General Counsel's Memorandum 10452 the conclusion was reached that where municipalities issued noninterest-bearing notes at a discount to meet expenses, the discount received in connection with such securities should be treated in the same manner as discount on Treasury bills is treated in Treasury Decision 4276 (C. B. VIII-2, 83), that is, the amount of the discount at which the security was issued is to be apportioned among the holders according to the periods of their holdings.

This office can not agree with the contention that under the contract in the present case the difference between the cash value of the apparatus as fixed in the contract and the sum of the several installments which the city of R agreed to pay under the contract, is discount. It is the opinion of this office that the entire amount of such installments is the purchase price which the city agreed to pay for the apparatus. The provisions in the contract relating to interest do not make any portion of such installments any less a part of the purchase price of the apparatus. The Bureau has consistently taken the position that where property is sold on a deferred-payment plan, and the contract of sale does not provide that any part of the deferred payments is interest, no part of such payments may be considered as interest. This position has been upheld by the courts. (Cf. *Daniel Bros. Co.* v. *Commissioner*, 7 B. T. A., 1086, C. B. VII-1, 8, affirmed 28 Fed. (2d), 761; *Henrietta Mills, Inc.*, v. *Commissioner*, 20 B. T. A., 651, affirmed 52 Fed. (2d), 931.) Under those decisions the difference between the cash price and the deferred-payment price of an article is not interest or discount. Consequently, General Counsel's Memorandum 10452 can have no possible application to the present case.

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

ARTICLE 105: Inventories by dealers in securities. XII-1-5964 Mim. 3990

Use of security inventories by banks.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., December 15, 1932.

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

To insure uniformity of treatment of cases involving the use by banks of security inventories, particularly in view of the decision in *Harriman National Bank* v. *Commissioner* (43 Fed. (2d), 950), it is deemed advisable to indicate the attitude of the Bureau on the question of whether all banks may inventory securities with no restrictions as to whether such banks are "regularly engaged in the

purchase of securities and their resale to customers" as required by article 105 of Regulations 74.

The adoption by a bank of the inventory method of computing income with respect to securities is contingent upon its compliance with the provisions of article 105 of Regulations 74 as to its classification as a dealer in securities.

As stated in I. T. 2564 (C. B. X–1, page 106), it is clearly apparent from reading the opinion in *Harriman National Bank* v. *Commissioner*, supra, that the question there involved was purely one of fact and that the court did not decide as a general proposition that all banks are entitled to inventory their securities.

Accordingly, the decision in the Harriman case should not be regarded as a controlling precedent in the disposition of other cases of banks seeking to inventory their securities.

Correspondence and inquiries regarding this mimeograph should refer to the number and the symbols IT:E:RR.

DAVID BURNET, *Commissioner.*

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

ARTICLE 121: Business expenses.

REVENUE ACT OF 1928.

Solicitor's Law Opinion 926 (C. B. 1, 241) modified, to the extent that it holds that penalties imposed for negligence or deliquency are ordinary and necessary business expenses which may legally be deducted from gross income. (See G. C. M. 11358, page 29.)

ARTICLE 132: Depositors' guaranty fund. XII–16–6134
G. C. M. 11651

REVENUE ACT OF 1928.

The bank guaranty law of Nebraska and the Nebraska act of 1930 are no longer in force in so far as they provide for assessments against banks in that State, and any amounts claimed to be deductible as assessments made in December, 1928, April, 1929, or January, 1930, and any amounts claimed to be deductible as assessments made under the provisions of the act of 1930 are not allowable as deductions for income tax purposes in the year 1930 or the year 1931.

An opinion is requested whether banks located in Nebraska may, under article 132 of Regulations 74, deduct in their income tax returns amounts assessed against them in accordance with the bank guaranty law of that State. The real questions presented are whether the "Guarantee fund law of the State of Nebraska" and the "Depositors' final settlement law" of that State are now in force, and whether the assessments made under such laws and claimed as deductions in the income tax returns of the banks filed for the years 1930 and 1931 are allowable.

In order that the complex legal situation in the State of Nebraska with respect to the guaranty of bank deposits may be made clear, a

review of the legislation in Nebraska relative to such guaranty and of the decisions of the State courts and the United States Supreme Court would seem advisable.

The bank guaranty law of Nebraska was originally enacted in 1909. (Laws of Nebraska, 1909, ch. 10, page 87.) Its purpose was to provide a guaranty fund for the protection of depositors in banks, and every corporation engaged in the business of banking under the laws of the State was declared to be subject to assessment to be levied and applied as prescribed by the statute. The banks were required to report semiannually to the State banking board their average daily deposits, and an assessment was levied on the bank in an amount equal to a certain percentage of the average daily deposits. The State banking board was succeeded in 1921 by the department of trade and commerce, which has supervision over the banks.

The moneys received from the payment of these assessments constituted what was known as the "Depositors' guaranty fund." By statute enacted in 1923 the administration of this fund was placed in the guaranty fund commission (Laws of Nebraska, 1923, ch. 191, page 438). By section 26 of the 1923 act a special annual assessment of not to exceed one-half of 1 per cent of the average daily deposits was authorized (1 per cent for 1923) if the amount of the depositors' guaranty fund was from any cause reduced below 1 per cent of the total average daily deposits. Special assessments, by virtue of the provisions of this law, were levied on December 15, 1928, April 17, 1929, and January 2, 1930, in addition to the regular assessments for those years.

Suit was instituted against the governor and the secretary of trade and commerce, on the grounds that the levying of the assessment of December 15, 1928, was unconstitutional and confiscatory. The district court of Lancaster County, Nebr., held that the bank guaranty law as originally conceived was no longer serving its purpose: that the guaranty fund was confiscatory; and that the enforcement of the law constituted the taking of property without due process. On appeal to the Supreme Court of Nebraska this decision was reversed, and the statute was upheld. (*Abie State Bank* v. *Weaver et al.*, 227 N. W., 922.) On appeal to the Supreme Court of the United States the judgment of the State Supreme Court was affirmed. (*Abie State Bank* v. *Bryan*, 282 U. S., 765.)

By a statute enacted in 1929 (Laws of Nebraska, 1929, ch. 38, section 8, pages 156 and 161) the guaranty fund commission was abolished, and its functions taken over by the secretary of the department of trade and commerce.

While the Abie State Bank case was pending in the United States Supreme Court the Legislature of Nebraska, in the special session of 1930, enacted a statute establishing a new fund to take the place of the former depositors' guaranty fund. This statute did not repeal the bank guaranty law as a whole but modified it to the extent of limiting future assessments, establishing a new fund into which the assessments were to be paid, and restricting the class of depositors who could receive payments from this newly designated fund. This new fund was styled "Depositors' final settlement fund" and was to consist of all the assets in the former "Depositors' guarantee fund," together with all due and unpaid assessments, regular and

special, including the above-mentioned special assessments of December 15, 1928, April 17, 1929, and January 21, 1930.

Out of this fund, only the following types of claims were to be paid, namely:

1. Unpaid claims of depositors and others entitled to priority, adjudicated prior to the date the act went into effect. (March 18, 1931.)

2. Unpaid claims for refund of assessments.

3. Certain claims against banks reorganized prior to the enactment of the statute.

For the purpose of providing a fund for depositors in State banks closed prior to the time the 1930 act went into effect, every corporation engaged in banking was subject to an annual assessment of a certain percentage of its average daily deposits. All payments were to go into this new depositors' final settlement fund. The former laws and former provisions for assessments were repealed. (See Compiled Statutes of Nebraska, 1929, sections 8–171, et seq.)

The Supreme Court of the United States in the Abie State Bank case referred specifically to this act of 1930 and to the three special assessments referred to above. The court, however, held that in view of the reduction in the extent of the obligations of the banks as to future assessments under the 1930 act the statute was not to be regarded as confiscatory but as a reasonable method of liquidating the guaranty plan.

In the course of its opinion the Supreme Court of the United States, however, used some very significant language, evidently based on a recognition of the fact that conditions in Nebraska were growing worse, rather than better, and that the scope of the opinion was not to be unduly extended. In the case of *Shallenberger* v. *First State Bank of Holstein* (219 U. S., 114) the court had held the Nebraska bank guaranty law valid as a police regulation. In the Abie State Bank case, however, the court said (page 772):

> • • • In the Shallenberger case, the suit was brought immediately upon the enactment of the law, and that decision sustaining the law can not be regarded as precluding a subsequent suit for the purpose of *testing the validity of assessments in the light of the later actual experience.* [Italics supplied.]

And again (page 772) the court said:

> • • • a police regulation, although valid when made, may become, by reason of later events, arbitrary and confiscatory in operation. • • •

Financial conditions in Nebraska grew worse, rather than better. The banks were apparently losing money, instead of making a profit, and the special assessments became burdensome. Suit was brought in the district court of Lancaster County by Hubbell Bank against the governor and others, to enjoin the collection of the regular and special assessments for the old depositors' guaranty fund, and, as well, the assessments levied and to be levied for the benefit of the new depositors' final settlement fund, established by the act of 1930.

The district court, on demurrer, held against the plaintiffs. The case was appealed to the Supreme Court of Nebraska (*Hubbell Bank et al.* v. *Bryan et al.*, 245 N. W., 20).

The court, after reviewing the legislation in Nebraska relative to the bank guaranty law, said, in part:

No ordinary exercise of the judicial process could import into the legislative act of March 18, 1930, any public purpose whatsoever which justified the passage of the act under the exercise of the police power by the legislature. This question was not adjudicated in the case of *Abie State Bank* v. *Bryan*, supra. Therefore the said act, in so far as it attempts to levy an assessment on State banks to create a fund to pay depositors' claims against banks having failed prior to the enactment thereof, is in violation of the due process clause of the Federal Constitution. It is also violative of section 1 of the fourteenth amendment. It is also violative of section 3, article 1, of the constitution of Nebraska, in that it deprives persons of their property without due process of law.

The court then adverted to the above-quoted language of the Supreme Court of the United States in the Abie Bank case, and said:

The substance of said opinion, as we understand it, is that, due to changed conditions resulting from new legislation, the court was unable to determine from the record whether the assessments were confiscatory. It therefore follows that the question now presented was not adjudicated in the above case.

The question now squarely presented is whether or not the special assessments levied on December 15, 1928, April 17, 1929, and January 2, 1930, and the regular assessments levied on July 1, 1929, and January 1, 1930, in view of changed conditions, including our finding herein that the depositors' final settlement fund is invalid and the old law, known as the depositors' guaranty fund, is thereby restored to an effective state, is confiscatory. If under the facts it is confiscatory it is violative of the fourteenth amendment to the Federal Constitution. If it is confiscatory, then it can no longer be sustained as a constitutional legislative enactment under the police power for a public purpose. If confiscatory, the public advantage does not justify taking of private property for what, in its purpose, is a private use.

In addition to the changed condition relating to changed statutory enactments, there are facts and circumstances inherent in the conditions of the banking business in this State since December, 1928. These facts are established by the record. It was a fact determined in 1928 that, due to the unprecedented number of failures of State banks, the depositors' guaranty fund was faced with a deficit of millions, and that it was impossible to restore the solvency of the fund. The comparatively small regular assessments had been levied and collected. In addition, the larger and more oppressive special assessments have been levied regularly for years, in the vain hope of restoring the solvency of the fund. The banks were faced with an indefinite continuance of these regular and special assessments. At the same time, the public purpose which this legislation undoubtedly had in the beginning was no longer served. From the condition of the fund itself, instead of a stabilizer of the State banks, it became a menace and a threat, sufficient to cause a great loss of public confidence in the banks with subsequent loss of business and earning power.

The court said further, in commenting on the changed financial condition in the State as a reason for changing its position relative to the constitutionality of the bank guaranty law:

Have conditions so changed in the State banking situation that the assessments in controversy here were or are confiscatory? The result of the operation of all the banks in the State have been compiled from the record by both plaintiffs and defendants. The plaintiffs contend that the operation of the banks for a 2-year period resulted in a loss of $23,576.09, while the defendants argue that the operations resulted in a gain of $984,138.73. The discrepancy is due largely to the time when the loss by real estate owned by the banks is charged against them. That such a loss occurred can not be denied. The argument that the banks in January, 1932, were in better condition and that their business was more profitable is not impressive. It is not supported by the facts pleaded, and admitted by the demurrer. Even taking the numerical argument submitted by the defendants, the alleged operating gain is not one-third the amount required to pay the assessments levied during the period. For a period consisting of some 11 months prior to December 15, 1928, it appears that the banks were able to earn more than enough to pay the assessments, although it is now clear from the record, which includes further experience

since this case was before this court, that this supposed earning was more apparent than real for that in the spirit of optimism the banks had not yet charged off some of their losses. During the period from December 15, 1928, to January 1, 1931, covering approximately two years, there is either a loss or a profit so small that it is sufficient to meet less than one-third of the assessments levied against the banks for the benefit of the guaranty fund. The assessments for this period can only be paid by the banks by a direct taking of their capital stock. Such a collection would impair the capital of the banks and would weaken their stability. In this respect, the law itself defeats the public purpose for which it had hitherto existed; that is, in the interests of the public welfare to stabilize banking and business conditions. Such a taking under assessments levied under the guise of the police power for the public welfare is a confiscation of property and deprives the plaintiffs of their property without due process of law in violation of section 1 of the fourteenth amendment to the Federal Constitution and section 3, article 1, of the constitution of the State of Nebraska. Under such conditions, the public advantage having long since vanished, and what was once a comparatively insignificant taking of private property having become such that it will impair and in time will dissipate the capital stock of the banks exclusively for a private purpose, it can not be sustained under the police power of the State. (*Noble State Bank* v. *Haskell*, 219 U. S., 104, 31 S. Ct., 186, 55 L. Ed., 112, 32 L. R. A. (N. S.), 1062, Ann. Cas., 1912A, 487.)

Furthermore, whether these assessments are levied and collected under the old depositors' guaranty fund or under the later enactment, the depositors' final settlement fund, there is no public purpose involved therein, a thing so necessary to the validity of said assessments.

And again:

Since the depositors' final settlement fund act became effective March 18, 1930, to the middle of September, 1932, 157 banks against which these assessments have been levied have closed. Of this, about 30 have reopened on some plan of reorganization. The total set-up in the 125 failed banks which have not reopened as a contingent liability for the depositors' final settlement fund is almost $700,000, while the amount so set up in the reopened banks is about $220,000. The collection of the $900,000 from those banks being liquidated or reorganized by the department of trade and commerce would be taking the money from one group of depositors who could not benefit from the provisions of the act and paying it to another group of depositors in banks which had failed prior to March 18, 1930. There is no public purpose involved to sustain such an action. It would be taking the money from one person and devoting it to a private use. The taking of money belonging to one class to pay claims of those of another class is in violation of the due process provision of the Federal and State Constitutions. (*Weaver* v. *Koehn*, 120 Neb., 114, 231 N. W., 703.)

* * * From any viewpoint from which we consider these assessments, it is apparent that all public purpose has been abandoned in relation thereto and that it now amounts to taking the property of one class of citizens to pay another class in contravention of the constitutional rights of the plaintiffs. The logical conclusion reached from the foregoing consideration of the questions presented is that the judgment of the trial court should be reversed and the suit remanded, with directions to enter an injunction against the defendants, as petitioned by the plaintiffs.

The court thereupon reversed the decision of the court below.

From the foregoing it is clear that the Supreme Court of Nebraska, in construing the bank guaranty law of that State, including the act of 1930, has held that, under the financial conditions obtaining in Nebraska since the latter part of 1928, assessments made on the banks of that State, by virtue of the provisions of the statutes in question, were violative of the constitution of the State of Nebraska (and, as well, the Constitution of the United States). It also held that any assessments, regular or special, made by virtue of the act of 1930, or any assessments which were made in December, 1928, April, 1929, or January, 1930, under the old law, were void as being confiscatory.

For the foregoing reasons it is the opinion of this office that the bank guaranty law of Nebraska and the Nebraska act of 1930 are no longer in force in so far as they provide for assessments against banks in that State, and that any amounts claimed to be deductible as assessments made in December, 1928, April, 1929, or January, 1930, and any amounts claimed to be deductible as assessments made under the provisions of the act of 1930, above, are not allowable as deductions, for income tax purposes, in the year 1930 or the year 1931.

C. M. CHAREST.
General Counsel, Bureau of Internal Revenue.

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

ARTICLE 141: Interest. XII-9-6047
(Also Section 42, Article 331.) I. T. 2679

REVENUE ACT OF 1928.

In the case of Maryland ground rents the annual rental on a redeemable ground rent is deductible as interest on a mortgage under the general provisions of section 23(b) of the Revenue Act of 1928. The annual rental on an irredeemable ground rent is deductible only as rent under section 23(a) of the Revenue Act of 1928.

No profit or loss is realized when an owner of real estate creates a ground rent by conveying the property in fee and taking a reconveyance by way of the usual 99-year lease.

When a ground rent is created on property in one year and conveyed by deed of lease in a subsequent year, gain is derived or loss is sustained in the subsequent year and is measured by the difference between the full selling price including the capital value of the ground rent and the cost or other basis in the hands of the vendor.

Advice is requested relative to the proper treatment of Maryland ground rents for income tax purposes. Attention is invited to the last sentence of the first paragraph of article 141, Regulations 74, and General Counsel's Memorandum 2042 (C. B. VI-2, 182). Certain questions are presented which will be answered.

Article 141, Regulations 74, provides:

* * * Payments made for Maryland or Pennsylvania ground rents are not deductible as interest but may, under proper circumstances, be deducted as rent.

In General Counsel's Memorandum 2042 (C. B. VI-2, 182) it was stated in the headnote as follows:

A transaction under which a deed of lease reserving a "ground rent" under the laws of Maryland was executed, held, for income tax purposes, to be a deferred payment sale of real estate on the installment plan, the redeemable ground-rent lease being in substance a mortgage. Recommended that Office Decision 1089 (C. B. 5, 98) be revoked.

It was also stated in the last paragraph of that memorandum as follows:

It is recommended that Office Decision 1089 be reversed. Article 121 of Regulations 45, 62, 65, and 69 is not to be taken as applying to ground-rent leases made in cases where the facts are similar to the facts considered in this memorandum.

Article 121 of the earlier regulations corresponds to article 141, Regulations 74.

In the case of *Pennsylvania Co. for Insurances on Lives and Granting Annuities* v. *Commissioner of Internal Revenue* (19 B. T. A., 699) it was held that where the petitioner sold real estate in Pennsylvania for part cash and for the balance reserved a ground rent, which the purchaser agreed to pay and extinguish on or before a fixed date, and which ground rent had a fair market value equal to the unpaid portion of the purchase money, the gain on the entire transaction measured by the excess of the selling price, including the capital value of the ground rent, over the cost or other basis was taxable in the year in which the sale was made. This decision was affirmed by the Circuit Court of Appeals for the Third Circuit. (*Pennsylvania Co., etc.*, v. *Commissioner*, 52 Fed. (2d), 601, Ct. D. 450, C. B. XI–1, 163.)

After a careful review of the subject and a full consideration of the various circumstances under which ground rents may be created, it appears that, except in the case of the old irredeemable Maryland ground rents created prior to the enactment of legislation in 1884 prohibiting the further creation of irredeemable ground rents, a ground rent is in substance a mortgage whether it is created at the time of the sale of property as in the case under consideration in General Counsel's Memorandum 2042 or whether it is merely placed upon property for the purpose of raising money. This being so, this office can see no consistency in treating the annual rental of a redeemable ground rent as interest on a mortgage in the case where the capital value thereof represents a part of the purchase price of property sold, and not treating it as interest on a mortgage in the case where a ground rent is put on property merely for the purpose of raising money. In the case of the old irredeemable ground rents, however, the situation is somewhat different for the reason that neither party, lessor or lessee, can require the redemption, or repayment of the capital value, and the motive back of their creation in the first instance was not substantially the same as that actuating the borrowing or lending of money on mortgages. Furthermore, it would be impossible at this late date to ascertain the circumstances under which any particular irredeemable ground rent was created. In the opinion of this office the redeemability of a ground rent is indicative of its similarity in substance to an ordinary mortgage transaction.

Therefore, in the case of redeemable ground rents the annual rental should be treated as interest, but in the case of irredeemable ground rents the annual rental should be treated as rental as provided in the last sentence of the first paragraph of article 141, Regulations 74.

The questions submitted are repeated and answered categorically as follows:

1. Is the annual "ground rent" allowable as a deduction for income tax purposes?

Answer. The annual rental on a redeemable ground rent is deductible as interest on a mortgage under the general provisions of section 23(b) of the Revenue Act of 1928. The annual rental on an irredeemable ground rent is deductible only as rent under section 23(a) of the Revenue Act of 1928.

2. Does an owner of real estate realize a profit or loss when he creates a "ground rent" by conveying the property in fee and taking a reconveyance by way of the usual 99-year lease?

Answer. No.

3. How and when should the profit or loss be determined when a real estate builder creates a "ground rent" on property in one year and conveys it by deed of lease in a subsequent year?

Answer. Gain is derived or loss sustained in the subsequent year and is measured by the difference between the full selling price, including the capital value of the ground rent (which for the purposes of the case is analogous to a mortgage being assumed by the purchaser), and the cost or other basis in the hands of the vendor.

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

ARTICLE 151: Taxes. XII-6-6018
(Also Section 131, Article 697.) I. T. 2675

REVENUE ACT OF 1928.

The taxpayer, a domestic corporation, is a majority shareholder of a Canadian corporation. In 1930 the taxpayer received royalties and dividends from its Canadian subsidiary. Both corporations use the accrual method of accounting. The taxpayer accrued as of December 31, 1930, the direct income taxes payable by it to Canada on the royalties received, and the Canadian subsidiary accrued the taxes on its 1930 income, from which income a part of its 1930 dividends was paid. Both taxes were accrued at the rate of 8 per cent under the law then in force. In 1931 Canada amended its income tax law and increased the rate to 10 per cent, such rate being retroactive and applicable to 1930 income.

The Canadian tax here involved should be treated as having accrued at the 10 per cent rate provided in the 1931 amendment, and as having accrued, both for deduction and credit purposes, as of December 31, 1930.

Advice is requested relative to the credit for foreign income taxes to which the M Company is entitled under section 131 of the Revenue Act of 1928.

The M Company, a domestic corporation, owns a majority of the voting stock of the O Company, a Canadian corporation, and comes within the provisions of section 131 of the Revenue Act of 1928, which permits the domestic corporation to claim the benefit of a credit for foreign taxes paid by its foreign subsidiary. During 1930 the domestic corporation received royalties from its Canadian subsidiary, as well as dividends from the same source. Both corporations use the accrual method of accounting. The domestic corporation accrued as of December 31, 1930, the direct income taxes payable by it to the Dominion of Canada on royalties received from Canadian sources, and the Canadian subsidiary accrued the taxes on its 1930 income, from which income a part of its 1930 dividends were paid. Both taxes were accrued at the rate of 8 per cent on income in excess of a $2,000 exemption, the rate of tax applicable to the income of corporations according to the Canadian income tax

law in force on December 31, 1930. Subsequently the Canadian Government amended its income tax law and increased the rate of tax on corporations to 10 per cent, such increased rate being retroactive and applicable to 1930 income.

Inquiry is made whether the credit for foreign income taxes paid on royalties should be based on the tax accrued under the statute in effect at the close of the taxable year for which the taxes are paid or whether it should be calculated on the amount actually paid for that year under a statute passed in a later year, and whether the credit for 1930 foreign income taxes deemed to have been paid should be at the 8 per cent rate in effect in Canada on December 31, 1930, or at the 10 per cent rate provided by a statute passed in 1931.

The situation presented in this case does not appear to differ greatly from that involved in *James Bliss Coombs et al., directors of Farjardo Sugar Co.*, v. *Commissioner* (17 B. T. A., 279). In that case the taxpayer was on the accrual basis and did business in Puerto Rico up to July 31, 1918. By an act of Puerto Rico approved June 26, 1919, the petitioner became liable for a tax on income for the period from January 1, 1918, to July 31, 1918. The Board of Tax Appeals held that the Puerto Rico tax had not accrued at the close of the petitioner's year on July 31, 1918, and that the petitioner was not entitled to a credit for such fiscal year by reason of the tax subsequently imposed upon it by the act of June 26, 1919.

The decision of the Board was appealed to the Circuit Court of Appeals for the Second Circuit and on January 5, 1931, the decision of the Board was affirmed per curiam. Subsequently, and after the decision by the United States Supreme Court in *Fawcus Machine Co.* v. *United States* (282 U. S., 375, Ct. D. 278, C. B. X-1, 424), the Circuit Court of Appeals for the Second Circuit, by a per curiam decision, reversed the Board's decision upon this point. This action was taken pursuant to a confession of error by the Government.

The Fawcus Machine Co. case involved the accrual for invested capital purposes of income taxes for the year 1918, and the validity of article 845 of Regulations 45, which provided in part as follows:

> Federal income * * * taxes are deemed to have been paid out of the net income of the taxable year for which they are levied.

The taxpayer in that case kept its accounts and filed its returns on the accrual basis. The Revenue Act of 1918 was not enacted until February 24, 1919, and the question there was whether the taxpayer should be made to reduce its invested capital for the calendar year 1919 by income and profits taxes computed at the rates provided in the Revenue Act of 1918. In that case the court sustained the validity of article 845 of Regulations 45, and stated as follows:

> Petitioner insists that article 845 is unreasonable as applied to 1918 taxes; that no one could know what those taxes would be at the close of the year, because the so-called Revenue Act of 1918 was not passed until February, 1919, and made changes in the rates. But the 1917 Act was in force, and required the payment of the same sort of taxes, and petitioner concedes it accrued its taxes for 1918 and set them up in a reserve at the end of the year. The Act of 1918 was retroactive and replaced the prior Act of October 3, 1917, and taxpayers understood that the policy of the United States with respect to income and profits tax was continuous. * * *

It seems evident from the foregoing that the Supreme Court regarded the operation of a retroactive taxing statute which imposes the same sort of taxes as being in the nature of an exception to the general rules relating to the accrual of income and deductions which were applied by the Supreme Court in *United States* v. *Anderson* (269 U. S., 422, T. D. 3439, C. B. V-1, 179), and followed by that court in numerous subsequent decisions. This construction permits a taxpayer to accrue retrospectively, for the year the income was earned, foreign income taxes which are retroactively imposed upon him for that year, thus avoiding the reduction of United States taxes for subsequent years by tax credits and deductions properly attributable to the income for the year to which the retroactive foreign tax relates.

Accordingly, on the basis of the Fawcus Machine Co. decision and the final action of the Circuit Court of Appeals for the Second Circuit in the Coombs case, supra, this office is of the opinion that the Canadian tax here involved should be treated as having accrued at the 10 per cent rate provided for in the 1931 amendment to the Canadian law, and not at the rate of 8 per cent. This office is also of the opinion that the taxes should be treated as accrued, both for deduction and credit purposes, as of December 31, 1930.

ARTICLE 151: Taxes.

XII-13-6095
I. T. 2685

REVENUE ACT OF 1928.

I. T. 2471 (C. B. VIII-1, 73), holding that the gasoline tax imposed by the State of Connecticut under the provisions of section 4 of the act of 1925, as amended, is deductible by the distributor who pays the tax, is limited in its application to years prior to 1931, in view of General Counsel's Memorandum 11635. (See page 31.)

ARTICLE 151: Taxes.

XII-19-6165
I. T. 2694

REVENUE ACT OF 1928.

The property taxes in the case of a transfer made in the State of Wisconsin on May 1, 1930, accrued on that date and are deductible by the vendor. The amount thereof if paid by the vendee is considered as a part of the cost of the property.

A ruling is requested relative to the deduction of real property taxes, as between buyer and seller, on certain parcels of real estate which were transferred in the State of Wisconsin as of May 1, 1930.

With respect to the accrual date of real property taxes under the Wisconsin Statutes of 1927, it has been held (I. T. 2633, C. B. XI-2, 77) that ownership of real property on the date (falling between May 1 and the first Monday in July of each year for cities, and between May 1 and the last Monday of June elsewhere in the State) as of which such property is actually valued for assessment purposes is the "event" which determines the liability for the tax. It was further held that where the tax had accrued prior to the purchase of the property it should be treated as a part of the cost of the property.

The Wisconsin Statutes of 1927 were amended in 1929. Section 70.06, Wisconsin Statutes, 1929, provides as follows:

70.06 *Assessment, when made.*—The assessor of each assessment district shall begin as soon as practicable after the April election, in assessment districts where an assessor is elected at such election, and in other assessment districts as soon as practicable after the 1st day of January in each year, and proceed to assess all the real and personal property liable to taxation in such district. Such assessment shall be completed, if possible, before the day set for the meeting of the board of review in each district but in any event, except in cities of the first class, shall be finally completed before the first Monday in August. All real and personal property shall be assessed as of the 1st day of May in such year * * *.

Section 70.17 of the Wisconsin statutes relating to real property and to whom assessed, provides that real property shall be entered in the name of the owner. Inasmuch as section 70.06, quoted above, relating to when the assessment shall be made, provides that all real property shall be assessed as of the 1st day of May, it follows that the owner of the property as of that date is the one against whom the property taxes are levied and who is primarily liable for taxes. In the instant case as the property was sold on May 1 the question arises whether the vendor or the vendee is entitled to receive the benefit of the deduction for the accrued taxes under section 23(c) of the Revenue Act of 1928. An apportionment of the taxes is not provided for by the State law and it is not to be inferred from any provision of the Federal income tax law. As both vendor and vendee can not be allowed a deduction for these taxes, the question arises relative to which shall be considered the owner of the property on May 1, 1930, in the instant case, and entitled to the deduction.

It is a general rule that fractions of days are not recognized in law, a day being considered a period of time from any midnight to the following midnight. (*Louisville* v. *Savings Bank*, 104 U. S., 469; *McGill* v. *Bank of the United States*, 12 Wheat., 511; *U. S.* v. *Edwin S. Hartwell Lumber Co.*, 142 Fed., 432.) In the space of a day all the 24 hours are usually reckoned; the law generally rejecting all fractions of a day, in order to avoid dispute. (Blackstone's Commentaries, Book II, page 141; *Fireman's Ins. Co.* v. *McGill*, 164 Ky., 621, 176 S. W., 27.) In computing time, or a given date, or event, the general rule is to exclude the day on which the act is done. (*Sheets* v. *Selden's Lessee*, 2 Wall., 177; *Hicks* v. *National Life Insurance Co.*, 60 Fed., 690.)

The Wisconsin law, as amended, sets May 1 as the date which shall control, both as to valuation of the property and the person against whom the liability for taxes shall accrue. Furthermore, section 74.01 of the Wisconsin statutes indicates that the lien for such taxes becomes effective May 1 in the year in which such taxes are levied, for it is provided in that section that logs cut from land after May 1 may be seized for unpaid taxes on the land wherever such logs may be. The Bureau, in pursuance of the rule laid down in *United States* v. *Anderson* (269 U. S., 422, T. D. 3839, C. B. V-1, 179), has consistently held that the event which determines the liability for property taxes is the ownership of the property on the day as of which the assessment is made under the State law. (See G. C. M. 6273, C. B. VIII-1, 168; I. T. 2495, C. B. VIII-2, 98; G. C.

M. 6667, C. B. VIII-2, 94; G. C. M. 6272, C. B. VIII-1, 170; G. C. M. 7190, C. B. VIII-2, 113; G. C. M. 8218, C. B. IX-2, 166.)

At the beginning of the day on May 1, 1930, the vendor in the instant case owned the property and the remaining fraction of the day should be disregarded, as he is presumed to have owned the property for the entire day. Thus, in so far as the vendee is concerned, the day of acquisition should be excluded. This view finds support in the decision of the Board of Tax Appeals in *Harriet M. Hooper* v. *Commissioner* (26 B. T. A., 758). In that case the Board held that in computing the period of time during which property must be held by a purchaser for "more than two years" under the capital net gain provision (section 208(a) of the Revenue Act of 1926), the purchaser of the property must exclude the date of acquisition by her.

The property taxes accrued in the instant case on May 1, 1930, and are deductible by the vendor. The amount thereof if paid by the vendee is considered as a part of the cost of the property. (S. M. 4122, C. B. V-1, 55; G. C. M. 7235, C. B. VIII-2, 197; I. T. 2633, supra.)

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

ARTICLE 206: Obsolescence.

REVENUE ACT OF 1928.

Ferryboats continued in service after construction of bridge. (See G. C. M. 10860, page 37.)

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

ARTICLE 236: Depletion—Adjustments of accounts based on bonus or advanced royalty.

REVENUE ACT OF 1928.

Depletion on the percentage basis. (See G. C. M. 11384, page 64.)

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

ARTICLE 261: Contributions or gifts by individuals.

REVENUE ACT OF 1928.

Contributions to the Military Training Camps Association. (See G. C. M. 11705, page 57.)

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

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

ARTICLE 331: When included in gross income.

REVENUE ACT OF 1928.

Ground rent created on property in one year and conveyed by deed of lease in subsequent year. (See I. T. 2679, page 103.)

ARTICLE 332: Income not reduced to possession. XII-5-6008
G. C. M. 11348

REVENUE ACT OF 1928.

Where a bank, which keeps its books on the cash receipts and disbursements basis, sets up a reserve each month for the estimated amount of interest due on savings accounts, known as "time deposits," the accrual of interest in the so-called reserve account does not constitute such interest a deductible item. The bank may deduct only the amount of interest actually credited to the accounts of its time depositors, and the depositors must report such interest as income.

An opinion is requested relative to the application of the provisions of article 332 of Regulations 74 in determining the amount of interest which may be deducted from the gross income of the M Company in connection with a proposed deficiency against the taxpayer for the year 1930.

The facts as set forth in the taxpayer's protest are as follows:

This taxpayer is in the banking business at the city of X, State of Y, and has on deposit various sums in savings accounts, otherwise known as "time deposits." During the year 1930 these savings accounts were about # dollars. Interest was payable upon these accounts during this year at the rate of 4 per cent per year. At the end of each calendar month the bank set up as a reserve the estimated amount of interest due on these accounts for that month. Once each six months the amount of interest due upon each individual account was entered as a credit to that individual account, and charged against the reserve theretofore set up. Up to and including the year 1929 these entries to the individual accounts had been made June 30 and December 31. In 1930 entries were made to the individual accounts for three months on April 1, 1930, and for six months' interest on October 1, 1930.

This interest is not paid out to the individual depositors, except at such time as they call for and withdraw their savings accounts. When such call is made, the depositor is paid the full amount of the interest up to the date of withdrawal, whether such date be on a day when credit is regularly made to his account (which would be a rare coincidence) or otherwise. The handling of the interest is altogether a matter of bookkeeping entries.

Taxpayer's returns were upon a cash receipts and disbursements basis. On its return for the year 1930 taxpayer deducted interest for 12 months on these savings accounts. * * *

The taxpayer states that at the end of each month a bookkeeping entry is made setting up accrued interest in a reserve account. Twice each year another bookkeeping entry is made setting up the interest in the account of the individual depositor. According to the taxpayer's brief, "He [the depositor] may come in any day that he

pleases (after furnishing the requisite notice, if his deposit is a time deposit) and interest up to that day is subject to his withdrawal, no matter what day it happens to be."

The opinion of this office is requested relative to the application of the decision of the Court of Claims in the case of the *Massachusetts Mutual Life Insurance Co.* v. *United States* (59 F. (2d), 116, Ct. D. 563, C. B. XI-2, 303) to the instant case, with specific reference to the following questions:

(a) Whether the taxpayer is entitled to deduct from its gross income the total amount of interest actually credited to the accounts of its time depositors during the year 1930;

(b) If the preceding question is answered in the negative, when is such interest deductible from the gross income of the taxpayer; and

(c) If the answer to the first question is in the negative, when are the time depositors required to report in gross income the interest credited to their accounts.

In the case of *Massachusetts Mutual Life Insurance Co.* v. *United States*, supra, it was held that a life insurance company, required by law and regulations to use the cash basis of accounting as distinguished from the accrual basis, may not deduct in 1926 interest credited to its policyholders in 1926 under the terms in the policies, although the policy contracts provided that the interest was subject to withdrawal on demand, and the policyholders were notified during the year of the amount of the interest so credited. In its opinion the Court of Claims used the following language:

Other than in the administration of estates or trusts, as to which the statute specifically provides for a deduction of credits under certain circumstances, we know of no instance, and none has been called to our attention, in which it has been held that an amount credited but not paid by a taxpayer employing the cash receipts and disbursements method of accounting constitutes income to the person to whom credited. It is not claimed that the interest credited by the plaintiff to its stockholders during 1926 was taxed as income to them in that year by the Commissioner. To hold that an amount credited by a taxpayer employing a cash receipts and disbursements method of accounting constitutes a payment, and is therefore deductible from gross income in the year in which credited, would destroy the distinction between the accrual and the receipts and disbursements methods of accounting which is recognized and made controlling by the revenue statutes. * * *

It is clear that the accrual of interest in the so-called reserve account does not constitute such interest a deductible item in the case of a taxpayer whose books of account are kept on the cash receipts and disbursements basis. Here the only question to be determined is the status of the interest actually credited to the accounts of depositors, i. e., whether the interest so credited may be considered as interest paid within the taxable year. It appears that the interest is credited on the depositors' accounts twice annually, at specified dates, instead of being paid in cash or by check, pursuant to an understanding or agreement between the bank and the depositors; and that the amount of the interest so credited becomes a part of the principal sum and bears interest from the date of the credit.

In banking the general rule in keeping the account of a depositor is that as money is paid in and drawn out a balance may be considered as struck at the date of each payment or entry, on either side of the account. (*Wasson* v. *Lamb*, 22 N. E., 729.) It is, of course, necessary that the bank should keep a correct entry in its books. Frequently depositors make use of what is known as the "pass book,"

in which entries are made corresponding to the entries made in the depositor's account on the books of the bank, and a balance is struck. From the entries thus made by the banker, the depositor is apprised of the state of his account. Such entry in the pass book is in effect an account stated between the bank and its depositor. (*Greenhalgh Co.* v. *Farmers' National Bank*, 226 Pa., 184, 134 Am. S. R., 1016, 75 Atl., 260.) In a note on this subject appearing in 134 Am. S. R., 1022, the law is stated as follows:

• • • Entries in a depositor's pass book striking a balance coupled with the delivery of the book to him, without objection on his part, constitute an account stated. (*Clark* v. *Mechanics' National Bank*, 11 Daly, 239; *August* v. *New York Fourth National Bank*, 1 N. Y. Supp., 139; *Leather Manufacturers' National Bank* v. *Morgan*, 117 U. S., 96, 6 Sup. Ct. Rep., 657, 29 L. Ed., 811.) And the proposition stands even on a firmer base, if, as is often done, the bank has returned to the customer his checks with the account of the balance. • • • *The mere fact that the account contains interest charges for which, of course, no checks have been drawn, does not impair the status of the account.* (*Schoonover* v. *Osborne*, 108 Iowa, 453, 79 N. W., 263.) [Italics supplied.]

In the Massachusetts Mutual Life Insurance Co. case, supra, the amounts credited to the policyholder's account do not become income to him until he elects to exercise the option afforded under the policy contract of taking same in cash, rather than to permit it to remain subject to the disposition of the company under the terms of the policy contract.

In the case of bank accounts, such as those involved in the instant case, the crediting of interest to the account of the depositor and the striking of a new balance upon which interest thereafter is computed constitutes, in the opinion of this office, a result that must be regarded as conclusive, since the account can not be reopened by a party seeking a different result except by mutual agreement or by clear and satisfactory evidence of error, fraud, or mistake. (See *Chappedelaine* v. *Dechenaux*, 4 Cranch, 306, and other cases cited therein.)

The crediting of interest to policyholders on the books of an insurance company in no sense presents a situation parallel to that under consideration in the instant case where a bank, by crediting interest on certain agreed due dates to the accounts of its depositors, in effect "deposits" the amount of the interest to such accounts. It would seem, on the contrary, that the credits involved in the instant case constitute, both for legal and practical purposes, that kind of deposit, peculiar to the banking business, in which the depositor, for his own convenience, parts with the title to his money and loans it to the banker; and the latter, in consideration of the loan of the money and the right to use it for his own profit, agrees to refund the same amount, or any part thereof, on demand. (See *Marine Bank* v. *Fulton Bank*, 2 Wall. (U. S.), 252, 256.) The only apparent difference between this and the ordinary deposit is that, by agreement or mutual understanding for the convenience of both parties, the formality of payment by cash or check and the actual deposit thereof by the depositor are dispensed with; and, as stated in 5 Cyc., 517 (IV):

The law presumes that a deposit belongs to the person in whose name it is entered, and the bank can not question his right thereto.

• • • When money is deposited in a bank it is said to be the debtor and the depositor the creditor. Yet in another sense the depositor is the owner and can at any time demand repayment. • • •

Moreover, the principles of law applicable to deposits, in so far as the status of credits to accounts of bank depositors are concerned for income tax purposes, appear to be the same whether the accounts relate to time deposit, checking, or savings accounts, where the amount of such credits becomes immediately available to the depositor or owner of the account.

Accordingly, it is the conclusion of this office that the taxpayer is entitled to deduct from its gross income only the amount of interest actually credited to the accounts of its time depositors during the year 1930, and the depositors must report such interest as income.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 44.—INSTALLMENT BASIS.

ARTICLE 351: Sale of personal property on installment plan. XII-25-6238 G. C. M. 11846

REVENUE ACT OF 1928.

The taxpayer, who was a stockholder in a corporation, sold his stock to a second corporation, receiving 25 per cent of the price in cash and the balance in notes of a third corporation.

Held, the payment in cash and notes of a third party constituted payments received in cash or property other than evidences of indebtedness of the purchaser, and installment classification must be denied.

The question presented is whether a sale of stock occurring in the year 1929 may be treated as an installment sale under section 44(b) of the Revenue Act of 1928 or whether the sale must be treated as a closed transaction in that year.

The M Company was formed in 1928 for the purpose of taking over a number of businesses owned or operated under leases by various individuals, corporations, and partnerships, including business places owned by the P Company. All of the stock in the P Company was owned by the taxpayer and B. The stock of these individuals was exchanged for stock in the M Company. The taxpayer became the president of the M Company, and the owner of —— shares of its outstanding stock. Early in 1929 the taxpayer and his associates conceived the idea of selling their business interests to the O Company. Negotiations continued until August, 1929, at which time a tentative deal was agreed upon. As a preliminary to the O Company transaction the taxpayer entered into a contract with the N Company pursuant to which the taxpayer agreed to sell his M Company stock to the N Company. The contract entered into between the taxpayer and the N Company was dated in 1929.

The taxpayer actually received in 1929 from the N Company, the purchaser, one-fourth of the purchase price in cash and three-fourths thereof in negotiable and nonnegotiable notes of the O Company. In his return for 1929 the taxpayer treated the transaction as an installment sale, reporting as income only a portion (approximately 75 per cent) of the cash received in that year. The revenue agent takes the position that by reason of the receipt of

notes of the O Company rather than notes of the purchaser, the N Company, the transaction may not be treated as an installment sale. The agent ascribes to the negotiable notes a fair market value of 90 per cent of their face, and to the nonnegotiable notes a fair market value of 85 per cent of their face, resulting in a taxable profit and a proposed deficiency for 1929.

The taxpayer urges that the contract of 1929 created a primary liability on the part of the N Company; that the notes of the O Company were not accepted in discharge of such primary liability but as additional security; that no *payments* (sufficient to constitute "initial payments") were received in 1929 other than cash in the amount of one-fourth of the purchase price; and that the transaction, therefore, qualifies as an installment sale. In support of his position the taxpayer claims that he expressly forbore from accepting the O Company notes in payment of the N Company's liability for the reason that the O Company was a State of R corporation; that if its notes had been received in complete payment of the purchaser's liability the taxpayer would have been required to sue the O Company in a foreign jurisdiction in case of default; that the taxpayer particularly intended and desired to, and in fact did, keep the liability of the N Company alive as an obligation of the buyer, a State of S corporation; that the purchaser agreed to keep the stock which was the subject of the sale in the State of S until the entire obligation was discharged; and that the fact that the purchaser was required to indorse and guarantee payment of the O Company notes indicated there was no intention on the part of the parties to the transaction to relieve the N Company from its primary liability as purchaser, or to give or receive the O Company notes in complete discharge of the primary liability created by the contract. The taxpayer cites numerous cases, including cases of the Supreme Court of the United States, holding that acceptance by a creditor of a note of a third person raises no presumption that it is received in payment, and that under the well established law of the United States and the State of S, delivery to a creditor of the note of a third person to meet an antecedent indebtedness is not payment of the debt unless it clearly appears that such was the intention of the parties. This argument, obviously, is based upon the theory that the word "payments" in the last sentence of section 44(b) of the Revenue Act of 1928 means only cash or property given and received in complete satisfaction and discharge of the obligation of a purchaser.

This office does not agree with the taxpayer's interpretation of the concluding sentence of section 44(b). That sentence states that the term "initial payments" means "payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made." The word "payments," standing alone, might be given the interpretation contended for. "Payments received in cash or property other than evidences of indebtedness of the purchaser * * *," mean, however, something more than property which a taxpayer might have chosen to accept in complete satisfaction and discharge of his claim against the purchaser. The phrase has been consistently interpreted by the Bureau to include any property, other than a purchaser's notes or promises to pay, received by a vendor in the taxable period in which a sale is made.

In *Lucas* v. *Schneider* (47 Fed. (2d), 1066, Ct. D. 341, C. B. X-1, 230) the vendor sold property subject to two mortgages which were in excess of the basis of the property to the vendor and which had been placed on the property shortly before the sale. The purchaser assumed and agreed to pay the mortgages as part consideration for the sale. The problem was how to treat the excess of the mortgages assumed over the basis. The Government contended such excess was part of the "initial payments" and when added to cash received made the "initial payments" exceed 25 per cent of the selling price, thereby precluding installment sale classification. In the Circuit Court of Appeals, Sixth Circuit, the Government prevailed. The court pointed out that as between the seller and purchaser, the assumption of the mortgages, constituted the seller the surety and the purchaser the principal debtor to the mortgagee. The court held that the assumption of the mortgages was a contract right and was property other than evidences of indebtedness of the purchaser; and that the excess of the value of such contract right over the basis constituted income. Thus the Government was sustained in its contention that the excess of the assumed mortgages over the basis constituted a part of the "initial payments."

The regulations of the Bureau (article 44 of Regulations 69) requiring the treatment of the excess of an assumed mortgage over the basis as part of the initial payments were also upheld in *Burnet* v. *S. & L. Building Corporation* (288 U. S., 406, 53 S. Ct., 428, Ct. D. 651, page 195, this Bulletin).

The decision of the Board of Tax Appeals in the appeal of *Georgia-Florida Land Co.* v. *Commissioner* (16 B. T. A., 1253, C. B. X-2, 26) does not support the taxpayer's position. In that case the Board held that whether a third person's notes are given directly to a vendor in payment of a purchaser's liability, or are given directly to the purchaser and by him indorsed to the vendor, they constitute payments in cash or property other than evidences of indebtedness of the purchaser, and are, therefore, part of the initial payments. To the same effect is *J. W. Elmore* v. *Commissioner* (15 B. T. A., 1210).

It is pertinent to state that the Bureau's interpretation of section 44(b) of the Revenue Act of 1928 appears to be the one most capable of general and uniform application in the administration of the Revenue Acts. Were the taxpayer's theory adopted, the classification of a transaction like that here considered as an installment sale might depend upon whether the *lex loci contractus* regarded the giving of the third person's note as payment or simply the furnishing of additional security. Again, classification of a sale might turn upon whether the parties agreed between themselves that a third person's note should constitute payment or additional security. The determination of this issue might easily involve questions of intent or of whether minds met on the point, and thus require extensive consideration of each contract and its attendant circumstances. Congress intended, it is believed, to enact a simple test, capable of broad and general application, when it provided that if there is received by a seller cash or property (other than evidences of indebtedness of the purchaser) not in excess of 40 per cent of the selling price, the transaction may at the election of the seller be treated as an installment sale. The application of this simple test in the general administration of the revenue law should not be complicated

by the adoption of a construction of "payments" raising involved and confusing questions both of fact and law, unless clearly necessary. As disclosed by the decisions hereinbefore cited, the Bureau has consistently applied the one simple test, has consistently construed "initial payments" as herein indicated, and has been sustained by the Board and the courts. In the opinion of this office there is no occasion to change the rule.

It must, therefore, be held that the O Company notes constituted payments received in property other than evidences of indebtedness of the purchaser during the taxable period in which the sale was made, and constituted part of the "initial payments" received by the taxpayer, from which it follows that installment classification must be denied.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 352: Sale of real property involving deferred payments.

REVENUE ACT OF 1928.

Sole test whether profit may be reported on the installment plan. (See I. T. 2691, page 52.)

ARTICLE 353: Sale of real property on installment plan. XII-1-5974 T. D. 4360

INCOME TAX.

Sale of real property on installment plan.—Article 45 of Regulations 69 and article 353 of Regulations 74 amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 45 of Regulations 69 and article 353 of Regulations 74 are hereby amended by the elimination of the second paragraph of each article and the substitution for the paragraph eliminated of a paragraph reading as follows:

If the vendor had retained title to the property and the purchaser defaults in any of his payments, and the vendor repossesses the property by agreement or process of law, the difference between (1) the entire amount of the payments actually received on the contract and retained by the vendor and (2) the sum of the profits previously returned as income in connection therewith and an amount representing what would have been a proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property during the period the property was in the hands of the purchaser had the sale not been made, will constitute gain or loss, as the case may be, to the vendor for the year in which the property is repossessed, and the basis of the property in the hands of the vendor will be the original basis at the time of the sale. If the vendor had previously transferred title to the purchaser, and the purchaser defaults in any of his payments and the vendor reacquires the property, such reacquisition shall be regarded as a transfer by the vendor, in exchange for the property, of such of the purchaser's obligations as are applied by the vendor to the purchase or bid price of the property. Such an exchange will be regarded as having resulted in the realization by the vendor of gain or loss, as the case may be, for the year of reacquisition, measured by the difference between the fair market value of the property

reacquired and the basis in the hands of the vendor of the obligations of the purchaser which were applied by the vendor to the purchase or bid price of the property. The basis in the hands of the vendor of the obligations of the purchaser so applied will be the excess of the face value of the obligations over an amount equal to the income which would be returnable were the obligations satisfied in full. The fair market value of the property reacquired shall be presumed to be the amount for which it is bid in by the vendor in the absence of clear and convincing proof to the contrary. If the property reacquired is subsequently sold, the basis for determining gain or loss is the fair market value of the property at the date of reacquisition.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved December 23, 1932.

OGDEN L. MILLS,
Secretary of the Treasury.

SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A.—RATES OF TAX.

SECTION 101.—CAPITAL NET GAINS AND LOSSES.

ARTICLE 501: Definition and illustration of capital net gain. XII-8-6036 I. T. 2678

REVENUE ACTS OF 1921, 1924, 1926, AND 1928.

I. T. 2488 (C. B. VIII-2, 127), which holds that the gain derived from stock of a corporation "called in," or the gain derived from bonds as the result of their maturity or redemption before maturity, where such stock or bonds have been held for more than two years, may be taxed as a capital net gain, is revoked, in so far as inconsistent with the decision of the Board of Tax Appeals in *John H. Watson, jr.*, v. *Commissioner* (27 B. T. A., 463, page 13, this Bulletin).

ARTICLE 501: Definition and illustration of capital net gain. XII-17-6143 G. C. M. 11645

REVENUE ACTS OF 1921, 1924, 1926, AND 1928.

Where the stock rights are sold, in determining the period for which the taxpayer has held the property, there should be included the period for which he held the stock with respect to which the rights were issued.

When at the time of the sale of the new share acquired by the exercise of stock rights, the old share has been held more than two years but the new share has not, the portion of the new share carried over from the old stock should be recognized as constituting a "capital asset," within the meaning of the capital gain provisions, and the total gain or loss on the sale of the new share should be allocated to the old and new portions of the property sold.

General Counsel's Memorandum 10063 (C. B. X-2, 159) modified.

An opinion is requested whether the capital net gain provisions of the Revenue Act of 1928 are applicable to the stock rights which were issued May 1 and sold July 1, the original stock having been held for more than two years.

In General Counsel's Memorandum 10063 it was held, following the Board's opinion in the case of *Rodman E. Griscom* v. *Commissioner* (22 B. T. A., 979), that stock acquired by the exercise of stock rights must itself be held for more than two years in order to constitute "capital assets," so that the 2-year period begins to run from the date of acquisition of the stock acquired through exercise of the rights and not from the date of acquisition of the stock with respect to which the rights are issued. Accordingly, I. T. 1786 (C. B. II-2, 45), which had held that it was sufficient if the original stock had been held more than two years, was revoked (I. T. 2609, C. B. X-2, 339). However, neither I. T. 1786 nor General Counsel's Memorandum 10063 made any ruling with respect to the case where the stock rights are sold instead of being exercised.

Where the stock rights are sold, it is the opinion of this office that in determining the period for which the taxpayer has held the property, there should be included the period for which he held the stock with respect to which the rights were issued. In *Miles* v. *Safe Deposit Co.* (259 U. S., 247, Ct. D. 29, C. B. I-1, 72) the court stated:

> The right to subscribe to the new stock was but a right to participate * * * in the privilege of contributing new capital called for by the corporation—an equity that inheres in stock ownership under such circumstances as a quality inseparable from the capital interest represented by the old stock * * *. The stockholder's right to take his part of the new shares therefore—assuming their intrinsic value to have exceeded the issuing price—was essentially analogous to a stock dividend. * * *

The regulations have provided from the beginning that if the taxpayer has held for more than two years stock upon which a stock dividend has been declared, both the original and the dividend shares are considered to be capital assets, and it is the opinion of this office that the same treatment must be accorded to the sale of stock rights which are analogous thereto.

Reconsideration of General Counsel's Memorandum 10063 has also been requested. General Counsel's Memorandum 10063, as before stated, followed the Griscom case in holding that where new stock is acquired through the exercise of stock rights the 2-year period for the new stock begins to run from the time such stock is acquired and not from the time of acquisition of the original stock. I. T. 1786, supra, was, therefore, revoked.

When the stockholder exercises the rights, acquires new stock, and then sells such stock, the situation is very different from that existing when the stockholder sells the rights. The stock rights, themselves, are purely an outgrowth of the old stock in the nature of stock dividends, and the Supreme Court's theory of stock dividends, when applied to the sale of stock rights, may reasonably be said to lead to the conclusion that the "property" the stock rights represent is essentially the same "property" the stockholder had all along, and that consequently the stock rights, which come to him without effort on his part and which represent no new investment in the corporation, have been "held" by the stockholder for the

same period that he has held the original stock. On the other hand, when a stockholder exercises the right to subscribe to new stock and pays the subscription price therefor he has made a new contribution of capital to the company, and at least such portion of the new stock as represents this additional investment constitutes property which is not acquired or "held" by him until he exercises the right to subscribe and secures the new stock. Ordinarily the undivided portion of the new stock representing the additional investment is much greater in amount than is the portion of the new stock which may be said to represent the stock right, and, through it, the old stock. Therefore, it would be letting the "tail wag the dog" to hold that the new share must be deemed to have been held as long as the old share simply because a small part of the new share may be looked upon as having been acquired when the original share was acquired.

Indeed, there is a strong technical argument that no part of the new share is acquired as *such* until the stock right is exercised, and, since the identical "property" sold must ordinarily have been held the required period in order to constitute a "capital asset," it does not necessarily follow that any part of the new share is a capital asset simply because the stock right was so regarded. A stock right is essentially an option to acquire new shares on the condition precedent of contributing additional capital. Thus, in *Miles* v. *Safe Deposit Co.*, supra, the Supreme Court said that the stock right "was in effect an opportunity * * * to share in contributing additional capital," and that "so far as the issuing price was concerned, payment of this was a *condition precedent to participation* * * *." [Italics supplied.] If the stock right option is not exercised by contributing the additional capital, the stockholder never acquires the new share, and his stock right will be lost to him, either by sale or lapse of time. Hence, there is considerable ground for the view that no part of the new share is acquired as such until the condition precedent is performed, even though it be true that once it has been performed the stock right is in effect incorporated in the new share.

However, it is more consistent with the method used by the Bureau in computing the basis of the new share to hold that the part of the new share which represents the stock right has been held as long as the original share was held, and General Counsel's Memorandum 10063 is modified to conform to the opinion herein expressed.

Therefore, when at the time of the sale of the new share the old share has been held for more than two years but the new share has not, the portion of the new share carried over from the old stock should be recognized as constituting a "capital asset," within the meaning of the capital gain provisions, and the total gain or loss on the sale of the new share should be allocated to the old and new portions of the property sold. This principle of allocation has been recognized for capital gain purposes in a similar situation, both by the Bureau and by the Board. (See I. T. 2469, C. B. VIII-1, 158; *Helen M. Dunigan, Admx.*, v. *Commissioner*, 23 B. T. A., 418, C. B. X-2, 20.) Several methods of allocation have been considered by this office, and the one which seems to achieve the most accurate result is given below.

Assume that the taxpayer owns 1 share of stock and that for each original share the corporation issues a right to acquire 1 new share, the dates and figures being as follows:

Cost of original share, purchased on March 1, 1913	$21
Market value of old share (ex rights) on issuance of right, January 1, 1926	85
Market value of right on issuance	14
Cost of old share apportioned to it after issuance of right (35/49 of 21)	15
Cost of old stock apportioned to stock right (14/49 of 21)	6
Subscription price of new share	20
Basis of new share (20+6)	26
Fair market value of new share when taxpayer exercises his stock right on March 1, 1926	32
New share sold on January 1, 1928, for	12
Total loss on new share (26−12)	14

The basis of the new share for gain or loss is the subscription price of $20, plus such portion of the cost of the old stock as was apportioned to the stock right, and, therefore, the basis of the new share is in effect composed of a new element having a basis of $20 and an old element having a basis of $6. The problem is to discover what portion of the loss of $14 may fairly be said to be attributable to the old element. Now the old element has a *basis* of $6, but since the market value of the new share was $32 when the stock right was exercised, and since only $20 was paid for such share, it may fairly be said that when the stock right was exercised the old element in the new share had an actual value of $32−$20, or $12, and that 12/32 of the amount finally received for the new share is received for the old investment and 20/32 is received for the new investment. The new share sold for $12, and 12/32 of $12, or $4.50, is therefore received for the old investment, and 20/32 of $12, or $7.50, is received for the new investment. Since the old investment had a basis of $6 and was sold for $4.50, the loss on the investment held for more than two years is $1.50. The investment held for less than two years has a basis of $20 and was sold for $7.50. The loss on this investment is, therefore, $20−$7.50, or $12.50.

All the values used in the above computations are on record for use in computing the basis of the new share, except the market value of the new share at the time the right is exercised. If this value is not known or is not readily obtainable the market value of the new share at the time the right is *issued* may be used, and unless the contrary appears such value may be assumed to be the subscription price of the new share, plus the market value of the one or more rights which are required in the particular case in order to obtain the new share. Thus in the example originally given, the market value of the new share at the time the right is issued would be $20+$14, or $34, and 14/34 of the $12 received for the new share would be received for the old investment and 20/34 for the new investment. The basis of the old and new investments would be $6 and $20 as before.

The objection to using the market value of the new share at the time the right is *issued* instead of at the time it is exercised, is that between the time the right is issued and the time it is exercised the value of the right may rise or fall, and since the particular stockholder in question has not yet put in his new capital this change in value, so far as he is concerned, is in reality all attributable to his

old investment, whereas the change is in fact allocated between the old and new investments if the market value of the new share at the time the right is issued is used for the computation. However, in the ordinary case the market value of the right will not greatly change between the time it is issued and the time it is exercised, and even if it has, the final result will usually be more accurate than is attained either under I. T. 1786 or General Counsel's Memorandum 10063.

C. M. CHAREST.
General Counsel, Bureau of Internal Revenue.

ARTICLE 501: Definition and illustration of capital net gain.

REVENUE ACT OF 1928.

Sale of stock received by members of a partnership in exchange for the partnership assets. (See G. C. M. 11557, page 128.)

SECTION 103.—EXEMPTIONS FROM TAX ON CORPORATIONS.

ARTICLE 521: Proof of exemption.

REVENUE ACT OF 1928.

Holding corporation paying income to several organizations each of which is entitled to exemption under one or the other of the subsections of section 103 of the Revenue Act of 1928. (See G. C. M. 11817, page 56.)

ARTICLE 525: Building and loan associations and cooperative banks. XII-13-6096 G. C. M. 11653

REVENUE ACT OF 1928 AND PRIOR REVENUE ACTS.

General Counsel's Memorandum 8090 (C. B. IX-1, 128), holding that the principle announced in *United States* v. *Cambridge Loan & Building Co.* (278 U. S., 55, T. D. 4252, C. B. VII-2, 290) does not apply to a rural loan and savings association under the laws of Indiana, is revoked, in view of the Commissioner's acquiescence in the Board of Tax Appeals decision in *Guaranty Building & Loan Co.* v. *Commissioner* (page 6, this Bulletin).

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 527: Religious, charitable, scientific, literary, and educational organizations and community chests.

REVENUE ACT OF 1928.

Military Training Camps Association. (See G. C. M. 11705, page 57.)

ARTICLE 530: Social clubs.

REVENUE ACT OF 1928.

Mountain improvement club. (See I. T. 2693, page 59.)

ARTICLE 532: Farmers' cooperative marketing and purchasing associations, and corporations organized to finance crop operations.

XII-22-6200
G. C. M. 11068

REVENUE ACTS OF 1926 AND 1928.

The distribution by a farmers' cooperative association of certain rebates only to those patrons who paid an annual membership fee does not involve a discrimination between members and nonmembers which would justify a denial of exemption. The fact that the amount of patronage refund due the patron is not set up as a credit to the name of the individual patron is not material where its permanent records clearly reflect the amount due the patron which will be paid upon compliance with uniform requirements.

An opinion has been requested whether the M Corporation, the N Association and the O Company are entitled to exemption under the provisions of section 231(12) of the Revenue Act of 1926 and section 103(12) of the Revenue Act of 1928.

The M Corporation was formed during the year 1925 as a subsidiary of the N Association to furnish financial, managerial, and other services in connection with various marketing operations of individual farmers' cooperative organizations and affiliated agencies in the State of R. All the common stock of the corporation, which carries voting privileges, is owned by the N Association and the activities of the corporation are, in effect, the activities of the N Association. The actual activities of the corporation consist of providing such services and facilities to the various county farm bureaus and their individual members as will enable them collectively to market their products and purchase their supplies and equipment to the best advantage.

The N Association is an unincorporated association, the membership of which is made up of representatives of the various county farm bureaus in the State of R. Voting control of the association rests with the county farm bureaus, which in turn are controlled by their individual members. Through its subsidiary, the O Company, the N Association markets the products of producers and purchases supplies and equipment for them. Business is transacted with both members and nonmembers, the value of the business transacted with nonmembers being less than that transacted with members. The income of the association consists of its portion of the membership dues and fees paid by the individual members of the various county farm bureaus in the State of R.

The O Company was formed for the purpose of buying, selling, and dealing in agricultural products and supplies of every kind as an agency of the N Association, and its capital stock is all owned by the M Corporation. Any profits earned are returned to the N Association, which in turn distributes such profits to the county farm bureaus of the State which make up its membership.

An examination of the books of the M Corporation was made by a revenue agent, who concluded that the corporation was not entitled to exemption for the reason that it did not treat members and nonmembers alike in so far as the distribution of patronage refunds is concerned. Specifically, it appeared from the books of the corporation that certain rebates were received on purchases of fertilizer which were not returned to nonmember patrons on the basis of purchases made by them. The facts are that the corporation distributed certain rebates, received originally from a fertilizer manufacturer, only to those who had paid an annual membership fee. One-half of this membership fee is retained by the county unit and one-half is remitted to the N Association. When the roll of patrons was made up at the end of 1929 there were excluded from this roll all patrons who had failed to qualify by the payment of the membership fee. It further appears that the particular patrons to whom the patronage dividend was available were known to the corporation and the amount due each will be paid when the qualifying membership fee is paid.

It is the opinion of this office that the requirement that patrons pay a reasonable membership fee, which is used to finance the operations of the cooperative organization, is no more than a requirement that those who avail themselves of the facilities offered by the cooperative organization pay their share of the cost of the operation of the organization. Obviously, until such cost of operation is determined and deducted there is nothing which the cooperative organization could, under the law, be required to distribute as a patronage refund to patrons. Therefore, where a patron has failed to meet his share of the cost of operation by the payment of the required membership fee, the cooperative organization is justified in withholding any refund which would otherwise be due the patron and applying it in whole or partial liquidation of that obligation.

It is, accordingly, the opinion of this office that the method of distributing the rebates here in question does not involve a discrimination between members and nonmembers which would justify the Bureau in denying the organization exemption. It is further the opinion of this office that the fact that the amount of patronage refund due the individual patron is not set up as a specific credit to him, is not material where the permanent records of the corporation clearly reflect the amount due the patron, which amount will be paid upon compliance with the uniform requirements of the cooperative organization.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 105.—TAXABLE PERIOD EMBRACING YEARS WITH DIFFERENT LAWS.

REVENUE ACT OF 1928.

Computation of tax liability of an affiliated group of corporations for a fiscal year ended in 1929. (See I. T. 2686, page 142.)

SECTION 111.—DETERMINATION OF AMOUNT OF GAIN OR LOSS.

ARTICLE 561: Determination of the amount of gain or loss.

REVENUE ACT OF 1928.

Election to capitalize "delay rentals" as carrying charges made prior to 1927 and prior to amendment of article 561 by Treasury Decision 4321 (C. B. X-2, 169). (See G. C. M. 11197, page 238.)

ARTICLE 561: Determination of the amount of gain or loss.

REVENUE ACT OF 1928.

Requirements for the allowance of estimated cost of future improvements to real estate. (See Mim. 4027, page 60.)

SECTION 113.—BASIS FOR DETERMINING GAIN OR LOSS.

ARTICLE 591: Basis for determining gain or loss from sale. XII-24-6225 G. C. M. 11878

REVENUE ACT OF 1928.

In 1929 the taxpayer issued to its stockholders the right to subscribe to new shares. The market price depreciated below the offering price and the company announced its readiness to refund subscriptions made in advance of the expiration date.

Held, the issuance and receipt of the rights had no effect upon the corporation or the interest of any shareholder. No adjustment in the basis of the stock held should be made, regardless of whether a stockholder failed to sell, exercise, or surrender his rights, or surrendered his rights to the corporation, or attempted to exercise his rights and thereafter received a refund of the subscription price.

In 1929 directors of the M Company authorized the offering to common stockholders of the right to subscribe, on or before a stated date, at $—— a share, for additional common stock in the ratio of 1 share for each —— shares of common stock held.

At the time the offering was made the rights were of substantial value to the stockholders, but with the change in market conditions they depreciated so rapidly that the company announced that it was ready to refund subscriptions made in advance of the expiration date. Prior to that date the common stock depreciated to a price below the subscription offer.

Advice is requested relative to what adjustment should be made to the basis of stock in respect of which stock rights were issued in 1929 by the M Company, in the following cases:

1. Where a stockholder failed to sell, exercise, or surrender his rights.

2. Where a stockholder surrendered his rights to the corporation.
3. Where a stockholder exercised his rights, subscribing for the new stock, his subscription later being returned to him by the corporation.

Attention is directed to *Miles* v. *Safe Deposit & Trust Co. of Baltimore* (259 U. S., 247, 42 S. Ct., 483, Ct. D. 29, C. B. I–1, 72), wherein the Supreme Court made the following statement concerning the nature of stock rights:

> It is not in dispute that the Hartford Fire Insurance Co. is a corporation of the State of Connecticut and that the stock increase in question was made under authority of certain acts of the legislature and certain resolutions of the stockholders, by which the right to subscribe to the new issue was offered to existing stockholders upon the terms mentioned. It is evident, we think, that such a distribution in and of itself constituted no division of any part of the accumulated profits or surplus of the company, or even of its capital; it was in effect an opportunity given to stockholders to share in contributing additional capital, not to participate in distribution. It was a recognition by the company that the condition of its affairs warranted an increase of its capital stock to double the par value of that already outstanding, and that the new stock would have a value to the recipients in excess of $150 per share; a determination that it should be issued pro rata to the existing stockholders, or so many of them as would pay that price. This privilege of itself was not a fruit of stock ownership in the nature of a profit; nor was it a division of any part of the assets of the company.
>
> The right to subscribe to the new stock was but a right to participate, in preference to strangers and on equal terms with other existing stockholders, in the privilege of contributing new capital called for by the corporation—an equity that inheres in stock ownership under such circumstances as a quality inseparable from the capital interest represented by the old stock, recognized so universally as to have become axiomatic in American corporation law. [Citing cases.] Evidently this inherent equity was recognized in the statute and the resolution under which the new stock here in question was offered and issued.
>
> The stockholder's right to take his part of the new shares therefore—assuming their intrinsic value to have exceeded the issuing price—was essentially analogous to a stock dividend. So far as the issuing price was concerned, payment of this was a condition precedent to participation, coupled with an opportunity to increase his capital investment. In either aspect, or both, the subscription right of itself constituted no gain, profit or income taxable without apportionment under the sixteenth amendment. *Eisner* v. *Macomber* (252 U.S., 189) is conclusive to this effect.

The situation here presented is in some respects the converse of that discussed in the foregoing portion of the opinion of the Supreme Court. In the Miles case it appeared that the intrinsic value of a share of stock in the Hartford Fire Insurance Co. exceeded the issuing or subscription price, and it was therefore advantageous to acquire additional stock in the issuing company. In the instant case it appears that the value of the shares of stock in the M Company depreciated to less than the subscription price during the period in which the rights could be exercised, and that the company returned all subscriptions which it received during that period. Under such circumstances no shareholder contributed any additional capital to the issuing corporation through the exercise of any of the rights which were issued. The mere issuance of the rights did not in itself effect a division or dilution of any part of the capital or surplus of the M Company. Accordingly, it is the opinion of this office that the issuance and receipt of the rights had no effect upon the corporation or the interest of any shareholder in the corporation, in any of the situations presented. No adjustment in the basis of the stock held by any stockholder should, therefore, be made, regardless of

whether a stockholder failed to sell, exercise, or surrender his rights, or surrendered his rights to the corporation, or attempted to exercise his rights and thereafter received a refund of the subscription price.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 596: Property transmitted at death. XII-12-6080
G. C. M. 11309

REVENUE ACT OF 1928.

Under all the circumstances of the instant case, distribution occurred on the date set in the will for termination of the trust. General Counsel's Memorandum 6195 (C. B. VIII-1, 99), General Counsel's Memorandum 10200 (C. B. XI-1, 79), and General Counsel's Memorandum 10698 (C. B. XI-2, 106), modified. Recommended that I. T. 2539 (C. B. IX-1, 139) also be modified.

An opinion is requested relative to the method of determining the basis of certain personal property acquired as a result of a general bequest and sold in 1929.

It appears that the taxpayer's mother died on May —, 1900, leaving a will bequeathing the residue of her estate in trust for her son, D, until he should reach the age of 26 years, when the trustees were to convey the property to him absolutely. If the son should die before that time, the property was to go to others. The trustees had the right to sell the trust property and reinvest the proceeds as they thought proper.

On July 13, 1923, D became 26 years of age. On July 17, 1923, he signed a receipt stating that the surviving trustee had accounted to him in full and had turned over to him the trust property.

On July 19, 1923, the judge of probate signed an order discharging the trustee and authorizing him to transfer all certificates of stock to D.

Included among the shares of stock so transferred were 2.9*y* shares of the M Company and .536*y* shares of the N Bank, which were sold by D in 1929. No part of such stock had been owned by the testatrix, all of it having been acquired by the trustees at various times during the years 1910 to 1923. The file does not disclose the date when the stock was transferred on the corporate books from the name of the trustees to the name of D, although it is evident that this must have occurred some time after the court issued its order of July 19, 1923. It does appear that on July 17, 1923, D signed a document acknowledging receipt of the trust estate, but whether manual delivery had then occurred is not revealed. D states that he "acquired the above-mentioned shares of stock from the estate of his mother on or about July 13, 1923," and that "among the assets transferred by said trustee to D on or about July 13, 1923, were" the shares in question. He contends that the basis of the stock in his hands is the fair market value thereof at the "time of the distribution" to him of such stock, and that "distribution" occurred on July 13, 1923, citing the third sentence of section 113(a)5 of the Revenue Act of 1928.

In the case of *Ralph W. Harbison* v. *Commissioner* (2 B. T. A., 896, page 6, this Bulletin) the Board of Tax Appeals refused to adopt the Bureau's position that where the beneficiary has a substantially vested equitable ownership at the time of distribution to the trustee then distribution to the trustee is distribution to the beneficiary, and held that distribution to the beneficiary does not occur until the termination of the trust.

Under the Board's decision it is clear that distribution to the son in the instant case did not occur prior to July 13, 1923. It is also clear that distribution of corporate stock is not necessarily postponed until the stock is transferred on the books of the corporation, for the Board's findings of fact show that the stock was not so transferred until May 12, 1925, whereas "distribution" was held to have occurred on May 11, 1925. (To the same effect, see the district court's decision in *Brewster* v. *Gage*, 25 Fed. (2d), 915, reversed on another ground, 280 U. S., 327, Ct. D. 148, C. B. IX–1, 274, and the decision of the Board in the *Appeal of F. W. Matthiessen, jr.*, 2 B. T. A., 921, nonacquiescence C. B. V–1, 7, and the decision of the Court of Claims in *F. W. Matthiessen, jr.*, v. *U. S.*, 65 Ct. Cls., 484.)

It is immaterial that the stock was purchased by the trustees and was not originally a part of the decedent's estate, for the stock was presumably acquired with proceeds of property that did form a part of such estate. Furthermore, the committee reports expressly show that the third sentence of section 113(a)5 of the Revenue Act of 1928 was intended to apply to cases where property is purchased by an *executor* and distributed to the legatees. (Conference Report No. 1882, May 25, 1928, page 14; Senate Report No. 960, May 1, 1928, page 26.) A similar rule would naturally obtain where the purchase is by a testamentary trustee, once it has been conceded that distribution to the trustee is not distribution to the beneficiary.

Since the taxpayer has conceded that distribution occurred on July 13, 1923, when he became 26 years of age, and since, under the Harbison decision, distribution to him could not have occurred earlier, it is the opinion of this office that the basis of the stock in his hands is its fair market value on July 13, 1923.

General Counsel's Memorandum 6195, General Counsel's Memorandum 10260, General Counsel's Memorandum 10698, and all other similar opinions of this office, are modified so as to accord with the views herein expressed, and it is recommended that I. T. 2539 be similarly modified.

C. M. Charest,
General Counsel, Bureau of Internal Revenue.

Article 596: Property transmitted at death. XII–12–6081
I. T. 2684

REVENUE ACT OF 1928.

I. T. 2539 (C. B. IX–1, 139), relative to the basis to be used in computing the gain or loss from the sale of securities received from trustees under a testamentary trust, is modified so as to accord with the views expressed in General Counsel's Memorandum 11309 (page 126).

ARTICLE 603: Basis of property acquired during affiliation.

REVENUE ACT OF 1928.

Recognition of departmental practice in enactment of section 113(a)12, Revenue Act of 1928, with respect to basis where property is acquired by one affiliate from another. (See Ct. D. 659, page 68.)

ARTICLE 604: Readjustment of partnership interests. (Also Section 101, Article 501.)

XII-21-6190
G. C. M. 11557

REVENUE ACT OF 1928.

Determination of gain or loss basis and application of capital net gain provisions in connection with the sale of stock of a corporation received by members of a partnership in exchange for the partnership's assets.

In 1925 A and three others entered into articles of copartnership, wherein it was provided, inter alia, that the four partners would engage in business under the firm name of A & Co., that the object and purpose of the partnership would be the manufacture and sale of machinery and equipment, and that the respective interests of the partners in the property and income of the business would be as follows:

	Per cent.		Per cent.
A	33⅓	C	16⅔
B	33⅓	D	16⅔

In 1929 the four partners organized a corporation named the M Company, with an authorized capital stock of $7x$ shares of no par value, and 1 (qualifying) share of stock was issued to A, B, and each of five others. In 1929 at a meeting of the directors of the corporation officers were elected and a contract of sale, presented to the corporation by the partnership of A & Co., was accepted. In the contract it was provided that the first parties thereto (the four partners doing business under the names of A & Co.) as partners sold and conveyed certain assets therein named (all partnership assets, including lands, buildings, supplies, stock in trade, and good will, except —— dollars in notes and warrants of trade customers which were expressly reserved to the partnership) to the corporation in return for $6x$ shares of its capital stock. The partnership property was immediately deeded to the corporation and shares of corporate stock were issued directly to the four partners, substantially in the following amounts:

	Shares.		Shares.
A	$2x$	C	x
B	$2x$	D	x

Later in 1929 the deed of conveyance was executed by A as trustee and by A and his three associates as individuals and as partners trading under the firm name of A & Co.

After the receipt of stock in the M Company each of the four individuals made several sales thereof during 1929. The sales were treated in the returns of the taxpayers for the year 1929 as sales

of property held for more than two years, and each taxpayer elected to have resulting gain taxed at the rate of 12½ per cent under the provisions of section 101 of the Revenue Act of 1928.

This office is requested to give consideration and advice (1) relative to the basis for determining the profit upon the shares sold and (2) whether the profit is to be treated as ordinary income or capital gain.

In determining the right of the taxpayers to treat the profit from the sale of stock as capital gain, it is necessary to ascertain whether the stock constituted a capital asset within the scope of section 101(c)8 of the Revenue Act of 1928, which reads in part as follows:

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. For the purposes of this definition—

(A) In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged.

There is no question that the stock itself was not held by the taxpayers for more than two years, but it is contended that the stock was received upon an exchange in which no gain or loss was recognized to the taxpayers; that under such circumstances section 113(a)6 of the Revenue Act of 1928 requires the taxpayers to assign to the stock the basis of the property exchanged; and that under section 101(c)8(A) the period for which the property exchanged was held should be added to the period for which the stock was held, in determining whether the stock may be treated as a capital asset. These contentions require a careful analysis both of the events which actually occurred and of the principles which must be applied thereto.

The transferee corporation was formed in 1929 with 7 qualifying shares issued to the individuals mentioned above, who thereafter were chosen directors of the corporation. Later in 1929 at a meeting of the board of directors officers were elected. At the same meeting one of the directors offered a resolution and moved its adoption. The preamble to the resolution recited that A, B, C, and D, as partners doing business under the name of "A & Co.," had tendered and delivered to the corporation for its acceptance and execution a contract in writing (thereafter the contract was set out in full) and further recited that the property described in such contract was necessary for the business of the corporation, was of the value of the stock to be issued therefor, and that it was for the best interests of the corporation to acquire the property. It was then resolved that the corporation accept the proposition of the four partners, doing business under the name of A & Co., to sell to the corporation the partnership property described in the contract. It was further resolved that the officers of the company should accept and execute the contract and should accept delivery of and take possession of the

property therein described; that the officers of the company were thereby authorized and directed to issue and deliver to the four partners, or their assigns as might be authorized, duly executed certificates for no par common stock of the corporation; and that the officers of the company were further authorized and directed to take any and all steps that might be necessary to complete the transaction and to perform all the terms, conditions, and considerations required of the corporation. The motion to adopt the resolution was seconded and unanimously carried. Thereafter, the contract was declared accepted by and for the benefit of the corporation.

The contract of sale stated that it was an agreement executed between A, B, C, and D, as "partners doing business under the name of 'A & Co.,'" therein called first parties, and the corporation as second party. The contract recited that the first parties, as partners, for the consideration thereinafter named, did thereby sell, convey, assign, transfer, and deliver unto the second party, its successors and assigns, the following described property. There followed the description of certain pieces of real estate, which were therein contracted to be conveyed by deed, together with all rights, privileges, and appurtenances belonging to the said real estate, and all rights owned by the grantors in and to all railroad switches or railroad sidings passing on, over, or adjacent to the real estate or serving the same, and including the buildings and improvements on the real estate. There were specifically conveyed all machinery, jigs, tools, appliances, and equipment, including drawings, plans and specifications, factory fixtures, trucks and automobiles, inventories of merchandise, materials, parts, supplies, and finished products, whether in stock or on consignment or in warehouses or elsewhere, office furniture and fixtures, cash on hand and in bank, contracts with salesmen, agents, and customers, and all other property used by the parties in connection with the operation of the partnership business, excepting, however, and not including, notes and warrants of trade customers and municipalities and accounts receivable, aggregating $——, which were expressly reserved to the partnership. There was also conveyed the good will of the business of the first parties as a going concern.

The contract provided that the second party, the corporation, should issue and deliver to the first parties and/or to the persons, firms, or corporations designated by them in writing, 6x shares of the common capital stock of the second party, which should include the 7 shares of stock subscribed for by its incorporators.

It is clear, therefore, that in carrying out the agreement the partnership as such conveyed a substantial portion, but by no means all, of its assets to the corporation and in return received corporate stock to the extent of 6x shares. Moreover, it is clear that the partnership actually conveyed to the corporation real estate, buildings, and appurtenances thereon, tools and manufacturing equipment, and, in addition, inventories of merchandise, materials, supplies, and finished products wherever located, together with contracts of all kinds and good will of the business. Thus the "property exchanged" was partnership property, in which each partner owned an undivided interest, and in consideration thereof the partnership received 6x shares of stock in each of which shares each partner

likewise owned an undivided interest. The fact that certificates for the shares were issued by the corporation directly to the individuals does not minimize the fact that ownership of the corporate shares was acquired, although perhaps only for a brief period, by the partnership, and that the shares were then owned and held by the several partners in their undivided proportions.

With this background established, solution of the problems inherent in this case may be approached. The partnership transferred part of its assets to the corporation in consideration of all the issued and outstanding capital stock. This was undoubtedly a transfer to a corporation controlled by the transferor within the meaning and scope of section 112(b)5 of the Revenue Act of 1928, and the basis of the corporate stock to the transferring partnership was the same as the basis of the assets transferred under section 113(a)6 of the Revenue Act of 1928. Moreover, under section 101(c)8(A) of the Revenue Act of 1928, to the period for which the stock was held by the partnership there may be "tacked" the period for which the partnership property exchanged (in so far as it constituted capital assets or property which by the passage of time could become such) was held by the partnership. In this connection the partnership property conveyed to the corporation consisted at the time of capital assets or of property capable of becoming such by the efflux of time, and of other property, such as stock in trade or other inventoriable property, and goods, wares, and merchandise held by the partnership primarily for sale in the course of business, which kind of property is specifically denied classification as capital assets by section 101(c)8, supra.

Such denial is not arbitrary but is predicated upon the thought that as a general rule in merchandising establishments, particularly those successful enough to operate at a profit, stock in trade, inventoriable goods, and similar property held for sale will be acquired, sold, and replaced several times in the course of two years. Such "turnover" of stock in trade necessarily precludes it from classifying as a capital asset. Section 101(c)8 simply gives the force of a conclusive presumption to this reason. Therefore, the corporate stock received by the partnership in consideration of stock in trade or other inventoriable property, or goods, wares, and merchandise held primarily for sale in the course of business, can not be considered as a capital asset to the partnership, for such stock was not held by the partners for more than two years and the property exchanged therefor was incapable of classification as a capital asset. As to all other stock, the circumstances of the case appear to justify its classification as a capital asset to the partners, for the large majority of remaining assets transferred to the corporation appears to have been partnership property held for more than two years. Thus, for capital gain purposes, it will be necessary to determine the proportion of noncapital assets in the aggregate mass of property transferred to the corporation, and to regard a similar portion of the corporate shares as noncapital assets; the remaining shares (and probably the larger number) may be regarded as capital assets of the partnership.

The discussion in the preceding paragraph has referred to and treated the 6x shares of corporate stock as received by the partners

as such, although stock certificates were by the direction contained in the contract of sale issued directly to the partners in certain stipulated amounts. In this connection, the contract itself provided that the corporation "shall issue and deliver to *the first parties* (the four partners acting as such) and/or to the persons * * * designated *by them* in writing * * * shares of the common capital stock of the second party * * *." This requirement clearly indicates that the four partners, as such, received the corporate shares and dealt with such shares as partnership property, thereafter requiring the stock certificates to be issued to suit their own joint convenience. Hence the right of each partner in and to an undivided interest in all the shares became fixed, and it is necessary to determine what, in legal effect, occurred when the relative rights of the partners were so changed as to permit each partner to obtain a fee title to a portion of the shares and thereafter to deal with such portion as his own.

In Solicitor's Opinion 42 (C. B. 3, 61) it was stated that for income tax purposes the common law conception of a partnership as a group of individuals contributing to the partnership capital, money, property, or services, or two or more combined, should be adopted, rather than the more modern doctrine which treats a partnership as an entity distinct from the component individuals. The right of a partner in the partnership assets is not, under such theory, that of a tenant in common or a joint tenant, although partaking of some of the characteristics of both class of tenancies (see Rowley, Modern Law of Partnership, Volume I, sections 291 and 292); but is a right to share in profits, and to receive back his contribution, subject to losses. In such view, it seems clear that no partner has any right whatever to any particular piece or kind of partnership property. As the brief of the taxpayers states the rule, "while the title to the firm's property is in the partners because it must lodge somewhere, no one partner has a particular right in rem or a property ownership right in any specific asset of the partnership. For the purpose of this memorandum such statement is sufficiently accurate. This leads at once to the question of what transpired between the receipt of the corporate shares by the four partners, as such, and the sales by the four partners as individuals, to free such shares from the rights of the partners therein, as such, and to lodge the complete titles to four portions of the shares in the four partners so that each could deal with a portion as his own.

The answer to this question may be found in General Counsel's Memorandum 10092 (C. B. XI–1, 114), where, in speaking of a purchase by one partner of partnership property, it was stated as follows:

> It has been suggested that complications will arise in computing either gain or loss where partnership property is purchased by one of the partners. However, such a transaction, whatever form it may take and however it may be designated, is in reality nothing more than one partner buying the interest of his partner in such property. That is, in effect the property in question is liquidated in kind pro rata among the partners and then one partner buys the undivided interest of the other partner. The gain or loss to the partner who sells his undivided interest will be measured by the difference between the basis of such interest in the property and the proceeds from the

sale of such interest. The purchasing partner does not, of course, realize gain or loss upon the liquidation of an undivided one-half interest in the property in kind or the purchase of the other undivided one-half interest in the property, but the basis which the entire property takes in his hands will be the basis to him of the interest in the property which he acquired upon liquidation, plus the amounts actually expended by him in the purchase of the other partner's interest. For example, in the illustrative gain case first stated above assume that A reacquired the mill at its then value of $200,000. The bases of the undivided interests of A and B in the mill upon liquidation to them in kind are $5,000 in the case of A (one-half of his original cost basis of $10,000) and $50,000 in the case of B (one-half of his original cash contribution). The basis of the mill in A's hands is $5,000, the basis of the undivided interest liquidated to him, plus $100,000 paid to B for the undivided interest liquidated to him, or a total basis of $105,000. The gain to B upon the sale of his undivided interest to A is $50,000.

This statement was obviously based upon the theory that before any one partner can acquire a fee title to any single partnership asset, such asset must be treated as first distributed in kind, with the result that each partner receives his proportionate undivided interest therein, and that there must then follow a purchase by one and sale by other partners of their undivided interests in the asset. Applying such theory here, there occurred first a distribution in kind of the $6x$ shares, with the result that each partner received his relative and undivided interest in all the stock. Thereafter, by agreement, evidenced by the direction contained in the contract, each partner exchanged with the other partners his and their undivided interests in the number of shares necessary to satisfy his and their rights to participate proportionately in the partnership assets. For example, A received on the distribution in kind an undivided 33⅓ per cent interest in $6x$ shares of stock. He thereafter retained his undivided 33⅓ per cent interest in $2x$ shares, and made three exchanges. In one exchange he transferred to B an undivided 33⅓ per cent interest in a like number of shares in return for B's undivided 33⅓ per cent interest in the shares in which A retained his interest. In two other and separate exchanges A transferred to C and D his undivided 33⅓ per cent interest in two blocks of x shares of stock each, in return for the undivided 16⅔ per cent interest of each in the $2x$ shares in which A retained his undivided interest. Thus A obtained the undivided interest of his three partners in the property he desired to have and treat as his own, and by so adding such interests to his own retained interest he acquired a fee title. The other partners did likewise.

These exchanges after a distribution in kind to readjust partnership interests must be treated as any other exchanges of property rights, in so far as the application of the revenue laws is concerned. Income or loss may or may not be realized or sustained, or if realized or sustained may or may not be recognized, depending entirely upon the circumstances of the case. In the instant case, each partner, after the distribution in kind and before his adjusting exchanges, held an undivided interest in $6x$ shares of corporate stock at a certain basis, i. e., the cost or other basis of his share or interest in the partnership proportionately reduced to reflect the value of his share or interest in the remaining assets (the receivables) of the partnership. Each partner exchanged a portion of his undivided interest in the corporate stock for similar interests in identical stock. The interests parted with and received were so similar in nature and

character that it might be argued there was no realization of income or loss in the exchange thereof. It is unnecessary, however, to rest there. In any event, either section 112(b)1 or 112(b)2 of the Revenue Act of 1928 precludes recognition of gain or loss in such exchanges. If the exchange of undivided interests in common stock of a corporation may be likened to an exchange of common stock for common stock in the same corporation, section 112(b)2 forbids recognition of gain. If, however, such an exchange of undivided interests is not essentially similar to an exchange of common stock for common stock in the same corporation (because strictly regarded as an exchange of undivided interests in property), then certainly it constitutes an exchange of property held for productive use or for investment for property of like kind, and is relieved from recognition of gain or loss by section 112(b)1.

However regarded the result is the same—no gain or loss may be recognized. Each partner held after the exchanges a fee title to a certain number of shares at the same basis at which he held his prior undivided interest, i. e., the cost or other basis of the partnership interest or share (cf. G. C. M. 10092, supra) reduced by the amount necessary to reflect the remaining partnership share. It remains necessary, therefore, only to trace through these transactions the capital asset characteristics of the corporate stock when it vested in the partners as such, section 101(c)8(A) applying to these readjusting exchanges to permit "tacking" where proper.

As before shown, a portion of the 6x shares constituted noncapital assets, while the remainder constituted capital assets, due to the "tacking" provisions of section 101(c)8(A). The distribution of these shares in kind did not result in gain or loss (article 604 of Regulations 74) nor did such distribution change the characteristics of the stock for capital gain purposes. The only result was that each partner obtained an undivided interest in some capital assets and in some noncapital assets. In the subsequent exchanges each partner should be treated as retaining his undivided interest in a proportionate part of each kind of asset, and as obtaining through the exchange a fee title in corporate shares of both capital-asset and noncapital-asset classification. In short, of the shares finally obtained in fee by each partner a portion constituted capital assets and a portion constituted noncapital assets, in exactly the same proportions as when the entire block of stock was received by the four partners as such.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION.

ARTICLE 611: Basis for allowance of depreciation and depletion.

REVENUE ACT OF 1928.

Computation of allowance for obsolescence for 1931 in the case of bulk-freight vessels of the older types on the Great Lakes. (See G. C. M. 11092, page 65.)

SECTION 115.—DISTRIBUTIONS BY CORPORATIONS.

ARTICLE 629: Distribution in redemption or cancellation of stock taxable as a dividend. XII-2-5978 G. C. M. 11304

REVENUE ACT OF 1928.

In 1927 the stockholders and directors authorized an increase of capitalization of the M Company to include $4x$ dollars preferred stock and the distribution thereof as a stock dividend, which was effected. Almost immediately a redemption of this stock was begun and in 1929 shares of this stock owned by the taxpayer were redeemed by payment of $.3x$ dollars. The taxpayer was president of the company and a large stockholder and was heavily indebted to it, that indebtedness being canceled in part by application thereto of the dividend. This distribution was less than the undistributed earnings accumulated since March 1, 1913. The redemption open to all was by tacit agreement limited to the taxpayer.

Held, the distributions should be treated as taxable ordinary dividends within the meaning of section 115(g) of the Revenue Act of 1928.

An opinion is requested on the taxability of distributions received by A in redemption of preferred stock of the M Company.

At a meeting of the stockholders of the company in 1927 a resolution was passed to increase the capital stock of the company to include $4x$ dollars of preferred stock, and at a directors' meeting a resolution was adopted to distribute such preferred stock to the stockholders on a pro rata basis in the form of a stock dividend. These resolutions were carried into effect.

The articles of incorporation of the company were also amended so as to provide for the calling or purchase of any or all of the outstanding preferred stock after July 1, 1928, "from holders offering to sell or shall be prorated or determined by law, by the board of directors."

Almost immediately a redemption of the preferred stock was begun pursuant to a plan put into effect by the taxpayer who was the president of, and a large stockholder in, the company, and who was heavily indebted to the company.

The question here presented is in connection with the redemption in 1929 of shares of preferred stock which had been issued in 1927 as a stock dividend on common stock owned by the taxpayer. The amount received ($.3x$ dollars) was substantially less than the undistributed accumulated earnings of the company since March 1, 1913, and appears to have been applied directly to the cancellation of part of the taxpayer's indebtedness to the company.

The taxpayer contends that the distribution in question was a liquidating dividend, whereas the revenue agent and the Income Tax Unit contend that it was a taxable ordinary dividend within the contemplation of section 115(g) of the Revenue Act of 1928, which is as follows:

If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. * * *

(See also article 629 of Regulations 74.)

The question then is whether the above-mentioned shares of preferred stock of the M Company, originally issued as a stock dividend, were purchased and canceled "at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend" within the meaning of the above-quoted statute.

Under such circumstances as are involved in this case, and even under less persuasive circumstances, the Bureau has consistently answered such questions in the affirmative, and where the Board of Tax Appeals has taken a different view, the Commissioner has declined to acquiesce or has taken an appeal.

In this case the following pertinent facts, among others, exist: The corporation had earnings subsequent to March 1, 1913, substantially in excess of the amount distributed; it was a stock dividend that was issued and redemption was thereafter soon begun; the distribution was pursuant to a plan essentially equivalent to the distribution of a taxable dividend; the taxpayer was an officer and large stockholder in the company and apparently in control of it and able to dictate its policies; he was heavily indebted to the company and a distribution of surplus was urgently necessary whereby he might proceed to and did liquidate that indebtedness; and there is nothing to indicate that there was any actual partial liquidation of the company (as through a contraction of its business, by sale or otherwise).

There is evidence which indicates that there was an agreement that none of the other preferred stockholders would offer at that time any of their stock for redemption. However, A admits that in accordance with the articles of incorporation it would have been necessary for the directors to retire preferred stock pro rata if any objection had been made against the retirement of A's stock only. This admission clearly indicates that all of the preferred stockholders had an equal right to offer stock for cancellation, and that if by mutual or other agreement they elected not to do so, and only one person's stock was retired, this in itself would not take the case out of the application of section 115(g) of the Revenue Act of 1928.

In *Huntoon* v. *Commissioner* (14 B. T. A., 459) the petitioner received a stock dividend of 249 shares of stock which he turned in to the corporation and thereupon his indebtedness to the corporation in the amount of $24,900 was canceled. The Board of Tax Appeals approved the Commissioner's determination that this transaction resulted in a taxable ordinary dividend. There is thus substantial similarity between that case and the instant case where the proceeds from the redemption of a stock dividend were applied to the cancellation of the taxpayer's indebtedness to the corporation.

The recent case of *Annie Watts Hill* v. *Commissioner* (27 B. T. A., 73), November 16, 1932, was decided in favor of the Commissioner, the Board finding that the preferred stock was redeemed at a time when it was supplanted by an issue of common stock in like amount, and stating that there was no evidence concerning liquidation of the corporation from which it could find that the cash distribution was made in partial liquidation. The Board held that redemption of stock and a resultant distribution may be treated as a taxable divi-

dend under the provisions of section 201(g), Revenue Act of 1926, although there is no proof of an existing relation between the issuance of the stock and its redemption evidencing a continuing, unified plan for distribution of surplus.

In view of the foregoing, this office is of the opinion that the distributions here in question should be treated as taxable ordinary dividends within the meaning and application of section 115(g) of the Revenue Act of 1928.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 116.—EXCLUSIONS FROM GROSS INCOME.

ARTICLE 642: Income of States. XII-20-6176
G. C. M. 11742

REVENUE ACT OF 1928.

In 1926 the board of education of the city of R, State of Oklahoma, leased to the taxpayer for 99 years a lot in that city with the express provision that all improvements, buildings, and appurtenances thereto, placed thereon, were to remain personal property during the life of the lease. On this lot an office building was completed in 1928.

Held, in the light of the authorities and the clear intent of the parties the building did not become realty but remained the taxpayer's personal property and the income therefrom is not exempt from Federal income tax.

An opinion is requested whether the taxpayer's claim for refund of income taxes for the years 1928 to 1930, inclusive, is allowable on the theory that income derived from the rental of a building erected on land leased from a State is exempt from taxation.

By an indenture and agreement of lease dated in 1926 the board of education of the city of R, Oklahoma, for itself, successors, and assigns, leased to the taxpayer, his heirs, successors, and assigns for 99 years, beginning in 1927, a lot in the city of R. Upon this property the taxpayer erected an office building which was completed in 1928. In the claim for refund the taxpayer alleges that during the years 1928 to 1930, inclusive, there was derived from rental of office space in this building the sum of x dollars. This sum he claims is exempt from Federal income tax for the reasons that the granting of the lease constituted an exercise by the State of Oklahoma of a sovereign power in the fulfillment of an essential governmental obligation to establish and maintain a public school system, and that he, the taxpayer, was an instrumentality employed by the State in the performance of its governmental functions.

Although it was stipulated in the lease that any building erected by the lessee should cost not less than ——, and that if erection were not commenced within the first year of the lease the lease would automatically terminate, erection of a building or improvements was not mandatory. It was expressly provided, however, that "all improvements, buildings, and appurtenances thereto, placed on the above described premises, *are to remain personal property during the life of said lease.*" [Italics supplied.] Moreover, among other things, it was provided that unless the lease should be sooner terminated,

the lessor on ———, 2025, the date of the expiration, should purchase, and the lessee should sell to it, the "buildings, and improvements then located and situate upon the above described premises, at their actual cash value * * *" and that the lessee should "execute and deliver to the lessor a good and valid conveyance of said improvements on or before the — day of ——, 2026, and shall, on or before said date, surrender peaceable possession of said premises to lessor, and shall assign and deliver over to lessor all insurance policies and other rights that may be necessary and proper to perfect and complete in lessor all of the right, title, and interest owned by both parties in said premises and the improvements thereon."

There can thus be no doubt that the parties definitely agreed that such buildings as might be erected by the lessee, should not become a part of the realty by their physical annexation thereto, but that during the term of the lease, in the absence of a reversion to the lessor because of defaults, the buildings should retain the character of personal property belonging exclusively to the lessee. Before considering whether this intention could be effected legally in Oklahoma, a question which must depend upon the statutes and decisions of the courts of that State, the law in general applicable to the subject will be considered.

It is stated in the footnote in 19 L. R. A., 441–442, that so far "as the parties to the contract themselves are concerned, the law is well established that their agreement will be effective to prevent a building from becoming real property and will make it merely a chattel when it is built by one person upon the land of another." In support of this statement many cases are cited, all of which show that because of agreements the structures involved were directly or in effect held to be personalty. (See also 26 Corpus Juris, 676, and 11 R. C. L., pages 1064, 1070, and 1083.)

As was stated in *Dame* v. *Dame* (38 N. H., 429, 75 Amer. Dec., 195), a leading case frequently cited:

> * * * where a building is erected by one man upon the land of another, by his permission, upon an agreement or understanding that it may be removed at the pleasure of the builder, it does not become a part of the real estate, but continues to be a personal chattel, and the property of the person who erected it. *In such case, it is immaterial what is the purpose, size, material, or mode of construction of such building* * * *. [Italics supplied.]

The statutes of Oklahoma contain various provisions relating to and defining real and personal property and fixtures. (See Compiled Statutes of Oklahoma, 1921, sections 2323–2325, 8394–8399, and 8555.) According to section 8395, real property consists of land, that which is affixed to land, that which is incidental or appurtenant to land, and that which is immovable by law. By section 8399 personal property is defined as every kind of property that is not real, and section 8397, defining fixtures, among other things, provides that what is imbedded in the land, as in the case of walls, or that which permanently rests upon land, as in the case of buildings, is deemed to be affixed to the land. Section 8555 provides, among other things, that when a person affixes his property to the land of another without an agreement permitting him to remove it, the thing affixed belongs to the owner of the land, unless he chooses to require or permit the former to remove it.

However, section 8555 has been held to have no application where there is a special agreement between a landlord and tenant permitting the removal of fixtures. (See *Welch* v. *Church*, 55 Okla., 600, 155 Pac., 620, holding that replevin to recover an ice and storage house lies against a purchaser of land having knowledge of an agreement between the vendor and a lessee who erected the buildings, which agreement gave the lessee the right to remove them as its personal property.) In *Shelton* v. *Jones* (66 Okla., 83, 167 Pac., 458), involving an action of trover to recover a 2-story building, the court said:

> * * * The law presumes that a building located upon a tract of land is a part of the land it occupies, and is therefore real property. This presumption may, however, be rebutted by showing that the building, in fact, was personal property, and not part of the realty.
>
> * * * * * * *
>
> * * * The character of the building was fixed by the terms of this lease. If the tenant complied with the two conditions provided therein, it was personalty. Upon a failure to comply therewith it became realty. * * *

In numerous other cases the Supreme Court of Oklahoma has also recognized that a building could have the character of personalty by agreement. (See *Bridges* v. *Thomas*, 8 Okla., 620, 58 Pac., 955; *Tolle* v. *Vandenberg*, 44 Okla., 780, 146 Pac., 212; *Uncle Sam Oil Co.* v. *Union Petroleum Co.*, 90 Okla., 135, 216 Pac., 443; and *Continental Gin Co.* v. *De Bord*, 49 Okla., 32, 150 Pac., 892.)

The question when property ordinarily deemed a fixture is considered personalty rather than realty has also arisen in numerous cases in Oklahoma relating to machinery and trade fixtures. A leading case of the latter kind is *Lawton Pressed Brick & Tile Co. et al.* v. *Ross-Kellar Triple Pressure Brick Mach. Co. et al.*, 33 Okla., 59, 124 Pac., 43), in which brick machinery had been sold with the express agreement that title should not pass to the vendee until the machinery was paid for and should not be affected by its delivery and erection. In an action by the vendor to recover the machinery, it was held that the agreement caused the property to remain personalty. The court said:

> It is well settled that chattels may be annexed to the real estate and still retain the character of personal property. Of the various circumstances which may determine whether, in any case, this character is or is not retained, the intention with which they are annexed is one; and if the intention is that they shall not by annexation become a part of the freehold, as a general rule, they will not. The limitation to this is where the subject or mode of annexation is such as that the attributes of personal property can not be predicated of the thing in controversy, as where the property could not be removed without practically destroying it, or where it, or part of it, is essential to the support of that to which it is attached.

The limitation mentioned in the foregoing quotation was also inferentially recognized in *Murray Co.* v. *Chickasha Cotton Oil Co. et al.* (73 Okla., 106, 174 Pac., 1091).

If this limitation was recognized by subsequent Oklahoma decisions as being a firmly established rule to be followed in all proper cases, it would raise serious doubts in the instant case. But an examination of the more recent Oklahoma cases has failed to reveal any decision in that State where the right to remove structures accorded the character of personalty was expressly denied on the ground that the removal would injure the property to which they were attached. On the contrary, the courts have clearly indicated that the intention of the parties was the primary test in such cases.

(In this connection see *Uncle Sam Oil Co.* v. ***Union Petroleum Co.***, supra; *Elerick et al.* v. *Reed*, 113 Okla., 195, 240 Pac., 1045; and *Kay County Gas Co.* v. *Bryant et al.*, 135 Okla., 135, 276 Pac., 218; and compare *Deering* v. *Ladd*, 22 Fed., 575.)

In view of the decisions of the Supreme Court of Oklahoma, it is obvious that the statutes of Oklahoma do not prevent what are ordinarily termed fixtures, such as buildings, from remaining personal property under certain circumstances. Accordingly, in the light of the authorities, and in view of the clear intent of the parties that the instant building was to be personal property of the taxpayer, it is concluded that the building actually did not become realty but remained the taxpayer's personal property.

In support of his claim that the income from the building is exempt from Federal income tax the taxpayer cites the cases of *Gillespie* v. *Oklahoma* (257 U. S., 501); *Burnet* v. *Coronado Oil & Gas Co.* (285 U. S., 393, Ct. D. 485, C. B. XI–1, 265); and *Marland* v. *United States* (53 Fed. (2d), 907), each of which involved the taxation of income derived from the operation of oil and gas leases.

It is well established that the instrumentalities by which the United States exercises its governmental powers are exempt from State taxation, and that the instrumentalities by which the States exercise their governmental powers are exempt from taxation by the United States. Nevertheless, where the effects upon the one government of such taxation by the other are *remote* and *indirect*, it has been held by the Supreme Court of the United States in numerous cases that there is no ground for exemption. Thus in *Group No. 1 Oil Corporation* v. *Bass* (283 U. S., 279, Ct. D. 330, C. B. X–1, 153), the court said:

> But the *remote* and *indirect* effects upon the one government of such a nondiscriminatory tax by the other have never been considered adequate grounds for thus aiding the one at the expense * * * of the other. * * * [Italics supplied.]

In *Willcuts* v. *Bunn* (282 U. S., 216, Ct. D. 280, C. B. X–1, 309) it was held that profits derived from the purchase and sale of exempt municipal bonds were subject to Federal taxation. In that case the court commented on the fact that it had not been shown (page 230) that the tax "casts any appreciable burden on the State's borrowing power" and also said (page 225) that the constitutional exemption from taxation is not extended "where no *direct* burden is laid upon the governmental instrumentality, and there is only a *remote*, if any, influence upon the exercise of the functions of government." [Italics supplied.]

(See, further, *Thomas* v. *Gay*, 169 U. S., 264; *Railroad Company* v. *Peniston*, 18 Wall., 5; and *Metcalf & Eddy* v. *Mitchell*, 269 U. S., 514, T. D. 3824, C. B. V–1, 218.)

In the instant case all the income as to which exemption is claimed was derived from rental of office space in the building, in other words, from personal property of the taxpayer, and taxation of this income by the United States may have some *remote* effect upon the taxing power of Oklahoma. But there is *no direct* burden imposed upon the State governmental instrumentality and such interference as there may be with a State governmental function is so *remote* and *indirect* that it is not an adequate cause for exempting the income from Federal taxation. Here no income came from the ground since

the tenants merely rented certain spaces in the taxpayer's personal property, namely, the building. On the other hand, in the cases of *Burnet* v. *Coronado Oil & Gas Co.*, supra, *Gillespie* v. *Oklahoma*, supra, and *Marland* v. *United States*, supra, the exempted income came directly from the sale of what was taken from the leased ground, so that it was directly attributable to operation of the leases which were governmental instrumentalities. Thus, these and similar cases involving oil and gas leases and the direct use of realty differ fundamentally from, and are not precedents to be followed in, the instant case, which involves only income from the use of the taxpayer's personal property.

Furthermore, under *Burnet* v. *A. T. Jergins Trust* (53 S. Ct. Rep., 439, March 13, 1933, Ct. D. 653, page 214, this Bulletin), the claimed exemption in this case must be denied because here the sovereign acted in no respect "as the trustee of an express trust" and, in addition, "the burden upon the public use" is extremely indefinite and indirect. The leased land in the instant case was acquired at private sale by the town of R for a consideration paid in cash; was by the city of R, successor to the town of R, conveyed to its board of education; and was, by its board of education, leased to this taxpayer. This land is in no respect governed by the enabling act and the constitution of Oklahoma, or the other provisions of law considered in *Burnet* v. *Coronado Oil & Gas Co.*, supra.

In view of the foregoing, this office is of the opinion that the income involved in the instant case is not exempt from Federal income tax and that the claim for refund should be disallowed.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 643: Compensation of State officers and employees. XII-7-6027 I. T. 2677

REVENUE ACT OF 1928.

An agricultural teacher in the public school system of Virginia is an employee of the State or political subdivision thereof engaged in the discharge of an essential governmental function. The entire amount of compensation received by him for such service is, therefore, exempt from Federal income tax, even though a part of such compensation is paid from funds contributed by the Federal Government under an Act approved February 23, 1917 (39 Stat., 929), providing for the promotion of vocational training.

Advice is requested whether the compensation received by a resident of Virginia, who is employed as a vocational agricultural teacher in the public school system of Virginia, is subject to Federal income tax on the portion of such compensation which is made available to him by appropriation from the United States Treasury under the Act approved February 23, 1917 (39 Stat., 929), providing for the promotion of vocational training.

Under the provisions of section 22(a) of the Revenue Act of 1928, the term "gross income" includes compensation for personal service, of whatever kind and in whatever form paid. It follows that compensation received under the Act of February 23, 1917, referred to

above, must be included in gross income unless it is specifically exempted by statute or is exempt in accordance with fundamental law. There is no provision in the Act approved February 23, 1917, supra, exempting from Federal income tax the amount of compensation received by a teacher in the public school systems of the States which is paid out of money contributed by the Federal Government. Article 643 of Regulations 74 provides that compensation paid to its officers and employees by a State or a political subdivision thereof for services rendered in connection with the exercise of an essential governmental function is not subject to tax. This is a recognition of the fundamental law in this respect.

An agricultural teacher in the public school system of Virginia is an employee of the State or political subdivision thereof engaged in the discharge of an essential governmental function. The entire amount of compensation received by him for such service is, therefore, exempt from Federal income tax, even though a part of such compensation is paid from funds contributed by the Federal Government under an Act approved February 23, 1917, providing for the promotion of vocational training.

SUPPLEMENT C.—CREDITS AGAINST TAX.

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

ARTICLE 697: When credit for taxes may be taken.

REVENUE ACT OF 1928.

Accrual of Canadian taxes for 1930 under 1931 Canadian Act retroactive for 1930. (See I. T. 2675, page 105.)

SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX.

SECTION 141.—CONSOLIDATED RETURNS OF CORPORATIONS—1929 AND SUBSEQUENT TAXABLE YEARS.

ARTICLE 31, REGULATIONS 75: Consolidated net income. (Also Section 105.) XII-13-6097 I. T. 2686

REVENUE ACT OF 1928.

In determining the consolidated net income of an affiliated group making a consolidated return for a fiscal year ended in 1929, Regulations 75 are applicable to that portion of the fiscal year falling within the calendar year 1928 as well as to that portion of the fiscal year falling within the calendar year 1929. In such a case the consolidated net income is to be computed for the entire fiscal year under Regulations 75, and neither section 142 nor section 105 of the Revenue Act of 1928 is applicable to the computation of the net income. The only application of section 105 in such a case is in computing the tax attributable to the calendar year 1928 at the rates provided in the Revenue Act of 1928 and the tax attributable to the calendar year 1929 at the rates provided in the resolution of Congress approved December 16, 1929 (H. J. Res. 133, Public, No. 23, Seventy-first Congress (C. B. IX-1, 411)).

A ruling is requested relative to the method of computing the net income and the tax liability of an affiliated group of corporations for the fiscal year ended March 31, 1929, in view of article 41(b) of Regulations 75, relating to consolidated net losses for years prior to 1929, where a consolidated return was made by the affiliated group for that year as well as for the years 1927 and 1928.

It is suggested that in view of I. T. 2639 (C. B. XI-2, 47) and General Counsel's Memorandum 8156 (C. B. IX-2, 124) the tax liability of the affiliated group for the fiscal year ended March 31, 1929, should be computed under section 105 of the Revenue Act of 1928 and that as so computed the tax would be the sum of the following:

(*a*) The tax attributable to the calendar year 1928, found by computing the tax upon the income of the group for the fiscal year under the provisions of section 142 of the Revenue Act of 1928, and by taking nine-twelfths of such tax; and

(*b*) The tax attributable to the calendar year 1929, found by computing the tax upon the income of the taxpayer for the fiscal year under the provisions of Regulations 75, and by taking three-twelfths of such tax.

It is the opinion of this office that in accordance with the rule laid down in General Counsel's Memorandum 8156, the fiscal year (April 1, 1928, to March 31, 1929) of the affiliated group is a period beginning in one calendar year and ending in the following calendar year and the law applicable to "the first calendar year" is different from the law applicable to "the second calendar year." Consequently, in so far as the different laws relate to the rates of tax, section 105 of the Revenue Act of 1928 is applicable. However, it is not believed that in such a case section 105 contemplates two separate computations of the consolidated net income.

Section 142 of the Revenue Act of 1928 is applicable in the case of consolidated returns for the taxable year 1928 and section 141 of that Act is applicable in the case of consolidated returns for the taxable year 1929 and subsequent years. In section 48 of the Revenue Act of 1928 the term "taxable year" is defined as "the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed * * *." Regulations 75, promulgated under the authority of section 141(b) of the Revenue Act of 1928, are applicable in the case of consolidated returns for fiscal years ended in 1929 as well as for the calendar year 1929. In determining the consolidated net income of an affiliated group making a consolidated return for a fiscal year ended in 1929, Regulations 75 are applicable to that portion of the fiscal year falling within the calendar year 1928 as well as to that portion of the fiscal year falling within the calendar year 1929. In such a case the consolidated net income is to be computed for the entire fiscal year under Regulations 75, and neither section 142 nor section 105 is applicable to the computation of the net income. The only application of section 105 in such a case is in computing the tax attributable to the calendar year 1928 at the rates provided in the Revenue Act of 1928, and the tax attributable to the calendar year 1929 at the rates provided in the resolution of Congress approved December 16, 1929 (H. J. Res. 133, Public, No. 23, Seventy-first Congress).

ARTICLE 711: Consolidated returns of affiliated corporations for 1929 and subsequent taxable years.

REVENUE ACT OF 1928.

Liquidation of subsidiary as an incident to the dissolution thereof. Sale of subsidiary's stock to outside interests. (See G. C. M. 11676, page 75.)

SECTION 142.—CONSOLIDATED RETURNS OF CORPORATIONS—TAXABLE YEAR 1928.

ARTICLE 731: Consolidated returns of affiliated corporations for 1928.

REVENUE ACT OF 1928.

Liquidation of subsidiary as an incident to the dissolution thereof. Sale of subsidiary's stock to outside interests. (See G. C. M. 11676, page 75.)

SUPPLEMENT E.—ESTATES AND TRUSTS.

SECTION 166.—REVOCABLE TRUSTS.

ARTICLE 881: Income of trusts taxable to grantor. XII-18-6154 G. C. M. 11640

REVENUE ACT OF 1928.

Where the grantor of a trust had the power of revocation by giving notice of a year and a day but did not give such notice, and the income from the trust for 1929 was paid to the beneficiary, the income is not taxable to the grantor. If the grantor had given requisite notice so that he had the power to revest title in himself in 1929, then the income would have been taxable to him, even though he permitted the income to be paid to the beneficiary.

An opinion is requested whether the income of a trust is taxable to the grantor for the year 1929 under section 166 of the Revenue Act of 1928, the income having been paid to the beneficiary (grantor's wife) but the grantor having had the power to revoke the trust by giving notice of a year and a day.

In the case of *Langley* v. *Commissioner* (61 Fed. (2d), 796), the Circuit Court of Appeals for the Second Circuit reversed the Board's decision (24 B. T. A., 1156) and held that where the grantor of a trust reserved the right to revoke on giving notice of a year and a day, and the notice was not given during the taxable year 1927, the income of the trust for 1928 was not taxable to the grantor, since during 1928 the grantor could not revest title.

Similar decisions have been rendered by the Court of Claims in *Faber* v. *United States* (1 Fed. Supplement, 859) and by the District Court for Massachusetts in *Lewis* v. *White* (56 Fed. (2d), 390). In the latter case the Circuit Court of Appeals, First Circuit, dismissed the Government's appeal without opinion (61 Fed. (2d), 1016). The Board has likewise reached the same conclusion in *Mabel A. Ashforth et al.* v. *Commissioner* (26 B. T. A., 1188), and the Com-

missioner has acquiesced (page 2, this Bulletin), withdrawing his former nonacquiescence.

Therefore, if the grantor in the instant case had no power actually to revest title in himself at any time during the year 1929, by reason of not having given the requisite notice, it is the opinion of this office that the income is not taxable to the grantor for the year 1929. On the other hand, if the grantor had given the requisite notice so that he had the power to revest title in himself in 1929, then the income would have been taxable to him, even though he permitted the income to be paid to the beneficiary.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 881: Income of trusts taxable to grantor. XII-22-6201 Ct. D. 671

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. INCOME—REVOCABLE TRUSTS—POWER TO REVOKE AT TERMINATION OF NOTICE.

In trusts for the benefit of minor beneficiaries the settlor was a cotrustee and reserved to herself a power of revocation which was exercisable only at the expiration of 12 months and a day after notice thereof. The trusts terminated in July and November, 1928, by the beneficiaries becoming 21 years of age, whereupon the principal became payable to the settlor. In each case on the day following such termination a new agreement was executed for the life of the beneficiary or of the settlor, whichever was shorter, the instrument containing the same power of revocation and the same requirement of notice. The income from the trusts was not taxable to the settlor in the year 1928, within the meaning of section 166 of the Revenue Act of 1928, since the power referred to in the statute must be one by which the settlor could revest in herself title to the corpus during the taxable year.

2. DECISION REVERSED.

The decision of the Board of Tax Appeals (24 B. T. A., 1156) reversed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Elida B. Langley, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Before MANTON, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

[November 7, 1932.]

OPINION.

MANTON, Circuit Judge: The petitioner created trusts on December 1, 1922, in favor of her daughter and a nephew for the duration of the life of the settlor or of the beneficiary or of the minority of the latter whichever period should first expire. The settlor was one of the two trustees. The income was to be paid to the beneficiaries in the discretion of the trustee and to be applied to the maintenance of the beneficiary or was to be paid to the settlor for the use of the beneficiaries. A complete power of amendment or revocation on written notice was reserved by the settlor in the original trust agreement. On June 16, 1924, the complete power of revocation in the original trust agreement was modified to read that the settlor "reserves the right to revoke this trust estate prior to the determination thereof, upon and at the expiration of 12 months and 1 day after notice of revocation as hereinafter set forth."

It was there stated that the notice of revocation should be sent by mail. On July 23, 1928, and November 14, 1928, the original trusts terminated by their terms upon the nephew and daughter respectively attaining their majorities. By the terms of the trusts, the principal became payable to the settlor. Instead of paying over the principal in each case on the day following each majority, July 24, 1928, in the case of the nephew and November 15, 1928, in the case of the daughter, new trust agreements were executed directing the trustees to hold the principal on the terms set forth. The trust was for the life of the beneficiary or settlor, whichever proved shorter. The power of revocation remained requiring a notice of one year and one day. Notice of revocation was not given in the year 1928. The Commissioner taxed the income of these trusts to the petitioner, applying Revenue Act 1928, section 166, derived from the Revenue Act of 1924, section 219(g). The Board of Tax Appeals upheld the tax. This petition to review seeks a reversal of that determination.

The original and substituted trusts of personal property are valid under the law of New York which restricts the purposes for which express trusts may be created. The power of revocation did not affect the validity of the trusts. (*Van Cott* v. *Prentice*, 104 N. Y., 45.) In the absence of revocation, the beneficiaries could enforce the trusts. (*Schreyer* v. *Schreyer*, 101 A. D., 456, affd. 182 N. Y., 555.)

The trust could be revoked only by complying with the terms of the power of revocation (*Gage* v. *Irving Trust Co.*, 222 A. D., 92, affd. 248 N. Y., 554) or by consent of all the persons interested as provided in the New York personal property law, section 23.

Upon the termination of the original trusts on July 23, 1928, and November 14, 1928, the principal was not paid to the settlor. But even though the settlor may not have received title to the corpus on the termination of the original trusts and before the trustees paid over the principal, as directed by the agreements, her complete control over the fund after such termination of the original trusts is clear and the income from the corpus after that time was disposed to another trust, the settlor retaining complete rights to the corpus for one day only in each case and the Government is not now seeking to tax the income for that period. But its claim is based on section 166 of the Revenue Act of 1928, which provides that income from a trust shall be taxed to the grantor if he "has, at any time during the taxable year, * * * the power to revest in himself title * * *" to the corpus.

The question presented is whether section 166 applies and if it does, whether or not that application violates the fifth amendment to the Constitution, if the settlor be taxed. The purpose of section 166 of the Revenue Act of 1928 is to prevent a taxpayer from evading the surtax rates by distributing his income among his family or otherwise attempting to have it taxable to distributees. Congress has the power to prevent this practice. (*Burnet* v. *Leininger*, 285 U. S., 136; *Corliss* v. *Bowers*, 281 U. S., 376 [Ct. D. 188, C. B. IX-1, 251].) It is also clear that in order to gain the advantage of the higher rates on larger incomes, the Federal Government can not create large incomes and tax them accordingly by considering the income of two or more persons as the income of one person or by measuring the income of one person by that of another. (*Hoeper* v. *Tax Commission of Wisc.*, 284 U. S., 206.) There is an ambiguity in section 166 which the legislative history referred to by counsel does not entirely remove. The Senate revision of the House draft of the tax bill makes it clear that if the settlor's power of revocation is shackled by a condition not satisfied in the taxable year, Congress did not intend to tax the income to the settlor. A condition entirely beyond the control of the settlor brings a trust within the exempted class but does a condition partially or completely in control of the settlor bring the case within the class of revocable trusts which Congress did not intend to tax to the settlor? It was within the power of Congress to have said that trusts revocable on a condition not happening within the year were not taxable to the settlor in that year. Congress might have inserted the phrase "at any time in the taxable year" in the House bill. Instead, Congress stated the class of revocable trusts taxable to the settlor. The language, "the power to revest in himself (settlor) title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor," is argued by the petitioner, to mean a revesting of the corpus within the taxable year to make it taxable to the settlor and, by the respondent, it is argued that it requires merely power of revocation. In *Corliss* v. *Bowers* (281 U. S., 376), where it was held that the income was taxable to the settlor, the court pointed out that—

"The acquisition by the wife of the income became complete only when the plaintiff failed to exercise the power that he reserved, * * *. Still speaking with reference to taxation, if a man disposes of a fund in such a way that another is allowed to enjoy the income which it is in the power of the first to appropriate, it does not matter whether the permission is given by assent or by failure to express dissent. The income that is subject to man's unfettered command and that he is free to enjoy at his own option, may be taxed to him as his income, whether he sees fit to enjoy it or not."

This settlor could not revest and obtain the income within the taxable year 1928 for she had not served the necessary notice of one year and a day. If the trust could not be revoked during such year then the income must be taxable to the recipient thereof. The power referred to in the statute must be one by which the grantor could revest in himself the title to the corpus during the taxable year. (*Lewis* v. *White*, 56 Fed. (2d), 390; appeal dismissed October 21, 1932 (C. C. A. 1).) In *Clapp* v. *Heiner* (51 Fed. (2d), 224 (C. C. A. 3)), the trust contained a provision of revocation on six months' notice. This gave, as Justice Holmes said, "the unfettered command" over the principal of the trust within the year and was held taxable to the settlor.

In the instant case, the principal of the trust, so far as 1928 was concerned, had been irrevocably transferred and did not belong to the petitioner and she, having put it beyond all control, gave the income during that year to another recipient. She could not by her own positive act revest herself with title to the property during the year 1928, within the terms of the trust and she had no control over the principal until the termination of the trust in that year. Therefore, she had lost control of the income during the period of taxation. (*Burnet* v. *Leininger*, 285 U. S., 136; *Mitchell* v. *Bowers*, 15 Fed. (2d), 287 (C. C. A. 2) [T. D. 3982, C. B. VI-1, 244].) Since during the year no act could be done by the petitioner so as to bring to her any portion of the corpus of the trusts or the income thereof, she is not subject to taxation within the purview of section 166. The Board of Tax Appeals in *Ashforth* v. *Commr.* (26 B. T. A., 1188) has expressly overruled their decision in this case and for the reason that they deemed it inconsistent with *Corliss* v. *Bowers*, *Clapp* v. *Heiner*, and *Lewis* v. *White*, supra.

With the view we take that the statute does not permit taxing the income of the trust to the settlor under the circumstances here disclosed, it becomes unnecessary to consider the argument advanced as to the constitutionality of section 166 of the Revenue Act of 1928.

Order reversed.

SUPPLEMENT L.—ASSESSMENT AND COLLECTION OF DEFICIENCIES.

SECTION 274.—BANKRUPTCY AND RECEIVERSHIPS.

ARTICLE 1191: Bankruptcy and receiverships. XII-8-6037
Ct. D. 632

FEDERAL TAXES—REVISED STATUTES—DECISION OF COURT.

1. RECEIVERSHIP—PRIORITY OF THE UNITED STATES.

Section 3466 of the Revised Statutes entitles the United States to priority of payment of a debt due the United States out of the assets of a corporation in receivership by consent where the corporation is insolvent when the claim of the United States for the debt is allowed, even though it is solvent at the inception of the receivership. The amount of elapsed time between appointment of a receiver and the date of insolvency is not decisive of whether or not the Government should be granted priority.

2. DECISION AFFIRMED.

The decision of the District Court, Southern District of New York (50 Fed. (2d), 640, Ct. D. 488, C. B. XI-1, 128), is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Robert L. Hatch, plaintiff, v. *Morosco Holding Co., Inc., defendant.*

United States of America, claimant-appellee, v. *Irving Trust Co., receiver-appellant.*

MANTON, AUGUSTUS N. HAND, and CHASE.

[December 5, 1932.]

OPINION.

Appeal from an order of the District Court for the Southern District of New York allowing a claim of the Government for taxes priority over all other claims. Affirmed.

All the facts upon which the order appealed from was based are shown by the following quotation from a stipulation filed by the parties:

"The claim herein is a proceeding, in a suit in equity now pending in the United States District Court for the Southern District of New York, entitled as hereinabove set forth, instituted by Robert L. Hatch, an unsecured simple contract creditor, who filed his bill in equity in the usual form alleging the solvency but temporary financial embarrassment of Morosco Holding Co. and praying for the appointment of a receiver with the usual powers, to conserve assets, to which bill the defendant duly filed its verified answer admitting the allegations of the bill and joining in the prayer thereof for relief.

"Other than as recited in the bill and answer, no proof was made or offered as to the financial condition of Morosco Holding Co., Inc., or of the receivership estate thereof, at any time.

"Nevertheless the receiver concedes that at the date of Judge Coleman's order herein, to wit, September 9, 1929, said receivership estate was insolvent within the meaning and definition of the Bankruptcy Act.

"It is conceded by the claimant that the order of July 23, 1923, appointing John Martin Richie as receiver herein (said order being the first order for appointment of receiver herein and said Richie being the predecessor of the present receiver herein), made such appointment under the recitals of the bill and answer as to solvency but temporary financial embarrassment, and for the express purpose solely of conserving assets."

CHASE, Circuit Judge: If the Government is entitled to priority in the payment of its claim for taxes, it must be solely because of the provisions of section 3466 R. S. (31 U. S. C. A., section 191). (*Price* v. *United States*, 269 U. S., 492 [T. D. 3820, C. B. V-1, 318]; *United States* v. *State Bank of North Carolina*, 6 Pet., 29.) That section reads as follows:

"*Priority established.*—Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

The statute applies to taxes since they are embraced within the term "debts." (*Price* v. *United States*, supra.)

Had the holding company been insolvent at the time the receiver was appointed in the sense of insolvency as used in section 3466 R. S. (see *United States* v. *Oklahoma*, 261 U. S., 253), the Government would certainly have been entitled to priority. (*United States* v. *Butterworth-Judson Corporation*, 269 U. S., 504 [T. D. 3825, C. B. V 1, 321].) As the holding company was not so insolvent at that time, it remains to be seen whether the Government was entitled to priority when it did become insolvent in the sense of section 3466 during the receivership and some six years after the receiver was appointed.

At the outset, it should be noticed that in *Price* v. *United States*, supra, insolvency at the time the receiver was appointed was not shown but it did appear that the corporation was in a failing condition and within a short time was insolvent. It was held that the Government was entitled to priority in pay-

ment of its taxes. But in this case neither a failing condition at the time of the appointment nor actual insolvency within a short time has been proved, and the problem, in a word, is whether the Price case is, accordingly, to be distinguished from this.

In *United States* v. *Oklahoma*, supra, a bank had been taken over by a State bank examiner and it became necessary to decide whether the United States was entitled to priority in payment of an Indian deposit over claims of the State under its lien law. In discussing whether the State's lien, and when the priority, if any, of the United States, attached, it was said that, "if priority in favor of the United States attaches at all, it takes effect immediately upon the taking over of the bank." The appellant earnestly urges us to accept this as foreclosing any right of the Government to priority in this case since, if the only time priority could attach was when the receiver was appointed, there can be no priority for there was then no insolvency. We do not think, however, that the quotation from the Oklahoma case should be given such a broad meaning apart from its relation to the situation in which it was used. (*Cohens* v. *Virginia*, 6 Wheat., 264, 399.) The question then being discussed was whether the State could have obtained a lien under its law before the priority, if any, of the Government attached and what was said, we think, merely meant that if the Government, upon the facts proved in that case had any right to priority at all, its priority attached before the State lien could come into effect. As the State lien could not come into being until the examiner took possession of the bank and, any priority of the United States would attach at the same time, it was pointed out that the priority of the Government could not be impaired or taken away by State law. The guarded expression as to whether there was any priority at all was due to a failure to show any insolvency at any time within the meaning of section 3466 and on that ground it was held that there was no priority. In *County of Spokane* v. *United States* (279 U. S., 80), the corporation was insolvent at the time the receiver was appointed and we do not understand there was any doubt of its insolvency being the kind required to make section 3466 applicable. The receiver was appointed in 1922. The taxes and penalties due the Government were assessed in 1923 and, in considering whether there was priority over assessments in 1924 by counties upon property in the hands of the receiver, the case of *United States* v. *Oklahoma*, supra, was mentioned as authority to the effect that in a case like the one then being decided priority attached when the receiver was appointed. We take this to mean that when insolvency is shown as of the time the receiver is appointed priority will then take effect, but can not believe that it is any indication that it will never come into being unless all requisite conditions are present at the time the receiver is appointed; for in the same opinion it is held that priority did attach "on or before" the taxes and penalties were assessed and that, as should be noticed, was in the year following the appointment of the receiver. In *United States* v. *Hooe et al.* (3 Cranch, 73), the question was whether a deed was fraudulent as to creditors and one point made in the case was that it could be avoided on the ground that the Government was entitled to priority because the maker of the deed, one Fitzgerald, was insolvent when it was made. In speaking of the evidence relied upon to prove the maker insolvent at that time the court said: "It must appear that at the time of making the conveyance, Fitzgerald was 'a debtor not having sufficient property to pay all his debts.'" This, too, can hardly be said to have a wider application than the facts in that case could give it for if there were proof of insolvency it went to the time of the conveyance and the court apparently was considering only the effect of that. Under the rule of construction already alluded to, we believe the statement should be taken to mean no more.

It has long been understood that this statute is to be given a liberal construction to effectuate the intention of Congress to aid the Government in the collection of debts due it. (*United States* v. *State Bank of North Carolina*, supra; *Bramwell* v. *United States Fidelity Co.*, 269 U. S., 483; *Price* v. *United States*, supra.) While this does not mean that it covers anything which does not fall fairly and reasonably within its reach, we think it should be, and that no previous decision forbids its being, construed to apply to debts owed the Government by a debtor in receivership who becomes insolvent after the receiver is appointed if the statute would have been applicable had the debtor been insolvent at the time the receiver was appointed. It is true that the statute speaks of insolvency in connection with the acts which have been

held necessary as manifestations (see *Prince* v. *Bartlett*, 8 Cranch, 431; *Conard* v. *Nicholl*, 4 Pet., 291; *Beaston* v. *Farmers' Bank of Delaware*, 12 Pet., 102; *United States* v. *McLellan*, Fed. Cas. No. 15,698; *Strain* v. *United States Fidelity & Guaranty Co.*, 292 Fed., 634) as of the present and without more that would, perhaps, compel the conclusion that only when the required manifestation and actual insolvency coexist as soon as the manifestation occurs does the priority take effect. But when one of the modes of releasing the condition which the explanatory clause of the statute makes upon the application of the first clause has been proved, and such a receivership as we have here is the equivalent of one of them, it falls fairly within the realm of reasonable construction to decide whether that is enough without contemporaneous insolvency to permit the first clause of the statute to be given effect whenever the Government's debtor is shown to be insolvent. That clause provides that "Whenever any person indebted to the United States is insolvent, * * *, the debts due to the United States shall first be satisfied;" and its coverage whenever it applies is as comprehensive as the words used. It, too, speaks in the present and that present looks to the time of insolvency.

We take *Price* v. *United States*, supra, to be a strong indication that the Government is entitled to priority in a situation like that now before us. There insolvency and the appointment of the receiver were not coetaneous. Accordingly, that can not be an absolute condition precedent upon the priority given the Government in the first clause of the statute. Nor does it seem reasonable to believe that the amount of elapsed time between the appointment of a receiver and the date of insolvency can be decisive. If insolvency proved to exist for the first time shortly after the receiver is appointed is enough, it would seem to follow as of course that proof of insolvency at any time during the receiver's administration would have like effect for every reason for granting a preference to the Government in the one instance would apply to the other. Certainly, this would be so unless the "short time" in the Price case is taken only to have some evidential force to show actual insolvency at the time that receiver was appointed. We find no basis in the opinion for that and can perceive no reason why it could be so. On the contrary it was there said that, "When the assets turned out to be less than the debts, the creditors were entitled to have them dealt with as a trust fund and distributed among them according to their rights and priorities. Under the statute, claims of the United States must first be satisfied. (*Bramwell* v. *United States Fidelity & Guaranty Co.*, ante, page 483, and *United States* v. *Butterworth-Judson Corporation*, post, page 504.)" "When the assets turned out to be less than the debts," is an expression which we take to mean when insolvency was proved to exist and so hold that the Government is here entitled to priority.

As the claim of the Government, now granted priority, has already been allowed with interest (*Hatch* v. *Morosco Holding Co.*, 50 Fed. (2d), 138), the question of interest is no longer open. (*Thompson, Adm'x, et al.*, v. *Maxwell Land Grant & Railway Co., et al.*, 168 U. S., 451, 456.)

Affirmed.

ARTICLE 1191: Bankruptcy and receiverships. XII-9-6048
Ct. D. 635

FEDERAL TAXES—REVISED STATUTES—DECISION OF SUPREME COURT.

1. RECEIVERSHIP—TAXES—PRIORITY OVER STATE TAXES.

Under section 3466, Revised Statutes, the United States is entitled to priority in the payment of Federal taxes over claims of the State of New York for unliquidated franchise taxes, even though under the State statutes the latter were a general lien upon the property of the insolvent at the time receivers were appointed. The doctrine of relation will not divest the United States of the preference that accrued when receivers were appointed.

2. DECISION AFFIRMED.

The decision of the Circuit Court of Appeals (59 Fed. (2d), 979 [Ct. D. 583, C. B. XI-2, 136]) is affirmed.

SUPREME COURT OF THE UNITED STATES.

The People of the State of New York, petitioners, v. Mark M. Maclay and Charles E. McWilliams, Receivers of McWilliams Bros., Inc., and The United States of America, respondents.

On writ of certiorari to the Circuit Court of Appeals for the Second Circuit.

[February 6, 1933.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the court.

The controversy is one between the United States and a State as to priority of payment out of the assets of an insolvent corporation.

Receivers of the corporation were appointed by a consent decree in January, 1927, and creditors were directed to file their claims. The decree had the effect of a general assignment. (*Price* v. *United States*, 269 U. S., 492, 502 [T. D. 3820, C. B. V-1, 318].) The United States filed with the receivers a claim for additional taxes in the sum of $33,663.97 due from the insolvent for the years 1917 and 1918, and also a claim for $516.46 expenses incurred in the replacement of a buoy run into by the insolvent's tug. The State of New York filed a claim for franchise taxes due for the years 1921 to 1925, but not assessed or liquidated till after the receivership. It filed another claim afterwards for taxes due for later years. The district court held that under section 3466 of the Revised Statutes (31 U. S. Code, section 191), the debt owing to the United States had a preference over the debt owing to the State in the distribution of the fund. Upon appeal to the Circuit Court of Appeals for the Second Circuit, the decree was affirmed. (59 F. (2d), 979.) The case is here on certiorari.

The decision of this court in *County of Spokane, Wash.*, v. *United States* (279 U. S., 80 [Ct. D. 56, C. B. VIII-1, 274]) upheld the power of Congress to give priority to debts due to the people of the United States, though the debts thereby subordinated were due to the people of a State, or its political subdivisions. To that decision we adhere. The hardship to the State, if there is any, "is the necessary consequence of the supremacy of the laws of the United States on all subjects to which the legislative power of Congress extends." (Marshall, C. J., in *United States* v. *Fisher*, 2 Cranch., 358, 396. Cf. *Florida* v. *Mellon*, 273 U. S., 12, 17.)

The tax held to have been subordinated in the Spokane County suit was not a perfected lien upon the property of the insolvent at the date of the receivership. (279 U. S., 80, 93, 94.) The question was reserved whether a different conclusion would have been necessary if such a lien had been proved. (279 U. S., 95.) Certiorari was granted in this case because of the claim of the petitioner that by the statutes of New York franchise taxes become liens in advance for the years in which they are due, though the amount is not fixed and must be liquidated thereafter.

Liens in a sense they unquestionably are, but, we think, not so perfected or specific as to change the rule of distribution. The receivers were appointed, as we have seen, in January, 1927; and the petitioner, if not preferred at the time of the appointment, did not win itself a preference by anything done thereafter. (*United States* v. *Oklahoma*, 261 U. S., 253, 260.) By the statutes of New York, "every such tax or fee (including the annual franchise tax to be paid by corporations) shall be a lien and binding upon the real and personal property of the corporation * * * liable to pay the same until the same is paid in full." (New York Tax Law, Consolidated Laws, ch. 60, section 197.) The lien thus created is effective for many purposes though its amount is undetermined. It is notice to mortgagees or purchasers, who are held to loan or purchase at their own risk if they take their mortgages or deeds before the tax has been assessed or paid. (*Carey* v. *Keith, Inc.*, 250 N. Y., 216; *Engelhardt* v. *Alvino Realty Co., Inc.*, 248 N. Y., 374.) In that respect it is similar to the lien of a transfer tax or duty upon the estate of a decedent. (*Midurban Realty Co.* v. *F. Dee & L. Realty Corporation*, 247 N. Y., 307; *Stock* v. *Mann*, 255 N. Y., 100, 104.) It will even be superior, at all events after assessment (*New York Terminal Co.* v. *Gaus*, 204 N. Y., 512, 514), to mortgages already made, and will thus prevail against a purchaser who buys at a foreclosure sale. (*New York Terminal Co.* v. *Gaus*,

supra. Cf. *Marshall* v. *New York*, 254 U. S., 380, 384.) All this is settled in New York by reiterated judgments.

The problem here is different. To hold that a lien has progressed to such a point as to be a warning to mortgagees and purchasers of a contingent liability like a notice of lis pendens is far from holding that while the liability is unliquidated and unknown the lien thus created is perfect and specific. By the terms of the hypothesis it is nothing of the kind. If the State were to stand upon the warning and omit to ascertain the debt, it would never be able to sell anything, for it would not know how much to sell. Against mortgagees and purchasers a lien perfected afterwards may take effect by relation as of the date of the inchoate lien through which mortgagees and purchasers became chargeable with notice. The doctrine of relation will not divest the United States of the preference that accrued when receivers were appointed.

In what has been written there has been an assumption in favor of the petitioner that the tax would have priority if its amount had been liquidated before rights and interests became static through insolvency proceedings. The assumption is hardly to be reconciled with a judgment of this court pronounced a century and more ago. (*Thelusson* v. *Smith*, 2 Wheat., 396, 426.) The ruling there was that the general lien of a judgment upon the lands of an insolvent debtor is subordinate to the preference established by the statute unless seizure by a marshal or some other equivalent act has made the lien specific and brought about a change of title or possession. Later cases have drawn a distinction between the liens of judgments and of mortgages. These last have been thought to have the effect of a conveyance, divesting the debtor of his title and leaving nothing but an equity to which a preference can attach. (*Conard* v. *Atlantic Insurance Co.*, 1 Pet., 386; *Brent* v. *Bank of Washington*, 10 Pet., 596, 611, 612; *Savings Society* v. *Multnomah County*, 169 U. S., 421, 428.) We do not now determine whether the holding in the mortgage cases is to be applied in jurisdiction where a mortgage upon real estate is a lien and nothing more (*Trimm* v. *Marsh*, 54 N. Y., 599), nor whether, if so applied, it imports a modification of the holding in the Thelusson case as to the lien of a judgment. (Cf. *United States* v. *Bank*, 3 Story, 79, 81; *United States* v. *Duncan*, 4 McLean, 607, 630.) A mortgage, even though a lien, is one much more specific than a judgment or a tax, much closer to ownership. (*Conard* v. *Atlantic Insurance Co.*, supra, 443; *In re Boyd*, 4 Sawyer, 262, 264.) Into these refinements and their consequences, there is no need to enter now. Enough for present purposes that the statutory preference must prevail against the lien of a tax not presently enforcible, but serving merely as a *caveat* of a more perfect lien to come.

The judgment is affirmed.

TITLE IV.—ADMINISTRATIVE PROVISIONS.

SECTION 602.—BOARD OF TAX APPEALS—TRANSFEREE PROCEEDINGS.

REVENUE ACT OF 1928.

Maintenance of burden of proof imposed on Commissioner. (See Ct. D. 646, page 301.)

SECTION 607.—EFFECT OF EXPIRATION OF PERIOD OF LIMITATION AGAINST UNITED STATES.

XII-17-6144
Ct. D. 656

INCOME AND EXCESS PROFITS TAX—REVENUE ACTS OF 1924, 1926, AND 1928—DECISION OF COURT.

1. COMPROMISE AGREEMENT—VALIDITY OF SETTLEMENT—RECOVERY BARRED.

Where an assessment of additional taxes for the year 1917 is satisfied by the credit of overassessments of taxes for the years

1918, 1919, 1920, and 1924 and by voluntary payments, the credits and payments being made more than five years after the filing of the return, and a compromise of the interest due on the additional assessment is offered and accepted, the compromise precludes recovery of the overassessments credited and the payments.

2. SAME—TAXES PAID "WITHOUT RECOURSE."

Where a compromise agreement is made "without recourse," such words and the attendant circumstances disclose an intention to finally settle all matters with reference to the taxes for that year. *Heber Hord* v. *United States* (59 Fed. (2d), 125 [Ct. D. 582, C. B. XI-2, 144]) followed.

3. SAME—LIMITATION.

Sections 607 and 608 of the Revenue Act of 1928 have no application to a case where, prior to the enactment of such Act, a settlement has been effected between the parties.

COURT OF CLAIMS OF THE UNITED STATES. No. L-177.

The Trumbull Steel Co. v. *The United States.*

[November 14, 1932.]

OPINION.

GREEN, Judge, delivered the opinion of the court.

This is a suit to recover $369,773.43, money received by the Government and applied on plaintiff's taxes for 1917. The material facts in the case are as follows:

On March 28, 1918, the plaintiff filed its corporation income and excess-profits tax return for the year 1917 showing a tax liability of $1,937,732.21 which was shortly thereafter paid by plaintiff, but the Commissioner of Internal Revenue on March 21, 1923, assessed an additional tax liability of $369,773.43. On April 6, 1923, the plaintiff filed a claim of abatement of the additional tax so assessed. This claim in abatement was rejected and the Commissioner having found that overassessments had been made against the plaintiff for the years 1918, 1919, 1920, and 1924, these overassessments were credited against the tax assessment for the year 1917 and cash payment was made of the remainder of the overassessment by the plaintiff voluntarily and without protest. All of these credits given on the 1917 tax on account of overassessment for other years and the two cash payments made thereon, being respectively $119,733.19 and $15,520.67, were credited or paid more than five years after the filing of the return for the 1917 taxes. These credits and cash payments equaled the amount of the taxes assessed for the year 1917 but the Commissioner made an additional claim for interest in the amount of $110,154.53 on the additional assessment against plaintiff for that year. On March 11, 1927, the plaintiff made an offer of compromise in the sum of $2,000 in settlement of the liability for interest which had been alleged by the Government. After all of the additional assessment for 1917 had been paid by the credits and cash payments above referred to, the defendant accepted the offer of $2,000 in compromise of the liability for interest and the whole matter was apparently closed, the cash payments having been made voluntarily by the plaintiff and no intimation of any objection to the credits having been made. In this suit, however, the plaintiff now claims that the settlement was void and of no effect. The plaintiff has filed a claim for refund specifying in its claim that it is for the taxes of 1917, 1918, 1919, 1920, and 1924 (the last four years being the years for which overassessments were allowed) and seeks to recover the full amount of the credits for overassessments and the cash payments made on the taxes of 1917 on the ground that such credits were made and the money collected after the period of limitations for the collection of the taxes of 1917 had expired.

The case turns, as we think, upon the validity of the settlement made between the parties. Counsel for plaintiff contend that defendant had no legal right to apply either the credits for the overassessments, or the cash payments made, upon the deficiency in the amount assessed on the 1917 taxes, and that a suit to recover the amount of this deficiency and interest could not have been successfully maintained. As the law now stands this must be conceded. The

payments were all made more than five years after the 1917 return had been made. The period of limitation for collection of the 1917 tax under the 1921 Act had therefore expired, and while section 278(d) of the 1924 Act provided that if the assessment was made in time (as it was in the case at bar) the tax could be collected within six years from the time of the assessment, it also contained in section 278(c) a somewhat contradictory provision, that in cases where either the assessment or the collection was barred by the statute of limitations when the 1924 Act was enacted "this section" should not apply. But the actions of both plaintiff and defendant showed that neither party considered at that time that the collection of the tax was barred by the statute of limitations. Plaintiff tried first to get the additional assessment abated, and when its plea for abatement was overruled paid the amount of the tax and endeavored to get a settlement for a small sum of the amount of interest which the defendant claimed. At no time was there any suggestion on the part of plaintiff that indicated that defendant was insisting on an unenforceable claim and the defendant on its part proceeded as deliberately as if it had six years from the time the assessment was made in which to make the collection. It is said that *Bowers v. New York & Albany Lighterage Co.* (273 U. S., 346 [T. D. 4068, C. B. VI-1, 268]) had already held that the defendant had no right to the money voluntarily paid on the additional assessment. This is not correct. This case merely held that under the 1921 Act, when the period of limitation had expired, defendant could not retain taxes which had been collected by distraint after the expiration of that period. Unquestionably the same rule would apply to any instance where the statute of limitation had expired under the law as it stood at the time when this decision was rendered. But the application of the 1924 Act had not been definitely settled at the time the payments in the case at bar were made, and, considering the fact that section 1106 of the statute of 1926 was then in force, the whole legal situation was at that time in doubt, for after these payments had been made, it might have been questioned whether, under the law as it stood when the settlement was entered into, section 1106 of the 1926 Act would not have prevented any refund because the tax was not overpaid. It should also be kept in mind all through that the plaintiff merely paid the tax which was originally properly assessed and later, after filing a claim in abatement and making a long plea as to why it should not pay the interest provided by law, obtained a settlement of the interest on payment of a small amount.

Thus we have a situation in which a settlement was made, sums were collected or the defendant received amounts which although originally due, at the time could not have been recovered by the defendant if the trial had then been had in the courts. It is not necessary, however, that defendant should show that it was able to recover something upon the claim in order to retain the proceeds of the settlement. In 12 C. J., page 329, section 18, it is said:

"It is clear, however, that the claim need not be valid in the sense that claimant be able to recover on it, and it is not material that the other party may have a good defense; or that a subsequent judicial decision may show the rights of the parties to have been different from what they at the time supposed; or that one of the parties may afterward find out that he might have obtained a judgment more favorable to him by trying out the claim on its merits."

Further, in section 19, page 331, it is said:

"According to the great weight of authority, it is sufficient to support a compromise that there be an actual controversy between the parties of which the issue fairly may be considered by both parties as doubtful and that, at the time of the compromise, they in good faith so consider it. *It is not essential that the question be in fact doubtful in legal contemplation.*" [Italics ours.]

In testing the validity of the settlement we must consider the circumstances and the law then applicable thereto. On plaintiff's behalf it seems to be assumed that defendant had no right to retain the sums credited or paid. Conceding for the sake of the argument only that the courts would now so hold, we think it may be properly said, as stated above, that there was at that time more or less doubt about the matter. Subdivision (a) of section 1106 provided that the bar of the statute of limitations with reference to any internal-revenue tax should not only operate to bar the remedy but to extinguish the liability, but it also provided that "no credit or refund in respect to such tax shall be allowed unless the taxpayer has overpaid the tax." We do not need to determine the effect of these somewhat inconsistent provisions. The

plaintiff had not overpaid the tax. Independently of the question of whether the 6-year limitation might apply, both plaintiff and defendant might well have considered that under all of the circumstances of the case it was doubtful whether the plaintiff could recover back the sums that had already been paid without regard to the interest, and the plaintiff might well have considered that under such circumstances the best thing to be done was to close the case for a small sum if settlement could be obtained on such terms. On the part of defendant's officials it might have been thought and considered that the Government could probably retain what had already been paid and recover the interest which it claimed, but as the delay in payment had not been entirely the fault of plaintiff it was hardly fair to collect the full amount, and on the whole it was well to accept a compromise offer of a small sum providing the case was completely closed and ended. It should be observed in this connection, that in order to sustain the compromise it is only necessary that the parties negotiating the compromise considered the claim doubtful and it is not necessary that the court should hold that it was in fact doubtful under the law applicable thereto. It is true that, as stated in section 20, page 332, 12 C. J.:

"A claim as to which the doubt or dispute arises must be asserted honestly and in good faith."

In other words, if the party receiving the benefits of the settlement knows that he has no claim, the making of the claim and the settlement may constitute a fraud upon the other party which will justify the court in setting the settlement aside. But the evidence fails to show that such a condition existed, and under the law as it stood at that time defendant had good cause to believe that at the time the settlement was made it could retain every dollar that had been paid.

Quoting again from 12 C. J., section 21, page 333, it is said:

"* * * a claim is honest if the claimant does not know that his claim is a mere nothing," and "if both parties know all the facts and with knowledge of those facts obtained a compromise, it can not be said to be dishonest."

It is urged on behalf of plaintiff that a knowledge of the law is presumed and that the Government officials at least ought to have known that they were not entitled to retain the funds that had been credited and paid. What we have said above shows that we are not disposed to agree with the conclusion that the Government officials should have known they were not entitled to retain these funds and in effect it is contrary to the findings which we have made. Moreover, if we were to concede that such was the fact it would not help plaintiff's case.

In section 20 of 12 C. J., the rule is laid down that—

"The presumption of knowledge of the law can not be availed of in order to show that a person asserting a claim had knowledge of its invalidity."

And it is well said in *Smith* v. *Richards* (29 Conn., 232, 239) that the ordinary rule that a man can not plead ignorance of the law has no application to bona fide compromises or settlements "the very object of which is to avoid the uncertainty of the law, when perhaps there is no uncertainty as to facts. It could never be endured that bona fide arrangements of this kind should be held to be of no validity."

The questions of whether the claim was asserted in good faith, or whether it was fairly and deliberately made, are questions for the jury to determine (12 C. J., section 20); or where the case is tried by the court to be determined by the court. Neither bad faith nor fraud are ever presumed and there is nothing in the evidence to show that the Government officials were making the claim in bad faith, and we have so found. The law as stated above has been applied by the Supreme Court in *Hennessy* v. *Bacon* (137 U. S., 78, 85), where the opinion of the court concedes that if the plaintiff had taken his case to the courts he must have been successful, but having settled it, the Supreme Court said:

"Such a settlement ought not to be overthrown, even if the court should now be of opinion that the party complaining of it surrendered rights that the law, if appealed to, would have sustained."

We are therefore of the opinion that the settlement was valid.

It is urged, however, on the part of the plaintiff that conceding the settlement to be valid, it settled nothing but the interest under the statements made therein. We do not concur in this construction of the wording of the

proposition submitted by plaintiff and the language accepting it. On this point the case is controlled by the opinion in *Heber Hord* v. *United States*, decided by this court June 6, 1932 [Ct. D. 582, C. B. XI-2, 144], where the terms of the proposition of settlement, so far as they relate to the point in controversy, were exactly the same. The proposition of compromise made by the plaintiff stated that the deficiency in the tax had been paid "without recourse." Counsel for plaintiff discuss the meaning of this language and show in their argument that when used in an indorsement on promissory notes it has no meaning which is applicable to this case. But we are obliged to give this language some meaning if we can consistently do so considering all of the other language used and the circumstances of the case. Even if we concede that these words as used in the proposition of settlement are ambiguous, we are still bound to determine what the parties intended unless there is no evidence from which such intention can be determined. When we consider all of the circumstances of the case we are forced to the conclusion, as the court was in the Hord case, supra, that the acceptance of the proposition by the Commissioner "was conditioned upon payment of the tax without recourse," meaning that the plaintiff would thereafter have no claim upon the Government to recover the amount so paid. Besides this, the Commissioner in accepting the offer of compromise stated that it was decided, "with the advice and consent of the Secretary of the Treasury to accept the amount heretofore paid and deposited in full settlement of the liability *and so close the case*." [Italics ours.] The evidence shows that there was no intimation on the part of the plaintiff that it intended to make any further claim in the case. Taking all of the circumstances of the case into consideration, we have concluded that both parties intended to finally settle all matters with reference to plaintiff's taxes for 1917 by this compromise and have so found.

One other matter needs to be mentioned. It is urged on behalf of plaintiff that under the law of 1928 and the decision of this court in *Parks & Woolson Machine Co.* v. *United States*, decided May 31, 1932 [Ct. D. 562, C. B. XI-2, 146], the credits upon the deficiency in the tax of 1917 were void and that when the certificates of overassessment were made such certificates constituted an account stated and plaintiff had six years in which to commence suit for their recovery.

For the purposes of the argument we may concede that if we consider these certificates of overassessment by themselves and apart from other transactions in the case they constituted an account stated and showed that the Government held money belonging to plaintiff in the amounts certified. But the fact that the Government holds money belonging to a taxpayer does not prevent its applying the money on other taxes assessed against him. In fact this is being done every day and when such action is taken, unless there is something in the law as applied to the circumstances which provides otherwise, the Government can and does retain the money so applied. In the case at bar there are two matters which enable the defendant to retain the funds of the plaintiff so applied. The first is that under section 1106 of the Act of 1926, even though the collection of the tax was barred and the liability extinguished, there can be no refund where the taxpayer has not overpaid the tax. The second matter is that the whole controversy between the plaintiff and defendant over the taxes of 1917 had been finally settled by the compromise agreement. It is contended on behalf of plaintiff that the Act of 1928 made such an application of the overassessments void. But, as stated above, the Act of 1928 was not in force at the time the settlement was made. It is true it repealed section 1106 of the 1926 Act as of the date of its passage but, as we have stated in the Hord case, supra, sections 607 and 608 of the Act of 1928 have no application to cases where prior to the enactment of the 1928 Act a settlement had been effected between the parties. Manifestly the 1928 Act was not intended to set aside and render void agreements that had been entered into between the taxpayer and the Government.

The defendant contends that the plaintiff is not entitled to maintain this suit for the reason that prior to the commencement of the action it had sold and transferred to another party all of its assets, including choses in action, and that section 3477 of the Revised Statutes makes every such assignment or transfer void. On behalf of the plaintiff it is argued that if the transfer is void the plaintiff still has the right to maintain the action, leaving its accountability to the assignee to be determined hereafter. The conclusions that we have stated above make it unnecessary that we should determine the effect of the conveyance executed by the plaintiff.

The petition of the plaintiff must be dismissed and it is so ordered.

INCOME TAX RULINGS.—PART III.

REVENUE ACT OF 1926 AND PRIOR ACTS.

TITLE II.—INCOME TAX.

PART I.—GENERAL PROVISIONS.

SECTION 201.—DISTRIBUTIONS BY CORPORATIONS.

ARTICLE 1545: Distributions in liquidation.

REVENUE ACT OF 1921.

Revocation of General Counsel's Memorandum 801 (C. B. V-2, 139) in so far as inconsistent with *John H. Watson, jr.*, v. *Commissioner* (27 B. T. A., 463, page 13, this Bulletin). (See G. C. M. 11503, page 181.)

ARTICLE 1545: Distributions in liquidation.

REVENUE ACT OF 1917.

Liquidation of subsidiary as an incident to the dissolution thereof. Solicitor's Opinion 131 (C. B. I-1, 18) modified. (See G. C. M. 11676, page 75.)

ARTICLE 1545: Distributions in liquidation.

REVENUE ACT OF 1918.

Liquidation of subsidiary as an incident to the dissolution thereof. General Counsel's Memorandum 2774 (C. B. VII-1, 196) modified. (See G. C. M. 11676, page 75.)

ARTICLE 1546: Distributions from depletion or depreciation reserves. XII-13-6098 Ct. D. 644

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. INCOME—DIVIDENDS FROM FOREIGN CORPORATIONS—DEPLETION RESERVE.

Where taxpayer, a citizen and resident of the United States, owned stock in a Canadian mining corporation and in 1922 received a dividend paid in part from a depletion reserve, such dividend was taxable to him in accordance with sections 201(a) and 234(a)9 of the Revenue Act of 1921. The provisions of the revenue laws of the United States relating to dividends and deductions for depletion govern, rather than those of the Canadian taxing act.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (24 B. T. A., 906) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Edward D. Untermyer, petitioner, v. Commissioner of Internal Revenue, respondent.

Before MANTON, SWAN, and AUGUSTUS N. HAND, Circuit Judges.

[June 27, 1932.]

OPINION.

Appeal from the United States Board of Tax Appeals. The taxpayer petitioned for a review of an order of the Board of Tax Appeals (24 B. T. A., 989) which affirmed the Commissioner's determination of his income tax for 1922. The taxpayer files the petition. Order affirmed.

PER CURIAM: The petitioner, a citizen and resident of the United States, in 1922, received a dividend of $42,000 from a mining corporation of Canada. In his tax return for that year, he reported $20,815.20, as representing a taxable dividend and the balance of $21,184.80, as not subject to income tax, pursuant to advices received from the Canadian mining company, upon the ground that this sum was paid from a fund which was set apart by the corporation as representing, according to the tax authorities of the Dominion of Canada, a proper deduction for depletion. This amount was consistent with the depletion rule made by the tax authorities of Canada. The respondent refused to allow this sum to be nontaxable as depletion. It resulted in a deficiency of $5,555.08. The Board of Tax Appeals sustained respondent's determination.

The distribution of $42,000 was made from the mining company's surplus out of earnings and profits and is a dividend. (Section 201(a), Revenue Act of 1921, ch. 136, 42 Stat., 227.) But petitioner now contends that the distribution received by him was paid out of accumulated earnings or profits only to the extent of $26,897.64 and the balance of $15,102.36 was paid out of depletion reserve and hence is tax free as being a return of capital.

The sustained depletion and the earned surplus of the corporation must be computed according to the revenue laws of the United States. The taxing Acts make allowances for depletion, based upon costs, limited to the amount of capital invested. (Section 234(a)9, Revenue Act of 1921; section 234(a)9, Revenue Act of 1918.) It is regarded as a return of capital, not a special bonus for enterprise or for willingness to assume risks. (*United States* v. *Ludey*, 274 U. S., 303 [T. D. 4046, C. B. VI-2, 157].) This theory of the nature of depletion allowances agrees with accounting principles. (Holmes Federal Taxes, 6th Ed., pages 1100, 1102.) And it is in line with the policy embodied in the provisions of the revenue laws which, upon the conversion of a capital asset, taxes any increment in value. (Sections 213(a), 202, Revenue Act of 1921.)

The reasons which impel the taxing authorities of Canada to make allowances for depletion are not material here. However, it may be noted that the allowance there has no relation to the cost or the quantity of ore extracted. The amount of the allowances seems to be discretionary as fixed by the Minister of Finance. The reasons and the method which impelled Congress to grant allowances for depletion are set forth in *United States* v. *Ludey* (supra). Our Revenue Acts have their own criterion and look to tests of liability and exemption. (*Weiss* v. *Wiener*, 279 U. S., 333 [Ct. D. 60, C. B. VIII 1, 257].) We have not permitted provisions of the Federal tax law to be abridged by the provisions of local statutes. (*Burk-Waggoner Oil Assn.* v. *Hopkins*, 269 U. S., 110 [T. D. 3790, C. B. V-1, 147]; *N. Y., N. H. & H. R. R.* v. *United States*, 289 F., 907 (C. C. A. 2) [Ct. D. 3, C. B. 4, 258]; *Boston & Maine R. R.* v. *United States*, 295 Fed., 578 (C. C. A. 1).)

Nor is the petitioner subject to the Canadian tax law. He was not a party before that administrative authority in any way. The administration of the Canadian taxing act granting allowances for depletion conferred no rights and incurred no obligations upon him so far as his tax liability to the United States was concerned—at least none that the Commissioner here could recognize. (*Disconto Gesellschaft* v. *Umbreit*, 208 U. S., 570; *Townsend* v. *Jemison*, 50 U. S., 406.)

Whether the distributions received by the petitioner in 1922 were entirely from earned surplus must be determined in accordance with our revenue laws. The Commissioner has determined that the petitioner was paid out of earned surplus of the Canadian mining company and that the amount received was taxable to him as a dividend. That determination is binding.
Order affirmed.

SECTION 202.—DETERMINATION OF AMOUNT OF GAIN OR LOSS.

ARTICLE 1561: Determination of the amount of gain or loss.

REVENUE ACTS OF 1921, 1924, AND 1926.

"Delay rentals" as carrying charges. (See G. C. M. 11197, page 238.)

ARTICLE 1561: Determination of the amount of gain or loss. XII-15-6123 G. C. M. 11655

REVENUE ACT OF 1918.

Recommended that Office Decision 945 (C. B. 4, 44), which relates to the proper basis to be used in determining gain or loss from the sale of land granted the taxpayer in return for a certain cash consideration and his promise to support the grantor during the remainder of her life, be revoked in so far as it makes no allowance for the fact that the payments for support and for insurance are not present payments.

An opinion is requested whether Office Decision 945 (C. B. 4, 44) should be revoked, in view of certain recent decisions.

The question involved is the proper basis to be used in determining gain or loss from the sale of land granted the taxpayer by his mother in return for a certain cash consideration and his promise of support for the remainder of her life.

In Office Decision 945, supra, it was held that the "basis may be determined by ascertaining from life tables the expectancy of life of the mother and multiplying the number of years in such expectancy of life by the cost of a year's maintenance, the amount so obtained to be added to the amount of the cash payment made."

It is contended that the above ruling makes no allowance for the fact that the payments for support are not present payments but are to be made in the future. The issue, therefore, is whether such payments should be discounted.

In General Counsel's Memorandum 1022 (C. B. VI-1, 12) the facts show that the taxpayer conveyed to a corporation an apartment house, receiving in payment an annuity contract whereby the corporation agreed to pay him a stated sum per annum during his lifetime. It was held that the exchange was productive of gain or loss, depending upon whether the value of the annuity contract (computed in accordance with "Table A," Regulations 70, relating to estate tax) was in excess of, or less than, the cost or other basis. It will be noted that the table referred to is based upon discounted present worth values.

In *Florence L. Klein* v. *Commissioner* (6 B. T. A., 617, C. B. X-2, 89) it appears from the facts that in April, 1913, the taxpayer by contract relinquished property rights in exchange for an annuity during her mother's life, the value of which in April, 1913, was stipulated on the basis of discounting the annual payments to a present worth basis. In that case the issue involved was the taxability of the annual payments when received. The Board held that when actually received in each year the annual payment consists of the principal value of 1913 of such payment plus the discount, the latter being the gain taxable as income.

In *John C. Moore Corporation* v. *Commissioner* (15 B. T. A., 1140, C. B. X-2, 95) the petitioner entered into an agreement with the owner of real estate to pay her an annuity as the consideration for the conveyance of such real estate. It was held that the petitioner entered upon an annuity venture upon which gain or loss is to be computed. It was further held that to the extent that each annual payment is in excess of the present value of such payment at the time when the annuity contract was undertaken, it is deductible in computing income. That decision was affirmed by the Circuit Court of Appeals for the Second Circuit (*Commissioner* v. *John C. Moore Corporation*, 42 Fed. (2d), 186). Petition for certiorari was not filed.

In view of the rulings and decisions above cited, it is clear that Office Decision 945 is erroneous in that it fails to make allowance for the fact that the payments for support and for insurance to secure such support in case of death are not present payments but are to be made in the future. The proper method of determining the basis depends upon the particular facts existing in each case.

It is the recommendation of this office that Office Decision 945 be revoked in so far as it makes no allowance for the fact that the payments for support and for insurance are not present payments.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1561: Determination of the amount of gain or loss. XII-15-6124 I. T. 2689

REVENUE ACT OF 1918.

In view of General Counsel's Memorandum 11655 (page 159), Office Decision 945 (C. B. 4, 44), which relates to the proper basis to be used in determining gain or loss from the sale of land granted the taxpayer in return for a certain cash consideration and his promise to support the grantor for the remainder of her life, is hereby revoked in so far as it makes no allowance for the fact that the payments for support and insurance are not present payments.

ARTICLE 1561: Determination of the amount of gain or loss.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Requirements for the allowance of estimated cost of future improvements to real estate. (See Mim. 4027, page 60.)

SECTION 203.—RECOGNITION OF GAIN OR LOSS FROM SALES AND EXCHANGES.

ARTICLE 1572: Exchanges of property.

REVENUE ACT OF 1917.

Liquidation of subsidiary as an incident to the dissolution thereof. Solicitor's Opinion 131 (C. B. I–1, 18) modified. (See G. C. M. 11676, page 75.)

ARTICLE 1572: Exchanges of property.

REVENUE ACT OF 1926.

Constitutionality of section 203(b)4 of the Revenue Act of 1926. (See Ct. D. 680, page 173.)

ARTICLE 1574: Exchanges in connection with corporate reorganizations. XII–7–6028 Ct. D. 630

INCOME TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

1. GAIN OR LOSS—SALE OF ASSETS.

Where petitioner corporation contracted with another to sell its physical property and good will of the business for a definite sum of money, part to be paid in cash and the balance to be paid by short-term promissory notes of the purchaser, secured by deposit of mortgage bonds, the gain must be recognized, as the transaction constituted a sale of petitioner's property for money and was not a reorganization, merger, or consolidation within the meaning of section 203 of the Revenue Act of 1926.

2. SAME—SECURITIES.

Short-term purchase money notes are not securities within the meaning of section 203 of the Revenue Act of 1926.

3. REORGANIZATION—MERGER OR CONSOLIDATION—CLAUSE (A) OF SECTION 203(h)1, REVENUE ACT OF 1926, CONSTRUED.

The parenthetical words in clause (A) of section 203(h)1 of the Revenue Act of 1926 expand the ordinary and accepted meaning of the words "merger or consolidation" to include some things which partake of the nature of a merger or consolidation so as to embrace circumstances difficult to delimit but which in strictness can not be designated as either merger or consolidation.

SUPREME COURT OF THE UNITED STATES.

Pinellas Ice & Cold Storage Co., petitioner, v. *Commissioner of Internal Revenue.*

On writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[January 9, 1933.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the court.

Petitioner, a Florida corporation, made and sold ice at St. Petersburg. Substantially the same stockholders owned the Citizens Ice & Cold Storage Co., engaged in like business at the same place. In February, 1926, Lewis, general manager of both companies, began negotiations for the sale of their properties to the National Public Service Corporation. Their directors and stockholders

were anxious to sell, distribute the assets and dissolve the corporations. The prospective vendee desired to acquire the properties of both companies, but not of one without the other.

In October, 1926, agreement was reached and the vendor's directors again approved the plan for distribution and dissolution. In November, 1926, petitioner and the National Corporation entered into a formal written contract conditioned upon a like one by the Citizens Company. This referred to petitioner as "vendor" and the National Corporation as "purchaser." The former agreed to sell, the latter to purchase the physical property, plants, etc., "together with the good will of the business, free and clear of all defects, liens, encumbrances, taxes and assessments for the sum of $1,400,000, payable as hereinafter provided." The specified date and place for consummation were 11 a. m., December 15, 1926, and 165 Broadway, New York City, when "the vendor shall deliver to the purchaser instruments of conveyance and transfer by general warranty in form satisfactory to the purchaser of the property set forth. * * * The purchaser shall pay to the vendor the sum of $400,000 in cash." The balance of the purchase price ($1,000,000) shall be paid $500,000 on or before January 31, 1927; $250,000 on or before March 1, 1927; $250,000 on or before April 1, 1927. Also, the deferred installments of the purchase price shall be evidenced by the purchaser's 6 per cent notes, secured either by notes or bonds of the Florida West Coast Ice Co., thereafter to be organized to take title, or other satisfactory collateral; or by 6 per cent notes of such Florida company secured by first lien on the property conveyed, or other satisfactory collateral.

The vendor agreed to procure undertakings by E. T. Lewis and Leon D. Lewis not to engage in manufacturing or selling ice in Pinellas County, Fla., for 10 years.

The $400,000 cash payment was necessary for discharge of debts, liens, encumbrances, etc. The Florida company, incorporated December 6, 1926, took title to the property and executed the purchase notes secured as agreed. These were paid at or before maturity except the one for $100,000, held until November, 1927, because of flaw in a title. As the notes were paid petitioner immediately distributed the proceeds to its stockholders according to the plan.

The property conveyed to the Florida company included all of petitioner's assets except a few vacant lots worth not more than $10,000, some accounts—$3,000 face value—also, a small amount of cash. Assets, not exceeding 1 per cent of the whole, were transferred to the Citizens Holding Corporation as trustee for petitioner's stockholders—99 per cent of all vendor's property went to the Florida company. The plan of the whole arrangement as carried out was accepted by petitioner's officers and stockholders prior to November 4, 1926.

The Commissioner of Internal Revenue determined that the petitioner derived taxable gain exceeding $500,000 and assessed it accordingly under the Act of 1926. The Board of Tax Appeals and the Circuit Court of Appeals approved this action.

The facts are not in controversy. The gain is admitted; but it is said this was definitely exempted from taxation by section 203, Revenue Act of 1926.

The Act, approved February 26, 1926 (ch. 27, 44 Stat., 9, 11, 12)—

"Sec. 202. (a) Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in subdivision (a) or (b) of section 204, and the loss shall be the excess of such basis over the amount realized.

"(b) * * *

"(c) The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

"(d) In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 203.

"(e) * * *

"Sec. 203. (a) Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 202, shall be recognized, except as hereinafter provided in this section.

"(b) (1) and (2) * * *

"(3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

"(4) and (5) * * *
"(c) and (d) * * *
"(e) If an exchange would be within the provisions of paragraph (3) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—
"(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but
"(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * * * *

"(h) As used in this section and sections 201 and 204—
"(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.
"(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation."

All of section 203(b) is in the margin.[1]

Counsel for the petitioner maintain—

The record discloses a "reorganization" to which petitioner was party and a preliminary plan strictly pursued. The Florida West Coast Ice Co. acquired substantially all of petitioner's property in exchange for cash and securities which were promptly distributed to the latter's stockholders. Consequently, under section 203, the admitted gain was not taxable.

The Board of Tax Appeals held that the transaction in question amounted to a sale of petitioner's property for money and not an exchange for securities

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[1] SEC. 203. (a) Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 202, shall be recognized, except as hereinafter provided in this section.
(b) (1) No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment, or if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.
(2) No gain or loss shall be recognized if stock or securities in a corporation a party to reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.
(3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.
(4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.
(5) If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

within the true meaning of the statute. It, accordingly and as we think properly, upheld the Commissioner's action.

The "vendor" agreed "to sell" and "the purchaser" agreed "to purchase" certain described property for a definite sum of money. Part of this sum was paid in cash; for the balance the purchaser executed three promissory notes, secured by the deposit of mortgage bonds, payable, with interest, in about 45, 75, and 105 days, respectively. These notes—mere evidence of obligation to pay the purchase price—were not securities within the intendment of the Act and were properly regarded as the equivalent of cash. It would require clear language to lead us to conclude that Congress intended to grant exemption to one who sells property and for the purchase price accepts well-secured, short-term notes (all payable within four months), when another who makes a like sale and receives cash certainly would be taxed. We can discover no good basis in reason for the contrary view and its acceptance would make evasion of taxation very easy. In substance the petitioner sold for the equivalent of cash; the gain must be recognized.

The court below held that the facts disclosed failed to show a "reorganization" within the statutory definition. And, in the circumstances, we approve that conclusion. But the construction which the court seems to have placed upon clause (A), paragraph (h) (1), section 203, we think is too narrow. It conflicts with established practice of the tax officers and if passed without comment, may produce perplexity.

The court said—"It must be assumed that in adopting paragraph (h) Congress intended to use the words 'merger' and 'consolidation' in their ordinary and accepted meanings. Giving the matter in parenthesis the most liberal construction, it is only when there is an acquisition of substantially all the property of another corporation in connection with a merger or consolidation that a reorganization takes place. Clause (B) of the paragraph removes any doubt as to the intention of Congress on this point."

The paragraph in question directs—"The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), * * *." The words within the parenthesis may not be disregarded. They expand the meaning of "merger" or "consolidation" so as to include some things which partake of the nature of a merger or consolidation but are beyond the ordinary and commonly accepted meaning of those words—so as to embrace circumstances difficult to delimit but which in strictness can not be designated as either merger or consolidation. But the mere purchase for money of the assets of one company by another is beyond the evident purpose of the provision, and has no real semblance to a merger or consolidation. Certainly, we think that to be within the exemption the seller must acquire an interest in the affairs of the purchasing company more definite than that incident to ownership of its short-term purchase money notes. This general view is adopted and well sustained in *Cortland Specialty Co.* v. *Commissioner of Internal Revenue* (60 F. (2d), 937, 939, 940). It harmonizes with the underlying purpose of the provisions in respect of exemptions and gives some effect to all the words employed.

The judgment of the court below is affirmed.

ARTICLE 1577: Definitions. XII-21-6191
Ct. D. 668

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. REORGANIZATION—TRANSFER OF PROPERTIES FOR CASH AND PROMISSORY NOTES.

Where, pursuant to an agreement between two corporations, the greater part of the assets of one of them was turned over to the other in 1925 for cash and the short-term unsecured promissory notes of the transferee corporation, with no interest in such assets retained by the transferor or its stockholders, the transaction did not constitute a reorganization within the meaning of section 203 of the Revenue Act of 1926, but bore all the characteristics of a

simple sale, the gain from which was presently taxable. When section 203(h)1(A) includes within the definition of the term "reorganization" the acquisition of "substantially all the properties of another corporation," it presupposes some continuity of interest on the part of the transferor corporation or its stockholders in the assets transferred. Reorganization, merger, and consolidation are words indicating corporate readjustments of existing interests.

2. SAME—"SECURITIES."

Where one corporation transfers to another properties for cash and short-term unsecured promissory notes of the transferee, such notes can not be considered "securities" within the meaning of section 203(e) of the Revenue Act of 1926.

3. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (22 B. T. A., 808) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Cortland Specialty Co., Mrs. H. R. Sargent, H. R. Sargent, petitioners, v. Commissioner of Internal Revenue, respondent.

Appeal from orders of the United States Board of Tax Appeals.

Before L. HAND, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

[July 29, 1932.]

OPINION.

From orders of the Board of Tax Appeals determining a tax deficiency of $13,412.82 against the petitioners Cortland Specialty Co., Mrs. H. R. Sargent and H. R. Sargent, respectively, each of said petitioners appeals. Affirmed.

AUGUSTUS N. HAND, Circuit Judge: The question raised by this appeal is whether the transfer by Cortland Specialty Co. to Deyo Oil Co., Inc., hereinafter described was a reorganization within the meaning of section 203(h)1 of the Revenue Act of 1926 which relieved the Cortland company from paying an income tax upon any gain that might result therefrom or whether the transfer was a mere sale which subjected the transferor to a tax on any profit which it realized. The Cortland company made its return upon the theory that the transfer was in effect a reorganization. The Commissioner held that it was nothing but a sale and assessed a tax deficiency against it for the year 1925 in the sum of $13,412.82 because of a profit of $101,175.58 over the depreciated cost of the property transferred. A similar tax deficiency was assessed against Mr. and Mrs. Sargent as transferees of the assets of the Cortland company. Their liability is undisputed in case that of the company should stand. The Board of Tax Appeals affirmed the action of the Commissioner.

During the year 1925 the Cortland company was engaged in the business of buying and selling petroleum products. Herbert R. Sargent and his wife Bertha C. Sargent were the sole owners of its stock. Mr. Sargent was the president, treasurer and general manager, and Mrs. Sargent was the secretary. The Deyo Oil Co. was a corporation engaged in the same business and each of the companies were New York corporations. On September 26, 1925, agreements were entered into between the Cortland company and Deyo company, and by Sargent and the latter, whereby the greater part of the assets of the Cortland company were turned over to the Deyo company, the Cortland company agreed to discontinue business after October 1, 1925, and Sargent became the general manager of the business of the Deyo company in the territory previously served by the Cortland company. The assets to be transferred under the contract were:

(1) Real property, leases and physical equipment of Cortland.
(2) Merchantable petroleum products of Cortland.

The consideration for the transfer, according to the contract, was:

Payments by Deyo for real property, leases and physical equipment of business made under articles "First" and "Third" of the contract of transfer:

Cash		$53,070.00
Promissory notes of Deyo, each dated October 1, 1925, and payable:		
Dec. 1, 1925	$35,500.00	
Jan. 1, 1926	21,300.00	
Mar. 1, 1926	26,625.00	
June 1, 1926	26,625.00	
Sept. 1, 1926	26,625.00	
Dec. 1, 1926	23,075.00	
		159,750.00
Total notes		212,820.00
Payment by Deyo, on October 9, 1925, for merchantable petroleum products purchased from Cortland under article "Fourth" of the contract		23,803.82
Total receipts by Cortland on account of transfer		236,623.83

The $53,070 of cash paid by Deyo to Cortland, and the $159,750 in notes of Deyo, were distributed by Cortland to Mr. and Mrs. Sargent, its sole stockholders, shortly after the transfer occurred. They collected the notes as they fell due, the note for $21,300, payable December 1, 1925, on that date, and the remaining notes when they matured in 1926.

The Cortland company proceeded to liquidate its accounts receivable and trade notes and other property not included in the transfer to Deyo to pay its debts and in general to prepare for dissolution which occurred June 30, 1926.

The following assets of Cortland were not transferable to Deyo under the contract with the latter:

Accounts and trade notes receivable amounting to about	$60,000.00
Stock of garage company valued at	4,000.00
Estimated cash on hand, not included in transfer	14,000.00
Total assets not transferred under contract	78,000.00
Amount owing by Cortland to its creditors was	56,000.00
Net amount of assets of Cortland not covered by contract with Deyo	22,000.00

From the foregoing, it is probable that, in view of an immediate proposed distribution by Cortland to its stockholders and of the possibility of poor returns from the $60,000 of accounts, Cortland omitted from the contract the $78,000 of assets in order safely to pay its own creditors, and relied on the assets which it retained and the amount which its petroleum products sold to Deyo would later yield, to care for its existing obligations and for further expenses connected with the transfer and the dissolution proceedings.

The net result of its transactions was to transfer to Deyo assets amounting to $236,623.82 and to withhold net assets from the transfer of $22,000, making its total assets at the date of transfer equal $258,623.82.

The foregoing tabulation shows that about 91½ per cent of Cortland's assets were transferred to Deyo and only about 8½ per cent were retained. There can be no doubt that by the transfer Deyo acquired substantially all the properties of Cortland and so the Board of Tax Appeals found.

Whether the above transfer of real property, leases and equipment was a sale resulting in a gain on which Cortland was taxable, or whether it represented an exchange in pursuance of a "plan of reorganization" on which no gain should be recognized, depends on the effect to be given to the provisions of section 203 of the Revenue Act of 1926.

It may be said at the outset that the contract of Cortland with Deyo and the corporate resolution authorizing it to be made treat the transfer to the latter as a sale. The instrument begins by reciting that Cortland "has determined * * * to sell and dispose of all its physical and tangible assets" and that Deyo "has determined to purchase said assets." It goes on to say that Cortland "agrees to sell, transfer and convey * * * all and singular its real property, interests in real property, leases of real property * * * and equipment * * *," and later to say that it "shall sell * * * all of the merchantable gasoline, kerosene, oils and other petroleum products" and that Deyo "agrees to pay" the "purchase price of $213,000" for the "real

property * * * and equipment" and a further "purchase price" to be determined by "an inventory taken at prevailing cost prices" for the "petroleum products." Nothing is said about the acquisition of any vested interest by Cortland or its stockholders in the business or assets of Deyo, but, on the contrary, it is provided that their interest shall be completely severed for, under article "Fifth" of the contract, Cortland is "not to engage in the business of buying, selling or dealing in gasoline, kerosene or other petroleum products from and after October 1, 1925," and is to receive nothing but cash and short-time promissory notes as the consideration for the business and property sold. The transaction certainly bore all the characteristics of a simple sale.

But it is argued that under subdivision (e) and (e)1 of section 203 of the Revenue Act of 1926 "no gain or loss shall be recognized if a corporation, a party to a reorganization" distributes "stock or securities" and "money" "in pursuance of the plan of reorganization," and that under subdivision (h)1(A) of the section the term "reorganization" is defined broadly enough to exempt Cortland from a profit tax on its transfer. In (h)1(A) a reorganization is defined as "a *merger or consolidation*" and the subdivision goes on to say that "merger or consolidation" *include* "the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation." If the last clause means that any transfer of "substantially all the properties" of one corporation to another corporation is a reorganization, the position of Cortland is strong; but we do not regard such an interpretation as warranted.

Reorganization, merger and consolidation are words indicating corporate readjustments of existing interests. They all differ fundamentally from a sale where the vendor corporation parts with its interest for cash and receives nothing more. Reorganization in the most ordinary sense suggests "the formation of a new corporation that is in financial difficulties, for the purpose of purchasing the company's works and other property, after the foreclosure of a mortgage or judicial sale." (Morawetz Corp., section 812; *Symmes* v. *Union Trust Co.*, 60 Fed., 870.) While the term includes financial readjustments in ways other than by judicial sale it does not properly embrace mere purchases by one company of the assets of another. (*Little Rock Chamber of Commerce* v. *Reliable Furniture Co.* (Ark.), 211 S.W., 371.) Reorganization is defined in (h)1(A) as including "a merger or consolidation." A merger ordinarily is an absorption by one corporation of the properties and franchises of another whose stock it has acquired. The merged corporation ceases to exist and the merging corporation alone survives. A consolidation involves a dissolution of the companies consolidating and a transfer of corporate assets and franchises to a new company. In each case interests of the stockholders and creditors of any company which disappears remain and are retained against the surviving or newly created company. (*Railroad Company* v. *Georgia*, 98 U. S., at p. 362; *Matter of Bergdorf*, 206 N. Y., 309; *Pinellas Ice & Cold Storage Co.* v. *Commissioner*, 57 Fed. (2d), 188; *Royal Palm Soap Co.* v. *Seaboard Air Line Railroad Co.*, 296 Fed., 448; *Lee* v. *Atlantic Coast Line*, 150 Fed., 775.) Undoubtedly such statutes vary in the different States, particularly in respect to how far the constituent companies may be deemed to survive the creation of the new or modified corporate structure, but we believe that the general purpose of them all has been to continue the interests of those owning enterprises, which have been merged or consolidated, in another corporate form. A sale of the assets of one corporation to another for cash without the retention of any interest by the seller in the purchaser is quite outside the objects of merger and consolidation statutes.

Section 203 of the Revenue Act of 1926 must be interpreted in this setting. Its purpose was to relieve those interested in corporations from profits taxes in cases where there was only a change in the corporate form in which business was conducted without an actual realization of any gain from an exchange of properties. When describing the kind of change in corporate structure that permits exemption from these taxes, section 203 does not disregard the necessity of continuity of interests under modified corporate forms. Such is the purpose of the word "reorganization" in section 203(h)3 where a corporation exchanges its property "solely for stock or securities." Such also is the nature of the "merger or consolidation" described in (h)1(A) where a corporation acquires a majority of the stock of another, and such is the nature of the "reorganization" described in (h)1(B) where a corpora-

tion transfers assets to another corporation and the transferor, or its stockholders, immediately thereafter are in control of the transferee. The words: "A recapitalization," in (h)1(C) and "A mere change in * * * form * * * of organization however effected," in (h)1(D) involve the same idea.

When subdivision (h)1(A) included in its definition of "merger or consolidation" the "acquisition by one corporation of * * * substantially all the properties of another," it did this so that the receipt of property by the corporation surviving the merger might serve to effect a reorganization as does an acquisition of stock. Each transaction presupposed a continuance of interest on the part of the transferor in the properties transferred. Such a limitation inheres in the conventional meaning of "merger and consolidation" and is implicit in almost every line of section 203 which we have quoted. In *Pinellas Ice & Cold Storage Co.* v. *Commissioner* (57 Fed. (2d), 188) the Court of Appeals of the Fifth Circuit decided that a transaction almost exactly like the present was not a "merger or consolidation" but a mere sale carrying no exemption. Judge Groner's opinion in *Corbett* v. *Burnet* (50 Fed. (2d), 492) is in accord. In defining "reorganization," section 203 of the Revenue Act gives the widest room for all kinds of changes in corporate structure but does not abandon the primary requisite that there must be some continuity of interest on the part of the transferor corporation or its stockholders in order to secure exemption. Reorganization presupposes continuance of business under modified corporate forms.

Furthermore the Cortland company can not come within the exception to the general rule that gains realized from exchanges of property represent taxable income unless section 203(e) and section 203(e)1 apply. Under those clauses, even if the transfer to Deyo was an exchange in pursuance of a "plan of reorganization" the property received by Cortland had to include *some* "stock or securities" (section 203(e)) or the exemption could not be had. As no stock was issued against the transfer, the conditions for an exemption were not fulfilled unless the notes, all payable within 14 months of the date of the transfer, and all unsecured can be considered "securities" under section 203(e). Inasmuch as a transfer made entirely for cash would not be enough, it can not be supposed that anything so near to cash as these notes payable in so short a time and doubtless readily marketable would meet the legislative requirements.

The very reason that section 203(e) requires that some of the property received in exchange should be "*stock or securities*" is to deprive a mere sale for cash of the benefits of an exemption and to require an amalgamation of the existing interests. There can be no justice or propriety in taxing one corporation who transfers its properties for cash and in relieving another that takes part of its pay in short-time notes. The situation might be different had the "securities," though not in stock, created such obligations as to give creditors or others some assured participation in the properties of the transferee corporation. The word "securities" was used so as not to defeat the exemption in cases where the interest of the transferor was carried over to the new corporation in some form.

It seems unnecessary to say that the contract whereby Sargent went into the employment of Deyo for one year as manager in the business territory formerly occupied by Cortland did not place Cortland or its stockholders in control of Deyo in such a way as to effect a reorganization within the meaning of section 203(h)1(B).

The orders of the Board of Tax Appeals are affirmed.

SECTION 204.—BASIS FOR DETERMINING GAIN OR LOSS, DEPLETION, AND DEPRECIATION.

ARTICLE 1591: Basis for determining gain or loss from sale. XII-18-6155 Ct. D. 659

INCOME TAX—REVENUE ACTS OF 1918, 1921, AND 1928—DECISION OF COURT.

1. GAIN OR LOSS—BASIS—SALE BY ONE AFFILIATE TO ANOTHER AND RESALE TO AN OUTSIDER.

Where, prior to 1921, a parent corporation purchased bonds and in that year sold them to its subsidiary at a profit, which profit

was properly disregarded in the consolidated return required by section 240(a) of the Revenue Act of 1918 as representing an intercompany transaction, and where the subsidiary sold such bonds to the public in 1922 and for that year filed a separate return as authorized by the Revenue Act of 1921, the subsidiary was properly taxed, under section 202(a) of that Act, upon the gain derived, based upon the difference between the cost of the bonds to the affiliated group and the price received by the subsidiary. An affiliated group which has been treated as an economic unit and has received the benefit of exemption from taxation upon intercompany transactions must also be treated as a unit for the purpose of determining gain or loss upon sale of its property, and cost must be considered as the price paid when the bonds came into the unit, and not the price paid one affiliate by another.

2. STATUTES—INTERPRETATION—DEPARTMENTAL PRACTICE.

The enactment of section 113(a)12 of the Revenue Act of 1928, relating to the basis where property is acquired by one affiliate from another of the same group, did not demonstrate that prior thereto the law was otherwise, but was in recognition of the long-established practice of the Department.

3. DECISION REVERSED.

The decision of the Board of Tax Appeals (18 B. T. A., 510) reversed.

UNITED STATES CIRCUIT COURT OF APPEALS, TENTH CIRCUIT.

Commissioner of Internal Revenue, petitioner, v. *Liberty National Co., respondent.*

On petition to review the decision of the United States Board of Tax Appeals.

Before LEWIS and MCDERMOTT, Circuit Judges, and SYMES, District Judge.

[March 7, 1932.]

OPINION.

MCDERMOTT, Circuit Judge, delivered the opinion of the court.

The Liberty National Co. and the Liberty National Bank are affiliated corporations—child and parent. Section 240 of the Revenue Act of 1918 (40 Stat., 1082) required them to file consolidated returns, and taxes were computed on the invested capital of the unit and levied upon the consolidated income of the unit. Items of profit and loss arising out of transactions between corporations within the unit were disregarded. For taxation purposes, the group was treated as a unit.

Prior to 1921 the bank had acquired Liberty bonds by purchase from the public of a par value of $750,000, for which it had paid $718,038.25. These bonds had increased in value by the fall of 1921 to the extent of about $22,000. On November 23, 1921, the Revenue Act of 1921 was passed, effective as of that date (42 Stat., 227). It authorized affiliated corporations to file separate returns for the taxable year 1922. The bank had these bonds on hand that showed a large profit on which a tax must be paid when they were sold. The bank conceived the idea of selling these bonds to its subsidiary at a large profit; this profit would then be eliminated in the consolidated return for 1921; separate returns could be filed for 1922; the subsidiary could sell the bonds in 1922 and return no profit on the sale, and in this manner evade paying any tax on the profit realized when the bonds were sold to the public.

That is what was done. Two weeks after the 1921 law was passed, the bank sold these bonds to its subsidiary; the bank realized a profit on the sale of about $22,000. In the consolidated return for 1921 this profit was properly eliminated, and no tax paid thereon. Early in 1922 the subsidiary sold the bonds for a trifle more than the December purchase price, but for $22,000 more than was paid for the bonds when they were acquired by the affiliated unit. Separate returns were then filed for 1922; the subsidiary returned as profit the trifling difference between the sale price and the December purchase price; the Commissioner determined that the $22,000 realized profit should be taxed. The

Board of Tax Appeals, three members dissenting, held with the company; as a result a realized profit has escaped tax by the simple expedient outlined. If there is such a loophole in the taxing laws, respondent is entitled to go through it. But we do not believe there is.

That the general intent of the taxing statutes is to tax a profit realized on a sale is not open to question. That there is a realized profit here is admitted. The respondent asserts that the profit on such a sale is the difference between the sale price and "the cost of such property." (Section 202(a).) It argues that the "cost" means the cost to the seller. Ordinarily of course that is true. But who purchased the bonds—the company or the affiliated companies? Under the 1918 Act the bank and the company were treated as an economic unit. The unit was taxed as such. Intercompany profits were not taxed. For four years the respondent had the benefit of this statute. For 1921, taxes were levied on the group as a unit. In 1922 the respondent says that while the affiliates were a unit in 1921 for the purpose of eliminating profits, they were not a unit in 1921 for the purpose of purchasing bonds. It says that the bonds were purchased, not by the unit, but by a constituent member thereof. We do not agree. Respondent can not blow hot and cold. The taxable unit from 1918 to 1921 was the group, and this for all tax purposes; not only for elimination of profit on intercompany transactions, but also for the purpose of determining cost of property acquired by the group. In *Golden Cycle Corporation* v. *Commissioner* (51 F. (2d), 927) this court reviewed the history of the statute requiring consolidated returns, and the applicable decisions, and held that affiliated corporations must be considered as a business unit. We adhere to that holding. It follows that the Commissioner was right in treating the cost of the bonds as the price paid therefor by the unit, and not the price paid one constituent member by another.

The Revenue Act of 1928 (section 113(a)12) provided that,

"In the case of property acquired by a corporation, during a period of affiliation, from a corporation with which it was affiliated, the basis of such property, after such period of affiliation, shall be determined, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, without regard to intercompany transactions in respect of which gain or loss was not recognized."

It is argued that the enactment of this statute demonstrates that such was not the law prior to 1928. The conclusion does not follow. In *Luckenbach S. S. Co.* v. *United States* (280 U. S., 173) the court held a statute was enacted not to change the prior practice, but to recognize it and crystallize it into statute law. So here. When this section of the 1928 statute was reported to the Senate, the chairman of the Finance Committee said:

"It is highly important that in such cases the basis in the hands of the corporation after the affiliation should be the same as it would be if still in the hands of the corporation by which the property was brought into the affiliated group, in accordance with the present interpretation of the Treasury, except in those cases where a proper adjustment of the basis should be made."

Furthermore, the brief of counsel for the Government assures us that the ruling of the Commissioner here challenged has long been the established practice of the Treasury Department in its administration of the law. That this is an entirely proper way to ascertain the practice of the Department, see *United States* v. *Boston & M. R. Co.* (279 U. S., 732 [Ct. D. 73, C. B. VIII-2, 315]). Undoubtedly this has been the practice, for certainly the Department would not readily countenance any such simple device to evade taxes that ought to be paid. A long-established departmental practice is, of course, entitled to much consideration. (*Brewster* v. *Gage*, 280 U. S., 327 [Ct. D. 118, C. B. IX 1, 274].) That courts may look to the general plan and intent of a statute in ascertaining the meaning of words and phrases, see *United States* v. *Ludey* (274 U. S., 295 [T. D. 4046, C. B. VI-2, 157]).

The respondent answers that it did not in fact make the profit on this sale which has been assessed to it as income; that this profit was made by the bank, a separate corporation; that it can not be required to pay a tax upon a profit accruing to another corporation. Ordinarily, this would be a complete answer. But the 1918 statute provided that if one corporation owns "substantially all" the stock of another, the corporations should be deemed to be affiliated—that is, treated as a unit. The regulations provided that ownership of 95 per cent of the stock constitutes an affiliation. (Regulations 45, article 633.) The Second Circuit has held that there is no affiliation unless the interest not owned "is so small as to be practically negligible." (*Ice Service*

Co. v. *Commissioner*, 30 F. (2d), 230.) Under such requirements for affiliation, the injustice pictured by respondent is more theoretical than actual. But a more satisfactory answer is this: Respondent purchased bonds from its affiliate at a time when the intercompany profit realized was not taxable; in that transaction, it could have protected itself against the tax to become due when the bonds were eventually sold to outsiders, either by indemnity from its affiliate which realized the nontaxable profit, or in the amount paid for the bonds. It is not, as we see it, a question of the respondent's right to file a separate return in 1922; that right is unquestioned. The question is this: When it becomes necessary, in its 1922 separate return, to go back to the affiliated period to ascertain cost, shall that cost be determined without regard to intercompany transactions? The question is not free from doubt, but the majority of the court is of the opinion that since the corporations were treated as a unit for all other tax purposes, they should be treated as a unit for this purpose, and that the cost was the price paid when the bonds came into the unit during the affiliation, and not the price paid one affiliate by another during that period.

The order of the Board of Tax Appeals is reversed for further proceedings in harmony with this opinion.

Reversed.

ARTICLE 1594: Property acquired by gift or transfer in trust on or before December 31, 1920, or by bequest, devise, or inheritance.

XII-19-6166
Ct. D. 662

INCOME TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

1. GAIN OR LOSS—SALE BY SURVIVING SPOUSE—TENANCY BY THE ENTIRETY.

The basis for determining gain upon the sale, in 1925, by the surviving wife, of real property purchased in 1915 by husband and wife as tenants by the entirety is the cost, in accordance with section 204(a) of the Revenue Act of 1926, although part of the purchase price was paid by the husband and a corresponding portion of the value of the property was included in his gross estate for Federal estate tax purposes. In such an estate the survivor does not acquire title by bequest, devise, or inheritance, and, therefore, the exception in section 204(a)5, providing that if the property was so acquired the basis for determining gain or loss shall be the fair market value thereof at the time of acquisition, does not apply.

2. DECISION DISTINGUISHED.

The decision in the case of *Tyler* v. *U. S.* (281 U. S., 497 [Ct. D. 100, C. B. IX-1, 383]) distinguished.

3. DECISION AFFIRMED.

The decision of the Circuit Court of Appeals, Fourth Circuit (61 Fed. (2d), 280), affirming 23 B. T. A., 854, affirmed.

SUPREME COURT OF THE UNITED STATES.

Mrs. Fannie E. Lang, petitioner, v. *Commissioner of Internal Revenue.*

On writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[April 10, 1933.]

OPINION.

Mr. Justice SUTHERLAND delivered the opinion of the court.

In 1915 petitioner and her husband purchased certain real property at a cost of $13,000, title being vested in them as tenants by the entirety. Of this amount petitioner contributed $1,560 (12 per cent), and her husband the remaining 88 per cent. The husband died in 1924, the property at that time having a market value of $40,000; and 88 per cent of that amount was included in the value of the decedent's gross estate for the purposes of the Federal estate tax.

In 1925 the property was sold for the sum last named. Petitioner, in her income tax return for that year, computed the profit on the basis of the market value of the property at the time of her husband's death, with the exception of 12 per cent, representing the sum which she had contributed to the purchase price of $13,000. The Commissioner determined a deficiency, using the entire 1915 cost as the basis for computing the amount of profit realized. The Commissioner's ruling was affirmed by a decision of the Board of Tax Appeals (12 B. T. A., 854), and that in turn was affirmed by the court below. (61 F. (2d), 280.)

The question to be determined, therefore, is whether cost of the property in 1915, or its market value at the time of decedent's death (with allowable deductions), is the proper basis for determining the gain from the sale in 1925.

The solution of the problem depends upon the meaning of the provision contained in section 204(a) of the Revenue Act of 1926 (ch. 27, 44 Stat., 9, 14), which reads:

"The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * *

"(5) If the property was acquired by bequest, devise, or inheritance, the basis shall be the fair market value of such property at the time of such acquisition."

An estate by the entirety is held by the husband and wife in single ownership, by a single title. They do not take by moieties, but both and each take the whole estate, that is to say, the entirety. The tenancy results from the common law principle of marital unity; and is said to be *sui generis*. Upon the death of one of the tenants "the survivor does not take as a new acquisition, but under the original limitation, his estate being simply freed from participation by the other; * * *." (1 Washburn, Real Property, 6th Ed., section 912.) In the present case, therefore, when the husband died, the wife, in respect of this estate, did not succeed to anything. She simply continued, in virtue of the nature of the tenancy, to possess and own what she already had. Giving the words of the statute their natural and ordinary meaning, as must be done, it is obvious that nothing passed to her by bequest, devise, or inheritance.

The foregoing view is confirmed, if that be necessary, by a consideration of the language immediately following the quotation from paragraph (5), section 204(a), supra, namely, "The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in subdivision * * * (c) or (f) of section 302 of this Act." Subdivision (c) deals with transfers by the decedent made in contemplation of or intended to take effect in possession or enjoyment at or after his death; and subdivision (f) has reference to property passing under a general power of appointment, exercised by the decedent by will or deed in like contemplation or with like intention. (Ch. 27, 44 Stat., 70-71.) The significant circumstance is that subdivision (e), which relates to interests held as joint tenants by the decedent and any other person, or as tenants by the entirety by the decedent and spouse, is not included in the enumeration. The result is that the interest held by a joint tenant or tenants by the entirety is expressly included in determining the value of the gross estate for purposes of the estate tax, but not so included as a basis for determining gain or loss under section 204(a). The express inclusion of the subdivision in the former case and its omission in the latter persuasively suggests that Congress did not intend to include estates by the entirety under the phrase "by bequest, devise, or inheritance." If Congress did so intend, it is hard to understand why subdivision (e) of section 302 was not expressly adopted as were (c) and (f). Compare *William B. Bend* v. *Jesse Hoyt* (13 Pet., 263, 272-273).

It is said that the decision of this court in *Tyler* v. *United States* (281 U. S., 497) requires a different conclusion. But that case does not decide that property held by tenants by the entirety is inherited by the survivor or passes from the dead to the living by right of succession. The decision rests alone upon the fact that Congress had provided in express words (section 202(c), Revenue Act of 1916, ch. 463, 39 Stat., 756, 777-778) that the value of such property, to the extent designated in subdivision (c), should be included for the purpose of determining the value of the gross estate. And the tax was upheld not upon the theory that there was a "transfer" of the property by the death of decedent, or a receipt of it by right of succession, but upon the ground that death had resulted in such an accession of rights in respect of the control

of the property as to make appropriate the imposition of a tax upon that result. In other words, the death of the husband had the effect of freeing the estate from his equal right of participation in its possession, use and disposition, which, while he lived, stood in the way of the wife's exclusive enjoyment of those rights which ordinarily flow from ownership; and this expansion of her power of control, and consequent enlargement of its value, furnished a sufficient occasion for the imposition of an excise tax, which Congress might denominate a death tax, or a transfer tax, or anything else it saw fit, although, in the absence of an expression of the legislative will, it properly could not thus be characterized. (*Tyler* v. *United States*, supra, at pages 502–503.)

If the legislation here under review results in imposing an unfair burden upon the taxpayer, the remedy is with Congress and not with the courts. Unless there is a violation of the Constitution, Congress may select the subjects of taxation and tax them differently as it sees fit; and if it does so in plain words, as it has done here, the courts are not at liberty to modify the Act by construction in order to avoid special hardship. (*Crooks* v. *Harrelson*, 282 U. S., 55, 61 [Ct. D. 271, C. B. X–1, 469].)

Judgment affirmed.

ARTICLE 1598: Property acquired after December 31, 1920, by a corporation. (Also Section 203, Article 1572.)

XII–24–6226
Ct. D. 680

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. GAIN OR LOSS—SALE BY TRANSFEREE—CONSTITUTIONALITY OF STATUTE—DOUBLE TAXATION.

A taxpayer corporation which issued 96 per cent of its authorized capital stock in 1925 to an individual in exchange for land which it sold during the following year was properly taxable upon a gain measured by the difference between the sale price and the March 1, 1913, value (the land having been bought by the individual before that date), in accordance with sections 203(b)4 and 204(a)8 of the Revenue Act of 1926. For neither of the asserted reasons are those sections of the statute unconstitutional. (1) There was an increase over the March 1, 1913, value of the land which constituted taxable income to some one on its realization by the sale, and the corporation was charged with notice of the burden imposed by the Revenue Act in force at the time it acquired the land. (2) The double taxation which may result from subjecting the same profit to tax when the individual sells his shares of stock, or when they are liquidated, would not be an infraction of the Constitution, and was a possibility of which the individual was chargeable with notice when he made the exchange.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (23 B. T. A., 1129) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Perthur Holding Corporation, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition to review an order of the Board of Tax Appeals fixing a deficiency in the petitioner's income tax for 1926.

Before L. HAND, SWAN, and AUGUSTUS N. HAND, Circuit Judges.

[November 7, 1932.]

OPINION.

L. HAND, Circuit Judge: The taxpayer was a corporation with an authorized capital of $200,000, none of which had been issued. In December, 1925, it issued $250,000 of its shares to one Kuttroff, in exchange for land in New York which at the time was worth that amount, and which it sold in 1926 at a

small loss. This it deducted in its return for that year, but the Commissioner struck out the deduction, and in its place assessed as a deficiency, a tax levied upon the difference between the proceeds of the sale in 1926 and the value of the land on March 1, 1913, Kuttroff having bought before that date. The case concededly falls within section 203(b)4 and section 204(a)8 of the Act of 1926, so that the only question raised is of the constitutionality of those two sections. The Court of Claims (*Newman, Saunders & Co.* v. *United States*, 36 Fed. (2d), 1009) and the Ninth Circuit (*Osburn California Co.* v. *Welch*, 39 Fed. (2d), 41 [Ct. D. 173, C. B. IX–1, 250]) have decided the point in favor of the Treasury under the Act of 1924, and this effort to secure an opposite ruling is no doubt in the hope of carrying the question to the Supreme Court.

The taxpayer's theory is that Kuttroff's conveyance so changed his relation to the land that he realized a taxable income at once, measured by the difference between the value of the shares and that of the land on March 1, 1913. This income could be taxed against him, but not against the company, for that would be to tax one person upon the income of another (*Hooper* v. *Wisconsin*, 284 U. S., 206). Furthermore, Kuttroff will be personally liable to a tax upon the same amount, if he sells his shares at an advance corresponding to the company's profit, in which event the "basis" for his calculation must be the value of the land on March 1, 1913 (section 204(a)6, Act of 1926).

Two questions arise: (1) whether there was an income to tax at all; (2) whether the company may be taxed upon it. The answer to the first is easy. When Kuttroff exchanged the land for shares, the increase could have been taxed as his income; until 1921 it was (section 202(b), Act of 1918), for it was only in that year that the law first refused to "recognize" such transactions as creating income (section 202(c)3, Act of 1921). When section 204(a)8 of the Act of 1926 taxed the increase up to the exchange along with any which arose afterwards, there was therefore no defect in subject-matter under the sixteenth amendment. *Eisner* v. *Macomber* (252 U. S., 189 [T. D. 3010, C. B. 3, 25]) throws no doubt upon that (*Marr* v. *United States*, 268 U. S., 536 [T. D. 3755, C. B. IV–2, 116]; *Insurance, etc., Co.* v. *Commissioner*, 36 Fed. (2d), 842 (C. C. A. 2) [Ct. D. 155, C. B. IX–1, 279]). In *Taft* v. *Bowers* (278 U. S., 470 [Ct. D. 49, C. B. VIII–1, 226]) this was not so clear. The increase in value in the donor's hands was not income at all, and became such only when the donee sold. But the court held that it was indubitably income after it was realized, and that was enough so far as concerned the subject-matter.

The answer to the second question is not so obvious. The exchange took place after the Act of 1924 had thrown upon the company the tax on Kuttroff's income; it was a consequence with notice of which the company was charged and which it could escape. The only possible objection is under the fifth amendment, on the notion that the tax takes property without due process of law; and it has indeed been sustained when the result was to affect transactions which took place before the tax was imposed (*Coolidge* v. *Nichols*, 274 U. S., 531 [T. D. 4072, C. B. VI–2, 351]; *Blodgett* v. *Holden*, 275 U. S., 142 [T. D. 4117, C. B. VII–1, 324]). But, so far as we know, it never has been when the tax impinges prospectively, for the root of the evil is the inability of the parties to count upon the burdens they assume. It was because of this that in *Taft* v. *Bowers*, supra (278 U. S., 470), the donee could be taxed upon what had indubitably never been her income, whether or not it was the donor's. *Hooper* v. *Wisconsin*, *supra* (284 U. S., 206), is only a verbal parallel. The court thought that the wife's income was no more the husband's than was his sister's; he had no escape from paying her taxes except divorce, ordinarily too drastic an alternative. The decision might have been pertinent if the law had touched only spouses, married thereafter.

Finally as to the argument that Kuttroff, too, may be taxed upon the whole income, either when he sells his shares, or when they are liquidated; and that there will be double taxation. That result is indeed uncertain; he may not sell, and the company may lose the gain before the shares are liquidated, if he does not. But we do not stand on that; we assume that he too will pay a tax upon the same amount. That may be unfair, but it is not unconstitutional; again, it was a matter for Kuttroff to consider when he put on a corporate dress. When the purpose is plain, the statute will stand; courts will not interfere because taxes are duplicated (*Cream of Wheat Co.* v. *Grand Forks*, 253 U. S., 325, 329, 330; *Hellmich* v. *Hellman*, 276 U. S., 233, 237, 238 [T. D. 4217, C. B. VII–2, 238]). No doubt there are limits to what Congress may do under the guise of taxation; (The Child Labor Tax Case, 259 U. S., 20); it is otherwise difficult to see how the tenth amendment could endure. But in general it is free to depress

one kind of activity and promote another, for the incidence of taxation inevitably has indirect social and economic effects, and with them courts do not, and must not, concern themselves. If these sections unduly discourage incorporation of such enterprises, Congress may have intended it, and was within its powers if it did. It is hard to conceive greater chaos than if judges were to upset fiscal policies of which they disapprove.

Order affirmed.

SECTION 206.—NET LOSSES.

ARTICLE 1621: Net losses, definition and computation. XII–3–5990 Ct. D. 620

INCOME TAX—REVENUE ACT OF 1921—DECISION OF SUPREME COURT.

1. DEDUCTION—NET LOSS.

Where a taxpayer was a majority stockholder and active head of a dredging company, devoting himself largely to its affairs, and to protect his interest therein at various times indorsed the company's notes, losses resulting from such indorsements and from sale of the company's stock are not "net losses resulting from the operation of any trade or business regularly carried on by the taxpayer" within the meaning of section 204 (a) and (b) of the Revenue Act of 1921, and therefore are not deductible from gains of succeeding years.

2. CORPORATION—LEGAL ENTITY.

A corporation and its stockholders are generally to be treated as separate entities.

SUPREME COURT OF THE UNITED STATES.

David Burnet, Commissioner of Internal Revenue, petitioner, v. *R. P. Clark.*

On writ of certiorari to the Court of Appeals of the District of Columbia.

[December 12, 1932.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the court.

Respondent Clark's income tax return for 1921 showed net loss exceeding $17,000; for 1922 net loss of about $5,000. He claimed these should be deducted from gains reported for 1923, under section 204 (a) and (b),[1] Revenue Act of 1921 (ch. 136, 42 Stat., 227, 231). The Commissioner of Internal Revenue ruled otherwise and the Board of Tax Appeals approved. The

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[1] Revenue Act, 1921:

"SEC. 204. (a) That as used in this section the term 'net loss' means only net losses resulting from the operation of any trade or business regularly carried on by the taxpayer (including losses sustained from the sale or other disposition of real estate, machinery, and other capital assets, used in the conduct of such trade or business); and when so resulting means the excess of the deductions allowed by section 214 or 234, as the case may be, over the sum of the following: (1) The gross income of the taxpayer for the taxable year, (2) the amount by which the interest received free from taxation under this title exceeds so much of the interest paid or accrued within the taxable year on indebtedness as is not permitted to be deducted by paragraph (2) of subdivision (a) of section 214 or by paragraph (2) of subdivision (a) of section 234, (3) the amount by which the deductible losses not sustained in such trade or business exceed the taxable gains or profits not derived from such trade or business, (4) amounts received as dividends and allowed as a deduction under paragraph (6) of subdivision (a) of section 234, and (5) so much of the depletion deduction allowed with respect to any mine, oil or gas well as is based upon discovery value in lieu of cost.

"(b) If for any taxable year beginning after December 31, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; and if such net loss is in excess of the net income for such succeeding taxable year, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year; the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary."

Court of Appeals, District of Columbia, reversed the Board's action. The matter is here upon certiorari.

From 1889 until 1922 respondent was closely connected with the Bowers Southern Dredging Co., which did river and harbor improvement work, dredging and jetty building. He was majority stockholder, active head, after 1905 president, and devoted himself largely to its affairs. During 1921 and 1922 he was a member of three partnerships similarly engaged and often associated with the Bowers company. Also, he owned and held as investments shares of a number of corporations. He was not in the investment business.

After 1917 the Bowers company encountered continuous financial difficulties. To protect his interest therein, at sundry undisclosed times respondent indorsed the company's obligations to the banks. In 1921 a creditors' committee took charge and thereafter respondent conducted the corporate affairs as managing director. A new concern took over the entire assets and business in 1922.

Because of his indorsements respondent paid $68,000 for the company during 1921. He claimed and was allowed to deduct the sum thus lost upon his return for that year. During the same year he also lost $9,500 through sale of the corporation's stock and in 1922 he sustained a similar loss amounting to $92,500. For both these sums appropriate deductions were permitted.

After considering all the circumstances, the collector held respondent's losses did not result "from the operation of any trade or business regularly carried on by the taxpayer," and could not be deducted from gains of succeeding years. The Board of Tax Appeals approved. Among other things, it said:

"In order for the losses here involved to be deductible in determining taxable income for 1923, they must be net losses resulting from the operation of a trade or business regularly carried on by the petitioner and not from isolated and occasional transactions.

"With respect to the loss of $68,000 resulting from the petitioner's indorsement of the Bowers company notes he testified that in indorsing the notes he was seeking to protect his investment in its stock. Aside from indorsing an undisclosed number of notes of this company there is nothing in the record to indicate that acting as indorser or guarantor constituted a business or trade with the petitioner. So far as the record shows these were the only notes ever indorsed by the petitioner for the Bowers company or for any other company or person. From the facts in the case we are of the opinion that the loss did not result from the operation of a trade or business regularly carried on by the petitioner but resulted from isolated or occasional transactions. * * *

"With respect to the remaining losses resulting from the sale of the Bowers company stock in 1921 and 1922, we do not think the petitioner's ownership of stock in a number of corporations which he held as an investment during 1921 and 1922 or the sale of some of such stock in those years constituted a business or trade regularly carried on by him. As to his being in the investment business, the petitioner testified as follows:

"'Q. Would you say you were in the investment business, Mr. Clark?'

"'A. No, sir.'

"Since the petitioner was not in the investment business or engaged in the business of a dealer in securities, we think the losses resulting from the sale of the Bowers company stock in 1921 and 1922 constituted losses arising from occasional or isolated transactions and not from the operation of a business regularly carried on. * * *"

In support of the contrary view the District Court of Appeals said—

"It appears that during the times in question appellant was engaged in regularly carrying on the business of dredging, operated by a corporation of which appellant was principal owner and active directing head, and to which he devoted all of his time and energies. Appellant accordingly was necessarily concerned with the financial conditions and difficulties which beset the business, and he was compelled by circumstances to indorse the company's notes in order to supply it with necessary operating funds. This action was not isolated or occasional but became part of the operation of the business, and helped to carry it on. It is true that appellant did not regularly carry on a business of indorsing notes for profit, but his indorsement of the company's notes was part of the business regularly carried on for the company. It is also true that appellant was not regularly engaged in the business of selling corporate stocks, but the transactions of that character appearing in the

record can not be separated from the regular course of business of which they were part, and must not be considered as if wholly independent transactions."

We agree with the Commissioner and the Board of Tax Appeals. The judgment below must be reversed.

The respondent was employed as an officer of the corporation; the business which he conducted for it was not his own. There were other stockholders. And in no sense can the corporation be regarded as his *alter ego*, or agent. He treated it as a separate entity for taxation; made his own personal return and claimed losses through dealings with it. He was not regularly engaged in indorsing notes, or buying and selling corporate securities. The unfortunate indorsements were no part of his ordinary business, but occasional transactions intended to preserve the value of his investment in capital shares.

A corporation and its stockholders are generally to be treated as separate entities. Only under exceptional circumstances—not present here—can the difference be disregarded.

Reversed.

ARTICLE 1621: Net losses, definition and computation. XII-3-5991 Ct. D. 621

INCOME TAX—REVENUE ACT OF 1924—DECISION OF SUPREME COURT.

1. DEDUCTION—NET LOSS—WORTHLESS STOCK.

Where a taxpayer organizes a corporation for the purpose of perfecting and marketing certain of his inventions, is in active charge of its affairs, purchases all its capital stock with the intention of selling it at a profit, considers the corporation as a branch of his own business, deals with the public through it, and files separate income tax returns for the corporation and for himself, claiming in his individual return deductions for debts owed him by the corporation, the business of the corporation is not that of the individual and the loss of his investment in the stock of the corporation is not "attributable to the operation of a trade or business regularly carried on by the taxpayer" within the meaning of section 206(a)1 of the Revenue Act of 1924, and is therefore not an allowable deduction under subdivision (b) of that section.

2. CORPORATION—LEGAL ENTITY.

For tax purposes a corporation is an entity distinct from its stockholders.

3. DECISION AFFIRMED.

The decision of the Circuit Court of Appeals (56 Fed. (2d), 16 [Ct. D. 535, C. B. XI-2, 204]) is affirmed.

SUPREME COURT OF THE UNITED STATES.

Hubert Dalton and Florence W. Dalton, petitioners, v. *Frank C. Bowers, as Executor of the Last Will and Testament of Frank K. Bowers, etc.*

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[December 12, 1932.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the court.

For 25 years petitioner Dalton has busied himself with physical research and invention; he has devised and patented hundreds of articles. A large income from sundry sources has enabled him to lay out considerable sums in connection with his inventions; the inventions brought in no net profit after 1914. During the five years following 1912 he caused the organization of six separate corporations and transferred to each certain patents for exploitation. The last of these—the Dalton Manufacturing Corporation—was incorporated under the laws of New York in 1917; he paid for all the capital stock—$395,000; became a director, president, treasurer and controlled its affairs. No other person was financially interested. He testified that his primary purpose in this

venture was to perfect his sundry models and patented articles and sell the corporate shares profitably; he thought it would be better to market such articles through the corporation, to have the business in corporate form; he considered the corporation as a branch or part of his own business as an inventor and dealer in patents, etc.—as a means to an end, an instrumentality of his purpose. Also, that he believed it essential thus to have his inventions manufactured and brought before the public; the corporations were used in order to develop and improve his inventions.

The manufacturing corporation promptly took over certain Dalton patents, manufactured the articles and sought to sell them. The petitioner endeavored to sell the corporate shares and thereby to obtain gain. From time to time he advanced large sums to pay debts and carry on the corporate business. These loans appeared on the books, but were not repaid. For six years credits were placed to his salary account; he withdrew nothing. In 1924 the corporation became hopelessly insolvent and during 1925 passed out of existence. The evidence indicates losses during several preceding years. All creditors were paid by petitioner.

The corporation and Dalton made separate returns for Federal income taxes. In 1923 and 1924 he claimed large deductions—$157,035.50 and $162,309.24—on account of bad debts due from it.

In their joint income return for 1925 Dalton and his wife claimed a deduction of $395,000—the full amount paid for the then worthless shares of the manufacturing corporation. The Commissioner ruled that this loss occurred in 1924. Adjustments for that year showed $374,000 net loss by the Daltons. The Commissioner refused to apply this upon their 1925 return because not attributable to the operation of a trade or business regularly carried on by the taxpayer. If so applied, there would have been no taxable income for that year. Payment of $56,841.32 was demanded and made under protest. This suit to recover followed.

Petitioners maintain that the $395,000 loss, adjudged by the collector to have occurred in 1924, was sustained in a trade or business regularly carried on by Mr. Dalton; consequently, the net loss for that year—$374,078.98—should have been deducted from the 1925 income under terms of the Revenue Act of 1924, section 206 (a) and (b), and Treasury Regulations 65, article 1621. The district court accepted their view; the circuit court of appeals held otherwise.

The latter court said—

"There is no justification for saying that the business of the corporation was that of the appellee. During the period the appellee dealt with the corporation as an entity. When he paid the debts of the corporation, he drew on his personal account in favor of the corporation's account and this made the corporation his debtor. Separate tax returns were filed by the corporation and by the appellee. He purchased the capital stock with the intention of disposing of it to the public. His individual time was spent in large part in matters of investment. * * * The loss now sought to be deducted was an investment which he made in the corporation and did not occur in the operation of the trade or business regularly carried on by the appellee. * * *

"By the statute, allowing the deductions and carrying over the loss for two years, Congress intended to give relief to persons engaged in an established business for losses incurred during a year of depression in order to equalize taxation in the two succeeding and more profitable years. It was not intended to apply to occasional or isolated losses. * * *

"This taxpayer did not regard the business losses of the Dalton Manufacturing Co. as his loss. The loss sustained by the appellee which he seeks to charge off is a capital investment loss. The rule is well settled that the corporation will be looked upon as a legal entity. * * *"

We agree with the conclusion of the circuit court of appeals and its judgment must be affirmed.

The Revenue Act of 1924 (ch. 234, 43 Stat., 253, 260 (U. S. C., Title 26, section 937)) provides—

"SEC. 206. (a) As used in this section the term 'net loss' means the excess of the deductions allowed by section 214 or 234 over the gross income, with the following exceptions and limitations:

"(1) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business;

"(2) In the case of a taxpayer other than a corporation, deductions for capital losses otherwise allowed by law shall be allowed only to the extent of the capital gains; * * *

"(b) If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called 'second year'), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called 'third year'); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary."

In the courts below the petitioners unsuccessfully insisted that the loss upon sale of the corporate shares occurred in 1925 and should be offset against gains received during that year. Here that insistence is not renewed.

The claim of right to offset the net loss of 1924 against 1925 gains can not prevail unless the requirements of the quoted section, Revenue Act of 1924, are met—the loss must have been "attributable to the operation of a trade or business regularly carried on by the taxpayer."

In support of their position petitioners say—

The losses of the manufacturing corporation were not the losses of the taxpayers. They do not seek to disregard the corporate entity, but respect it. Taken as a whole this entity constituted a part of the individual trade or business of Hubert Dalton. His trade or business was not merely that of inventing; it included exploiting of his inventions, putting them on a paying basis by developing, manufacturing, improving and selling them through corporations organized for that special purpose. All of these things formed a complete, comprehensive enterprise of which the corporation was part. It was an instrumentality of the taxpayer's business. Consequently, the investment in the corporate shares was part of business regularly carried on.

Whether theoretically valid or not, this argument rests upon assumptions out of harmony with the facts disclosed by the record. Dalton was not regularly engaged in the business of buying and selling corporate stocks. He organized the manufacturing corporation and took over all its shares with the intention of selling them at a profit. He treated it as something apart from his ordinary affairs, accepted credits for salaries as an officer, claimed loss to himself because of loans to it which had become worthless, and caused it to make returns for taxation distinct from his own. Nothing indicates that he regarded the corporation as his agent with authority to contract or act in his behalf. Ownership of all the stock is not enough to show that creation and management of the corporation was a part of his ordinary business. Certainly, under the general rule for tax purposes a corporation is an entity distinct from its stockholders, and the circumstances here are not so unusual as to create an exception.

Affirmed.

ARTICLE 1621: Net losses, definition and computation. XII-13-6099 Ct. D. 645

INCOME TAX—REVENUE ACTS OF 1921 AND 1924—DECISION OF COURT.

1. DEDUCTION—NET LOSS—PERSONAL CONTRACT OF GUARANTY.

Where taxpayer, an officer and stockholder of a corporation organized to take over the business of a partnership of which he was a former member, with others personally guaranteed to make good any loss suffered by certain former members of the firm if the corporation failed to carry out an agreement with them to redeem its preferred stock, and in 1923 was obliged to surrender his stock in order to fulfill his guaranty, thereby sustaining a loss, such guaranty was a personal, isolated, and disconnected act, and taxpayer was not entitled to deduction for "net loss" sustained in the operation of a trade or business regularly carried on by him, within the meaning of section 204(a) of the Revenue Act of 1921.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (24 B. T. A., 748) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

Eli Strouse, petitioner, v. Commissioner of Internal Revenue, respondent.

On petition to review the decision of the United States Board of Tax Appeals.

Before PARKER and SOPER, Circuit Judges, and WAY, District Judge.

[June 13, 1932.]

OPINION.

SOPER, Circuit Judge: Eli Strouse, the petitioner in this case, is endeavoring to take advantage of those provisions of the Revenue Acts whereby a net loss for any taxable year, resulting from the operation of a trade or business regularly carried on by a taxpayer, is allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year. (See Revenue Act of 1921, section 204(a), 42 Stat., 227; Revenue Act of 1924, section 206(b)(f), 43 Stat., 253.) In 1923 the petitioner sustained a substantial loss upon the final disposition of certain shares of preferred stock of Strouse Bros., Inc., and the question is whether this loss was deductible from his net income for 1924 as one incurred in the manner described in the statutes.

The taxpayer had been a member of the partnership of Strouse & Bros., which had been organized by his father and uncles, and had successfully conducted a wholesale clothing business in Baltimore from 1865 to 1917. In the latter year, a corporation, Strouse Bros., Inc., was formed, and the business of the partnership was transferred to it. When this change took place, the estate of Isaac Strouse, the taxpayer's father, still had an interest, and Benjamin Strouse, an uncle, was still a partner in the firm. The combined capital of these two interests amounted to approximately $525,000, and it was essential to the successful operation of the business by the new corporation that this sum be invested in its stock; but these interests were unwilling to make an unconditional subscription to the capital stock. Accordingly, an agreement was made on January 8, 1917, between the trustees of the estate of Isaac Strouse and the partners in the firm, including the taxpayer, which recited that the corporation had taken over the business of the firm. The trustees agreed to accept 1,000 shares of preferred stock of the corporation in full payment of $100,000 of the indebtedness due the estate, and consented that the balance of the indebtedness, amounting to $58,721.76, should be assumed by the corporation, upon the condition that the corporation would retire at least $30,000 of the stock in each year until it was all retired, and thereafter would pay the indebtedness at the same rate. The partners on their part guaranteed that the redemption of the stock and the payment of the debt by the corporation would be carried out. A similar agreement was made between Benjamin Strouse and the remaining copartners, including the taxpayer, with reference to the redemption by the corporation at the rate of $30,000 per year of 3,678 shares of the preferred stock accepted by Benjamin Strouse in payment of his interest in the partnership.

Eli Strouse, the taxpayer, received 1,536 shares of preferred stock for his interest in the firm, and later acquired 52 additional shares for $4,472, making the total cost of his investment in the preferred stock $158,072. He became the president of the new corporation at an annual salary of $15,000. The business did not prove to be as successful as had been hoped, and the corporation was unable, after a payment in January, 1919, to make additional redemptions of its preferred stock. It commenced to liquidate its assets in the year 1921. The trustees of Isaac Strouse still held 400 shares and Benjamin Strouse 2,778 shares of the preferred stock, which they had acquired in accordance with the agreements of 1917. The other parties thereto, in order to comply with their obligations, entered into a new agreement on October 8, 1922, whereby they agreed to turn over all the preferred stock which they owned to the trustees of Isaac Strouse and to Benjamin Strouse; and the taxpayer delivered his 1,588 shares on January 25, 1923. It is admitted that thereby he sustained a loss of $135,797.96 in the year 1923. Some question is raised as to whether this loss was caused by a depreciation in the value of the stock, or by the transfer of a valuable asset in compliance with the terms of the agreement of guaranty. We shall assume, for the purpose of this decision as seems to have been done by the Board of Tax Appeals, that

the taxpayer suffered a net loss by the transfer of the stock in a substantial amount in excess of his net income for the year 1923, that would have been deductible in the succeeding year if the transactions under discussion are covered by the Revenue Acts referred to.

It is clear from this recital that when the loss occurred in 1923, the taxpayer was not carrying on the business of the partnership, for this business had been transferred to the corporation when the guaranty was given. It has been held that it is sufficient, to bring a case within the sections of the statutes in question, that the loss result from the operation of a regular trade or business, whether the taxpayer was engaged in that business when the loss occurred or not. (*Marston* v. *Commissioner*, 18 B. T. A., 558, 561, affirmed by the Court of Appeals of the District of Columbia on March 14, 1932. Prentice-Hall Federal Tax Service, 1932, volume 1, 1057. See also *Hines* v. *Commissioner* (C. C. A. 7), 58 Fed. (2d), 29 [Ct. D. 577, C. B. XI-2, 207].) We need not consider this aspect of the case, but shall confine ourselves to the question whether the guaranty was given in the course of the operation of a trade or business regularly carried on by the taxpayer. He emphasizes the facts that when the agreements of 1917 were made, he had no other business than his share in the partnership with which he had been actively associated as an employee and partner since 1889; that he was personally interested in the transfer to the corporation, because his capital in the firm would have been jeopardized by a liquidation, and because he was made president of the new company at a substantial salary; and that the new enterprise could not have been launched without the agreements of guaranty. He contends that he entered into the transaction, while a member of the partnership, in order to prevent the liquidation of the partnership and to permit the business to continue. Speaking broadly, these assertions are not without foundation; but it can not be said in a true sense that his personal contract of guaranty was an act performed by him in the operation of the business of the partnership, the only business which he was carrying on before the contracts were made, or that it was an act performed by him as president of the corporation, the only activity in which he was engaged for some years thereafter. The contracts were signed not as a partner, but as an individual, to put a successful end to the partnership, and to secure for the corporation the means necessary to carry on what had become the corporation's business. In short, the transaction was not effected in the course of any regular business carried on by the taxpayer; but it was a personal, isolated, disconnected act, such as the decisions uniformly hold to be outside the provisions of the statutes. (*Goldberg* v. *Commissioner*, 36 F. (2d), 551; *Pabst* v. *Lucas*, 36 F. (2d), 614; *Anderson* v. *U. S.*, 48 (2d), 201; *Dalton* v. *Bowers*, 56 F. (2d), 16 [Ct. D. 535, C. B. XI-2, 204]; compare *Washburn* v. *Commissioner*, 51 F. (2d), 949.)

The decision of the Board of Tax Appeals is affirmed.

SECTION 208.—CAPITAL GAINS AND LOSSES.

ARTICLE 1651: Definition and illustration of capital net gain. (Also Section 201, Article 1545.)

XII-8-6038
G. C. M. 11503

REVENUE ACT OF 1921.

General Counsel's Memorandum 801 (C. B. V-2, 139), which holds that if stock held by a taxpayer for more than two years is liquidated the resultant gain, under the Revenue Act of 1921, except to the extent it is out of earnings or profits of the corporation or out of increase in value of the corporate property accrued prior to March 1, 1913, is "capital gain," is revoked, in so far as inconsistent with the decision of the Board of Tax Appeals in *John H. Watson, jr.*, v. *Commissioner* (27 B. T. A., 463, page 13, this Bulletin).

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1651: Definition and illustration of capital net gain.

REVENUE ACTS OF 1921, 1924, AND 1926.

Revocation of I. T. 2488 (C. B. VIII–2, 127), in so far as inconsistent with *John H. Watson, jr.*, v. *Commissioner* (27 B. T. A., 463, page 13, this Bulletin). (See I. T. 2678, page 117.)

ARTICLE 1651: Definition and illustration of capital net gain.

REVENUE ACTS OF 1921, 1924, AND 1926.

Stock acquired through exercise of stock rights. Modification of General Counsel's Memorandum 10063 (C. B. X–2, 159). (See G. C. M. 11645, page 117.)

ARTICLE 1654: Capital net losses. XII–17–6145
Ct. D. 657

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. DEDUCTION—CAPITAL LOSS WORTHLESS STOCK—SALE OR EXCHANGE.

A taxpayer owning stock in a corporation which liquidates by bankruptcy proceedings and distributes nothing to its stockholders may not treat the loss sustained as a "capital loss," there having been no "sale or exchange" of a capital asset within the meaning of section 208(a)2 of the Revenue Act of 1926.

2. STATUTORY CONSTRUCTION.

Section 201(c) of the Revenue Act of 1926, referring to "Amounts distributed" in liquidation of a corporation, may not be extended to include a case where there is no distribution to stockholders upon liquidation. Where the words of a statute are plain and unambiguous, no duty of interpretation arises.

3. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (24 B. T. A., 1127) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.

Mont S. Echols, petitioner, v. *Commissioner of Internal Revenue, respondent.*

On petition to review decision of United States Board of Tax Appeals.

Before STONE, KENYON, and VAN VALKENBURGH, Circuit Judges.

[August 20, 1932.]

OPINION.

KENYON, Circuit Judge, delivered the opinion of the court.

Petitioner in the year 1924 purchased $5,500 worth of stock in the Pine Mountain Coal Co. In 1927 the corporation was liquidated by bankruptcy proceedings. The proceeds of the assets were insufficient to pay the corporation debts, and nothing was distributed to any of the stockholders as the result of the liquidation. Petitioner in his income tax return for the year 1927 treated this loss as a capital loss, and as he had realized capital gains on sales of stock during that year he sought to deduct said loss from his capital gain instead of claiming it as an ordinary loss.

The Board of Tax Appeals held that the loss was not a capital loss under section 208(a)2 of the Revenue Act of 1926, and found there was a deficiency in the income tax for the calendar year 1927 of $579.10.

Petitioner asks for a review of this decision.

Section 208(a)2 is as follows:

"(a) For the purposes of this title—

* * * * * * *

"(2) The term 'capital loss' means deductible loss resulting from the sale or exchange of capital assets;"

It is clear that petitioner's loss does not come under the term "capital loss" as defined by this section, for there was no "sale or exchange" of capital assets as the words "sale or exchange" are commonly used and understood, and there is no reason to construe them in any other way. (*Burkett* v. *Commissioner of Internal Revenue*, 31 F. (2d), 667.) Petitioner does not assert otherwise, but insists that section 208(a)2, supra, must be read in connection with section 201(c) of the same Act, which is as follows:

"Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 202, but shall be recognized only to the extent provided in section 203."

The purpose of its enactment seems to have been to assist in the administration of the Act as the character of distributions therein provided was not covered in prior Acts.

The argument of petitioner is that the court must so construe section 201(c) as to cover the present situation and should hold that under said section the liquidation of the corporation is to be considered as a sale or exchange of the stock. This section refers only to *amounts distributed* in complete or partial liquidation of a corporation and does not provide that the liquidation is payment in exchange for the stock, but that the *amounts distributed* shall be treated as in payment in exchange for the stock, etc.

The language of these two sections is plain, and if they be read literally it is clear that if there is no amount distributed in the liquidation there is nothing that can be treated as part or full payment in exchange for the stock, and hence as there is no sale or exchange of capital assets the loss can not be brought under the term "capital loss" as defined in section 208(a), supra.

Petitioner's theory is that such could not have been the intent of Congress; that unless section 201(c) is construed to cover a situation where there is no distribution of any amount to stockholders upon liquidation of a corporation it leads to a ridiculous and unjust result which counsel for petitioner states in his brief as follows:

"Clearly, the object of Congress was to permit a deduction for a capital loss. Such a loss under the statutes can be sustained in no other way than by a sale, exchange or liquidation. To say that a stockholder in a corporation has not suffered a capital loss on stock, although nothing has been distributed to him on the stock, and that another stockholder in another corporation has sustained a capital loss, by reason of having received some minute amount in distribution on his stock, is a too ridiculous and absurd intention to be imputed to any legislative body. To arrive at such a conclusion and thus sustain the respondent's contention, it is necessary to ignore the object of Congress in passing section 201(c), and is to permit the mere literal meaning of the words used to prevail over the obvious intent of Congress, and results in ridiculous and unjust results."

Of course courts should construe statutes so as to avoid absurdity or injustice if it can be done under the language employed, but if the intention of the legislative body clearly appear from the plain words of the Act the presumption is that such body has said what it meant and intended. If it has not, the remedy is to change the law by legislative act and not to attempt to change it by court decision. This court has many times expressed its disapproval of any judicial journeys into the field of legislation by construction of statutes. We refer to some of its opinions:

In *Union Cent. Life Ins. Co.* v. *Champlin* (116 F., 858, 860) it said: "The courts may not import into a plain and unambiguous law and give effect to a

supposed intention or purpose of the legislative body which is neither expressed nor indicated in the Act. Such a course of action would pass beyond the limits of construction or interpretation into the forbidden domain of judicial legislation."

In *Swarts* v. *Siegel* (117 F., 13, 18–19): "Attempted judicial construction of the unequivocal language of a statute or of a contract serves only to create doubt and to confuse the judgment. There is no safer or better settled canon of interpretation than that when language is clear and unambiguous it must be held to mean what it plainly expresses, and no room is left for construction."

In *United States* v. *Colorado & N. W. R. Co.* (157 F., 321, 324): "But construction and interpretation have no place or function where the terms of the statute are clear and certain, and its meaning is plain."

In *Wabash R. Co.* v. *United States* (178 F., 5, 11–12): "And it is the intention expressed in the statute, and that alone, to which the courts may lawfully give effect. They may not assume or presume purposes and intentions that the terms of the law do not indicate, and then enact and expunge provisions to carry out those supposed intentions. The Act must be held to mean what it clearly expresses."

See also *United States* v. *Ninety-Nine Diamonds* (139 F., 961); *United States* v. *Alamogordo Lumber Co.* (202 F., 700); *United States* v. *Missouri Pac. Ry. Co.* (213 F., 169); *Soliss* v. *General Electric Co.* (213 F., 204); *Eclipse Lumber Co.* v. *Iowa Loan & Trust Co. et al.* (38 F. (2d), 608); *United States* v. *Chicago, St. P., M. & O. Ry. Co.* (43 F. (2d), 300).

In *Fidelity Nat. Bank & Trust Co. of Kansas City, Mo.*, v. *Commissioner of Internal Revenue* (39 F. (2d), 58), this court approved the canon of statutory construction, "that where the meaning is not perfectly clear from the words used, a reasonable construction should be given which will carry out the object and purpose of the statute."

From the Supreme Court of the United States we quote:

Caminetti v. *United States* (242 U. S., 470, 485): "It is elementary that the meaning of a statute must, in the first instance, be sought in the language in which the Act is framed, and if that is plain, and if the law is within the constitutional authority of the law-making body which passed it, the sole function of the courts is to enforce it according to its terms. * * *

"Where the language is plain and admits of no more than one meaning the duty of interpretation does not arise and the rules which are to aid doubtful meanings need no discussion."

There are a few cases on this subject which might tend to support petitioner's theory in that the literal meaning of the statute was disregarded. We may group the principal ones as: *Church of the Holy Trinity* v. *United States* (143 U. S., 457); *Fleischmann Construction Co. et al.* v. *United States* (270 U. S., 349); *United States* v. *Katz et al.* (271 U. S., 354); *International Ry. Co.* v. *United States* (238 F., 317).

The leading case on this point undoubtedly is the much quoted one of *Church of the Holy Trinity* v. *United States*. It involved the construction of an Act of Congress making it unlawful for a person or corporation to prepay the transportation of aliens into the United States under a contract or agreement made prior to such migration to perform labor or service of any kind in the United States, etc. Trinity Church made a contract with an Englishman to serve as its rector. The Supreme Court held this contract to be without the scope of the statute. It pointed out that the act of the corporation was within the letter of the section as the relationship of a rector to the church implied labor on his part and compensation on the other, but said, "It is a familiar rule, that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers."

In *Fleischmann Co.* v. *United States* (270 U. S., 349, 360), the Supreme Court said, "The strict letter of an Act must, however, yield to its evident spirit and purpose, when this is necessary to give effect to the intent of Congress. * * * And unjust or absurd consequences are, if possible, to be avoided." In *United States* v. *Katz* (271 U. S., 354), a case in which the United States was prosecuting a bootlegger for failing to keep records of his transactions as required of persons dealing in intoxicating liquors, the court said: "All laws are to be given a sensible construction; and a literal application of a statute, which would lead to absurd consequences, should be avoided whenever a reasonable application can be given to it, consistent with the legislative purpose."

In *International Ry. Co.* v. *United States* (238 F., 317, 321), the court said: "There are few surer tests in statutory construction than to observe whether the interpretation contended for exposes the statute itself to ridicule;"

In each of these cases it is to be noted that the literal meaning of the statute involved was disregarded for the purpose of cutting down the scope of the same, which doctrine it is clear involves less danger of judicial legislation than does the disregarding of a strictly literal interpretation for the purpose of extending the scope of a statute. All that the court was doing in these cases was to enforce what was the clearly expressed intention of the legislative body, and refusing to enforce that which the court was certain was not intended by said legislative body to be enacted. That presents quite a different situation from extending the meaning of a statute by judicial construction to cover what a court might suppose Congress did intend or should have intended. The case of *Commissioner of Immigration* v. *Gottlieb* (265 U. S., 310, 313–314) bears strongly on the instant case. That case, as the court points out, was one of great hardship, involving the deportation of a wife and infant son of a Jewish rabbi. It was strongly urged that a construction of the statute which would exclude them led to absurd results. The court said: "The case, as the evidence shows, is one of peculiar and distressing hardship and it is not unnatural that any appropriate canon of construction should be laid hold of to justify a conclusion favorable to the respondents. But if the plain words of the statute are against such a conclusion, leaving no room for construction, the courts have no choice but to follow it, without regard to the consequences."

Probably all that is necessary to be said on the question of departure from the letter of an Act of Congress because leading to absurd results is said in *Crooks* v. *Harrelson* (282 U. S., 55), where the court, referring to *Holy Trinity Church* v. *United States*, supra, said, "but a consideration of what is there said will disclose that the principle is to be applied to override the literal terms of a statute only under rare and exceptional circumstances. The illustrative cases cited in the opinion demonstrate that to justify a departure from the letter of the law upon that ground, the absurdity must be so gross as to shock the general moral or common sense. * * * It is not enough merely that hard and objectionable or absurd consequences, which probably were not within the contemplation of the framers, are produced by an act of legislation. Laws enacted with good intention, when put to the test, frequently, and to the surprise of the lawmaker himself, turn out to be mischievous, absurd or otherwise objectionable. But in such case the remedy lies with the law-making authority, and not with the courts." The court further points out that it is dealing with a taxing Act "with regard to which the general rule requiring adherence to the letter applies with peculiar strictness."

We may well inquire, What are the absurd consequences that result from the construction given to section 201(c) by the Board of Tax Appeals? While under the particular situation here as to the facts there may be some hardship upon petitioner, yet in other cases the statute may operate to the taxpayer's advantage, depending upon the amount of income subject to the tax. So the absurdity could not be considered in any event "so gross as to shock the general moral or common sense."

We feel it unnecessary to consider the question argued by appellee as to administrative interpretations of somewhat related Acts, for we are well satisfied that there is no ambiguity whatever in this section. However we may say that the departmental regulations have uniformly treated such losses as were sustained by petitioner deductible as ordinary losses.

The words of the statute in question here are plain, the language is unambiguous, and indicates clearly that section 201(c), supra, applies only where there is an actual distribution to stockholders in the liquidation of a corporation no matter how that liquidation is brought about. Why should a court say that Congress intended something different from what the plain meaning of the words shows its intention to be, even if the same result in some hardship or absurdity? There is nothing in the record aside from the statute itself to show the intention of the framers of the legislation. Petitioner offers no such proof. He offers only the conjecture that had the matter been brought to the attention of Congress it would not have been willing to leave such persons as petitioner without the scope of the legislation. For the court to assume such intention and to construe section 201(c) to cover the situation here presented would go far into the domain of judicial legislation. The petition for review is denied and the order of the Board of Tax Appeals affirmed.

PART II.—INDIVIDUALS.

SECTION 212.—NET INCOME OF INDIVIDUALS DEFINED.

ARTICLE 22: Computation of net income. (Also Section 213(a), Article 50.) XII-20-6177 Ct. D. 665

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. INCOME—WHEN ACCRUED—PAYMENTS UNDER LEASE AGREEMENT.

A sum payable by a lessee as consideration for an agreement, executed in modification of the original lease, providing that certain restrictions should be waived and that the sum so payable should be treated as fully earned by the lessor upon execution of the agreement and not applied in satisfaction of rentals subsequently payable, was taxable to the lessor as income accrued in the year the agreement was executed. Taxpayer's book entries, in which the sum was treated as ratably earned over the remainder of the term of the lease, did not, in view of the express terms of the agreement, correctly reflect the income, and the Commissioner was justified in disregarding such entries in determining when the obligation accrued, as provided in section 212(b) of the Revenue Act of 1921.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (21 B. T. A., 381) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Jennings & Co., Inc., a Corporation, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition to review an order of the United States Board of Tax Appeals.

Before WILBUR and SAWTELLE, Circuit Judges.

[May 31, 1932.]

OPINION.

WILBUR, Circuit Judge: From the findings of fact made by the Board of Tax Appeals it appears that "the petitioner, an Oregon corporation, in January, 1918, acquired a lease for the 25-year period from March 1, 1908, to and including February 28, 1933, on two improved lots at the southeast corner of Washington and Broadway Streets, Portland, Oreg. On February 11, 1920, the petitioner sublet a portion of the leased premises to the Metropolitan 5 to 50¢ Stores, Inc., at a monthly rental of $2,850 during the period from March 1, 1920, to February 28, 1922, and $3,550 during the period beginning March 1, 1922, and ending February 28, 1933." Subsequently the sublease was modified by a written agreement dated December 9, 1921, between the petitioner named as "lessor" and said Metropolitan Stores as "lessee," the pertinent provisions of which were, in substance, that the lessor, in consideration of $42,600, to be paid to it, agreed that the original sublease between the parties should be modified so as to confer on the sublessee the right, with a few specified limitations, to sublet the leased premises, such right of subletting under the terms of the original lease having been made subject to the consent of the lessor and to certain other restrictions which were waived in the modification and that the provision of the original sublease requiring the sublessee to use and occupy the leased premises as a retail store for the sale of merchandise usually sold in a 5 to 50 cent store should be canceled; and said agreement, among other things, further provided:

"First: Contemporaneously with the execution hereof said lessee pays to said lessor the sum of $8,000, the receipt whereof said lessor hereby acknowl-

edges, and executes and delivers to said lessor its promissory note in and by which it promises to pay said lessor $34,600 on or before February 1, 1922. The consideration for said $42,600 is the execution by said lessor of this agreement; *and said $42,600 is fully earned by said lessor upon its execution of this agreement and no part thereof is to be applied on or in satisfaction of any of the payments to be made hereafter by said lessee to said lessor under said lease as modified by this agreement.*

"Second: Said lease is hereby so modified that the rentals to be paid by said lessee for and during the last 11 years of the term thereof shall be * * * $3,227 per month, instead of the * * * $3,550 per month provided in said (original) lease." [Italics ours.]

In its findings of fact the Board of Tax Appeals found that petitioner's income in 1921 and for several years prior thereto was derived from the premises referred to above; and that the amount of gross rent returned by petitioner for 1921 was $76,046.25, which sum did not include any part of the $42,600 item; and the Board, including in petitioner's income the sum of $42,292.90, being the amount of that item less $307.10 representing cash discount on the note given by the sublessee, ordered and decided that there was a deficiency of $19,794.81 in income and profits taxes for the year 1921.

Respondent, in his answer to the amended petition filed below, admitted that the petitioner's income and profits tax returns for 1920, 1919, and 1918 and prior years were made on the basis of actual receipts and disbursements; and further admitted that petitioner's income and profits tax return for the year 1921 was prepared and filed on the accrual basis, and that the books of petitioner were kept on the accrual basis during the year 1921; and with respect to the allegation that petitioner did not secure permission from the Commissioner to change to the accrual basis for the year 1921, respondent in his answer stated that he neither admitted nor denied said allegation, considering it, as we do, as immaterial with respect to this particular proceeding.

The legal basis for the order and decision appealed from, as it is presented here by the Government, is to the effect that the entire amount of $42,600 agreed to be paid to the taxpayer under the agreement of December 9, 1921, and which was actually paid, $8,000 on that date and $34,600 in four payments made in January and February, 1922, was in contemplation of law received by the taxpayer, and accrued to it, in 1921, and was therefore taxable to it as income in that year.

Appellant, the taxpayer, on the other hand contends that the sums aggregating the $42,600 did not represent income when received, nor did it represent a bonus for making said agreement of December 9, 1921, but represented, strictly, prepaid rentals, earned ratably over the term of the lease, and which, properly, should be accrued and reported over the portion of the leasehold term to which such rentals applied. It appears that they were so accrued and entered in the accounts of the taxpayer, and reported in its income tax return.

As against this contention of appellant is to be noted the above quoted statement to the effect that "said $42,600 is fully earned." Having thus, for the purposes then in view, characterized the sum in question as then "fully earned," and having further provided that no part of it should be applied on or in satisfaction of any of the rentals subsequently payable under the lease, the taxpayer in this proceeding seeks to impress upon said payments an intention and a character directly opposed to those attached to them when they were made and received. It is true that the sum of $42,600 is equivalent to the amount of reductions in the aggregate of the monthly installments which by the terms of the original lease had been made payable during the last 11 years of the term demised and which were remitted by the modification. The petitioner seeks to take advantage of this coincidence to claim that the payment of $42,600 was in fact an advancement of the due date of rentals to subsequently accrue under the lease, and that it should be so treated for taxation purposes notwithstanding the fact that the parties to the lease expressly stipulated to an agreement directly to the contrary. We see no reason and no justification for such a course. While it is true that in levying income taxes the Government looks to the substance of the transaction and its practical effect, it does not, for that reason, disregard the essential nature of the transactions of the taxpayer as defined by law or agreement. The explicit designation, by the taxpayer itself and its lessee, of their intention as to what should constitute the nature and purpose of the payments in question is an element clearly distinguishing the case at bar from the facts in the

case of *Work* v. *United States* (261 U. S., 352), cited by appellant as a typical case. There, Mr. Justice Taft, delivering the opinion of the court, upon an inquiry into the nature of certain payments generally referred to as "bonuses," which were made in connection with bids for the leasing of mineral rights in tribal Indian lands under Act of Congress and departmental rules, held in substance that, having in view the subject matter and the circumstances under which such payments were made, they were really part of the royalty or rental payable upon the making of such leases, and that the bonus offered at the public auction while nominally collateral to a bid for a lease with definite royalty, was in substance and effect a bid increasing the royalty reserved in the written lease for which the bids were offered by a definite cash payment in the way of advance royalty. In that case the term "bonus" as used in connection with the bids for the leases in question had not been defined, and the circumstances were such as to create some uncertainty as to what was really the nature of the payments in question. Here no such uncertainty exists, because the parties to the agreement of December 9, 1921, indicated their intention as to how the payments made thereunder were to be regarded and treated, in words so clear and unambiguous as to preclude a contrary interpretation by the parties or by judicial construction.

Apparently as an alternative contention to the one just considered, counsel for petitioner in their brief suggest that if we adopt the rule which was applied in certain cited decisions of the Board of Tax Appeals and $8,000 were taxed in 1921, and $34,600 in 1922, when said amounts were respectively received by appellant such a conclusion, while not as truly and justly reflecting the taxpayer's true net income as would the method adopted by the taxpayer in keeping its books of account and preparing its returns, would be far more equitable in its result than the result arrived at by the Board in its decision, and far closer to the previous decisions of the Board and of the courts.

Were it not for the provision of the modification agreement and the consequences flowing therefrom previously discussed herein, the alternative contention of appellant might, under section 213 of the Revenue Act of 1921 and articles 22 and 23 of Regulations 62 in force in 1921, 1922, and 1923, be entitled to some consideration. In the absence of the provision of modification the payment of $42,600 might well be regarded in view of "approved standard methods of accounting," as prepaid rentals properly apportionable to the respective years to which such payment by the terms of the original lease related and entries made in the accounts of the taxpayer following that method of apportionment might be held justified as correctly reflecting income. But the taxpayer and his lessee had, in express terms, at the time the payment was agreed to be made, clearly disclaimed any intention to treat the payment in question as future rentals, and had indicated their desire that it should be treated as an amount fully earned and as not being applicable in satisfaction of any of the payments to be made thereafter by said lessee to said lessor under said lease as modified by the agreement of December 9, 1921. In view of this positive, affirmative action, the entries apportioning the payment in question on the books of the taxpayer as prepaid rentals did not "correctly reflect income," the positive language of the modification agreement requiring that the payment should be given a present effect only. The fact that installments making up payment of the unpaid balance of the $42,600 were not actually paid until January and February, 1922, did not, in the circumstances here shown, prevent the payment from being regarded and treated, for income tax purposes, as fully accrued in 1921; because by the agreement of December 9, 1921, the lessee had definitely bound itself to pay the $42,600 as an amount fully earned; and being so earned the law required that it be included as income in the recipient's return for that year.

The conclusions thus reached, based upon the clear, controlling language used by the parties to the modification agreement, distinguish the present case in its facts from the decisions of the Board of Tax Appeals, cited by appellant, to the effect that payments in the nature of bonuses under leases were income in the year received, and from the decisions of our Supreme Court and the Court of Appeals of the District of Columbia, cited by respondent (*U. S.* v. *Anderson*, 269 U. S., 422 [T. D. 3839, C. B. V–1, 179]; *American Natl. Co.* v. *U. S.*, 274 U. S., 99, 105 [T. D. 4099, C. B. VI–2, 193]; *U. S.* v. *American Can Co.*, 280 U. S., 412 [Ct. D. 164, C. B. IX–1, 292]; *Lucas* v. *American Code Co.*, 280 U. S., 445 [Ct. D. 168, C. B. IX–1, 314]; *S. Naitove & Co.* v. *Comm'r* (D. C. App.), 32 F. (2d), 949, 950–951 [Ct D. 77, C. B. VIII–2, 295], cert. den., 280 U. S., 582; and *Evergreen Cemetery Ass'n* v. *Burnet* (D. C. App.), 45 F. (2d), 667). Having in mind the circumstances previously reviewed herein

under which the payment of $42,600 was by the taxpayer and its lessee constituted a present, consummated earning, freed from the operation of any future contingency that would deprive the taxpayer of its use and enjoyment or the use and enjoyment of any part of it, we hold that the accounts of appellant, treating the payment in question as rentals paid in advance, "accrued and reported ratably over the period of the lease to which it applies" did not clearly reflect appellant's net income for the year 1921 which should have been entered in appellant's accounts and in its return for said year, as including the payment in question, and that therefore the Commissioner of Internal Revenue was justified in disregarding these entries in determining when the obligation accrued to the taxpayer, as is proposed by section 212(b) of the Revenue Act of 1921 (42 Stat., 227, 237) as follows:

"* * * if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income * * *."

The order and decision of the Board of Tax Appeals in effect so holding, is affirmed.

SECTION 213(a).—GROSS INCOME DEFINED: INCLUSIONS.

ARTICLE 31: What included in gross income.

REVENUE ACT OF 1926.

Modification of General Counsel's Memorandum 8826 (C. B. IX–2, 194), holding that renewal commissions on insurance premiums received by a trust under the will of the decedent are income subject to tax to the extent that the sums received after the taxpayer's death exceed the fair market value of the contract right at the decedent's death. (See G. C. M. 11473, page 91.)

ARTICLE 31: What included in gross income. XII–25–6239
Ct. D. 685

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. INCOME—WASHINGTON COMMUNITY PROPERTY—RENTALS.

Rentals received by decedent in 1924 and 1925 from a commercial building erected in 1906–1908 upon a lot in the State of Washington purchased by him in 1878, the year before his marriage, were taxable to him as income from his separate property, notwithstanding the following facts: that his wife made a gift to him before their marriage of part of the purchase price; that community funds were used in erecting the building; that decedent made a declaration in his will expressly confirming "the absolute title" of his wife's one-half of all his property; and that the probate court, in the administration of decedent's estate, decreed that all his property was community property. Such circumstances can not alter the general rule of law repeatedly announced by the Supreme Court of the State of Washington that title to property is fixed at the time of its acquisition and that when community funds are expended in improvements on separate property the title to the improvements follows the title to the land.

2. DECISION REVERSED.

The decision of the Board of Tax Appeals (22 B. T. A., 337) reversed, in so far as in conflict with the court's holdings.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Commissioner of Internal Revenue, petitioner and cross-respondent, v. *Caroline E. Burke and Seattle Title Trust Co., a Corporation, as Administrators with the Will Annexed of the Estate of Thomas Burke, Deceased, respondents and cross-petitioners.*

Upon petition and cross-petition to review an order of the United States Board of Tax Appeals.

Before WILBUR and SAWTELLE, Circuit Judges, and NORCROSS, District Judge.

[November 28, 1932.]

OPINION.

SAWTELLE, Circuit Judge: This appeal is from a decision of the United States Board of Tax Appeals, declaring deficiencies in the income taxes of the respondents and cross-petitioners, hereinafter called the taxpayers, for the calendar year 1924 of $969.96, and for the period between January 1, 1925, to December 4, 1925, of $777.87.

The question presented for determination here is whether the income from the Empire Building, in Seattle, Wash., was the separate property of Thomas Burke or the community income of Burke and his wife.

The material facts, which are not disputed, were found by the Board to be as follows:

In 1878, Burke, then a single man, purchased at sheriff's sale a lot in Seattle. At that time Burke had but little money, and was preparing to be married in the near future. His fiancee gave him $500 to apply on the purchase of the property. With this fund and with $800 borrowed from a banker he paid the purchase price of $1,250. The loan of $800 from the banker was paid off by Burke in monthly installments of $20 each.

In 1879, Burke and his fiancee were married at Seattle, where they continued to reside until the marital relation was terminated by Burke's death, on December 4, 1925. At the time of his marriage Burke had practically no property except the lot that he had purchased at sheriff's sale. At the time of his purchase of that property, it was improved with a small frame dwelling house of a story and a half. This frame dwelling was razed in the year 1897, the lot was excavated to the street level extending back for 25 feet, a one-story brick store building was erected on the lot, and the frame building was set over it. The cost of this improvement was $6,500. No substantial changes or alterations to these improvements on the lot were made until 1906, when they were removed and a modern reinforced concrete office building was erected on the lot and completed in 1908, at a cost of $392,742. The lot, exclusive of this improvement, had a value of $210,000 during the years 1906–1908. During 1924 and 1925, the building bore the same proportionate value to the lot without the improvements thereon, as during the period from 1906 to 1908.

Burke, after his marriage, received a substantial income from the practice of law. This income, together with the rentals from the Empire Building property, the properties he acquired after marriage, the dividends on stocks and the proceeds from the sale of securities, and all other income, were deposited into one checking account in a Seattle bank. The funds from this checking account were used to pay the $6,500 expended in 1897 for the improvements on the Empire Building lot. The funds accumulated in this account, together with the credit obtained from short-time loans at the bank, and the proceeds from a $150,000 note and mortgage signed by Burke and his wife, mortgaging the Empire Building property, were used to pay all of the cost of $392,742, expended for constructing the office building.

The net rentals received by the Empire Building up to 1925, inclusive, amounted to $642,273.60. These rentals are computed without making an allowance for interest paid on the mortgage indebtedness on the property. During the period from 1907 to 1925 Burke received net rentals from other properties, which had been acquired subsequently to his marriage, aggregating $1,075,552.42, and these rentals were deposited in the aforesaid checking account.

All the income derived from the Empire Building property was included by Burke as a part of his general income in making his returns for income tax purposes since 1913, and he always reported the income from his property in the

same manner as the income from the other properties referred to above, which had been acquired since his marriage.

In Burke's will, dated November 3, 1925, he expressly "confirmed" "the absolute title" of his wife's one-half of all his property, which he describes as community property. The probate court under the jurisdiction of which Burke's estate was administered, entered a decree approving the final account of the administrators, which decree stated "that all of Burke's property coming into the hands of the administrators as set forth in their inventory and supplemental inventory filed herein, was declared by the will of said deceased, and is the community property of the said deceased and Caroline E. Burke, widow of the deceased."

Upon a review by the Commissioner of Internal Revenue of the income tax returns for the calendar year 1924 and the period from January 1, 1925, to December 4, 1925, the Commissioner determined that the entire income from the Empire Building property was separate income and should be so reported by the estate of Thomas Burke. The Board of Tax Appeals determined that the income from the Empire Building property in 1924 and 1925 that was attributable to the land represented the separate income of Burke, and the income attributable to the improvements represented the community income of Burke and his wife.

Petition for review was filed by the Commissioner on October 6, 1931, and a cross-petition for review was filed by the taxpayers on October 19, 1931.

It is almost axiomatic in the law that title to property is fixed at the time of its acquisition. This rule has been adhered to by the Supreme Court of the State of Washington in an unbroken line of decisions:

"But the real question here is, In whom is the title now vested? The property was acquired in 1905 in exchange for separate property of respondent Olson, and we must hold that title was then vested in him alone and, by that conveyance, the community obtained no interest. We have said in a long line of cases that the status of real property is fixed as of the time when it was acquired. Our previous holdings to that effect, 14 cases in all, are cited in *In re Brown's Estate* (124 Wash., 273, 214 Pac., 10), and since that time we have continued with unbroken regularity to recognize the principle. (*Riverside Finance Co.* v. *Griffith*, 140 Wash., 322, 248 Pac., 786; *Norman* v. *Levenhagen*, 142 Wash., 372, 253 Pac., 113; *In re Williams' Estate*, 145 Wash., 19, 258 Pac., 851. See, also, *In re Hart's Estate*, 149 Wash., 600, 271 Pac., 886.) This is a wholesome rule and we can not now depart from it." (*Rawleigh Company* v. *McLeod et al.* (1929), 151 Wash., 221, 224. See, also, *Merritt et al.* v. *Newkirk et al.* (1930), 155 Wash., 517, 522.)

In the instant case, there is no doubt that the lot was the separate property of the decedent Burke at the time that he acquired it. The stipulation of facts sets forth that he "purchased" the land in 1878. He was married in 1879. Obviously, there was no community in existence at the time Burke purchased the lot; and, under the general law, which, as we have seen, has been steadfastly followed by the courts of Washington, the separate character of the property became fixed as of 1878, the date of its acquisition.

The fact that his fiancee, a year before their marriage, "gave" Burke some money to help him pay the purchase price of the lot, did not convert its essential separate character into community. Mrs. Burke testified that the decedent did not "borrow" the $500, but that she "gave" it to him. There is no evidence which would warrant the taxpayers' contention that this "gift" was an "advance" which gave rise to a "resulting trust." The gift was unconditional, hence, as Mrs. Burke testified, she "had hard work to make him take it." Had there been contemplated a business arrangement—i. e., a resulting trust—her fiance would not have hesitated to enter into it. His reluctance was clearly due to his disinclination to accept an outright gift of money from his fiancee. This is clearly established by Mrs. Burke's own testimony.

Nor are we impressed with the taxpayers' argument based upon the fact that "the remaining sum of approximately $800 was * * * repaid, not by him before his marriage, but by the two of them after his marriage out of their then meager earnings at the rate of $20 per month." The general rule above referred to, which the many Washington decisions recognize, effectively disposes of the contention that the lot itself was or ever became community property.

But the taxpayers, after fully arguing this point, assert that "the real issue, however, is narrower, namely, the title to the *income* from this property."

In this regard, the taxpayers contend that "the value of the improvements, amounting to over $390,000, placed upon this lot by the community, the funds for which were in part raised by both members signing a note and mortgage for $150,000, is sufficient to give the community at least a proportionate interest in, if not the entire title to, the property."

Here, again, however, we find that the position taken by the taxpayers is contrary to the general law and to the most recent decisions of the Supreme Court of the State of Washington. Some of the earlier decisions cited by the taxpayers seem to sustain the taxpayers' contention, but we are bound by the later and emphatic expressions of the State court.

In 31 Corpus Juris, section 1123, at pages 34–35, we find the following statement of the general law:

"*Improvements.* As a general rule, when the separate funds of the other spouse or the community funds are expended in improvements on the separate property of one of the spouses, the title to the improvements follows the land, in the absence of any specific agreement to the contrary, the equities of the parties being balanced by mutual credits and debits between the several estates involved."

In McKay's "Law of Community Property" (2d Ed.) we find the following language:

"Section 342: *Fixtures, increase and improvement.* Whatever is attached to a thing, as a fixture, or an improvement, or is incorporated into it by accretion or confusion, takes the character as separate or common of the thing to which it is attached. The date of the acquisition of the added thing does not determine its character, nor does the consideration given for it, but the character of the thing to which it is added determines its character."

"Section 347: *Improvements on land.* Such improvements are incorporated into it, and follow the title to it. They are not a thing apart, nor does the making of them create any form of title or interest in the land. This is the rule of both the civil and the common law. The character of the land as separate or common determines the ownership of the improvements.

"The circumstances which give rise to a right to have compensation for making improvements is considered at length in another place." (Chapter 16.)

"Section 1013: *The improvement of land passes no title to the property.* The common law and the civil law authorities are in complete accord that the improvement of land passes no form of title to it or interest in it. The utmost the improver can successfully claim is compensation. There (are) some dicta to the effect that the improvement of land imposes a lien upon it to secure compensation, but the weight of authority is against this doctrine."

The act of November 14, 1879 (General Laws of Washington for 1879, page 77), provides that "all property owned by the husband before marriage and that acquired by him afterwards by gift, bequest, devise, or descent, *with the rents, issues, and profits thereof*, is his separate property." Section 6890 of Remington's Compiled Statutes of Washington, 1922, Volume II, sets forth that "property and pecuniary rights owned by the husband before marriage, and that acquired by him afterward by gift, bequest, devise or descent, *with the rents, issues, and profits thereof*, shall not be subject to the debts or contracts of his wife," etc. [Italics our own.]

In *Rawleigh Co.* v. *McLeod*, supra, at pages 224–225, this entire question is fully treated by the Supreme Court of Washington. That decision so thoroughly and effectually disposes of the present contention of the taxpayers, that we quote from it in extenso:

"But it is contended that, in *In re Carmack's Estate* (133 Wash., 374, 233 Pac., 942), we held that the community, by improving the separate realty of one of the spouses, became an owner in proportion as the community funds increased the value of the whole. We think that is not a correct estimate of the holding. It was there said:

"'This situation would unquestionably give the community a large interest in, but not the entire ownership of, the property, because there can be a segregation of the community interest from the separate interest of Mrs. Carmack. The bare lot was hers, the improvements thereon belonged to the community * * *. We therefore hold that Mrs. Carmack had an interest in this property which is her separate property, yet much the larger interest belongs to the community. It is impossible, of course, to physically segregate the separate from the community interest. It is therefore necessary that the

whole of it be put into the hands of the administrator for administration. It is probable that the administrator should ultimately be required to account to Mrs. Carmack according to her separate interest.'

"In speaking of the community interest, the court did not mean title, but was looking to the equities of the case, probably having in mind that, on the death of one of the spouses and the probate of the estate, an equitable lien in favor of the community could be recognized and adjudicated. In the recent case of *In re Hart's Estate*, supra, the community advances were held to be a gift to the wife, but there is, in that case, no denial of the principle that, if there was no such gift, the community might have, by such advances acquired an equitable lien.

"However, that question is not now before us, and will be left for decision when presented. We hold that the title, when taken, vested in the respondent alone, as his separate estate, and, since there has been no conveyance by Olson or by operation of law, the title still remains in him and subject to the lien of the judgment in its proper order. What that order may be, whether it is preceded by an equitable lien in favor of the community, by homestead rights, or other liens and encumbrances, can all be determined if, and when such prior rights are asserted at any time before sale on execution or perhaps, as to some, afterwards."

Again, in *Merritt* v. *Newkirk*, supra, an even more recent decision of the Supreme Court of Washington, we find, at page 522, the following clear restatement of the general rule:

"The title to property, whether separate or community, is determined as of the date of its acquisition, and the general rule is that, when community funds are expended in improvements on the separate property of one of the spouses, the title to the improvements follows the title to the land. Unless, therefore, there is a specific agreement to the contrary, or the equities of the case require a different conclusion, the ownership of the property is not changed."

In the early case of *Donovan* v. *Olsen* (47 Wash., 441, 443), in an opinion by the late Judge Rudkin, who subsequently became a member of this court, we find the following language:

"We think it clearly appears, therefore, that the property was paid for by the appellant out of her separate funds, and that the respondent has no interest therein. If we assume that the deceased husband performed some labor in fencing and making improvements on the land this would not change its character."

Approving the foregoing expression by Judge Rudkin, and extending its application so as to bring it squarely within the facts before us here, the Supreme Court of Washington, in *In re Hart's Estate*, supra, at page 609, said:

"If the performance of labor of that kind would not work a change, it is difficult to see how the furnishing of money to pay the total cost of fencing and other improvements would."

Finally, in a case brought before it from the United States District Court of Washington, this court already has followed the doctrines outlined above. In *Seeber et al.* v. *Randall et ux.* (102 F., 215, 218), Judge Ross said:

"And, assuming that it is competent for the legislature to declare the rents, issues and profits of the separate property of either spouse to be community property, there is nothing in the present bill to take the case out of the general rule that the skill or labor of either spouse in carrying on farming or other like operations has nothing to do with the question of the ownership of the crops or other proceeds thereof. In such cases, the title to the products grows out of the title to the land itself, and belongs to the owner. [Many cases cited.]"

The taxpayers earnestly insist that "the record shows that all of the income from this property had been continuously treated by the deceased as, and commingled with, all his other community income," that "this would estop him from asserting to the contrary if he were living," and that "it should likewise estop the Government." Similar contentions, however, were made in the recent case of *Merritt* v. *Newkirk*, supra, and, at pages 522–523, the Supreme Court of Washington thus disposed of them:

"A third circumstance thought to show that the home tract was the community property of the husband and wife were declarations made by the spouses in which they spoke of the property as belonging to both of them. There was also a declaration of homestead filed on the property subsequent to the entry of the judgment in which the property was described as community property. But these matters do not require a different conclusion from that reached by the trial court. The first mentioned are but common modes of expression, and have no more than a general bearing where title to property is at issue. The declaration of homestead, while of more moment, was ill-advised and of no effect, and was due evidently to a misunderstanding of the facts on the part of the attorney who prepared and advised it. Whether, under any circumstances, the filing of a homestead declaration could be regarded as an estoppel, it can not be so considered in this instance. It in no way affected the rights of the judgment creditor, or caused him to act in a way (in) which he otherwise would not have acted. It has, therefore, no other weight than a declaration against interest, and as such it is not sufficient to overcome the positive evidence to the effect that the property is the separate property of the wife."

A precisely identical contention was made in another case from the State of Washington, decided by this court, *Hatch et al.* v. *Ferguson et al.* (68 F., 43, 50). There, as here, the decedent, in his will, described all his property as belonging to the community. Of the legal effects flowing from such misapprehension, Judge Gilbert said:

"It may be conceded that Ezra Hatch believed both his preemption claim and his homestead claim to be the community property of himself and his wife, and it is possible that, had he known the nature of his estate in the two claims, he might have made a different testamentary disposition thereof. But the specific devise of all his interest and estate to his children can not be controlled or diverted by the expression of his belief that the estate so devised was the one-half interest in community property. This opinion was not an admission against his interest, so as to estop him or his devisees from thereafter asserting the truth. He may have assumed that he owned an undivided one-half of the preemption claim and an undivided half of the homestead claim. If so, he was in error as to both claims, for the preemption claim was his separate property, and all of the homestead claim was subsequently patented to Josephine, so that the children took no interest therein under the will. * * * Nor can it be said that third persons, acting upon the faith of such a misrepresentation in the will, are misled. There was no specific statement in the will that the preemption claim was community property. * * * Neither do we find any warrant for holding, as contended by the appellants, that the provision of the will just quoted is in law a devise upon the part of Ezra Hatch to his wife, giving her a one-half interest in the land. * * * The reference to the community property tends only to prove that he entertained the erroneous belief that both claims were community property, and that Josephine owned the undivided one-half of each, whereas, in fact, the children took under the will all of the preemption claim, and the widow took under the homestead law all of the homestead claim."

Taking into consideration all of the facts in the instant case, as well as the principles of law applicable thereto, as above set forth, we believe that there is no ground for holding that either the Empire Building property or the income therefrom belonged to the community. We are of the opinion that neither the decedent's erroneous declarations, in his will and elsewhere, nor the probate court's decree of distribution, if influenced by such erroneous declarations, can alter the general rule of law and the doctrine repeatedly announced in recent decisions of the Supreme Court of Washington. This is especially true in view of the fact that the Government was not a party to the proceedings that culminated in the above mentioned decree of distribution. We can not believe that the rights of the Government to collect its revenue can be impaired by an ex parte decree of a lower court, when the recent decisions of the highest tribunal in the same jurisdiction compel a contrary conclusion.

Accordingly, we hold that all of the income from the Empire Building property of the taxpayer, Thomas Burke, was his separate income, and that the Commissioner of Internal Revenue was correct in his original determination that it should have been so reported by his estate.

The decision of the Board of Tax Appeals is therefore reversed, in so far as it is in conflict with the above holdings.

ARTICLE 44: Sale of real property involving deferred payments. XII-15-6125 Ct. D. 651

INCOME TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

1. INSTALLMENT SALES—MORTGAGED PROPERTY—VALIDITY OF REGULATIONS.

The general provisions of article 44 of Regulations 69, relating to the sale of real property on the installment plan, and providing that in the sale of mortgaged property the mortgage is not to be considered a part of the "initial payments" or of the "total contract price," thus permitting the tax payments to be spread over the period during which the taxpayer would receive payments directly from the purchaser, are valid.

2. SAME.

Article 44 (as amended in 1929), excepting from the general rule the excess of the mortgage over the basis to the vendor of the property sold, thus requiring such excess to be taxed in the year of sale, is also valid.

3. SAME.

Installment sales of real estate encumbered by liens give rise to many complications which Congress could not readily foresee. Accordingly, it intrusted to the Commissioner wide discretion in respect of details. Considering the practical requirements of the taxing system, the regulations constitute a fair attempt to effectuate the legislative intent.

4. DECISION REVERSED.

The decision of the Circuit Court of Appeals, Second Circuit (60 Fed. (2d), 719), reversing 19 B. T. A., 788, reversed.

SUPREME COURT OF THE UNITED STATES.

David Burnet, Commissioner of Internal Revenue, petitioner, v. *S. & L. Building Corporation.*

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[March 13, 1933.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the court.

The respondent, Building Corporation, sought redetermination of deficiency income taxes for 1924 and 1925. The Board of Tax Appeals sustained the Commissioner's final action of June 17, 1930; the court below reversed its judgment. The point now in controversy has relation to the distribution for taxation of income derived from sales on the installment plan of two pieces of real estate on Eighty-second and Eighty-third Streets, New York City. Each was covered by one or more mortgages which the purchaser assumed.

The Revenue Act 1926 (ch. 27, 44 Stat., 9, 23, 39, 41), section 230, lays a tax upon the net income of corporations. Section 232 provides—

"In the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226. * * *"

"SEC. 212. (b) The net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but * * * if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

"(d) Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any

taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price. In the case (1) of a casual sale or other casual disposition of personal property for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed one-fourth of the purchase price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this subdivision. As used in this subdivision the term 'initial payments' means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made."

"SEC. 1208. The provisions of subdivision (d) of section 212 shall be retroactively applied in computing income under the provisions of * * * the Revenue Act of 1924, * * *"

Treasury Regulations 69, article 44, promulgated August 28, 1926—as amended in 1929:

"ART. 44. *Sale of real property involving deferred payments.*—Under section 212(d) deferred-payment sales of real property fall into two classes when considered with respect to the terms of sale, as follows:

"(1) Sales of property on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do not exceed one-fourth of the purchase price.

"(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed one-fourth of the purchase price.

"Sales falling within class (1) and class (2) alike include (*a*) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the purchase price has been paid, and (*b*) sales where there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

"In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall be included as a part of the 'purchase price,' but the amount of the mortgage, to the extent it does not exceed the basis to the vendor of the property sold, shall not be considered as a part of the 'initial payments' or of the 'total contract price,' as those terms are used in section 212(d), in articles 42 and 45, and in this article. Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount of the 'initial payments,' the 'total contract price,' or the 'purchase price.'

"ART. 45. *Sale of real property on installment plan.*—In transactions included in class (1) in article 44, the vendor may return as income from such transactions in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the property is paid for bears to the total contract price."

In 1924 respondent sold the Eighty-second Street property then under mortgage which it had executed to secure a loan of $1,100,000, payable in semiannual installments of $22,000 until 1933 when the balance would become due. The purchaser assumed the mortgage; paid $300,000 in cash; agreed to pay $700,000 and secured this by a purchase money mortgage. Upon the latter mortgage $30,000 was paid in 1924 and $36,250 in 1925. In 1924 and 1925, respectively, the purchaser paid upon the assumed mortgage $22,000 and $24,000.

The Commissioner estimated the depreciated cost of the property at $1,541,323.48. Subtracting this from the total sale price, $2,100,000, he ascertained realized profit—$558,676.52.

He ruled that for 1924 the taxable sum was the same proportion of the amount actually received during the year ($330,000) as the entire profit ($558,676.52) was of the total ($1,000,000) payable directly to the taxpayer—55 per cent plus. He excluded the assumed mortgage from the total used for determining the applicable percentage and held "total contract price" was what the purchaser agreed to pay directly to the vendor—the whole amount which the taxpayer expected to receive in money.

Payments received by respondent during 1925 were likewise assessed.

In 1925 respondent sold the Eighty-third Street property then subject to two mortgages which it had executed to secure loans of $1,100,000 and $500,000 respectively, payable in installments—six and three months—until 1933 and 1934 when the balance would become due. The purchaser assumed both mortgages; paid $300,000 in cash; and agreed to pay $265,000 and secured this by a purchase money mortgage. On the latter obligation $2,000 was paid in 1925. During 1925 the purchaser paid on the assumed second mortgage $22,500.

The Commissioner fixed the depreciated cost of the property at $1,522,035. Subtracting this from the total sale price, $2,165,000, he found the realized profit—$642,967. He ruled that the difference ($77,967) between the base, or depreciated cost ($1,522,033) and the total of the assumed mortgages ($1,600,000) should be treated as if received in money by the taxpayer during 1925; also, that the sum subject to taxation in 1925 was the same proportion of what the taxpayer received, actually and constructively, during the year ($302,000 plus $77,967) as the realized profit ($642,967) was of the total amount ($565,000) which the purchaser agreed to pay directly to the taxpayer—100 per cent plus.

He excluded the amount of the assumed mortgages from the totals used to determine the applicable percentage and payments on them were not regarded as received by the vendor. He also treated as if cash received by the vendor in 1925 the difference between the depreciated cost and the total of the assumed mortgages. "Total contract price" was held to be the total amount payable directly to the vendor.

The respondent maintains that the assumed mortgages should be regarded as part of the contract price and payments upon them by the purchaser should be treated as money received by the vendor. In this way it is said the tax would be spread over the entire life of the assumed mortgage. And it further insists that the excess of the assumed mortgages over the depreciated value of the Eighty-third Street property should not be regarded as if money actually received by the vendor during 1925.

Respondent's books were kept upon the accrual basis; but all agree that in the circumstances the Revenue Act of 1926 permitted assessments upon the installment basis. The Commissioner undertook to act according to his prescribed regulations.

Prior to the Act of 1926 the Revenue Acts definitely recognized only two bases for tax returns—cash and accrual. Where sales were upon the installment plan application of either of these bases led to hardship; payment of the total tax on ascertained profit was often required in a single year. By regulations the Commissioner offered some alleviation; the vendor was allowed to distribute the profit through the years during which purchase money was actually received. The general principle underlying these regulations was to make division of partial payments and apply part as return of capital and part to profit. In 1926 the Board of Tax Appeals disapproved of the earlier regulations and pointed out that the statutes permitted returns only upon the cash or accrual basis. Thereupon, Congress enacted section 212(d), above quoted. The end in view was to permit the Commissioner to make assessments according to the general principle theretofore followed under regulations deemed appropriate to the varying situations. The new plan was optional; taxpayers were allowed to elect whether to make returns under the regulations upon the new basis or upon one of the old bases.

The conference report to the House, on Revenue Act of 1926 (page 32, House Reports, Volume I, Sixty-ninth Congress, first session, 1925–1926), declares concerning section 212(d):—"This amendment writes into the bill the basic principles of the installment method authorized by prior regulations." See Report Senate Committee on Finance, No. 52, Sixty-ninth Congress.

Installment sales of real estate encumbered by liens give rise to many complications which Congress could not readily foresee. Accordingly, it intrusted to the Commissioner wide discretion in respect of details. And considering the practical requirements of the taxing system, we think the regulations now challenged constitute a fair attempt to effectuate the legislative intent. They are within the broad discretion granted to the Commissioner and violate no definite provision of the statute.

The amounts which respondent realized as profits are not in question. These were subject to taxation either upon the accrual basis or at the taxpayer's option on the installment basis. Generally, the Commissioner's regulations permitted the tax payments to be spread over the period during which the

taxpayer would receive funds and divided these partly into return of capital and partly into profits actually collected. The method suggested by the respondent would inevitably lead to many practical difficulties, might postpone collection far beyond the time when the vendor would receive any direct payments; and probably would render impossible determination from the taxpayer's books of what he should account for.

The Commissioner's treatment of the excess of the mortgages on the Eighty-third Street property over the base cost followed the general purpose to place reasonable limitation upon the spread of the tax. It was appropriate in the unusual circumstances presented—certainly not prohibited. It was a practical way to accomplish the end. Some possible departure from the method prescribed for ordinary circumstances is not enough to destroy what he deemed necessary to meet unusual conditions.

The excess of $77,967 under the sale agreement would never actually come into the vendor's hands but it represented part of the admitted profits and was subject to taxation. No positive provision in the statute required that it be spread over subsequent years and we think there was nothing illegal or oppressive in treating this as if an actual payment. The taxpayer has been treated more leniently than if required to report upon the accrual basis. The regulations were not contrary to any positive provisions of the statute and, as said by the Board of Tax Appeals, were "both equitably and legally sound."

Since 1926, the Board has consistently upheld the Commissioner's regulations as to profits on installment sales. (*Frank J. Bosshardt*, 4 B. T. A., 1262; *Dalriada Realty Co., Inc.*, 5 B. T. A., 905; *Pacheco Creek Orchard Co.*, 12 B. T. A., 329; *Katherine H. Watson*, 20 B. T. A., 270; *Fifty-three West Seventy-second Street, Inc.*, 23 B. T. A., 164; *Metropolitan Properties Corporation*, 24 B. T. A., 220.) And the Revenue Acts of 1928 and 1932 substantially reenacted the pertinent provision of the Act of 1926.

The Commissioner and Board of Tax Appeals have practical knowledge of the intricate details incident to tax problems and their determination in circumstances like those under consideration here should be given effect when not clearly contrary to the will of Congress.

Reversed.

ARTICLE 45: Sale of real property on installment plan.

REVENUE ACT OF 1926.

Amendment of Regulations 69, article 45, pertaining to sale of real property on installment plan. (See T. D. 4360), page 116.)

ARTICLE 50: When included in gross income.

REVENUE ACT OF 1921.

Amount received for modification of lease, characterized therein as fully earned upon execution of agreement. (See Ct. D. 665, page 186.)

ARTICLE 52: Examples of constructive receipt. XII-1-5967
Ct. D. 616

INCOME TAX—REVENUE ACTS OF 1918, 1921, AND 1924—DECISION OF COURT.

INCOME—CONSTRUCTIVE RECEIPT—JOINT ADVENTURERS.

Portion of joint adventurer's share of receipts from leases of oil lands applied by his coowner to reimburse it for expense of development and operation of wells, pursuant to agreement, was constructively received by him and therefore constituted taxable income to him for the years involved.

UNITED STATES CIRCUIT COURT OF APPEALS, TENTH CIRCUIT.

Marshall S. Reynolds, Individually and as Collector of Internal Revenue, appellant, v. Donald McMurray, appellee.

Appeal from the District Court of the United States for the District of Wyoming.

[August 5, 1932.]

OPINION.

PHILLIPS, Circuit Judge, delivered the opinion of the court.

Donald McMurray brought this action to recover alleged overpayments of income taxes, with interest, for the years 1920, 1922, and 1924.

The stipulated facts are as follows: On December 7, 1917, W. M. Armstrong and the Ohio Oil Co. owned oil leases on certain lands in Wyoming in the proportion of 40 per cent and 60 per cent, respectively. On that date they entered into agreements with respect thereto which provided that the Ohio company should manage, control, develop, and operate such leases, and should immediately drill a well thereon at its own expense; that after the completion of the first well the Ohio company should continue to manage, control, develop, and operate the leases and pay all costs incident thereto, and should charge Armstrong's undivided interest with its proportionate part thereof; that it should market the oil and gas produced and account to Armstrong for his proportionate part thereof; that it should be reimbursed by Armstrong from the proceeds derived from the sale of his proportionate part of the oil and gas, to be effected by crediting Armstrong's account with the Ohio company, on the 1st of each month, with the proceeds derived from the sales during the month preceding of his proportionate part of the oil and gas; and that it should make monthly remittances to him of his proportionate share of any proceeds remaining after deducting the amounts due it for expenditures made by it for him.

On December 21, 1917, Armstrong assigned an undivided portion of his interest in the leases to Will McMurray. Thereafter the Ohio company carried an account on its books, in accordance with such agreements, covering Will McMurray's share in the expense of the development and operation of such leases and the revenue therefrom. The latter died intestate on February 3, 1925, and plaintiff is his sole heir at law.

The Commissioner made deficiency assessments against Will McMurray for 1920, 1922, and 1924. His administrator paid such deficiencies under protest, and duly filed claims for refund thereof, which were rejected. Such deficiencies were based wholly upon the income of Will McMurray arising out of the production of oil and gas by the Ohio company on such leases. The Commissioner, in recomputing the taxes for the years in question, included the entire amount credited to Will McMurray on the books of the Ohio company in his gross income and allowed deductions for business expense, depletion, and depreciation.

The question presented by this appeal is whether that portion of Will McMurray's share of the receipts from such leases applied to reimburse the Ohio company for expense of development and operations, less proper deductions, was income to Will McMurray for the years involved, and therefore subject to the tax.

Counsel for plaintiff contend that such amounts were not income to Will McMurray because profits to him were contingent upon the leases producing revenue in excess of the cost of development and operation.

Where one coowner makes advances for the benefit of the other, to be repaid from earnings from the property before any division of profits is to be made but without personal obligation on the part of the other to repay such advances, thus making them subject to the risks of the business, the coowners are joint adventurers in the operation of the property. (*Nelson* v. *Lindsey*, 179 Ia., 862, 162 N. W., 3.)

If the agreements in the instant case could be construed to be a relinquishment of the rights which Armstrong had in such leases in return for a percentage in the net profit, then plaintiff's contention would have merit. But such was not the effect of the agreements. They provided that the Ohio company should account to Armstrong not for net proceeds but for his proportionate part of the oil and gas produced and sold; that it should charge Arm-

strong's undivided interest with its proportionate part of the expenses; and that it should be reimbursed out of the proceeds derived from the sale of his proportionate part of the oil and gas. The purpose of the agreements was to facilitate development; not to transfer title. The title of the respective owners remained as before.

It follows that Armstrong, the Ohio company, and Will McMurray were coowners of the leases and joint adventurers in the operation of such leases, and the income produced therefrom was the income of all. (*Ferry Market, Inc.*, v. *Commissioner*, 5 B. T. A., 167; *Dickey* v. *Commissioner*, 14 B. T. A., 1295; *Glenmore Securities Corporation* v. *Commissioner*, 24 B. T. A., 697.)

While the obligations of Armstrong and Will McMurray, as his assignee, to reimburse the Ohio company were contingent and limited to payment from a particular source, they became certain and fixed to the extent of the full amounts charged against them when the receipts from the leases equaled the expenses incurred by the Ohio company.

A part of the advances made and expended by the Ohio company under the agreements was business expenses and a part was capital expenditures. It is true that, had development of the leases not resulted in commercial wells, there would have been no capital improvements in fact, no obligation on the part of Will McMurray to pay therefor, and no income to him (*Bliss* v. *Commissioner* (C. C. A. 5), 57 Fed. (2d), 984); but, when such development did result in commercial wells, there was a capital improvement, 40 per cent of which accrued to Armstrong and Will McMurray, and they derived income from the leases as a result thereof.

The agreements did not constitute a present transfer of an interest in the leases. They authorized the Ohio company to receive and apply to its claim moneys accruing to Armstrong and Will McMurray. They were agreements to pay in the future from a particular source.

Under each of the several applicable Revenue Acts the tax is imposed by force of the statute itself (*United States* v. *Nashville C. & St. L. Ry.* (C. C. A. 6), 249 Fed., 678) immediately when the income is derived, actually or constructively, and the tax attaches before such income passes from the recipient by a transfer to take effect in the future. (*Rensselaer & S. R. Co.* v. *Irwin* (C. C. A. 2), 249 Fed., 726; *Northern R. Co. of New Jersey* v. *Lowe* (C. C. A. 2), 250 Fed., 856; *Hamilton* v. *Kentucky & I. T. R. Co.* (C. C. A. 6), 289 Fed., 20 [T. D. 3518, C. B. II–2, 58]; *Leydig* v. *Commissioner* (C. C. A. 10), 43 Fed. (2d), 494; *Lucas* v. *Earl*, 281 U. S., 111. See also *Corliss* v. *Bowers*, 281 U. S., 376 [Ct. D. 188, C. B. IX–1, 254].)

Counsel for plaintiff further contend that the amounts of Will McMurray's share applied to reimburse the Ohio company were not income to him because they were not received by him or placed at his disposal. But it was not necessary that his share of the proceeds be paid to him personally to render it subject to the tax. Profits which would constitute income if paid directly to a person are also income to him if paid, pursuant to his agreement, to a third person to discharge his obligation to such third person. (*Old Colony Trust Co.* v. *Commissioner*, 279 U. S., 716 [Ct. D. 80, C. B. VIII–2, 222]; *United States* v. *Boston & Maine R. Co.*, 279 U. S., 732 [Ct. D. 73, C. B. VIII–2, 315]; *Blalock* v. *Georgia R. & E. Co.*, 246 Fed., 387; *Rensselaer & S. E. Co.* v. *Irwin*, supra; *Washington Market Co.* v. *Commissioner*, 25 B. T. A., 576.) The Ohio company acted as Will McMurray's agent in applying to his account the proceeds from the sales of his share of the oil and gas produced (*Ferry Market, Inc.*, v. *Commissioner*, supra), and thereby discharged, in accordance with such agreements, his obligations to it. Will McMurray and Armstrong derived benefits therefrom in that the amounts credited on their accounts paid in part for capital expenditures, which resulted in the development of such leases and increased the value of their interests therein.

We therefore conclude that the method used by the Commissioner in arriving at the tax liability was correct. We do not, however, undertake to pass on the correctness of the items. The issues as to them will have to be determined by the trial court.

The decree is reversed and remanded with instructions to grant the collector a new trial.

ARTICLE 52: Examples of constructive receipt. XII–12–6082
Ct. D. 642

INCOME TAX—REVENUE ACTS OF 1921, 1924, AND 1926—DECISION OF COURT.

1. INCOME—ASSIGNMENT—RENTS.

Where a lessor assigns the income from rents, without assigning the income-producing corpus, such assigned income is taxable to the assignor.

2. SAME—ASSIGNMENT—COLLECTION AGENCY.

Where leases provide that rents shall be payable to a bank as trustee, to be distributed as specified therein, such trustee is merely a collection agent and has no title to or power over the income-producing corpus.

3. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (22 B. T. A., 352) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

John Shirley Ward and Chandler P. Ward, Executors of the Last Will and Testament of Shirley C. Ward, Deceased, petitioners, v. *Commissioner of Internal Revenue, respondent.*

Upon petition to review an order of the United States Board of Tax Appeals.

Before WILBUR and SAWTELLE, Circuit Judges.

[May 23, 1932.]

OPINION.

SAWTELLE, Circuit Judge: This appeal involves an alleged deficiency in income taxes, as found by the Board of Tax Appeals, for the years 1922, 1924, 1925, and 1926 in the amounts of $1,822.41, $2,435.81, $3,252.87, and $1,765.86, respectively. During the pendency of this proceeding before the Board of Tax Appeals, Shirley C. Ward, the taxpayer, died. The executors of his estate are the petitioners in this court.

The following is disclosed by the agreed statement of facts herein: In 1913 the decedent became the lessee for a term of 99 years of certain premises known as the Pohlman property, located at Seventh Street and Grand Avenue, in the city of Los Angeles, Calif., owned by one Philip Pohlman. In 1917 decedent assigned this lease to the Pohlman Leasehold Co. for the remainder of its term. In 1920 the Pohlman Leasehold Co. sublet the property back to decedent for the unexpired term, less one day. Under the provisions of the latter agreement and of the original, basic lease, decedent agreed to pay to the Pohlman Leasehold Co. the sum of $200 per month for the first two years and $300 per month thereafter, and the sum of $1,600 per month to Philip Pohlman.

May 26, 1920, decedent sublet the property for the remainder of his term, less one day, to the California Chocolate Shops, Inc., E. C. Quinby and P. W. Quinby, and the sublessees assumed all of the obligations of decedent to Philip Pohlman and the Pohlman Leasehold Co. The rentals agreed to be paid thereunder ranged from $2,100 per month for certain years to $3,600 per month for the remaining years. This sublease provided that all rents due under it would be paid to a trustee, to be distributed by the trustee to the owner and the sublessors. This provision reads as follows:

"As security to the lessees that the ground rental called for in the original lease on the demised premises from Philip Pohlman to Shirley C. Ward, dated December 4, 1913, as modified by the agreement hereinabove mentioned of December 22, 1917, will be paid by the lessor herein to the original lessor, Philip Pohlman, or his heirs, successors or assigns, as and when the same

becomes due, and as security that the rental payable by Shirley C. Ward, as lessee to the Pohlman Leasehold Co., as lessor, under the lease of said premises held by said Ward from the Pohlman Leasehold Co., will be paid as and when the same becomes due and payable, it is agreed that all rentals payable hereunder shall be payable to the Los Angeles Trust & Savings Bank, as trustee, under instructions to said bank to distribute such rental in accordance with the rights thereto of Philip Pohlman, the original lessor, and of the Pohlman Leasehold Co., the subsequent lessor, and the remainder of such rental, after the rentals due Philip Pohlman and due the Pohlman Leasehold Co. have been paid, to the lessor herein, Shirley C. Ward. The lessor herein, or his heirs, successors or assigns, may have the privilege at any time of changing the trustee to whom said rentals shall be payable, provided said trustee shall at all times be a responsible trust company having an office in and doing business in the city of Los Angeles."

January 2, 1922, decedent executed and delivered to Blanche C. Ward, his wife, a written assignment of all his interest in the rentals from the sublease to the California Chocolate Shops. The pertinent portions of this assignment read as follows:

"In consideration of love and affection, I hereby assign, set over and transfer to my wife, Blanche C. Ward, the following property to be her own, absolute and sole and separate property, free from any claim of mine whatsoever, viz: * * *

"Second. All my interest in the rentals on the Pohlman property at the northeast corner of Seventh Street and Grand Avenue, Los Angeles, Calif., payable to me under lease from me to the California Chocolate Shops, E. C. Quinby and P. W. Quinby, dated May 26, 1920, now recorded in the office of the county recorder of Los Angeles County, Calif. * * *

"It is my interest in such Chocolate Shops-Quinby rentals, subject to the foregoing charges thereon, that is intended to be assigned hereby; the net rentals coming to me and so assigned hereby being as follows, viz: Until January 1, 1923, $300 per month; thereafter until Bryan and Bradford are paid off $1,150; thereafter to the end of the 99-year lease $1,450 per month. * * *"

Thereafter the said rentals were paid by the trustee to Blanche C. Ward and to her daughters, to whom she subsequently assigned a portion of the income.

January 12, 1922, decedent executed an assignment to his sister, Annie E. Ward, of $250 per month from these same rentals, and thereafter that sum was paid monthly by the trustee to Annie E. Ward.

The net income accruing to the decedent under the terms of the California Chocolate Shops sublease, and paid by the trustee to the assignees of decedent, amounted to $3,600 in 1922, $16,800 in 1924, $13,800 in 1925, and $12,400 in 1926. These rentals were included as income for the respective years in the income tax returns filed by the assignees, decedent's wife, daughters and sister. No part of the amounts was reported as income by decedent in his returns for those years. The Commissioner of Internal Revenue determined that the amounts should have been returned as income by decedent in the respective years, and this determination was affirmed by the Board of Tax Appeals.

Decedent was also the owner of a certain lot in Los Angeles and the building thereon, known as the Kinema Theatre Building, which covered all of the lot except a strip 10 feet wide along the southern boundary. This property was sold by decedent in 1919, but the deed reserved to the grantor, his heirs and assigns, an easement over the vacant strip of land on the southern boundary of the lot as long as the Kinema Theatre Building remained thereon. In 1920 decedent granted to the Standard Fireproof Building Co. the right to use this strip of land as a means of access to and egress from a structure adjacent thereto known as the Brack Shops Building, for a consideration of $200 per month. By the assignment of January 2, 1922, above referred to, decedent also assigned to his wife his right to receive this $200 per month payment from the Brack Shops Building for the use of the easement, and thereafter she received said rental.

In 1924 and 1925 decedent included the rentals received from the Brack Shops Building for the use of the easement in his income tax returns, but the rentals were not included as income in his returns for the years 1922 and 1926. The Commissioner of Internal Revenue determined that the rentals should have been included in the 1922 and 1926 returns also, and his determination was affirmed by the Board of Tax Appeals.

The question thus presented is whether an assignor, by an assignment of bare rentals without assigning the lease that produces the rentals, can relieve himself of income taxes thereon. We think the question must be answered in the negative.

From the language of the assignments it seems clear that decedent intended to assign only his right to the income from the lease and not the lease itself or any interest therein, other than the rentals to accrue thereunder. The language used is: "I hereby assign * * * all of my interest in the rentals on the Pohlman property * * *"; again, "It is my interest in such Chocolate Shops-Quinby rentals * * * that is intended to be assigned hereby"; and again, "I further hereby assign, transfer and set over to my wife my right to receive from the Brack Shops Building * * * a monthly rental of $200 per month * * *." Decedent's son and legal adviser, one of the petitioners here, testified:

"I examined a draft which he had prepared, and we discussed the subject of whether the Pohlman property rentals alone should be the subject of the assignment or whether it should also include the reversion. It was my advice to him at that time that inasmuch as he was dividing the rents between his sister as to $250 a month, and his wife as to the balance, that he should not transfer the reversion, inasmuch as both women were inexperienced in business affairs, and the building required to be erected by the tenant, California Chocolate Shops, Inc., had not yet been erected, and it might be necessary to give an extension of time, or rearrange its obligations in reference to the erection of that building, and that the reversion, therefore, and the final determination of the problem of securing performance of the lease, would best be left in his hands. It was for that reason that the rents and the reversion are separated in the instrument."

It is urged by petitioners, and conceded by respondent, that the owner of a reversion may sever the rents therefrom and grant them separately. At the same time, however, petitioners contend that the assignment of all the income under the lease operated to pass reversion. However, the admitted facts and pertinent excerpts from the instruments assigning the income do not support this contention. Moreover, it can not be said that the assignees would be liable for any default on the part of their assignor with respect to the terms of the original demise from the owner of the property; and it is doubtful if the assignees could sue for any default or breach on the part of the sublessees. In other words, the mutual obligations of the several parties to the lease and subleases remained the same after the assignment of the rentals by the deceased sublessor. In this situation, decedent was free to transfer the lease itself, thereby depriving himself of the right to receive future rentals and rendering the assignments to petitioners valueless and ineffective. It is clear, therefore, that decedent retained title to the lease, the income-producing corpus, and the interest of the assignees was merely in the nature of a right to receive the rentals as and if they accrued to their assignor.

In its opinion the Board of Tax Appeals said:

"It is the contention of the petitioners that in each case the decedent, by his assignment, completely divested himself of all property rights and interests in and to the several sums paid under these contracts to his assignees, so that when paid they constituted income to such assignees and not to decedent. * * *

"* * * Since the status of the decedent, as lessor, under this lease remained unchanged and all payments of rent were made to his nominee, it follows that when so made they belonged to him and were a part of his income when received by the bank. * * *

"In each of the several decisions cited by the petitioners, to sustain their contentions, the basic facts have shown not simply that the rights involved were such as could be legally assigned, but the further fact that the assignor had in each case actually parted with all or some part of his title to the income-producing corpus. In the present case the producer of the income was decedent's lease, not the funds after payment into the bank. And it was to portions of this fund that the decedent passed title by his assignments which, after receipt and disbursements otherwise made by the bank but not before, became accounts receivable in favor of the assignees. * * *"

In other words, the Board held that the assignment merely of the rentals to accrue, without an assignment of the lease itself, did not relieve the assignor of his liability for income taxes, inasmuch as he remained the owner of the lease, or income-producing corpus.

In *Bing* v. *Bowers* (22 F. (2d), 450, affirmed (C. C. A. 2) 26 F. (2d), 1017 [T. D. 4124, C. B. VII–1, 210]) the taxpayer had assigned to his mother an annuity out of his share of the income from certain properties owned by him, in whole or in part. In holding that the taxpayer was subject to income tax on the gross income, Circuit Judge Mack, sitting in the district court, said:

"To permit the assignor of future income from his own property to escape taxation thereon by a gift grant in advance of the receipt by him of such income would by indirection enlarge the limited class of deductions established by statute. As long as he remains the owner of the property, the income therefrom should be taxable to him as fully, when he grants it as a gift in advance of its receipt, as it clearly is despite a gift thereof immediately after its receipt."

In *Rosenwald* v. *Commissioner* (C. C. A. 7) (33 F. (2d), 423, certiorari denied 280 U. S., 599), the taxpayer had assigned, among other things, all rentals accruing to him, as lessor, under a certain lease, and the court held that the rentals were taxable as income of the assignor, saying:

"The ultimate question here is, Did petitioner so divest himself of the income from the securities mentioned that it never became taxable income as against him?

"Petitioner's chief contention is that there was a completed gift, and that petitioner never received the income.

"It is doubtful whether a holder of securities may separate the income thereafter to accrue from the principal, and make a gift by way of assignment of the income, without assigning or trusteeing the thing out of which the income arises, where the effect would be to relieve the donor from tax otherwise imposed."

Numerous other cases also hold that assigned income is taxable to the assignor, unless the corpus producing the income is also assigned. (See Appeal *of Fred W. Warner*, 5 B. T. A., 963, and *Irene McFadden Winder, Executrix*, v. *Commissioner*, 17 B. T. A., 303, and cases cited therein. See, also, *Porter* v. *United States* (Ct. Cls.), 52 F. (2d), 1056 [Ct. D. 452, C. B. XI–1, 160]; *Bishop* v. *Commissioner* (C. C. A. 7), 54 F. (2d), 298 [Ct. D. 477, C. B. XI–1, 164].)

Likewise, an assignment making the assignee a joint tenant of salary to be earned does not relieve the assignor from income tax liability on the whole thereof. (*Lucas* v. *Earl*, 281 U. S., 111.)

It has been held that an assignment of future profits from a partnership without an assignment of the partnership property, that is, without an assignment of the income-producing corpus, is an assignment merely of income. Such income is taxable against the assignor. (*Mitchell* v. *Bowers* (C. C. A. 2), 15 F. (2d), 287, certiorari denied, 273 U. S., 759 [T. D. 3982, C. B. VI–1, 244]; *Harris* v. *Commissioner* (C. C. A. 2), 39 F. (2d), 456; *Burnet* v. *Leininger*, 285 U. S., 136, decided March 14, 1932, reversing 51 F. (2d), 7.)

The assigned rentals were therefore properly taxed as income of the decedent in the first instance.

As above stated, decedent was the owner of an easement used as an approach to the Brack Shops Building, which right of way he had leased to the Standard Fireproof Building Co., lessee of the Brack Shops, at a rental of $200 per month. Later the Standard Fireproof Building Co. sold its leasehold interest in the Brack Shops and the purchaser thereof agreed to pay decedent the $200 monthly easement rental theretofore paid by the Standard Fireproof Building Co. As an incident to the sale of the Brack Shops lease, decedent transferred to the Standard Fireproof Building Co. his easement over this lot, in consideration of the purchaser of the leasehold estate continuing the $200 monthly rental therefor. Petitioners now contend that decedent thereby divested himself of all title to his property right in the easement in exchange for a contract right to receive the rent for the use of the easement, and that therefore, at the time of the assignment of this rental to his wife, he had merely a right to receive the $200 monthly rental—an account receivable—which passed in toto to his wife by the assignment. The Board of Tax Appeals, on the other hand, held that decedent retained full title to the basic easement and the reversion and that his assignee acquired merely a right to receive these monthly rentals as they accrued.

What has been said hereinabove with reference to the interest which the assignees took under the assignments of rents from the Pohlman property is equally applicable to the interest which the wife took in this monthly easement

rental. We believe that the Board of Tax Appeals was correct in holding that decedent retained in himself the basic easement and reversion. The language of the so-called deed granting the easement to the Standard Fireproof Building Co. would so indicate. It recites:

"* * * but the rights hereby granted are not intended to interfere with or to restrict the existing rights of the grantor in such strip of land except to the extent of the rights in such strip of land herein specifically granted to the grantee, its successors and assigns, and shall not interfere with the grantor's rights to give similar rights and privileges to other properties abutting on such 10-foot strip of land * * * on such terms and for such consideration as the said grantor may fix and determine."

It is further contended by the petitioners that the instrument above referred to, whereby the Los Angeles Trust & Savings Bank was designated as trustee to receive and disburse the monthly rentals as specified in the several leases, constituted or created a trust; that the beneficial interest under such trust was assigned; and that the assignees and not the assignor were taxable with the income.

We think there is no merit in this contention for the obvious reason that no trust was created, except for the limited purpose of enabling the bank to receive and disburse the rentals. The lease was still held and owned by the decedent. The bank was merely a collection agent, and had no trust estate in its possession. It had no title to or power over the leases producing the rentals.

As we have seen, the decedent could have disposed of the corpus and thereby terminated the authority of the bank entirely. Such an arrangement as here shown does not constitute a trust within the meaning of the cases upon which the petitioners rely.

This income was, therefore, properly taxable as income of decedent.

Affirmed.

ARTICLE 52: Examples of constructive receipt. XII-22-6202 Ct. D. 672

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. INCOME—ASSIGNMENT—TRUST INCOME.

Future income from a trust estate, of which petitioner was a beneficiary, assigned by her to her husband subject to the conditions that it should not be alienated, assigned, or otherwise disposed of by him, and with instructions to the trustees to pay the assigned income directly to the husband, and which, at the direction of both husband and wife, was paid to a designated bank for deposit to their joint account, was properly taxable to the wife, since she never lost control of the income and it never became the separate property of the husband.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (23 B. T. A., 428) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.

Hazel T. Power, petitioner, v. *Commissioner of Internal Revenue, respondent.*

On petition to review decision of United States Board of Tax Appeals.

Before STONE and KENYON, Circuit Judges, and OTIS, District Judge.

[November 18, 1932.]

OPINION.

STONE, Circuit Judge, delivered the opinion of the court.

This is a petition to review the action of the Board of Tax Appeals which affirmed the Commissioner in a deficiency tax assessment on certain income (from a trust) which petitioner claims was assigned to her husband and

taxable to him and not to her. The taxable year is 1924 in this petition. Other petitions covering the same matter for the years 1926 and 1927 are, under stipulation, to abide the result here.

The will of the mother of this petitioner established a trust in certain personal property for the benefit of petitioner, her sister and their descendants. In so far as the petitioner was concerned, the terms of the trust provided the income from the trust estate should be paid in equal parts to the two daughters with right in the survivor to the entire income, both for life. The sole interest of petitioner in the trust was this life income therefrom. There was no restraint or limitation as to the right of these two beneficiaries to alienate.

In 1923, petitioner executed an assignment to her husband of "one-third of the income of the trust estate * * * to which (she) * * * may be or may become entitled to under and by virtue of the terms of the will * * * and the trust therein created." The assignment was expressly made subject to the "conditions subsequent" that any alienation or disposition by him of "anticipated income or income payable in the future" or any insolvency or "other means" preventing personal enjoyment of the income by him and resulting in the income vesting in or being payable to some other person should terminate his interest in all income payable thereafter and operate as a reversion to her. Assignment of the income by her husband was expressly prohibited. Upon the same date, petitioner served an authorization on the trustees for payment direct by them to her husband of the assigned income. The pertinent portion thereof is as follows:

"The undersigned, Hazel E. Power, has this day executed and delivered to her husband, Charles E. Power, an assignment of a one-third interest in the income to which she will become entitled under the terms of the trust estate created by her mother. A duplicate original of said assignment is hereto attached and made a part hereof.

"The undersigned hereby requests that in distributing the income to which the undersigned may become entitled to receive under the terms of said will and the trust thereby created, that at the time of distribution, you distribute the same in two checks, one for two-thirds of the amount to the undersigned, Hazel E. Power, and one for one-third of the amount to my husband, Charles E. Power."

Several matters are argued here respecting the effectiveness of this assignment to transfer this income so that it would not constitute income taxable to petitioner. We think such matters not controlling under the facts of this case. Whatever the legal effect of this assignment in so far as transferring title not only to future income but also to the equitable interest from which such income would be derived, the record is clear that the assignment did not actually remove this income from control of petitioner. The assignment is silent as to whether the assigned income was to be paid direct to the assignee by the trustees but an authority to the trustees to pay direct was served upon the same day the assignment was executed and delivered to the assignee. If this were all, it might well be determined that such direction was within the intention of the parties in making the assignment and should be regarded as a part of that transaction. The facts are, however, that no part of the assigned income was so paid. At the direction of both parties these payments were made to a designated bank as payee "for deposit to their joint bank account." Thus petitioner never lost control of this income as matter of fact and it never became the separate property of the assignee. As to actualities, the assignment might have been a blank page. The record is silent even as to whether the joint bank account resulted from the assignment although that would not be controlling. It may be that this assignment was executed with no thought of taxation liability. Be that as it may, tax statutes are not so easily avoided or evaded. The facts are that this entire matter starts with a trust estate in which petitioner has a right to one-half the annual income and ends with that income paid by the trustees, at her direction, to a joint bank account of herself and her husband. Whatever her intentions and whatever she did concerning the disposition of her income or interest in the trust estate, the net result was that her entire income under the trust was deposited directly to an account over which she had entire control.

The determination of the Board of Tax Appeals was correct and this petition must be dismissed.

Under the stipulation that the result of this appeal shall govern disposition of the appeals for the tax years 1926 and 1927, like orders will be made therein.

ARTICLE 52: Examples of constructive receipt. XII-23-6209
Ct. D. 675

INCOME TAX—REVENUE ACTS OF 1921, 1924, AND 1926—DECISION OF COURT.

1. INCOME—ASSIGNMENT—RENEWAL COMMISSIONS.

Renewal commissions paid by an insurance company directly to the assignees of its corporate general agent, pursuant to a contract between them, constituted taxable income of the agency, notwithstanding their assignment, since the agency contract itself, the source of the income, was not assigned. Congress has the power to tax income to the earner thereof, irrespective of the fact that it is actually received and enjoyed by some one else.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (22 B. T. A., 1202) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.

B. D. Van Meter, petitioner, v. *Commissioner of Internal Revenue, respondent.*

A. R. Ingleman, petitioner, v. *Commissioner of Internal Revenue, respondent.*

On petition to review decisions of the United States Board of Tax Appeals.

Before STONE and KENYON, Circuit Judges, and OTIS, District Judge.

[November 18, 1932.]

OPINION.

STONE, Circuit Judge, delivered the opinion of the court.

The Hawkeye Life Insurance Co. was organized March 9, 1920, and commenced business on the following July 1. The Van Meter company was organized April 29, 1920, by five persons, one of whom was this petitioner, Van Meter. On June 15, 1920, and subsequently on January 21, 1924, the Hawkeye and Van Meter companies entered into contracts whereby the latter was appointed the general agent for the former, and provided among other things, that renewal commissions were to be paid the Van Meter company "or its assigns" by the Hawkeye company. At various meetings of the stockholders of the Van Meter company, that company assigned the renewal commissions on business written under the general agency contracts to various persons, among whom was the taxpayer in this case. The Van Meter company was dissolved on August 31, 1925. During the years 1922, 1923, 1924, and 1925, the Hawkeye company paid direct, by individual check, to the various assignees of the Van Meter company all of the renewal commissions arising under the two general agency contracts, and no part of the renewal commissions was paid to the Van Meter company. During the years in controversy, the assignees paid an income tax upon the sums so received by them.

The present taxes are sought as taxes of the Van Meter company for the years 1922 to August 31, 1925, and the claimed liability of this petitioner is as a transferee under section 280 of the Revenue Act of 1926 (44 Stat., 61). While petitioner argues that the Van Meter company was a personal service corporation, we do not deem it necessary to examine that matter except to say this taxable period begins with the year 1922 and personal service corporations were subject to taxation after December 31, 1921 (Revenue Act of 1921, section 218(d), 42 Stat., 245). The decisive question presented here is whether these assignments of renewals prevented such renewals from being income of that company, in a taxable sense, for the years in which they were paid by the Insurance company to the assignees.

There is no question that these renewal premiums constitute taxable income. There is no question that the Van Meter company and it alone earned this income. There is no question that the company made assignments of this income to petitioner with authority, accepted and acted upon by the Insurance company, for direct payment to petitioner, and that this income was never received nor enjoyed by the Van Meter company. If the Van Meter company is taxable for this income it must be because Congress has the power to tax

income to the earner, irrespective of whether he or some one else actually receives and enjoys it, and because Congress has exercised this power.

The Supreme Court has definitely determined that Congress has the power to tax the *earner* of income therefor, irrespective of whether it is paid to some one else (*Burnet* v. *Leininger*, 285 U. S., 136, 142; *Lucas* v. *Earl*, 281 U. S., 111, 114; *Corliss* v. *Bowers*, 281 U. S., 376, 378 [Ct. D. 188, C. B. IX–1, 254]; *Old Colony Trust Co.* v. *Commissioner*, 279 U. S., 716 [Ct. D. 80, C. B. VIII–2, 222].) Our only question is, therefore, has Congress manifested such an intention in the statutes here applicable.

The "earner" of income is one whose personal efforts have produced it; who owns property which produced it or a combination of the two. Decisions of the Supreme Court have declared that the income statutes require taxation to the earner in each of the three above sources of income where the income was actually realized but never came to beneficial enjoyment by the earner. *Lucas* v. *Earl* (281 U. S., 111) is the decision in the instance of income earned by personal efforts alone—the income there being fees and salary of an attorney. *Corliss* v. *Bowers* (281 U. S., 376) is the instance of income from owned property. *Burnet* v. *Leininger* (285 U. S., 136) is the instance of combined personal effort and property (or capital). These decisions were made upon the sections of the statutes defining taxable income here involved (sections 210, 213, and 233 of Revenue Acts of 1921, 1924, and 1926), or upon sections of other Federal income statutes having precisely the same meaning in this respect. All of these decisions are governing authority in this case—the Lucas case being more exactly so only because that and this case both deal with income earned through personal effort (in the Lucas case by Earl, and here by the agents of the Van Meter company).

In determining who is taxable for an income, there are three considerations which *may* be of importance, to wit, who earns the income; who receives it and who enjoys it. Where the same person earns, receives and enjoys the income (the normal and usual situation), there is no difficulty. Where different persons earn, receive and/or enjoy the income, disputes occur. In determining such disputes, the vital matter is always the relation of the earner (whether a person, owner of property or combination of the two) of the income to the income so earned. The rule and intent of the taxing statutes is that the earner of income which he might and, normally, would receive and enjoy for himself is not relieved because he chooses not to receive or not to enjoy it, and this is not necessarily changed by such deprivation taking the form of an obligation legally binding him thereto. If there exists a legal relationship of the earner to others which results in the earnings (in part or whole) being for the benefit of others than the actual earner, the statutes do not attempt to tax the earner for such income as he was not earning in his own right,[1] but where the earner of the income does nothing more than transfer the income earned in his own right to another, even though such disposal be in advance of the earning thereof (*Burnet* v. *Leininger* and *Lucas* v. *Earl*, supra), or where he retains any power of control over the income earning property or the income therefrom (*Corliss* v. *Bowers*, 281 U. S., 376) and analogous as to transfer tax (*Chase Nat. Bank* v. *United States*, 278, U. S., 327 [Ct. D. 40, C. B. VIII–1, 308]; *Reinecke* v. *Northern Trust Co.*, 278 U. S., 339 [T. D. 4261, C. B. VIII–1, 305]), and as to State succession tax (*Saltonstall* v. *Saltonstall*, 276 U. S., 260), such income is taxable to him within the intent of the statute (*Burnet* v. *Leininger*, *Lucas* v. *Earl*, and *Corliss* v. *Bowers*, supra).

It is argued that it was the intention of the incorporators of the Van Meter company from the first that "the Van Meter company was contemplated only as a vehicle, as an intermediary by which to conduct the sale of life insurance for the Hawkeye Life Insurance Co., and the contract for selling life insurance for the Hawkeye was made between the Van Meter company and the Hawkeye; the commissions and renewal commissions were contemplated as being paid direct from the Hawkeye Life to the individuals, without using the Van Meter company as an intermediary" (testimony of McBride). This may be taken as true, but the fact remains that the Van Meter company was the actual earner of these renewals under its contracts with the Insurance company and was not a mere agency of the incorporators. A corporation is, in its very nature, an entity operating for the benefit of its stockholders. To permit it to be treated as the mere agent of the stockholders in a taxation

[1] Instances are where an employee earns money through his efforts for his employer (such as sales agents); where a partner earns for a partnership (*Burnet* v. *Leininger*, 285 U. S., 136, 141) or a husband for a community estate (*Seaborn* v. *Poe*, 282 U. S., 101 [Ct. D. 259, C. B. IX–2, 202]).

sense would be to violate all legal conceptions of the true relationship and would open the door to unlimited escape from taxation.

It is argued that these assignments were effective as passing title to the renewals as choses in action. It may be conceded that the assignments legally entitled the assignees to have the renewals. That is not determinative here. There was no assignment of the agency contract. The Van Meter company alone acted thereunder and it alone produced the insurance business which was the basis or earning of the renewals. The actual effect of the assignments was to transfer to the assignees what had been solely earned by the Van Meter company and to authorize direct payment thereof to the assignees by the Hawkeye company. What it did with its earnings can not affect the application of the taxing statutes. The *Burnet* v. *Leininger* and *Lucas* v. *Earl* cases, supra, did not turn on any failure of the contracts there involved to pass the taxed income from the earner but in both cases those contracts were treated as fully affective for that purpose and yet were held not to affect the application of the taxing statutes.

Petitioner strongly urges several circuit and district cases as sustaining his position. Only one of them opposes what has been said above. The latest of these is *Nelson v. Ferguson* (56 Fed. (2d), 121 C. C. A. 3). This is a case where the income consisted of profits from a contract. The petitioner assigned these profits yet to be earned to his wife in a crudely drawn instrument which the court treated as an assignment or transfer of his rights under the contract. There the source or "earner" of the income was assigned so that the wife became owner thereof. That is essentially different from this case, where the earnings only were assigned.

Another of these is *Hall* v. *Burnet* (54 Fed. (2d), 443, Court of Appeals of District of Columbia). We think this case is an authority for petitioner. However, and with all due respect, we think the distinction of the *Lucas* v. *Earl* case, attempted in the opinion, is unsound. It may be true that income already entirely earned is transferable as a species of property, but that has no effect upon the power and intention of Congress to tax income to the earner. The earner may, in a legally binding way, dispose of his earnings, whether they are already earned or are to be earned, without affecting in the slightest manner his status as earner thereof and his resulting liability for taxation thereon as income. Such is the rule of the Lucas, Corliss, and Leininger cases, to which the Hall case is, in our judgment opposed.

Another of these cases is *Central Life Assur. Soc. Mut.* v. *Commissioner* (51 Fed. (2d), 939), in this court. There an insurance company, which had written both participating and nonparticipating policies, sold its business to another company under a contract providing that earnings collected by the purchaser on the nonparticipating policies already existing should be paid over to certain designated persons. There, the purchaser had not earned any of these earnings and, under this contract, never received any beneficial right or title to them. The purchaser was a mere collector or conduit through which they passed.

The next case is *Bettendorf* v. *Commissioner* (49 Fed. (2d), 173), this court. That case involved income (dividends) from corporate stock where the owner had transferred only legal title to the stock under a contract requiring collection and payment by the transferee to her of all dividends during her life. At the time the stock earned the dividends involved in that controversy, the petitioner there held only a bare legal title to the stock with power to collect and transmit the earnings. This court held the transferee to be a "trustee, a fiduciary" (page 175), "the innocent agency by or through whom a substantial income was derived for some one else" (page 176).

Another is *Iowa Bridge Co.* v. *Commissioner* (39 Fed. (2d), 777), this court. There a corporation which had partially constructed bridges under contracts, sold and assigned its rights in such contracts for the cash investment it had made therein up to the assignment and for the obligation of the assignee to complete the contracts. The tax sought to be levied against the corporation was upon the profits realized by the assignee from completion of the contracts. The Commissioner conceded that if the assignment was valid the corporation was not taxable for these profits (page 780). There the earner of the profits was the assignee who acted under the assigned contracts.

Another case is *Shellabarger* v. *Commissioner* (38 Fed. (2d), 566 (C. C. A. 7)). There, a beneficiary of the income from two trust funds contracted to pay a certain part thereof to another. In determining that the part transferred was not taxable income of the beneficiary, the court thought the reason for not

requiring payment direct of the part transferred was a requirement in the trust deed that income from the trust was "payable to her (the beneficiary) on her sole and separate receipt therefor" and that she was "but an instrumentality or agency for receiving and conveying" the part transferred. In so far as the petitioner was concerned, the interest owned by her and producing her income was the right to receive the income designated in the trust instrument. The opinion does not directly discuss whether the conveyance by her was of a fraction of this "interest" or only of a part of the income produced thereby but it is clear the court regarded the conveyance to be of the interest as well as of the income therefrom. The court says: "it (the doubtful authority of the trustees to make payment to any one than petitioner) tends to dispel any inference that, under the terms of the contract, any power or control over the three-tenths and one-fifth remained in Maud except to receive it and turn it over as in the contract specified" (page 567) and "She did all she reasonably could to invest Georgia and the bank with full right and title to the half" (page 567).

United States v. *Looney* (29 Fed. (2d), 884 (C. C. A. 5)) involved the question of whether an oil royalty was taxable to the landowner or his transferee of the royalty. The court held that "The right to receive a part or share of the oil extracted from the land mentioned was an interest in the land. * * * That right, as to the whole or a part of the subject of it, may be sold or otherwise disposed of by its owner" and that the transfer passed ownership of the royalty as an interest in the land. The distinction made is that, although a royalty is income to the landowner, it is also an interest in the land and, as the latter, may be completely transferred even for income purposes.

Young v. *Gnichtel* (28 Fed. (2d), 789 (New Jersey District Court)) is cited but not discussed. Here a beneficiary under a trust assigned a portion of the income therefrom with power in the transferee to collect direct from the trustee. Unless this case is like the Shellabarger case, it is questionable authority.

O'Malley-Keyes v. *Eaton* (24 Fed. (2d), 436 (Conn. D. C.)) is like the Young case. Of four cases cited from the Board of Tax Appeals, three are discussed. That of *Paulson* v. *Commissioner* (10 B. T. A., 732) is like the Looney case. The others, *Blaney* v. *Commissioner* (13 B. T. A., 1315) and *Grace Scripps Clark* v. *Commissioner* (16 B. T. A., 453) are like the Young and O'Malley-Keyes cases.

Petitioner argues two matters which may be treated together. The first is that the assignment of these renewals was by way of "remuneration for time expended and money expended by the stockholders in the service of the corporation." The other is that they were partial distributions of the corporate assets. In either event, the renewals must be regarded as assets of the corporation in order to pass from it either as remuneration or in distribution. How they could be assets or property of the corporation, and their character as income of the corporation avoided, is not quite clear to us. But whatever the reason for the assignments or however we name the legal effect thereof, the stark fact remains undisturbed and decisive that the corporation alone earned the renewals in its own right. To that fact, the statutes attach the liability to pay an income tax upon such as are actually realized.

We think the Board right in its determination and the petition is, therefore, dismissed.

In case No. 9377, *A. R. Ingleman, petitioner,* v. *Commissioner of Internal Revenue, respondent,* the stipulation having been filed that the result in case No. 9376, *B. D. Van Meter, petitioner,* v. *Commissioner of Internal Revenue, respondent,* should govern in the Ingleman case, an order will be entered dismissing the petition therein.

SECTION 213(b).—GROSS INCOME DEFINED: EXCLUSIONS.

ARTICLE 74: Interest upon State obligations. XII–19–6167
Ct. D. 663

INCOME TAX—REVENUE ACTS OF 1921, 1924, AND 1926—DECISION OF COURT.

1. INCOME—EXEMPTION—INTEREST—OBLIGATION OF STATE OR POLITICAL SUBDIVISION.

Where, to obviate the objection of loans to any one person or firm in excess of the amount authorized by the national bank law,

the taxpayer bank and a company dealing in municipal bonds entered into contracts of sale, with the approval of the Comptroller, whereby the bank during the years 1922–1927 purchased bonds from the company, the latter agreeing to reimburse the former for any loss it might suffer upon sale of the bonds or at their maturity, and having the privilege of repurchasing the bonds from the bank, and where the proceeds were credited to the company's account and it paid the bank monthly specified rates of interest thereon, such rates not always being the same as those which the bonds bore, and the bank clipped the interest coupons and turned them over to the company, such practice clearly showed that it was not intended that the bank should be entitled to the interest accrued on the bonds. Therefore, the bank could not properly claim exemption under section 213(b)4 of the Revenue Acts of 1921, 1924, and 1926, which exempts from tax interest upon obligations of a State or political subdivision thereof.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (19 B. T. A., 744) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, TENTH CIRCUIT.

First National Bank in Wichita, petitioner, v. *Commissioner of Internal Revenue, respondent.*

On petition to review decision of the United States Board of Tax Appeals.

Before LEWIS and COTTERAL, Circuit Judges, and KENNAMER, District Judge.

[March 28, 1932.]

OPINION.

LEWIS, Circuit Judge, delivered the opinion of the court.

During the latter part of the year 1922 and continuously thereafter throughout the years here involved (1922–1927, inclusive) petitioner held a large amount of tax-exempt municipal bonds. It complains that "The respondent has included in the taxable income of the petitioner nontaxable interest received from obligations of States and political subdivisions thereof owned by the petitioner * * * which have been added to the income of the petitioner by the respondent" and "should be eliminated from said income in accordance with the statute * * *." There is no doubt of the exemption from income taxes of the interest on these securities in favor of the person or persons who were entitled to receive it and did receive it. So, the issue is one of fact.

The facts found by the Board and sustained by the proof are in substance these: Brown-Crummer Co. are large dealers in municipal bonds at Wichita, and they needed at times a million or more dollars from outside sources in their business; during the years here involved it procured from petitioner between five and six million dollars in the manner hereinafter stated; prior to November, 1922, when they desired funds from the petitioner they would deliver to petitioner bonds and receive from petitioner the amount agreed upon, giving to petitioner at the time this written statement:

FIRST NATIONAL BANK,

GENTLEMEN: We hand you herewith ——— bonds Nos. —— for —— each. Please credit our account with the face value of these bonds, $——, said bonds to be held by you for our account and to be taken up at any time on your or our demand at par and accrued interest from this date at bond rate, — %.

Very truly yours,

BROWN-CRUMMER CO.,
By ———————.

The comptroller appears to have objected to this written statement of the transaction, apparently on the ground that it was a mortgage and the amount

a loan, the face value of bonds held by the bank in this way being found to greatly exceed the amount which the bank was authorized to loan to any one person or firm. Conferences were then held by an officer of the bank with the comptroller, and this form of agreement was agreed upon as obviating the objection:

"This agreement by and between ——— and the First National Bank in Wichita, Kans., chartered under the laws of the United States of America.

"Witnesseth, that whereas the said ——— has this day sold to the First National Bank in Wichita the following described bonds, namely ——— receipt of which is hereby acknowledged, in consideration of the purchase price of $—— the receipt of which is hereby acknowledged, the said ——— does hereby agree to reimburse said bank for any loss said bank may suffer when at its option it shall sell said bonds, or when said bonds are matured, and shall for any reason not be paid by the makers thereof; provided, however, the said ——— shall be entitled to 30 days notice of the bank's intention to sell said bonds, provided further that said ——— shall have the privilege of purchasing said bonds from said bank upon the payment of $—— and interest at — from ——— until paid.

"In testimony whereof the said bank and said ——— have caused these presents to be signed this — day of ——— 192–."

The comptroller in his letter approving this agreement said:

"The copy of the agreement between the Brown-Crummer Co. and your bank is also received, under which the company agrees to sell to your bank certain bonds and to reimburse the bank for any loss suffered by it in the event it shall dispose of the bonds, or at their maturity, but with the understanding that the Brown-Crummer Co. shall have the privilege of purchasing such securities so sold to the bank upon the payment of the principal and interest. This agreement is satisfactory, inasmuch as the Brown-Crummer Co. merely has the privilege of repurchasing the bonds referred to, and does not bind itself absolutely so to do. If the Brown-Crummer Co. could be compelled to repurchase these bonds, the transaction would then be a loan subject to the limit prescribed by section 5200, U. S. R. S."

After this approval by the comptroller, the transactions between the bank and Brown-Crummer Co. continued, and as bonds were delivered to the bank Brown-Crummer Co. received credit to its account. The approved written agreement accompanied these transactions and others of like character with other bond brokers, and the bank entered the bonds on its books as a part of its assets. But Brown-Crummer Co. continued to carry the bonds so delivered on its books as its assets, and showed the amount obtained thereon from the bank as a loan payable. Except in special instances on account of the character and amount of the bonds, Brown-Crummer Co. were given the privilege of substituting other bonds in place of those then held by the bank, and when substitutions were made Brown-Crummer Co. delivered to the bank this written statement:

FIRST NATIONAL BANK,
Wichita, Kans.

DEAR SIRS: We are handing you herewith the following described securities: ——— which we desire to exchange for securities which you are now holding for our account, and therefore would thank you to deliver to bearer the following securities ——— receipt of which is hereby acknowledged.

THE BROWN-CRUMMER CO.,
By _____.

Date _____

Exchanges were frequently made, sometimes several times a day, and were requested and usually consented to when Brown-Crummer Co. sold some of the deposited bonds or had occasion to otherwise use them. The same arrangement and procedure was had between the bank and other dealers in bonds, but of the total amounts handled during the years in question, 80 to 90 per cent were in transactions with Brown-Crummer Co. Interest accruing on the bonds was represented by attached coupons due semiannually. When they came due, the bank would clip them, and deliver them to Brown-Crummer Co. By agreement between the parties at the time the bonds were delivered to the bank, and by uniform course of dealing, a rate of interest was agreed

upon on the amounts the bank credited Brown-Crummer Co., and the latter paid the bank this interest monthly. In some instances the interest paid by Brown-Crummer Co. on the amount placed to its credit, when the bonds were delivered, was at the same rate as that named in the bonds, but was payable monthly and not at the times interest fell due on the bonds. In some instances the interest paid by Brown-Crummer Co. was at a higher rate than that on the bonds, and in other instances a lesser rate. On the whole during the years in question Brown-Crummer Co. paid the bank less interest than it received on the bonds. None of these bonds were ever sold by the bank unless it can be said that those taken up by substituting other bonds on the part of Brown-Crummer Co., or the payment in cash of the amount that had been received on them by it were sales to Brown-Crummer Co. As instances of a less rate of interest charged by the bank and paid by Brown-Crummer Co. than that borne by the bonds an exhibit shows these: $360,000 Bartlesville, Okla., bonds bore 5 per cent, the bank collected 4 per cent from Brown-Crummer Co.; $1,520,000 Hidalgo County, Tex., bonds bore 6 per cent, the bank collected 4 per cent from Brown-Crummer Co.; $628,000 Tulsa, Okla., bonds bore 5 per cent, the bank collected 4 per cent from Brown-Crummer Co.; $100,000 Sutter County, Calif., bonds bore 7 per cent, the bank charged and collected 5 per cent from Brown-Crummer Co. On United States Liberty bonds bearing 4¼ per cent of comparatively small amounts, the bank collected 6 per cent.

It is contended that the written contract made by the parties when the bonds were delivered passed legal title to the bonds in the bank, and by force thereof interest on them was the bank's property. There is no doubt that the form of contract might have been carried out in that way, but the blanks in the contract submitted to the comptroller left an opportunity to the bank of which it availed itself, and the practice as carried on by the parties clearly shows that it was never intended that the bank should be entitled to the interest accrued on the bonds. Conceding that under the contract the legal title to the bonds was in the bank, the uniform conduct and practice of the parties was a joint admission that the interest coupons and their proceeds when collected did not belong to the bank, but were the property of Brown-Crummer Co. They were collected by Brown-Crummer Co. and applied to its use and benefit. When the coupons were detached from the bonds by the bank and delivered to Brown-Crummer Co., the interest represented by them "was no longer a mere incident of the principal indebtedness represented by the bond," and the coupons became independent obligations, separate and apart from the bonds. (*Edwards* v. *Bates County*, 163 U. S., 269, 272; *Nesbit* v. *Riverside Independent District*, 144 U. S., 610.) The bank got none of the interest that accrued on the bonds. It was not entitled to it. Brown-Crummer Co. paid the bank all its interest charges. The Board of Tax Appeals held that these interest charges received by the bank from Brown-Crummer Co. should be included in the bank's taxable income.

Affirmed.

ARTICLE 77: Interest upon United States obligations.

XII-18-6156
Ct. D. 660

INCOME AND PROFITS TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. INCOME—INTEREST—OBLIGATIONS OF THE UNITED STATES—EXEMPTION.

The obligation imposed by section 1116 of the Revenue Act of 1926 to refund with interest taxes erroneously or illegally collected is not such an obligation of the United States as comes within the purview of section 213(b)4 of that Act, which was intended to cover transactions relating to the flotation of Government bonds and securities, and interest paid upon refunded taxes is not exempt from taxation.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (19 B. T. A., 937) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

American Viscose Corporation, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition to review an order of the United States Board of Tax Appeals.

Before BUFFINGTON, WOOLLEY, and DAVIS, Circuit Judges.

[February 16, 1932.]

OPINION.

BUFFINGTON, J.: In 1926 the Government refunded to the taxpayer $3,896,663.14 income and profit taxes illegally assessed and collected for the years 1917–18–19. This sum, together with $1,409,856.46 interest, was paid to the taxpayer in 1926. Thereupon the question here involved arose, namely, whether interest paid by the United States in 1926, pursuant to section 1116 of the Revenue Act of 1926, on money refunded as overpayments of Federal income and profits taxes, as interest upon "obligations of the United States" and therefore exempt from tax under section 213(b)4 of said Act, which provides: "The term 'gross income' does not include the following items, which shall be exempt from taxation under this title: * * * (4) interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or (C) the obligations of the United States or its possessions."

The simple question, therefore, is, was this refund of illegal taxes an "obligation of the United States" and the interest paid thereon exempt from taxation. That the interest was income is apparent and that it, as such, is taxable is equally clear, unless the refund was one of the obligations of the United States Congress meant to exempt. The Tax Board, following the principle stated in *Kansas City Southern Railway et al.* v. *Commissioner* (16 B. T. A., 665), held this refund was not exempt by the Act. We agree with that conclusion. The exemptions of Congress were evidently meant to aid in the flotation of Government bonds and securities by making them tax-free and, therefore, more attractive to investors. We see no reason why the construction of the statute should be so broadened as to cover a transaction which had no relation to the flotation of securities, but was one where the Government had wrongfully collected money and, in righting the wrong, had, pro tanto, compensated therefor by paying interest. Nor do we find any error in the Board treating this payment of interest, which was made in toto in 1926, as income received that year which it in fact was.

ARTICLE 87: Income of States. XII–16–6135
Ct. D. 653

INCOME TAX—REVENUE ACTS OF 1921 AND 1924—DECISION OF SUPREME COURT.

1. INCOME—EXEMPTION—PROPERTY LEASED FROM MUNICIPALITY.

Income received by a trust as lessee of land which had been acquired by a city for water and other purposes and upon which oil was discovered, the lease providing that the lessor and the lessee should sell as joint vendors the oil and gas produced and should receive 40 per cent and 60 per cent, respectively, of the proceeds, was not exempt from taxation. The trust was not a governmental agency so intimately connected with the exercise of a power or the performance of a duty by the Government that taxation of its income would be a direct interference with the functions of government. Its operations were carried on in a private and not a public capacity for the personal gain of its cestuis que trust.

2. DEDUCTION—COST OF DRILLING OIL WELL—DEPLETION.

The decision in *United States* v. *Dakota-Montana Oil Co.*, rendered March 13, 1933 [Ct. D. 655, page 243, this Bulletin], holding

that capitalized cost of drilling oil wells is allowable by way of depletion, followed.

3. DECISION REVERSED.

The decision of the Circuit Court of Appeals, Ninth Circuit (61 Fed. (2d), 92), reversing 22 B. T. A., 551, reversed.

SUPREME COURT OF THE UNITED STATES.

David Burnet, Commissioner of Internal Revenue, petitioner, v. *A. T. Jergins Trust.*

On writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[March 13, 1933.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the court.

Prior to 1911 the city of Long Beach, Calif., procured water from companies owning and operating artesian wells on lands lying outside the city. The service proving inadequate and unsatisfactory the municipality in 1911 acquired these lands, comprising about 600 acres, and the appurtenant systems, and has since used the tract for water supply and other purposes. In 1922 oil was discovered in the vicinity, and the respondent was organized under the law of California with the intention of obtaining an oil and gas lease on the lands in question. The city leased to the respondent 140 acres, the agreement stipulating that the lessee should receive 60 per cent of the proceeds of oil and gas recovered and the city 40 per cent. As permitted by the lease the oil and gas produced have been sold under a contract made by the city and the respondent as joint vendors. The trust has derived substantial income from the lease.

Upon audit of the taxpayer's returns for the years 1922, 1923, and 1924, the Commissioner, by formal written notification, proposed a deficiency in income taxes for those years. The respondent appealed to the United States Board of Tax Appeals raising two issues, (1) Whether its income derived from the lease was immune from taxation, and, if not, (2) Whether capitalized expenses for drilling and developing its oil wells were to be returned through depletion allowance, as ruled by the Commissioner, or by way of depreciation. The Board held the income taxable and the intangible development costs recoverable through depreciation charges. The circuit court of appeals upon cross-petitions for review decided that the income from the lease was immune from Federal income tax, and therefore found it unnecessary to pass upon the matter of depreciation allowance presented by the Commissioner's petition. Both questions are raised by the petition for certiorari.

The respondent, in support of its claim of immunity, relies upon the principle that a tax upon instrumentalities of the States is forbidden by the Federal Constitution; that by clear implication the means employed by the General Government to carry into operation the powers granted to it are exempt from taxation by the States, as are those employed by the States exempt from taxation by the General Government. The principle is settled by a wealth of authority and has been applied in varying circumstances; has been recently fully discussed and the authorities collected and commented upon in decisions of this court (*Metcalf & Eddy* v. *Mitchell*, 269 U. S., 514 [T. D. 3824, C. B. V–1, 218]; *Willcuts* v. *Bunn*, 282 U. S., 216 [Ct. D. 280, C. B. X–1, 309]; *Indian Territory Illuminating Oil Co.* v. *Board of Equalization*, and *Indian Territory Illuminating Oil Co.* v. *Board of County Commissioners*, Nos. 356, 357, October term, 1932, decided February 13, 1933); and no purpose would be served by a repetition of what was there said.

The Revenue Acts do not discriminate between the respondent and others similarly situated, in the imposition of the income tax. If the respondent is exempt from the exaction the conclusion must follow because the tax directly burdens the functions of the State acting through the city of Long Beach. Considerations which have led to the condemnation of taxes in other circumstances are here absent. The levy is not upon the property of the municipality, nor upon the income it derives from its property, is not upon the city's share of the oil recovered, the lease, or the gross income therefrom. The law measures

the assessment by the net income of the respondent, whose operations are carried on in a private and not in a public capacity for the personal gain of its *cestuis que trust*. The Government asserts that the incidence of the tax is so remote from the activities of the municipality as to have no substantial adverse effect upon them. The respondent insists that as lessee of the lands in question it is a governmental agency and any tax laid upon its income directly burdens governmental functions.

In *Metcalf & Eddy* v. *Mitchell*, supra, this court said:

"Just what instrumentalities of either a State or the Federal Government are exempt from taxation by the other can not be stated in terms of universal application."

And further:

"As cases arise, lying beween the two extremes, it becomes necessary to draw the line which separates those activities having some relation to government, which are nevertheless subject to taxation, from those which are immune. Experience has shown that there is no formula by which that line may be plotted with precision in advance. But recourse may be had to the reason upon which the rule rests, and which must be the guiding principle to control its operation. Its origin was due to the essential requirement of our constitutional system that the Federal Government must exercise its authority within the territorial limits of the States; and it rests on the conviction that each government, in order that it may administer its affairs within its own sphere, must be left free from undue interference by the other * * *."

It was there pointed out that while in one aspect the extent of the exemption must finally depend upon the effect of the tax upon the functions of the government alleged to be affected, still the nature of the governmental agencies and the mode of their constitution may not be disregarded in passing upon the question of tax exemption. An agency may be so intimately connected with the exercise of a power or the performance of a duty by the Government that any taxation of it would be a direct interference with the functions of government itself. In *Baltimore Shipbuilding Co.* v. *Baltimore* (195 U. S., 375) it was said:

"* * * it seems to us extravagant to say that an independent private corporation for gain, created by a State, is exempt from State taxation, either in its corporate person, or its property, because it is employed by the United States, even if the work for which it is employed is important and takes much of its time."

The statement holds true as well, when the positions of the sovereigns are reversed.

The application of the doctrine of implied immunity must be practical (*Railroad Company* v. *Peniston*, 18 Wall., 5, 31, 36) and should have regard to the circumstances disclosed. We think that in the present instance the subject of the tax is so remote from any governmental function as to render the effect of the exaction inconsiderable as respects the activities of the city. (Compare *Alward* v. *Johnson*, 282 U. S., 509, 514.) Its collection is not inconsistent with and does not trench upon the immunity of the State as a sovereign. The income of the respondent from the lease is not immune from Federal income tax.

The respondent relies upon *Gillespie* v. *Oklahoma* (257 U. S., 501) and *Burnet* v. *Coronado Oil & Gas Co.* (285 U. S., 393 [Ct. D. 485, C. B. X–1, 265]), as authorities binding upon us and requiring a decision in its favor. In both of those cases the sovereign was acting as the trustee of an express trust with regard to the lands leased. In both the burden upon the public use was more definite and direct than in the present case. As said in the Coronado case, the doctrine of *Gillespie* v. *Oklahoma* is to be applied strictly and only in circumstances closely analogous to those which it disclosed. The decisions relied on can not be held to be authority upon the facts presented by this record.

The petitioner also asserts that the Board of Tax Appeals was in error in holding that the cost of drilling should be amortized by way of depreciation charges, and not through the statutory allowance for depletion. The identical issue is involved and settled in favor of petitioner by *United States* v. *Dakota-Montana Oil Co.* (No. 434, October term, 1932 [Ct. D. 655, page 243]), and *Petroleum Exploration* v. *Burnet* (No. 448, October term, 1932 [Ct. D. 612, C. B. XI–2, 262]), decided this day.

The judgment is reversed and the cause remanded for further proceedings in conformity with this opinion.

Reversed.

INCOME TAX—REVENUE ACTS OF 1924 AND 1926—DECISION OF COURT.

INCOME—EXEMPTION—STATE INSTRUMENTALITY—OIL AND GAS LEASE—PUBLIC LANDS.

Income derived by a lessee from sale of oil and gas produced under leases of public lands set aside by the State of Texas for the support of the university of that State is not exempt from Federal income tax upon the ground that the leases were State instrumentalities. The stipulated facts are identical with those presented in *Group No. 1 Oil Corporation* v. *Bass, Collector* (283 U. S., 279 [Ct. D. 330, C. B. X-1, 153], but plaintiff bases its claim of exemption upon what it conceives to be a change of view on the part of the majority of the members of the Supreme Court in *Burnet* v. *Coronado Oil & Gas Co.* (285 U. S., 393 [Ct. D. 485, C. B. XI-1, 265]), where the facts were the same with the exception that the leases were upon lands in the State of Oklahoma. In the Group No. 1 Oil Corporation case the court bases its decision upon the varying views of the State courts of Texas and Oklahoma, the Texas courts holding such leases to be present sales upon the execution of the leases of the oil and gas in place, whereas, by the holdings of the Oklahoma courts there is no transfer of title to the oil and gas until it has been brought to the surface.

DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF PENNSYLVANIA.

Big Lake Oil Co., plaintiff, v. *D. B. Heiner, Collector of Internal Revenue for the Twenty-third District of Pennsylvania, defendant.*

[December 28, 1932.]

OPINION.

GIBSON, District Judge: The Big Lake Oil Co. has brought suit against the collector of internal revenue to recover $1,565,875.84, with interest, which is alleged to have been erroneously assessed and collected as income taxes for the years 1924, 1925, 1926, and 1927. The parties have agreed upon the facts and the only question before us is whether or not the income of the plaintiff obtained from oil and gas leases in the State of Texas is subject to an income tax by the United States.

The stipulated facts in the instant case are identical with those appearing in *Group No. 1 Oil Corporation* v. *Bass, Collector* (283 U. S., 279). In that case, as in this, the State of Texas had leased certain of its public lands to an oil company. The leases were on part of the public land of the State which had been set aside by it under its constitution for the support of the University of Texas. It was held in the Group No. 1 case that the profits derived by the lessee from the sale of oil and gas produced, after deducting the State's royalties, were not immune from Federal taxation upon the ground that the leases were State instrumentalities. Despite the fact that the exact question before the court in that case was the same in all respects as that before us, it is urged upon this court that it should hold that the income derived by the lessees from said leases is not subject to Federal taxation because the leases in question were State instrumentalities. Plaintiff bases its claim upon what it conceives to be a change of views in the majority of the court evidenced by the decision in *Burnet* v. *Coronado Oil & Gas Co.* (285 U. S., 393). The latter case, so far as the facts were concerned, was exactly parallel with the facts in Group No. 1 case, with the exception that the leases were upon public lands of the State of Oklahoma, which had been leased for the benefit of the public schools of that State. In the Oklahoma case the majority of the court held that the lease was an instrumentality of the State in the exercise of a strictly governmental function, and that the application of the Federal income tax to the income derived from the lease by the lessee was therefore unconstitutional. In the Coronado case decision the Supreme Court followed *Gillespie* v. *Oklahoma* (257 U. S., 501), which was substantially identical with it in point of facts. The

learned counsel for the plaintiff viewed this decision as a return to a principle which had been abandoned in the Group No. 1 case. We should feel some delicacy in placing such an interpretation upon an opinion of the Supreme Court in the absence of any distinct statement to that effect by that court, even though we agreed with the interpretation, which we do not.

The Supreme Court in its opinion in the Group No. 1 case based its decision upon varying views of the State courts of Texas and Oklahoma in respect to oil and gas leases of the nature of those under consideration. In Texas the State courts have held such leases as present sales to the lessees upon execution of the leases of the oil and gas in place. The courts of Oklahoma hold that such leases do not transfer to the lessee title to such oil and gas until it has been brought to the surface.

The learned justice who wrote the opinion in the Group No. 1 case, and who, with other members of the court, dissented in the Coronado case, in the latter case receded from the position taken in the opinion in the Group No. 1 case, stating, in effect, that he was of opinion that the distinction so urged between *Gillespie* v. *Oklahoma*, supra, and Group No. 1 case did not furnish a sound basis for the difference in results. In his opinion and in the opinion of several of his associates, it was the duty of the Supreme Court to overrule *Gillespie* v. *Oklahoma*. The majority of the court disagreed with his contention, reciting, however, "We are disposed to apply the doctrine of *Gillespie* v. *Oklahoma* strictly and only in circumstances closely analogous to those which it disclosed." The majority opinion, following its declaration as to its intention to circumscribe *Gillespie* v. *Oklahoma*, went on to discuss Group No. 1 decision without any criticism of it. In view of the nature of the dissenting opinion it seems plain to us that the majority intended to adhere to the Group No. 1 decision.

In *Burnet* v. *Harmel*, decided November 7, 1932, reversing decision of Court of Appeals (56 Fed. (2d), 153), opinion by Mr. Justice Stone, *Group No. 1 Oil Corporation* v. *Bass* was discussed in such manner as to plainly indicate that it was regarded by the Supreme Court as being in full force and effect.

We feel that we are controlled by it, and that judgment must be entered for the defendant.

SECTION 214(a)1.—DEDUCTIONS ALLOWED INDIVIDUALS: BUSINESS EXPENSES.

ARTICLE 101: Business expenses.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Solicitor's Law Opinion 926 (C. B. 1, 241) modified, to the extent that it holds that penalties imposed for negligence or delinquency are ordinary and necessary business expenses which may legally be deducted from gross income. (See G. C. M. 11358, page 29.)

ARTICLE 101: Business expenses. XII-20-6178
Ct. D. 667

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. DEDUCTIONS—ATTORNEYS' FEES—ORDINARY AND NECESSARY EXPENSES.

Fees paid by a manufacturing company to counsel who successfully defended it before the Federal Trade Commission against charges of violation of the Sherman Anti-Trust Act were directly connected with its business and therefore deductible from gross income as "ordinary and necessary expenses" paid in carrying on its business, under the provisions of section 234(a)1 of the Revenue Act of 1926.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (19 B. T. A., 1095) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

Commissioner of Internal Revenue, petitioner, v. Continental Screen Co., respondent.

Petition to review an order of the United States Board of Tax Appeals.

Before HICKS, HICKENLOOPER, and SIMONS, Circuit Judges.

[May 13, 1932.]

OPINION.

HICKS, Circuit Judge: Petition by the Commissioner of Internal Revenue to review a decision of the Board of Tax Appeals reversing the action of the Commissioner in assessing a deficiency in income taxes against respondent in the sum of $7,224.99 for the year 1925 and for the period from January 1 to July 31 of the year 1926. These deficiencies arose from a disallowance by the Commissioner of $40,000 and $15,000 which respondent had paid in the years 1925 and 1926 respectively as attorney fees.

Whether these fees were allowable as deductions depends of course upon whether they were paid as "ordinary and necessary expenses" in carrying on respondent's business. (See Revenue Act of 1926, ch. 27, section 34(a), paragraph (1), 44 Stat., 9.) The Board of Tax Appeals concluded that they were. Its relevant findings are that respondent was organized in 1905 for the purpose of manufacturing screen doors and the like; that in 1920 the Federal Trade Commission began to investigate its practices upon charges that it was operating in violation of the Sherman Anti-Trust Act; that respondent convinced the commission in 1922 that the charges were unfounded but that as a result of renewed investigations by agents of the commission respondent on December 29, 1924, was served with a notice of complaint by the commission that it was operating in violation of the Sherman Act; that a date was set for a hearing before the commission; that respondent through its officers was much concerned over the complaint because from their viewpoint adverse determination of it might result in the dissolution of respondent's business; that a meeting of respondent's directors was called at which it was decided to employ three firms of attorneys to represent respondent before the commission; that these attorneys obtained a continuance of the hearing, prepared voluminous data for submission to the commission; that respondent was accorded a hearing before its board of review in May, 1925, at which its counsel presented the data and moved that the complaint be dismissed as not being proved; that after careful consideration the commission on October 14, 1925, entered an order dismissing the complaint. The Board of Tax Appeals found that the attorney fees for which deduction was claimed by respondent were paid solely for services in representing respondent before the commission. The reasonableness of the fees has not been questioned.

In the absence of a statement of all the evidence submitted to the Board we must accept its findings as conclusive (*Commr.* v. *Continental Screen Co.*, 53 Fed. (2d), 210 (C. C. A. 6); *Cogar* v. *Commr.*, 44 Fed. (2d), 554, 556 (C. C. A. 6); *Evergreen Cemetery Ass'n* v. *Burnet*, 45 Fed. (2d), 667 (C. A. D. C.)) and when the applicable test (*Kornhauser* v. *United States*, 276 U. S. 145, 152, 153 [T. D. 4222, C. B. VII–2, 267]) is applied thereto we have no doubt as to the correctness of the Board's decision. The proceeding before the Trade Commission was undoubtedly an "action" against respondent which was "directly connected with" or which "proximately resulted" from its business. To respondent's board of directors the situation was ominous. The life of the business was endangered. Under such circumstances respondent followed the very natural and ordinary procedure suggested by the vital necessity of the situation. It employed counsel to protect its interest and agreed to pay for their services. Any other course upon the part of its board of directors would have been unusual and would, no doubt, have subjected them to well founded criticism by its stockholders.

We see no reason for interfering with the order of the Board of Tax Appeals and it is therefore affirmed.

ARTICLE 112: When charges deductible. XII-11-6069
Ct. D. 640

INCOME TAX—REVENUE ACTS OF 1918 AND 1921—DECISION OF SUPREME COURT.

1. DEDUCTION—LOSS—EMBEZZLEMENT OF TRUST FUNDS.

Where a partner in 1921 personally paid to the partnership firm an amount his copartner had embezzled from trust funds of the partnership in 1920, the amount of the embezzlement being unascertained until 1921, such payment did not constitute a deductible loss in the year 1920, within the meaning of section 214 of the Revenue Act of 1918.

2. DEDUCTION—LOSS—WORTHLESS DEBT.

Where a partnership was not liquidated until 1921, the amount due taxpayer by the firm was not a debt ascertained to be worthless in the year 1920, within the meaning of section 214(a)7 of the Revenue Act of 1921.

SUPREME COURT OF THE UNITED STATES.

David Burnet, Commissioner of Internal Revenue, petitioner, v. *R. E. Huff, Individually, and R. E. Huff and Wm. E. Huff, Independent Executors of the Estate of Mrs. E. B. Huff, Deceased.*

On writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[February 6, 1933.]

OPINION.

Mr. Chief Justice HUGHES delivered the opinion of the court.

In computing net income for 1920, the respondents, R. E. Huff, and his wife, E. B. Huff (now deceased), sought deduction of a loss alleged to have been sustained in that year, in relation to community property, through the embezzlement of trust funds. The funds were held by a partnership of which R. E. Huff was a member and were embezzled by his copartner. The Commissioner disallowed the deduction, holding that as the funds were not the property of the petitioners, and they were not called upon to make good the amount embezzled until 1921, they sustained no loss in 1920. The Board of Tax Appeals, upon the authority of *Farish* v. *Commissioner* (C. C. A. 8) (31 F. (2d), 79), upheld this ruling. An alternative claim, for the deduction of the amount in question as a worthless debt, was also disallowed. (20 B. T. A., 516.) The Circuit Court of Appeals, declining to follow the Farish case, reversed the decision of the Board (56 F. (2d), 788) and this court granted certiorari (286 U. S., 541).

The pertinent facts as found by the Board of Tax Appeals are these: R. E. Huff, a lawyer and banker in Wichita Falls, Tex., and J. S. Mabry were copartners engaged in managing the business of a reciprocal fire insurance association known as Wichita Great Western Underwriters. Under the plan of organization, 25 per cent of the gross premium income of the association was allotted to expenses and profits, and the remaining 75 per cent was to be set apart as a reserve to pay fire losses. Any person might become an "underwriter" by subscribing to the association such amount as he wished to invest, paying one-fourth in cash. Ten per cent of the cash payments was allowed to the managing attorneys and the rest constituted a reserve or trust fund which was to remain the property of the underwriters and to be used only for the payment of fire losses in excess of the association's reserve. An advisory board was created for safeguarding the interests of the subscribers but undertook no active supervision until about the end of 1920. The board looked to Huff for the proper conduct of the affairs of the association, but the management was left almost entirely to Mabry. Early in 1920, on Mabry's representation that the sum of $25,000 was needed for working capital, Huff advanced this amount to the partnership upon partnership notes payable in six months. The entire amount was repaid to Huff in the autumn of 1920 by checks drawn by Mabry, the money being taken from the trust fund of the

association held in reserve for the subscribing underwriters. Huff and Mabry were not the owners of that fund and neither of them had authority to use it for any purpose other than the payment of fire losses. To cover the checks, given to repay Huff, Mabry gave a demand note signed in the firm name in favor of the reserve fund. Mabry had no authority to execute the note and Huff did not know until near the end of 1920 that the note had been given or that the repayment to him had not been made from funds belonging to the firm. The unauthorized use of the trust fund was discovered, in the absence of Mabry, in December, 1920. On Mabry's return in January, 1921, he was removed as one of the managing attorneys and the firm then discontinued business. Mabry promised to pay back the money he had taken but did not do so, and a judgment against him would have been worthless. Huff was unable to determine the amount of the assets of the firm of Huff & Mabry before the close of 1920, and in February, 1921, these assets, amounting to $3,228.65, were turned over by Huff to the association, together with $21,771.35 which he paid personally. He has not been reimbursed. Huff kept no regular books of account and made up his income tax returns upon a cash receipts and disbursements basis.

First. The Revenue Act of 1918 (40 Stat., 1057, 1066, 1067) provided for the deduction of losses incurred "in trade or business" or "in any transaction entered into for profit," or arising from theft of property "not connected with the trade or business," when the losses were "sustained during the taxable year" and were "not compensated for by insurance or otherwise." (Sections 214 (a) (4) (5) (6).)

The Government concedes that if assets of the taxpayer used in trade or business, or "in any transaction entered into for profit," are stolen in any year, the taxpayer sustains the loss in that year and the deduction must then be taken even though the theft is not discovered or the amount ascertained until the following year. This is said to be the import of the regulation adopted by the Treasury Department under the Revenue Act of 1921. (Regulations No. 45, article 111.[1]) But the Government contends that a different rule applies (at least where the taxpayer is on a cash basis) when the property stolen is not that of the taxpayer but is held by him in trust, and the theft is not discovered until the following year, as in that case "the taxpayer, being nothing out of pocket, can not be said to have 'sustained' the loss in the year of the theft." The Government also raises the question whether Huff, in the absence of a finding of negligence, or of improper delegation of the administration of the trust to Mabry, can be regarded as legally bound to make restitution. Respondents insist that Huff was "liable for the trust funds" from the moment they were received by his firm, and that the loss was sustained at the time of the embezzlement because it deprived him of assets with which he could have discharged his obligation.

We find it unnecessary to discuss the question whether Huff was bound to make good the amount taken from the funds of the association by his copartner. We may assume that he was. But the mere existence of liability is not enough to establish a deductible loss. There is liability in the case of a breach of contract, but as the court said in *Lucas* v. *American Code Co.* (280 U. S., 445, 450 [Ct. D. 168, C. B. IX–1, 314]), "even an unquestionable breach does not result in loss if the injured party forgives or refrains from prosecuting his claim." And whether a taxpayer will actually sustain a loss through embezzlement of trust funds of which he is trustee will depend upon a variety of circumstances. If there is liability on his part for the misappropriation, it does not create a certainty of loss, as the defalcation may be made good by the one who caused it, or the liability of the taxpayer may be enforced only to a limited extent or not at all. The requirement that losses be deducted in the year in which they are sustained calls for a practical test. The loss "must be actual and present." (*Weiss* v. *Wiener*, 279 U. S., 333, 335 [Ct. D. 60, C. B. VIII–1, 257]; *Lucas* v. *American Code Co.*, supra; *Eckert* v. *Burnet*, 283 U. S., 140, 141, 142 [Ct. D. 325, C. B. X–1, 241].)

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[1] Article 111 of Regulations No. 45 provides: "* * * A loss from theft or embezzlement occurring in one year and discovered in another is deductible only for the year of its occurrence. * * * If subsequently to its occurrence, however, a taxpayer first ascertains the amount of a loss sustained during a prior taxable year which has not been deducted from gross income, he may render an amended return for such preceding taxable year, including such amount of loss in the deductions from gross income, and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss in the original return." (See, also, Regulations No. 62, article 111; No. 65, article 112; No. 69, article 112; No. 74, article 342.)

The instant case aptly illustrates the importance of this principle and calls for its application. Huff himself received the entire amount embezzled. He received this amount in payment of notes given to him by his firm to cover his advances to the firm. If he was liable to restore the amount taken from the trust fund, he himself had the full sum that was to be restored. So far as his individual estate was concerned, he had lost nothing by the embezzlement. If Huff had learned of the embezzlement immediately upon the payment to him and had at once restored the entire amount to the trust fund, he would have been in the same position as that in which he was before he received the money; that is, he would have held the partnership notes, for his advances to the partnership, which had not been properly discharged. Huff's personal wealth would have remained the same as it was prior to the embezzlement, and his individual gains or losses would have turned not upon the embezzlement but upon the result of the partnership business. When in 1921, on the liquidation of that business, Huff turned over to the association the sum of $21,771.35, he was merely restoring part of what he himself had received of the misappropriated fund, and whatever loss he sustained was upon his investment in, or his advances to, his firm. That loss was determinable only through the winding up of the partnership business.

The result of the partnership transactions was not known and could not be ascertained in 1920. The firm did not discontinue business until January, 1921. The finding is explicit that "some collections from premiums were made in January and February, 1921," and "Huff was unable to determine the amount of Huff & Mabry's assets before the close of 1920." In February, 1921, the firm assets were found to amount to $3,2[illegible]8.65 and this sum was paid to the association, with the amount paid by Huff as above stated. Upon these facts we find no basis for the conclusion that Huff sustained a deductible loss in 1920.

Second. The respondents make an alternative claim upon the ground that the amount due Huff by his firm was a debt "ascertained to be worthless" and hence deductible under section 214(a)7 of the Revenue Act of 1921. This claim was not passed upon by the Circuit Court of Appeals, but it was considered and rejected, properly as we think, by the Board of Tax Appeals. The facts as found show that the results of the firm's business were not known prior to 1921 and that no portion of the debt was ascertained to be worthless within the preceding taxable year.

Judgment reversed.

ARTICLE 112: When charges deductible. XII-20-6179
G. C. M. 11774

REVENUE ACTS OF 1924 AND 1926.

Losses sustained on account of contracts entered into with customers solvent at the time the contracts were breached are deductible in the year in which judgment was rendered or the claims settled. This will have the effect of deferring such losses until the time that they are actually ascertained and represented by closed and completed transactions.

An opinion is requested relative to the year in which losses sustained in connection with certain contracts entered into in 1920 are deductible for income tax purposes. The taxable years in question are 1924 to 1926, inclusive.

During May, June, and July, 1920, when a serious shortage of a certain commodity was prevalent and generally predicted for many months to come, the taxpayer contracted to buy large quantities of the raw commodity at prices averaging around 4z cents per pound and, at the same time, entered into contracts with customers under which they undertook to buy specified quantities of the finished commodity for delivery during stipulated months from July, 1920, through March, 1921.

The market price of the finished commodity declined abruptly and unexpectedly about August —, 1920, and continued to fall off until

June —, 1921, when the net market price was z cents per pound as compared with the net price of $4z$ cents per pound specified in practically all the above-mentioned contracts.

Many customers, being unwilling to take the loss involved in accepting and paying for the commodity which they would be obliged to resell on this falling market, refused to carry out their contracts with the taxpayer. Suits were instituted against customers who persisted in their refusal to recognize these contractual obligations, and, in almost every jurisdiction in which these suits were tried or decided on appeal, the taxpayer's claims, based upon these contracts, were upheld. Each claim involved different facts with respect to such matters as the date of repudiation and the existence of any arrangement to defer delivery. Even on similar facts, different juries returned verdicts for different amounts.

Litigation with respect to the breach of the contracts was pressed, but congested court calendars and frequent appeals made it impossible to dispose of the suits promptly. Many of the claims were settled out of court, after or before suit was filed. The disposition of these claims through litigation and settlement has continued from 1920 up to the present time, although few of the claims remain outstanding.

In its return for 1920 the taxpayer, in arriving at the cost of goods sold, refused to recognize the repudiation of the contracts and valued at cost the commodity on hand at the end of the year for delivery under the contracts, in accordance with article 1582 of Regulations 45. During 1921 substantial amounts of the commodity were delivered to customers under these 1920 contracts. In its return for 1921 all such deliveries were reported by the taxpayer under gross sales and deducted from its inventory. Since the commodity in question deteriorates in storage, it was necessary for the taxpayer, during 1921, to dispose of the balance of the commodity originally obtained and held for delivery under repudiated contracts. This commodity was, therefore, sold to the trade in the regular course of business at the then current market price. In its return for 1921 the taxpayer reported, under gross sales, the amounts received from the resale of this commodity during 1921. In the same return it added to the physical inventory at the end of 1921 the amounts of the claims against customers, so stating in the return. The amounts of these claims, as used for that purpose, were arrived at by taking the amounts (after deducting cash discount and expected profits) which customers originally contracted to pay and deducting therefrom the amounts received from the resale. In other words, the difference between the cost of the commodity and the amount for which sold was carried in the inventory. In its returns for 1922 and subsequent years, all unsettled claims remained in the inventory. Since the taxpayer excluded from the amount of the claims any portion thereof in excess of cost, by setting up a reserve for the portion of the claims in excess of cost, it appears that the amounts received in settlement represented a partial return of cost and contained no element of profit.

As the claims were settled under judgments, or out of court, during 1921 and succeeding years, the taxpayer reported the loss for the year the claims were so disposed of by including under gross sales the amounts which customers paid or agreed to pay, and taking out of

the inventory for that year the amounts representing these particular claims. This effected the deduction for the net amount of the losses as determined.

The taxpayer contends that the transactions involved were evidenced by contracts made in 1920, which contracts constituted the basis for the subsequent litigation; that the resale of the commodity in 1921 did not prejudice its rights under the contracts, nor close the transaction relative to the contracts which were not closed until the settlements were effected in subsequent years. It is contended that the sale of the commodity in 1921 gave rise to a deductible loss in that year, and that there is no authority under the law or regulations requiring or permitting the taxpayer to accrue the claims against its contract customers.

There is an apparent distinction, recognized by the courts and the Board of Tax Appeals, between the accrual of claims for loss of profits and claims for recovery of capital.

A loss, to be deductible, must be absolute, an actual loss, sustained and ascertained during the taxable year and determined by an actual, completed, and closed transaction. This should apply with particular force where a taxpayer, by his action, evidences that he has not abandoned hope of recovery, and where he does not concede the loss to himself nor reflect it in his accounts.

The law provides for the deduction of " losses sustained during the taxable year and not compensated for by insurance or otherwise." In the instant case, any alleged loss in 1920 or 1921 was compensated for by claims against customers. Until the claims were settled the taxpayer could make no final determination of loss. If, at the time of resale of the commodity the taxpayer had also sold its claims against customers under the contracts, the transactions evidenced by the contracts would have been closed. However, as disposition of the claims was not made at that time the transactions were neither completed nor closed. The resale of the commodity was but an incident in the transactions and in no way indicated what the eventual recovery under the contracts might be.

The general rule of damages applicable to sales of the instant type has been codified in section 64(3) of the uniform sales act which reads as follows:

> Where there is an available market for the goods in question, the measure of damages is, in the absence of special circumstances showing proximate damage of a greater amount, the difference between the contract price and the market or current price at the time or times when the goods ought to have been accepted, or, if no time was fixed for acceptance, then at the time of the refusal to accept.

It appears, therefore, that the taxpayer was under a legal duty, when the customers refused acceptance, to sell at the then current market price, since that price constituted a part of the measure of damages. It is the opinion of this office, therefore, that the resale of the commodity need not necessarily control the method of reporting the losses incurred by reason of the breach.

It might be argued that the taxpayer's right of recovery was merely contingent, but such fact alone would not be sufficient to permit the deduction of a loss, as will be shown later. In this connection the file does not indicate whether the customers who breached were solvent or insolvent concerns. The fact that recoveries were

had in most cases would indicate solvency. However, if it is found that claims were set up in 1920 in the case of insolvent concerns, the commodity involved in such contracts should be inventoried on December 31, 1920, at market, and the loss taken in that year.

In *Lewellyn* v. *Electric Reduction Co.* (275 U. S., 243) the Supreme Court decided that a taxpayer could not deduct a loss in 1918 for money advanced under a contract where the taxpayer instituted suit in 1919, and it did not appear that the taxpayer would be unable to collect until after judgment in 1922. In the course of its opinion the Supreme Court said:

> Here the only fact relied upon to show a loss is the outcome of the litigations two years after respondent's payment to Jouravleff. There is nothing in the findings from which we could conclude that the respondent in 1918 had ceased to regard his rights under the contract as having value or that there was then reasonable ground to suppose that efforts to enforce them would be fruitless. * * *

The court's reasoning appears to fit the instant case exactly. The Bureau properly would have denied any loss on these contracts in 1920.

An almost analogous case is *Appeal of Bert K. Smith et al.* (5 B. T. A., 480, C. B. VI–1, 5). In that case the taxpayer, apparently in 1918, shipped 2 carloads of grain under contract to two different purchasers, and drafts for the purchase price were charged to each customer's account. The customers refused the grain and brokers were employed to resell it, the selling price being less than the contract price. The proceeds were credited to the respective customers' accounts and the balance carried as accounts receivable. These accounts were determined to be worthless in 1919 and charged off. The Board allowed the deductions in 1919. That case also involved claims against common carriers for goods lost or damaged in transit. The accounting practice of the petitioner was to credit merchandise for the amount of the claim, and charge the carrier. The Board held that these claims should be treated as ordinary accounts receivable in computing taxable income.

It is true that in the Smith case there was an appropriation of specific goods to the contracts, while in the instant case there was not. This fact, however, is not believed to be sufficient to distinguish the cases. The fact that the taxpayer herein was able to secure damages, indicates that there was sufficient performance on its part to permit it to recover.

The question involved in the instant case is not whether the taxpayer can be required or permitted to accrue income on the basis of repudiated contracts, but whether it can be required or permitted to deduct losses on such contracts where it is maintaining actions for damages. It is the opinion of this office that the above cases are authority for holding that the losses on contracts with customers solvent at the time the contracts were breached are deductible in the year in which judgment was rendered or the claims settled.

It is obvious that the taxpayer's method of inventory adjustment, in order to defer the losses, can not be accepted for income tax purposes. However, the same result will be effected by setting up, in the year of the breach, the cost of the commodity covered by the contracts, in the form of an account receivable, and applying against this account any recoveries subsequently made until a final deter-

mination of the amount of loss is ascertained, and allowing such loss in the year of final determination.

This office is of the opinion that the losses sustained on account of contracts entered into in 1920 should be reflected, for income tax purposes, in the year or years in which final settlement was made. This will have the effect of deferring such losses until the time that they are actually ascertained and represented by closed and completed transactions.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 112: When charges deductible. XII-26-6251
Ct. D. 686

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. DEDUCTIONS—LOSSES—SALE ON INSTALLMENT BASIS.

Where sale of stock was made in 1925, the contract providing for certain cash payments and the balance being represented by 26 interest-bearing notes payable over a period of 5 years, with option of payment in full on any interest date, the loss sustained may not be spread over the term of the contract and deduction allowed each year in proportion to the installment payments received, since the sale was completed and the loss ascertained in 1925, when the stock was transferred and cash and notes received in payment therefor. Section 212(d) of the Revenue Act of 1926, dealing with sales made on the installment plan, permits a taxpayer to spread the income therefrom over the period covered by the installment payments, but makes no provision for apportioning losses sustained.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (24 B. T. A., 528) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Darwin D. Martin, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Before MANTON, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

[December 5, 1932.]

OPINION.

Petition to review decision of the Board of Tax Appeals (24 B. T. A., 528). The Commissioner disallowed losses claimed for years 1926 and 1927. Taxpayer appeals. Order affirmed.

MANTON, Circuit Judge: The taxpayer seeks a review of the income taxes assessed against him for the years 1926 and 1927. His petition is filed pursuant to the Revenue Act of 1926 (ch. 27, 44 Stat., 9), sections 1001–1003 (26 U. S. C. A., sections 1224–1226). The question involved is whether, under the provisions of the Revenue Act relating to installment sales, a taxpayer may spread a loss on a sales contract over a term of years in proportion to the payment received, or he must take his loss only in the year in which it occurred.

During the taxable year 1926, the petitioner owned 17,000 shares of common and 20,000 shares of preferred stock of a corporation which he had acquired prior to March 1, 1913. Its fair market value then was $1,933,328. He sold all this stock to the corporation in 1925 for $1,670,000 sustaining a loss thereon of $263,328. The contract of sale in 1925 provided for a cash payment of $170,000 for the common stock and the part payment of $200,000 for the 20,000 shares of preferred stock; the balance of the sale price of $1,300,000 being

represented by 26 notes of the corporation bearing interest at 5 per cent payable over a period of five years with an option of payment in full with interest on any interest date.

In his income tax return for 1925, the petitioner claimed as a deduction that part of the total loss which the payments received in that year bore to the total sale price. But the Commissioner, over the objection of the petitioner, allowed the entire loss in the year 1925. During the taxable year 1926, petitioner received payment of $300,000 on the notes, and in his return for that year he claimed as a deduction that part of the total loss which the payment of $300,000 received bore to the total sale price of $1,670,000 or 300/1670 of the total loss or $47,304.24. This was disallowed for the year 1926 as a deductible loss. In 1927, payments were received on the notes amounting to $700,000, and, in his income tax return for that year, the petitioner claimed a deduction of $110,363.40 representing 700/1670 of the total loss. This also was disallowed.

Section 212(d) of the Revenue Act of 1926 grants a privilege to the taxpayer in returning net income on the installment basis in case of a sale on like basis, which, prior to its enactment, was required to be reported either as cash receipts and disbursements or on an accrual basis. It makes no reference to losses, but the petitioner contends that he is entitled to spread his loss incurred in the sale of the stock over the period covered by the installment payments. The sale was completed and the loss ascertained when in 1925 the stock was transferred and cash and notes were received in payment therefor. The loss then was known to be the difference between the fair market value on March 1, 1913, and the sale price. There can be no deduction for losses unless provision is made in the statute. Sections 210 and 211 of the Revenue Act of 1926 make provisions for normal and sur taxes upon net income of every individual. Section 214 of the Act defines allowable deductions to which the taxpayer is entitled, and deductions are allowed for losses sustained during the taxable year if incurred in any transaction entered into for profit though not connected with his trade or business. Section 212(d) makes provision for the return of income upon regulations to be prescribed by the Commissioner where a dealer sells his personal property for installment payments.

Moreover, the section provides that, in case of a casual sale of personal property at a price exceeding $1,000 and the initial payments do not exceed one-fourth of the purchase price, the income may, under regulations prescribed by the Commissioner, be returned on the installment basis. Nowhere in this provision are losses mentioned. The statute limiting the thing to be done in a particular mode includes the negative of any other mode. (*Botany Worsted Mills* v. *United States*, 278 U. S., 282 [Ct. D. 39, C. B. VIII–1, 279].) Ordinary losses are deductible only in the year in which they are sustained. (*Lucas* v. *American Code Co.*, 280 U. S., 445 [Ct. D. 168, C. B. IX–1, 314].) The general principle underlying income tax statutes since the sixteenth amendment was adopted has been a computation of gains and losses on the basis of annual accounting for the transactions of the year. (*Burnet* v. *Sanford & Brooks Co.*, 282 U. S., 359 [Ct. D. 277, C. B. X–1, 363].) In order to support a right to deduct over a period of years a loss sustained in a particular year there must be some authority therefor in the statute permitting the deduction, or otherwise the general principle of an annual accounting for tax purposes must be applied. (*Woolford Realty Co.* v. *Rose*, 286 U. S., 319 [Ct. D. 493, C. B. XI–1, 154].) The income tax law is concerned only with realized losses as well as realized gains. (*Weiss* v. *Wiener*, 279 U. S., 333 [Ct. D. 60, C. B. VIII–1, 257].) The transaction here was completed and the loss definitely fixed in 1925. (*Lewellyn* v. *Elec. Reduction Co.*, 275 U. S., 243 [T. D. 3739, C. B. IV–2, 208]; *Dresser* v. *United States*, 55 Fed. (2d), 499, 512 [Ct. D. 503, C. B. XI–1, 267].)

Nor is there substance in the argument that income as used in section 212 (d) of the Revenue Act of 1926 may be either negative or positive and thus that the statute permitted the return of a loss on an installment sale as well as the return of profit. This interesting theory finds no support in the matter of taxation, and, whatever may be possible as to the concept of negative income, it is academic in so far as the administration of the provisions of this Revenue Act is concerned. Levying taxes upon income is a practical matter and does not take into account an absence of income or negative income. (*Woolford Realty* v. *Rose*, 286 U. S., 319, 327.)

Nor was there error committed in interpreting and applying article 45 of Regulations 62, promulgated under the Revenue Act of 1921, which authorized the return of income on installment sales of real estate. We think that section 212(d) was designed to validate the regulations as applied to the periods prior

to January 1, 1925. Section 212(d) constituted legislative approval of the Commissioner's regulations. (*Natl. Lead Co.* v. *United States*, 252 U. S., 140.) Article 42 of Regulations 69, promulgated under the Revenue Act of 1926, relates to installment sales by dealers and also to casual sales of personal property. Nothing in the regulations relating to dealers indicates that losses on such sales could be returned as income, and in the specific provision relating to casual sales reference is made to return of income in the same terms as the reference is made in the statute, and it has the same meaning.

If a further loss occurred by a nonpayment of any of the notes accepted in payment, a question of further loss would be allowed in the year in which the note was found to be worthless and not paid.

Order affirmed.

SECTION 214(a)8.—DEDUCTIONS ALLOWED INDIVIDUALS: DEPRECIATION.

ARTICLE 162: Depreciable property. XII-21-6192
Ct.D. 670

INCOME TAX—REVENUE ACTS OF 1924 AND 1926—DECISION OF COURT.

1. DEDUCTIONS—EXHAUSTION OF PROPERTY USED IN TRADE OR BUSINESS.

Unexploited patents individually owned by a corporate vice president who refrained from prosecution of suits against infringers because they were customers of the corporation were not so "used in" the owner's business as to entitle him to the deduction for exhaustion allowed by section 214(a)8 of the Revenue Acts of 1924 and 1926. Such deduction is allowable only where the property is used in carrying on a trade or business.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (20 B. T. A., 1005) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

Tracy V. Buckwalter, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition to review order of Board of Tax Appeals.

Before MOORMAN, HICKENLOOPER, and SIMONS, Circuit Judges.

[October 31, 1932.]

OPINION.

HICKENLOOPER, Circuit Judge: The petitioner is one of the vice presidents of the Timken Roller Bearing Co. and complains that in the assessment of his personal income tax for the years 1924 and 1925 he was denied a deduction for the exhaustion of two patents owned by him and susceptible to valuation as of March 1, 1913, but which had not been exploited in any way, as by the granting of licenses or the prosecution of suits against infringers. One of these patents covered a special design of truck for use in creosoting railroad ties and the other a roller bearing assembly for the axles of such trucks. Neither patented device was used by the Timken Roller Bearing Co. The contention is that the petitioner was compelled to forego the prosecution of actions for infringement because practically all infringers (the railroads) were users of Timken bearings and such suits would therefore have antagonized customers and possibly have been detrimental to the business of his employer; that this fact was taken into consideration by his employer in fixing the amount of the annual bonus for each year in question; that the patent situation was thus instrumental in the production of income; and that the patents themselves must therefore be regarded as used in the petitioner's business as an executive of the Timken Roller Bearing Co.

The Revenue Acts of 1924 and 1926 permit the deduction of an allowance for exhaustion only "of property used in the trade or business" of the taxpayer.

(43 Stat., 253, ch. 234; 44 Stat., 9, ch. 27.) While there may be serious doubt whether the petitioner, as a salaried executive, was engaged in a "trade or business" within the meaning of the Act (cf. *Hughes* v. *Commissioner*, 38 F. (2d), 755 (C. C. A. 10); *Refling* v. *Commissioner*, 47 F. (2d), 859 (C. C. A. 8); *Ames* v. *Commissioner*, 49 F. (2d), 853 (C. C. A. 8)), we do not consider it necessary to determine this point. It seems obvious to us that, whether he was or was not so engaged, the patents were not "used in" that business. Only that which is directly employed in carrying on a trade or business falls within the statutory definition. To abstain from use can not be considered as the equivalent of use. To use is an active verb; the position of the petitioner was entirely passive. It is true that his inaction possibly may have redounded to his financial benefit, by placing him in a better grace with his employer, or it may have been a condition precedent to the continuance of his employment; but the patents were not a means by which this service to his employer was rendered, and can not be considered as used in the performance of those duties from which they were entirely distinct.

Affirmed.

SECTION 214(a)9.—DEDUCTIONS ALLOWED INDIVIDUALS: DEPLETION.

ARTICLE 203: Amount returnable through depletion and depreciation deductions in the case of lessee. XII–23–6211 G. C. M. 11822

REVENUE ACTS OF 1921, 1924, AND 1926.

The right to a depletion allowance does not depend upon the nature or character of the legal estate retained or acquired by the parties to an original oil and gas lease or their successors, but depends entirely upon whether any of such parties is entitled to share in the oil and gas produced from the properties. If any of such parties is entitled to a share of the oil and gas, he has the "economic interest" upon which the Supreme Court bases the right to a depletion allowance. General Counsel's Memorandum 8650 (C. B. IX–2, 214) revoked.

An opinion is requested whether the decision of the United States Supreme Court in *Palmer* v. *Bender* (287 U. S., 551, 53 S. Ct. Rep., 225, Ct. D. 641, page 235, this Bulletin) necessitates the revocation of General Counsel's Memorandum 8650.

In General Counsel's Memorandum 8650, it was disclosed that C had obtained a lease on certain foreign oil properties in 1901. On October —, 1906, C assigned his entire interest in and to the lease to the M Company in consideration of — per cent of the net profits derived from the sale of the products of the lands extracted under the oil and gas lease, payable during the entire term of the lease and all extensions thereof. C died in 1917. Producing wells were drilled upon the leased property in 1922, and large amounts of income were paid to the estate in 1922 and subsequent years by the M Company. The estate did not include these amounts as income in its returns, claiming such amounts to have been a return of capital, i. e., the fair market value of the M Company contract on the date of C's death. It was held by this office that C had assigned his entire interest in the leasehold estate, that neither he nor his estate held any depletable interest in the property, and that the estate could recover as capital only a proportion of the amounts received in 1922 and subsequent years (under *Eldredge* v. *United States*, 31 Fed. (2d), 924) until the value of the contract at date of death should have been recovered. In General Counsel's Memorandum 9798 (C. B. X–2, 221) it was held that the Eldredge decision in effect had

been overruled by *Burnet* v. *Logan* (283 U. S., 404, Ct. D. 351, C. B. X–1, 345), and that the estate was entitled to recover the entire value of the contract before treating any receipts as income.

In *Palmer* v. *Bender*, supra, the petitioner was a member of two partnerships which, after 1913, acquired oil and gas leases on unproved Louisiana lands and engaged in drilling operations. Oil was discovered on these lands in 1919 and 1921. In April, 1921, one partnership executed a writing by which it conferred on the Ohio Oil Co. the right to take over a part of the leased property on which the producing well was located in consideration of (1) a cash bonus, (2) payment of $1,000,000 to be made out of one-half of the first oil produced and saved from the premises, and (3) royalty of one-eighth of all oil produced and saved from the premises. The instrument in terms stated that the partnership did sell, assign, set over, transfer, and deliver its interest in the described premises. The second partnership in November, 1921, gave a similar document to the Gulf Refining Co. The petitioner reported in his returns for 1921 and 1922 his distributive share of the income of the partnerships derived from the bonus payment and amounts received under the contracts. In such returns the petitioner took a deduction for depletion, based on the value of the oil in place on the respective dates of discovery. The Commissioner refused to allow depletion deductions on the theory that both transactions by the partnerships constituted assignments of the leases, assessed and collected additional taxes, and refused to refund the same. Suit followed and judgment was rendered against the petitioner in both the United States District Court and the Circuit Court of Appeals for the Fifth Circuit. The Supreme Court reversed the decision of the lower courts.

The Supreme Court stated that it was necessary to look to the statute itself (section 214(a)10 of the Revenue Act of 1921) and to the decisions construing it to ascertain to what interests the statute is to be applied. The court pointed out that the statute permits a reasonable depletion allowance to be made in the case of oil and gas wells according to the peculiar conditions in each case; that there is nothing in the statute or regulations to confine a depletion allowance to persons who are technical lessors; and that the concluding sentence of the section, to the effect that, in the case of leases deductions shall be equitably apportioned between lessor and lessee, indicates that depletion deductions may be allowed in other cases. The court expressed the opinion that the language of the statute is broad enough to permit a depletion allowance in every case where a taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which the taxpayer must look for a return of his capital. The court also stated that a lessor's right to a depletion allowance does not depend upon his retention of ownership or any other form of legal interest in the mineral content of the land, but upon his right to share in the oil produced. In short, the court made it clear that the lessor, lessee, or any other person having or acquiring an interest in the oil in place or a right to share in the oil produced, has such an economic interest in the oil that he is entitled to a depletion allowance. The court then applied that principle to the case before it, pointing out that the original lessors, the two partnerships, and their transferees were all entitled to share

in the oil produced, and that the production and sale of the oil would result in its depletion and a return of capital investment to such parties according to their respective interests. The court concluded that the interest of the petitioner was included within the meaning of the statute permitting deduction of a reasonable allowance for depletion according to the peculiar conditions in each case.

Accordingly, the right to a depletion allowance does not depend upon the nature or character of the legal estate retained or acquired by the parties to an original oil and gas lease or their successors, but depends entirely upon whether any of such parties is entitled to share in the oil and gas produced from the properties. If any of such parties is entitled to a share of the oil and gas, he has the "economic interest" upon which the Supreme Court bases the right to a depletion allowance. In view of the foregoing, General Counsel's Memorandum 8650 is revoked.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 216: Depletion—Adjustments of accounts based on bonus or advanced royalty. XII-2-5979 Ct. D. 619

INCOME TAX—REVENUE ACT OF 1918—DECISION OF SUPREME COURT.

1. DEDUCTIONS—DEPLETION—BONUS PAYMENTS—ADVANCED ROYALTIES—RETURN OF CAPITAL.

When the execution of an oil and gas lease is followed by production of oil, the bonus and royalties paid to the lessor involve a return of its capital investment, for which a depletion allowance must be made under section 234(a)9 of the Revenue Act of 1918.

2. DEDUCTIONS—REASONABLE ALLOWANCE—ALLOCATION OF DEPLETION TO BONUS AND ROYALTIES.

Where the owner of oil lands leases them for stipulated net bonus payments and royalties, which bonus and expected royalties together are not found to exceed the capital investment of the lessor, the method used by the Commissioner in article 215, Regulations 45 (1920 edition) as amended, in treating the whole bonus as a return of capital and deducting from the depletion allowance on each barrel of royalty oil the proportion of its capital investment already returned by the bonus, constitutes a reasonable allowance for depletion within the meaning of section 234(a)9 of the Revenue Act of 1918.

3. DECISION DISTINGUISHED.

The decision in *Burnet* v. *Thompson Oil & Gas Co.* (283 U. S., 301 [Ct. D. 331, C. B. X-1, 390]) distinguished.

SUPREME COURT OF THE UNITED STATES.

Murphy Oil Co., petitioner, v. *David Burnet, Commissioner of Internal Revenue.*

On writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[December 5, 1932.]

OPINION.

Mr. Justice STONE delivered the opinion of the court.

This case is here on certiorari (286 U. S., 541), to review a judgment of the Court of Appeals for the Ninth Circuit (55 F. (2d), 17), which reversed an

order of the Board of Tax Appeals (15 B. T. A., 1195) and sustained a ruling of the Commissioner of Internal Revenue fixing the amount of depletion to be allowed and deducted from royalties received by petitioner in 1919 and 1920 as the lessor of oil lands, in determining petitioner's taxable income for those years.

In December, 1913, petitioner, the owner of two tracts of oil lands, leased them for stipulated net bonus payments, aggregating $5,173,595.18 and royalties of one-fourth of the oil produced by the lessee. All the bonus payments were made before 1919. Whether petitioner returned those payments as income or paid income tax on them for the years when received does not appear. During 1919 and 1920 petitioner received royalties from the leased lands. In returning its income for those years, it sought to deduct from the royalties received the entire original unit cost to it of the oil extracted during the taxable period, without any diminution by reason of the bonus payments which it had already received. Under the applicable Revenue Act of 1918 (ch. 18, 40 Stat., 1057), bonus and royalties received by the lessor of an oil lease, after deductions allowed by the taxing Act, are taxable income of the lessor. (See *Burnet* v. *Harmel*, decided November 7, 1932 [Ct. D. 611, C. B. XI–2, 210].) The question to be decided is whether the Commissioner correctly calculated the deduction for depletion for the years in question, by treating the bonus previously received by the petitioner, as a return of capital and by reducing *pro tanto* the depletion allowed on the royalties received in later taxable years.

The court below sustained the Commissioner's treatment of the bonus payments as advanced royalties for which depletion must be allowed under section 234(a)9, Revenue Act of 1918, to the extent that they represent a return of capital, and held erroneous the conclusion of the Board of Tax Appeals that the entire bonus, was taxable income. The correctness of this decision must first be determined, for if the Board was right in ruling that the bonus was not subject to a depletion allowance, the method of computing the depletion to be allowed on the royalties received during the taxable years in question would present no problem. The taxpayer would be entitled to deduct the full capital investment per barrel in the oil extracted during those years.

Section 234(a)9 of the 1918 Act includes in the authorized deductions from gross income:

"(9) In the case of mines, oil and gas wells, * * * a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: * * * such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and the lessee;"

We think it no longer open to doubt that when the execution of an oil and gas lease is followed by production of oil, the bonus and royalties paid to the lessor both involve at least some return of his capital investment in oil in the ground, for which a depletion allowance must be made under section 234. (See *Burnet* v. *Harmel*, supra.) This is obvious where royalties alone are insufficient to return the capital investment. A distinction between royalties and bonus, which would allow a depletion deduction on the former but tax the latter in full as income, when received, making no provision for a reasonably anticipated production of oil on the leased premises, would deny the "reasonable allowance for depletion" which the statute provides. The harsh operation of such a rule with respect to taxpayers generally is apparent and is emphasized by the opportunist character of petitioner's argument here. The rule for which it contends can operate to its advantage only if it fortuitously escapes payment of any tax on the bonus payments, which it insists shall be treated as income without the deduction of any depletion allowance.

Doubts, if any, whether the statute authorizes depletion of bonus payments, have been definitely set at rest by the repeated reenactment, without substantial change, of the provisions of section 234(a)9,[1] since the promulgation of Treasury regulations providing for such depletion.[2] (See *Burnet* v. *Thompson*

[1] Section 234(a)9, Revenue Act of 1921 (42 Stat., 227, 256); section 234(a)8, Revenue Act of 1924 (43 Stat., 253, 284); section 234(a)8, Revenue Act of 1926 (44 Stat., 9, 42); section 23(l), Revenue Act of 1928 (45 Stat., 791, 800); section 23(l), Revenue Act of 1932 (47 Stat., 173, 180).

[2] Article 215(a), Treasury Regulations 45 (1920 edition), Revenue Act of 1918, continued intact in article 215(a), Treasury Regulations 62, Revenue Act of 1921; article

Oil & Gas Co., 283 U. S.. 301, 307–308 [Ct. D. 331, C. B. X–1, 390]; *Brewster* v. *Gage*, 280 U. S., 327, 337 [Ct. D. 148, C. B. IX–1, 274]; *National Lead Co.* v. *United States*, 252 U. S., 140, 146–147.)

The question remains whether the method followed by the Commissioner in this case in allocating depletion to bonus and royalties failed to afford that "reasonable allowance" for depletion which the statute provides.

Article 215, Treasury Regulations 45 (1920 edition), provided:

"(a) Where a lessor receives a bonus or other sum in addition to royalties, such bonus or other sum shall be regarded as a return of capital to the lessor, but only to the extent of the capital remaining to be recovered through depletion by the lessor at the date of lease. If the bonus exceeds the capital remaining to be recovered, the excess and all the royalties thereafter received will be income and not depletable. If the bonus is less than the capital remaining to be recovered by the lessor through depletion, the difference may be recovered through depletion deductions based on the royalties thereafter received. The bonus or other sum paid by the lessee for a lease made on or after March 1, 1913, will be his value for depletion as of date of acquisition."

This paragraph of the regulation was amended, November 13, 1926, by Treasury Decision 3938 (C. B. V–2, 117), to read as follows:

"(a) Where a lessor receives a bonus in addition to royalties, there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received."

The important difference in operation between the regulation before its amendment and after, is in the case where the Commissioner properly finds that the sum of the bonus and expected royalties exceeds the lessor's capital investment in the oil in the ground. If, for example, the bonus were $1,000,000 and the estimated royalties were $2,000,000 and the capital investment of the lessor in the oil in the ground, to be depleted, were $2,000,000, the allowed depletion for return of the capital investment would be deducted, one-third from the bonus and two-thirds from the royalties as received.

The regulation thus operates to distribute the lessor's anticipated profit or the taxable net income to be derived from the extraction of all the oil ratably between the bonus and royalties, so that the estimated profit element in each will be taxed as received, subject to such readjustments of capital account as are authorized by paragraphs (c) and (d) of the amended regulation, in the event of termination, abandonment, or expiration of the lease before all the oil is extracted. But if the bonus and expected royalties together are not found to exceed the capital investment of the lessor, the entire bonus received in advance of royalties must be treated, after the amended regulation as well as before, as a return of capital, since, in that case, the expected royalties added to the bonus are, by hypothesis, sufficient to return no more than the lessor's capital.

Such was the case here. In determining petitioner's depletion allowance for the two years in question, the Commissioner made no specific determination of the "expected royalties" from the leased lands. But such a determination was of consequence in allocating depletion to the bonus only in the event that the total of bonus and expected royalties exceeded the invested capital of the taxpayer. No facts appear which would have justified such a finding and, without it, the requirements of the amended regulation were satisfied by treating the whole bonus as a return of capital, and deducting from the depletion allowance on each barrel of the royalty oil the proportion of the capital investment already returned by the bonus. This is what the Commissioner did.

He determined, on the basis of engineers' reports, the total amount of oil in the ground at the date of the lease and its value as of March 1, 1913. This he treated as petitioner's capital investment, to be returned by the depletion allowance. The computation necessarily revealed the per barrel capital

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216(a), Treasury Regulations 65, Revenue Act of 1924. The amendment of subdivision (a), November 13, 1926, by Treasury Decision 3938 (C. B. V–2, 117), appears in article 216(a), Treasury Regulations 69, Revenue Act of 1926; article 236(a), Treasury Regulations 74, Revenue Act of 1928. See also the minimum royalty provision in article 236(b) of Regulations 74.

investment in oil in the ground at the date of the lease. By making certain necessary capital investment adjustments, reflecting oil extraction during the years before 1919, the detail of which is not now important, he arrived at the per barrel capital investment of petitioner in oil in the ground in 1919 and 1920, the figure which would represent the actual amount of depletion of the capital investment for each barrel of oil extracted during those years, if there had been no bonus payments. His method of bringing the bonus into the computation amounted, in effect, to dividing the amount of the bonus by the total number of barrels of royalty oil in the ground, as indicated by the engineers' reports. The result represented the amount to be deducted from the depletion allowance per barrel of royalty oil which would otherwise have been made for those years. Stated in another way, the total amount of the bonus was deducted from petitioner's total capital investment in oil in the ground returnable by depletion allowances, with a corresponding reduction in the per barrel capital investment in the oil reserve. Thus the Commissioner treated the whole of the bonus as a return, in advance of abstraction of the oil, of a part of the petitioner's capital investment in the oil in the ground, with which it would part, in a technical legal sense, only upon abstraction. In consequence, the deduction for depletion allowed on royalties received in 1919 and 1920 was reduced; it is of this reduction that petitioner complains.

We think the Commissioner's method "reasonable" within the meaning of the statute. The deduction for depletion from the bonus payments, which the statute requires, must either be made after the process of extracting the oil is complete, to the extent that the royalties received have been insufficient to replace invested capital, with the attendant inconvenience of indefinite postponement of the allocation of the bonus to income and return of capital, or a formula must be adopted by which the appropriate allocation may be made as the two classes of gross income, bonus and royalties, are received.

That formula the regulation purports to furnish. Where the estimates are reasonable, the formula affords a fair and convenient method of avoiding the present taxation of the bonus, when received, as income, in the face of the probability that it will ultimately prove not to be such. It will not fail to provide, with reasonable certainty, for the restoration of capital to which the taxpayer is entitled, if the oil extracted equals or exceeds the amount originally estimated. If less than that amount, it does not preclude revision and necessary adjustments, as errors appear probable. In addition, provision is made by subdivisions (c) and (d) of the regulation, as amended, for such necessary capital readjustments as may be occasioned by the termination, abandonment or expiration of the lease before all the oil is extracted.

The method of computation provided by the amended regulation must be taken to have received the approval of Congress, for, as already noted, the provisions of article 215(a), as amended, have been continued in the Treasury regulations since 1926 and those of section 234(a)9 of the Revenue Act of 1918 have been reenacted without substantial change in the Revenue Acts of 1928 and 1932.

The problem here is different from that involved in *Burnet* v. *Thompson Oil & Gas Co.*, supra. There it was held, interpreting section 234(a)9, that the part of the depletion not allowed by the 1913 statute in the year in which it occurred could not be carried over and added to the depletable base used in computing the tax for a later year under the 1918 Act, which allowed depletion in full. Here an anticipated depletion of capital is to be returned from bonus and future royalties, to the extent that the applicable statutes allow, and the problem is to allocate such anticipated depletion to a payment made in advance of its occurrence. This allocation is permitted by the statute.

Petitioner argues, nevertheless, that the regulation is unreasonable because it requires the Commissioner to estimate probable royalties which are dependent on the frequently unforeseeable future market value of oil. But the regulation does not require him to make estimates which are unreasonable, for where none can be made with reasonable accuracy the Commissioner can not find that "the sum of the bonus and royalties expected to be received" exceeds the capital investment. In that event, the whole of the bonus will be treated, as in this case, as a return of capital. We can not say that such a result is unreasonable on its face. The exigencies which "the peculiar conditions of each case" may present, we need not now consider. It is also unnecessary to inquire under what circumstances the application of the regulation may fail to comply with the statute because the appraisals which are made are extravagant or impossible. In the case before us the accuracy of every estimate

of the Commissioner is unchallenged. It can not be said that the regulation, as applied here, was unauthorized by the statute because inadequate for its purpose or inconvenient or unjust in its operation.

Finally, petitioner urges that as the Commissioner failed to find the expected royalties to be received under the lease, the court below should have exercised its discretion to remand the case to the Board of Tax Appeals for a rehearing. Section 1003(b), Revenue Act of 1926 (44 Stat., 9, 110). As we have said above, the record does not disclose any facts from which the expected royalties might be determined. Neither the petitioner nor the Commissioner asked opportunity to supply such facts. It does not appear whether such an estimate could be made, or that, if made, the sum of the bonus and expected royalties would exceed the petitioner's capital investment, returnable by depletion. Hence, no case was made calling for the court below to exercise its discretion in petitioner's favor.

Affirmed.

ARTICLE 216: Depletion—Adjustments of accounts based on bonus or advanced royalty.

REVENUE ACT OF 1926.

Depletion on the percentage basis. (See G. C. M. 11384, page 64.)

ARTICLE 216: Depletion—Adjustments of accounts based on bonus or advanced royalty.

XII-11-6070
Ct. D. 641

INCOME TAX—REVENUE ACT OF 1921—DECISION OF SUPREME COURT.

1. DEDUCTION—DEPLETION—REASONABLE ALLOWANCE.

Where petitioner was a member of two partnerships which, subsequent to March 1, 1913, acquired certain oil and gas leases, drilled for oil, and after discovery transferred their operating rights to two oil companies in consideration of certain future payments, an excess royalty of one-eighth of oil produced and saved, and in the case of one of the partnerships a cash bonus, he may properly claim deduction for depletion based on the fair market value of oil in place on dates of discovery, for whether the partnerships became technical sublessors or not, they retained, by their stipulation for royalties, an economic interest in the oil, in place, identical with that of a lessor, which interest is included within the meaning and purpose of section 214(a)10 of the Revenue Act of 1921 permitting deduction in the case of oil and gas wells of a reasonable allowance for depletion according to the peculiar conditions in each case.

2. SAME—CASH BONUS.

Under the above circumstances, the bonus received by one of the partnerships was a return *pro tanto* of the petitioner's capital investment in the oil, in anticipation of its extraction, resulting in a corresponding diminution in the unit depletion allowance upon the royalty oil as produced.

SUPREME COURT OF THE UNITED STATES.

E. G. Palmer, petitioner, v. *Mrs. Agnes McGravel Bender, Administratrix of the Estate of James G. Bender, late Collector of Internal Revenue for the District of Louisiana.*

On writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[January 9, 1933.]

OPINION.

MR. JUSTICE STONE delivered the opinion of the court.

Petitioner brought suit in the District Court for Western Louisiana to recover taxes alleged to have been illegally exacted for 1921 and 1922 upon in-

come derived from oil properties by petitioner as a member of two partnerships, known respectively as the Smitherman and Baird partnerships. Both partnerships, after 1913, acquired oil and gas leases of unproved Louisiana lands and engaged in drilling operations on them which resulted in discovery of oil on March 30, 1921, in the case of the Smitherman leases and on August 23, 1919, in the case of the Baird leases.

In April, 1921, the Smitherman partnership executed a writing by which it conferred on the Ohio Oil Co. the right to take over a part of the leased property on which the producing well was located, subject to the obligations of the covenants of the leases, in consideration of a present payment of a cash bonus, a future payment to be made "out of one-half of the first oil produced and saved" to the extent of $1,000,000, and an additional "excess royalty" of one-eighth of all the oil produced and saved. The instrument in terms stated that the partnership "does sell, assign, set over, transfer and deliver * * * unto the Ohio Oil Co." the described leased premises. The Baird partnership in November, 1921, gave a similar document to the Gulf Refining Co. containing some additional features which in the view we take are immaterial. It too stipulated for future payment of royalties in kind from the oil produced and saved.

Petitioner's tax returns for the years 1921 and 1922 reported his distributive share of the income from the Smitherman partnership, derived from the bonus payment and oil received under its contract with the Ohio Oil Co., and also his share in the income from the Baird partnership from oil received under its contract with the Gulf Refining Co. In the returns for both years petitioner, relying upon the provisions of section 214(a)10 of the Revenue Act of 1921 (42 Stat., 239), regulating depletion allowances in the case of oil and gas wells, made a deduction for depletion based on the value of the oil in place in the two properties on the respective dates of discovery.

The Commissioner refused to allow these deductions on the theory that both transactions were sales of the leases by the partnerships and that the only allowable deductions, in calculating taxable gain, are those based upon the cost of the respective properties to petitioner, in each case materially less than their value at the date of the discovery of oil. This resulted in the assessment and payment of an increased tax which is the subject of the present suit. Judgment of the district court (49 F. (2d), 316) denying petitioner the right to make the deductions claimed, was affirmed by the Court of Appeals for the Fifth Circuit (57 F. (2d), 32). This court granted certiorari (287 U. S., 586).

Both courts below, following earlier decisions of the court of appeals with respect to the two instruments involved here, held that they were assignments or sales of the leases for the stipulated consideration of bonus paid and royalties to be received. (See *Waller* v. *Commissioner*, 40 F. (2d), 892 [Ct. D. 229, C. B. IX–2, 351]; *Herold* v. *Commissioner*, 42 F. (2d), 942.) The Government rests its case on this conclusion. It concedes that if any reversionary interest, according to the common law, however small, has been retained in the leased land by the two partnerships, the petitioner is entitled to the depletion allowances claimed, but insists that no such interest was reserved by the instruments in question. Petitioner contends that by the Louisiana law any transfer of an interest in land, yielding to the transferor, as consideration, the fruits of the land as they may be produced, such as the royalty oil in the present case, must be regarded as a lease. (See *Robertson* v. *Pioneer Gas Co.*, 173 La., 313.) From this he concludes that the two instruments were subleases and invokes the rule recently affirmed in No. 80, *Murphy Oil Co.* v. *Burnet*, decided December 5, 1932 [Ct. D. 619, page 231, this Bulletin], that the lessor of an oil and gas well is entitled to a depletion allowance upon bonus and royalties received from the lessee, under section 234(a)9 of the Revenue Act of 1918. Section 214(a)10 of the Revenue Act of 1921, which is applicable here, contains the same provisions.

It has been elaborately argued at the bar and in the briefs whether under Louisiana law the two instruments are assignments or subleases. We do not think the distinction material. Nothing in section 214(a)10 indicates that its application is to be controlled or varied by any particular characterization by local law of the interests to which it is to be applied. (See No. 26, *Burnet* v. *Harmel*, decided November 7, 1932 [Ct. D. 611, C. B. XI–2, 210].) We look to the statute itself and to the decisions construing it to ascertain to what interests it is to be applied and then to the particular interests secured to the two partnerships by the instruments in question to ascertain whether they

come within the statutory provision. The formal attributes of those instruments or the descriptive terminology which may be applied to them in the local law are both irrelevant.

Section 214(a)10 of the Act of 1921 so far as now material is printed in the margin.[1] It will be observed that the statute directs that reasonable allowance for depletion be made as a deduction in computing net taxable income, "in the case of oil and gas wells, * * * according to the peculiar conditions in each case." The allowance to the taxpayer is not restricted by the words of the statute to cases of any particular class or to any special form of legal interest in the oil well. It is true that under article 215 of Treasury Regulations 62 the lessor of an oil or gas well is entitled to a depletion allowance upon the bonus and royalties received from the lessee. (See *Murphy Oil Co.* v. *Burnet*, supra.) But there is nothing in the statute or regulations which confines depletion allowances to those who are technically lessors. The concluding sentence of the section that "In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and the lessee" presupposes that the deductions may be allowed in other cases. The language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital.

That the allowance for depletion is not made dependent upon the particular legal form of the taxpayer's interest in the property to be depleted was recognized by this court in *Lynch* v. *Alworth-Stephens Co.* (267 U. S., 364 [T. D. 3690, C. B. IV–1, 162]). There a depletion allowance under section 12(a) of the 1916 Act (39 Stat., 767) was claimed by a lessee of a mining lease, in the computation of tax on income from the proceeds of ore mined. The statute made no specific reference to lessees and the Government argued that as the lessee acquired no ownership of the ore until the severance from the soil (see *United States* v. *Biwabik Mining Co.*, 247 U. S., 116, 123) the lease gave him no depletable interest in the ore in place. But this court held that regardless of the technical ownership of the ore before severance, the taxpayer, by his lease, had acquired legal control of a valuable economic interest in the ore capable of realization as gross income by the exercise of his mining rights under the lease. Depletion was, therefore, allowed.

Similarly, the lessor's right to a depletion allowance does not depend upon his retention of ownership or any other particular form of legal interest in the mineral content of the land. It is enough, if by virtue of the leasing transaction, he has retained a right to share in the oil produced. If so he has an economic interest in the oil, in place, which is depleted by production. Thus, we have recently held that the lessor is entitled to a depletion allowance on bonus and royalties, although by the local law ownership of the minerals, in place, passed from the lessor upon the execution of the lease. (See *Burnet* v. *Harmel*, supra; No. 104, *Bankers Pocahontas Coal Co.* v. *Burnet*, decided December 5, 1932 [Ct. D. 531, C. B. XI–2, 275].)

In the present case the two partnerships acquired, by the leases to them, complete legal control of the oil in place. Even though legal ownership of it, in a technical sense, remained in their lessor, they, as lessees, nevertheless acquired an economic interest in it which represented their capital investment and was subject to depletion under the statute. (*Lynch* v. *Alworth-Stephens Co.*, supra.) When the two lessees transferred their operating rights to the two oil companies, whether they became technical sublessors or not, they retained, by their stipulations for royalties, an economic interest in the oil, in place, identical with that of a lessor. (*Burnet* v. *Harmel: Bankers Pocahontas Coal Co.* v. *Burnet*, supra.) Thus, throughout their changing relationships

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[1] SEC. 214. (a) That in computing net income there shall be allowed as deductions:
* * * * * * * * *

(10) In the case of mines, oil and gas wells, * * * a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: * * * *Provided further*, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within 30 days thereafter: * * * such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and the lessee.

with respect to the properties, the oil in the ground was a reservoir of capital investment of the several parties, all of whom, the original lessors, the two partnerships and their transferees, were entitled to share in the oil produced. Production and sale of the oil would result in its depletion and also in a return of capital investment to the parties according to their respective interests. The loss or destruction of the oil at any time from the date of the leases until complete extraction would have resulted in loss to the partnerships. Such an interest is, we think, included within the meaning and purpose of the statute permitting deduction in the case of oil and gas wells of a reasonable allowance for depletion according to the peculiar conditions in each case.

The statute makes effective the legislative policy, favoring the discoverer of oil, by valuing his capital investment for purposes of depletion at the date of the discovery rather than at its original cost. The benefit of it accrues to the discoverer if he operates the well as owner or lessee, or if he leases it to another. It would be an anomaly if that policy were to be defeated and all benefit of the depletion allowance withheld because he chose to secure the return of his capital investment by stipulating for a share of the oil produced from the discovered well through operation by another.

The bonus received by the Smitherman partnership was a return *pro tanto* of the petitioner's capital investment in the oil, in anticipation of its extraction, resulting in a corresponding diminution in the unit depletion allowance upon the royalty oil as produced. Compare *Murphy Oil Co.* v. *Burnet*, supra.

Reversed.

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells. (Also Section 202, Article 1561.)

XII–4–5999
G. C. M. 11197

REVENUE ACTS OF 1921, 1924, 1926, AND 1928.

In 1927, the taxpayer acquired, in exchange for a portion of its common and preferred stock, 94 per cent of the properties of another corporation. This acquisition was held to constitute a nontaxable reorganization under section 203(b)3 of the Revenue Act of 1926, with the result that the basis of the properties to the transferee was the same as that of the transferor. Included in the acquisition were undeveloped leaseholds carried by the transferor at a cost of $2\frac{1}{2}x$ dollars, of which x dollars represented accumulated delay rentals. The delay rentals were payments required in the leases to be paid annually by the lessee during the period before they became productive.

Held, the taxpayer as lessee may not capitalize delay rentals on the theory that they form a part of the consideration paid to the lessor for granting the lease. Delay rentals may not be capitalized as incidental expenses within the purview of article 223 of Regulations 69. Delay rentals, under the facts in the instant case, may be treated as carrying charges on unproductive property and form part of the taxpayer's basis for gain or loss purposes under article 1561 of Regulations 69 and article 561 of Regulations 74. Under these articles the taxpayer had an election prior to the amendment of article 561 of Regulations 74 to capitalize carrying charges on unproductive property and add them to its basis. The instant taxpayer may include in its basis the delay rentals which were capitalized by its predecessor.

An opinion is requested relative to the proper treatment for income tax purposes of " delay rentals " paid by the taxpayer during the years 1921 to 1927, inclusive.

The M Company, the taxpayer, acquired in 1927, in exchange for a portion of its common and preferred stock, 94 per cent of the properties of the O Company. The Income Tax Unit held that the acquisition of these properties constituted a nontaxable reorganization under the provisions of section 203(b)3 of the Revenue Act of 1926, with the result that the taxpayer's basis for depletion,

depreciation, and gain or loss purposes was the same as the basis in the hands of the O Company. Included in the properties acquired by the taxpayer were undeveloped oil and gas leaseholds carried on the books of the O Company at a cost of $2\frac{1}{2}x$ dollars. Of this amount x dollars represented accumulated delay rentals and the balance represented the cost of acquiring the leases. The leases under which the O Company acquired the property in question are the customary form of oil and gas leases. They provide for the payment of royalties by the lessee to the lessor, in the event oil or gas is produced from the land, and for the payment, during the period before the land becomes productive, of certain annual amounts, designated in the lease as rentals, which are ordinarily known as "delay rentals." The taxpayer states that both it and its predecessor paid large amounts of such rentals, and that the predecessor capitalized all rentals in all years from 1921 to 1927 and did not deduct any such rentals as current expenses.

The taxpayer contends that the delay rentals were properly capitalized as a part of the cost of the leaseholds; that if this contention is not conceded then the delay rentals were properly capitalized under article 223 of Regulations 62 and 69 and article 225 of Regulations 65, which give the taxpayer an option either to deduct as development expense or charge to capital account "such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property"; and that if such rentals do not fall under those provisions of the regulations then they should be treated as carrying charges under article 1561 of Regulations 69.

In view of the above-stated facts and the contentions of the taxpayer, an expression of opinion is requested upon the following issues:

(1) Where a taxpayer is lessee under an oil and gas lease and, in accordance with its provisions, makes periodical payments, ordinarily called "delay rentals," for the purpose of continuing his rights under the lease during the period preliminary to the production of oil or gas (or preliminary to the commencement of active development if the lease so provides):

(a) *May* the taxpayer capitalize such rentals on the theory that they form a part of the consideration paid to the lessor for granting the lease?

(b) *Must* the taxpayer capitalize such rentals for that reason?

(c) May such rentals be considered as being included in "such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property" and therefore treated in the same manner as that in which the taxpayer treats intangible development costs through his general election under article 223 of Regulations 69?

(d) May such rentals be considered to be carrying charges on unproductive property and therefore to form a part of his basis for gain or loss, under article 1561 of Regulations 69?

(e) If such rentals are carrying charges on unproductive property, *must* they be capitalized or has the taxpayer an election aside from any election under article 223, Regulations 69?

(2) If the taxpayer, or its predecessor under a nontaxable reorganization, has, in fact, capitalized such rentals in previous years, regardless of the answers to questions 1, a, b, c, d, e, may such accrued capitalized rentals be included in the taxpayer's gain or loss basis for the years now under consideration?

In connection with the first contention of the taxpayer, that the delay rentals were not in fact rent within the ordinary meaning of that term, but were a part of the cost of the leasehold, it is well settled that the cost of acquiring a lease is a capital expenditure, while rent is an ordinary and necessary business expense. (*Galatoire Bros.* v. *Lines, Collector*, 23 Fed. (2d), 676, T. D. 4138, C. B. VII–1, 229.) For income tax purposes it is clear that there is no distinction between the term "rent," in the sense in which that term ordinarily is used, and "delay rentals." 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 plaintiff in error contended that the owner of a dower right "was only entitled to the interest on the rental or delay money." The court, after pointing out that there had been no development under the oil and gas leases and the fund involved was merely annual rental or delay money paid to keep the lease in force pending development, 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 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 follows that delay rentals are not a part of the cost of acquiring the leaseholds and may not, therefore, properly be capitalized upon that basis.

In connection with the contention of the taxpayer that delay rentals may either be charged to expense or capitalized under article 223 of Regulations 62 and 69 and article 225 of Regulations 65, this office is of the opinion that delay rentals do not fall within the meaning of the term "incidental expenses" referred to in those articles of the regulations. The incidental expenses which a taxpayer may, at his option, capitalize or charge to expense are those arising "in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property." Delay rentals are paid merely to extend the time within which the lessee may enter upon the premises and begin operations, as distinguished from incidental expenses incurred in connection with the exploration and development of the property. Clearly article 223 of Regulations 62 and 69 and article 225 of Regulations 65 do not include delay rentals as an incidental expense which the taxpayer may, at his option, capitalize.

The third contention advanced by the taxpayer is that the delay rentals in question were properly capitalized on the theory that they

were carrying charges within the scope of article 1561 of Regulations 69, which provides, in so far as applicable, as follows:

* * * In computing the amount of gain or loss, however, the cost or other basis of the property must be increased by the cost of capital improvements and betterments made to the property since the basic date, and by carrying charges, such as taxes on unproductive property. Where the taxpayer has elected to deduct carrying charges in computing net income, or used such charges in determining his liability for filing returns of income for prior years, the cost or other basis may not be increased by such items in computing the gain or loss from the subsequent sale of the property.

In the case of *Westerfield* v. *Rafferty* (4 Fed. (2d), 590; T. D. 3667, C. B. IV–1, 96) it was held that taxes and interest under the proper definition thereof do not represent a capital investment and can not be classed as carrying charges which the taxpayer may, at his option, charge to capital expenditures. In *Fraser* v. *Commissioner of Internal Revenue* (25 Fed. (2d), 653) the court pointed out that the payment of annual taxes and interest on property is not necessary for the retention of ownership thereof, and that such taxes and interest are not a part of the cost of the property. The same argument applies to delay rentals which are likewise paid merely to retain an interest in the property.

In the case of the *H. M. O. Lumber Co.* v. *United States* (Ct. D. 313, C. B. X–1, 340) the court quoted with approval the Westerfield and Fraser cases, supra. In its opinion the court pointed out that such items, expended for the continued use and possession of land and which add nothing to its value, are not capital in their nature and can not be added to the cost of the property in determining gain or loss. It is clear that delay rentals add no more to the value of property than does the payment of taxes and interest.

In the case of the *Central Real Estate Co.* v. *Commissioner* (47 Fed. (2d), 1036, Ct. D. 362, C. B. X–2, 219) the issue before the court was whether taxes and interest could, at the option of the taxpayer, be added to the cost of the property in determining gain or loss. The taxpayer contended that article 1561, supra, was a correct interpretation of section 202(b)1 of the Revenue Act of 1926. In denying the taxpayer's position the court stated in part that:

* * * If the statute were ambiguous, the argument might be persuasive, but the rule is well settled that, while reports of committees accompanying the introduction of proposed laws may be looked to in determining the intent of Congress, in cases of doubtful interpretation, if the words of the statute are free from doubt, and do not lead to absurd and wholly impracticable consequences, the statute is the sole evidence of the legislative intent. * * *

Section 202 above referred to is unambiguous and does not require extraneous aids to its interpretation. The provision permitting proper adjustment to be made for any expenditure or item of loss properly chargeable to capital account clearly means such items as add to the value of the property. It would be impracticable for Congress to enumerate in detail what those items might be, but taxes and interest do not fall into that class and no difficulty presents itself in dealing with them specifically. All the Revenue Acts have specifically provided for the deduction of taxes and interest from gross income annually while dealing generally with other items of expense. If Congress had intended to give the taxpayer the privilege of adding taxes and interest to cost, it would have been very easy to have said so. * * *

As pointed out by the court in the Central Real Estate Co. case, the language of the statute is plain and unambiguous. A taxpayer is entitled to make proper adjustments for capital expenditures only, and expenses to be properly chargeable to capital accounts must add

to the value of the property. Delay rentals clearly do not fall within the scope of capital expenditures as that term has been defined by the courts in the cases herein cited. It follows that delay rentals are not proper additions to the cost or other basis of the property for gain or loss purposes. This conclusion, however, does not necessarily mean that delay rentals may never be capitalized as carrying charges. Under article 1561 of Regulations 65 and 69, taxes on unproductive property were permitted to be capitalized and added to the cost or other basis of the property. A like provision was incorporated in article 561 of Regulations 74. On August 6, 1931, Treasury Decision 4321 (C. B. X–2, 169) was promulgated by the Bureau, amending article 561 of Regulations 74 to provide that "Carrying charges, such as interest and taxes on unproductive property, may not be treated as items properly chargeable to capital account, except in the case of carrying charges paid or incurred, as the case may be, prior to August 6, 1931, by a taxpayer who did not elect to deduct carrying charges in computing net income and did not use such charges in determining his liability for filing returns of income." The objections found by the courts with respect to the treatment of carrying charges have been remedied by the above-quoted amendment to article 561 of Regulations 74, in so far as cases arising under the Revenue Act of 1928 are concerned. However, in view of the provisions of article 1561 of Regulations 65 and 69, and article 561 of Regulations 74 prior to its amendment on August 6, 1931, it was deemed best not to penalize taxpayers who had previously capitalized such items in accordance with the regulations of the Bureau then in force. Accordingly, such carrying charges paid or incurred prior to August 6, 1931, which a taxpayer capitalized and did not deduct in computing net income will not be disturbed.

In the light of the above, the question in the instant case narrows down to whether "delay rentals" fall within the meaning of carrying charges such as interest and taxes on unproductive property. It is the opinion of this office that such delay rentals which have been paid in connection with, or to carry, unproductive property, are not materially different from taxes and interest paid on such property. While under the several court decisions above mentioned such payments do not meet the test of capital expenditures, in view of the fact that they were capitalized by the taxpayer relying upon the regulations of the Bureau in force at that time, the basis for computing gain or loss from the sale or other disposition of the property will be increased accordingly.

To summarize with specific reference to the several subdivisions under question No. 1:

(a) The taxpayer may not capitalize delay rentals on the ground that they form a part of the consideration paid to the lessor for granting a lease.

(b) In view of the answer to (a) it is unnecessary to answer (b).

(c) Delay rentals may not be capitalized as incidental expenses within the purview of article 223 of Regulations 69.

(d) Delay rentals may, under the facts in this case, be treated as carrying charges on unproductive property and form a part of the taxpayer's basis for gain or loss purposes under article 1561 of Regulations 69 and article 561 of Regulations 74.

(e) Under the language used in article 1561 of Regulations 69 and article 561 of Regulations 74, it is apparent that the taxpayer had an election prior to the amendment of article 561 of Regulations 74 to capitalize carrying charges such as interest and taxes on unproductive property, and add them to the basis of the property for gain or loss purposes.

In connection with the second question there appears to be no doubt, in view of the above conclusions, that the instant taxpayer may include in its basis for gain or loss purposes the delay rentals which were capitalized by its predecessor. Section 204(a)7 of the Revenue Act of 1926 provides in part as follows:

> If the property (other than stock or securities in a corporation a party to the reorganization) was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 80 per centum or more remained in the same persons or any of them, then *the basis shall be the same as it would be in the hands of the transferor*, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. [Italics supplied.]

The italicized portion of section 204(a)7 of the Revenue Act of 1926 specifically provides that the basis for the property in the hands of the transferee shall be the same as it would have been in the hands of the transferor. Accordingly, the basis in the hands of the M Company is the same as it would have been in the hands of the O Company. Since the O Company capitalized the delay rentals as a part of the cost of the property, it follows that the M Company may increase the basis of the properties by such capitalized rentals for gain or loss purposes.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells. XII–16–6136 Ct. D. 655

INCOME TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

1. DEDUCTION—CAPITALIZED COST OF DRILLING OIL WELLS—DEPLETION—DEPRECIATION.

Where the taxpayer charges the cost of preliminary development and drilling of oil wells to capital account, such cost is deductible from income derived from operation of the wells as an allowance for depletion under sections 204(c)2 and 234(a)8 of the Revenue Act of 1926, but may not properly be claimed as a deduction for depreciation, the latter being limited by the regulations to physical property, such as machinery, equipment, pipes, etc.

2. DEPLETION — DEPARTMENTAL CONSTRUCTION — LEGISLATIVE APPROVAL.

Where the regulations have consistently construed the earlier Revenue Acts as permitting an allowance for depletion but not for depreciation on account of costs of developing and drilling oil wells, such administrative construction must be deemed to have received legislative approval by the reenactment of the statute without material change. By the abandonment in section 204 of the 1926 Act of discovery value and the permission given taxpayers to substitute for cost a fixed percentage of the gross income from the well, Congress did not change the meaning of "depletion" but

intended it should include precisely what had been included under the earlier Acts. The regulations under the 1926 Act have so interpreted the section, and have continued the provisions of the earlier regulations under which costs of developing and drilling were returnable by depletion allowance.

3. DECISION REVERSED.

The decision of the Court of Claims (59 Fed. (2d), 853) reversed.

SUPREME COURT OF THE UNITED STATES.

The United States, petitioner, v. *Dakota-Montana Oil Co.*

On writ of certiorari to the Court of Claims.

[March 13, 1933.]

OPINION.

Mr. Justice STONE delivered the opinion of the court.

Respondent, a North Dakota corporation, in making its tax return of income derived from its operation of oil wells in 1926, claimed a deduction from gross income of a depreciation allowance on account of the capitalized costs of preliminary development and drilling. The Commissioner refused to allow the deduction claimed, ruling that it was for depletion, not depreciation, and was therefore included in the statutory depletion allowance of 27½ per cent of the gross income, which the respondent had also deducted. (Sections 204(c), 234(a)8, Revenue Act of 1926, ch. 27, 44 Stat., 9, 16, 41.) Having paid the correspondingly increased tax, respondent brought this suit in the Court of Claims to recover the excess. The court gave judgment for respondent, holding that the development and drilling costs were the proper subjects of a depreciation allowance which should have been made in addition to that for depletion. (59 F. (2d), 853.) This court granted certiorari to resolve a conflict of the decision below with that of the Circuit Court of Appeals for the Fourth Circuit in *Burnet* v. *Petroleum Exploration* (61 F. (2d), 273 [Ct. D. 612, C. B. XI-2, 262]).

The Revenue Act of 1926, like earlier Acts,[1] provided generally that "in the case of * * * oil and gas wells," taxpayers should be allowed, as a deduction from gross income, "a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case"; such allowance "in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary." [Section 234(a)8.] The earlier Acts provided that depletion should be allowed on the basis of cost unless the taxpayer was the discoverer of the well upon an unproven tract, in which case the basis was the "value of the property" at the time of the discovery or within 30 days thereafter.[2] (See No. 215, *Palmer* v. *Bender*, decided January 9, 1933 [Ct. D. 641, page 235, this Bulletin].) But the "discovery value" provision was eliminated from the Act of 1926, which is applicable here, and the taxpayer was permitted to calculate depletion on the basis of cost alone [section 204(c)] or else to deduct an arbitrary allowance, fixed by the statute, without reference to cost or discovery value, at 27½ per cent of gross income from the well.[3]

Articles 223 and 225 of Treasury Regulations 69, under the Revenue Act of 1926, were followed by the Commissioner in assessing the present tax. Article 223 purports to permit the taxpayer to choose whether to deduct costs of development and drilling as a development expense in the year in which they occur or

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[1] Section 234(a)9, Revenue Act of 1918; section 234(a)9, Revenue Act of 1921; section 234(a)8, Revenue Act of 1924.

[2] Section 234(a)9, Revenue Act of 1918; section 234(a)9, Revenue Act of 1921; section 204(c), Revenue Act of 1924.

[3] SEC. 204. (c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * * * *

(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph. * * *

else to charge them "to capital account returnable through depletion." In the latter event, which is the case here, "in so far as such expense is represented by physical property, it may be taken into account in determining a reasonable allowance for depreciation" which, if the arbitrary deduction for depletion were claimed, would constitute an additional allowance. Article 225 limits the depreciation for which an allowance may be made to that of "physical property, such as machinery, tools, equipment, pipes, etc." We do not doubt that the effect of this language is to require the taxpayer to look to the depletion allowance, in this case 27½ per cent of gross income, for a return of the costs of developing and drilling the well, which are involved here.

Respondent challenges the validity of the regulations thus applied as in conflict with section 234(a)8, which allows the deduction of a reasonable allowance "for depreciation of improvements" in addition to the deduction for depletion. It is urged that the drill hole is an "improvement" of the taxpayer's oil land and that no logical distinction in accounting practice can be made between the cost of this improvement and the cost of buildings and machinery placed on the property for the operation of the well, for which depreciation should admittedly be allowed.

The Government argues that the well itself is not tangible physical property which wears out with use so as properly to be the subject of depreciation, and that in any event the regulations are based upon the practices of the oil industry and are within the requirements of section 234(a)8 that a reasonable allowance for depletion and depreciation of improvements be made in all cases under rules and regulations to be prescribed by the Treasury Department.

We do not stop to inquire whether, under correct accounting practice, an anticipated loss of a part of the capitalized cost of developing and drilling an oil well because of decreased utility of the well would be described or treated differently than wear and tear of the machinery used in production, or whether an allowance for the former serves a purpose logically distinguishable from one for the latter. For the issue before us, whether the statute requires the former to be treated as depletion, is resolved by the history of the legislation and the administrative practice under it.

The Revenue Act of 1916 permitted the deduction of a reasonable allowance for the "exhaustion, wear and tear of property" used in a business or trade and in the case of oil and gas wells "a reasonable allowance for actual reduction in flow and production." [Section 12(b) Second.] The regulations authorized the deduction of an annual allowance for "depreciation" and, in the case of oil and gas wells, for "depletion" (Treasury Regulations 33, articles 159, 160, 162, 170), but ruled that no annual deduction for "obsolescence" was authorized by the statute in any case; such a loss it was provided, might only be deducted in the year when it became complete by abandonment of the property as no longer useful. (See articles 162, 178, 179 of Treasury Regulations 33; *Gambrinus Brewery Co.* v. *Anderson*, 282 U. S., 638, 643 [Ct. D. 314, C. B. X-1, 400].) In defining these terms, therefore, the Department was apparently faced with the practical consequence that no annual deduction could be made in anticipation of those losses which it regarded as attributable to obsolescence, while such a deduction might be made for those which it attributed to depreciation or depletion. Depreciation was defined generally to include the wear and tear and exhaustion of property by use, and obsolescence, the loss in value of property due to the fact that because of changing conditions it has ceased to be useful.

Plainly, under these definitions the loss in value of the drill hole for an oil well, because of the approaching exhaustion of the oil in the ground, was not to be treated as depreciation. Article 170 of Regulations 33 necessarily ruled that it was not to be treated as obsolescence by declaring that the purpose of the statutory provision relative to oil wells was to return, through the aggregate of annual depletion deductions, the taxpayer's capital investment in the oil, including "the cost of development (other than the cost of physical property incident to such development)." Article 170 thus contemplated that an annual deduction should be made for costs of development by including them in the cost of the oil in the ground for which a depletion allowance was authorized by section 12(b) Second "for actual reduction in flow and production."

While the Revenue Acts which followed that of 1916 provided that taxpayers generally might deduct "a reasonable allowance for obsolescence" in addition to that "for the exhaustion, wear and tear of property used in the trade or

business,"[4] in each of them the section expressly applicable to oil and gas wells,[5] omitted the word obsolescence and provided, in terms, only for the deduction of an allowance for depletion and for depreciation of improvements. Whatever doubts this omission may have suggested as to the propriety of an allowance for obsolescence in the case of oil and gas wells, raising the same problem as that under the Act of 1916, the question whether an allowance should be made for development and drilling costs was set at rest, where cost was the basis of depletion and depreciation of improvements, by the express language of the Acts of 1918 and 1921, that the cost basis should include "costs of development not otherwise deducted." But the questions remained whether the allowance was to be treated as for depreciation or depletion, and more important, whether any allowance could be made for development costs when the basis of depletion was discovery value rather than cost.[6] In answering these questions the Department adhered to and made explicit the position taken by it under the 1916 Act that development costs other than the cost of physical property incident to the development must be returned through the depletion allowance, but the regulations also provided expressly that the cost of "physical property such as machinery, tools, equipment, pipes, etc.," should be returned by an annual allowance for depreciation. (Articles 223, 225 of Treasury Regulations 45 under the Revenue Act of 1918.) The distinction thus taken was continued in the regulations under the Acts of 1921, 1924, and 1926,[7] although beginning with that of 1924 the express declaration of the statute, already noted, that the cost basis for depletion and depreciation of improvements should include costs of development was eliminated, leaving the broad provision that a reasonable allowance should in all cases be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary.

Doubts arising because of the silence of the Revenue Acts of 1918 and later years as to whether costs of development and drilling were to be included in depletion when based on discovery value, were resolved by the regulations already noted and by the addition of another. Article 220(a)3 of Treasury Regulations 45 provided that "the 'property' which may be valued after discovery is the 'well.' For the purposes of these sections the 'well' is the drill hole, the surface necessary for the drilling and operation of the well, the oil or gas content of the particular sand, zone or reservoir * * * in which the discovery was made by the drilling, and from which the production is drawn." By including the drill hole in the property to be valued for depletion under section 234(a)9, this article necessarily carried forward the distinction taken under the 1916 Act between drilling costs, subject to depletion allowance, and costs of machinery, tools and equipment, subject to allowance for depreciation. Section 234(a)9 of the Revenue Act of 1921 and section 204(c) of the Act of 1924 continued the provisions of the 1918 Act, and this regulation remained unchanged.[8] It was eliminated under the 1926 Act, being no longer necessary, as the statute omitted the "discovery value" provision and substituted the arbitrary percentage allowance for depletion.[9]

Thus the Acts of 1918, 1921, and 1924 were consistently construed by the regulations to permit a depletion, but not a depreciation allowance for the costs of development work and drilling, which were treated for this purpose either as a part of the cost or an addition to the discovery value of the oil in the ground. The administrative construction must be deemed to have received legislative approval by the reenactment of the statutory provision, without material change. (No. 80, *Murphy Oil Co.* v. *Burnet*, decided December 5, 1932 [Ct. D. 619, page 231, this Bulletin]; *Brewster* v. *Gage*, 280 U. S., 327, 337 [Ct. D. 148, C. B. IX–1, 274].)

Respondent argues that whatever effect may be attributed to earlier reenactments, that of 1926, which is applicable here, is without force because section 204 of that Act abandoned discovery value as the basis of depletion and permitted the taxpayer to abandon cost and substitute a fixed allowance of 27½ per cent of gross income from the well. We think the contention un-

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[4] Section 234(a)7 of the Revenue Acts of 1918, 1921, 1924, and 1926.
[5] See note 1, supra.
[6] The discoverer of an oil well upon an unproven tract was permitted, for the first time by section 234(a)9 of the Revenue Act of 1918, to calculate the allowance for depletion upon the basis of the value of the "property" at the time of the discovery or within 30 days thereafter. See note 2, supra. The statute was silent as to the inclusion of development costs.
[7] Articles 223, 225 of Treasury Regulations 62, 69; articles 225, 227 of Treasury Regulations 65.
[8] Articles 220(a)3 of Treasury Regulations 62 and 222(3) of Treasury Regulations 65.
[9] See Senate Report No. 52, Sixty-ninth Congress, first session, pages 17, 18.

founded and that, on the contrary, what was included in the reasonable allowance for depletion by the established construction of the earlier Acts gave significant content to the word as used in the Act of 1926. There is no ground for supposing that Congress, by providing a new method for computing the allowance for depletion intended to break with the past and narrow the function of that allowance. The reasonable inference is that it did not and that depletion includes under the 1926 Act precisely what it included under the earlier Acts. The regulations under the 1926 Act so ruled, as has been shown, by continuing the provisions of earlier regulations under which costs of development and drilling were returnable by the depletion allowance and not by an additional allowance for depreciation.[10]

It is true that the Board of Tax Appeals in construing the 1924 and 1926 Acts has held that capitalized drilling costs are subject to a depreciation rather than a depletion allowance. (*Jergins Trust Co.* v. *Commissioner*, 22 B. T. A., 551; *Ziegler* v. *Commissioner*, 23 B. T. A., 1091; *P. M. K. Petroleum Co.* v. *Commissioner*, 24 B. T. A., 360.) But these cases were all decided after the enactment of the 1926 Act and did not consider the administrative and legislative history, which we think decisive.

Reversed.

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells. XII-26-6252 Ct. D. 690

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

DEDUCTIONS—COST OF DRILLING OIL WELLS—CAPITAL INVESTMENT—DEPLETION.

Where the owner of oil-producing properties entered into "turnkey" contracts for the drilling of wells, under which the contractor was obligated to furnish all labor, equipment, and supplies necessary to complete the wells to the top of the ground, and, for income tax purposes, treated the physical properties as a capital investment and the difference between their value and the total amount paid for the wells as deductible expenses, and used the same method in making returns for subsequent years, regardless of whether the wells were completed by contractors on a footage basis or under turnkey contracts, or by the owner using its own machinery and labor, the Commissioner's action in treating the total sums paid for the wells as capital investment and allowing deduction for depletion on the entire amount for each fiscal year involved is not prohibited by statute or regulation, opposes no principle, practice, or authority, and is as reasonable and just as the method contended for by taxpayer, who has the burden of overcoming the prima facie correctness of the Commissioner's action.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

J. K. Hughes Oil Co., appellant, v. *James W. Bass, Collector of Internal Revenue, appellee.*

Appeal from the District Court of the United States for the Western District of Texas.

[December 13, 1932.]

OPINION.

HUTCHESON, Circuit Judge: Appellant is the owner of oil-producing properties. In its fiscal year ending June 30, 1922, it made "turnkey" contracts at a fixed price of $22,500 each, with a drilling contractor, for the drilling of 13 oil wells. These contracts obligated the contractor "to furnish all derricks, all necessary drilling equipment, machinery, casing, cement and labor, in fact, everything necessary to complete said well in a first-class workmanlike manner,

[10] Compare also Treasury Decision 4333, Internal Revenue Bulletin XI, April 11, 1932, No. 15, pages 2, 3 [C. B. XI-1, 31].

including fuel and water, the owner not being obligated to furnish anything whatever in the way of labor, fuel, drilling supplies, or anything necessary for the completion of the well"; to drill the wells to a depth of 3,200 feet, and to complete them to the top of the ground. The total price paid for all the wells was $281,950.19. The cost to the contractor of the derrick, pipe, casing and liners erected and set in the wells is stipulated to have been $69,241.70. The taxpayer determined that these physical properties were of the reasonable and actual value of $58,000 and entered that sum upon its books as an investment. $223,450.19, the difference between that amount and the total spent for the wells, the taxpayer deducted as an expense.

In all other operations in the year and in subsequent years the taxpayer in the same way capitalized as an investment and deducted as expense the same items making up the cost of wells, whether they were drilled and completed by a drilling contractor or on a footage basis, or for a flat sum, that is, on a turnkey contract, as were the 13 producing wells in question, or by the taxpayer using its own machinery and employees.

The Commissioner in computing the taxpayers' liability refused to allow the deduction. He treated the entire sums paid for the wells as capital expenditures and made provision for their return to the taxpayer by allowing depletion deductions on the entire amount for the fiscal year 1922 of $39,575.05; for the fiscal year 1923 of $61,472.43; for the fiscal year 1924 of $44,996.20.

In the court below the taxpayer contended that the regulations, rules and practices of the Commissioner require the allowance of the deduction claimed by him. The collector insisted there were no such rules, regulations and practices and that the Commissioner was right in treating the whole cost as capital investment. The trial judge agreeing with him, found for the defendant. Appealing from that order, appellant thus states the question for review:

"The question presented by this appeal, from appellant's standpoint, is whether or not the Commissioner of Internal Revenue can refuse to allow the plaintiff to deduct as an expense in computing its taxable income, intangible drilling and development cost incurred by it in developing an oil or gas lease owned by it, and force the plaintiff to recover these costs through annual depletion and depreciation deduction, solely because these costs were incurred under 'turnkey' drilling contracts, when the right to take the deduction would, under settled rules and decisions of the Treasury Department, have been allowed had the walls been drilled either with the plaintiff's own labor and machinery or under the ordinary footage contracts."

Appellee, urging that the case was correctly decided below, insists that if he is wrong in this and appellant is to prevail, the amount of the expenses claimed must be reduced by the amounts allowed to and accepted by appellant as depletion allowances for 1921, 1922, and 1923.

Whether these amounts could be offset in a case of this kind, and also what effect appellant's acceptance of them would have to estop it from now questioning the Commissioner's disposition of the matter in controversy (*Ramsey* v. *Commr.*, 26 B. T. A., 281) we do not decide, for we think it quite plain that the case was rightly decided below.

Regulations aside, it is quite clear that the Commissioner was well within the statute, in treating the cost price of the wells as captial investment.[1] We think it equally clear that his action does not contravene any of the rulings, practices, or regulations of the Department relied on by appellant.[2]

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[1] SEC. 234. (a) (Revenue Act 1921.) That in computing the net income of a corporation * * * there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: * * *; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. * * *

SEC. 215. (a) That, in computing net income no deduction shall in any case be allowed in respect of * * * any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate.

[2] Regulations 62, article 223: *Charges to capital and to expense in the case of oil and gas wells.*—Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of property, may at the option of the taxpayer be deducted as a development expense or charged to the capital account returnable through depletion.

Treasury Decision 4333, April 11, 1932 [C. B. XI–1, 31], provides:

* * * Regulations 62 * * * are hereby restated, so as to incorporate therein certain details of administrative application and practice of long standing. No change

It is not claimed by appellant that these regulations in precise terms provide for the deduction which it claims. It is contended that they do so in principle. It is alleged that there is no reason in or basis for the distinction, for the purposes of capitalization, between moneys which an owner pays out when he drills a well himself, on his own property, with his own labor and equipment, or when a contractor drills it for him on a footage basis and the same amount of moneys representing the same amount of drilling and development costs paid out to a contractor as a part of the whole cost price of a turnkey job.

If appellant claims no more than that the distinction is supported by no evident principle; that subjected to analysis moneys laid out in a completed improvement such as an oil well are no less and no more capital expenditures when it is furnished by a contractor on a footage basis than when it is done under a turnkey contract, I think we could agree with him. If, however, he means to claim that because this is so, he is entitled to have his deduction allowed, we can not. The burden upon him to overcome the *prima facies* of the action of the Commissioner is not discharged by a showing that the treatment he asks for is no more unreasonable or unjust than one which, under other circumstances, has been actually accorded him by the Commissioner.

But this is not the whole of it. We are not concerned here with the question of whether the regulation invoked here by analogy is reasonable or unreasonable. (*Sterling Gas & Oil Co.* v. *Lucas*, 51 Fed (2d), 413; *Old Farmers Oil Co.* v. *Commr.*, 12 B. T. A., 203; *Ramsey* v. *Commr.*, 26 B. T. A., 277.) We have here only the question whether appellant has sustained the burden of showing that the action of the Commissioner is unreasonable and invalid.

We find no statute, no regulation prohibiting it; no statute, no regulation enjoining upon the Commissioner a contrary course. We find no principle, no practice, no authority opposed to it. On the contrary, we find that the ruling he made "that a producing oil well is a physical property having a useful life beyond the taxable year, and that its acquisition for a price increases the invested capital of the purchaser to the extent of that price" is supported not only by the presumption of validity which ordinarily attends the ruling of the Commissioner, but that it is reasonable on its face, and is in accord with practice, principle and authority. (*Old Farmers Oil Co.* v. *Commr.*, 12 B. T. A., 203; *Sunbright Oil Co.* v. *Commr.*, 23 B. T. A., 29; *Christy* v. *Commr.*, 23 B. T. A., 300; *Commr.* v. *Liberty Inv. Co.*, 58 Fed. (2d), 57; *Dakota-Montana Oil Co.* v. *United States*, 59 Fed. (2d), 853; *Great Northern Ry. Co.* v. *Commr.*, 40 Fed. (2d), 872; *Brockton Cahawba Coal Co.* v. *United States*, 24 Fed. (2d), 180.)

The judgment is affirmed.

SECTION 214(a)10.—DEDUCTIONS ALLOWED INDIVIDUALS: CONTRIBUTIONS OR GIFTS.

ARTICLE 251: Contributions or gifts.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Contributions to the Military Training Camps Association. (See G. C. M. 11705, page 57.)

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in administrative policy or in the practice under the regulations is made, or intended to be made, by this restatement; nor is any new option or election as to the treatment of the expenditures involved granted or intended to be granted. * * *

Charges to capital and to expense in the case of oil and gas wells.—(a) Items chargeable to capital or to expense at taxpayer's option. (1) Option with respect to intangible drilling and development costs in general: All expenditures for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas, may, at the option of the taxpayer, be deducted from gross income as an expense or charged to capital account. Such expenditures have for convenience been termed intangible drilling and development costs. * * * Drilling and development costs shall not be excepted from the option merely because they are incurred under a contract providing for the drilling of a well to an agreed depth, or depths, at an agreed price per foot or other unit of measurement.

SECTION 215.—ITEMS NOT DEDUCTIBLE.

ARTICLE 291: Personal and family expenses. XII-14-6111
G. C. M. 11654

REVENUE ACT OF 1921.

The following items in connection with research work of a teacher in a college, for which he receives no remuneration on account thereof, are not personal expenses: (1) Expenditures in connection with the publication of the results of investigation, such as plates and figures for illustrative purposes, (2) depreciation on books and instruments purchased for use in research work, and (3) expenses incurred when traveling for the purpose of attending meetings of scientific societies.

Expenditures (2) and (3) are deductible from gross income. Expenditure (1) may or may not be deductible, depending upon whether such expenses are ordinary and necessary, or constitute capital expenditures.

Recommended that I. T. 1520 (C. B. I-2, 145) be revoked in so far as it holds that the expenditures therein discussed are of a personal nature.

An opinion is requested whether I. T. 1520 (C. B. I-2, 145) should be expressly modified, in view of I. T. 2602 (C. B. X-2, 130), which revoked I. T. 1369 (C. B. I-1, 123).

In I. T. 1520 it was held that expenditures in connection with the publication of the results of investigation, such as plates and figures for illustrative purposes, depreciation on books and instruments purchased for use in research work, and expenses incurred when traveling for the purpose of attending meetings of scientific societies, are personal expenses and not, therefore, deductible from gross income.

In I. T. 2602 it was held that the necessary expenses incurred by a member of a professional association in sending a representative to the annual convention of the association, for the sole purpose of furthering the business interests of such member, constitute an allowable deduction. I. T. 1369, which reached a contrary conclusion in the case of amounts expended by a physician in attending a medical convention, was expressly revoked by I. T. 2602.

The Board of Tax Appeals has held that amounts expended by a physician in attending medical conventions are properly deductible as business expenses. (*Cecil M. Jack* v. *Commissioner*, 13 B. T. A., 726, C. B. X-2, 35; *J. Bentley Squier* v. *Commissioner*, 13 B. T. A., 1223, C. B. X-2, 66; *Robert C. Coffey* v. *Commissioner*, 21 B. T. A., 1242, C. B. X-2, 14.) Likewise, amounts expended by a clergyman in attending a general convention of the church were held to be deductible. (*Appeal of Marion D. Shutter*, 2 B. T. A., 23, C. B. X-2, 65.) Also, amounts expended by a professor of chemistry in connection with the carrying on of his profession and in attending scientific meetings and conventions, were held to constitute ordinary and necessary business expenses. (*Alexander Silverman* v. *Commissioner*, 6 B. T. A., 1328, C. B. X-2, 65.)

Bulletin "F" (revised January, 1931), relating to depreciation and obsolescence (page 24), provides as follows:

Professional libraries.—A professional man is entitled to deduct a reasonable allowance covering depreciation actually sustained on that part of his library which is necessary and used wholly in the pursuit of his profession, taking as a basis for such allowance the cost or other allowable basis. * * *

In view of the decisions and rulings above cited, it is clear that I. T. 1520 is erroneous in holding that (1) expenditures in connection with the publication of the results of investigation, such as plates and figures for illustrative purposes, (2) depreciation on books and instruments purchased for use in research work, and (3) expenses incurred when traveling for the purpose of attending meetings of scientific societies, are personal expenses. It is also apparent that expenditures (2) and (3) are deductible from gross income. Expenditure (1) may or may not be deductible, depending upon whether such expenses are ordinary and necessary or constitute capital expenditures.

It is the opinion of this office that I. T. 1520 should be expressly revoked in so far as it holds that the expenditures therein discussed are of a personal nature.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 291: Personal and family expenses. XII-14-6112
I. T. 2688

REVENUE ACT OF 1921.

I. T. 1520 (C. B. I-2, 145), holding that (1) expenditures in connection with the publication of the results of investigation, such as plates and figures for illustrative purposes, (2) depreciation on books and instruments purchased for use in research work, and (3) expenses incurred when traveling for the purpose of attending meetings of scientific societies in connection with professional work of a teacher in a college are personal expenses, is revoked, in so far as it holds that the expenditures therein discussed are of a personal nature, in view of General Counsel's Memorandum 11654 (page 250).

ARTICLE 292: Capital expenditures. XII-21-6193
Ct. D. 669

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. DEDUCTIONS—BUSINESS EXPENSES—BROKERS' COMMISSIONS.

Where lessors of real property in 1924 paid to brokers, for service in negotiating a 99-year lease, a commission consisting of cash and the right to remove a building from the premises, and for that year filed returns upon cash receipts and disbursements basis, the commission so paid may not be deducted as an ordinary and necessary expense of carrying on business for that year, as provided in section 214(a)1 of the Revenue Act of 1924, the amount paid being a capital expenditure and therefore deductible ratably over the term of the lease. *Young* v. *Commissioner* (59 Fed. (2d), 691) followed.

The ruling in I. T. 1171, promulgated in 1922, that brokers' commissions for negotiating a long-term lease were properly deductible for the year in which paid or accrued, was revoked in 1926 by I. T. 2263, and is therefore without application.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (22 B. T. A., 738) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

John Tonningsen and Pauline Tonningsen, petitioners, v. *Commissioner Internal Revenue, respondent.*

Upon petition to review an order of the United States Board of Tax Appeals.

Before WILBUR and SAWTELLE, Circuit Judges.

[September 6, 1932.]

OPINION.

SAWTELLE, Circuit Judge: December 31, 1923, petitioners, husband and wife, executed a 99-year lease of property owned by them in the city and county of San Francisco and gave to their lessees an option to purchase the demised property within a certain time. January 3, 1924, petitioners paid to the real estate brokers who negotiated the lease the sum of $21,333 as a commission, consisting of $10,000 cash and the right to remove from the demised premises a building of the then market value of $11,333. In their joint income tax return for the calendar year 1924, filed on the cash receipts and disbursements basis, petitioners deducted from their gross income $21,333, the amount paid as a commission to the brokers who negotiated the aforesaid lease. May 12, 1928, respondent notified petitioners that their tax return for the calendar year 1924 disclosed a deficiency of $5,152.41. This deficiency was arrived at by allowing a deduction of only $215.48, representing one ninety-ninth of the $21,333 commission deducted from gross income by the taxpayers. The determination of the respondent was affirmed by the Board of Tax Appeals, and this appeal is prosecuted from the decision of the Board, holding that the commission paid by petitioners was a capital expenditure, deductible in aliquot parts during the term of the lease, and not deductible in a lump sum as an ordinary and necessary expense of carrying on business for the year, as provided in section 214(a)1 of the Revenue Act of 1924 (43 Stat., 269).

The question presented by the facts of this case is precisely the same as one of the questions considered and decided by this court in *Young* v. *Commissioner*, No. 6427, filed June 24, 1932, namely: Is an amount paid as a commission for effecting a 99-year lease deductible from gross income in the tax return for that year, or is such amount a capital expenditure to be deducted ratably over the term of the lease? The facts in the Young case, pertaining to dates, procedure followed, etc., are practically the same as in this case. In the Young case we held that such an expense was properly amortized over the term of the lease; and that decision is controlling here.

However, a further argument, not considered in the Young case, is presented here, namely, that the claimed deduction was authorized by ruling I. T. 1171 (C. B. I–1, 117) of the Bureau of Internal Revenue, promulgated under the Revenue Act of 1921, which provided:

"The commission paid by the lessor to a broker for negotiating a long-term lease should not be prorated over the term of the lease but constitutes a proper deduction in computing net income for the year in which paid or accrued."

This ruling was revoked by I. T. 2263 (C. B. V–1, 66), promulgated in 1926. It was, therefore, in effect at the time the lease in question was executed and at the time the petitioners filed their income tax return and paid the original tax for the year 1924. I. T. 2263, however, was made applicable to the Revenue Act of 1924, and accordingly, as above stated, petitioners were notified by respondent of a deficiency in their tax return for the year in question.

The argument advanced as to the applicability of I. T. 1171 to the tax return in question is answered adversely to petitioners by the settled rule that the Commissioner is not precluded by a previous determination from a reexamination and redetermination of tax liability. See *McIlhenny* v. *Commissioner* (C. C. A. 3) (39 F. (2d), 356) and *Porter* v. *Commissioner* (39 F. (2d), 360), same court, both approved in *Burnet, Com'r,* v. *Porter* (283 U. S. 230); *Bonwit Teller & Co.* v. *Commissioner* (C.C.A. 2) (53 F. (2d), 381), certiorari denied, 284 U. S., 690.

Decision affirmed.

SECTION 219.—ESTATES AND TRUSTS.

ARTICLE 341: Estates and trusts. XII–15–6126
Ct. D. 650

INCOME TAX—REVENUE ACT OF 1921—DECISION OF SUPREME COURT.

1. DEDUCTION—LOSS—SALE BY EXECUTORS—INTEREST OF BENEFICIARIES—LOCAL LAW.

Where testator gave his entire residuary estate to his executors, in trust, to sell and convert into personalty, the time of sale and distribution of the proceeds to be discretionary with them and the net income from the estate to be paid periodically to the beneficiaries until distribution, and where in 1922 they sold at a loss certain real property and distributed a portion of the proceeds, the loss was sustained by the trust estate and may not be claimed as a deduction from the gross income by the beneficiaries. By the terms of the will nothing belonged to the beneficiaries until the sale, since, under the New York law, the executors were not mere donees of a power but were clothed with fee title to the land, the interest of the beneficiaries being only in the proceeds of the sale.

2. TRUSTS AND ESTATES—SEPARATE ENTITIES—FEDERAL LAW.

The Federal law deals with a trust or an estate as a separate entity, which makes its own returns under the hands of the fiduciary and claims and receives its own appropriate deductions.

3. DECISION AFFIRMED.

The decision of the Circuit Court of Appeals, Second Circuit (60 Fed. (2d), 52), which reversed 51 Fed. (2d), 268, affirmed.

SUPREME COURT OF THE UNITED STATES.

460. *Charles W. Anderson, Collector of Internal Revenue for the Third District of New York, petitioner,* v. *Marian Stedman Wilson et al., as Executors of the Estate of Richard T. Wilson, jr., Deceased, respondents.*

461. *Marian Stedman Wilson et al., as Executors of the Estate of Richard T. Wilson, jr., Deceased, petitioners,* v. *Charles W. Anderson, Collector of Internal Revenue for the Third District of New York, respondent.*

On writs of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[March 13, 1933.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the court.

The question to be decided is whether the difference between the value of real estate at the death of a testator and the proceeds realized thereafter upon a sale by the trustees may be deducted as a loss by the taxpayer, the beneficial owner of the proceeds, upon his return to the collector for the income of the year.

Richard T. Wilson, sr., a resident of New York, died in November, 1910, the owner of a large estate. By the fourth article of his will he directed his executors to sell and convert into personalty his entire residuary estate, and to divide the proceeds thereof into five equal parts. Out of the fifth part set aside for the use of his son, Richard T. Wilson, jr., the sum of $500,000 was to be held for the use of the son during life with remainder to lineal descendants, and in default of such descendants to others. "The balance of such part I give to my said son, Richard T. Wilson, jr., to be his absolutely."

This gift, if it had stood alone, might have seemed to allow to the executors no discretion as to the time of sale, and might have bred uncertainty as to their powers and duties before the time for distribution. The next or fifth article clarifies the meaning. The testator there recalls the fact that after setting up

the trust for $500,000 and other special funds, a large part of his residuary estate will consist of real estate in New York and other States, and shares of manufacturing and business corporations, "which should not be sold excepting under favorable conditions." Accordingly he lays upon his executors the following command: "to hold and manage such remaining portion of my residuary estate until in their judgment it can from time to time be advantageously sold and disposed of, not exceeding, however, a period longer than the lives of my sons Marshall Orme Wilson and Richard T. Wilson, jr., and the survivor of them, and I hereby authorize and empower my said executors within said period to sell, convey, assign and transfer the same, or any part thereof, at such time or times as they may deem for the best interests of my estate, and upon such terms and conditions as they may deem proper, including the terms and mode of payment thereof." Nor is this all. The executors are authorized in their discretion to organize a corporation, to convey to it the whole or any part of the residuary estate in return for the capital stock, and to hold the stock "until it can in their judgment be advantageously disposed of." Finally there is a provision that upon the making of a sale, the executors in their discretion may distribute the proceeds, "or retain the same, or any part thereof for further conversion before distribution, not, however, beyond the period of the lives of my said sons and the survivor of them." Until the time of distribution the net income is to be paid semiannually to those entitled to receive it.

Included in the real estate at the death of the testator was a building in the city of New York known as the "Commercial Building," of a value at that time of $290,000. This building the executors held till 1922, when they sold it for $165,000. After allowance for depreciation, the loss to the estate by reason of this sale was $113,300. The executors were at liberty to distribute the entire proceeds ($165,000) among the residuary legatees if their judgment moved them to that course. They did not do so. They distributed only $50,000, and held the balance in the trust. One-fifth of the part distributed belonged and was paid to Richard T. Wilson, jr. One-fifth of the part retained was held for his use as it had been before the sale.

The present controversy grows out of a tax return of income for 1922. From the gross income of that year the taxpayer, Richard T. Wilson, jr., deducted $25,001.17, one-fifth, according to his computation, of the loss resulting from the sale. It was afterwards agreed that one-fifth of the loss was not more than $22,660, and that the amount of the claimed deduction should be corrected accordingly. The Commissioner disallowed the loss altogether, and assessed an additional tax. The taxpayer upon payment of the tax filed a claim for refund which the Commissioner rejected. This suit was then brought to recover the amount paid upon the additional assessment. During the pendency of the suit the taxpayer died, and his executors were substituted. The district court gave judgment in their favor, holding that one-fifth of the loss upon the sale of the Commercial Building was a loss suffered by the taxpayer, the beneficiary of the trust, and was a proper deduction from his income for the year of sale. Upon an appeal by the Government, the Court of Appeals for the Second Circuit sustained the representatives of the taxpayer in their claim for a deduction, but reduced the amount. In the view of that court the loss allowable to the beneficiary was not one-fifth of the entire loss that had been suffered by the trust estate, but only that part of one-fifth of the total loss represented by the ratio between the part of the proceeds presently distributed (not more than $50,000), and $165,000, the entire proceeds of the sale. The record left room for some uncertainty whether the payment of $50,000 had been derived altogether from a sale of the Commercial Building, or in part from other sources. To the end that this uncertainty might be removed, the judgment of the district court was reversed, and the cause remanded for retrial in accordance with the opinion. (60 F. (2d), 52.) Cross-petitions for certiorari, allowed by this court, have brought the controversy here. In No. 460, the Government complains that there was error in the refusal to disallow the deduction altogether. In No. 461, the representatives of the taxpayer complain that there was error to their prejudice in restricting the amount.

To determine whether the loss was one suffered by the trust estate, or one suffered by the taxpayer to whom the proceeds of the sale were payable, there is need at the outset to determine the meaning of the will. The Government contends, and so the courts below have held, that title to the realty was given to the executors upon a valid trust to sell and to apply the rents and

profits in the interval. The representatives of the taxpayer contend that the executors had no title, but only a power in trust, and that subject to the execution of that power, the taxpayer was owner. If that be so, the loss was his and no one else's. A mere donee of a power is not the owner of an estate, nor to be classed as a juristic entity to which a loss can be attributed. We think, however, that what passed to the executors was ownership or title. True the will does not say in so many words that the residuary estate is given or devised to them, but the absence of such words is of no controlling significance when a gift or devise is the appropriate and normal medium for the attainment of purposes explicitly declared. (*Robert* v. *Corning*, 89 N. Y., 225, 237; *Vernon* v. *Vernon*, 53 N. Y., 351, 359; *Tobias* v. *Ketcham*, 32 N. Y., 319; *Brewster* v. *Striker*, 2 N. Y., 19.) Nothing less than ownership will supply that medium here. The executors are charged with active and continuing duties not susceptible of fulfillment without possession and dominion. They are to collect the income and pay it over in semiannual installments after deducting the expenses. They are to "hold and manage" the estate with full discretionary powers. They are even at liberty to convey it to a corporation if they believe that efficient administration will thereby be promoted. Under reiterated judgments of the highest court of New York they are more than the donees of a power. They are the repositories of title. (*Morse* v. *Morse*, 85 N. Y., 53; *Robert* v. *Corning*, supra; *Ward* v. *Ward*, 105 N. Y., 68; *Mee* v. *Gordon*, 187 N. Y., 400; *Putnam* v. *Lincoln Safe Deposit Co.*, 191 N. Y., 166, 182; *Striker* v. *Daly*, 223 N. Y., 468, 472.)

Another question of construction has yet to be considered. We have seen that the effect of the will was to clothe the executors with title to the land. We have yet to determine whether the title that came to them was the fee or something less. If it was the fee, the whole estate was in them, and no one else had any ownership or interest in the land as distinguished from ownership or interest in the proceeds of a sale. (*Delafield* v. *Barlow*, 107 N. Y., 535; *Salisbury* v. *Slade*, 160 N. Y., 278, 290; *Weintraub* v. *Siegel*, 133 App. Div. (N. Y.), 677, 681.) If it was less than the fee, there may have vested in others upon the death of the testator a future estate in remainder, which would take effect in possession on the termination of the trust. (*Losey* v. *Stanley*, 147 N. Y., 560, 568; *Stevenson* v. *Lesley*, 70 N. Y., 512; *Matter of Easterly*, 202 N. Y., 466, 474.) Under the law of New York what passed to these executors was the title to the fee. By the will of this testator all his property, real and personal (with exceptions not now material) was to be converted into money. The five sons and daughters among whom the money was to be divided had no interest in the land, aside from a right in equity to compel the performance of the trust. (Real Property Law of New York, section 100; *Schenck* v. *Barnes*, 156 N. Y., 316, 321; *Melenky* v. *Melen*, 233 N. Y., 19, 23.) What was given to them was the money forthcoming from a sale. (*Delafield* v. *Barlow*, *Salisbury* v. *Slade*, *Weintraub* v. *Siegel*, supra.) Their interest in the corpus was that and nothing more.

Our answer to the inquiry as to the meaning of the will comes close to being an answer to the inquiry as to the incidence of the loss. The taxpayer has received the only legacy bequeathed to him, and received it as it was given without the abatement of a dollar. What was bequeathed was an interest in a fund to be made up when the trustees were of opinion that it would be advisable to sell. This alone was given, and this has been received. There has been no loss by the taxpayer of anything that belonged to him before the hour of the sale, for nothing was ever his until the sale had been made and the fund thereby created. A shrinkage of values between the creation of the power of sale and its discretionary exercise is a loss to the trust, which may be allowable as a deduction upon a return by the trustees. It is not a loss to a legatee who has received his legacy in full. One might as well say that a legatee of shares of stock to be bought by executors out of the moneys of the estate would have an allowance of a loss upon a showing that the value would have been greater if the executors in the exercise of their discretion had bought sooner than they did. The legatee must take the legacy as the testator has bequeathed it.

We hold that the trust, and not the taxpayer, has suffered the loss resulting from the sale of the Commercial Building, and it follows that where loss has not been suffered, there is none to be allowed. Whether the result would be the same if the beneficiaries had been the owner of future estates in

remainder, we are not required to determine. (Cf. *Francis* v. *Commissioner*, 15 B. T. A., 1332, 1340.) Our ruling will be kept within the limits of the case before us. In so ruling we do not forget that the trust is an abstraction, and that the economic pinch is felt by men of flesh and blood. Even so, the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return under the hand of the fiduciary and claiming and receiving its own appropriate deductions. The Revenue Act of 1921 under which the tax in question was imposed defines the word "taxpayer" as including a trust or an estate. (Revenue Act of 1921, ch. 136; 42 Stat., 227, section 2(9).) The definition is pursued to its logical conclusion in a long series of decisions. (*Baltzell* v. *Mitchell*, 3 F. (2d), 428 [T. D. 3668, C. B. IV–1, 191]; *Whitcomb* v. *Blair*, 25 F. (2d), 528; *Abell* v. *Tait*, 30 F. (2d), 54 [Ct. D. 48, C. B. VIII–1, 261]; *Busch* v. *Commissioner*, 50 F. (2d), 800, 801; *Roxburghe* v. *Burnet*, 58 F. (2d), 693; cf. *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S., 509 [T. D. 3173, C. B. 4, 34].) These and other cases bear witness to the rule that an equitable life tenant may not receive a deduction for the loss of capital assets of the trust, though the result of such a loss is a reduction of his income. The argument will not hold that what was lost to this taxpayer was not the capital of the trust, but rather his own capital, withdrawn from his possession, but held for his account by the executors as custodians or bailiffs. His capital was in the proceeds, to the extent that they were distributed, and never in the land. We do not pause to consider whether a statute differently conceived and framed would yield results more consonant with fairness and reason. We take the statute as we find it.

The circuit court of appeals did not err in reversing the judgment of the district court. It did err in its instructions as to the relief upon a second trial.

The judgment of reversal is accordingly affirmed, and the cause remanded to the district court with instructions that a judgment should be entered dismissing the complaint.

ARTICLE 347: Income of trusts taxable to grantor.

XII–19–6168
Ct. D. 664

INCOME TAX—REVENUE ACT OF 1924—DECISION OF SUPREME COURT.

1. INCOME—REVOCABLE TRUSTS—CONSTITUTIONALITY OF SECTION 219(g).

Where trusts were created in 1922, the grantor naming himself and two others as trustees, one only of the latter being a beneficiary, and reserving the power in conjunction with either one of his cotrustees to modify or revoke the trusts at any time, and on October 22, 1924, the trusts were amended so as to be irrevocable, the income therefrom for the period January 1, 1924, to October 22, 1924, was taxable to the grantor under the provisions of section 219(g) of the Revenue Act of 1924, since the grantor retained a measure of control over the trust property until the modification of the instruments. The tax being laid upon the income accruing after January 1, 1924, the Act has not such retroactive effect as to render its requirements arbitrary, nor is it otherwise violative of the fifth amendment.

2. TRUSTEE OWES NO DUTY TO RESIST REVOCATION.

The fiduciary is not a trustee of the power of revocation and owes no duty to the beneficiary to resist an alteration or revocation of the trust.

3. DECISION REVERSED.

The decision of the Circuit Court of Appeals, Seventh Circuit (61 Fed. (2d), 324), reversed.

SUPREME COURT OF THE UNITED STATES.

Mabel G. Reinecke, formerly Collector of Internal Revenue, petitioner, v. Kenneth G. Smith et al., Executors of the Will of Douglas Smith.

On writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[April 10, 1933.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the court.

In 1922 Douglas Smith, by five instruments, created as many trusts for the benefit of his wife and four children. The trustees named were the grantor; a son who was a direct beneficiary of one of the trusts and a contingent beneficiary of the others; and a banking company possessed of trust powers. Neither the grantor nor the corporate trustee was a *cestui que trust* under any of the writings. In each agreement it was stipulated:

"Anything herein contained to the contrary notwithstanding, this trust may be modified or revoked at any time by an instrument in writing signed by Douglas Smith (the grantor) and either one of the other two trustees or their successors."

October 22, 1924, each of the agreements was modified by striking out the quoted clause, and the grantor resigned as trustee. He did not report any of the income which accrued in the year 1924 upon the trust property. The Revenue Act of 1924, section 219(g) (43 Stat., 253, 277), directs:

"Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor."

The Commissioner of Internal Revenue held that this section required a return by Smith of the trust income for the period January 1, 1924, to October 22, 1924, and assessed against him additional tax, which was paid under protest. The respondents, who are the personal representatives of Smith, now deceased, brought this suit to recover the sum paid. A demurrer to the declaration was overruled and judgment given for the respondents. The circuit court of appeals affirmed, holding that as to trusts created prior to the adoption of the Act section 219(g) violates the fifth amendment when applied to impose a tax by reason of property and the income therefrom disposed of by the grantor before the passage of that or any other law taxing the income of such a trust to the settlor. The case is here on certiorari.

Petitioner maintains the section in terms applies in the circumstances disclosed; as the tax is laid only upon income accruing after January 1, 1924, the statute is not retroactive; and, as the grantor retained a measure of control, to tax him upon the income is not arbitrary or unreasonable though the trusts were created before any statute had laid a tax upon the settlor measured by the income of such a trust.

The respondents argue in support of the judgment that the trustee is a beneficiary of the trust as the phrase is used in the section and the income in question is therefore exempt from taxation to the settlor; and that if this view be rejected the provision offends the fifth amendment.

The unambiguous phraseology of the Act precludes the suggested construction. A trustee is not subsumed under the designation beneficiary. Both words have a common and accepted meaning; the former signifies the person who holds title to the *res* and administers it for the benefit of others; the latter the *cestui que trust* who enjoys the advantages of such administration. The ordinary meaning of the terms used, which we are bound to adopt (*Old Colony R. Co.* v. *Commissioner*, 284 U. S., 552, 560 [Ct. D. 456, C. B. XI-1, 274]), and the view held by those charged with the enforcement of the Act, ratified

by reenactment of the section,[1] alike forbid the adoption of the construction for which the respondents contend.

Nor do we think the Act has such a retroactive effect as to render its requirements arbitrary within the principle announced as to estate and gift taxes in *Nichols* v. *Coolidge* (274 U. S., 531 [T. D. 4072, C. B. VI–2, 351]); *Untermyer* v. *Anderson* (276 U. S., 440 [T. D. 4157, C. B. VII–1, 326]), and *Blodgett* v. *Holden* (275 U. S., 142 [T. D. 4117, C. B. VII–1, 324]). In those cases the issue was the validity of a tax on a transaction consummated before the enactment of the statute authorizing the exaction. In the present case the subject of the tax is not the creation of the trusts or the transfer of the corpus from the grantor to the trustees, but the income of the trusts which accrued after January 1, 1924, the effective date of the Revenue Act of 1924.[2] Although the Act was passed June 2, 1924, the imposition of the tax on income received or accrued from the beginning of the year has been held unobjectionable. (*Cooper* v. *United States*, 280 U. S., 409, 411 [Ct. D. 163, C. B. IX–1, 272]. Compare *Fawcus Machine Co.* v. *United States*, 282 U. S., 375, 379 [Ct. D. 278, C. B. X–1, 424].)

We come then to the final position of the respondents: That when applied in this case the statute is so arbitrary and unreasonable as to deny the due process guaranteed by the fifth amendment, since the exaction is based not on the settlor's income or on income from his property, but on that which accrued to other persons from property to which they alone had sole and exclusive title. The argument proceeds upon the theory that until alteration or revocation of the trust the trustees held the legal title to the property for the sole benefit of the *cestuis*, and received the income; that both principal and income were beyond the control of the grantor until the alteration of the trust on October 22, 1924.

We have not heretofore had occasion to pass upon the question thus presented. In *Corliss* v. *Bowers* (281 U. S., 376 [Ct. D. 188, C. B. IX–1, 254]), the section of the Revenue Act of 1924 now under consideration was held to justify assessment of income tax to the settlor with respect to the income of a trust revocable by him alone. *Reinecke* v. *Northern Trust Co.* (278 U. S., 339 [T. D. 4261, C. B. VIII–1, 305]), construed section 402(c) of the Revenue Act of 1921, which included within the sweep of a transfer tax any interest of which a decedent had at any time made a transfer, or with respect to which he had created a trust intended to take effect in possession or enjoyment at or after his death. The tax was upheld as applied to the corpus of trusts over which the grantor had sole power of revocation. It was, however, condemned as to those where revocation was dependent upon joint action of the grantor and the beneficiary, for the reason that the interest of the beneficiary was adverse and the grantor unable at will to alter or destroy the trust. In the latter case the transfer was said to be effective when made, not at death. As pointed out in *Burnet* v. *Guggenheim* (No. 283, October term, 1932 [Ct. D. 636, page 374, this Bulletin]), the same considerations as to ownership and control affect the power to impose a tax on the transfer of the corpus and upon the income.

In approaching the decision of the question before us it is to be borne in mind that the trustee is not a trustee of the power of revocation and owes no duty to the beneficiary to resist alteration or revocation of the trust. Of course he owes a duty to the beneficiary to protect the trust *res*, faithfully to administer it, and to distribute the income; but the very fact that he participates in the right of alteration or revocation negatives any fiduciary duty to the beneficiary to refrain from exercising the power. The facts of this case illustrate the point; for it appears the trust in favor of the grantor's wife was substantially modified, to her financial detriment, by the concurrent action of the grantor and the trustees. This case must be viewed, therefore, as if the reserved right of revocation had been vested jointly in the grantor and a stranger to the trust.

Decisions of this court declare that where taxing Acts are challenged we look not to the refinements of title but to the actual command over the property taxed—the actual benefit for which the tax is paid. (*Corliss* v. *Bowers*, supra, at page 378; *Tyler* v. *United States*, 281 U. S., 497, 503 [Ct. D. 190, C. B. IX–1, 383]; *Burnet* v. *Guggenheim*, supra.) A settlor who at every moment retains the power to repossess the corpus and enjoy the income has such a measure

[1] Revenue Acts of 1926 (ch. 27, 44 Stat., 32); 1928 (ch. 852, 45 Stat., 840); 1932 (ch. 209, 47 Stat., 221). Regulations 65, article 347; Regulations 69, article 347; Regulations 74, article 881.

[2] See section 283, 42 Stat., 303.

of control as justifies the imposition of the tax upon him. (*Corliss* v. *Bowers*, supra.) We think Congress may with reason declare that where one has placed his property in trust subject to a right of revocation in himself and another, not a beneficiary, he shall be deemed to be in control of the property. We can not say that this enactment is so arbitrary and capricious as to amount to a deprivation of property without due process of law. As declared by the committee reporting the section in question, a revocable trust amounts, in its practical aspects, to no more than an assignment of income. This court has repeatedly said that such an assignment, where the assignor continued to own the corpus, does not immunize him from taxation upon the income. (*Burnet* v. *Leininger*, 285 U. S., 136; *Lucas* v. *Earl*, 281 U. S., 111.) It can not therefore be successfully urged that as the legal title was held by the trustees the income necessarily must for income taxation be deemed to accrue from property of some one other than Douglas Smith. The case is plainly distinguishable from *Hoeper* v. *Tax Commission* (284 U. S., 206), on which respondents rely, for there the attempt was to tax income arising from property always owned by one other than the taxpayer, who had never had title to or control over either the property or the income from it. The measure of control of corpus and income retained by the grantor was sufficient to justify the attribution of the income of the trust to him. The enactment does not violate the fifth amendment.

A contrary decision would make evasion of the tax a simple matter. There being no legally significant distinction between the trustee and a stranger to the trust as joint holder with the grantor of a power to revoke, if the contention of the respondents were accepted it would be easy to select a friend or relative as coholder of such a power and so place large amounts of principal and income accruing therefrom beyond the reach of taxation upon the grantor while he retained to all intents and purposes control of both. Congress had power, in order to make the system of income taxation complete and consistent and to prevent facile evasion of the law, to make provision by section 219(g) for taxation of trust income to the grantor in the circumstances here disclosed. (Compare *Taft* v. *Bowers*, 278 U. S., 470, 482, 483 [Ct. D. 49, C. B. VIII–1, 226]; *Tyler* v. *United States*, supra, at page 505.)

Judgment reversed.

ARTICLE 347: Income of trusts taxable to grantor.

XII–26–6253
Ct. D. 687

INCOME TAX—REVENUE ACTS OF 1924 AND 1926—DECISION OF SUPREME COURT.

1. IRREVOCABLE TRUSTS—INSURANCE PREMIUMS TO BE PAID FROM INCOME—CONSTITUTIONALITY OF STATUTE.

Irrevocable trusts were created by petitioner in 1923 for the benefit of his wife and children, there being then transferred to the trustee policies of insurance on petitioner's life and shares of stock, the income from the latter to be used to maintain the policies. The trusts were to continue for three years, with provisions for successive extensions upon notice by petitioner, and by extensions were in existence throughout the year 1926. The instruments provided that should the trusts terminate before petitioner's death, the stock and accumulated income should revert to him, but all interest in the policies should then vest in certain beneficiaries; and that should petitioner die while the trusts were still in force, the stock and accumulated income should be divided among his children or their issue, but proceeds of the policies should be held in trust for the beneficiaries named in the trust instruments. Held: Section 219(h) of the Revenue Acts of 1924 and 1926 is not unconstitutional in taxing to the petitioner that part of the trust income for 1924, 1925, and 1926 expended by the trustee in keeping the policies in force.

2. DECISION AFFIRMED.

The decision of the Circuit Court of Appeals, Third Circuit (63 Fed. (2d), 44), affirming decision of the Board of Tax Appeals (20 B. T. A., 482), affirmed.

SUPREME COURT OF THE UNITED STATES. No. 791.—OCTOBER TERM, 1932.

Irenee Du Pont, petitioner, v. *Commissioner of Internal Revenue, respondent.*

On writ of certiorari to the Circuit Court of Appeals for the Third Circuit.

[May 29, 1933.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the court.

This case, like *Commissioner* v. *Wells*, No. 792, decided to-day [Ct. D. 688, page 261, this Bulletin], requires us to determine whether section 219(h) of the Revenue Acts of 1924 and 1926 is consistent with the fifth amendment in its application to trusts for the payment of premiums on policies of insurance.

On September 18, 1923, the petitioner, Du Pont, created nine trusts for the benefit of his wife and children, transferring to the trustee thereby two policies of insurance on his life, and shares of stock in a corporation, the income to be used to keep the policies in force. The trusts were to last for three years, during which term they were to be irrevocable. At the end of the term, they might be extended for a like period at the option of the settlor, and successively thereafter. Two such notices were given, with the result that in 1924, 1925, and 1926, the taxable years involved in this proceeding, the trusts were still in being.

The deeds make provision for the disposition of the policies and separate provision for the disposition of the shares.

As to the policies, the provision is that if the trusts shall be terminated before the petitioner's death, all interest in the policies shall vest in certain named beneficiaries. The petitioner is not one of these, nor has he any power to change them. If the petitioner shall die while the trusts are still in force, the trustee is to collect the insurance, and to hold the proceeds in trust for the use of the beneficiaries named in the agreements.

As to the shares of stock, the provision is that if the trusts shall be terminated before the petitioner's death, the shares and any income not paid out shall be transferred to the petitioner. If, however, he shall die while the trusts are still in force, the shares are to be divided among the children or their issue.

The Commissioner of Internal Revenue, following the command of section 219(h) of the applicable statutes (Revenue Acts of 1924 and 1926; ch. 234, 43 Stat., 253; 26 United States Code, section 960; ch. 27, 44 Stat., 9; 26 United States Code App., section 960), made a deficiency assessment by adding to the taxpayer's income the amount expended by the trustee in the preservation of the policies. The Board of Tax Appeals sustained the assessment (20 B. T. A., 482), and the Court of Appeals for the Third Circuit affirmed (63 F. (2d), 44). A writ of certiorari was granted by this court.

The case is ruled by our judgment in *Burnet, Commissioner,* v. *Wells*, No. 792, upholding the validity of the contested statute. If the income of such a trust may be taxed to the grantor though he has retained to himself no reversionary interest in the principal of the trust, *a fortiori* that result must follow where he has made a grant of the estate for a short term of years, reserving the reversion when the term is at an end.

The provisions of these deeds would require a determination in favor of the Government, though *Burnet* v. *Wells* had been decided the other way. "A statute may be invalid as applied to one state of facts and yet valid as applied to another." (*Dahnke-Walker Co.* v. *Bondurant*, 257 U. S., 282, 289.) Here the grantor did not divest himself of title in any permanent or definitive way, did not strip himself of every interest in the subject matter of the trust estate. During a term of three years, the trustee was to apply the income to the preservation of the policies, and while thus applying the income was to hold the principal intact for return to the grantor unless instructed to retain it longer. The situation in its legal effect would not be greatly different if the trusts had been created for a month or from day to day. One who retains for himself so many of the attributes of ownership is not the victim of despotic power when for the purpose of taxation he is treated as owner altogether.

The judgment is affirmed.

Mr. Justice VAN DEVANTER, Mr. Justice MCREYNOLDS, Mr. Justice SUTHERLAND, and Mr. Justice BUTLER concur upon the reasons stated in the last paragraph.

ARTICLE 347: Income of trusts taxable to grantor. XII-26-6254
Ct. D. 688

INCOME TAX—REVENUE ACTS OF 1924 AND 1926—DECISION OF SUPREME COURT.

1. IRREVOCABLE TRUSTS—INSURANCE PREMIUMS TO BE PAID FROM INCOME—CONSTITUTIONALITY OF STATUTE.

Irrevocable trusts were created by the respondent in 1922 and 1923, the trust income, so far as required, to be used by the trustees in paying the premiums on policies of insurance on the life of respondent and on accident policies taken out by him, the life policies being payable to persons other than the respondent or his estate, and the accident policies being payable to himself. With the proceeds of certain of the policies the trustees were to purchase securities forming a part of respondent's estate at his death. Held: Such portion of the trust income as was used in paying the insurance premiums was properly taxed to the respondent for the years 1924, 1925, and 1926, under the provisions of section 219(h) of the Revenue Acts of 1924 and 1926, which section does not offend the Constitution, whether the trust be created before or after the enactment thereof.

2. DECISION REVERSED.

The decision of the Circuit Court of Appeals, Eighth Circuit (63 Fed. (2d), 425), reversing in part the decision of the Board of Tax Appeals (19 B. T. A., 1213), reversed.

SUPREME COURT OF THE UNITED STATES. No. 792.—OCTOBER TERM, 1932.

David Burnet, Commissioner of Internal Revenue, petitioner, v. *Frederick B. Wells, respondent.*

On writ of certiorari to the Circuit Court of Appeals for the Eighth Circuit.

[May 29, 1933.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the court.

Income of a trust has been reckoned by the taxing officers of the Government as income to be attributed to the creator of the trust in so far as it has been applied to the maintenance of insurance on his life. Section 219(h) of the Revenue Acts of 1924 and 1926 permits this to be done. The question is whether as applied to this case the Acts are constitutional.

On December 30, 1922, the respondent, Frederick B. Wells, created three trusts, referred to in the record as Nos. 1, 2, and 3, and on August 6, 1923, two additional ones, Nos. 4 and 5, all five being irrevocable.

By trust No. 1, he assigned certain shares of stock of the par value of $100,000 to the Minneapolis Trust Co. as trustee. The income of the trust was to be used to pay the annual premiums upon a policy of insurance for $100,000 on the life of the grantor. After the payment of the premiums, the excess income, if any, was to be accumulated until an amount sufficient to pay an additional annual premium had been reserved. Any additional income was, in the discretion of the trustee, to be paid to a daughter. Upon the death of the grantor, the trustee was to collect the policy, and with the proceeds was to buy securities belonging to the Wells estate amounting to $100,000 at their appraised value. The securities so purchased, which were a substitute for the cash proceeds of the policy, were to be held as part of the trust during the life of the daughter, who was to receive the income. On her death the trust was to end, and the corpus was to be divided as she might appoint by her will, and, in default of appointment or issue, to the grantor's sons.

The other trusts carried out very similar plans, though for the use of other beneficiaries. Thus, trust No. 2 had in view the preservation of a policy of life insurance which was to be held when collected for the use of one Lindstrom,

said to be a kinswoman. Trust No. 3 was directed to the maintenance of four policies of insurance for named beneficiaries, three of them relatives of the grantor and one a valued employee, who later became his wife. Trust No. 4 kept alive seven policies of life insurance which had been taken out by the grantor for the use of sons and daughter, and three accident policies for his own use. Trust No. 5 kept alive nine life policies for his sons and daughter, and two accident policies for himself. Several of the deeds made provision for contingent limitations for the benefit of charities.

The grantor in making the returns of his own income for the years 1924, 1925, and 1926, did not include any part of the income belonging to the trusts. Upon an audit of the returns the Commissioner of Internal Revenue assessed a deficiency to the extent that the income of the trusts had been applied to the payment of premiums on the policies of insurance. There was no attempt to charge against the taxpayer the whole income of the trusts, to charge him with the excess applied to other uses than the preservation of the policies. The deficiency assessment was limited to that part of the income which had kept the policies alive. The Board of Tax Appeals upheld the Commissioner. (19 B. T. A., 1213.) The circuit court of appeals reversed except as to the premiums on the policies of accident insurance, those policies, in the event of loss thereunder, being payable to the insured himself. As to the income applied to the maintenance of the policies of life insurance, payable, as they were, to persons other than the insured or his estate, the court of appeals held that an assessment could not be made against the creator of the trust without an arbitrary taking of his property in violation of the fifth amendment. (63 F. (2d), 425.) Section 219(h) of the Revenue Acts of 1924 and 1926, permitting such an assessment, was adjudged to be void. The court drew no distinction between the validity of the statute in its application to trusts in existence at the time of its enactment and its validity in application to trusts to be created afterwards. A writ of certiorari brings the case here.

The meaning of the statute is not doubtful, whatever may be said of its validity. "Where any part of the income of a trust is or may be applied to the payment of premiums upon policies on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in paragraph (10) of subdivision (a) of section 214 [the exception having relation to trusts for charities]), such part of the income of the trust shall be included in computing the net income of the grantor." (Section 219(h), Revenue Act of 1924, ch. 234, 43 Stat., 253; 26 United States Code, section 960; Revenue Act of 1926, ch. 27, 44 Stat., 9; 26 United States Code App., section 960.)

The purpose of the law is disclosed by its legislative history, and indeed is clear upon the surface. When the bill which became the Revenue Act of 1924 was introduced in the House of Representatives, the report of the Committee on Ways and Means made an explanatory statement. Referring to section 219(h) it said: "Trusts have been used to evade taxes by means of provisions allowing the distribution of the income to the grantor or its use for his benefit. The purpose of this subdivision of the bill is to stop this evasion." (House Report No. 179, Sixty-eighth Congress, first session, page 21.) There is a like statement in the report of the Senate Committee on Finance. (Senate Report No. 398, Sixty-eighth Congress, first session, pages 25, 26.) By the creation of trusts, incomes had been so divided and subdivided as to withdraw from the Government the benefit of the graduated taxes and surtaxes applicable to income when concentrated in a single ownership. Like methods of evasion, or, to speak more accurately, of avoidance (*Wisconsin* v. *Bullen*, 240 U. S., 625, 630), had been used to diminish the transfer or succession taxes payable at death. One can read in the revisions of the Revenue Acts the record of the Government's endeavor to keep pace with the fertility of invention whereby taxpayers had contrived to keep the larger benefits of ownership and be relieved of the attendant burdens.

A method, much in vogue until an amendment made it worthless, was the creation of a trust with a power of revocation. This device was adopted to escape the burdens of the tax upon incomes and the tax upon estates. To neutralize the effect of the device in its application to incomes, Congress made provision by section 219(g) of the Revenue Act of 1924 that "where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor." The validity of this provision was assailed

by taxpayers. It was upheld by this court in *Corliss* v. *Bowers* (281 U. S., 376 [Ct. D. 188, C. B. IX–1, 254]), as applied to a trust in existence at the enactment of the statute, the power of revocation in that case being reserved to the grantor alone, and recently, at the present term, was upheld where the power of revocation had been reserved to the grantor in conjunction with some one else. (*Reinecke* v. *Smith*, 289 U. S., 172, April 10, 1933 [Ct. D. 664, page 256, this Bulletin]. Cf. *Burnet* v. *Guggenheim*, 288 U. S., 280.) Other amendments of the statute were directed to the trust as an instrument for the avoidance of the tax upon estates. By section 302(d) of the Revenue Act of 1924, the gross estate of a decedent is to be taken as including the subject of any trust which he has created during life "where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for a fair consideration in money or money's worth." The validity of this provision as to trusts both past and future is no longer open to debate. (*Porter* v. *Commissioner*, 288 U. S., 436 [Ct. D. 647, page 354, this Bulletin]. Cf. *Reinecke* v. *Northern Trust Co.*, 278 U. S., 339 [T. D. 4261, C. B. VIII–1, 305]; *Chase National Bank* v. *United States*, 278 U. S., 327 [Ct. D. 40, C. B. VIII–1, 308]; *Saltonstall* v. *Saltonstall*, 276 U. S., 260.)

Through the devices thus neutralized as well as through many others there runs a common thread of purpose. The solidarity of the family is to make it possible for the taxpayer to surrender title to another and to keep dominion for himself, or if not technical dominion, at least the substance of enjoyment. At times escape has been blocked by the resources of the judicial process without the aid of legislation. Thus, *Lucas* v. *Earl* (281 U. S., 111) held that the salary earned by a husband was taxable to him, though he had bound himself by a valid contract to assign it to his wife. *Burnet* v. *Leininger* (285 U. S., 136) laid down a like rule where there had been an assignment by a partner of his interest in the future profits of a partnership. *Old Colony Trust Co.* v. *Commissioner* (279 U. S., 716 [Ct. D. 89, C. B. VIII–2, 222]) and *United States* v *Boston & Maine Railroad Co.* (279 U. S., 732 [Ct. D. 73, C. B. VIII–2, 315]) held that income was received by a taxpayer when pursuant to a contract a debt or other obligation was discharged by another for his benefit, the transaction being the same in substance as if the money had been paid to the debtor and then transmitted to the creditor. (Cf. *United States* v. *Mahoning Coal Railroad Co.*, 51 F. (2d), 208 [Ct. D. 398, C. B. X–2, 398].) In these and other cases there has been a progressive endeavor by the Congress and the courts to bring about a correspondence between the legal concept of ownership and the economic realities of enjoyment or fruition. Of a piece with that endeavor is the statute now assailed.

The controversy is one as to the boundaries of legislative power. It must be dealt with in a large way, as questions of due process always are, not narrowly or pedantically, in slavery to forms or phrases. "Taxation is not so much concerned with the refinements of title as it is with the actual command over the property taxed—the actual benefit for which the tax is paid." (*Corliss* v. *Bowers*, supra, page 378. Cf. *Burnet* v. *Guggenheim*, supra, page 283.) Refinements of title have at times supplied the rule when the question has been one of construction and nothing more, a question as to the meaning of a taxing Act to be read in favor of the taxpayer. Refinements of title are without controlling force when a statute, unmistakable in meaning, is assailed by a taxpayer as overpassing the bounds of reason, an exercise by the lawmakers of arbitrary power. In such circumstances the question is no longer whether the concept of ownership reflected in the statute is to be squared with the concept embodied, more or less vaguely, in common law traditions. The question is whether it is one that an enlightened legislator might act upon without affront to justice. Even administrative convenience, the practical necessities of an efficient system of taxation, will have heed and recognition within reasonable limits. (*Milliken* v. *United States*, 283 U. S., 15, 24, 25 [Ct. D. 320, C. B. X–1, 472]; *Reinecke* v. *Smith*, supra.) Liability does not have to rest upon the enjoyment by the taxpayer of all the privileges and benefits enjoyed by the most favored owner at a given time or place. (*Corliss* v. *Bowers*, supra; *Reinecke* v. *Smith*, supra.) Government in casting about for proper subjects of taxation is not confined by the traditional classification of interests or estates. It may tax not only ownership, but any right or privilege that is a constituent of ownership. (*Nashville, Chattanooga & St. Louis Ry. Co.* v. *Wallace*, 288

U. S., 249, 268; *Bromley* v. *McCaughn*, 280 U. S., 124, 136.) Liability may rest upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis. A margin must be allowed for the play of legislative judgment. To overcome this statute the taxpayer must show that in attributing to him the ownership of the income of the trusts, or something fairly to be dealt with as equivalent to ownership, the lawmakers have done a wholly arbitrary thing, have found equivalence where there was none nor anything approaching it, and laid a burden unrelated to privilege or benefit. (*Purity Extract & Tonic Co.* v. *Lynch*, 226 U. S., 192, 204; *Hebe Co.* v. *Shaw*, 248 U. S., 297, 303; *Milliken* v. *United States*, supra.) The statute, as we view it, is not subject to that reproach.[1]

A policy of life insurance is a contract susceptible of ownership like any other chose in action. It "is not an assurance for a single year with a privilege of renewal from year to year by paying the annual premium." It is "an entire contract of assurance for life, subject to discontinuance and forfeiture for nonpayment of any of the stipulated premiums." (*New York Life Insurance Co.* v. *Statham*, 93 U. S., 24, 30; Vance on Insurance, pages 260, 262, and cases there cited.) One who takes out a policy on his own life, after application in his own name accepted by the company, becomes in so doing a party to a contract, though the benefits of the insurance are to accrue to some one else. (*Mutual Life Insurance Co.* v. *Hurni Packing Co.*, 263 U. S., 167, 177; Vance on Insurance, pages 90, 91, and 108.) The rights and interests thereby generated do not inhere solely in those who are to receive the proceeds. They inhere also in the insured who in cooperation with the insurer has brought the contract into being. If the Minneapolis Trust Co., the trustee, were to refuse to apply the income to the preservation of the insurance, the insured might maintain a suit to hold it to its duty. If the insurer without cause were to repudiate the policies, the insured would have such an interest in the preservation of the contracts that he might maintain a suit in equity to declare them still in being. (*Cohen* v. *M. L. Ins. Co.*, 50 N. Y., 610, 624; *Meyer* v. *Knickerbocker Life Insurance Co.*, 73 N. Y., 516, 524; *Fidelity National Bank* v. *Swope*, 274 U. S., 123, 132; cf. *Croker* v. *New York Trust Co.*, 245 N. Y., 17, 18, 20; *Johnson Service Co.* v. *Morin, Inc.*, 253 N. Y., 417, 421; American Law Institute, Restatement of the Law of Contracts, sections 135, 138; Williston, Contracts, sections 358, 359.) The contracts remain his, or his at least in part, though the fruits when they are gathered are to go to some one else. (American Law Institute, Restatement of the Law of Contracts, supra.)

With the aid of this analysis the path is cleared to a conclusion. Wells by the creation of these trusts did more than devote his income to the benefit of relatives. He devoted it at the same time to the preservation of his own contracts, to the protection of an interest which he wished to keep alive. The ends to be attained must be viewed in combination. True he would have been at liberty, if the trusts had not been made, to put an end to his interest in the policies through nonpayment of the premiums, to stamp the contracts out. The chance that economic changes might force him to that choice was a motive, along with others, for the foundation of the trusts. In effect he said to the trustee that for the rest of his life he would dedicate a part of his income to the preservation of these contracts, so much did they mean for his peace of mind and happiness. Income permanently applied by the act of the taxpayer to the maintenance of contracts of insurance made in his name for the support of his dependents is income used for his benefit in such a sense and to such a degree that there is nothing arbitrary or tyrannical in taxing it as his.

Insurance for dependents is to-day in the thought of many a pressing social duty. Even if not a duty, it is a common item in the family budget, kept up very often at the cost of painful sacrifice, and abandoned only under dire compulsion. It will be a vain effort at persuasion to argue to the average man that a trust created by a father to pay premiums on life policies for the use of sons and daughters is not a benefit to the one who will have to pay the premiums if the policies are not to lapse. Only by closing our minds to common modes of thought, to everyday realities, shall we find it in our power to

[1] The trusts, having been created in 1922 and 1923, were not subject to the gift tax of 1924 (43 Stat., 253, 313, ch. 234, sections 319, 320; 26 United States Code, sections 1131, 1132). Whether they would have been subject to that tax if they had been created at a later date is a question not before us. There is no inconsistency between a gift to take effect in enjoyment upon the death of a grantor and the reservation of benefits to be enjoyed during his life.

form another judgment. The case is not helped by imagining exceptional conditions in which the advantage to the creator of the trust would be slender or remote. By and large the purpose of trusts for the maintenance of policies is to make provision for dependents, or so at least the lawmakers might not unreasonably assume. Trusts to give insurance to creditors are beneficial to the grantor by reducing his indebtedness. Trusts for charities are expressly excepted from the operation of the tax. (Section 219(h); section 214(a)10.) If other classes of life policies exist, they must be relatively few. The line of division between the rational and the arbitrary in legislation is not to be drawn with an eye to remote possibilities. What the law looks for in establishing its standards is a probability or tendency of general validity. If this is attained, the formula will serve, though there are imperfections here and there. The exceptional, if it arises, may have its special rule. (*Dahnke-Walker Co.* v. *Bondurant*, 257 U. S., 282, 289.)

Trusts for the preservation of policies of insurance involve a continuing exercise by the settlor of a power to direct the application of the income along predetermined channels. In this they are to be distinguished from trusts where the income of a fund, though payable to wife or kin, may be expended by the beneficiaries without restraint, may be given away or squandered, the founder of the trust doing nothing to impose his will upon the use. There is no occasion at this time to mark the applicable principle for those and other cases. The relation between the parties, the tendency of the transfer to give relief from obligations that are recognized as binding by normal men and women, will be facts to be considered. (Cf. *Reinecke* v. *Smith*, supra, distinguishing *Hoeper* v. *Tax Commission*, 284 U. S., 206.) We do not go into their bearing now. Here the use to be made of the income of the trust was subject, from first to last, to the will of the grantor announced at the beginning. A particular expense, which for millions of men and women has become a fixed charge, as it doubtless was for Wells, an expense which would have to be continued if he was to preserve a contract right, was to be met in a particular way. He might have created a blanket trust for the payment of all the items of his own and the family budget, classifying the proposed expenses by adequate description. If the transaction had taken such a form, one can hardly doubt the validity of a legislative declaration that income so applied should be deemed to be devoted to his use. Instead of shaping the transaction thus, he picked out of the total budget an item or class of items, the cost of continuing his contracts of insurance, and created a source of income to preserve them against lapse.

Congress does not play the despot in ordaining that trusts for such uses, if created in the future, shall be treated for the purpose of taxation as if the income of the trust had been retained by the grantor.

It does not play the despot in ordaining a like rule as to trusts created in the past, at all events when in so doing it does not cast the burden backward beyond the income of the current year. (*Reinecke* v. *Smith*, supra; *Corliss* v. *Bowers*, supra; *Brushaber* v. *Union Pacific R. R. Co.*, 240 U. S., 1; *Cooper* v. *United States*, 280 U. S., 409, 411 [Ct. D. 163, C. B. IX-1, 272]; *Milliken* v. *United States*, supra.)

The judgment is reversed.

Mr. Justice SUTHERLAND, Mr. Justice VAN DEVANTER, Mr. Justice MCREYNOLDS, and Mr. Justice BUTLER dissent, with dissenting opinion written by Mr. Justice Sutherland.

SECTION 226.—RETURNS FOR A PERIOD OF LESS THAN 12 MONTHS.

ARTICLE 431: Returns for periods of less than 12 months. XII-4-6000 Ct. D. 624

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. COMPUTATION OF TAX—CHANGE FROM CALENDAR TO FISCAL YEAR BASIS.

Where a corporation having a fiscal year ending June 30 had, prior to 1918, filed its returns on the basis of a calendar year, section 226 of the Revenue Act of 1918 requires a separate return for the period from December 31, 1917, to July 1, 1918, and the tax should be computed as provided therein.

2. MOTION DENIED.

The motion to reconsider the original opinion (60 Fed. (2d), 97, Ct. D. 592, C. B. XI–2, 147) denied.

3. CASE DISTINGUISHED.

The decision in *American Hide & Leather Co.* v. *United States* (284 U. S., 343, 351, Ct. D. 444, C. B. XI–1, 201) distinguished.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

Arthur C. Harvey Co., plaintiff, appellant, v. *John F. Malley and/or Malcom E. Nichols, Former Collectors of Internal Revenue, defendants, appellees.*

Appeal from the District Court of the United States for the District of Massachusetts.

[October 11, 1932.]

OPINION.

WILSON, J.: The plaintiff in this case filed a petition for a rehearing, which has been denied. It now asks to be heard orally on the question of the proper method of computing taxes under sections 205 and 226 of the 1918 Act in order that this court may correct what plaintiff's counsel conceives to be an error on the part of the court in interpreting these two sections.

Rule 29 requires that petitions for rehearing shall be filed within 15 days after judgment. Plaintiff's motion is in effect a petition for rehearing in another guise. To establish a practice of granting such a motion, filed after the time has elapsed for filing a petition for rehearing, would render the rule nugatory. Furthermore, we do not think the grounds assigned by counsel have any merit.

The plaintiff's fiscal year ended on June 30. Prior to 1918 it had filed its returns on the basis of the calendar year. Under section 226 of the 1918 Act it was obliged to file its returns on the basis of its fiscal year and a separate return for the period from December 31, 1917, to July 1, 1918. Counsel originally contended that the tax for this latter period should be computed according to the provisions of section 205, but counsel now contends that whether computed under section 205 or section 226, the result is the same.

Section 205 of the 1918 Act covered cases where the taxpayer made a return for a fiscal year beginning in 1917 and ending in 1918, while section 226 applied to cases where the taxpayer had filed a return for the calendar year of 1917, but its fiscal year differed from the calendar year, in which case section 226 provided that "a separate return shall be made for the period between the close of the last calendar year for which a return was made (in this case December 31, 1917) and the date designated as the close of the fiscal year."

Under section 205 the tax for the entire fiscal year beginning in 1917 and ending in 1918, and computed in accordance with that section, was apportioned according to the part of the fiscal year falling within each of the calendar years.

Counsel contends, apparently basing his contention on some language in the opinion in *American Hide & Leather Co.* v. *United States* (284 U. S., 343, 351 [Ct. D. 444, C. B. XI–1, 201]), that the gross income and deductions for the entire fiscal year of 1917–18 should be apportioned to the part of the fiscal year falling in 1918, and the tax computed on the net income thus obtained for that period, which of course, assuming the gross income and deductions are agreed to, would produce the same result as if computed under section 205.

But the question of how the tax should be computed under section 226 was not in issue in the American Hide & Leather Co. case, and the language in the opinion on which counsel relies, being obviously dictum, should not control this court, since it is not only contrary to the language of the statute, but would produce inequitable results.

To illustrate: Let us assume that the plaintiff corporation had a taxable income during the period from June 30, 1917, to January 1, 1918, of $50,000, on which, since it made its return for the year 1917 on the basis of the calendar year, it had already paid a tax under the 1916 Act, and from December 31, 1917, to July 1, 1918, its taxable income was $150,000. Applying the theory of the

plaintiff's counsel, it would in such case be taxed on an income of only $100,000 during the period from December 31, 1917, to July 1, 1918, although its taxable income during that period was $150,000. In other words, under such an interpretation of section 226 it would escape taxation on $50,000.

To state the converse of this: Assuming that its taxable income during the last half of the calendar year of 1917 was $150,000, and for the first half of 1918 was only $50,000, the taxpayer under the 1916 Act, making a return for the calendar year of 1917, would have already paid a tax on $150,000 of income; yet, according to the theory of counsel for the plaintiff, its return for the period of the fiscal year falling in 1918 should show a taxable income of $100,000, and as a result he would not only pay a tax on the $50,000 actually earned in the period of the fiscal year falling in 1918, but a double tax on $50,000 more earned in 1917.

Nothing more is needed to show that such could not have been the intent of Congress, when it said in section 226 that, if a change were made from a calendar year to a fiscal year, "a separate return should be made for the period between the close of the last calendar year for which a return was made and the date designated as the close of the fiscal year."

It is clear that without the original return made in March, 1919, for the first six months of the year 1918, it can not be shown that there was error in the denial of a refund by the Commissioner, assuming that the claim for refund had been filed within the time limit fixed by the statute.

Motion denied.

SECTION 227.—TIME AND PLACE FOR FILING INDIVIDUAL, PARTNERSHIP, AND FIDUCIARY RETURNS.

ARTICLE 443: Extensions of time for filing returns. XII–12–6083 Ct. D. 643

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. INCOME—TENTATIVE RETURN.

Where taxpayer by his agent requests an extension of time for filing his income tax return, and extension is granted on the condition that on a certain date a tentative return be filed and payment made of one-fourth of the estimated tax shown thereon to be due, a return showing no tax due, and mailed to the collector on the day before the specified date, no attempt being made to ascertain the taxpayer's income, does not constitute a bona fide tentative return.

2. SAME—DELINQUENT RETURN—WILLFUL NEGLECT—PENALTY.

Where taxpayer relies upon an agent to file his income tax return, and the agent fails to file a bona fide tentative return within the specified time, taxpayer is personally chargeable with "willful neglect." Having claimed the benefits of his agent's efforts to procure an extension of time, he takes such benefit *cum onere* and is properly chargeable with the 25 per cent penalty for delinquency prescribed by section 1003 of the Revenue Act of 1924.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Irving Berlin, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Appeal from the United States Board of Tax Appeals.

Before MANTON, SWAN, and CHASE, Circuit Judges.

[June 20, 1932.]

OPINION.

SWAN, Circuit Judge: The deficiency assessment involved in this appeal represents a 25 per cent penalty, amounting to $3,354.64, which the Commis-

sioner assessed against the taxpayer for the tardy filing of his income tax return for the year 1924. The penalty is claimed by virtue of section 1003 of the Revenue Act of 1924 (43 Stat., 339). This reads in part as follows:

" * * * In case of any failure to make and file a return or list within the time prescribed by law, or prescribed by the Commissioner of Internal Revenue or the collector in pursuance of law, the Commissioner shall add to the tax 25 per centum of its amount, except that when a return is filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. * * *"

Confessedly the return, filed on May 15, 1925, was late, but the taxpayer contends that under the circumstances hereafter to be related his failure to file it within the time prescribed by the Commissioner, "was due to a reasonable cause and not to willful neglect." If so, it was within the exception, and no penalty was incurred. The Board held the contrary, one member dissenting. The correctness of this ruling is the question presented.

Mr. Berlin, the taxpayer, is a musical composer, author and publisher. His residence and place of business were in New York City. In the latter part of December, 1924, he went to Florida and shortly after his arrival contracted a cold which developed into a "bronchial condition" that caused his return to New York to be delayed until the end of April, 1925. For several years prior to 1924 the preparation and filing of income tax returns had been handled for Mr. Berlin by a firm of tax accountants; and prior to March 15, 1925, Mr. Leopold of this firm applied to the Commissioner for an extension of time to file the 1924 return on the ground that Mr. Berlin was out of the city and in ill health. Pursuant to section 227(a) of the Revenue Act of 1924 (43 Stat., 281) the Commissioner first granted an unconditional extension to April 15, and subsequently, by letter dated April 14, which referred to a request by Mr. Leopold for a further extension, extended the time to May 15 on condition that a tentative return be filed on April 15 and payment made of one-fourth of the estimated tax shown thereon to be due. Mr. Leopold testified that this letter from the Commissioner was received by him in New York on the evening of April 14 and that he forthwith prepared and mailed to the collector at New York a tentative return showing no tax to be due. The records of the collector, however, do not show the receipt of any tentative return. The Board did not find as a fact that none was mailed, but ruled that mailing did not comply with the condition that the tentative return be "filed." This ruling the taxpayer does not question. (See *United States* v. *Lombardo*, 241 U. S., 73, 76.) Assuming that he had complied with the conditions of the extension, Mr. Leopold prepared a complete return after Mr. Berlin's return from Florida and filed it, within the time prescribed, as he supposed, on May 15. Although Mr. Leopold could have obtained much of the information necessary for a complete return from the taxpayer's New York office, information regarding certain deductions could be obtained only from Mr. Berlin himself.

It is urged by the petitioner that the "willful neglect" which justifies the imposition of a penalty must be that of the taxpayer personally, not that of his agent. However that may be when the taxpayer relies upon an agent whom he has supplied with all necessary information for the preparation of his return, in the case at bar the petitioner can relieve himself of a charge of having personally neglected the filing of his tax return only by claiming the benefit of his agent's efforts to procure an extension of time. Under such circumstances, we think he takes the benefit *cum onere*, and is chargeable with any "willful neglect" ascribable to his agent. (See *Eagle Piece Dye Works* v. *Commissioner*, 10 B. T. A., 1360, 1368; cf. *Beam* v. *Hamilton*, 289 F., 9, 14 (C. C. A. 6) [T. D. 3519, C. B. II-2, 217].) Hence the conduct of the petitioner's tax accountant must be examined.

The unconditional extension expired on April 15. Prior to that time the accountant had applied for a further extension, which the Commissioner agreed to grant upon condition that a tentative return be filed and one-quarter of the estimated tax be paid on the 15th. Knowledge of this conditional extension reached the accountant late in the day on the 14th. Forthwith he prepared a "tentative return" showing gross income of $50,000, estimated deductions of the same figure, and no tax liability. This he deposited in the mail addressed to the collector, to whom he naturally supposed it would be delivered on the 15th. If this was a bona fide attempt to comply with the conditions of the proposed extension, we should hesitate to hold that the failure of the post

office to make delivery to the addressee rendered the taxpayer guilty of willful neglect in failing to file his return within the time prescribed by law. But the Board has found that the accountant made no attempt to ascertain the petitioner's income for 1924 and that a return showing no tax liability was not a bona fide tentative return. If this finding is sustainable, then the accountant made no bona fide attempt to comply with the Commissioner's conditions and thus to procure a further extension for filing the complete return. The failure to file it within the time prescribed would, therefore, seem clearly to be due to "willful neglect" and without "reasonable cause." The burden of explaining the delay is by the regulations upon the taxpayer. (Regulations 65, article 445.) While it is true that the Commissioner's letter of April 14 stated that a tentative return meant only "a return on the appropriate income tax form, showing only the name and address of the taxpayer and the estimated amount, if any, of the tax due," still it required a bona fide estimate of the tax. (See *Florsheim Bros. Co.* v. *United States*, 280 U. S., 453, 462 [Ct. D. 167, C. B. IX–1, 260].) The accountant argues that he had no time to investigate after receipt of the Commissioner's letter. Although the time was short, it did not preclude all investigation nor the possibility of any attempt at accuracy. The petitioner's business office was still open, for the accountant testified that he may have sent the tentative return there for signature, and filing of the return might have been delayed till late the next day by delivering it in person at the collector's office. In the meantime the books at the petitioner's office could have been consulted. No attempt was made to get any information whatever. The accountant simply assumed, as he testified, that the tentative return was "a mere formality." We can not say that the Board's finding is wholly unsupported by the evidence. Hence the penalty was rightly imposed. (See *Am. Milk Products Corp.* v. *United States*, 41 F. (2d), 966 (Ct. Cls.); *Winston* v. *Commissioner*, 22 B. T. A., 1194, 1199.) The order is affirmed.

SECTION 229 (REVENUE ACT OF 1921).—INCORPORATION OF INDIVIDUAL OR PARTNERSHIP BUSINESS.

SECTION 229. XII–26–6255
Ct. D. 689

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. JURISDICTION OF BOARD OF TAX APPEALS.

Where a corporation, formed in January, 1922, to take over the assets and assume the liabilities of a partnership, by its officers filed in the name of the partnership a tax return for the year 1921, and later, in the name of the partnership, a petition to the Board of Tax Appeals, the deficiency was properly asserted against the partnership, and the Board had jurisdiction.

2. DECISION AFFIRMED.

Memorandum opinion of the Board, rendered August 31, 1931, affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

William B. Thalhimer and Nathan Klee, as Executors of the Last Will and Testament of Isaac Thalhimer and William B. Thalhimer, Individually, petitioners, v. *Commissioner of Internal Revenue, respondent.*

In the Matter of Thalhimer Bros. v. *Commissioner of Internal Revenue.*

On petition to review the decision of the United States Board of Tax Appeals.

Before PARKER and SOPER, Circuit Judges, and CHESNUT, District Judge.

[January 10, 1933.]

OPINION.

PARKER, Circuit Judge: This is a petition to review a decision of the Board of Tax Appeals which determined against Thalhimer Bros., a partnership, a

deficiency of income taxes for the year 1921. No point is made in the petition before us as to the merits of the determination. The petitioners are William B. Thalhimer, one of the partners and the executors of Isaac Thalhimer, the other partner now deceased. They say that they are "appearing specially" and for the sole purpose of contesting the jurisdiction of the Board of Tax Appeals to determine a deficiency against them. Their contentions are that the tax for 1921 was not imposed upon the partnership; that notice of deficiency was not properly sent to the partnership; that the appeal to the Board was taken, not by the partnership, but by the corporation which succeeded it; and that the Board was without jurisdiction to determine the deficiency because no appeal had been properly taken. We think that all of these contentions are wholly lacking in merit.

The facts are that in 1921 William B. and Isaac Thalhimer were partners engaged in the mercantile business in Richmond, Va., under the name of Thalhimer Bros. In January, 1922, their business was incorporated under the name of Thalhimer Bros., Inc., the corporation taking over the assets and assuming the liabilities of the partnership. In March, 1922, a tax return was filed covering the business done in the tax year 1921. This return was made in the name of Thalhimer Bros., but was signed "Thalhimer Bros., Inc.," by Isaac Thalhimer, president, and Irving May, treasurer. It is conceded that this return was made, and the tax determined, just as though the partnership were a corporation, pursuant to section 229 of the Revenue Act of 1921 (42 Stat., 227, 252), which provides:

"SEC. 229. That in the case of the organization as a corporation within four months after the passage of this Act of any trade or business in which capital is a material income-producing factor, and which was previously owned by a partnership or individual, the net income of such trade or business from January 1, 1921, to the date of such organization may at the option of the individual or partnership be taxed as the net income of a corporation is taxed under Titles II and III; in which event the net income and invested capital of such trade or business shall be computed as if such corporation had been in existence on and after January 1, 1921, and the undistributed profits or earnings of such trade or business shall not be subject to the surtaxes imposed in section 211, but amounts distributed on and after January 1, 1921, from the earnings or profits of such trade or business accumulated after December 31, 1920, shall be taxed to the recipients as dividends; and all the provisions of Titles II and III relating to corporations shall so far as practicable apply to such trade or business."

On September 16, 1926, the Commissioner determined a deficiency in income and profits taxes as disclosed by the return and mailed a notice of deficiency addressed to Thalhimer Bros. A petition for review of the deficiency asserted in this notice was filed with the Board on November 15, 1926; and assessment of the deficiency by the Commissioner was thus prevented. The petition was captioned in the name of Thalhimer Bros. It referred to the deficiency letter and appealed therefrom, attaching a copy thereof to the petition. It asked correction of alleged errors in the computation of taxes due for the business year 1921 during which, it will be remembered, the partnership, and not the corporation, was operating the business. It was signed and verified by the attorney who is now representing petitioners before this court, who appeared in all the hearings before the Board of Tax Appeals, and who, in his verification, stated that he was attorney for Thalhimer Bros., the petitioner in the appeal. An amended petition filed January 10, 1929, raised the point that petitioner had no existence during the tax year 1921; but it, also, was captioned in the name of Thalhimer Bros. and prayed relief on the merits as to taxes assessed against Thalhimer Bros. for the year 1921.

We need not decide the question as to whether petitioners can ask us to review a proceeding before the Board of Tax Appeals to which they say that they were not parties; for it is perfectly clear that there is nothing either in their contention that taxes could not be assessed against the partnership under the Act of 1921, or in their contention that no appeal was taken to the Board which would vest it with jurisdiction to decree the deficiency assessment of which they complain.

On the first proposition it is clear that it was the intention of Congress to tax the business of a partnership which availed itself of the provisions of section 229 of the Act just as though it were a corporation. See *Sadowsky* v. *Anderson* (D. C.) (25 Fed. (2d), 1014), construing somewhat similar pro-

visions of the Act of 1918. In introducing the provisions of section 229 as amendment 354 of H. R. 8245, Senator Frelinghuysen said:

"Mr. President, this simply provides that where a partnership or business desires to incorporate, and does so within four months after the passage of this Act, they shall be taxed as to net income as if the corporation had been in existence on January 1, 1921; that is, they shall be taxed as a corporation and not as a partnership or incorporated business. An equalization of this character was put into the Act of 1918 in reference to the excess-profits tax, and I think the amendment is perfectly fair and just. I have talked with the experts regarding it, and they say that the amount of loss of revenue is exceptionally small, less than $100,000, and that it is a perfectly just and fair request."

On the second proposition, we think it equally clear that the appeal to the Board was properly taken and that the Board thereby acquired jurisdiction to assess the deficiency. As stated above, the tax was assessed against the business of the partnership; and the corporation which had succeeded to the assets and liabilities of the business was ultimately liable for its payment. That corporation by its officers had signed the tax return made in the name of the partnership; and, upon notice of deficiency assessment, its treasurer directed that petition for review be filed with the Board. This petition was filed in the name of the partnership by an attorney of good standing practicing before the Board; and the fact that the treasurer of the corporation directed that it be filed does not negative the presumption that this was done with the knowledge and approval of the partners, who owned the stock of the corporation and controlled its affairs, or that it was, as it professed to be, a petition by them. We think that the finding of the Board that the petition was filed in behalf of the partnership is sustained by the evidence, and that the Board acquired jurisdiction thereby to determine the deficiency.

The decision of the Board will be affirmed.

Affirmed.

PART III.—CORPORATIONS.

SECTION 231.—CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS.

ARTICLE 511: Proof of exemption.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Holding corporation paying income to several organizations each of which is entitled to exemption under one or the other of the subsections of section 231 of the Revenue Act of 1926 and prior Revenue Acts. (See G. C. M. 11817, page 56.)

ARTICLE 515: Building and loan associations and cooperative banks.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Revocation of General Counsel's Memorandum 8090 (C. B. IX–1, 128), relative to rural loan and savings associations in Indiana. (See G. C. M. 11653, page 121.)

ARTICLE 517: Religious, charitable, scientific, literary, and educational organizations and community chests.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Military Training Camps Association. (See G. C. M. 11705, page 57.)

ARTICLE 519: Civic leagues and local associations of employees. XII-24-6227 I. T. 2697

REVENUE ACTS OF 1918, 1921, AND 1924.

I. T. 2267 (C. B. V-1, 84), relating to the exemption from income tax of the Military Training Camps Association, is modified to conform with General Counsel's Memorandum 11705 (page 57, this Bulletin), which holds that association exempt from taxation under section 103(6) of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts, and that contributions thereto are deductible under section 23(n) of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts, subject to the limitations imposed by such Revenue Acts.

ARTICLE 520: Social clubs.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Mountain improvement club. (See I. T. 2693, page 59.)

ARTICLE 523: Farmers' cooperative marketing and purchasing associations.

REVENUE ACT OF 1926.

Distribution of rebates among patrons who comply with uniform requirement relative to annual membership fee. (See G. C. M. 11068, page 122.)

SECTION 233.—GROSS INCOME OF CORPORATIONS DEFINED.

ARTICLE 541: Gross income. XII-2-5980 Ct. D. 618

INCOME TAX—REVENUE ACTS OF 1918, 1921, 1924, AND 1926—DECISION OF SUPREME COURT.

1. INCOME—ROYALTIES UNDER LEASES OF COAL LANDS.

Royalties received by a lessor under leases of coal lands constitute taxable income to it under the applicable Revenue Acts, although under State law title to coal in place passes to the lessee immediately upon execution of the lease.

2. RES ADJUDICATA—DIFFERENT PARTIES—DEPLETION ALLOWANCE.

A decision by the district court, in a suit against the collector, that petitioner should be allowed a certain depletion allowance on royalties is not res adjudicata of that issue in a subsequent pro-

ceeding against the Commissioner before the Board of Tax Appeals and the Circuit Court of Appeals.

3. EVIDENCE—HEARING UNDER RULE 50 OF BOARD.

Where the taxpayer, lessor, at a hearing before the Board of Tax Appeals under its rule 50, which rule restricts such hearing to the consideration of the correct computation of the deficiency resulting from the determination already made, claims for the first time that the minimum royalty payments stipulated by the leases had in some instances exceeded the amount of the per ton royalty which would have been payable on actual production, tenders evidence in support of such claim, and asks that the depletion allowance be computed upon the basis of actual payments made rather than upon the number of tons extracted, the Board properly rejected such evidence and denied petitioner's motion for a rehearing.

4. DECISION AFFIRMED.

Decision of the Circuit Court of Appeals (55 Fed. (2d), 626 [Ct. D. 531, C. B. XI–2, 275]) affirmed.

SUPREME COURT OF THE UNITED STATES.

Bankers Pocahontas Coal Co., petitioner, v. *David Burnet, Commissioner of Internal Revenue.*

On writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[December 5, 1932.]

OPINION.

Mr. Justice STONE delivered the opinion of the court.

Petitioner, in 1912, acquired West Virginia coal lands in fee and, by assignment from the prior owners, certain leases or contracts entered into by them with various coal operators, by which the latter acquired the right to enter upon and use the lands for the production of coal and coke for a specified period, in consideration of stipulated royalties for the coal and coke produced, including minimum royalty payments in each year. In determining petitioner's income and profits taxes for the years 1920 to 1926, the Commissioner of Internal Revenue treated the royalty payments, after deducting a depletion allowance of 3.6 cents per ton of coal mined, as taxable income of petitioner, and assessed a corresponding increase in the tax. On appeal this ruling of the Commissioner was sustained, both by the Board of Tax Appeals (18 B. T. A., 901) and the Court of Appeals for the Fourth Circuit (55 F. (2d), 626). We granted certiorari (287 U. S., 584) on a petition which assails the judgment below on three grounds, which will be separately considered.

First. It is insisted that no part of the royalties is taxable income of petitioner. Petitioner rests this contention on what is stated to be a rule of law of West Virginia, that under coal leases, like those presently involved, the title to the coal, in place, passes to the lessee or operator immediately on execution of the lease. From this it is argued that the royalties received were but payments for capital assets acquired and sold by petitioner before the adoption of the sixteenth amendment, and that their taxation as income is not authorized either by the statute or by the sixteenth amendment, because not apportioned.

The question whether payments of bonus and royalties from the lessee to the lessor of an oil lease are income within the meaning of the revenue laws taxing income, or a return of capital as upon a sale of the oil, was recently before this court in No. 26, *Burnet* v. *Harmel*, decided November 7, 1932 [Ct. D. 611, C. B. XI–2, 210]. Although it was contended there, as it is here, that by State law the title to the mineral content of the leased land passed to the lessee upon execution of the lease, it was held that this characterization of the transaction in the local law did not affect the conclusion that the payments were gross income subject to tax, after the deductions allowed by the taxing Act. The considerations which led to the conclusion that bonus and

royalties paid to the lessor of Texas oil lands are taxable income and not a conversion of capital, as upon a sale of capital assets, are equally applicable to West Virginia coal leases, whether the title to the coal passes to the lessee in place at the date of the lease, or only upon severance by the lessee.

The applicable statutes thus construed and applied do not tax any part of petitioner's capital investment before March 1, 1913. Section 234(a)9 of the Revenue Act of 1918 (ch. 18, 40 Stat., 1057, 1077), and regulations under it, require depletion allowances upon bonus and royalty payments received by the lessor of mineral lands, sufficient to provide for a return in full of his invested capital. The provisions of that section, and the related Treasury regulations have been continued with the later Revenue Acts (see No. 80, *Murphy Oil Co.* v. *Burnet*, decided this day [Ct. D. 619, page 231, this Bulletin]). The fact that the depletion allowance under the Revenue Act of 1913 was more limited is not pertinent here. (*Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301 [Ct. D. 331, C. B. X–1, 390].)

Second. In a suit brought by the petitioner in the District Court for Northern West Virginia (*Bankers Pocahontas Coal Co.* v. *White, Collector of Internal Revenue*), with respect to taxes for the years 1914 to 1919, it was held that petitioner was entitled to a depletion allowance on royalties received from the leases involved in the present suit, of 5 cents per ton of coal mined. It is insisted that the decision in that case was *res adjudicata* of that issue, and that in fixing the depletion allowance of the present case at 3.6 cents per ton, the court below and the Board of Tax Appeals erroneously refused to follow the decision of the district court in the earlier case. With respect to this contention it is sufficient to say that the suit in the district court was not against the Commissioner of Internal Revenue, the respondent here, but against the collector, judgment against whom is not *res adjudicata* against the Commissioner or the United States. (*Graham & Foster* v. *Goodcell*, 282 U. S., 409, 430 [Ct. D. 287, C. B. X–1, 191]; *Sage* v. *United States*, 250 U. S., 33; see *Smietanka* v. *Indiana Steel Co.*, 257 U. S., 1 [Ct. D. 17, C. B. 5, 251]; compare *Union Trust Co.* v. *Wardell*, 258 U. S., 537 [T. D. 3338, C. B. I–2, 310].)

Third. After the Board of Tax Appeals had filed its findings of fact and opinion, both respondent and petitioner submitted recomputations of the amount of the deficiency under the Board's report, as provided by rule 50 of the Board's rules of practice. In petitioner's recomputation, the claim was made for the first time that the minimum royalty payments stipulated by the leases had in some instances exceeded the amount of the per ton royalty which would have been payable on actual production, and it was asked that the depletion allowance be computed upon the basis of the actual payments made, instead of upon the number of tons extracted. Petitioner, at a hearing on the recomputation, tendered evidence in support of this claim. The Board rejected the evidence and denied petitioner's motion for a rehearing in order to present this contention. The court below upheld this action.

The Board is authorized to prescribe rules of practice and procedure for the conduct of proceedings before it. Section 601, Revenue Act of 1928 (ch. 852, 45 Stat., 791, 871, 872), amending section 907(a), Revenue Act of 1924, as amended; see *Goldsmith* v. *Board of Tax Appeals* (270 U. S., 117). Rule 50 prescribes the procedure for computing the amount of the deficiency after the Board has heard and decided the issues raised and presented on the merits. In terms, it directs that the hearing on the computation which it authorizes is to be "confined strictly to the consideration of the correct computation of the deficiency or overpayment resulting from the determination already made, and no argument will be heard upon or consideration given to * * * any new issues." The Board has held that under the rule new issues may not be raised and urged on a hearing upon the computation. (*Great Northern Ry. Co.* v. *Commissioner*, 10 B. T. A., 1347, affirmed on other issues 40 F. (2d), 372.) The rule was a proper exercise of the power of the Board to prescribe the practice in proceedings before it. (See *O'Meara* v. *Commissioner*, 34 F. (2d), 390, 395; *Boggs & Buhl* v. *Commissioner*, 34 F. (2d), 859, 861; *Metropolitan Business College* v. *Blair*, 24 F. (2d), 176, 178; compare *Sooy* v. *Commissioner*, 40 F. (2d), 634 [Ct. D. 217, C. B. IX–2, 283].)

The purpose of the tendered evidence was to bring the case within the ruling of the Court of Appeals for the Ninth Circuit affirmed in No. 80, *Murphy Oil Co.* v. *Burnet*, supra, that bonus payments to the lessor of a mineral lease are to be treated as advanced payments of royalties and depletion allowed.

This was a new issue. We need not consider the contention of the Government that it does not clearly appear either that the stipulated minimum payments exceeded the total per ton royalties upon the leases or that, even if they did, the excess of the minimum royalties over the royalties computed on actual production can, upon a proper construction of the leases, be treated as advance payment of the per ton royalties to accrue in future years. It is not shown that the evidence tendered was not available to the petitioner in ample time to present it before the Board had made and filed its findings of fact and opinion. Under the circumstances, we can not say that the Board abused its discretion in denying a rehearing.

Affirmed.

ARTICLE 543: Sale of capital stock.

XII-20-6180
Ct. D. 666

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. INCOME—RECEIPT BY CORPORATION OF ITS OWN CAPITAL STOCK.

Where a corporation, in settlement of a patent infringement suit, received shares of its own stock, which it then retired, the transaction was equivalent to the payment of the debt in cash and the investment of the proceeds by the corporation in its own stock, and gave rise to taxable income. Whether the acquisition or sale by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction.

2. PENALTY—NEGLIGENCE.

Where, under the above circumstances, the taxpayer honestly believed that it was not liable for tax, and such belief was not obviously untenable, it was not liable for negligence penalty.

3. DECISION REVERSED.

The decision of the Board of Tax Appeals (21 B. T. A. 818) reversed as to the first issue.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

Commissioner of Internal Revenue, petitioner for review, v. *S. A. Woods Machine Co.*

Appeal from Board of Tax Appeals.

Before BINGHAM, WILSON, and MORTON, JJ.

[April 7, 1932.]

OPINION.

MORTON, J.: This is an appeal by the Government from a decision by the Board of Tax Appeals. The respondent, which we shall refer to as the Woods company, sued the Yates Machine Co. for infringement of a patent and obtained a final decree in its favor, with the usual order of reference to ascertain damages and profits. The parties then settled the controversy and, in connection with the settlement, the Yates company transferred to the Woods company 1,022 shares of the capital stock of the Woods company having a value of $433,200.04. For this stock and the other considerations coming to it under the agreement of settlement, the Woods company acknowledged satisfaction of its rights under the decree. After acquiring the stock, the Woods company by proper corporate action retired it, thereby reducing its capital stock from 3,000 shares to 1,978 shares.

The Commissioner ruled that the value of the stock received was taxable income. As it had not been returned, he assessed a 5 per cent penalty for negligence in making the return. The Board of Tax Appeals held—six members dissenting—that the receipt of the stock did not constitute taxable income. The majority of the Board said, "we have uniformly held that the corporation realizes no gain or loss from the purchase or sale of its own stock." "But when it (the Woods company) received 1,022 shares of its own common stock, it owned no property which it did not own before. The corporation, S. A. Woods Machine Co., was already the owner of all the property of the corporation, and the acquirement of these 1,022 shares added nothing to this ownership."

The statute definition of gross income (Revenue Act of 1924, ch. 234, sections 233 and 213) is in general terms which throw no light on the present question. The Treasury regulations provide: "If * * * for any * * * purpose the stockholders donate or return to the corporation certain shares of the stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock." (Regulations 65, article 543.)

Whether the acquisition or sale by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction involved. (*Walville Lumber Co.* v. *Com. of Internal Revenue*, 35 Fed. (2d), 445; *Spear & Co.* v. *Heiner*, 54 Fed. (2d), 134.) If it was in fact a capital transaction, i.e., if the shares were acquired or parted with in connection with a readjustment of the capital structure of the corporation, the Board rule applies. (*Doyle* v. *Mitchell Bros. Co.*, 247 U. S., 179, 184; *Eisner* v. *Macomber*, 252 U. S., 189 [T. D. 3010, C. B. 3, 25].) But where the transaction is not of that character, and a corporation has legally dealt in its own stock as it might in the shares of another corporation, and in so doing has made a gain or suffered a loss, we perceive no sufficient reason why the gain or loss should not be taken into account in computing the taxable income. The view taken by the Board of Tax Appeals (see *Houston Bros. Co.*, 21 B. T. A., 804) presses accounting theory too far in disregard of plain facts. It is not supported by any decision which has come to our attention except those of the Board. In *Knickerbocker Imp. Co.* v. *Board of Assessors* (74 N. J. L., 583, 585), the plaintiff corporation was held liable for the franchise tax on its own stock which it had bought and held in its treasury. The court said: "Stock once issued is and remains outstanding until retired and canceled by the method provided by statute for the retirement and cancellation of capital stock." (Dill, J.) In *United States* v. *Kirby Lumber Co.* (284 U. S., 1 [Ct. D. 420, C. B. X–2, 356]), dealing with a question somewhat similar to the present one, the court said: "We see nothing to be gained by the discussion of judicial definitions. The defendant in error has realized within the year an accession to income, if we take the words in their plain, popular meaning, as they should be taken here." (Holmes, J.) (See, too, *Maryland Casualty Co.* v. *United States*, 251 U. S., 342.) As has often been said, taxes are practical things and should be dealt with on a practical basis.

The transaction involved in this case was equivalent to the payment of the debt in cash and the investment of the proceeds by the corporation in its own stock. If that had been done clearly the cash received would have been taxable income. The transaction was not changed in its essential character by the fact that, as the debtor happened also to own the stock, the money payment and the purchase of stock were by-passed, and the stock was directly transferred in payment of the debt. The stock was the medium in which the debt was paid. The wide door to evasion of taxes opened by the decision of the Board is an additional reason, and a weighty one, against it.

The penalty was wrongfully assessed. The Woods company had the right to act on its own view of the law, if honestly held and not obviously untenable. That it was honestly held, there appears no reason to doubt; that it was not obviously untenable is shown by the decision of the Board.

The order or decision of the Board of Tax Appeals is reversed and the case is remanded to that Board for further proceedings not inconsistent with this opinion.

SECTION 234.—DEDUCTIONS ALLOWED CORPORATIONS.

ARTICLE 561: Allowable deductions. XII-3-5992
Ct. D. 622

INCOME AND EXCESS PROFITS TAX—REVENUE ACT OF 1918—DECISION OF SUPREME COURT.

1. DEDUCTION—LOSS ON TRANSFER OF STOCK—CORPORATION AND STOCKHOLDER SEPARATE ENTITIES.

A corporation and an estate are separate and distinct entities, even though the estate owns all the stock of the corporation, and a transfer of stock from the corporation to the estate constitutes a transaction resulting in taxable gain or deductible loss.

2. CASES DISTINGUISHED.

Southern Pacific Co. v. *Lowe* (247 U. S., 330) and *Gulf Oil Corporation* v. *Lewellyn* (248 U. S., 71) distinguished.

SUPREME COURT OF THE UNITED STATES.

David Burnet, Commissioner of Internal Revenue, petitioner, v. *Commonwealth Improvement Co.*

On writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[December 12, 1932.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the court.

Respondent—Commonwealth Improvement Co.—all of whose shares are owned by the estate of P. A. B. Widener (he died in 1915), made return concerning income and excess profits taxes for 1920 wherein it claimed deduction for loss occasioned by transfer of British-American Tobacco Co. stock to the estate. The Commissioner refused to allow the deduction and found that rightly regarded the transaction had yielded gain to the taxpayer. A deficiency assessment followed.

The Board of Tax Appeals approved the Commissioner's action; but the Circuit Court of Appeals, Third Circuit, held otherwise.

Having acquired control of the Commonwealth Improvement Co., incorporated under an old Pennsylvania charter, Mr. Widener caused an increase of its capital stock and authorization of $20,000,000 script and debentures. He then—May 1, 1912—conveyed to the corporation sundry stocks valued at $25,000,000, taking in payment all its shares and $20,000,000 in debentures and script. He was old and the double purpose was to avoid multifold death duties or transfer taxes and to insure the safety of an endowment which he wished to donate to a favorite charity—School for Crippled Children. Four million dollars of the debentures so received were promptly deposited in trust for the benefit of that school.

Among the securities transferred by Widener to respondent were 225,000 shares British-American Tobacco Co. Their market value March 1, 1913, was $5,315,625—$23.625 per share.

In 1919 the Improvement company, under privilege extended to stockholders, subscribed for and received 75,000 new shares then issued by the British-American Co. Paying therefor $326,437.50—$4.3525 per share—much less than market value.

In 1920 the trustees of the estate acquired the $4,000,000 of respondent's debentures theretofore deposited for benefit of the school. These were transferred to respondent and in part payment it transferred to the estate the original block (the identical certificates) of 225,000 British-American Tobacco Co. shares valued at $5,287,500—$23.50 per share. The apparent result was sale

of the whole block at 12½ cents per share under the March 1, 1913, value with consequent net loss of $28,125. For this sum respondent claimed deduction upon its 1920 tax return.

When the Commissioner audited the return he decided that the base value per unit (for taxation purposes) of the 225,000 shares British-American Tobacco Co., transferred as shown, should be ascertained by adding to their total market value March 1, 1913—$5,315,625—the total paid for the 75,000 shares acquired in 1919, $326,437.50, and dividing the resulting sum by 300,000. The quotient, $18.806875, he held was the base cost of each transferred share. Accordingly, he found a gain by respondent of $1,055,953.12 and made an appropriate deficiency assessment.

In brief and argument here respondent advances two points. First, it is said the Commissioner improperly reckoned the base value of the British-American Tobacco Co. shares. Second, that under the peculiar facts of the cause the transaction under consideration resulted in no true loss or gain. Respondent was merely the agency or instrumentality of the trustees of the estate in administering their trust. Practically considered, the Improvement company and the estate are the same entity.

The Board of Tax Appeals expressed no opinion concerning the Commissioner's method of reckoning—it was not requested so to do. There the respondent relied entirely upon the second point. The Circuit Court of Appeals ruled only on the same point. In such circumstances, we do not undertake to determine what was not considered below.

Upon the second point we think the Board of Tax Appeals reached the right conclusion; the judgment of the Circuit Court of Appeals must be reversed.

Among other things, the Board well said—

"The petitioner does not now argue before the Board that the method of computing the gain was incorrect, but relies entirely upon its contention that the corporation and the estate are the same entity. If this contention were logically applied it would follow that all income received by the corporation since its organization was properly taxable as income of P. A. B. Widener and his estate and should have been added to any other income which Widener and his estate received during these years and taxed at the rates applicable to individuals rather than returned by the petitioner and taxed at the rates fixed for corporations. For the purposes of inheritance and transfer taxes imposed by the various States upon the transfer of the stocks owned by petitioner the corporate entity should have been disregarded upon the death of Widener and these stocks subjected to whatever taxes would have been payable had they been owned by the decedent. But petitioner does not seek to carry its contention to such a conclusion. Having enjoyed the benefits which resulted from its separate existence, it seeks to perpetuate those benefits and asks that the separate existence and tax liability of the petitioner and its single stockholder be overlooked only with respect to transactions which take place between them. That this is an afterthought is plainly evidenced by the action of petitioner in claiming a deduction upon this same transaction when it believed a deductible loss had been sustained. * * *

"The fact is that petitioner did have a separate legal existence with privileges and obligations entirely separate from those of its stockholders. The fact that it had only one stockholder seems of no legal significance. (*Cannon Mfg. Co.* v. *Cudahy Co.*, 267 U. S., 333.)"

Counsel for respondent concede that ordinarily a corporation and its stockholders are separate entities, whether the shares are divided among many or are owned by one. Consequently, they make no effort to support any general rule under which a corporation and its single stockholder have such identity of interest that transactions between them must be disregarded for tax purposes. They submit, however, the peculiar facts here disclosed suffice to show there was really no income, nothing properly taxable as such. They refer to *Southern Pacific Co.* v. *Lowe* (247 U. S., 330) and *Gulf Oil Corporation* v. *Lewellyn* (248 U. S., 71) not as controlling but as instances where the court looked through mere form and regarded substance.

While unusual cases may require disregard of corporate form, we think the record here fails to disclose any circumstances sufficient to support the petitioner's claim. Certainly, the Improvement company and the estate were separate and distinct entities; the former was avowedly utilized to bring about a change in ownership beneficial to the latter. For years they were

recognized and treated as different things and taxed accordingly upon separate returns. The situation is not materially different from the not infrequent one where a corporation is controlled by a single stockholder. (See *Eisner* v. *Macomber*, 252 U. S., 189, 208, 209 [T. D. 3010, C. B. 3, 25]; *Lynch* v. *Hornby*, 247 U. S., 339, 341; *United States* v. *Phellis*, 257 U. S., 156, 172, 173 [T. D. 3270, C. B. 5, 37].)

Southern Pacific Co. v. *Lowe*, supra, and *Gulf Oil Corporation* v. *Lewellyn*, supra (the latter covered in principle by the first), can not be regarded as laying down any general rule authorizing disregard of corporate entity in respect of taxation. These cases presented peculiar situations and were determined upon consideration of them. In the former this court said: "This case turns upon its very peculiar facts, and is distinguishable from others in which the question of the identity of a controlling stockholder with his corporation has been raised. (*Pullman Car Co.* v. *Missouri Pacific Ry. Co.*, 115 U. S., 587, 596; *Peterson* v. *Chicago, Rock Island & Pacific Ry. Co.*, 205 U. S., 364, 391.)"

Reversed.

ARTICLE 561: Allowable deductions.

XII-24-6228
Ct. D. 681

INCOME TAX—REVENUE ACTS OF 1921, 1924, AND 1926—DECISION OF COURT.

1. DEDUCTIONS—ORDINARY AND NECESSARY BUSINESS EXPENSE—PAYMENT OF GUARANTEED DIVIDENDS.

Payments made in the years 1922–1926 by a domestic corporation to a foreign corporation pursuant to a contract whereby it was agreed that, in consideration of the purchase by the domestic corporation of the foreign corporation's American business, the former would guarantee payment of dividends to the preferred stockholders of the latter, up to a certain amount, the foreign corporation agreeing to reimburse the domestic corporation for such payments, were nothing more than advances on the credit of the foreign corporation. Although the domestic corporation had not enforced the right to reimbursement, it had not agreed to forego such right, and the payments were not ordinary and necessary business expenses within the purview of section 234(a)1 of the Revenue Acts of 1921, 1924, and 1926.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (24 B. T. A., 518) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Glendinning, McLeish & Co., Inc., petitioner, v. *Commissioner of Internal Revenue, respondent.*

Before MANTON, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

[December 5, 1932.]

OPINION.

Petitioner brought this petition to review orders of redetermination made by the Board of Tax Appeals under which there are deficiency assessments of income taxes for the years 1922, 1923, 1924, 1925, and 1926.

The petitioner is a New York corporation which was organized in January, 1918, to take over the American business of Glendinning, McLeish & Co., Ltd., of Belfast, Ireland. It entered into a written agreement with the Belfast company in February, 1918, under which it acquired that company's American business including all its tangible and intangible property in this country as of January 1, 1918, and it has since been a large importer of handkerchiefs and the sole outlet for the Belfast company's product in this country.

The agreement provided in part as follows:

"(6) In consideration of the sale and transfer to your company of said property, you will further agree that you will, at our request, at any time within one year from this date,

"(a) Guarantee the payment of all or any part of the 5 per cent, cumulative dividends upon the outstanding preferred stock of Glendinning, McLeish & Co., Ltd., to an amount not exceeding the sum of £5,000 yearly, and

"(b) We agree that if said company is wound up, and there shall, upon such winding-up or dissolution, be insufficient assets of Glendinning, McLeish & Co., Ltd., to pay the preferred stockholders of said company the par value of the preferred stock then outstanding, that you will make good any deficiency not exceeding £100,000.

"We agree that in no event shall your company be requested or required to make any guarantee or assume any obligation with regard to or in connection with the preferred stock of said company in excess of the contract obligations of said company to its preferred shareholders, and that your company shall in no event be obligated to advance any sums of money whatsoever to said Glendinning, McLeish & Co., Ltd., or to its shareholders, in the event of dissolution, unless and until there shall be a deficiency remaining after all of the assets of Glendinning, McLeish & Co., Ltd., shall have been first exhausted.

"We agree further that we will procure from Glendinning, McLeish & Co., Ltd., its agreement to reimburse you for any expenditures which you may make, pursuant to this clause of this agreement, on its behalf, or on behalf of its shareholders."

The capital stock of the petitioner of par value equal to the amount ascertained to be the fair value of the property purchased was agreed to be delivered to the Belfast company in payment for its American business and, in addition to the promises above quoted in (6) and some others not now material, completed the purchase price.

The petitioner paid to the Belfast company in accordance with its agreement to guarantee the dividends on the preferred stock of that company $10,588.80 in 1922; $3,089.23 in 1923; $21,850 in 1924; $25,250 in 1925; and $25,000 in 1926 and has not been reimbursed by the Belfast company. It was stipulated that the agreement has since remained in effect. Also that the Belfast company has allowed the petitioner a discount of 5 per cent off list prices on all purchases; supplied the services of a style originator without charge; and absorbed all inventory losses on raw materials purchased to manufacture the goods ordered by the petitioner. It was not shown, however, that the petitioner agreed to forego any right it had under the contract to be reimbursed for the payments now being considered. Each of these payments was charged by the petitioner to operating expense in the year in which it was paid and its right to deduct from gross income the amount so paid in the respective years in computing its income tax for such years is now in issue. The deductions are claimed as ordinary and necessary expenses paid during the taxable years in carrying on its business.

CHASE, Circuit Judge: The contention of the petitioner that the agreement for reimbursement applied only to subdivision (b) of paragraph (6) flies in the face of the fact that there was not only no limitation in terms to subdivision (b) but an apparent impossibility of performance if it covered only that. For if the Belfast company upon dissolution should be without assets sufficient to pay to its preferred stockholders the par value of the preferred stock then outstanding it would, of course, be without funds with which to reimburse the petitioner for any payments it made under subdivision (b). While nothing as to ability to perform is now directly before us, we mention this feature to point out that so far as the record now stands it would seemingly be impossible to give substance to the agreement to reimburse the petitioner and read into the language used a limitation that would exclude subdivision (a) from its coverage. For present purposes that is but an added reason for declining to accept the construction urged by the petitioner in restriction of the natural, broad meaning of the words the parties chose to use.

Being advances made by the petitioner in accordance with its agreement to make them and the agreement of the Belfast company to repay them, the amounts here involved were not within the statute permitting the deduction of ordinary and necessary business expenses since they could not be expenses of any kind provided the petitioner could and did enforce its right to reimbursement. Although we know that it has not, there is no proof that it could

not have required the agreed repayment if it had elected to do so. Perhaps it would be going far to call these advances loans in the ordinary sense but there is no occasion to define them precisely for we are now concerned only with their deductibility for the computation of the net income for purposes of taxation and it is enough to determine negatively only that in none of the taxable years was the payment made in that year an expense of the business. The agreement for reimbursement made them at least advances on the credit of the Belfast company and requires that they be so treated in computing the net income of the petitioner. As such they were not deductible. (*Cohen* v. *Commissioner*, 39 Fed. (2d), 540; *Island Petroleum Co.* v. *Commissioner*, 57 Fed. (2d), 992.)

In view of the above we have no occasion to consider whether, in the absence of any agreement to reimburse, these payments would have been properly charged to business expense or would have been capital expenditures.

Affirmed.

SECTION 240.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 632: Consolidated returns.

REVENUE ACT OF 1926.

Liquidation of subsidiary as an incident to the dissolution thereof. Sale of subsidiary's stock to outside interests. General Counsel's Memorandum 8889 (C. B. IX–2, 236) revoked. (See G. C. M. 11676, page 75.)

ARTICLE 633: When corporations are affiliated. XII–10–6058
Ct. D. 637

INCOME TAX—REVENUE ACTS OF 1917, 1918, AND 1921—DECISION OF SUPREME COURT.

CONSOLIDATED RETURNS—AFFILIATION—OWNERSHIP OR CONTROL OF STOCK.

Where petitioner, a public service corporation, during the years 1917, 1918, and 1919 had outstanding common and preferred stock, the preferred stock entitling the holders thereof to vote, to annual dividends, to redemption at any time, and to preference upon final liquidation, and a holding company owned all of the common stock but none of the preferred, its holdings constituting approximately 77 per cent of the entire voting stock, both preferred and common, the corporations are not affiliated, within the meaning of section 240 of the Revenue Act of 1918 and section 1331 of the Revenue Act of 1921, so as to authorize the filing of consolidated returns. Preferred stock with voting rights can not be excluded where it is redeemable at any time and has a limited interest in dividends.

SUPREME COURT OF THE UNITED STATES.

Atlantic City Elcctric Co., petitioner, v. *Commissioner of Internal Revenue.*

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[February 6, 1933.]

OPINION.

Mr. Chief Justice HUGHES delivered the opinion of the court.

The question presented is whether the petitioner, Atlantic City Electric Co., was affiliated with the American Gas & Electric Co., so that the Federal taxes for 1917, 1918, and 1919 should be determined upon the basis of consolidated

returns under section 1331 of the Revenue Act of 1921 (42 Stat., 319), as applicable to the year 1917, and section 240 of the Revenue Act of 1918 (40 Stat., 1081, 1082). The Circuit Court of Appeals, reversing the order of the Board of Tax Appeals (15 B. T. A., 1084), upheld the ruling of the Commissioner that the corporations were not affiliated and must make separate returns. (57 F. (2d), 186.) The case comes here on certiorari (287 U. S., 582).

The following facts were found by the Board of Tax Appeals: The petitioner, Atlantic City Electric Co., is a public service corporation. During the years in question, it had outstanding 12,500 shares of common stock, of the par value of $100 per share, and 3,702 shares of preferred stock. Holders of preferred stock were entitled to vote and that stock was preferred to the extent of an annual cumulative dividend of 6 per cent and on final liquidation. The preferred stock was redeemable at any time and had no interest in dividends except as above stated. The American Gas & Electric Co. was a holding company. It owned all the common stock of the Atlantic City Electric Co. and none of its preferred stock. Six hundred and fifty-five to seven hundred and sixty-one shares of that preferred stock were owned by stockholders of the American Gas & Electric Co., but the finding is that the control exercised by that company resulted "from its absolute ownership of the entire common stock of its subsidiaries and not from control or ownership of preferred stock by its stockholders." Of the total outstanding stock of the Atlantic City Electric Co., preferred and common, the American Gas & Electric Co. owned approximately 77 per cent.

With respect to control of stock, as creating the affiliation which affords a basis for a consolidated return, section 1331 of the Revenue Act of 1921 is to the same effect as section 240 of the Revenue Act of 1918. The requirement of control, in the absence of legal title or beneficial ownership, is not satisfied by acquiescence or by business considerations without binding force. There must be a control that is legally enforceable. (*Handy & Harman* v. *Burnet*, 284 U. S., 136, 140, 141 [Ct. D. 425, C. B. X–2, 370].) And it must be control of "substantially all the stock." In *Handy & Harman* v. *Burnet*, supra, legally enforceable control of somewhat more than 75 per cent of the stock was held to be insufficient. The question, then, is whether in the instant case the entire voting stock, preferred and common, should be considered in determining whether there was affiliation, or the common stock alone.

The purpose of the Congress was to secure substantial equality among stockholders who ultimately bear the burden of taxation and to prevent evasion through the manipulation of intercompany transactions. (*Handy & Harman* v. *Burnet*, supra. See, also, *Burnet* v. *Aluminum Goods Manufacturing Co.*, decided January 9, 1933 [Ct. D. 631, page 283, this Bulletin].) The requirement of consolidated returns was "based upon the principle of levying the tax according to the true net income and invested capital of a single business enterprise, even though the business is operated through more than one corporation." (Treasury Regulations No. 45, article 631.[1]) In establishing ownership or control of substantially all the stock as the criterion of a business unit, the statute made no distinction between preferred and common stock. It referred simply to "stock" and we perceive no ground upon which stock with voting right can be treated as excepted. The Treasury regulations under the Revenue Act of 1918 regarded the statutory requirement as relating to the "outstanding voting capital stock (not including stock in the treasury) at the beginning of and during the taxable year." (Regulations No. 45, article 633.) The same construction was given by the Department to the corresponding provision of the Revenue

[1] Article 631 of Regulations No. 45 is as follows:

"*Affiliated corporations.*—The provision of the statute requiring affiliated corporations to file consolidated returns is based upon the principle of levying the tax according to the true net income and invested capital of a single business enterprise, even though the business is operated through more than one corporation. Where one corporation owns the capital stock of another corporation or other corporations, or where the stock of two or more corporations is owned by the same interests, a situation results which is closely analogous to that of a business maintaining one or more branch establishments. In the latter case, because of the direct ownership of the property, the invested capital and net income of the branch form a part of the invested capital and net income of the entire organization. Where such branches or units of a business are owned and controlled through the medium of separate corporations, it is necessary to require a consolidated return in order that the invested capital and net income of the entire group may be accurately determined. Otherwise opportunity would be afforded for the evasion of taxation by the shifting of income through price fixing, charges for services and other means by which income could be arbitrarily assigned to one or another unit of the group. In other cases without a consolidated return excessive taxation might be imposed as a result of purely artificial conditions existing between corporations within a controlled group."

Act of 1921. (Regulations No. 62, article 633.) The Congress, in the Revenue Act of 1924, embodied this construction in the statute itself.[2] (Section 240(c)1, 43 Stat., 288.) (See, also, Revenue Act of 1926, section 240(c)(d), 44 Stat., 46; Revenue Act of 1928, section 141(d), 45 Stat., 831; Revenue Act of 1932, section 141(d), 47 Stat., 213. Compare *Schlafly* v. *United States*, 4 F. (2d), 195, 200 [T. D. 3693, C. B. IV-1, 220]; *Ice Service Co.* v. *Commissioner*, 30 F. (2d), 230, 231; *United States* v. *Cleveland, P. & E. R. Co.*, 42 F. (2d), 413 [Ct. D. 252, C. B. IX-2, 387]; *Commissioner* v. *City Button Works*, 49 F. (2d), 705.)

Nor are we able to conclude that in the instant case the preferred stock with voting right should be excluded because it was redeemable at any time and had a limited interest in dividends. (Compare *Commissioner* v. *Shillito Realty Co.*, 39 F. (2d), 830; *United States* v. *Cleveland, P. & E. R. Co.*, 42 F. (2d), 413.) Despite redeemability and the limitation of dividends, the owners of the preferred stock were not in the position of creditors, but were stockholders with a proprietary interest in the corporate undertaking and with a corresponding relation, through the voting right, to the direction of that undertaking. The voting right remained unimpaired until actual redemption. The statute is not concerned with a failure to exercise existing rights, but with what is deemed to be a more certain and adequate test of a unitary enterprise. According to this test, petitioner failed to show affiliation. (*Burnet* v. *Howes Bros. Hide Co.*, 284 U. S., 583, 584.)

Judgment affirmed.

ARTICLE 635: Consolidated net income of affiliated corporations.

XII-7-6029
Ct. D. 631

INCOME AND WAR EXCESS-PROFITS TAXES—REVENUE ACTS OF 1917 AND 1921—DECISION OF SUPREME COURT.

DEDUCTIONS—LOSSES—CONSOLIDATED RETURN—AFFILIATED CORPORATIONS.

Where A Corporation in 1914 purchased all the capital stock of B Corporation, which latter corporation sustained operating net losses during 1914, 1915, and 1916, was liquidating in 1917, and dissolved in 1918, and where for the year 1917 the two corporations filed separate returns for income tax purposes, A claiming in its return deduction for aggregate loss due to advances to B and investment in B's stock, less the value of equipment and good will realized on liquidation of B, which claim was allowed, and for the same year a consolidated return was filed for purposes of war excess-profits tax, affiliation did not cease in 1917 merely because B was liquidating, and A's capital loss in 1917, reduced by the amount of the operating loss of B for that year, was properly deductible in the consolidated return, under Title II of the Revenue Act of 1917 and section 1331 of the Revenue Act of 1921, and is not prohibited by articles 77 and 78 of Regulations 41. Such deduction involved no double deduction of losses of the business of the two companies during the period of their affiliation.

SUPREME COURT OF THE UNITED STATES.

David Burnet, Commissioner of Internal Revenue, petitioner, v. *Aluminum Goods Manufacturing Co.*

On writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[January 9, 1933.]

OPINION.

Mr. Justice STONE delivered the opinion of the court.

In 1914 respondent, a New Jersey manufacturing corporation, purchased all the capital stock of the Aluminum Sales & Manufacturing Co., a New York cor-

[2] With respect to this provision, the report of the Committee on Ways and Means of the House of Representatives said: "The requirement that the stock held must be 'voting' stock merely embodies in the law the present rule of the Treasury Department." (House Report No. 179, Sixty-eighth Congress, first session, page 24.)

poration. From that time until its liquidation, carried on in 1917, the Sales company was principally engaged in selling goods manufactured by respondent. In February, 1918, it was dissolved. The operation of the Sales company reflected net losses during the years 1914, 1915, and 1916, as well as in the year 1917. As a result of the operating losses and the liquidation of the Sales company, respondent suffered the loss of certain sums advanced to the Sales company, and of the total investment in its stock.

For 1917 the two corporations filed separate returns for computation of the normal income tax, and a consolidated return for the purposes of the excess profits tax. In its separate return respondent claimed, and the Commissioner allowed, deduction of an aggregate loss made up of respondent's advances to the Sales company, and the cost of its stock, less the value of equipment and good will realized on its liquidation. This loss, reduced by the 1917 operating loss of the Sales company, was deducted from gross income in the consolidated return. The Commissioner's refusal to allow the deduction was sustained by the Board of Tax Appeals (22 B. T. A., 1), whose determination was reversed by the Court of Appeals for the Seventh Circuit (56 F. (2d), 568). The Court of Appeals held that respondent's affiliation with the Sales company was ended by the liquidation in 1917, so that the loss was suffered "outside the period of affiliation," and that, in any case, as the loss did not result from an "intercompany" transaction, it could be deducted in the consolidated return. This court granted certiorari (287 U. S., 583) to resolve an alleged conflict with the decision of the Court of Claims in *Utica Knitting Co.* v. *United States* (68 Ct. Cls., 77 [Ct. D. 126, C. B. VIII–2, 352]), and see *Autosales Corporation* v. *Commissioner* (43 F. (2d), 931, 933).

Title II of the Revenue Act of 1917 (40 Stat., 300, 302) imposed a war excess profits tax in addition to the normal tax upon the income of corporations. The statute made no provision for consolidated returns by affiliated corporations, but articles 77 and 78 of Treasury Regulations 41, adopted pursuant to the Act, did authorize the Commissioner to require affiliated corporations, including those, the stock of one of which was owned by another, to file a consolidated return of net income and invested capital. And section 1331 of the Revenue Act of 1921 (42 Stat., 227, 319) provided that for the purpose of determining excess profits taxes the Revenue Act of 1917 "shall be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of domestic corporations and domestic partnerships that were affiliated during the calendar year 1917."[1]

The purpose of requiring consolidated returns by affiliated corporations was, as the Government contends, to impose the war profits tax, according to true net income and invested capital of what was, in practical effect, a single business enterprise, even though conducted by means of more than one corporation. Primarily, the consolidated return was to preclude reduction of the total tax payable by the business, viewed as a unit, by redistribution of income or capital among the component corporations by means of intercompany transactions. See *Handy & Harman* v. *Burnet* (284 U. S., 136, 140 [Ct. D. 425, C. B. X–2, 370]); *Appeal of Gould Coupler Co.* (5 B. T. A., 499, 514–516); *cf.* Treasury Regulations 41, article 77; Treasury Regulations 45, article 631.

It is not denied that the two corporations became affiliated when respondent acquired all the capital stock of the Sales company. But on the basis of the finding of the Board of Tax Appeals that the Sales company was chiefly engaged during 1917 in closing up its business preparatory to formal dissolution, which took place in February, 1918, that all its assets and liabilities were disposed of by the end of 1917, and that it did not do any business after that date, petitioner argues that the affiliation of the two companies was terminated by the liquidation.

Since complete stock ownership is made the test of affiliation applicable here under article 77 of Treasury Regulations 41 and section 1331 of the Revenue Act of 1921, no ground is apparent for saying that the corporations ceased to be affiliated, merely because, without change of corporate control, one of them was being liquidated. The findings do not reveal that the liquidation of the Sales

[1] Subsequent to 1917, affiliated corporations were required to file such a return for all purposes for any taxable year prior to January 1, 1922 (section 240, Revenue Act of 1918, 40 Stat., 1057, 1081; section 240, Revenue Act of 1921, 42 Stat., 227, 260). Thereafter, it became optional whether to file a consolidated or separate return. (Section 240, Revenue Act of 1921; section 240, Revenue Act of 1924, 43 Stat., 253, 288; section 240, Revenue Act of 1926, 44 Stat., 9, 46; sections 141, 142, Revenue Act of 1928, 45 Stat., 791, 831, 832.)

company was completed, that it ceased to do any business or to function as a corporation before the end of 1917. Neither statute nor regulations recognize that affiliation may be terminated by the mere fact that such liquidation is being carried on, and the reasons for requiring the consolidated return may be quite as valid during that liquidation as before. During that period the unitary character of the business enterprise is not necessarily ended and intercompany manipulations are not precluded.

In the present case, even though the affiliation continued, it does not follow as a matter of law that the loss was not rightly deducted in the consolidated return. Section 12, Revenue Act of 1916 (39 Stat., 756, 767) governs the computation of the excess profits tax under section 206, Revenue Act of 1917 (40 Stat., 300, 305). That section and the regulation under it (see article 147, Treasury Regulations 33 (1918 ed.)) direct that taxable net income of a corporate taxpayer shall be ascertained by deducting, from gross income, losses sustained within the year. It is conceded that the loss of respondent's advances to the Sales company and the investment in its stock was sustained in 1917, was deductible, therefore, if at all, in that year, and might properly have been deducted by respondent in a separate return, if a separate return had been permissible. But the Government insists that the loss can not be deducted in the mandatory consolidated return for 1917 because it occurred as the result of "intercompany" transactions.

We need not decide whether the loss resulted from intercompany transactions within the meaning of the regulations under later statutes[2] which broadly exclude from the consolidated returns profit or loss upon all such transactions. For neither the Revenue Act of 1917, nor section 1331 of the Revenue Act of 1921, nor the regulations under them[3] prescribe specifically the method of making up the consolidated return or require the elimination from the computation of the tax of the results of all intercompany transactions. Article 77 of Treasury Regulations 41 required every corporation to describe in its return "all its intercorporate relationships with other corporations, with which it is affiliated," and to "furnish such information in relation thereto as will enable the Commissioner of Internal Revenue to compute the amount of the tax properly due from each corporation on the basis of an equitable and lawful accounting." Article 78 authorizes the Commissioner to require consolidated returns of affiliated corporations "whenever necessary to more equitably determine invested capital or taxable income," and provides that "the total tax will be computed in the first instance as a unit on the basis of the consolidated return."

These provisions plainly do not lay down any rigid rule of accounting to be applied to consolidated returns which would exclude from the computation of taxable income the results of every intercompany transaction, regardless of its effect upon the capital or the net gains or losses of the business of the affiliated corporations. Instead, they merely disclose the purpose underlying regulations and statute to prevent, through the exercise of a common power of control, any intercompany manipulation which would distort invested capital or the true income of the unitary business carried on by the affiliated corporations. Hence, no method of accounting, in calculating taxable income upon the consolidated return, can be upheld, which would withhold from the taxpayer all benefit of deduction for losses actually sustained and deductible under the sections governing the computation of taxable income, and which at the same time would not further, in some way, the very purpose for which consolidated returns are required.

Such, we think, is the effect of the method adopted by the Commissioner. The Sales company suffered losses during the years 1914, 1915, and 1916 which could not be deducted in its separate returns for those years, because they were net losses, and which could not be deducted from the profits of the parent company because there was no consolidated return in those years. While it may be assumed that those losses affected the value of the stock owned by

[2] See articles 637, 864 of Treasury Regulations 45 under the Revenue Act of 1918; articles 635, 864 of Treasury Regulations 62 under the Revenue Act of 1921; article 636 of Treasury Regulations 65 under the Revenue Act of 1924; article 635 of Treasury Regulations 69 under the Revenue Act of 1926; article 734 of Treasury Regulations 74 and articles 15, 31, 37(a), 38(b) of Treasury Regulations 75 under the Revenue Act of 1928.

[3] Article 1735 of Treasury Regulations 62, under section 1331 of the Revenue Act of 1921, merely refers to Treasury Regulations 41 under the Revenue Act of 1917.

the parent company, the loss of its investment in the stock of the Sales company and in advances to it could not be deducted by the parent company in its separate return for those years because the loss had not then been sustained with such finality as to permit its deduction under the applicable statute and regulations. So far as the loss from operation of the Sales company in earlier years contributed to respondent's capital loss in 1917, deduction of the latter in the consolidated return involved no double deduction of losses of the business of the two companies during the period of their affiliation. As respondents' total loss in 1917 was reduced, before deduction in the consolidated return, by the amount of the operating loss of the Sales company for that year, there was no duplication of any losses accrued or sustained in that year.

The loss was a real one, suffered by respondent as a separate corporate entity and it was equally a loss suffered by the single business carried on by the two corporations during the period of their affiliation, ultimately reflected in the 1917 loss of capital invested in that business. While equitable principles of accounting applied to the calculation of the net income of the business unit do not permit deduction of the loss twice, they do require its deduction once. Hence, the loss was deductible in 1917 under the statute and regulations controlling computation of taxable income, and its deduction is not forbidden by the regulations applicable to the consolidated return. Articles 77 and 78 of Treasury Regulations 41 would, indeed, require the elimination of any losses resulting from intercompany transactions the inclusion of which would defeat the purpose of consolidated returns to tax the true income of the single business of affiliated corporations, calculated by correct accounting methods. The deductions claimed here had no such effect.

Affirmed.

ARTICLE 635: Consolidated net income of affiliated corporations.

REVENUE ACTS OF 1918 AND 1921.

Liquidation of subsidiary as an incident to the dissolution thereof. General Counsel's Memorandum 1501 (C. B. VI–1, 260) modified. (See G. C. M. 11676, page 75.)

SECTION 245.

ARTICLE 685: Other deductions. XII–10–6059
Ct. D. 638

INCOME TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

1. DEDUCTION—INTEREST CREDITED—LIFE INSURANCE COMPANY—CASH RECEIPTS AND DISBURSEMENTS METHOD.

Interest accrued and credited in 1926, but not paid in that year, to policyholders under policy contracts providing that it was subject to withdrawal at any time on demand does not constitute a constructive payment of the interest in 1926 and is not an allowable deduction in that year, under section 245(a)8 of the Revenue Act of 1926, from the gross income of a life insurance company employing, as required by the Revenue Act of 1926 and the income tax regulations thereunder, the cash receipts and disbursements method of accounting.

2. DECISION AFFIRMED.

The decision of the Court of Claims (59 Fed. (2d), 116, Ct. D. 563, C. B. XI–2, 303) is affirmed.

SUPREME COURT OF THE UNITED STATES.

The Massachusetts Mutual Life Insurance Co., petitioner, v. United States of America.

On writ of certiorari to the Court of Claims.

[February 6, 1933.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the court.

The question in this case is whether the petitioner, a Massachusetts life insurance company operating on the mutual level premium plan, is entitled, under section 245 of the Revenue Act of 1926,[1] to deduct from its gross income, as interest paid, the amount of interest credited to its policyholders during the taxable year, but not withdrawn by them.

Petitioner agrees to repay a portion of its receipts to policyholders in the form of dividends. The policies provide that these dividends, when declared, may at the option of the insured be withdrawn in cash, applied as premium payments, or allowed to remain on deposit with the company at interest. If the last alternative be chosen the dividends and interest accumulate; interest being added to the accumulated sum at the end of each policy year. The dividends and all accrued interest thereon may be withdrawn at any time on demand. Of the total which became due policyholders in 1926 as interest on sums so left with the company, $544,964.40, the portion not withdrawn, was credited in appropriate amounts to the individual accounts of the policyholders during that year. In its tax return the petitioner deducted as interest paid the amount so credited. Interest actually withdrawn during 1926 totaled $248,405.97, some of which was credited to the policyholders in that year, but the greater portion of which had accrued prior to 1926, and had been credited in the respective years of accrual. No deduction was taken for this sum. The Commissioner disallowed the claimed deduction, and allowed in lieu thereof the amount of interest actually withdrawn in 1926. The resulting additional tax was paid under protest, a claim for refund filed, and, the Commissioner having failed to act upon the claim, suit was brought in the Court of Claims to recover the amount. That court dismissed the petition[2] and we brought the case here by certiorari.

The earlier Revenue Acts made no distinction, in the method of computing the tax, between insurance companies and other corporations. The Act of 1921 and those subsequently adopted embodies special and separate provisions respecting such companies.[3] In the Act of 1926, with which we are here concerned, the applicable sections are 242 to 247, inclusive, the first four dealing with life companies. Section 244 defines gross income as the amount received during the taxable year from interest, dividends and rents. Section 245 defines net income as the gross income, less certain enumerated deductions. Paragraph (8) permits deduction of: "All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities * * * the interest upon which is wholly exempt from taxation under this title."

The language of paragraph (8) with respect to interest paid or accrued on indebtedness is precisely the same as that employed with respect to deductions allowed to individuals by section 214(a)2[4] and to corporations by section 234(a)2.[5] Section 200(d)[6] enacts that "The terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232."

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[1] 44 Stat., 9, 47.
[2] 75 C. Cls., 117.
[3] Revenue Act 1921, sections 242–247, 42 Stat., 261; Revenue Act 1924, sections 242–247, 43 Stat., 288; Revenue Act 1926, sections 242–247, 44 Stat., 47; Revenue Act 1928, sections 201–205, 45 Stat., 842; Revenue Act 1932, sections 201–205, 47 Stat., 223.
[4] 44 Stat., 26.
[5] Ibid., 41.
[6] Ibid., 10.

* * * The sections mentioned are those applicable to individuals and to corporations generally; neither deals with insurance companies, which, as above said, are treated exclusively in sections 242 to 247, inclusive.

In the light of these provisions the petitioner insists that insurance companies are forbidden by the terms of the statute to keep their accounts and make their returns by the accrual method, but must report on the cash basis. Hence it is claimed the words "paid or accrued," as applied to interest, can not grant an option in the matter of returns, depending upon whether the insurance company keeps its accounts on a cash basis or on an accrual basis, as in the case of other taxpayers, since the company has no choice in this respect; that the word "accrued" can not be read out of the statute or left without meaning or effect; and that the phrase is employed to describe and allow deduction of interest accrued on dividends left with the company.

The Government replies that prior to 1921 there was no statutory direction as to how insurance companies' returns should be made; a regulation required them to be upon the cash basis; when new sections were inserted in the Act of 1921 as to insurance companies the phraseology with respect to interest deductions of individuals and corporations generally was lifted bodily out of the sections applicable to individuals and corporations and inserted in these new sections; as the Act does not permit insurance companies to account on the accrual basis, only interest paid is deductible, and the term "accrued" has no application. It further points to a regulation adopted immediately upon the passage of the Act of 1921 and carried forward in the regulations under the Acts of 1924 and 1926. This regulation is:[7]

"The deduction allowed by section 245(a)8 for interest on indebtedness is the same as that allowed other corporations by section 234(a)2 (see articles 561 and 121), but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein."

Item 18 of the disbursement page of the annual statement of insurance companies includes the amount of interest actually paid policyholders, whereas accrued interest credited and not withdrawn is shown in item 22 on page 5 of the standard form of report. Insurance companies have without exception complied with the regulation and taken a deduction only for interest paid. The right to deduct interest credited to policyholders but not withdrawn is now asserted for the first time.

The Congress in the Revenue Acts of 1928 and 1932 reenacted section 245 without alteration.[8] This action was taken with knowledge of the construction placed upon the section by the official charged with its administration. If the legislative body had considered the Treasury interpretation erroneous it would have amended the section. Its failure so to do requires the conclusion that the regulation was not inconsistent with the intent of the statute (*National Lead Co.* v. *United States*, 252 U. S., 140, 146; *Poe* v. *Seaborn*, 282 U. S., 101, 116 [Ct. D. 259, C. B. IX–2, 202]; *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S., 488, 492 [Ct. D. 345, C. B. X–1, 444]; *Costanzo* v. *Tillinghast*, 287 U. S., 341) unless, perhaps, the language of the Act is unambiguous and the regulation clearly inconsistent with it. (Compare *Louisville & N. R. Co.* v. *United States*, 282 U. S., 740, 757–758.) The petitioner insists that the statute needs no interpretation and its plain mandate should be enforced. But on examination the proper application of the section is not so clear as is claimed.

The regulations of the Treasury under all the Revenue Acts since 1916 have required taxpayers to report on the cash or accrual basis, depending on which method was pursued in their accounting.[9] Since the adoption of the Revenue Act of 1921 the requirement has been statutory. It is settled beyond cavil that taxpayers other than insurance companies may not accrue receipts and treat expenditures on a cash basis, or vice versa. Nor may they accrue a portion of income and deal with the remainder on a cash basis, nor take deductions partly on one and partly on the other basis. Congress we think did not intend to make an exception of insurance companies. If they are not allowed to account on an accrual basis for interest owed them there is no reason for permitting them to treat interest owed by them on any different basis. The very paragraph (8) on which petitioner relies as defining interest credited but not

[7] Treasury Regulations 62, article 685(3). See Regulations 65, article 685(3); Regulations 69, article 685(3).

[8] See note 3, supra.

[9] Regulations 33 (1918 ed.), articles 126, 180; Regulations 45, articles 23, 1533.

paid, by the use of the word "accrued," recognizes that insurance companies may have indebtedness of other sorts, such as that arising from borrowings to carry securities. Since the company is required to treat interest received on a cash basis, it ought not have the privilege of accruing interest owed. That privilege must be accorded, if petitioner is right. We think the result would be unreasonable and is not intended by the Act.

We are referred to a regulation which provides: "Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession." [10] It is argued that the regulation requires the policyholder to report interest credited to him as received in the year of credit. The conclusion drawn is that if the credit is income to the insured it must constitute a "constructive payment" by the company. In this view the transaction is said to come within the term "paid" and we may disregard the word "accrued." This regulation has, however, not been applied in any case where income has been credited to another by a taxpayer employing the cash receipts and disbursements method of accounting; and specifically it has not been invoked to require policyholders to report as income the dividends or interest credited to them in cases such as this. No tax is demanded of them until actual receipt of the money. The constructive payment theory is, we think, untenable.

We conclude Congress did not intend by the use of the word "accrued" in section 245(a)8 to permit the deduction of interest on policy dividends credited but not paid during the taxable year.

The judgment of the Court of Claims is affirmed. So ordered.

PART V.—PAYMENT, COLLECTION, AND REFUND OF TAX AND PENALTIES.

SECTION 270.—DATE ON WHICH TAX SHALL BE PAID.

ARTICLE 1206: Compromise of tax cases. XII–4–6001
Ct. D. 625

FEDERAL TAXES—COMPROMISE—DECISION OF COURT.

OFFER IN COMPROMISE—DURESS—NOTICE OF DISTRAINT AND SEIZURE.

Where the taxpayer submits an offer in compromise of asserted fraud penalties, which offer is accepted, notices of distraint and seizure issued by the collector, which the law authorizes and requires, do not constitute duress so as to vitiate the compromise.

UNITED STATES DISTRICT COURT, EASTERN DISTRICT OF NEW YORK.

Shaw & Truesdell Co., a Corporation, plaintiff, v. *The United States of America, defendant.*

[November 21, 1932.]

OPINION.

GALSTON, D. J.: This suit is brought pursuant to Title 28, Judicial Code, section 41 (Judicial Code, section 24 amended), subdivision 20.

The plaintiff, a taxpayer, seeks to have an offer of compromise in the amount of $13,803.21, which was submitted on or about May 28, 1926, and duly accepted by the Commissioner of Internal Revenue, set aside, as made under duress and, therefore, illegal and void; that the plaintiff recover the said sum of $13,803.21 with interest thereon from May 28, 1926; and that the plaintiff recover from

[10] Regulations 69, article 51.

the defendant the sum of $19,148.04 with interest thereon from December 13, 1924. At the trial plaintiff withdrew such part of the prayer of the complaint as seeks to recover the sum of $19,148.04 with interest.

It is alleged that the plaintiff filed its income and profits tax return for the fiscal year ended June 30, 1917, and paid the taxes thereon. That thereafter the Commissioner of Internal Revenue assessed additional income and profits taxes for that fiscal year in the sum of $15,686.82, together with a penalty in the sum of $16,931.52 for the making of a false and fraudulent return. On April 23, 1923, the plaintiff paid the additional taxes in the sum of $15,686.82.

A similar situation arose with respect to the filing of its income and profits tax return for the fiscal year ended June 30, 1918. The Commissioner of Internal Revenue assessed additional income and profits taxes for that year in the sum of $22,190.69, and a penalty assessment of $11,095.35 also, for the alleged making of a false and fraudulent return. The additional taxes of $22,190.69 so assessed was paid in two installments—on April 23, 1923, $3,042.65; on December 13, 1924, $19,148.04.

It is alleged that neither of these income and profits tax returns was fraudulently made or filed, but that the returns contained errors which were unknown to the plaintiff's officers when the returns were filed

It is alleged that on or about May 28, 1926, the plaintiff was advised by the collector of internal revenue for the first district of New York, that unless the penalties were paid he would distrain and seize the plaintiff's business to collect the same; and by virtue of such notice and acting under compulsion and duress to protect the alleged illegal distraint and seizure, and after protesting and explaining to the Commissioner of Internal Revenue that no errors were made by the plaintiff with fraudulent intent, the plaintiff, on or about May 28, 1926, filed with the collector of internal revenue an offer of compromise of these penalties in the amount of $13,803.21, which the plaintiff tendered at the same time to the said collector in full settlement.

The answer sets up the offer of compromise as a full and complete settlement of the penalties assessed, and denies that there was any duress asserted in obtaining the offer of compromise.

There are important questions presented by the defendant. Among them are these:

1. Does the evidence introduced at the trial establish that the plaintiff submitted the offer of compromise under duress or as a result of illegal and unlawful coercion on the part of the defendant?

2. Has this court jurisdiction of a suit in equity against the United States to set aside and cancel a contract in the form of an offer in compromise and acceptance thereof wherein the amount involved exceeds $10,000, the collector of internal revenue being out of office at the time the proceeding was commenced?

3. Has this court jurisdiction of a suit in equity brought against the United States as defendant to cancel and set aside an offer of compromise which was duly accepted in accordance with the provisions of the Revised Statutes, section 3229 (U. S. Code, Title 26, section 158), on the ground of duress?

The view which I take of the first question makes unnecessary the consideration of the second and third.

The only evidence on which the plaintiff relies to show duress, in addition to the notice of distraint from the collector of internal revenue, is consultation which the plaintiff's president had with the collector of internal revenue about the penalties. But he was unable to fix the date of these consultations, and unless the notice of distraint can be interpreted as duress, plaintiff's case absolutely falls.

After the additional assessments and the penalties had been assessed, the plaintiff, on or about May 27, 1924, submitted an offer in compromise of $500, accompanied with a full explanation of the errors, unknown to the plaintiff's officers, which had been made in preparing the original returns for the fiscal years 1917 and 1918. This offer was rejected; and a second notice and demand for tax was served upon the plaintiff, requiring the taxpayer to make the payments on or before June 6, 1924. The notice contained the usual printed notice "To avoid seizure and sale of property this tax must be paid to the collector of internal revenue within 10 days from the date stated above." This second notice was received before the Commissioner of Internal Revenue, on August 20, 1924, had rejected the offer in compromise of $500. On December 3, 1924, the plaintiff submitted a second offer in compromise raising its

first offer by the amount of $777.36, and again accompanied the offer with an explanation of the innocent errors committed in the preparation and filing of the original returns. This offer was rejected by the Commissioner of Internal Revenue on January 15, 1925. Thereafter, on May 28, 1926, a third offer in compromise, which is the subject matter of this suit, of $13,803.21, was submitted in settlement of the penalty assessments totaling $28,126.87. On or about March 5, 1928, almost two years thereafter, that offer in compromise was accepted with the advice and consent of the Secretary of the Treasury. During the intervening years plaintiff never demanded a cancellation of the offer or a return of the money submitted with the offer in compromise, until the institution of this suit on February 28, 1931.

There is no evidence in the case of actual duress. The most that the plaintiff can contend is that the notice of distraint constituted constructive duress. If such constructive duress existed, it certainly persisted a long time, for it began in 1924. The plaintiff apparently was not harassed, for in a most leisurely way it submitted during the period from 1924 to 1926 two offers before the final offer in 1926. In such circumstances, certainly no actual duress can be spelled out of the situation.

Nor do the authorities indicate that there was any legal duress. In *Burnet* v. *Chicago Railway Equipment Co.* (282 U. S., 295 [Ct. D. 276, C. B. X–1, 323]), the court said:

"The taxpayer contends that the waiver was inoperative because secured by duress. The argument is that while the Commissioner in December, 1925, might have made a jeopardy assessment and have enforced collection, such action would have been illegal because the statutory period had then expired, and that a waiver procured by such a threat is ineffective. Whether or not the Commissioner would have been liable to the taxpayer for a collection made as the result of a jeopardy assessment in 1925, we need not determine. He clearly had the power to make such assessment and thereby compel the filing of a claim for abatement and the giving of a bond, or, if such claim and accompanying bond were not filed, to make collection and relegate respondent to an action at law. In the absence of a determination that this deficiency was barred, it was the Commissioner's duty to proceed to insure the assessment and collection of the tax. At his suggestion, the taxpayer executed the waiver. Thereby it was enabled to have all questions concerning the alleged deficiency considered by the Board. A waiver given under such circumstances is not invalid. This contention, which seems to have been raised for the first time in this court, is also unsound."

Certainly it can not be duress for an officer of the Government to threaten to do that which the law authorizes and indeed requires him to do; and I agree with the United States Board of Tax Appeals in what was said by that Board in *Mulford* v. *Commissioner* (25 B. T. A., 238, at 243):

"It is not duress on the part of the Commissioner to give the taxpayer notice that he is going to use the lawful means provided by the statute to assess and collect the tax. (*Burnet* v. *Chicago Railway Equipment Co.*, 282 U. S., 295.)"

My view at the trial was that the proper procedure for the plaintiff was to pay the tax and bring an action for a recovery. That seems to have been indicated in the unreported opinion of the United States District Court for the Northern District of Ohio in the case of *The Simmons Manufacturing Co.* v. *Routzahn* [Ct. D. 380, C. B. X–2, 395], in which it was said:

"Plaintiff by reply denies acknowledging or promising to pay the debt and challenges the validity of the bond as given under duress and threat of seizure of its property and without consideration. And further alleges in substance that payment was not under the bond, but of the taxes, and was extorted by threats of distraint,

"On April 20, 1925, when the bond was given, collection of the taxes by suit or distraint was barred. * * *

"* * * There may be a question whether the moral obligation to pay the outlawed claim was sufficient to raise an implied promise to pay the tax in the absence of some recognition by plaintiff of a subsisting liability. However that may be, the bond averted an immediate seizure of its property, and this was sufficient consideration. * * *

"Further, the court regards this bond as a waiver, and as such effective even though executed after the statute had barred collection. (See *Stange* v. *United States*, 282 U. S., 270 [Ct. D. 274, C. B. X–1, 414].) 'An effective and not a futile act was intended.' (Id., 277.) And it is not shown to have been

procured by duress. The stipulation is that when a few days prior to April 20, 1925, the deputies called to collect the tax, the plaintiff's general manager promised to furnish a bond as soon as possible, whereupon they refrained from seizing the plaintiff's property, and the bond was given as promised, the plaintiff contending that no tax was due. * * *

"In *Burnet* v. *Ry. Equipment Co.* (282 U. S., 295, 303), it is said that in the absence of a determination that a deficiency was barred, it was the Commissioner's duty to proceed to insure the assessment and collection of the tax, and that a waiver which enabled the Board to consider the matter was not invalid, even though enforced collection of the taxes would have been illegal because of the statute of limitations.

"When the bond in this case was given, it was the general belief that collection by distraint was not barred, for the Bowers case had not been decided. And if it was then the collector's duty to insure collection, and he had the right to take the security, and did so upon no greater show of force and under circumstances no more onerous to the taxpayer than appeared here, I do not think it should be held that he illegally extorted the bond. The plaintiff could have paid the tax, and as is now understood, could have recovered back. Instead it chose to give the bond, and must abide the consequences."

There is no suggestion that the offer in compromise and the statement accompanying it were made under mistake, and indeed that is not either the theory of the complaint or of the proof. The plaintiff elected to base its case solely on duress. There is every reason to believe from the proofs that what the plaintiff did and now seeks to have set aside was done voluntarily.

Nor is pressure of financial difficulties sufficient to spell out duress. As was said in *United States* v. *Child & Co.* (12 Wallace, 232):

"We can hardly conceive of a definition of duress that would bring this case within its terms. Authorities are cited to show that where, under peculiar circumstances, property is withheld from the owner and he is forced to pay some unjust demand to obtain possession of it, he can afterwards maintain a suit for the money so paid. But no case can be found, we apprehend, where a party who, without force or intimidation and with a full knowledge of all the facts of the case, accepts on account of an unliquidated and controverted demand, a sum less than what he claims and believes to be due him, and agrees to accept that sum in full satisfaction, has been permitted to avoid his act on the ground that this is duress. If the principle contended for here be sound, no party can safely pay by way of compromise any sum less than what is claimed of him, for the compromise will be void as obtained by duress. The common and generally praiseworthy procedure by which business men every day sacrifice part of claims which they believe to be just to secure payment of the remainder would always be duress, and the compromise void."

The complaint is dismissed.

If this opinion is not in sufficient compliance with the rule requiring findings of fact and conclusions of law, submit findings of fact and conclusions of law in accordance therewith.

SECTIONS 277 AND 278.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION OF TAX.

ARTICLE 1271: Period of limitation upon assessment of tax. XII-6-6019 Ct. D. 629

FEDERAL TAXES—WAIVER—DECISION OF COURT.

ASSESSMENT—STATUTE OF LIMITATIONS—WAIVER.

Where the statutory period of limitation within which the Commissioner could assess and collect an additional tax for 1918 without a waiver expired on April 17, 1924, and correspondence in the record indicates that a waiver, duly executed by the taxpayer, was received in the office of the Commissioner on February 4, 1924, and where the assessment list signed by the Commissioner, assessing a deficiency against the taxpayer for 1918, contains a statement that a waiver had been filed, the taxpayer can not re-

cover for taxes paid on May 26, 1924, on the ground there was no valid waiver on file. It is not necessary to the validity of a waiver that the consent of the taxpayer and the Commissioner be evidenced in a single document. The presumption of regularity of the action of the Commissioner in making the assessment and collection on the basis of the waiver gives great weight to the conclusion that the waiver was in effect at the time the tax was assessed and collected.

COURT OF CLAIMS OF THE UNITED STATES.

Eclipse Lawn Mower Co. v. *The United States.*

[November 14, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

The plaintiff's case is based entirely upon the contention that there was no valid waiver on file with the Commissioner which authorized him to assess the additional tax on May 15, 1924, and to make collection thereof on May 26, 1924. It is our opinion that this claim can not be sustained. The facts show that the statutory period of limitation within which the Commissioner could assess and collect an additional tax for 1918 without a waiver expired April 17, 1924. On January 28, 1924, about four months prior to the date of assessment and while the case was under consideration and audit by the Commissioner, he requested the plaintiff to execute a waiver of the statute of limitation. This the plaintiff did, and on February 2, 1924, returned the same to the Commissioner, duly executed. It was received in the Commissioner's office February 4, 1924. On February 28, 1924, a notation was made in the record of plaintiff's case in the Bureau by the supervising auditor who was charged with the duty of reviewing the audits of plaintiff's case that there was a waiver of the statute of limitation on file.

March 8, 1924, the Commissioner mailed plaintiff the usual 30-day deficiency letter giving it 30 days thereafter within which to file a protest or appeal with reference to the proposed deficiency. The plaintiff's case appears to have proceeded in the usual way in the Bureau with full knowledge of the officials that the statutory period of limitation would expire April, 1924, and that plaintiff had executed and filed a waiver. The facts and circumstances justify the conclusion that no action was taken to assess and collect the tax before April 17, 1924, for the reason that there was a valid waiver on file.

Whether the plaintiff filed a protest to the deficiency proposed in the letter of March 8, 1924, does not appear, but it does appear that shortly thereafter the Commissioner duly signed an assessment list in which he made an assessment of a deficiency of $28,938.21 against the plaintiff for 1918. This assessment list contained a statement under the column headed "Remarks" that there was a waiver, and also referred to the account number of plaintiff and to the office letter of March 8, 1924. Whether or not the document constituting the waiver which plaintiff executed and filed with the Commissioner was ever signed by the Commissioner is not important in this case. The signing of the assessment list containing the statement that there was a waiver by this taxpayer was sufficient under the statute. It is not necessary that a waiver in order to be valid must be in one document or that in order to constitute a valid waiver the consent of the taxpayer and the Commissioner must be evidenced on a single document. Although a waiver is not, strictly speaking, a contract, the rule that agreements may be evidenced in more than one instrument is applicable. The Commissioner's consent is only for administrative purposes (*Stange* v. *United States*, 68 C. Cls., 395, affirmed 282 U. S., 270 [Ct. D. 274, C. B. X–1, 414]), and the consent of the Commissioner may be evidenced as well on an assessment list as on the waiver itself. (*Sabin* v. *United States*, 70 C. Cls., 574, 44 Fed. (2d), 70.)

The only remaining point urged by plaintiff is that the Government has not shown that the waiver in question was in force and had not expired prior to the date on which the tax was paid. At the time of the trial of this case during 1931 the waiver in question had been misplaced in the Commissioner's office and could not be located. It could not, therefore, be produced by the

defendant and there is no direct and positive testimony as to the date of expiration of the waiver. The evidence of record however is sufficient to justify the conclusion that the waiver was in force and effect at the time the tax sought to be recovered was assessed and paid. The facts establish that the Commissioner was aware at all times from and after January 28, 1924, that the statute of limitation would soon expire and the presumption of regularity of his action in making the assessment and collection on the basis of the waiver gives great weight to the conclusion that the waiver was in effect at the time the tax was assessed and collected. Plaintiff also was aware of the date of the expiration of the 5-year period of limitation when it executed the waiver, and the fact that it paid the tax in May, 1926, without question, is a circumstance to be considered against the contention now made. We are satisfied from all the facts and circumstances of record that the waiver had not expired on May 26, 1924, when the additional tax was paid, and we have found this to be the fact. The petition is dismissed. It is so ordered.

ARTICLE 1271: Period of limitation upon assessment of tax. XII-16-6137 Ct. D. 654

INCOME TAX—REVENUE ACT OF 1924—DECISION OF SUPREME COURT.

1. WAIVER—VALIDITY—EXECUTED AFTER EXPIRATION OF STATUTORY PERIOD—STATUTORY PERIOD EXPIRED PRIOR TO ENACTMENT OF REVENUE ACT OF 1924.

Where the 5-year period within which assessment of tax might be made expired prior to the enactment of the Revenue Act of 1924, and where after such period and enactment a waiver of the statute of limitations was executed by the taxpayer, the waiver was not invalid because of the provisions of section 278(e) of that Act. Nothing in the legislative history indicates an intention to exclude such a case from the generality of the terms of section 278(c) relating to waivers. Section 250(d) of the 1921 Act and section 278(c) of the 1924 Act were enacted, not to grant authority for waivers or to limit their effect, but to expressly recognize the administrative practice out of which the execution of waivers had grown, and the only purpose of subdivision (e) of section 278 was to prevent the section from being given a retroactive effect.

2. DECISION AFFIRMED.

The decision of the Court of Claims (59 Fed. (2d), 290, Ct. D. 570, C. B. XI-2, 328) affirmed.

SUPREME COURT OF THE UNITED STATES.

330. *Peter L. McDonnell, petitioner*, v. *The United States.*

331. *Dominic A. Truda, petitioner*, v. *The United States.*

On writs of certiorari to the Court of Claims.

[March 13, 1933.]

OPINION.

Mr. Justice BRANDEIS delivered the opinion of the court.

These cases arose out of the same transaction and present, on substantially the same facts, the same question of law. Reference will be made in the opinion only to the McDonnell case.

The action was brought by McDonnell in the Court of Claims on November 4, 1929, to recover $4,549.03 with interest from the date of payment, October 23, 1926. McDonnell filed his individual income tax return for 1917 on April 1, 1918, and paid the amount shown thereon to be due. The sum now sought to

be recovered was paid to the collector of internal revenue for the second district of New York pursuant to an assessment of an additional income tax for the year 1917, which was made by the Commissioner of Internal Revenue on October 9, 1926. There had been a waiver on February 23, 1926, of the statutory limitation upon the time for making the assessment. Claims for refund were made on December 27, 1928, and May 31, 1929, alleging that the waiver was invalid and that the amount claimed was collected after the running of the statute. The claims for refund were rejected on March 6, 1929, and July 25, 1929. The Court of Claims entered judgment for the defendant. (59 F. (2d), 290.) Because of conflict of the decision with that in *Uncasville Manufacturing Co.* v. *Commissioner* (55 F. (2d), 893), certiorari was granted, limited to the question of the validity of the waiver under section 278(e) of the Revenue Act of 1924. (287 U. S., 589.)

The waiver was given under the following circumstances: McDonnell was in 1917 a member of the firm of McDonnell & Truda, which in that year filed its income tax return and paid the taxes therein shown to be due. On March 18, 1923, that is, within five years after the filing of the return and before the expiration of the period allowed by section 250(d) of the Revenue Act of 1921 for assessment and collection of an additional tax, the Commissioner made a jeopardy assessment against the firm of $100,005.14. On November 30, 1925, that is, after the expiration of the statutory period for making an additional assessment against the plaintiff, the Commissioner notified the plaintiff that the amount payable by the firm for additional tax should, because of errors, be reduced to $24,863.28; but that a reduction of the liability of the partnership necessitated additional taxes to the individual members of the firm; and that he would not make the reduction to the firm unless plaintiff and his partner would waive the statute of limitations so as to permit additional individual taxes and would pay the amounts assessed against them. Each gave the waiver requested and paid the amount now sought to be recovered.

It is conceded by McDonnell that the tax was payable, unless it was barred by the period of limitations prescribed in section 250(d) of the Revenue Act of 1921 or section 277(a)2 of the Revenue Act of 1924. It is conceded by the Government that it was so barred, unless the limitation was removed by the waiver signed by McDonnell on February 23, 1926, which, by its terms, purported to extend to December 31, 1926, the time within which the Commissioner could assess additional taxes for the year 1917.

McDonnell claims that the Revenue Act of June 2, 1924, renders the waiver ineffective, because the assessment of the tax had been barred on April 1, 1923. The contention is that, since the period of limitation had expired before the passage of the 1924 Act, the waiver was inoperative under the express terms of paragraph (e) of section 278 of that Act, which declares:

"This section shall not (1) authorize the assessment of a tax or the collection thereof by distraint or by a proceeding in court if at the time of the enactment of this Act such assessment, distraint or proceeding was barred by the period of limitation then in existence, or (2) affect any assessment made or distraint or proceeding in court begun, before the enactment of this Act."[1]

The contention of the petitioner, expressed in different terms, is that waivers executed subsequent to June 2, 1924, are invalid where the date of filing the

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[1] Act of June 2, 1924 (ch. 234, section 278(e), 43 Stat., 253, 300). The preceding paragraphs of the section are as follows:

"(a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

"(b) Any deficiency attributable to a change in a deduction tentatively allowed under paragraph (9) of subdivision (a) of section 214, or paragraph (8) of subdivision (a) of section 234, of the Revenue Act of 1918 or the Revenue Act of 1921, may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

"(c) Where both the Commissioner and the taxpayer have consented in writing to the assessment of the tax after the time prescribed in section 277 for its assessment the tax may be assessed at any time prior to the expiration of the period agreed upon.

"(d) Where the assessment of the tax is made within the period prescribed in section 277 or in this section, such tax may be collected by distraint or by a proceeding in court, begun within six years after the assessment of the tax. Nothing in this Act shall be construed as preventing the beginning, without assessment, of a proceeding in court for the collection of the tax at any time before the expiration of the period within which an assessment may be made."

return was such that the 5-year period for assessment elapsed before June 2, 1924. Obviously, the waiver would have been good if executed before June 2, 1924, the period of limitation expiring when it did; for in that event the assessment would not have been "barred by the period of limitation" at the time of the enactment of the 1924 Act. The fact that the waiver was executed after the running of the statute of limitations does not render it invalid. (*Burnet* v. *Chicago Railway Equipment Co.*, 282 U. S., 295, 298–299 [Ct. D. 276, C. B. X–1, 323]; *Stange* v. *United States*, 282 U. S., 270, 273–275 [Ct. D. 274, C. B. X–1, 414].) And confessedly, the waiver would have been good, executed when it was, if the period of limitation had expired after June 2, 1924.

Nothing in the legislative history of section 278 indicates an intention to exclude cases like that at bar from the generality of those in which waivers may be given. The purpose of Congress in enacting paragraph (c) of section 278 indicates the contrary. Prior to the 1921 Act there was no statutory provision expressly authorizing waivers; but their execution had grown out of administrative practice. Doubt as to their validity in the absence of statute, however, had been raised; and the doubt in that situation was not removed until the decision in *Aiken* v. *Burnet* (282 U. S., 277 [Ct. D. 275, C. B. X–1, 417]). The purpose of Congress in enacting paragraph (d) of section 250 of the Revenue Act of 1921 and paragraph (c) of section 278 of the Revenue Act of 1924 was not to grant authority for waivers or to limit their effect, but to remove that doubt by expressly recognizing them. The latter paragraph substantially reenacted paragraph (d) of section 250 of the Revenue Act of 1921.[2]

Both the language and the purpose of paragraph (e) are consistent with this view. It was pointed out in *Burnet* v. *Chicago Railway Equipment Co.* (282 U. S., 295, 300), note 5, that paragraph (e) can not have been intended to qualify every other subdivision in section 278. The petitioner assumes, in fact, that it does not qualify subdivisions (a) and (b), which provide, respectively, for assessment at any time in the case of false or fraudulent returns or failure to file returns, and in the case of deficiencies attributable to a change in deductions taken in amortization of war investments. That paragraph (e) does qualify paragraph (d), which extends the period in which collection may be made to six years after assessment, was decided in *Russell* v. *United States* (278 U. S., 181 [T. D. 4620, C. B. VIII–1, 206]). The petitioner argues that since paragraph (d) relates only to collection, and since the qualifications of paragraph (e) apply in terms to assessments as well, the latter paragraph must limit paragraph (c), the only remaining subdivision. But this conclusion does not necessarily follow. Congress may have inserted the reference to "assessments" in paragraph (e) in order to make it clear that the extension of time for collections should in no event be regarded as authorizing an assessment already barred by the applicable statute of limitations. Moreover, paragraph (d) alone marked a change in the policy of Congress.[3] Paragraph (e) was inserted to prevent the section from being given a "retroactive effect."[4] To apply it to paragraph (c) would not serve that function. On the contrary, it would serve to cause a break in the policy of giving effect to waivers—a policy expressly adopted in the Act of 1921 and avowedly continued by the Act of 1924. The disclaimer of an intention to "authorize an assessment" where "such assessment" was already barred can not be taken to refer to assessments which were authorized by section 278 only in the sense that they were made pursuant to an agreement by the taxpayer of the kind which the Act continued to recognize and sanction.

Affirmed.

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[2] See H. Rept. No. 179, Sixty-eighth Congress, first session, page 26; S. Rept. No. 398, Sixty-eighth Congress, first session, page 32.

[3] See the committee reports, *loc. cit*, supra, note 2; also, Hearings on H. R. 6715 before Senate Committee on Finance, Sixty-eighth Congress, first session, pages 36, 39. As originally drafted, paragraph (d) authorized collection without limitation of time. See Hearings, supra, page 39; Statement of changes made in the Revenue Act of 1921 by H. R. 6715 and the reasons therefor, Senate Committee on Finance, Sixty-eighth Congress, first session, page 27. The limitation on collections of six years from the date of assessment was proposed by the Senate and agreed to by the House. See conference report, H. R. No. 844, Sixty-eighth Congress, first session, page 24. The 1921 Act, section 250(d), had imposed a limit on collections of five years from the date of return. See *Russell* v. *United States* (278 U. S., 181, 185).

[4] See Hearings on H. R. 6715 before the Senate Committee on Finance, Sixty-eighth Congress, first session, page 41 (statement of A. W. Gregg, Treasury draftsman).

ARTICLE 1271: Period of limitation upon assessment of tax. XII-23-6212 G. C. M. 11859

REVENUE ACT OF 1926.

Where the Commissioner mails to a taxpayer a notice of deficiency within the statutory period of limitation and the taxpayer does not appeal therefrom to the Board, the notice of deficiency so given does not suspend the running of the statute of limitations on assessment for the purpose of any additional deficiency shown to be due in a subsequent deficiency notice.

General Counsel's Memorandum 9541 (C. B. X-1, 259) revoked.

The Board of Tax Appeals has held that where the Commissioner mails to a taxpayer a notice of deficiency within the statutory period of limitation and the taxpayer does not appeal therefrom to the Board, the notice of deficiency so given does not suspend the running of the statute of limitations on assessment for the purpose of any additional deficiency shown to be due in a subsequent deficiency notice. (*Alice Wilson* v. *Commissioner*, 23 B. T. A., 644; *Fannie Snyder Hickman et al.* v. *Commissioner*, 24 B. T. A., 438.) The former decision was affirmed by the Circuit Court of Appeals for the Tenth Circuit (60 Fed. (2d), 501), and the Commissioner's acquiescence in the latter decision was published in C. B. XI-2, 5.

In view of the foregoing, General Counsel's Memorandum 9541 is revoked.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1271: Period of limitation upon assessment of tax. XII-24-6229 Ct. D. 682

INCOME TAX—REVENUE ACTS OF 1918 AND 1921—DECISION OF COURT.

STATUTE OF LIMITATIONS—WAIVERS—ADMISSIBILITY—PRESUMPTION OF GENUINENESS—TIMELY CHALLENGE.

Where the question of whether the statute of limitations was tolled depended upon the admissibility in evidence of waivers, and upon hearing before the Board of Tax Appeals taxpayer's counsel objected to their admission on the ground that there was no evidence that they had been filed with the Bureau, testimony of counsel for the Commissioner that the waivers were taken from the files of the Bureau relating to the case, that they were the same as those offered in evidence at the time of taking depositions, and that they were stamped by the notary before whom the depositions were taken and by him returned therewith, sufficiently identified the waivers as having been part of and taken from the files of the Bureau. The objection also being made that the waivers had not been proved genuine, the Board of Tax Appeals properly made comparison of the signature of taxpayer's president upon the waivers with the signatures upon the petition and other papers in the file, and of the corporate seals upon the petition and waivers. Being found regular in form and in possession of the proper Government bureau, they were presumptively genuine and admissible in evidence. Such objections should have been presented at the time depositions were taken, or, in any event, within a reasonable time prior to the hearing.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Wausau Sulphate Fibre Co., petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition for review of decision of the United States Board of Tax Appeals.

Before ALSCHULER, EVANS, and SPARKS, Circuit Judges.

[November 30, 1932.]

OPINION.

ALSCHULER, Circuit Judge: The one question here involved is whether the statute of limitations bars the asserted tax, and this depends on whether a series of waivers, which upon their face admittedly would toll the statute, are shown by the record to have been sufficiently identified to warrant their admissibility in evidence. The Board of Tax Appeals admitted them, and the alleged erroneous admission is the basis of the appeal.

On the hearing before the Board, respondent offered the original waivers in evidence in connection with the offer of depositions of taxpayer's officers taken at taxpayer's instance some months before, at Wausau, Wis. Counsel for taxpayer objected to their reception by the Board on the ground that there was no evidence that they were signed as they purported to be, nor of their having been filed with or taken from the Bureau of Internal Revenue; and that no witness identified them as a part of his testimony. It appears that thereupon the special counsel in charge of the case before the Board was sworn, and he testified that these waivers were from, and were taken from, the files of the Bureau of Internal Revenue relating to this case, and that they were the same files which were offered in evidence on the taking of the depositions, and were stamped by the notary before whom they were taken, who duly returned them with the depositions. This sufficiently identified the waivers as having been part of and taken from the files of the Bureau of Internal Revenue.

If it be deemed that further proof of the genuineness of the waivers was necessary, the record afforded such proof. In the files of the case there were several original papers of the taxpayer, including the petition itself, whereon the signature of the taxpayer's president appears. These files were of course before the Board, which then had opportunity for comparison of the signature thereon with those on the waivers purporting to be by the same president. When the Board found, as it did, that the taxpayer made the waivers, it had before it the evidence which was afforded by these signatures. Such comparisons with the signature on documents admittedly in the files may properly be made by the trier of the facts. (37 Stat., 633, 28 U. S. C. A., section 638; *Citizens' Bank & Trust Co. of Middlesboro, Ky.*, v. *Allen*, 43 F. (2d), 549; *Smythe* v. *Inhabitants, etc.*, 263 Fed., 481.)

Besides, the waivers, as well as the papers referred to, bear taxpayer's corporate seal, which afforded prima facie evidence of the genuineness of the papers to which it was attached. (*Philip Carey Mfg. Co.* v. *Dean*, 58 F. (2d), 737 [Ct. D. 557, C. B. XI–2, 325].)

Where the paper is regular in form and is in possession of the proper Government bureau, it is presumptively genuine and therefore admissible in evidence. (*Stern Bros. & Co.* v. *Burnet*, 51 F. (2d), 1042, 1046 [Ct. D. 476, C. B. XI–1, 311]; *Concrete Engineering Co.* v. *Commissioner*, 58 F. (2d), 566, 568.)

Furthermore, the waivers were offered in evidence on the taking of the depositions, without any protest or objection by taxpayer's counsel, who was then present and participating. It was testified in the depositions that the person whose name appeared as taxpayer's president upon the waivers and on the other papers, was then in fact its president. The waivers were identified and attached by the notary, and upon their return presumably remained in the files of the Board for the several months before the hearing, during all of which time no action was taken to suppress the waivers as evidence, nor to question their genuineness nor the fact of their due and timely filing with the Bureau of Internal Revenue, whose receiving stamp appears thereon.

The objection goes only to the formality of proof of their genuineness and filing, and has no bearing on the sufficiency of the waivers themselves. In such circumstances the challenge of these matters should have been presented

at the time the depositions were taken, or, in any event, within reasonable time before the hearing of the case. (*York Company* v. *Central Railroad*, 8 Wall., 107; *Howard* v. *Stillwell & Bierce Mfg. Co.*, 139 U. S., 199; *Columbia-Knickerbocker Trust Co.* v. *Abbott* (C. C. A. 1), 247 Fed., 833.)

The order of the Board of Tax Appeals is affirmed.

ARTICLE 1272: Period of limitation upon collection of tax. XII-17-6146 Ct. D. 658

INCOME TAX—REVENUE ACTS OF 1921 AND 1924—DECISION OF SUPREME COURT.

1. WAIVER—VALIDITY—EXECUTED AFTER EXPIRATION OF STATUTORY PERIOD—ASSESSMENT MADE WITHIN STATUTORY PERIOD.

Where assessment of tax for the year 1917 was made within the statutory period prescribed by section 250(d) of the Revenue Act of 1921 and before the enactment of the Revenue Act of 1924, a waiver given after such period and enactment was not rendered invalid by the provisions of clause (2) of subdivision (e) of section 278 of the 1924 Act. That clause, which provides that the section shall not affect any assessment made before the enactment of the Act, does not render inoperative the general provisions of subdivision (c) relating to waivers.

2. SAME.

Clause (1) of section 278(e), providing that the section shall not authorize an assessment or collection by distraint or a court proceeding barred at the time of the enactment of the Act, does not impair the validity of the waiver in this case. *McDonnell* v. *United States*, decided March 13, 1933, followed.

3. DECISION AFFIRMED.

The decision of the Circuit Court of Appeals, Ninth Circuit (61 Fed. (2d), 73), affirmed.

SUPREME COURT OF THE UNITED STATES.

Pacific Coast Steel Co., petitioner, v. *John P. McLaughlin.*

On certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[March 13, 1933.]

OPINION.

Mr. Justice BRANDEIS delivered the opinion of the court.

McDonnell v. *United States*, decided this day, involved the question of the effect of section 278(e) on assessment waivers where the period for assessment had expired before the effective date of the Act of 1924. This case involves the effect of that section on collection waivers where the period for collection had expired before the effective date of the Act of 1924, but where the assessment had been timely and before the Act.

On May 13, 1929, Pacific Coast Steel Co. brought this action in the Federal Court for Northern California, to recover the amount paid as additional income and excess profits taxes for the year 1917. The return for that year was made, and the tax thereby shown to be due was paid, on March 30, 1918. On December 9, 1922, the Commissioner of Internal Revenue determined a deficiency of $257,443.30; and on February 9, 1923, he assessed that amount against the plaintiff. Thus the assessment was made within five years from the date of the filing of the return and before expiration of the period allowed therefor by section 250(d) of the Revenue Act of 1921. Thereafter, by proceedings in the Bureau, the amount of the claimed deficiency was reduced to $129,020.06 through credits of overpayments of other years. For that amount the Com-

missioner made demand on July 16, 1927; that is, more than five years after the date of the taxpayer's return, in 1918. The Government relied, as extending the period for collection, upon a waiver given on December 7, 1925; that is, more than five years after the return.

The district court, without opinion, entered judgment for the defendant. The circuit court of appeals held that the waiver, though in terms extending the time for assessment, was effective to extend that for collection; and that the waiver was valid under section 278 of the Revenue Act of 1924. The judgment of the district court was accordingly affirmed. (61 F. (2d), 73 [Ct. D. 614, C. B. XI–2, 344].) This court granted certiorari, "limited to the question of the effect of section 278(e) of the Revenue Act of 1924." (287 U. S., 595.)

The petitioner contends that clause (2) of paragraph (e) of section 278, which states that the section shall not "affect any assessment made, or distraint or proceeding in court begun, before the enactment of the Act," renders paragraph (c) inoperative in the case at bar; that the waiver therefore had no statutory authority and was of no effect. The Government insists, in answer to this contention, that even if clause (2) thus qualifies paragraph (c),[1] the waiver is nevertheless valid either without express statutory authority or under the authority of the Revenue Act of 1921, section 250(d),[2] which, it is argued, remained in force by virtue of section 1100(b) of the Act of 1924.[3] We do not pass upon this contention of the Government; for we are of opinion that paragraph (c) is not rendered inoperative by clause (2) of paragraph (e).

The meaning of clause (2) was considered in *Russell* v. *United States* (278 U. S., 181 [T. D. 4260, C. B. VIII–1, 206]). It was there pointed out that the distinction in the Act of 1924 between existing and subsequent assessments derived significance from the contemporaneous creation of the Board of Tax Appeals. Assessments made after June 2, 1924, "generally at least, if objected to, could not be made without assent of the Board. To secure proper action by the Board might require considerable time, and this was provided for by extending the limitation to six years after assessment." (278 U. S., at 186.) Where an assessment was made before the Act, the reason for the extension did not exist. In the case of waivers, no such considerations exist to indicate that Congress intended to distinguish between assessments made before and those made after the Act. It was held in the Russell case that to apply paragraph (d), extending the period for collection to six years after assessment, to an assessment made before the Act, would "affect" that assessment, and hence was forbidden by clause (2) of paragraph (e). Such an application, it was said, "would be retroactive; and certainly it would produce radical change in the existing status of the claim against the petitioners—would extend for some five years a liability which had almost expired." (278 U. S., at 187.) In the case at bar no such effect follows upon a recognition of the waiver. The claim against the petitioners was barred, it is true, at the time of the enactment of the 1924 Act; but even before the Act the claim was subject to revival by waiver of the statute of limitations. We are of opinion, therefore, that paragraph (c) does not "affect" the assessment in the case at bar so as to be rendered inoperative by clause (2) of paragraph (e).

There remains the question of the effect of clause (1) of paragraph (e), which provides that section 278 shall not authorize an assessment or collection already barred at the effective date of the 1924 Act. This is the same question considered in the McDonnell case, ante, with respect to assessment waivers, and for the reasons there stated we hold that the clause does not impair the validity of the waiver here involved.

Affirmed.

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[1] (c) Where both the Commissioner and the taxpayer have consented in writing to the assessment of the tax after the time prescribed in section 277 for its assessment the tax may be assessed at any time prior to the expiration of the period agreed upon. (Act of June 2, 1924, ch. 234, section 278(c), 43 Stat., 253, 299.)

[2] (d) * * * the amount of any such taxes due under any return made under this Act for prior taxable years or under prior income, excess-profits, or war-profits tax Acts, * * * shall be determined and assessed within five years after the return was filed, unless both the Commissioner and the taxpayer consent in writing to a later determination, assessment, and collection of the tax; * * *. (Act of November 23, 1921, ch. 136, section 250(d), 42 Stat., 227, 265.)

[3] (b) The parts of the Revenue Act of 1921 which are repealed by this Act shall (except as provided in sections 280 and 316 and except as otherwise specifically provided in this Act) remain in force for * * * the assessment and collection, to the extent provided in the Revenue Act of 1921, of all taxes imposed by prior income, war-profits, or excess-profits tax Acts, and for the assessment, imposition, and collection of all interest, penalties, or forfeitures which have accrued or may accrue in relation to any such taxes. * * * (Act of June 2, 1924, ch. 234, section 1100(b), 43 Stat., 253, 352.)

SECTION 280.—CLAIMS AGAINST TRANSFERRED ASSETS.

ARTICLE 1291: Claims in cases of transferred assets. XII-13-6100 Ct. D. 646

INCOME AND EXCESS PROFITS TAX—REVENUE ACTS OF 1926 AND 1928—DECISION OF COURT.

1. CLAIMS AGAINST TRANSFERRED ASSETS—DISSOLVED CORPORATION.

Where an insolvent corporation dissolved and transferred all its assets to petitioner, its sole stockholder, and thereafter petitioner paid certain of the company's outstanding obligations, he was liable, under the provisions of section 280 of the Revenue Act of 1926, for unpaid taxes assessed against the company.

2. TRANSFERRED ASSETS—PRIORITY OF GOVERNMENT'S CLAIM—BURDEN OF PROOF.

Where the Commissioner has established the Government's claim against an insolvent and dissolved corporation which has transferred all its assets, and has traced into the hands of the sole stockholder of the company sufficient assets to pay the claim, he has thereby established the Government's right to recover its tax from the stockholder and has maintained the burden of proof imposed upon him by section 602 of the Revenue Act of 1928. The fact that the stockholder paid out the money received by him from the corporation to its creditors does not require the Commissioner to adduce evidence that such claims did not have priority over that of the Government.

3. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (21 B. T. A., 101) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

C. A. Hutton, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Upon petition to review an order of the United States Board of Tax Appeals.

Before WILBUR and SAWTELLE, Circuit Judges.

[May 31, 1932.]

OPINION.

WILBUR, Circuit Judge: Petitioner seeks to reverse a decision of the United States Board of Tax Appeals on his petition for review of the action of the Commissioner of Internal Revenue assessing him as transferee of the C. A. Hutton Flour Co., Inc., for income and profits taxes for the calendar years 1919 and 1920, amounting to $6,428.76 for the year 1919 and $1,454.48 for the year 1920. The Board of Tax Appeals affirmed the Commissioner. The facts upon which the decision of the Board of Tax Appeals rests are either stipulated or admitted in the pleadings. From such stipulation and admission it appears that the taxpayer was the sole owner of the C. A. Hutton Flour Co. from the time of its organization up to the time of its liquidation; that it was incorporated in 1908, and engaged in the business of buying and selling flour until 1920; that the corporation was dissolved and liquidated in 1921; that the liquidation of the company resulted from heavy losses sustained by it in post-war readjustments which were accompanied by declines in market and inventory values and the collapse of the business of many of the company's debtors, resulting in heavy losses in accounts and bills receivable; that the liquidation was accomplished by realizing on all sound assets and by some of the largest merchandise creditors accepting as credits some of the corporation's questionable bills receivable, bearing the personal indorsement and guaranty of the petitioner, some of which are still outstanding and unpaid; that upon the liquidation of the company the petitioner received the sum of $72,000 from said company; that subsequent to such receipt by him of said amount he paid certain outstanding obligations of the company, which payments exceeded the said sum of $72,000 so received by him.

At the conclusion of the presentation of the stipulation of facts to the Board of Tax Appeals a colloquy occurred between a member of the Board and counsel representing the respective parties which is of significance on this review solely for the reason that the petitioner contends that the Commissioner thereby, in effect, stipulated that the sole question involved in the case was whether or not there was a lien in favor of the Government upon the $72,000 received by the taxpayer from the C. A. Hutton Flour Co. The matter arose as follows:

"The MEMBER. Well, if I remember correctly, and understand it correctly, in the liquidation and distribution of the assets of this corporation, the petitioner here got about $72,000.

"Mr. WILSON. That is admitted; yes, sir.

"The MEMBER. It is also stipulated and admitted that he paid out subsequent to that receipt amounts of outstanding liabilities of the corporation in excess of $72,000.

"Mr. WILSON. That is correct.

"The MEMBER. Well, then, why shouldn't judgment be rendered for the petitioner on that statement of facts? He is not really a distributee rendering him liable, is he?

"Mr. WILSON. The only point on which the Commissioner contends, your honor, is that the Government takes the position that the petitioner received the sum of $72,000 on the liquidation of the C. A. Hutton Flour Co.; that the amount of income taxes heretofore duly assessed against the company became a lien prior to any of its general creditors against the company. If the Commissioner is mistaken in that contention, then I will say that the petitioner is entitled to judgment. That is the sole ground upon which the Commissioner stands in this case.

"The MEMBER. Then it really becomes a question of law as to whether or not a lien did attach by reason of this assessment, and second whether or not that lien takes precedence of the preferred creditors.

"Mr. DINKELSPIEL. That is the first question of law, and of course, there is the additional contention and the further question that is raised. We realize that it has been decided adversely several times by the Board, but nevertheless has been sustained by the district court, namely, the constitutionality of the procedure under section 280 of the Revenue Act of 1926.

"The MEMBER. Has the Board ever passed directly upon the question of whether or not this assessment fixes a lien that gives a preference to the Government?

"Mr. DINKELSPIEL. I do not believe so. I have been unable to find a decision, and I would like to ask Mr. Wilson whether he has been able to find such a decision.

"Mr. WILSON. I am unaware of such a decision upon that point."

Petitioner contends that, inasmuch as there is no such thing as a lien under the circumstances, the Board of Tax Appeals should have confined its consideration to that issue, and that not having done so this court should reverse the action of the Board. It is sufficient to say that the contention of the Commissioner here, and no doubt before the Board of Tax Appeals as well, is that the Government had priority over the general creditors of the company by reason of the provisions of sections 3466, 3467 of the Revised Statutes (31 U. S. C. A., sections 191, 192). Whether or not that priority resulted in a lien in the strict sense of the term, is entirely immaterial. Nor do we think the impromptu statement of counsel for the Commissioner before the Board of Tax Appeals did or should limit the Board in considering the stipulated facts to determine therefrom whether or not the taxpayer was liable for the tax. For that reason, we proceeded to consider the matter upon its merits.

The stipulation of facts leaves much to be desired and many questions unanswered. Each party contends he should prevail in view of these uncertainties and of the burden of proof thereon. Before considering that controversy some of the deficiencies in the stipulation should be noted. The manner of the dissolution of the corporation is not stated. The date thereof is not fixed, except that it is stipulated that it occurred during the year 1921. Neither is the date of the payment of the sum of $72,000 by the corporation to its sole stockholder fixed. Whether it was paid before, upon or after dissolution is not stated; nor is it shown in what manner or by whom said payment was authorized to be made to the stockholder. It is not shown when or to whom the taxpayer paid said sum upon "certain outstanding obligations of the C. A. Hutton Flour Co." Nor is it shown whether or not the petitioner as sole

stockholder was a director or manager of the corporation although it is clearly inferable that he was because a director must be a stockholder, and he was the sole stockholder. Petitioner states:

"It is important to note that there is absolutely no evidence or stipulation as to the nature of the obligations paid, as to whether they were obligations of mortgage creditors, judgment creditors, preferred creditors or others, nor is there anything in the record which would support the holding that the petitioner had any notice at the time of the receipt by him of the sum of $72,000 or at the time of the distribution thereof by him of this sum in liquidation of the corporation's debts, of any claim for taxes by the Government. There is, moreover, nothing in the record as to the filing of any lien claim by the Government."

And the respondent points out that:

"There is not a word in the agreed statement of facts or the findings of the Board to show that the respondent was required to pay these obligations; that he ever assumed to pay said obligations, much less that he received the $72,000 impressed with a trust to pay them; that he received said sum in a representative capacity, or as the agent of the taxpayer corporation; nor is there anything to indicate the character or extent of the obligations which were paid. Whether they were secured or unsecured, or whether they consisted in whole or in part of obligations upon which petitioner was liable are all matters which are left to conjecture."

It is well to remember in dealing with the facts that the corporation was the alter ego of the "sole stockholder" and that he was a director thereof. The law of California at the time of the dissolution of the corporation prohibited the distribution of the capital of a corporation to the stockholders until its debts were all paid. Section 309 of the Civil Code of California, as amended in 1917 (Stats. Cal., 1917, 657), provided:

"Unless they shall have been first permitted or authorized so to do by the commissioner of corporations, directors of corporations (1) must not make dividends except from the surplus profits arising from the business thereof; * * * (3) nor must they divide, withdraw, or pay to the stockholders, or any of them, any part of the capital stock, except as hereinafter provided * * *.

"For a violation of the provisions of this section, the directors under whose administration the same may have happened * * * are, in their individual or private capacity, jointly and severally liable to the corporation, and to the creditors thereof, to the full amount of the capital stock so divided, withdrawn, paid out, or reduced or debt contracted. Nothing herein prohibits a division and distribution of the capital stock of any corporation which remains after the payment of all its debts, upon its dissolution, or the expiration of its term of existence."

Section 560 of the Penal Code of California, in force at the time of the dissolution of this corporation, made it a misdemeanor for a director of a corporation "to divide, withdraw, or in any manner, except as provided by law, pay to the stockholders, or any of them, any part of the capital stock of the corporation."

By section 400 of the Civil Code of California, it is provided that:

"Unless other persons are appointed by the court, the directors or managers of the affairs of a corporation at the time of its dissolution are trustees of the creditors and stockholders or members of the corporation dissolved, and have full powers to settle the affairs of the corporation, collect and pay outstanding debts, sell the assets thereof in such manner as the court shall direct, and distribute the proceeds of such sales and all other assets to the stockholders. Such trustees shall have authority to sue for and recover the debts and property of the corporation, and shall be jointly and severally personally liable to its creditors and stockholders or members, to the extent of its property and effects that shall come into their hands. * * *"

In *Hedges* v. *Frink* (174 Cal., 552) the Supreme Court of California had occasion to consider distribution of some of the assets of a corporation to one of its stockholders, under a situation somewhat similar to that involved in the case at bar. In dealing with that situation, the court stated:

"The language of our law and of our decisions permits of no doubt but that this attempted method of distributing a portion of the capital stock of the corporation was illegal and void. Section 309 of the civil code forbids. Section 560 of the penal code condemns it as criminal. Such an act of dis-

tribution is not permitted, whether attempted by the directors, the stockholders, or both. (*Kohl* v. *Lilienthal*, 81 Cal., 378, 385 (6 L. R. A., 520, 20 Pac., 401, 22 Pac., 689); *Kreamer* v. *Earl*, 91 Cal., 112 (27 Pac., 735); *Tapscott* v. *Mexican Colorado, etc., Co.*, 153 Cal., 664, 667 (96 Pac., 271; *Burne* v. *Lee*, 156 Cal., 221, 228 (104 Pac., 438).)"

In *Talcott Land Co.* v. *Hershiser* (184 Cal., 748, 755), referring to the amendment, above quoted, to section 309 of the Civil Code of California, as adopted in 1917 (Stat. of California, 1917, 657), it was said:

"* * * it is clear that the purpose of the legislature was to excuse directors only in the event that the affairs of the corporation had been wound up by the consent of all parties; in other words, only where the parties by agreement had arrived at a conclusion which they could have as well reached by a formal application to the court for dissolution after the payment of the debts and obligations of the corporation. We think that the outstanding obligations of the corporation to convey these lands, although assumed by another party, constituted a liability to creditors within the meaning of this law and prevented the application of the saving clause therein to the particular facts of this case (*Balfour* v. *Garrett*, 14 Cal. App., 261, 111 Pac., 615; Bouvier's Law Dictionary, 3d Rev., 726)."

See our decision in *McPherson* v. *Commissioner of Internal Revenue* (54 F. (2d), 751) for a discussion of the powers of trustees of a dissolved corporation under the California law.

In view of the foregoing statutes of California and decisions interpreting the same, it seems clear that the petitioner having received $72,000 of the capital of the corporation, is liable to return that amount to the corporation, regardless of the fact that he may have applied the amount to debts of the corporation (*Talcott Land Co.* v. *Hershiser*, supra). However that may be it is stipulated that the C. A. Hutton Flour Co., while insolvent, transferred all its assets to its sole stockholder, while it was obligated to the Government for income taxes, which, although not yet formally ascertained, were nevertheless an accrued obligation. (*Hatch* v. *Morosco Holding Co.*, 50 F. (2d), 227; *Updike* v. *U. S.*, 8 F. (2d), 913 [T. D. 3815, C. B. V–1, 312].)

In *Pann* v. *United States* (44 F. (2d), 321 [Ct. D. 309, C. B. X–1, 411]), we sustained a judgment of the district court in favor of the Government and against the transferees of the property of a dissolved corporation, which by the distribution of its property had been left without assets. Speaking of one of the stockholders, we said:

"He alleges that the corporation has dissolved and he has possession of and claims as his own all the assets of the corporation. Under these circumstances it is well established that the appellant was liable for the tax upon the corporation income where the property received by him is in excess of that tax. (*United States* v. *Garbutt* (C. C. A.), 35 F. (2d), 294, and cases therein cited; *United States* v. *Updike* (C. C. A.), 8 F. (2d), 913.) This right is assumed, if not decided, in *United States* v. *Updike* (281 U. S., 489, 50 S. Ct., 369, 74 L. Ed., 984 [Ct. D. 192, C. B. IX–1, 228]) and *Russell* v. *United States* (278 U. S., 181, 49 S. Ct., 121, 73 L. Ed., 255 [T. D. 4260, C. B. VIII–1, 206])."

This view is in accord with the decision of the Circuit Court of Appeals for the Second Circuit in *Hatch* v. *Morosco Holding Co.*, supra (50 F. (2d), 138):

"Although the additional taxes were not assessed against the theater company until 1925, the obligation to pay them existed from the time the taxes for 1919 and 1920, respectively, accrued. (*Heyward* v. *United States*, 2 F. (2d), 467 (C. C. A. 6) [T. D. 3663, C. B. IV–1, 247]; section 250, Revenue Act of 1918 (40 Stat., 1082).) Hence the United States was a creditor of the theater company during the entire period of the holding company's occupation of the leased premises. When the assets of a corporation are distributed to its shareholders, leaving corporate debts unpaid, liability of the shareholders to a creditor, to the extent of the value of the assets received is beyond question. (*McWilliams* v. *Excelsior Coal Co.*, 298 F., 884 (C. C. A. 8); *Capps Mfg. Co.* v. *U. S.*, 15 F. (2d), 528 (C. C. A. 5) [T. D. 3972, C. B. VI–1, 264]; *Angle* v. *Chicago, St. Paul, etc., Ry. Co.*, 151 U. S., 1, 15, 14 S. Ct., 240, 38 L. Ed., 55; *Curran* v. *Arkansas*, 15 How., 304, 14 L. Ed., 705; *Wood* v. *Drummer*, Fed. Cas. No. 17,944; *Updike* v. *U. S.*, 8 F. (2d), 913 (C. C. A. 8); *United States* v. *McHatton*, 266 F., 602 (D. C. Mont.) [T. D. 3043, C. B. 3, 283].)"

See also, *Phillips* v. *Commissioner* (283 U. S., 589, 605 [Ct. D. 350, C. B. X–1, 264]); *United States* v. *Garfunkle* (52 F. (2d), 727); *United States* v. *Armstrong* (26 F. (2d), 227).

The Commissioner having established the Government's claim against an insolvent and dissolved corporation which has transferred all its assets, and having traced sufficient thereof to pay the tax into the hands of the stockholder and director, has thereby established its right to recover its tax from the stockholder and the Commissioner has maintained the burden of proof imposed upon him by section 912 of the Revenue Act of 1928 (45 Stats., 873; 26 U. S. C. A., section 1229); see *Willard* v. *Dobbins* (191 Cal., 287); and if by reason of other facts that right is terminated, the burden is upon the stockholder to show that fact. The petitioner claims that the fact that he has paid out the money he received from the corporation to its creditors required the Commissioner to adduce evidence that the claims he paid did not have priority over that of the Government. We know of no rule by which a stockholder of a corporation who has received the assets of a corporation paid to him without legal authority can resist payment on behalf of the corporation or of its creditors because of the fact that he has paid the money out to creditors of the corporation. The mere fact that the transferee has paid the money out on the debts of the corporation without further evidence does not relieve the transferee. He had no right to the capital of the corporation until all its debts were paid. (*Talcott Land Co.* v. *Hershiser*, supra.)

Order affirmed.

ARTICLE 1291: Claims in cases of transferred assets. XII-25-6240 Ct. D. 684

INCOME TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

1. SUIT IN EQUITY AGAINST TRANSFEREES.

Sections 274, 278, and 280 of the Revenue Act of 1926 did not take away the right of the United States, theretofore existing, to proceed in equity against the transferees of the assets of a corporation, without assessment against them, for recovery of corporate property in order to discharge taxes assessed against the corporation.

2. DECISION AFFIRMED.

The decision of the Circuit Court of Appeals, Ninth Circuit (61 Fed. (2d), 530), affirmed.

SUPREME COURT OF THE UNITED STATES.

John H. Leighton, James A. McPherson, Sue P. Leighton, et al., petitioners, v. *The United States of America.*

On writ of certiorari to the United States Circuit Court of Appeals for Ninth Circuit.

[May 29, 1933.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the court.

In 1921 all assets of Leighton & Co., Inc., of California, were sold and the proceeds distributed pro rata among stockholders, including petitioners. Nothing remained to satisfy outstanding corporate obligations.

September, 1925, within the time permitted by statute, or written waivers, the Commissioner of Internal Revenue notified the corporation of tax deficiencies for 1918, 1919, and 1920; and on January 16, 1926, he assessed these against it. There was no contest. Efforts to enforce payment by distraint were unsuccessful. The present equity suit seeks to compel petitioners severally to account for corporate property in order that it may be applied toward payment of taxes due by the company. No assessment was made against any petitioner.

The district court ruled that the distributed assets constituted a trust fund and adjudged that each petitioner should account for the amount he received, with interest, from January 16, 1926. The circuit court of appeals affirmed this judgment. The matter comes here by certiorari.

Pertinent provisions of the Revenue Act of 1926 (ch. 27, 44 Stat., 9, 55, 59, 61) are in the margin.[1]

Prior to the Revenue Act of 1926, the United States in an equity proceeding might recover from distributees of corporate assets, without assessment against them, the value of what they received in order to discharge taxes assessed against the corporation. (*Phillips* v. *Commissioner*, 283 U. S. 589, 592 [Ct. D. 350, C. B. X–1, 264]; *United States* v. *Updike*, 281 U. S., 489 [Ct. D. 192, C. B. IX–1, 228].) And this right remained unless taken away by the specific words or clear intendment of the 1926 enactment. (*United States* v. *Chamberlain*, 219 U. S., 250, 261; *United States* v. *Nashville, C. & St. L. Ry.*, 249 Fed., 678, 681.)

Petitioners rely upon section 280 of that Act and maintain that while the words of this standing alone would not suffice to destroy the right, nevertheless when read in connection with sections 274(a) and 278 there is enough clearly to show the purpose of Congress to require an assessment against them before suit for restitution. And, further, that the sole remedy available in the present circumstances is the one prescribed by section 280.

The meaning of the statute is not free from uncertainty. The insistence presented in behalf of the petitioners is at least plausible, but this has been before the courts several times and none has approved it. On the other hand, the right of the United States to proceed against transferees by suit since the Act of 1926 has been definitely recognized. (*United States* v. *Updike*, 25 F. (2d), 746 (district court); affirmed C. C. A., 32 F. (2d), 1; *Phillips* v. *Commissioner*, 42 F. (2d), 177; affirmed 283 U. S., 589, 593 (note); *United States* v. *Greenfield Tap & Die Corp.*, 27 F. (2d), 933 (district court) [T. D. 4196, C. B. VII–2, 170]; *United States* v. *Garfunkel*, 52 F. (2d), 727 (district court) [Ct. D. 405, C. B. X–2, 384].)

Considering the established rule of strict construction, the views expressed in the cases cited, also the possible conflict with other statutory provisions pointed

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[1] SEC. 274. (a) If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within 60 days after such notice is mailed (not counting Sunday as the sixtieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. Except as otherwise provided in subdivision (d) or (f) of this section or in section 279, 282, or 1001, no assessment of a deficiency in respect of the tax imposed by this title and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 60-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. Notwithstanding the provisions of section 3224 of the Revised Statutes, the making of such assessment or the beginning of such proceeding or distraint during the time such prohibition is in force may be enjoined by a proceeding in the proper court.

* * * * * * *

SEC. 278. (a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(b) Any deficiency attributable to a change in a deduction tentatively allowed under paragraph (9) of subdivision (a) of section 214, or paragraph (8) of subdivision (a) of section 234, of the Revenue Act of 1918 or the Revenue Act of 1921, may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(c) Where both the Commissioner and the taxpayer have consented in writing to the assessment of the tax after the time prescribed in section 277 for its assessment the tax may be assessed at any time prior to the expiration of the period agreed upon.

(d) Where the assessment of any income, excess-profits, or war-profits tax imposed by this title or by prior Act of Congress has been made (whether before or after the enactment of this Act) within the statutory period of limitation properly applicable thereto, such tax may be collected by distraint or by a proceeding in court (begun before or after the enactment of this Act), but only if begun (1) within six years after the assessment of the tax, or (2) prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer (U. S. C. App., Title 26, section 1061).

* * * * * * *

SEC. 280. (a) The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this title (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this title or by any prior income, excess-profits, or war-profits tax Act.

* * * * * * *

(b) The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:

(1) Within one year after the expiration of the period of limitation for assessment against the taxpayer.

out in those opinions, we can not accept petitioners' interpretation of the statute. The present suit was properly brought, we think, and the courts below reached the correct conclusion. There was no abuse of discretion in respect of interest.

Affirmed.

SECTION 284.—CREDITS AND REFUNDS.

ARTICLE 1304: Claims for refund by taxpayers. XII–5–6009
Ct. D. 626

INCOME TAX—REVENUE ACTS OF 1921 AND 1926—DECISION OF SUPREME COURT.

CLAIM FOR REFUND—LIMITATION—AMENDMENT BEFORE FINAL REJECTION.

A general claim for refund of income tax filed within the statutory period of limitation not specifying grounds and therefore irregular in form under the Treasury regulations, article 1036, Regulations 62, may be amended after the period of limitation by specifying the grounds, if the amendment is made before final rejection.

SUPREME COURT OF THE UNITED STATES.

The United States of America, petitioner, v. *Memphis Oil Co., respondent.*

On writ of certiorari to the Court of Claims.

[January 9, 1933.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the court.

Respondent, the plaintiff in the court below, brought suit against the United States in the Court of Claims to recover overpayments of income taxes for the years 1922 and 1923. The Government opposed recovery upon the ground that the claims filed with the Commissioner of Internal Revenue for the refund of the tax were too general and indefinite to comply with the provisions of the statutes and regulations, and that amendment came too late. The Court of Claims gave judgment in favor of the taxpayer. (59 Fed. (2d), 276.) A writ of certiorari brings the case here.

The central question in the controversy can be stated in a sentence: May a claim for a tax refund which has been seasonably filed, but which fails to state the grounds upon which the refund is demanded, be amended by specifying the grounds at any time before the claim in its original form has been finally rejected, though it be after the time when a wholly new claim would be barred by limitation?

The respondent made and filed its income tax returns for 1922 and 1923 in accordance with the statute. It paid the last installment of the earlier tax on December 7, 1923, and the last installment of the later one on December 6, 1924. Claims for refund of overpayments were filed in June, 1927, within the time prescribed by law.

In the refund claim for 1922 there was a statement of the amount of the tax paid ($25,626.25), a statement of the correct amount due ($24,296.56), a statement that there had been overpaid in error $1,329.69, and a request for refund of that amount with interest as provided by law, or such greater amount as might be legally refundable. Attached to the claim was the following summary of the method of computation: Net income $194,372.46; 12½ per cent, $24,296.56; previously paid, $25,626.25; overpaid, $1,329.69. There was no other specification of supporting facts or reasons.

In the refund claim for 1923 the claimant followed the same form that was used for 1922, but with appropriate changes of the figures. The overpayment was stated to be $1,813.39, and there was a request for the return of that amount or of any greater amount due.

Upon receipt of these claims, the Commissioner of Internal Revenue, in order to pass upon the merits, made an investigation and an audit of the claimant's books and records for 1922 and 1923 through a duly appointed agent. The agent reported to the Commissioner that there had been overassessments for both years, the excess being fixed at $1,660.70 for 1922 and $4,835.76 for 1923. Thereupon a deputy commissioner notified the taxpayer in writing under date of October 13, 1928, that its refund claims had been considered, that the taxes had been readjusted in accordance with the new audit, and that the overassessments for the two years would be made the subject of certificates of overassessment, which would be transmitted in due course through the office of the appropriate collector. Nothing further was said or done as to the matter till January 26, 1929, when the same deputy commissioner who had signed the notice last mentioned, transmitted to the taxpayer another notice that the claims were defective in form in that they failed to satisfy the requirements of the Treasury regulations. After quoting the pertinent provisions, he stated: "Since the information on file with the claims does not meet the requirements" of the regulations, "and the claims do not indicate (i. e., apart from the investigations of the revenue agent) that the taxes have been illegally assessed, they will be rejected. The rejection will officially appear in a schedule to be approved by the Commissioner." Thereupon the claimant, protesting that an amendment was unnecessary, filed a new claim with the Commissioner on April 2, 1929, in which the facts were set forth in detail. The Commissioner gave final notice of rejection on October 23, 1929, placing his ruling on the ground that the claims as first presented were defective and irregular. In this suit by the taxpayer, the Court of Claims has given judgment for the moneys overpaid.

Statutes make it necessary that claims for the refunding or crediting of any internal revenue tax erroneously or illegally assessed or collected shall be presented to the Commissioner within a prescribed period of time and prohibit allowance of the claims if these conditions are not satisfied. (Revenue Act of 1926, section 284(b).) Statutes also provide that no suit or proceeding shall be maintained in any court for the recovery of such a tax "until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof." (Revenue Act of 1921, section 1318 as amended by Act of March 4, 1923, ch. 276.) During the period of these transactions, there had been promulgated under the Revenue Act of 1921 and was continuously in force a Treasury regulation which provides as follows: "Claims by the taxpayer for the refunding of taxes and penalties erroneously or illegally collected shall be made on Form 843. In this case the burden of proof rests upon the claimant. All the facts relied upon in support of the claim should be clearly set forth under oath." (Treasury Regulations 62, article 1036.[1])

The claim for refund filed with the Commissioner in June, 1927, was not subject to rejection on the score of the time of its submission. As to this the parties are agreed. Indefinite and general it was, and hence, until amended or supplemented, an inadequate compliance with the Treasury requirement that the facts relied upon in support of a claim are to be stated under oath. Beyond doubt it might have been rejected as irregular while its form was uncorrected. This is far from saying that there was the presentation of a new claim and not the perfecting of an old one when the gaps were filled thereafter.[2]

Both the Government and the taxpayer invoke analogies suggested by pleadings in a lawsuit. The general rule is said to be that an amendment of a pleading will take effect by relation and thus relieve against the bar of an intervening limitation if the identity of the cause of action is still substantially the same, but that the limitation will prevail if under the guise of an amendment, there is the substitution of a new cause of action in place of another wholly different. (*B. & O. S. W. R. Co.* v. *Carroll*, 280 U. S., 491; *Seaboard Air Line Ry.* v. *Renn*, 241 U. S., 290, 293; *Harriss* v. *Tams*, 258 N. Y., 229, 242.) The

[1] A later regulation, different in form, is applicable to claims filed on or after May 1, 1929. Treasury Decision 4265, Cumulative Bulletin VIII–1, page 110.

[2] Official statistics indicate that "85.20 per cent of all the overassessments are attributable to clerical or bookkeeping adjustments or to causes beyond the control of either the Treasury or the taxpayer, that is to adjustments after the payment of taxes based upon causes which could not fairly be considered prior to the payment." (Refunds and Credits of Internal Revenue Taxes, Report of the Joint Committee on Internal Revenue Taxation, 1929, pursuant to section 710 of the Revenue Act of 1928, H. Doc. No. 43, Supplement to Part II, page 29. Cf. H. Doc. No. 478, Seventy-first Congress, second session (1930).) These statistics, covering adjustments of taxes under the Act of 1928, give support to the conclusion that in determining the application of a statute of limitations the word "claim" should be interpreted with reasonable liberality.

analogy is helpful, yet it will confuse, instead of helping, if we do not insist at the beginning upon a definition of our terms or at least a recognition of their shifting meanings. A "cause of action" may mean one thing for one purpose and something different for another.[3] It may mean one thing when the question is whether it is good upon demurrer, and something different when there is a question of the amendment of a pleading or of the application of the principle of *res judicata*. (Cf. *Chicago R. I. & P. Ry. Co.* v. *Schendel*, 270 U. S., 611, 617; *Baltimore S. S. Co.* v. *Phillips*, 274 U. S., 316, 321.) At times and in certain contexts, it is identified with the infringement of a right or the violation of a duty.[4] At other times and in other contexts, it is a concept of the law of remedies, the identity of the cause being then dependent on that of the form of action or the writ.[5] Another aspect reveals it as something separate from writs and remedies, the group of operative facts out of which a grievance has developed.[6] This court has not committed itself to the view that the phrase is susceptible of any single definition that will be independent of the context or of the relation to be governed. Nonetheless, it has fixed the limits of amendment with increasing liberality. A change of the legal theory of the action, "a departure from law to law," has at times been offered as a test. (*Union Pacific Ry. Co.* v. *Wyler*, 158 U. S., 285, 295.) Later decisions have made it clear that this test is no longer accepted as one of general validity. Thus, in *Missouri, Kansas & Texas Ry. Co.* v. *Wulf* (226 U. S., 570), plaintiff suing in her individual capacity under a Kansas statute for her son's death was allowed to amend to sue as administratrix under the Federal Employers' Liability Act after the statute of limitations would have barred another action. In *New York Central Railroad Co.* v. *Kinney* (260 U. S., 340), there was in substance the same ruling. In *Friederichsen* v. *Renard* (247 U. S., 207), a cause of action by a defrauded buyer to set aside a contract was turned into a cause of action to recover damages for deceit. "Of course an argument can be made on the other side, but where a defendant has had notice from the beginning that the plaintiff sets up and is trying to enforce a claim against it because of specified conduct, the reasons for the statute of limitations do not exist, and we are of opinion that a liberal rule should be applied." (*New York Central Railroad Co.* v. *Kinney*, supra, 346.)[7]

With this background of analogy, we reach the specific problem that calls for answer here. The respondent filed a claim for taxes overpaid, a claim for money had and received to his use by the agents of the Government. The identity of the cause of action may be said in one aspect to depend upon the mere fact of overpayment, the existence of a net balance owing to the taxpayer after the ascertainment of all items of debit and of credit. In another aspect it may be said to depend upon the identity of the items illegally exacted, and hence upon the particular grounds that determine illegality. Choice between these meanings must avoid a doctrinaire adherence to abstract definitions. It must keep in view the realities of administrative practice, for its effect will be to regulate the conduct of administrative officers. Definitions and analogies borrowed from pleadings in a lawsuit will have their place and recognition, but in due subordination to differences of end and aim. Viewing the problem thus, we must say whether a statement by the taxpayer of supporting facts and reasons is to be assimilated to a bill of particulars explanatory of a claim, or is something so essential that there can be no claim without it.

Our decision in *Lewis* v. *Reynolds* (284 U. S., 281) goes far to point the answer. The court there ruled that upon a claim for the refund of a tax because of the disallowance of a particular deduction, the Commissioner might sustain the result by the disallowance of another deduction, and this though the time had gone by within which he would have been at liberty, if a claim had not been filed, to make a new assessment. The court applied the analogy of a common law action for money had and received. "The ultimate question presented for decision upon a claim for refund, is whether the taxpayer has overpaid his tax. This involves a redetermination of the entire tax liability." No matter though the claim for refund be specific and limited, the Commissioner is at liberty to audit the return afresh and to strike a new balance as

[3] The uncertainties of the phrase have been well developed by Dean Clark with full citation of the decisions in his treatise on Code Pleading, pages 75–87, 501–508.
[4] Clark, Code Pleading, page 81, and cases there cited. Pomeroy, Code Remedies, fourth edition, section 347.
[5] Clark, supra, page 502, and cases there cited.
[6] Clark, supra, pages 83, 84, 505, and cases there cited.
[7] Other cases are collected by Clark, supra, pages 504, 505.

the facts may then appear. Commonly, though, it seems, not always, a general audit will be necessary or will be at least a wise precaution, whether the claim is broad or narrow, if the Government is to have the benefit of any compensating adjustments.[8] There is little doubt that this conception of duty and of prudence has had recognition and emphasis in administrative practice.

The practice is portrayed in action in the pages of this record. We are there informed in a striking way of the actual procedure where a notice, general in its terms, is not rejected at the beginning for irregularity of form, but is considered on the merits. At once upon the filing of the claim for refund, there was an order for the complete examination of the business of the taxpayer, to the end that the net amount of its tax liability might be reported to the Bureau. Every claim put forward in its amended notice has been investigated, every fact alleged in its behalf has been verified and found. The files of the Bureau contain the report of an examiner informing his superior that the tax has been overpaid, and the files of the taxpayer contain an official notice that the overassessment is recognized and that justice will be done. Of a sudden, at the end, the discovery is made that the inquiry is mere futility because the notice starting it in motion has departed in form from the requirements of a rule.

In the light thus supplied by the practice of the Bureau and the analogy of pleadings, the way is cleared for a conclusion. The line of division must be kept a sharp one between the function of a statute requiring the presentation of a claim within a given period of time, and the function of a regulation making provision as to form. The function of the statute, like that of limitations generally, is to give protection against stale demands. The function of the regulation is to facilitate research. The Commissioner has the remedy in his own hands if the claim as presented is so indefinite as to cause embarrassment to him or to others in his Bureau. He may disallow the claim promptly for a departure from the rule. If, however, he holds it without action until the form has been corrected, and still more clearly if he hears it, and hears it on the merits, what is before him is not a double claim, but a claim single and indivisible, the new indissolubly welded into the structure of the old.

The cases in this court are not at all at variance with the conclusion now arrived at, though they leave the problem open. *Tucker* v. *Alexander* (275 U. S., 228 [T. D. 3973, C. B. VI–1, 287]) holds that it is within the power of the Commissioner to waive the objection that the supporting facts or reasons have not been stated in the claim. *United States* v. *Felt & Tarrant Co.* (283 U. S., 269 [Ct. D. 336, C. B. X–1, 431]) holds that a defective claim for refund 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. *Bonwit Teller & Co.* v. *United States* (283 U. S., 258 [Ct. D. 334, C. B. X–1, 328]) holds that a letter from the taxpayer, accompanied by a form of waiver requested by the Bureau, will be the equivalent of a notice of claim if the Commissioner has so treated it.

The cases in the lower Federal courts may not be wholly harmonious as to the extent to which amendments are allowable after the running of the statute, but there is general agreement that the applicable analogy is to be found in the rules governing the amendment of a pleading. (*McKesson & Robbins, Inc.*, v. *Edwards*, 57 F. (2d), 147; *Art Metal Construction Co.* v. *United States*, 47 F. (2d), 558 [Ct. D. 300, C. B. X–1, 421]; *Lancaster Cotton Mills* v. *United States*, 59 F. (2d), 270; *Lehigh & Wilkes-Barre Coal Co.* v. *United States*, 38 F. (2d), 637. Cf. *The Peruna Co.*, 11 B. T. A., 1180, 1189; *Marian Shainwald Sevier*, 14 B. T. A., 709, 716.)

One other question, less general in its significance, is yet to be considered. An argument is made that at the time of this amendment the claim had been finally rejected and the proceeding thereby ended. If so, it was too late. (*McKesson & Robbins* v. *Edwards*, supra; *Solomon* v. *United States*, 57 F. (2d), 150.) When correction is thus postponed, there is no longer anything to amend, any more than in a lawsuit after the complaint has been dismissed. We think the matter was still *in fieri*. True the deputy commissioner had given notice to the taxpayer that the claims would be rejected, and that the rejection would be officially announced in a schedule to be approved thereafter. No reason is apparent why at any time before such approval the Commissioner or his deputy was not at liberty to recall the first announcement, and dispose of the case otherwise. (*Michel* v. *United States*, 37 F. (2d), 38, reversed, but on other

[8] Compare Report of the Joint Committee on Internal Revenue Taxation, 1928, pursuant to section 1203 of the Revenue Act of 1926, Volume III, pages 25, 30.

grounds, 282 U. S., 656 [Ct. D. 310, C. B. X–1, 297].) We are not now considering what the practice ought to be if there were need to open the proceeding for the submission of other evidence extrinsic to the claims themselves. Neither in the record nor in the argument do we find a suggestion of that need. Long before the amendment the Commissioner had ascertained the facts and had even notified the taxpayer of the justice of its claims and of the ruling of the Bureau that adjustments would be made accordingly. The dismissal of the claims, when finally announced, was for defects of form only. The defects had been corrected, and the dismissal may not stand.

We find it unnecessary to determine whether the conduct of the Commissioner in investigating the claims upon their merits and reporting to the claimant the result of his inquiry was a waiver of defects of form which would call for the return of overpayments though no amendment had been offered.

The judgment is affirmed.

ARTICLE 1304: Claims for refund by taxpayers.

XII–5–6010
Ct. D. 627

INCOME AND EXCESS PROFITS TAX—REVENUE ACT OF 1918—DECISION OF SUPREME COURT.

1. CLAIM FOR REFUND — SPECIAL ASSESSMENT — LIMITATION — AMENDMENT.

A claim for refund of income and excess profits tax filed within the statutory period specifying as the sole ground for relief the necessity for a special assessment under sections 327 and 328 of the Revenue Act of 1918 by reason of anomalous conditions prevailing in the claimant's business may not be turned by amendment after the period of limitation into one for the revision of an assessment by increasing the value of real estate included in invested capital.

2. CASE DISTINGUISHED.

Decision in *United States* v. *Memphis Oil Co.* (288 U. S., 62 [Ct. D. 626, page 307, this Bulletin]) distinguished.

SUPREME COURT OF THE UNITED STATES.

The United States of America, petitioner, v. *Henry Prentiss & Co., Inc., respondent.*

On writ of certiorari to the Circuit Court of Appeals for the Second Circuit.

[January 9, 1933.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the court.

Respondent (the plaintiff in the court below) brought suit against the United States in a district court to recover overpayments of income and excess-profits taxes for the years 1918 and 1920. The overpayments had come about, so it was claimed, from the undervaluation by the Commissioner of the respondent's invested capital, with a consequent exaggeration of the profits to be taxed. Two items or classes of property were the subject of the controversy. In each year there has been an omission to include the full value of the real estate; indeed the parties have stipulated that the value of the real estate was greater by the sum of $46,371.08 than the sum allowed in the assessment. In each year also there had been an omission to include the value of intangible property, and particularly good will. The district court held that there could be no relief in respect of either item for the year 1918 because the claim for refund filed with the Commissioner did not comply with the statute and the Treasury regulations. In respect of both items, real estate and intangibles, relief was granted to the taxpayer to the extent of overpayments for the year 1920. The result was a judgment in favor of the respondent for $7,975.21. Cross-appeals followed to the Court of Appeals for the Second Circuit. Upon the taxpayer's appeal, the decision was that the defective refund claim for 1918 had been

made good by amendment, and that the tax for that year, as well as for 1920, had been overpaid as to the real estate. Upon the Government's appeal, the decision was that the item of intangibles should have been excluded for both years. (57 F. (2d), 676.) A writ of certiorari, designed to bring up the ruling as to the amendment of the claim for 1918, was granted by this court on the petition of the Government. No petition for a writ was submitted by the taxpayer.

On June 16, 1919, respondent filed its income and excess profits tax return for the year 1918, showing a total tax of $535,144.20, which it paid. On December 28, 1920, it paid for the year 1918 an additional tax of $119,191.19, as the result of an additional assessment, receiving back, however, $9,559.19 on the completion of the audit. Within the time prescribed by law there was filed with the Commissioner, on March 14, 1924, a claim for refund. In this claim, the respondent demanded the repayment of $200,000. It stated in substance as the ground for this demand that owing to abnormal conditions affecting its invested capital and income, there could be no fair computation of the tax by the appraisal of the cash value of its property in accordance with section 326 of the Revenue Act of 1918 (ch. 18, 40 Stat., 1057, 1091, 1092, 1093), and that it should have the benefit of a special assessment under sections 327 and 328.

Section 327 of the Act provides in subdivision (d) that the tax shall be determined in accordance with section 328 "where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328."

Section 328 provides in effect that in cases covered thereby the tax shall be computed without reference to the value of the invested capital and shall be determined by the ratio which the average tax of representative corporations engaged in a like or similar trade or business bears to their average net income.

The respondent's claim for refund, with the specification of the erroneous denial of a special assessment as the statement of its grievance, was filed, as we have seen, in March, 1924. On May 14 of that year, the respondent received from the Commissioner a letter acknowledging the filing and notifying the claimant of the procedure to be followed. "No consideration," it was there written, "may be given under the provisions of sections 327 and 328 until statutory net income and invested capital are definitely determined. It is therefore necessary that you acquiesce in the net income and invested capital as shown in the revenue agent's report of March 25, 1920, for the year 1918, or submit exceptions, if any, which you may take thereto. If exceptions are taken they should be presented in the form of an appeal prepared in accordance with the provisions of Treasury Decision 3492, a copy of which is inclosed."

The respondent does not assert that in response to this notice it took any appeal or filed any exceptions complaining of the assessment of capital or income. If any such document were in existence, it would have been equivalent to an amendment of the claim, and no doubt would be in evidence. What the respondent chose to do was obviously to acquiesce in the report that the cash value of the capital had been fairly ascertained, and to take its stand on the position that under sections 327 and 328 its tax should be determined without reference to such value and in accordance with other methods both exceptional and discretionary. Accordingly the Commissioner proceeded to a consideration of the claim that error had been committed in failing to give the taxpayer the benefit of a special method of assessment. On July 16, 1925, the respondent was advised by written notice that there was no evidence of abnormal conditions sufficient to call for a departure from the usual forms of computation. The notice, signed by an acting deputy commissioner, closes with these words: "In accordance with the above conclusions, your claim will be rejected." To this is added a statement that the collector for the taxpayer's district will be officially notified of the rejection at the expiration of 30 days.

Notwithstanding this notice, the Bureau of Internal Revenue kept the proceeding open. Writing to the respondent on February 23, 1926, the Solicitor of the Bureau states that his office has before it for consideration the applica-

tion for a special assessment of the taxes for 1918, and that "before a final decision is reached" the taxpayer "will be granted an opportunity to be heard orally." If such a hearing is not desired, "the decision in the matter will be based upon the record as it now stands." In answer to that invitation the respondent requested an oral hearing, which it received, and also filed on April 8, 1926, a statement under oath, which, by concession, was equivalent in form to an amended proof of claim. In this statement the respondent put before the Commissioner the evidence both as to the undervaluation of the real estate and as to the exclusion of intangibles.[1] The Commissioner rejected the claim on September 3, 1926, by signing the rejection schedule.

We are holding in *United States* v. *Memphis Oil Co.* (288 U. S., 62), decided herewith, that a general claim for refund, though irregular in form under the Treasury regulations, may be amended after the period of limitation by specifying the grounds, if the amendment is made before final rejection. A statement, without explanation, to the effect that overpayments have been made in an aggregate amount is broad enough to cover any and all grounds for reassessment and return. This at all events is true where the basis of the grievance is that the tax has been erroneously computed even by the normal method, that there has been a deviation, in other words, from the statutory rule. Such is not the claim in controversy here. Here the taxpayer by its claim as originally presented abandoned the position that there had been any error of fact or law in the assessment of the tax according to the normal method, and planted itself on the position that the special method would be fairer. We are to say whether the ground thus deserted may be recovered by amendment.

The act of the Commissioner of Internal Revenue in granting or refusing a special assessment under section 327(d) of the Act of 1918 is discretionary and administrative, not subject to be challenged in any court, at least in the absence of fraud or other irregularities. (*Williamsport Co.* v. *United States*, 277 U. S., 551, 562 [T. D. 4172, C. B. VII–2, 323].) Discretionary and administrative also is the review of his determination by the Board of Tax Appeals. (*Williamsport* v. *United States*, supra.) If this amendment is permissible, a request for the exercise of a discretionary jurisdiction, will have been turned after the running of the statute (Revenue Act of 1921, ch. 136, section 252, 42 Stat., 227, 268; Revenue Act of 1924, ch. 234, section 1011; 43 Stat., 253, 342; Revenue Act of 1926, ch. 27, sections 284, 1113, 44 Stat., 9, 66, 116) into a claim of error of law or fact, and hence into a controversy within the jurisdiction of a court. What at the beginning was nonjusticiable, with the exceptions few and narrow (*Williamsport Co.* v. *United States*, supra, 562) will have become justiciable at the end.

An amendment so far-reaching, a metamorphosis so complete, may well be thought to destroy the identity of the claim or cause of action if the analogies of pleading in a lawsuit are to govern our decision. A declaration according to the common count for money had and received may be good though it does not tell us how the money was received or the use established. (*United States* v. *Memphis Oil Co.*, supra.) This does not mean that a pleader who abandons the common count and states the particular facts out of which his grievance has arisen retains unfettered freedom to change the statement at his pleasure. All will then depend on the degree and kind of the departure. A cause of action alleging as a grievance that there has been a deviation from a rule of law or the breach of a legal duty in the collection of a tax is far apart from an appeal to an administrative officer to abandon the normal rule or method and substitute another, the substitution being dependent upon administrative discretion. Overpayments there may have been in each case, yet in senses widely different. But the analogies of pleadings are not decisive of the controversy before us, wherever they may point and however helpful they may be.

To make our conclusion sound, we must keep in mind also the necessities and realities of administrative practice. A demand for a special assessment in accordance with section 327(d) of the statute of 1918 is not a challenge to any act of the Commissioner in the valuation of invested capital. On the contrary, the valuation of invested capital is irrelevant if the special method is accepted. The very basis of the application for the use of such a method is the presence of abnormal conditions whereby an unfair and disproportionate burden will be

[1] Certain forms of intangibles, for example, good will, are excluded in general from the definition of invested capital, but there are special conditions in which there is a duty to include them. (Revenue Act of 1918, section 326, (4) and (5).)

laid upon the taxpayer if invested capital is to be reckoned according to the statutory definition (sections 325, 326) and the profits of the taxpayer subjected to a tax accordingly. Let the new method be adopted, and the value of the invested capital ceases to be a factor in the process. The taxpayer, it is true, may complain even then that there is a variance between such capital when restricted to the elements covered by the statute and invested capital when viewed as an economic concept, and that by reason of special conditions there should be an addition of other elements commonly excluded. See, e. g., *Tipton Cotton Mills* v. *Commissioner* (11 B. T. A., 913, 921). Indeed that is the very reason why a special assessment becomes necessary. The fact remains, however, that the grievance does not grow out of a failure of the assessors to value the invested capital truly according to the statute. It has no relation, for example, to an assessment of tangible property, such as land or buildings, at less than the cash value. The grievance that will support an application for a special method of assessment under subdivision (d) of section 327 assumes adherence to the statute, and counts upon extraordinary conditions as justifying a claim that the statute is oppressive. If the special method is accepted, the income of the taxpayer is considered without reference to capital as commonly determined, and the tax becomes proportionate to that of other representative corporations engaged in a like business.

A claim or cause of action will be ill-defined for the purpose of an administrative remedy if the definition gives no heed to the understanding or conduct of administrative officers. We are to ask ourselves how a request for a special method of assessment might be expected to be viewed or acted on by those required to consider it. The presentation of such a claim, unlike the presentation of a claim of error in fact or law, does not suggest the need for a new and general audit of assets and liabilities.[2] The two proceedings, alike in form and in consequences, are essentially diverse. By the very terms of the statute (section 327(d)), the special assessment is the outcome of a special application; it is made on motion of the taxpayer. A revision for error of fact or law, on the other hand, may be made by the Commissioner on his own motion, and indeed is commonly so made, for it is incidental to his general duty to audit the accounts. Upon an application for special relief (under subdivision (d)) there are no compensating adjustments favorable to the Government that will move an examiner to reconsider the value of the tangibles, and make it either less or greater. (*Lewis* v. *Reynolds*, 284 U. S., 281 [Ct. D. 443, C. B. XI–1, 130].) He will conceive of the invested capital as deposited in a separate compartment which there is no need for him to open. Upon a claim of deviation from the statute, the taxable balance for the year will be subject to reaudit as if the tax were laid anew. The grievances differ so essentially that the assertion of the one must be felt to be unrelated to any complaint as to the other.

The conclusion derived from the analogies of pleadings in a lawsuit is thus seen to be confirmed by the probabilities, if not the certainties, of administrative practice. If this is not enough, however, there is confirmation from other sources. In the pages of this record we find convincing evidence that by the understanding of the parties the claim for a special assessment was to exclude any claim for the revision of the value of the capital, and that no such claim would be pressed, at all events while the claim for a new method of assessment was alive and undetermined. We have seen that in May, 1924, the Commissioner of Internal Revenue gave notice to the taxpayer that there could be no consideration of the prayer for relief under sections 327 and 328 of the applicable statute "until statutory net income and invested capital are definitely determined." The taxpayer was accordingly informed in accordance, it seems, with the usual practice of the Department, that it would be necessary to do one or other of two things: to appeal from the report as to invested capital and income in accordance with a prescribed form, or to acquiesce in it. (Cf. *Commissioner* v. *Ohio Falls Dye & F. Works*, 50 F. (2d), 660; *Norton Co.* v. *Commissioner*, 50 F. (2d), 664.) The notice would tend to show, though assent to its requirements were lacking, that in the judgment of the men intrusted with the administration of the Act, the two subjects of inquiry are diverse and independent. Coupled with the assent of the taxpayer, its significance is heightened. There is no suggestion that the taxpayer, when faced with this alterna-

[2] The range of investigation upon special applications is considered by Albert E. James, a former member of the Board of Tax Appeals in an article "Special assessment cases in the courts and the Board," published in volume 8, part 1, National Income Tax Magazine, 287, 289, 290, August, 1930. See, also, Investigation of Bureau of Internal Revenue, Senate Report No. 27, Part I, Sixty-ninth Congress, first session, page 215.

tive, resorted to an appeal. In these circumstances its conduct in proceeding with its application for a special assessment was a tacit assent to the condition imposed by the Commissioner and an abandonment of any objection that capital and income had been erroneously valued if valuation was to be ascertained according to the normal method. We have seen that an application for a special assessment involves an appeal by the taxpayer to the Commissioner's discretion. The application being of that order, a condition may reasonably be imposed that the inquiry shall be postponed until other and unrelated objections have been either determined or abandoned. There is room for argument that the taxpayer, having won the privilege of a hearing on those terms, is estopped from retracting its assent and resuming the abandoned ground. (*Sturm* v. *Boker*, 150 U. S., 312, 333, 334; *Davis* v. *Wakelee*, 156 U. S., 680, 689.) At least its assent is equivalent to an agreement that the claim for a special assessment shall be deemed to be a distinct one from that for a revision of the values. Retraction, if ever possible, must be held to be too late when the statute of limitations has interposed a bar.

The respondent complains of the ruling of the court of appeals whereby the value of intangibles was excluded from the invested capital for the year 1920 and the judgment of the district court modified accordingly. The argument is that this court has jurisdiction in the exercise of its discretion to review those parts of the judgment adverse to the respondent, though no writ of certiorari was granted except to the petitioner, the Government, nor was any other even asked for. We are not required at this time either to affirm or to deny the existence of the power that the argument imputes to us. If the power exists, the respondent has not persuaded us that our discretion should be moved to use it.

The judgment of the circuit court of appeals should be reversed to the extent of the petitioner's objections thereto, and the cause remanded to the district court for further proceedings in conformity with this opinion.

ARTICLE 1304: Claims for refund by taxpayers.

XII-5-6011
Ct. D. 628

INCOME AND PROFITS TAX—REVENUE ACT OF 1917—DECISION OF SUPREME COURT.

1. CLAIM FOR REFUND—LIMITATION—AMENDMENT BEFORE FINAL REJECTION.

A general claim for refund of income and profits tax filed within the statutory period of limitation not specifying grounds and therefore irregular in form under the Treasury regulations, article 1036, Regulations 62, may be amended after the period of limitation by specifying the grounds, special assessment under section 210 of the Revenue Act of 1917, if the amendment is made before final rejection.

2. CASE FOLLOWED.

United States v. *Memphis Oil Co.* (288 U. S., 62 [Ct. D. 626, page 307, this Bulletin]) followed.

3. CASE DISTINGUISHED.

United States v. *Henry Prentiss & Co., Inc.* (288 U. S., 73 [Ct. D. 627, page 311, this Bulletin]) distinguished.

SUPREME COURT OF THE UNITED STATES.

The United States of America, petitioner, v. *Factors & Finance Co., respondent.*

On writ of certiorari to the Court of Claims.

[January 9, 1933.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the court.

The suit is by a taxpayer to recover $19,995.44, with interest, on overpayment of income and profits tax. Here, as in other cases decided at this session,

the judgment stands or falls according to our determination of the time within which a notice of a claim for refund is subject to amendment.

On June 15, 1918, respondent, a corporation, filed an income and profits tax return for the calendar year ending December 31, 1917, and made payment of the tax in accordance therewith. The amount of the payment was $177,338.72. In May, 1920, the Commissioner made an assessment of an additional tax for 1917 in the sum of $267.32, which was paid by the respondent on June 29, 1920. In August, 1920, the Commissioner made another assessment of an additional tax for the same year in the sum of $25,327.91. On account of this additional tax respondent on October 4, 1920, made a payment of $9,388.57, and in the same month filed a claim for the abatement of $15,933.34, the amount of the unpaid balance. In connection with this claim for abatement the Commissioner made an order on May 6, 1921, for a full examination of the affairs of the taxpayer by an agent of the Bureau of Internal Revenue. Such an examination was made, and a report by the examiner was filed with his superior.

In February, 1923, the audit by the Commissioner was still incomplete, and the amount of the assessment not finally determined. The taxpayer was fearful, so it seems, that the time might go by within which claims for overpayments were due under the law. To forestall any default it lodged with the Commissioner on February 27, 1923, a claim for $177,606.04 in terms of sweeping generality. It stated in so doing that there had been at that time no final audit of its return or assessment of the tax, and that the purpose of the notice was to save the taxpayer's rights under the applicable statutes "and to permit the Commissioner to refund to deponent any excess paid over taxes actually found to be due." There was no statement in this notice as to the grounds of the claim that the payments were excessive. No such statement was made until July 17, 1925, when there was filed with the Commissioner an amended claim for refund, setting forth the grounds in detail. In this amended claim the taxpayer explains the reasons why a special assessment should be made in accordance with section 210 of the Revenue Act of 1917 (ch. 63, 40 Stat., 300, 307), permitting that procedure where the amount of the tax can not otherwise be determined with accuracy or justice. A copy of that section is quoted in the margin.[1]

In the interval between February, 1923, and July, 1927, there had been action by the Commissioner upon the claim for abatement which had been filed by the taxpayer in October, 1920. A claim for abatement, unlike a claim for refund, has relation to a tax assessed, but still unpaid. (*Rock Island, A. & L. R. R. Co.* v. *United States*, 254 U. S., 141 [Ct. D. 2, C. B. 4, 342].) The Commissioner declined to abate the whole amount of $15,933.34 withheld by the taxpayer, but did declare an overassessment of $3,293.89, leaving a balance of $12,639.45, with interest, then determined to be due. This balance the taxpayer discharged by payment to the collector in November, 1923.

The claim for abatement had thus been disposed of, but no action had yet been taken upon the claim for refund. The Commissioner permitted this to slumber, without deciding or considering it, till after the filing of the amendment in July, 1925. Upon receipt of that amendment, or soon afterwards, he proceeded to a consideration of the claim upon the merits. There were hearings and rehearings at which the taxpayer gave evidence in support of its claim that its payments had been excessive and that there was need of a special assessment to arrive at a computation consistent with equity and justice. The Commissioner decided the merits of the controversy in favor of the taxpayer. He held that a case had been made out for a special assessment in accordance with section 210 of the Revenue Act of 1917. He held, after computing the tax ac-

[1] SEC. 210. That if the Secretary of the Treasury is unable in any case satisfactorily to determine the invested capital, the amount of the deduction shall be the sum of (1) an amount equal to the same proportion of the net income of the trade or business received during the taxable year as the proportion which the average deduction (determined in the same manner as provided in section 203, without including the $3,000 or $6,000 therein referred to) for the same calendar year of representative corporations, partnerships, and individuals, engaged in a like or similar trade or business, bears to the total net income of the trade or business received by such corporations, partnerships, and individuals, plus (2) in the case of a domestic corporation $3,000, and in the case of a domestic partnership or a citizen or resident of the United States $6,000.

For the purpose of this section the proportion between the deduction and the net income in each trade or business shall be determined by the Commissioner of Internal Revenue in accordance with regulations prescribed by him, with the approval of the Secretary of the Treasury. In the case of a corporation or partnership which has fixed its own fiscal year, the proportion determined for the calendar year ending during such fiscal year shall be used.

cordingly, that there had been an overpayment of taxes in the sum of $32,634.89. He held, however, that the notice of claim of February 27, 1923, was defective for failure to state the grounds of the taxpayer's objections; that the notice of July 17, 1925, was without avail as an amendment in respect of overpayments made in 1918 and 1920, since as to these it was too late; that it was good as an original claim for the refund of the overpayment made in November, 1923; and hence that of the total overpayments of $32,634.89 there should be a refund of $12,639.45, the 1923 installment, with $3,028.24, interest paid thereon, and that as to the residue of the overpayments, $19,995.44, a refund should be refused. A very different case would be here if the Commissioner had ruled that no adequate reason for a special assessment had been established, and had refused relief upon that ground. We do not say that a justiciable controversy would then have arisen for a court. (*Williamsport Co.* v. *United States*, 277 U. S., 551, 562 [T. D. 4172, C. B. VII–2, 323]; *United States* v. *Henry Prentiss & Co.*, 288 U. S., 73, decided herewith [Ct. D. 627, page 311, this Bulletin].) What he did was to find that there was need for a special method, that the application of such a method would reduce the tax by a stated sum, but that because of defects in the form of the claimant's notice, there could be relief only in part. For the amount thus disallowed the taxpayer brought suit in the Court of Claims, which overruled the action of the Commissioner and gave judgment accordingly. (56 F. (2d), 902; 73 C. Cls., 707.) A writ of certiorari brings the case here.

We are holding in *United States* v. *Memphis Oil Co.* (288 U. S., 62 [Ct. D. 626, page 307, this Bulletin]) that a general claim for refund, not specifying grounds, is subject to amendment until final rejection irrespective of a limitation running in the interval. We are holding in *United States* v. *Henry Prentiss Co., Inc.* (288 U. S., 73 [supra]), that under the Revenue Act of 1918 a claim specifying as the sole ground for relief the necessity for a special assessment by reason of anomalous conditions prevailing in the claimant's business may not be turned by amendment into one for the revision of an assessment by increasing the value of real estate included in invested capital. The present case falls midway, or near to that, between the other two. Here the taxpayer did not specify any ground in the claim first presented, but offered an amendment afterwards setting forth the reasons why the assessment should be special.

The case is a close one, giving fair opportunity for argument either way, but we think the better reasons uphold the privilege of amendment.

1. The conclusion favorable to the privilege has support in the analogies of pleadings in a lawsuit. The claim in its original form is one for money had and received to the use of the respondent after the manner of the common counts in a suit at common law. It does not specify a particular state of facts, as did the claim in the Prentiss case, abandoning all others. It charges overpayment generally, and thus brings within its range whatever facts reside in the domain of equity and conscience.

2. The conclusion thus supported by the analogy of pleadings is not inconsistent with the necessities of administrative practice.

This is not a case where the grounds injected by the amendment have already been abandoned by agreement tacit or express. Such abandonment and agreement there was in the Prentiss case, the claimant seeking at the beginning the privilege of the special method of assessment and reverting thereafter to another ground of challenge which by implication, if not expressly, it had promised to renounce. This is a case where the claimant has left the grounds of challenge open, and where the Bureau has itself to blame for not insisting at the outset upon a full disclosure of the grievance.

There are other elements of difference, however, besides the presence or absence of agreement, that divide the Prentiss case from this one. These other elements of difference are even more important, for the Prentiss ruling would have been the same if agreement had been absent. When the two cases are considered in the light of administrative practice a distinction is to be noted at the outset between the nature of a special assessment under the Revenue Act of 1918 (section 327(d)) and the nature of such an assessment under the Act of 1917 (section 210). The application in the Prentiss case was made under section 327(d) of the Act of 1918, whereby the taxpayer, ignoring a possible challenge of the computation of invested capital, plants itself upon the ground of a variance between the statutory definition and the economic concept, and calls upon the Commissioner to exercise a dispensing power given to him, in circumstances of hardship, by the provisions of the statute. In an application for special relief under section 210 of the Act of 1917, the grounds

of challenge are very different if the letter of the section is the measure of relief thereunder. The value of the invested capital under the statutory definition (Revenue Act of 1917, section 207) is not put aside in such circumstances as an irrelevant inquiry. On the contrary it becomes the very essence of the claim by the taxpayer that there must be a recourse to another method. Under section 210 of the Act of 1917, the special method is not permissible unless "the Secretary of the Treasury is unable in any case satisfactorily to determine the invested capital." In brief, section 210 of the Act of 1917 is the precursor of section 327(a) of the Act of 1918, and is not at all the analogue of section 327(d). (Cf. *Williamsport Co.* v. *United States*, 277 U. S., 551, 558.)

We are not forgetful of the fact that by the regulations of the Commissioner and the practice of his Bureau, the distinction between the two Acts has been obscured, if not destroyed. Relief has been granted under the Act of 1917 as if its provisions were the same as those of the Act adopted later. (Treasury Regulations 41, 1918, article 52; cf. R. H. Montgomery, Excess Profits Tax Assessment (1920), pages 242, 243.) The validity of the regulations, if applied to proceedings under the Act of 1917, is a question not now before us. The practice, we may say in passing, has not been left unchallenged, but has been criticized in the report of the Senate Committee for the Investigation of the Bureau of Internal Revenue. (See Report No. 27, Part I, pages 214, 215, et seq., Sixty-ninth Congress, first session, 1925–1926.) Certain at all events it is that an appeal to the Commissioner to exercise his jurisdiction under section 210 of the Act of 1917 is not confined to the occasions stated in section 327(d) of the Act of 1918, if indeed it covers them at all. It is at least broad enough to give notice that jurisdiction should be exercised in accordance with the letter of section 210, upon the ground, that is to say, of the inability of the Commissioner to arrive at a conclusion as to value satisfactory to himself. Under section 327(d) of the Act of 1918, a special assessment is not ordered except on the motion of the taxpayer, setting forth the special reasons why the statutory definition is oppressive, and why another method should be adopted. Under section 210 of the Act of 1917, as under section 327(a) of the Act of 1918, the Commissioner acts of his own motion whenever he is unable to satisfy himself that the valuation will be accurate if there is adherence to the statute.

This question, if no other, he must have considered and determined when a claim for refund was submitted by the taxpayer without specifying the grounds. (*United States* v. *Memphis Oil Co.*, 288 U. S., 62.) This question, if no other, he must again have considered and determined when he certified to the taxpayer, after the claim had been amended and after submission of the evidence, that section 210 of the Act of 1917 supplied the applicable rule. It is a question that in last analysis is addressed to his own conscience, and in the absence of any evidence impeaching his conclusion his certificate of satisfaction on the contrary is binding on the courts.

The cumulative force of these administrative opportunities and these procedural analogies upholds the claim and the amendment.

The judgment of the Court of Claims is accordingly affirmed.

Article 1304: Claims for refund by taxpayers.

REVENUE ACT OF 1926.

Amendment after rejection when limitation period for filing new claim has expired. (See Ct. D. 649, page 338.)

Article 1304: Claims for refund by taxpayers. XII–18–6157 Ct. D. 661

INCOME TAX—REVENUE ACTS OF 1921 AND 1924—DECISION OF COURT.

CLAIMS FOR REFUND—SUFFICIENCY—LIMITATION.

Where taxpayer filed claims for refund alleging general grounds and stating that they were filed to protect it against the running of the statute of limitations, which claims (save for an allowance in part) were rejected, and thereafter and subsequent to the running of the statute of limitations the taxpayer requested a reopen-

ing and reconsideration of the claims in the light of a then showing that certain interest which taxpayer had reported in its returns had been held usurious by a State court, such request was in substance a new claim upon a new and specific ground which can not be regarded as a mere particularization of general allegations in the original claims, and was barred at the time of filing.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

National Cattle Loan Co., appellant, v. *The United States of America, appellee.*

Appeal from the District Court of the United States for the Eastern District of Illinois.

Before ALSCHULER and SPARKS, Circuit Judges, and WILKERSON, District Judge.

[December 7, 1932.]

OPINION.

This action was begun October 1, 1928, to recover income taxes aggregating $17,514.10, for the years 1918, 1919, and 1920, which were paid by appellant to former collectors of internal revenue who were out of office when the action was commenced.

A demurrer to the amended complaint was sustained. Appellant elected to stand upon its exceptions to that ruling, and the action was dismissed with costs.

During the period in controversy appellant was engaged in loaning money to cattlemen and ranchers, and kept its books upon the accrual basis. It filed its returns of income upon that basis and paid to the proper collectors the taxes so reported as follows:

Return filed.	Year.	Tax reported.	Year paid.
June 15, 1919	1918	$21,567.52	1919
Mar. 15, 1920	1919	16,738.59	1920
Mar. 15, 1921	1920	38,782.32	1921

Thereafter appellant filed the following claims for refund:

Date of filing.	Year involved.	Overpayment claimed.
Feb. 15, 1923	1917 to 1920, inclusive	$40,894.97
May 22, 1924	1918	24,658.73
Mar. 4, 1925	1919	16,738.59
Feb. 12, 1926	1920	38,782.32

Those claims are all similar in form, and the grounds for recovery asserted therein are set forth in the following language:

"This corporation in compiling its taxable income has included items as income which in fact are not income, and it has also failed to take losses sustained and expenses incurred. * * * This claim is filed for the protection of the company against the running of the statute of limitation so that the correct amount of tax overpaid may be refunded in the final adjustment of the correct tax liability."

After considering the data submitted by appellant in relation to those claims, the Commissioner by letter dated July 14, 1926, notified appellant that its taxes had been overassessed in the sums of $5,418.50 for the year 1918 and $27,919.77 for 1920, and subsequently made partial refunds upon that basis. The final action by the Commissioner on said claims was had on October 5, 1926, in which he rejected them other than the allowances made on July 14, 1926, as above referred to.

On July 5, 1927, appellant, by letter or petition, requested that the disallowed claims be reopened and reconsidered and that further refunds be made upon the basis of the following facts, concerning which no information had been previously disclosed to the Commissioner.

During the years 1918, 1919, and 1920, appellant made certain loans and renewals of loans to George W. Armstrong & Sons, a Mississippi copartnership, taking notes therefor, secured by chattel mortgages and trust deeds upon property of the borrower, at a discount rate of 8 per cent per annum during 1918 and 1919, and at 9 and 10 per cent per annum during 1920. Appellant accrued such discount or interest upon its books at those respective rates of discount as income earned during those years, and returned the same as income earned or accrued during those years.

Some years later appellant became engaged in a lawsuit with the trustee in bankruptcy for the estate of George W. Armstrong & Sons in the chancery court of Mississippi. In that action a decree was entered on May 20, 1926, in which the notes and securities of said George W. Armstrong & Sons were declared to be invalid to the extent, at least, of purging certain interest charges from accounts against that copartnership as usurious and illegal.

On July 30, 1927, the Commissioner notified appellant of his denial of its application to reopen the claims for refund, and refused to permit appellant to then amend, supplement, or enlarge the claims rejected on October 5, 1926.

The district court, in sustaining the demurrer to the declaration, ruled that appellant failed to meet the statutory conditions precedent under which appellee had consented to be sued in cases of this character, by reason of the failure to show that proper and sufficient claims for refund had been made within the time prescribed by law.

SPARKS, Circuit Judge: The only question involved in this appeal is whether the claims for refund filed for each of the years involved are sufficient for the refunding of income taxes paid by appellant upon that part of its reported income with which it had credited itself on the accrual basis as due from George W. Armstrong & Sons but which was never paid, and which had subsequently been declared by the Mississippi court to be usurious and illegal.

The following statutes are pertinent:

Section 252 of the Revenue Act of 1921 (ch. 136, 42 Stat., 268):

"That if, upon examination of any return of income made pursuant to * * * the Revenue Act of 1918, it appears that an amount of income * * * or excess-profits tax has been paid in excess of that properly due, then * * * the amount of the excess shall be credited * * * and any balance of such excess shall be * * * refunded to the taxpayer: *Provided*, That no such credit or refund shall be allowed or made after five years from the date when the return was due, unless before the expiration of such five years a claim therefor is filed by the taxpayer: * * *."

Section 281(f) of the Revenue Act of 1924 (ch. 234, 43 Stat., 302):

"This section shall not * * * bar from allowance a claim * * * in respect of a tax for the taxable year 1919 or 1920 if such claim is filed before the expiration of five years after the date the return was due."

Section 1014. (a) Section 3226 of the Revised Statutes, as amended, is amended to read as follows:

"SEC. 3226. No suit or proceeding shall be maintained in any court for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury, established in pursuance thereof; * * *."

(The provisions of this section are also found in section 1113(a) of the Revenue Act of 1926 (ch. 27, 44 Stat., 115 and 116).)

Article 1306 of Treasury Department Regulations 65, promulgated October 6, 1924, contains the following:

"*Claims for refund of taxes erroneously collected.*—Claims by the taxpayer for the refunding of taxes, interest, penalties and additions to tax erroneously or illegally collected shall be made on Form 843. All facts relied upon in support of the claim should be clearly set forth under oath."

Article 1304 of Treasury Department Regulations 69, promulgated August 28, 1926, substantially follows the above regulation.

The United States may not be sued except upon its consent, and then only upon the conditions under which it has consented to be sued, even though they be purely formal. (*Rock Island, Arkansas & Louisiana R. R. Co.* v. *United States*, 254 U. S., 141 [Ct. D. 2, C. B. 4, 342]; *United States* v. *Michel*, 282 U. S., 656 [Ct. D. 310, C. B. X–1, 297]; *Eastern Transportation Co.* v. *United States*, 272 U. S., 675; *Ritter* v. *United States*, 28 F. (2d), 265 [T. D. 4234, C. B. VII–2, 212].)

In order to support an action against the United States to recover an overpayment of taxes, the complainant must present to the Commissioner of Internal Revenue, within five years from the date taxpayer's return was due, a claim for refund, in which claim shall be clearly stated all facts relied upon in support of the claim. (*United States* v. *Felt & Tarrant Mfg. Co.*, 283 U. S., 269 [Ct. D. 336, C. B. X–1, 431]; *Wausau Sulphate Fibre Co.* v. *United States*, 49 F. (2d), 665 [Ct. D. 384, C. B. X–2, 274]; *Art Metal Const. Co.* v. *United States*, 47 F. (2d), 558 [Ct. D. 300, C. B. X–1, 421].)

After the rejection of a claim for refund, and after the period of limitation for filing new or further claims for refund has expired, appellant can not amend its rejected claim by alleging for the first time a specific ground for recovery not theretofore presented to the Commissioner. (*Solomon* v. *United States*, 57 F. (2d), 150 [Ct. D. 520, C. B. XI–2, 399]; *Wausau Sulphate Fibre Co.* v. *United States*, supra; *Sugar Land Ry. Co.* v. *United States* (Court of Claims), 48 F. (2d), 973 [Ct. D. 382, C. B. X–2, 309]; *Art Metal Const. Co.* v. *United States*, supra.)

Appellant contends, however, that the facts presented in his petition of July 5, 1927, to reopen and reconsider the claim which was rejected on October 5, 1926, was not a new claim, but a mere particularization of the general allegation in the original claims that appellant "in compiling the income included items as income which in fact are not income, and has also failed to deduct losses sustained and expenses incurred."

With that contention we can not agree, and we are convinced, from a perusal of the cases hereinbefore referred to, that the language just quoted from the original claims was not alone sufficient under the statute and Treasury regulations to require the Commissioner to consider the claims. He did, however, consider the claims; but it is to be noted in this respect that in the claims for the years 1918 and 1919 appellant also asked for special relief under sections 327 and 328 of the Revenue Act of 1918. But even if that special relief had not been demanded, and the Commissioner had granted a hearing on the claims, which in that event would have been insufficient for lack of particularization, those facts would not prevent the Commissioner from questioning the validity of the original claims on a petition for a refund under the circumstances herein presented. At the hearing, in so far as the record discloses, appellant was accorded the opportunity of presenting any claim he then desired to present, and he submitted no evidence and until July 5, 1927, made no reference to the specific claim which he now seeks to enforce, notwithstanding the fact that the chancery court of Mississippi had, on May 20, 1896 [1926], decreed the Armstrong interest to be usurious and illegal. On July 14, 1926, the Commissioner granted appellant relief on its original petition in the respective sums of $5,418.50 for the year 1918 and $27,919.77 for 1919, and on October 5, 1926, the Commissioner finally disposed of the matter by rejecting further allowance.

In *Wausau Sulphate Fibre Co.* v. *United States*, supra, the court, in considering whether an amendment operates to prevent the application of the statute of limitations, said:

"* * * we think a rule of pleading should be followed, especially as this rule is based on logic and reason. It is well settled that where a cause of action is defectively pleaded, an amendment not changing the cause of action but curing these defects does not make the cause of action subject to the statute of limitations, even though the amendment be filed after the expiration of the period thereof. On the other hand, if an amendment is filed after the expiration of the period of limitations setting up an entirely new cause of action it is barred by the statute, notwithstanding the original plea was filed in time."

In *Art Metal Const. Co.* v. *United States*, supra, appellant filed a claim for a refund in which it stated that it was engaged in manufacture; that the claim

related to its income and profits tax, which had been assessed at the figure returned; and that it requested a reduction of $1 or more as the amount to be refunded. It also contained the following:

"This claim is filed pursuant to the provisions of section 252 of the Revenue Act of 1921, as amended by the Act of March 4, 1923, for the refunding of any sum which, by reason of future court cases, Treasury rulings, or for other reasons, it may appear has been illegally or erroneously assessed or collected. The purpose in submitting this claim is to protect the taxpayer's rights in respect of the time within which such claims must be filed."

The court said:

"The supposed claim was no claim at all; it was a mere caveat, an attempt to reserve the taxpayer's right at some later time to file a claim, should something turn up * * * which might lead him to suppose that he could get back what he had already paid. * * * Moreover, we can not agree that such a claim can be pieced out by matter in pais, certainly when it is no more than a general reservation of all future claims. Whatever the purpose of the statute, it is at least to advise the Commissioner that the taxpayer intends by it to assert that a part of his tax was never due. To allow him to substitute, not a claim, but a warning that he may in the future make a claim—which is all on any theory that the supposed claim was—substantially dispenses with the statute altogether. Presumably, it was to avoid exactly such resulting uncertainties that the Act and the regulations required something definite enough for action. The claim called for, and indeed admitted, no action at all. * * * It bore no evidence that the plaintiff had any present complaint in mind; * * * the claim was nothing but an effort to extend the time which the statute had given; * * *."

In *United States* v. *Felt & Tarrant Mfg. Co.*, supra, respondent filed an application for reduction of its 1917 tax liability and for a corresponding return of taxes paid which it designated a claim "for refund of taxes illegally collected." The sole ground stated was that respondent had filed with Commissioner an application for special relief from excess profits tax under section 210 of the Act of 1917. The claim contained the following: "This claim is filed to protect all possible legal rights of the taxpayer, pending, and at the rate of, the settlement of the claim for relief." Under that claim plaintiff sought a deduction from gross income for that year on account of exhaustion or obsolescence of patents. The Supreme Court, in holding the claim insufficient for the purpose, said:

"The filing of a claim or demand as a prerequisite to a suit to recover taxes paid is a familiar provision of the revenue laws, compliance with which may be insisted upon by the defendant, whether the collector or the United States. * * *

"One object of such requirement is to advise the appropriate officials of the demands or claims intended to be asserted, so as to insure an orderly administration of the revenue, * * * a purpose not accomplished with respect to the present demand by the bare declaration in respondent's claim that it was filed 'to protect all possible legal rights of the taxpayer.' The claim for refund, which section 1318 makes prerequisite to suit, obviously relates to the claim which may be asserted by the suit. Hence, quite apart from the provisions of the regulation, the statute is not satisfied by the filing of a paper which gives no notice of the amount or nature of the claim for which the suit is brought, and refers to no facts upon which it may be founded."

It is quite true that the facts in the cases from which we have quoted are not identical with those in the instant case, but they are indeed analogous, and we are convinced that the requirements of the statute and the Treasury regulations as construed by those cases prevent appellant's recovery.

There is a line of earlier cases decided by district courts and by the Court of Claims which seem to support appellant's contention. Typical of these cases are *Union & New Haven Trust Co.* v. *Eaton* (20 F. (2d), 419); *Warner* v. *Walsh* (24 F. (2d), 449); and *Felt & Tarrant Mfg. Co.* v. *United States* (37 F. (2d), 977). These cases are referred to but not followed in *Art Metal Const. Co.* v. *United States*, supra. Since that decision the case of *Felt & Tarrant Mfg. Co.* (37 F. (2d), 977) has been reversed by the Supreme Court (283 U. S., 269).

We therefore hold that appellant's claim for a refund on account of the usurious interest on the Armstrong claim was barred by the statute of limitations at the time it was filed with the Commissioner.

Judgment affirmed.

ARTICLE 1304: Claims for refund by taxpayers.

REVENUE ACT OF 1924.

Amendment before rejection of timely claim filed in general terms. (See Ct. D. 676, page 341.)

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid. XII–4–6002 Ct. D. 623

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. LIMITATION—CREDIT BY DIRECTION OF TAXPAYER.

Where plaintiff directed that overpayment of his tax for 1918 be applied to tax for 1917 assessed against a partnership of which he was a member, and such direction was made before the expiration of the statute of limitations but the application was not made until the statutory period as to part of plaintiff's taxes had expired, the statute then in force could not be construed as extinguishing the debt due from the taxpayer when the period of limitation had run, but as merely abrogating the remedy.

2. MOTION DENIED.

Motion for new trial denied. For original opinion see Court Decision 596 (C. B. XI–2, 373).

COURT OF CLAIMS OF THE UNITED STATES.

David Daube v. *The United States.*

[November 14, 1932.]

SUPPLEMENTAL OPINION.

GREEN, Judge, delivered the opinion of the court.

The motion for new trial is based upon the statement that the court erred in stating in the opinion that although the application of the overpayment was made after the statute of limitations had run, the statute then in force did not extinguish the debt due from the taxpayer, it merely abrogated the remedy. It is urged on behalf of plaintiff that *Bowers* v. *New York & Albany Lighterage Co.* (273 U. S., 346 [T. D. 4009, C. B. VI–1, 268]) held to the contrary. This is a mistake. The question for decision in that case, as expressly stated in the opinion, was whether section 250(d) of the Act of 1921 barred collection by distraint proceedings begun after the expiration of the 5-year period of limitation, and it was held that the word "proceeding" as used in this limitation clause "can not be restricted to steps taken in a suit; it includes as well steps taken for the collection of taxes by distraint." The reversal by the Supreme Court in 273 U. S., 781, of the Toxaway Mills case (61 C. Cls., 363 [T. D. 3805, C. B. V–1, 322]), a case which involved the construction of the same statute, did not amount to a decision that the statute barring the remedy extinguished the tax debt. In the Toxaway Mills case, the record showed that the tax was paid by reason of a demand made by the Government after the period of limitations had expired, and the only inference that can properly be made from the reversal is that the Supreme Court considered that a demand made by Government officials was a "proceeding" which was barred by the statute, the court having held in the Bowers case, supra, that the word "proceeding" was "used broadly in reference to steps for the collection of taxes," and that its meaning was not limited to collection by suit.

The basic principle of these cases, as we understand it, is that where the Government, after the period of limitations has run, collects taxes by a proceeding forbidden by law, a suit can be maintained to recover back the money so paid. Obviously if this were not the case, the statutes so violated would be practically nullified in tax cases, as the taxpayer can not enjoin proceedings to collect the tax but is compelled to bring suit to recover the money illegally taken

from him. But no such situation is presented by the case at bar and, as we think, there was no statute in force during the period involved which could possibly be construed as extinguishing the debt when the period of limitations had run.

The argument made on behalf of plaintiff assumes that the case at bar is one in which the Government, after action to collect the tax was barred, initiated some kind of proceedings to obtain its payment. On the contrary, the plaintiff initiated proceedings to have money which belonged to him and was held by defendant applied on the tax debt. The direction to make the application was made before the expiration of the statute of limitations.

It is true that the period of limitation as to a part of plaintiff's taxes had expired when the application was made, but that does not alter the situation. The direction to apply the overpayments on the tax still unpaid had not been withdrawn. In the case of *Stange* v. *United States* (282 U. S., 270 [Ct. D. 274, C. B. X–1, 414]), the Supreme Court, in affirming the decision of this court (68 C. Cls., 395) held that a waiver filed after the period of limitations had expired was not ineffective, and that by reason of the waiver, money paid on a tax which was barred by the statute of limitations, could be retained by the Government. Such a holding would not have been made if the Supreme Court considered that the debt had been completely extinguished by the statute of limitations.

Language is quoted from the decision in *Mascot Oil Co.* v. *United States* (282 U. S., 434, 436 [Ct. D. 286, C. B. X–1, 190]), which it is claimed supports plaintiff's contention because it contains a reference to the case of *Graham* v. *Goodcell* (282 U. S., 409 [Ct. D. 287, C. B. X–1, 191]), as being one in which no "liability" existed on the part of the taxpayers after the statute of limitations had run. But the word "liability" has different meanings and must be construed in accordance with the context. We think it was not used by the Supreme Court in the case cited in the meaning given it by plaintiff. In financial matters the most common meaning of the word, according to the dictionary, is "that which one is under obligation to pay," and an "obligation" is also defined as "that which a person is bound to do or forbear." Plaintiff could not be compelled or obliged to pay the debt but the indebtedness still existed. The general rule in respect to debts is that "statutes of limitation are regarded as barring the remedy, and not as extinguishing the cause of action." (37 C. J., pages 698–699, section 18.) In *Campbell* v. *Holt* (115 U. S., 620, 626) the Supreme Court approved the rule that—

"The statute of limitations only bars the plaintiff's remedy and not the debt, * * *."

In the absence of any special statutory provision which rendered it necessary to so hold, we do not think the Supreme Court intended to abrogate this time-honored doctrine everywhere recognized.

To avoid confusion it should be kept in mind that there are three different periods of limitation referred to in the former opinion: First, the 1918 taxes of plaintiff as to which the limitation expired before the date of the Commissioner's letter authorizing the collector, out of the overassessment of plaintiff's taxes for that year, to satisfy the partnership's liability for 1917 taxes to the extent of $10,874.64, but not until after the approval of the schedule of refunds on March 29, 1924; second, the period of limitations on plaintiff's tax for 1919 which did not expire until 1925 and as to which under no theory of the case did any bar exist during the period involved; third, the period of limitations as to the partnership's tax for 1917 under the waiver which expired April 1, 1924. As to the partnership's tax, it will be seen that at the time the credits were made upon it the period of limitations had run, but both the majority and the dissenting opinions, on account of the directions by plaintiff and the facts of the case (although for somewhat different reasons), considered that the Commissioner might properly apply the overpayment on the 1918 tax of plaintiff to the satisfaction of the partnership's tax at the time it was so done. With reference to the refund of $2,628.26 claimed on the taxes for 1919 we stated very fully in the original opinion why we considered that there was no account stated upon which suit could be brought, and further consideration has only strengthened our view that the holding heretofore made was correct.

The motion for new trial must be overruled, and it is so ordered.

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid. XII–15–6127 G. C. M. 11650

REVENUE ACT OF 1926.

The Bureau is without authority to exclude from computation Sunday, the last day of the limitation period within which a claim for refund might have been filed.

Recommended that Mimeograph 3080 (C. B. II–1, 180) be overruled.

An opinion is requested whether a refund may be allowed on the basis of the claim filed in the instant case.

The taxpayer's income tax return for the year 1926 disclosed on its face a tax liability of $100x$ dollars, which was duly assessed. Payments of $25x$ dollars each were made on March 12, June 15, September 14, and December 14, 1927.

In November, 1928, an additional assessment of $.02x$ dollars was made and on November 6, 1928, this additional assessment was paid. The deficiency assessment was based upon information discovered during a field investigation which disclosed an error in the amount of dividends reported in the original return.

On December 15, 1930, there was filed with the collector of internal revenue a claim for refund of $75x$ dollars, a part of the total amount paid during the year 1927 in satisfaction of the original assessment. It was alleged in the claim that the time within which it might be filed would expire " under section 284 of the Revenue Act of 1926 on November 6, 1931." The date of payment of the additional assessment of $.02x$ dollars was evidently assumed by the taxpayer as being the date on which the statute of limitations began to run for payments made in 1927 on the original assessment, concerning which alone the claim for refund relates. No claim has been made for refund of the tax paid in satisfaction of the additional assessment nor has any question been raised as to its validity.

The last installment of the original assessment of 1926 tax, as already stated, was paid on December 14, 1927. The statutory 3-year period within which a claim for refund of that portion of the tax could have been filed expired on December 14, 1930, which date fell on Sunday. The claim for refund was filed on Monday, December 15, 1930, and the question is therefore presented whether the claim may be considered as timely filed in so far as the payment on December 14, 1927, is concerned. The pertinent provisions of section 284(b) of the Revenue Act of 1926 are as follows:

(1) No such * * * refund shall be allowed or made after three years from the time the tax was paid in the case of a tax imposed by this Act * * * unless before the expiration of such period a claim therefor is filed by the taxpayer; and

(2) The amount of the * * * refund shall not exceed the portion of the tax paid during the three * * * years * * * immediately preceding the filing of the claim * * *.

The exclusion or inclusion of Sundays in applying statutes of limitations has frequently been considered by courts.

In *Cunningham* v. *Mahan* (112 Mass., 58, 59) it is said that where a statute fixes the limitation of time within which a particular

act may or may not be done, if the time limited exceeds a week Sunday is included in the computation; but if it is less than a week Sunday is excluded. This case was followed in *Haley* v. *Young*, 134 Mass., 364); *Cowley* v. *McLaughlin* (141 Mass., 181, 4 N.E., 821); *Tuttle* v. *Boston* (215 Mass., 57, 102 N.E., 350); and *Stevenson* v. *Donnelly* (221 Mass., 161, 108 N.E., 926).

Appended to the *Stevenson* v. *Donnelly* case, as printed in Ann. Cas. 1917 E., is a note as follows:

When by a statute or a rule of court the time stipulated for the performance of an act is such that it does not necessarily include a Sunday, that day will be excluded in the computation of time for the performance of the act without an express requirement; and when the time stipulated must necessarily include one or more Sundays, those days will be included in the absence of an express proviso for their exclusion.

The note just cited is quoted with approval in *Yerkes* v. *Board of Supervisors, etc.* (117 Atl. (Md.), 772), in which it was held that where a period fixed in a statute is such that the legislature must have known that one or more Sundays would occur, then the Sundays are not to be excluded unless there is an express declaration to that effect.

The general rule for the inclusion or exclusion of Sundays is succinctly and comprehensively set forth in *Johnson* v. *Meyers* (54 Fed., 417, 418), as follows:

* * * Where the time limited for the performance of an act is less than seven days, where the unit of its measurement is the day, and there is reason to suppose that juridical days were intended by a statute or Act of Congress, there is reasonable ground for the holding that Sundays and legal holidays falling within such time should be excluded. (*Hales* v. *Owen*, 2 Salk., 625; *Rex* v. *Elkins*, 4 Burrows, 2130; *Thayer* v. *Felt*, 4 Pick., 354.) But where the time limited is such that one or more Sundays must fall within it, and there is no statute or act excluding any of them, it is certainly not the province of the court to extend the time fixed by excluding the last, the first, or any intermediate Sunday or holiday. (*Alderman* v. *Phelps*, 15 Mass., 225; *Ex parte Dodge*, 7 Cow., 147.) * * *

The reason for the general rule mentioned is thus given in *American Tobacco Co.* v. *Strickling* (88 Md., 500, 41 Atl., 1083, 1086):

* * * The rule may be said to be somewhat arbitrary, yet it is not without a reason. When the legislature fixes a limitation of time of more than seven days, it knows that the period must necessarily include one or more Sundays; and hence, if it intends to exclude them, it can and should say so; but, when the period of time is less than seven days, it may or may not include a Sunday, depending upon the day of the week it is computed from. * * *

In *Johnson* v. *Meyers*, supra, a more specific treatment of the basic reason for the general rule is thus given:

* * * Moreover, where the unit of measurement of the time limited is not the day, but is the month or year, there is still less reason to hold that any day that falls within the month or year can be excluded by the court. There are Sundays in every month. They are as much a part of the month as Saturdays, or any of the other days of the week; and where the time limited is measured by the month, and there is no statute excluding any day, there is no more reason for excluding the last Sunday of the last month from the six months limited by Act of Congress for taking an appeal, when the last day of the six months falls on Sunday, than there is for excluding the first Sunday of the first month, when the first day of the six months happens to fall on Sunday, or all the Sundays in the six months, for that matter; and, if they were all excluded, the time limited would be extended nearly another month. The result is that when the last day of the six months within which an appeal may

be taken, or writ of error sued out, to review in this court a decree or judgment below, falls on Sunday, the appeal can not be taken, or writ sued out, on any subsequent day. * * *

Cases illustrative of the general rule are very numerous and only a few need be mentioned here, such as *Damron* v. *Johnson* (233 S. W. (Ky.), 745); *Croissant* v. *De Soto Improvement Co.* (101 So. (Fla.), 37); *McCoy* v. *Duehay* (51 D. C. Appeals, 363, 279 Fed., 1001); and the cases cited in such decisions.

Cases sustaining the general rule in which the last day of a limitation period, more than seven days, fell on Sunday are likewise numerous. In the case of *Maresca et al.* v. *United States* (277 Fed., 727) the court held that a bill of exceptions in a criminal case can not be signed and filed on the day after the last day of the term of the trial court, where the last day of the period falls on Sunday or a legal holiday. Certiorari was denied in this case. (257 U. S., 657.) In *Siegelschiffer* v. *Penn Mut. Life Ins. Co. et al.* (248 Fed., 226) it was held that, in computing the time within which an appeal can be taken or a writ of error sued out after entry of judgment, when the last day of the six months' period falls on Sunday the act can not lawfully be done on the following Monday. Other cases where the last day of the limitation period, if falling on Sunday, is not to be excluded in computation of time are *American Tobacco Co.* v. *Strickling*, supra; *Frackelton* v. *United States* (57 Ct. Cl., 587); *Cooley* v. *Cook* (125 Mass., 406); *Stevenson* v. *Donnelly*, supra; *Meyer* v. *Hot Springs Improvement Co.* (169 Fed., 628); *Blaffer* v. *New Orleans Water Supply Co. et al.* (160 Fed., 389); *In re Anttonen* (293 Fed., 473); *Covey* v. *Williamson et al.* (286 Fed., 459); *Sam Satovsky* (1 B. T. A., 22); and *National Casket Co.* v. *Commissioner* (16 B. T. A., 1141, C. B. X-2, 50).

It is of interest to note, however, that where a *date certain* is fixed by a statute as that on or before which an act must be performed, and such date falls on a *dies non*, the party charged with the performance of the act may accomplish it on the day following the specific date mentioned in the statute or other instrument. Thus, in an Oregon case, where July 5 was named as the date on which a report of the county surveyor with respect to the location of a proposed county road was to be filed, and that day happened to be a holiday, the filing of the report on the next day was held to be sufficient, although under the court's order the report was to have been filed on July 5 (*Rice et al.* v. *Douglas County et al.*, 183 Pac., 768.) In *Street* v. *United States* (133 U. S., 299) the Supreme Court used the following language:

> Again, it must be noticed that the 1st day of January was Sunday, that is, a *dies non*, and a power that may be exercised up to and including a given day of the month may generally, when that day happens to be Sunday, be exercised on the succeeding day. So that it is a matter worthy at least of consideration whether the power was not exercised within the very limits of time prescribed by the act.

It is clear that the situation presented in the instant case is one where a limitation period is involved and not one where an act is to be performed on a date certain. Accordingly, this office is of the opinion that the Bureau is without authority to exclude from

computation Sunday, December 14, 1930, the last day of the 3-year period within which a claim for refund might have been filed by the taxpayer.

It is, therefore, recommended that Mimeograph 3080 be overruled.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid. XII-15-6128 I. T. 2690

REVENUE ACT OF 1921.

Mimeograph 3080 (C. B. II-1, 180), holding that the limitation period within which claims for refund of income tax for 1917 may be filed expires on Monday, April 2, 1923, is overruled, in view of General Counsel's Memorandum 11650 (page 325, this Bulletin).

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid. XII-22-6203 Ct. D. 673

INCOME TAX—JUDICIAL CODE—DECISION OF COURT.

SUITS AGAINST THE UNITED STATES—JURISDICTION OF DISTRICT COURT.

The United States was sued in the district court for a sum in excess of $10,000, the collector to whom the tax for 1916 was paid and the collector who held office in 1923 (when a part of the overpayment for 1916 was credited against a deficiency for 1915 and the balance refunded) both being out of office. The allegations of the complaint and the proof were sufficient to establish a cause of action upon an account stated. Dismissal of the complaint by the court below held sustainable whether considered in any one of the following three aspects:

(1) The limitation of $10,000 was removed by the amendment of section 24(20) of the Judicial Code (28 U. S. C. A., section 41(20)) in suits against the United States in district courts where recovery was sought of internal revenue tax payments or collections, the collector receiving the payment or making the collection being dead or out of office when the suit was brought. Such suits must be of the same kind as those for which they are a substitute, and if they are not such as could have been brought against the collector, they are not within the jurisdiction conferred. If plaintiffs' theory of their cause of action be accepted, it is on an implied promise—a cause of action which could not arise against a collector—and the lower court had no jurisdiction.

(2) Treating the credit applied on the then alleged barred deficiency for 1915 as an illegal collection of tax does not obviate the jurisdictional objection, since the complaint charges the collection to have been made, not by the collector, but by the United States. Moreover, no timely claim for refund was filed.

(3) If the complaint be regarded as alleging a cause of action arising from an erroneous collection of the 1916 tax by the collector and his retention of the amount credited on the 1915 tax, there is no right of recovery, the suit having been brought more than two years after the Commissioner rejected plaintiffs' claim.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Frank H. Moses and James T. Berney, as Executors of the Estate of Benjamin Adriance, Deceased, plaintiffs-appellants, v. ***The United States of America, defendant-appellee.***

Appeal from the District Court of the United States for the Eastern District of New York.

[November 14, 1932.]

OPINION.

SWAN, Circuit Judge: In June, 1917, Benjamin Adriance paid some $82,000 as his income tax assessment for the year 1916. Subsequent to his death, the plaintiffs, as his executors, filed amended returns for the years 1915 and 1916, and asserting an underassessment for the former year and an overassessment for the latter, claimed a refund of some $28,000 of the taxes paid for 1916. Upon an audit of these documents and the taxpayer's books, the Commissioner determined in 1923 that an overassessment of more than $81,000 had occurred with respect to the 1916 tax and an underassessment of some $52,000 with respect to the 1915 tax. On November 28, 1923, the Commissioner caused to be paid to the plaintiffs $28,872.23 in cash, and credited the balance of the overassessment against an additional assessment of $52,516.36 for the year 1915. This the plaintiffs accepted without objection, but more than five years later, having in the meantime suffered a change of heart, they demanded, on January 30, 1929, payment of the $52,516.36 so retained, with interest thereon, on the theory that the assessment in 1923 of an additional tax for 1915 was barred by the statute of limitations. On April 5, 1929, the Commissioner refused such demand, and on November 11, 1929, the present suit was begun against the United States.

The complaint sets up the foregoing facts and charges that, by the application of $52,516.36 of the admitted overpayment for 1916 to payment of the additional assessment for 1915, the United States "attempted to collect and did collect" said additional assessment on November 28, 1923, and that this was illegal because the collection of any additional assessment for 1915 was then outlawed. It was further alleged that the collector to whom the 1916 tax was paid and the collector who held office in 1923 were both out of office at the commencement of this suit. Judgment was demanded for the said sum of $52,516.36, with interest thereon from June 14, 1917. In defense the Government's answer asserted (1) that the additional tax for 1915 was legally assessed because prior thereto the plaintiffs had consented in writing to the assessment, and (2) that the suit was barred by the statute of limitations. Trial was to the court, without a jury, upon stipulated facts, and resulted in a dismissal of the complaint.

The disposition of the case which we are to make renders unnecessary a determination of the question whether there was such a consent in writing as would permit assessment of the additional tax for 1915 under section 250(d) of the Revenue Act of 1921 (42 Stat., 265). We shall assume arguendo throughout the discussion which follows that such additional assessment in 1923 was illegal.

The appellants' brief has presented their suit as one founded upon the Commissioner's allowance in 1923 of the claim of overassessment for the year 1916, and the failure of the United States to pay the full amount so allowed. Both the allegations of the complaint and the proofs adduced at the trial are sufficient to establish such a cause of action. (*Bonwit Teller & Co.* v. *United States*, 283 U. S., 258.) But the appellee challenges the jurisdiction of the court to entertain such a suit, and this raises the first question for consideration.

It involves an interpretation of section 24(20) of the Judicial Code, as amended in 1921 and 1926 (28 U. S. C. A., section 41(20)). Prior to these amendments, section 24 conferred jurisdiction on the district court, concurrently with the Court of Claims, of suits against the United States on "claims not exceeding $10,000 founded upon * * * any law of Congress, * * * or upon any contract, express or implied, with the Government of the United

States * * *." The plaintiffs argue that their cause of action is on the implied promise of the Government to refund the allowed claim of overpayment of the 1916 tax and arose on November 28, 1923, upon delivery to them of a certificate of overassessment. They concede that prior to the amendment of section 24 the district court would have had no jurisdiction, since the amount claimed was more than $10,000, but they assert that the amendment has removed the limitation as to amount in such a suit as this. The amendment added to section 24 a paragraph which reads as follows (44 Stat., 121):

"Concurrent with the Court of Claims, of any suit or proceeding, commenced after the passage of the Revenue Act of 1921, for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected, under the internal revenue laws, even if the claim exceeds $10,000, if the collector of internal revenue by whom such tax, penalty, or sum was collected is dead or is not in office as collector of internal revenue at the time such suit or proceeding is commenced."

It is apparent that this amendment enlarges the district court's jurisdiction by giving claimants who allege that money has been wrongfully collected under the internal revenue laws, the privilege of suing the United States regardless of the amount of the claim, but only on condition that "the collector of internal revenue by whom such tax, penalty or sum was collected" is dead or out of office. This condition makes apparent the intent of the legislation, namely, to permit suit against the United States as an alternative to a suit against a deceased or retired collector. Of suits against a collector, the district court already had jurisdiction unlimited as to amount. (Judicial Code, section 24(5) (28 U. S. C. A., section 41(5).) Such a suit was personal to the collector, would survive his retirement from office and would not abate upon his death. (See *Smietanka* v. *Indiana Steel Co.*, 257 U. S., 1 [Ct. D. 17, C. B. 5, 251]; *Union Trust Co.* v. *Wardell*, 258 U. S., 537 [T. D. 3338, C. B. I–2, 310]; *Patton* v. *Brady*, 184 U. S., 608.) We think it clear that the suits allowed under the amendment must be of the same kind as those for which they are a substitute. In other words, after the amendment, if the collector by whom the tax was wrongfully collected is still in office, the suit must, as before, be brought against him, if the claim exceeds $10,000; but if he is out of office, then it may be brought in the district court against the United States, regardless of the amount claimed. Hence, unless the plaintiff's suit is one that could be brought against a collector, it is not within the jurisdiction conferred on district courts by the amendment.

Accepting the appellants' theory of their suit the cause of action is grounded upon the Commissioner's determination evidenced by his certificate of overassessment. (*Bonwit Teller & Co.* v. *United States*, 283 U. S., 258, 265 [Ct. D. 334, C. B. X–1, 328].) The liability of the United States rests upon an implied promise to pay the allowed refund. (*United States* v. *Savings Bank*, 104 U. S., 728, 733; *United States* v. *Kaufman*, 96 U. S., 567, 570.) But no such cause of action can arise against a collector. He can neither allow a refund nor draw money from the Treasury to pay it. Hence no suit will lie against him based on the allowance of a refund. In *Arthur C. Harvey Co.* v. *Malley* (60 F. (2d), 97, 100 (C. C. A. 1)) the court said:

"If the appellant had declared as on an account stated, or a promise to pay by reason of the certificate of overassessment issued by the collector in May, 1923, as in *Bonwit Teller & Co.* v. *United States* (283 U. S., 258, 265, 51 S. Ct., 395, 75 L. Ed., 1018), we think its action would have to be brought against the United States, as neither of the defendants had anything to do with issuing of the certificate of overassessment or were privy to any promise therein contained, either express or implied, to refund the overpayment."

Routzahn v. *Reeves Bros. Co.* (59 F. (2d), 915 (C. C. A. 6)) is in accord; cf. *Peerless Paper Box Mfg. Co.* v. *Routzahn* (22 F. (2d), 459 (N. D. Oh.)). See also *United States* v. *Savings Bank* (104 U. S., 728, 734), where it is said that a rejected claim may be prosecuted against the collector, and an allowed claim, not paid, against the United States, in the Court of Claims.

In the case at bar, the plaintiffs proved facts which created a contractual obligation on the part of the United States to pay over the allowed refund, and

a breach of that obligation by retention of $52,000 for an unjustifiable reason, i. e., the illegally assessed additional tax for 1915. They urge that regardless of the legal theory upon which their suit is based, it is a suit for a "tax alleged to have been erroneously or illegally assessed or collected," and so within the letter of the amendment expanding the district court's jurisdiction. But the theory of the suit determines whether it is one which would lie against a collector if he were alive and in office; and if it be not such a suit, then for reasons already stated, we are satisfied that the amendment does not cover it. Two decisions of the district court are cited as having assumed jurisdiction of a suit like the present. (*Brady* v. *United States*, 24 F. (2d), 205 (D. Mass.); *United Motors Corp.* v. *United States*, 44 F. (2d), 407 (S. D. N. Y.).) In the Brady case, it does not appear that more than $10,000 was involved. In the United Motors case, where the claim was greater, jurisdiction was assumed without discussion. We think this assumption was erroneous. Therefore, if the plaintiffs can rely only upon the cause of action above discussed, we must reverse the judgment and direct dismissal for lack of jurisdiction.

However, it is not entirely clear from the complaint what cause of action it attempts to set forth. Paragraph 13 of the complaint alleges that by the application of part of the admitted overpayment for the year 1916 to the alleged additional assessment for 1915, "the defendant attempted to collect and did collect, on or about November 28, 1923, said alleged additional assessment upon the income of said Benjamin Adriance for the year 1915." This is followed by allegations that in 1923 the defendant was barred from collecting any additional assessment for the year 1915, and that the application of $52,516.36 of the admitted overpayment as a credit to the alleged 1915 assessment was illegal. This portion of the complaint seems to allege an illegal collection of the 1915 tax in November, 1923. But, if this be the theory of the complaint, it is subject to the same jurisdictional objection already discussed. The allegation is that the collection was made by "the defendant," and there are set forth no acts by any collector in connection with it. Paragraph 10 does say that one Ferguson was collector of internal revenue in October and November, 1923, and was out of office when the suit was commenced, but there is nothing alleged to show that he had anything to do with the collection made by the defendant. The proof, however, showed that Ferguson made certain bookkeeping entries relating to crediting the 1916 overpayment against the 1915 assessment. These were mere ministerial acts pursuant to instructions given by the Commissioner. Even if the allegations of the complaint were amended to conform to the proof (which was not asked), they would not charge any acts which would render Ferguson liable to the plaintiffs. Therefore, construing the complaint as based upon the illegal collection of the 1915 tax, and assuming this to be a valid cause of action against the United States, it is not one of which the district court had jurisdiction, because no such action would lie against collector Ferguson were he still in office.

Moreover, even if our conclusion as to jurisdiction with respect to this second cause of action were wrong, and the district court had jurisdiction, no right of action with respect to an illegal collection of the 1915 tax was proved, because no timely claim for refund thereof was presented to the Commissioner as required by Revised Statutes, section 3226 as amended (26 U. S. C. A., section 156). The collection was made in November, 1923, and the demand for repayment made by letter of January 30, 1929 (even if the letter be assumed to be a sufficiently formal claim), was more than five years after payment of such tax. This was too late. (Revised Statutes, section 3228 (26 U. S. C. A., section 157).) The filing of a claim is a prerequisite to suit for recovery of a tax illegally collected (*United States* v. *Felt & Tarrant Co.*, 283 U. S., 269, 272 [Ct. D. 336, C. B. X–1, 431]), and it must be filed before the statute of limitations has run. (*Solomon* v. *United States*, 57 F. (2d), 150, 151 (C. C. A. 2) [Ct. D. 520, C. B. XI–2, 399].) Hence on the assumption that the suit was to recover the illegally collected tax for 1915 and that the court had jurisdiction, the judgment of dismissal was correct.

There is a third possibility to be considered out of lenity to the complaint. It may be construed as alleging a cause of action founded upon the erroneous collection of $82,000 for the 1916 tax by the collector to whom that sum was paid in June, 1917, and the retention from the plaintiffs of $52,000 of that sum. In this view the allegations of why it was retained—to satisfy the illegal

1915 tax—would be merely surplusage. A suit based on an illegal collection of the 1916 tax would lie against the collector were he still in office, and, therefore, after his retirement could be brought against the United States by virtue of the amendment to section 24(20) of the Judicial Code. In other words, if this be the theory of the complaint, the court had jurisdiction, and we must consider whether the judgment of dismissal was correct under the evidence.

The tax was paid voluntarily. At common law and under the internal revenue statutes as they existed for many years, neither a collector nor the United States was liable to repay an erroneously collected tax unless the taxpayer paid under protest and duress. (*Elliott* v. *Swartout*, 10 Pet., 137, 153; *Chesebrough* v. *United States*, 192 U. S., 253; *United States* v. *New York & Cuba Mail S. S. Co.*, 200 U. S., 488; *Fox* v. *Edwards*, 287 F., 669 (C. C. A. 2) [T. D. 3445, C. B. II–1, 218]; *Winant* v. *Gardner*, 29 F. (2d), 836 (C. C. A. 2).) In 1924, section 3226 of the Revised Statutes was amended by section 1014 of the Revenue Act of 1924 (43 Stat., 343) so as to permit suit for a tax erroneously assessed or collected whether or not the tax was paid under protest or duress. Paragraph (b) of section 1014 expressly declared that the amendment shall not apply to pending suits. The implication is that it shall apply to all subsequent suits even though they relate to taxes paid prior to the enactment of section 1014. This court apparently so assumed by way of dictum in *Winant* v. *Gardner* (29 F. (2d), 836), which involved a suit pending when section 1014 was enacted. *Fox* v. *Edwards* (287 F., 669) was also a pending suit. Compare *Rasmussen* v. *Brownfield-Canty Carpet Co.* (31 F. (2d), 89, 92 (C. C. A. 9)), where the collector was held free from liability for a tax erroneously but voluntarily paid before the 1924 amendment went into effect, although the suit was commenced thereafter; and see *Warner* v. *Walsh* (27 F. (2d), 952 (D. Conn.)), questioning the constitutionality of the opposite construction. We shall assume arguendo that the fact that the tax was voluntarily paid in 1917 would be no bar to the present suit. There is, however, the prohibition of Revised Statutes, section 3226 (26 U. S. C. A., section 156) against maintaining any suit for the recovery of an illegally collected tax "until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue." The claim for refund filed by the plaintiffs in January, 1922, asked for a refund of $28,872.18, stating the reasons therefor as follows:

"A large part of this income was received in December, 1915, and should have been returned in that year, but was not, owing to the sickness of the claimant (now deceased) and the unfamiliarity of his bookkeeper with the income tax law and the transactions involved."

It then states the taxes actually paid for 1915 and 1916 and the correct taxes as shown by amended returns, and claims that the difference, namely, $28,872.18, "should be refunded." The Commissioner granted the exact relief demanded by this claim; he refunded in cash $28,872.23 and gave credit on the additional assessment for 1915 of the balance of the overassessment for 1916. It is true that opposite the amount specified as claimed the printed form contained the words: "Amount now asked to be refunded (or such greater amount as is legally refundable)." But this does not negative our statement that the plaintiffs obtained the exact relief they demanded. They are now suing for a sum they never asked the Commissioner to refund. That being so, we do not think the statute was satisfied. The claim for refund which the statute makes prerequisite to suit obviously relates to the claim which may be asserted by the suit. (*United States* v. *Felt & Tarrant Co.*, 283 U. S., 269, 272.) If, however, the claim could be construed as asking for more than $28,872.23, then the Commissioner's notification that the balance would be applied to the 1915 tax should be considered a rejection of the claim, and suit had to be brought within two years thereafter. Were the plaintiffs' cause of action founded upon the Commissioner's allowance of their claim, the limitation of section 3226 would not apply, as was held in the Bonwit Teller case; but if their cause of action is upon an illegal collection of the 1916 tax, as it must be to give the court jurisdiction, then section 3226 does apply both as to the necessity of filing a claim and as to the period within which suit must be brought after its rejection.

Viewing the complaint in the light most favorable to the complainants, we hold that it alleged a cause of action founded upon the illegal collection of the 1916 tax, but that such cause of action was barred by the delay in bringing suit. Accordingly, the judgment is affirmed.

SECTION 328 (REVENUE ACT OF 1918).—COMPUTATION OF TAX IN SPECIAL CASES.

ARTICLE 911 (REGULATIONS 45): Computation of tax in special cases. XII-15-6129 Ct. D. 652

INCOME AND EXCESS PROFITS TAX—REVENUE ACT OF 1918—DECISION OF SUPREME COURT.

1. SPECIAL ASSESSMENT—POWER OF COURTS TO REVIEW COMMISSIONER'S DETERMINATION OF PROFITS TAX UNDER SECTION 328.

Where the Commissioner, after determining the net income of the taxpayer for 1918 and 1919, found that, owing to abnormal conditions affecting the invested capital or income, computation of the tax under section 301 of the Revenue Act of 1918 would work an exceptional hardship, and that taxpayer's request for special assessment pursuant to sections 327 and 328 of that Act should be granted, and he thereupon determined the tax by applying the rate per cent found in the comparison made by him with the chosen representative corporations, it was beyond the power of the lower courts to redetermine the net income and apply thereto the rate per cent used by the Commissioner. Courts may not usurp the Commissioner's function with respect to special assessments, or substitute their discretion for his as to the factors to be used in computing the tax.

2. DECISION REVERSED.

The decision of the Circuit Court of Appeals, Third Circuit (60 Fed. (2d), 505) reversed.

SUPREME COURT OF THE UNITED STATES.

476. *D. B. Heiner, Collector of Internal Revenue, petitioner,* v. *Diamond Alkali Co.*

477. *D. B. Heiner, Collector of Internal Revenue, petitioner,* v. *Diamond Alkali Co.*

478. *C. G. Lewellyn, formerly Collector of Internal Revenue, petitioner,* v. *Diamond Alkali Co.*

On writs of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[March 13, 1933.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the court.

These cases present the question whether, where the Commissioner of Internal Revenue has granted special assessments of profits taxes pursuant to section 328 of the Revenue Act of 1918 (40 Stat., 1093), a court, in an action for a refund, may recalculate the taxpayer's net income and recompute the tax by applying to the corrected net income the rate per cent used by the Commissioner in his computation of the tax.

The Alkali company filed returns for income and profits taxes for 1918 and 1919 and paid the tax shown to be due. The Commissioner proposed certain changes in income and capital as reported, principally due to decreases in amortization and depreciation allowances. At some date not disclosed by the record the company asked that its profits taxes be computed pursuant to sections 327 and 328 of the Act. The request was denied and correspondence and conferences ensued between the Commissioner and the taxpayer in an effort to settle the disputed items. The demand for computation of the taxes pursuant to the special assessment sections was pressed by the company. Twice during the period of negotiation the Commissioner advised that until

the true net income was ascertained the propriety of special assessment could not be determined. Finally, in July, 1927, as a result of audits and investigations, he found the company's net income, and decided that, owing to abnormal conditions affecting its capital or income, assessment according to the usual method under section 301 would work an exceptional hardship, and relief should be granted pursuant to sections 327 and 328. He so notified the respondent, inclosing a calculation of the taxes made by him pursuant to section 328. The taxpayer protested on several grounds, amongst others, that the net income as determined under section 301 was excessive, and that the ratio of tax to net income obtained by the Commissioner by comparison with the taxes of other representative corporations, as provided in section 328, was too high. It did not, however, as was its right, appeal to the Board of Tax Appeals from the determination of net income.

In November, 1927, the Commissioner made an assessment in accordance with his findings and demanded payment of a deficiency thereby disclosed. The respondent paid under protest and filed claims for refund, asserting the same objections it had previously urged. The claims were rejected and the respondent brought suits to recover the alleged overpayments. The district court found that additional amounts should have been allowed for amortization, reduced the net income as determined, thereupon recomputed the taxes on the reduced income by applying the rate per cent used by the Commissioner in his computation, and rendered judgment in favor of the respondent. Both parties appealed. The circuit court of appeals increased the amortization allowance, made additional deductions from gross income for depreciation, found a net income much less than that fixed by the district court, and held that the tax should be recomputed by applying the rate used by the Commissioner to the new figure found as the net income.

Section 327(d), so far as here material, enacts that "Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328," the tax shall be computed as provided in the latter section. Section 328 declares that the tax shall be "the amount which bears the same ratio to the net income of the taxpayer" as the average tax of representative corporations engaged in a like or similar trade or business bears to their average net income, and directs that in computing the tax the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined in accordance with section 326, which are as nearly as may be "similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances."

In *Williamsport Wire Rope Co.* v. *United States* (277 U. S., 551 [T. D. 4172, C. B. VII–2, 323]) it was decided that the allowance of special assessment is a matter of administrative discretion; and it was further said that the selection for comparison of representative corporations engaged in a like or similar trade or business is also a question of discretion. The Commissioner can not make an administrative finding upon the question for decision under section 327(d) or that under 328 until he has determined the net income of the taxpayer. (See *United States* v. *Henry Prentiss & Co., Inc.*, No. 234, October term, 1932, decided January 9, 1933 [Ct. D. 627, page 311, this Bulletin].) He must compare the income of the taxpayer with that of corporations he deems representative in order to determine abnormality or gross disproportion between capital and income. When he comes to compute the ratio or rate of tax to be applied to the taxpayer's net income, as prescribed in section 328, he obviously will consider as a factor the ratio of tax to net income of the same representative corporations he examined for the purpose of deciding whether he should grant special assessment under section 327(d).

The parties are in agreement that the Williamsport Wire Rope Co. case, supra, precludes revision, correction, or abrogation of the Commissioner's administrative discretionary findings, where, as here, there is no allegation of fraud. On the one hand the petitioners claim that the decisions below amount to such abrogation and the making of a new finding as to the right of special

assessment and a fresh computation of the tax upon revised net income; on the other, the respondent says that the courts recognized the binding character of the Commissioner's findings, enforced rather than set aside his allowance of relief, and adopting the rate found by him, applied it to the true statutory net income as judicially determined in accordance with law.

We think the petitioners' position is correct. The taxpayer's true net income was an essential factor in the problem. Until that was known the Commissioner could make no proper or satisfactory comparison with conditions prevailing in other corporations similarly circumstanced. We can not say that if the income had been substantially less than the figure he used he would have granted special assessment under section 327(d). Moreover, with a different net income, he might well have had to compare the relevant conditions in respondent's business with the operating results of corporations other than those he selected on the basis of respondent's net income as found, and might have concluded that a different ratio of tax to net income was applicable in respondent's case.

The grant of special assessment and the ascertainment of the rate or ratio of tax to be applied to the net income of the taxpayer are indissolubly connected by the terms of the statute. The exercise of the discretion in both aspects is committed to the Commissioner and to the Board of Tax Appeals upon review of his action. That discretion can not be reviewed by the courts, nor exercised by them in place of the administrative officer designated by law. It is beyond the power of a court to usurp the Commissioner's function of finding that special assessment should be accorded, and equally so to substitute its discretion for his as to the factors to be used in computing the tax. The courts below were in error in adopting the rate chosen by the Commissioner and applying it to a net income other than that which he used in making his comparisons and arriving at the rate. The respondent's tax could only be computed in accordance with section 301 or under section 328. The former prescribes the elements to be considered, and error in the computation remains subject to judicial correction; the latter grants the taxpayer the benefit of discretionary action by the Commissioner, and precludes judicial revision or alteration of the computation of the tax.

The judgments must be reversed and the cases remanded for further proceedings in conformity with this opinion.

Reversed.

TITLE XI.—GENERAL ADMINISTRATIVE PROVISIONS.

SECTION 1113.—LIMITATIONS UPON SUITS AND PROCEEDINGS BY THE TAXPAYER.

ARTICLE 1351: Suits for recovery of taxes erroneously collected. XII-10-6060 Ct. D. 639

FEDERAL TAXES—REVISED STATUTES—DECISION OF COURT.

1. SUIT—CLAIM FOR REFUND—SUFFICIENCY OF CLAIM.

A timely claim for a refund, based on the ground that additional depreciation should be allowed on buildings and machinery, does not constitute such a claim for refund, under section 3226 of the Revised Statutes as amended, as will support a suit to recover a tax based on the different ground, set forth in a claim for refund filed after the expiration of the statutory period of limitation, that the taxpayer is entitled to depreciation of a contract for the purchase of bleached sulphite.

2. DECISION AFFIRMED.

The decision of the district court (Ct. D. 379, C. B. X-2, 295) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

Bryant Paper Co., appellant, v. *Marie Sprague Holden, Executrix of the Estate of Charles Holden, Deceased, appellee.*

Appeal from the District Court for the Western District of Michigan.

[December 16, 1932.]

OPINION.

HICKS, Circuit Judge: Appellant, herein called plaintiff, sued the executrix of the will of Holden, a former collector of internal revenue, to recover an overpayment of income and profits taxes for the year 1922. The foundation for the suit laid in the original declaration was the general allegation that plaintiff was entitled to additional deductions for depreciation in the years 1921 and 1922. The amount in controversy was $7,386.35. Plaintiff claimed that it was entitled to depreciation upon the value of a contract it had with the Nashwaak Pulp & Paper Co., Ltd., for the purchase of bleached sulphite.

It is agreed that if the filing of a claim for refund by plaintiff was timely it was entitled to a judgment in the court below; otherwise not, because the filing of such claim within the statutory period, i. e., four years after the payment of the tax, is a prerequisite to recovery. (Title 26, sections 156, 157, U. S. C.; Treasury Regulations 69, article 1304.)

The sole question is, whether plaintiff filed such claim within the statutory period.

By written stipulation the case was heard without a jury. The district judge filed a written opinion, made special findings of fact and conclusions of law, and dismissed the case.

The court found that on March 14, 1927, plaintiff filed a claim for a refund of part of its 1922 taxes; that this claim was based "on the ground that adjustment of depreciation for prior years now being considered by the unit, may, when carried forward result in additional deductions for 1921 and 1922, and loss on Home Life Publishing Co. may be determined to be allowable in 1921 or 1922 rather than in an earlier year as claimed." It further found that this claim was rejected on May 19, 1927, because it was not sufficiently specific. These findings were not excepted to.

Thereafter, on June 10, 1927, plaintiff, by letter, protested the rejection of its claim of March 14, 1927, and explained *that it was claiming deduction for depreciation upon machinery and equipment at 10 per cent per annum and for $44,553.87 which it had charged off as a worthless account against the Home Life Publishing Co.*

The court did not find as a fact but it was agreed that following the letter of June 10, 1927, plaintiff on October 31, 1927, filed a revised claim for the year 1922, which contains the following statement:

"Deponent verily believes that this application should be allowed for the following reasons:

"The details supporting this claim are contained in a protest submitted herewith dated October 26, 1927. The points involved are:

"Additional depreciation—1921	$44,038.32
"Additional depreciation—1922	21,733.14
"Loss on Home Life Publishing Co.—1921	44,553.87
"Loss on F. B. Mills Co.—1921	314.42
"Loss on F. B. Mills Co.—1922	220.09
"Total	110,859.84"

The accompanying protest states that "the following specific facts are submitted which we believe will enable you to make a proper adjustment. The points in question are three, namely:

"(a) *A claim for additional depreciation.*

* * * * * * *

"The *claim for additional depreciation* arises from following the procedure, rates and depreciable cost determined by the Bureau *with respect to buildings and machinery* for the years 1917 to 1920, inclusive. The effect of applying the basis adopted by the Bureau is indicated in *the attached schedule,* in which

it is shown that additional depreciation is allowable in the amounts of $44,038.32 and $21,733.14 for the years 1921 and 1922, respectively.

* * * * * * *

"A revised claim to cover the refund which will result from *the specific corrections cited herein* is attached."

And the accompanying computation shows that the additional depreciation for 1922 *was based solely upon buildings, machinery, and equipment.*[1]

This revised claim was timely. It was filed prior to December 13, 1927, the expiration date of the statutory period of four years, but it carried no suggestion that overpayment was claimed on account of depreciation of the Nashwaak contract and no formal effort was ever made to amend or enlarge this revised claim to include depreciation therefor.

However, on April 30, 1929, after the expiration of the 4-year period, plaintiff filed a refund claim for the amount in controversy for the year 1922 based upon an allowance by the Commissioner of depreciation of the Nashwaak contract. This claim appears in the record as an independent demand. It does not seek to relate itself to the one filed on October 31, 1927. With the exception of mention made in certain briefs, the earliest of which was filed April 7, 1929, more than 16 months after the bar of the statute had fallen, this claim made on April 30, 1929, was the first intimation that plaintiff was seeking the return of an overpayment upon its 1922 taxes on account of depreciation upon the Nashwaak contract.

We are not in accord with plaintiff's view that the claim of April 30, 1929, was so far amendatory or explanatory of the timely claim of October 31, 1927, as to relate to its date and thereby be brought within the statutory period. The claim of October 31, 1927, was meticulously specific. It was purposely made so to correct the imperfections of the former claim of March 14, 1927. It fully complied with Treasury Regulations 60, article 1304. It set out in detail under oath upon the prescribed form the facts relied upon to support it. It was definitely for depreciation upon buildings and machinery and for losses upon the accounts therein mentioned. The inclusion of these specific matters was equivalent to the exclusion of all others. The Commissioner had no authority to extend the statute of limitations by allowing claims for overpayment which were not presented to him until they were barred by limitations.

In *United States* v. *Felt & Tarrant Manufacturing Co.* (283 U. S., 269, 272 [Ct. D. 336, C. B. X–1, 431]), the court said:

"The claim for refund which section 1318 makes prerequisite to suit, obviously relates to the claim which may be asserted by the suit. Hence quite apart from the provisions of the regulation, the statute is not satisfied by the filing of a paper which gives no notice of the amount or nature of the claim for which the suit is brought and refers to no facts upon which it may be founded."

In *Tucker* v. *Alexander* (275 U. S., 228, 231) the court said:

"Liberal compliance with statutory requirements that a claim or appeal be filed with the Commissioner before suit is brought for a tax refund may be insisted upon by the defendant whether the collector or the United States. (*Kings County Savings Institution* v. *Blair*, 116 U. S., 200; *Maryland Casualty Co.* v. *U. S.*, 251 U. S., 342, 353, 354; *Nichols* v. *U. S.*, 7 Wall., 122, 130.)"

In *Red Wing Malting Co.* v. *Williams* [*Willcuts*] (15 Fed. (2d), 626, 634 (C. C. A. 8) [T. D. 3980, C. B. VI–1, 225]) the court said:

"The precise ground upon which the refund is demanded must be stated in the application to the Commissioner, and we think, if that is not done, a party can not base a recovery in the court upon an entirely different and distinct ground from that presented to the Commissioner."

See also *Bemis Bros. Bag Co.* v. *United States* (60 Fed. (2d), 944, 948 (C. C. A. 8) [Ct. D. 613, C. B. XI–2, 409]).

We are not dealing with a situation wherein a refund claim was imperfectly presented before the statute of limitations had run for the claim in controversy was not presented at all within that period.

The necessity for the requirement of the statute is obvious. The reasons for it have often been stated by the courts. A repetition would seem to be useless for the words of the statute "mark the conditions of the claimant's right." (*United States* v. *Felt & Tarrant Manufacturing Co.*, supra.)

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[1] All italics herein are ours.

Plaintiff insists that the district court erred in failing to find as a fact that plaintiff filed the revised claim of October 31, 1927. It was agreed that plaintiff did file this claim but there was no reversible error in failing to find the fact because the finding would have been immaterial. The essential and insurmountable feature is that the demand upon which plaintiff's suit is founded as particularly reflected in the amendment to its declaration bore no relation whatever to the timely claim of October 31, 1927, and was not presented for consideration by the Commissioner until after the bar of the statute had fallen.

Affirmed.

ARTICLE 1351: Suits for recovery of taxes erroneously collected. (Also Section 284, Article 1304.)

XII-14-6113
Ct. D. 649

INCOME AND EXCESS PROFITS TAX—REVENUE ACT OF 1918—DECISION OF SUPREME COURT.

1. CLAIMS FOR REFUND—SPECIAL ASSESSMENT—AMENDMENT—SUFFICIENCY—LIMITATION.

Where in its original claims for refund taxpayer requested special assessment under sections 327 and 328 of the Revenue Act of 1918, alleging three grounds and submitting facts in support of each, two of the grounds being to the effect that there had been no accurate determination of invested capital, thus imposing upon the Commissioner the duty of making such determination, if he could, and where special assessment was denied because insufficient evidence had been presented to justify relief upon the third ground (namely, the presence of abnormal conditions), and where taxpayer subsequently filed amended claims with no important change therein except in the relief requested, which, as an alternative, asked that items improperly eliminated from invested capital be restored and the tax recalculated on that basis, and where upon reconsideration the Commissioner found there had been an undervaluation of invested capital, his denial of the claims upon the grounds that their form as first presented was defective and that the amendments came too late was error.

2. DECISION REVERSED.

The decision of the Circuit Court of Appeals, Eighth Circuit (60 Fed. (2d), 944, Ct. D. 613, C. B. XI-2, 409), which affirmed the District Court (56 Fed. (2d), 407, Ct. D. 433, C. B. X-2, 297), reversed.

SUPREME COURT OF THE UNITED STATES.

Bemis Bros. Bag Co., petitioner, v. *The United States of America.*

On writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[March 13, 1933.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the court.

The controversy to be determined presents another phase of a problem which has been much considered by the court in opinions recently announced. (*United States* v. *Memphis Cotton Oil Co.*, 288 U. S., 62 [Ct. D. 626, page 307, this Bulletin]; *United States* v. *Prentiss & Co.*, 288 U. S., 73 [Ct. D. 627, page 311, this Bulletin]; *United States* v. *Factors & Finance Co.*, 288 U. S., 89 [Ct. D. 628, page 315, this Bulletin], January 9, 1933.) There is need once again to decide whether a claim for the refund of a tax has been presented by the taxpayer in such a form as to be subject to amendment after a claim wholly new would be barred by limitation.

The petitioner, Bemis Bros. Bag Co., having made payment of excess profits taxes for 1918 and 1919, filed its claims for refund with the Commissioner of Internal Revenue. The claims contained a request for a special assessment

under sections 327 and 328 of the Revenue Act of 1918, and in support of the request annexed a statement under oath which had been filed with a like claim as to the taxes of another year.

By the statement thus annexed, the right to the relief demanded is placed upon three grounds which are not to be confused.

The first is that the case is one "where the Commissioner is unable to determine the invested capital" in the ordinary way. This is the ground covered by section 327(a) of the applicable statute.

The second is that the case is one "where a mixed aggregate of tangible and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively." This is the ground covered by section 327(c).

The third is that the case is one where "the tax, if determined without the benefit of this section [327] would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without the benefit of this section and the tax computed by reference to the representative corporations specified in section 328." This is the ground covered by section 327(d).

The taxpayer in presenting its claims to the Commissioner submitted facts and arguments in support of each of the three grounds.

To show that the invested capital had been inaccurately determined, and could not be accurately determined by resort to the usual methods, the taxpayer stated *inter alia* that the value of printing plates and patterns had been erroneously omitted, and that owing to the loss of vouchers and the changes wrought by the lapse of time, the value of these items could not be measured with complete precision, though it was susceptible even then of being fixed approximately. An estimate of the value was included in the claims.

To show that the case was one of a mixed aggregate of tangibles and intangibles paid for in stock, with the value of the several elements not subject to accurate division, the taxpayer made a statement of the corporate history and structure.

To show that there were abnormal conditions that would bring about injustice if the computation of the tax were to be made according to the usual method, and this though the invested capital were to be accurately determined, the taxpayer made a statement of the inequalities between its position and that of other corporations engaged in a like business.

Grounds Nos. 1 and 2 gave notice to the Commissioner that the taxpayer's invested capital had been erroneously assessed and charged him with a duty to inquire into the error and to give appropriate relief. (*United States* v. *Factors & Finance Co.*, supra.) If he found that items had been omitted, but that he was unable to ascertain their value with reasonable accuracy, he might resort to section 328, and order the tax to be assessed in accordance with a special method. If he found that there had been omissions, but that he was able to his own satisfaction to identify and appraise them, he would learn in the process that there had been an undervaluation of invested capital, and that the assessment of the tax was correspondingly erroneous.

Ground No. 3 is independent of the others, and has a different origin and meaning. "A demand for a special assessment in accordance with section 327(d) of the statute of 1918 is not a challenge to any act of the Commissioner in the valuation of invested capital. On the contrary, the valuation of invested capital is irrelevant if the special method is accepted. The very basis of the application for the use of such a method is the presence of abnormal conditions whereby an unfair and disproportionate burden will be laid upon the taxpayer if invested capital is to be reckoned according to the statutory definition (sections 325, 326), and the profits of the taxpayer subjected to a tax accordingly. Let the new method be adopted and the value of the invested capital ceases to be a factor in the process." (*United States* v. *Prentiss & Co.*, supra.)

The Commissioner notified the taxpayer in October and November, 1926, that there was no evidence before him sufficient to justify relief under section 327(d) on the ground of abnormal conditions in the business of the claimant as compared with that of others. He seems to have overlooked the fact that the taxpayer was claiming relief also under subdivisions (a) and (c). A protest promptly followed the delivery of the notice, and with the protest went an amended claim. In this amended claim there was no change of importance,

unless importance be attached to the form of the relief demanded. The request for a computation in accordance with section 328 was accompanied by a request for relief in the alternative. In the event of a denial of a special assessment, the taxpayer now demanded that the items "improperly eliminated from invested capital should be restored to invested capital, and the excess profits tax recalculated on that basis." The Commissioner ordered another hearing, and considered the claim anew. Upon reconsideration he held that there had been an undervaluation of invested capital in 1918 and 1919 with the result that the taxes for the one year had been overpaid in the sum of $14,054.18, and for the other in the sum of $9,073.15. After thus finding an error in the assessment, he dismissed the claims for refund on the ground that their form as first presented was defective and that the amendment came too late. (Cf. *United States* v. *Memphis Cotton Oil Co.*, supra.) In a suit by the taxpayer to recover the moneys overpaid, the district court gave judgment for the Government, and the court of appeals affirmed. (60 F. (2d), 944.) The case is here on certiorari.

We held in *United States* v. *Prentiss & Co.*, supra, that after the period of limitation a claim for a special assessment under section 327(d) may not be turned by amendment into one for the reaudit of invested capital and for the reassessment of the tax accordingly. The two proceedings, it was pointed out, are essentially diverse. The one is nonjusticiable, invoking, as it does, an administrative and discretionary jurisdiction. The other is akin to a judicial inquiry, reexamining an earlier determination for error of fact or law. The one "assumes adherence to the statute in the valuation of invested capital, and counts upon extraordinary conditions as justifying a claim that the statute is oppressive." The other, rejecting the assumption, is a demand for a new audit. The distinction between a special assessment under subdivision (d) and a claim for like relief under subdivisions (a) and (c) becomes apparent when the Prentiss case is compared with another case decided the same day. In *United States* v. *Factors & Finance Co.*, supra, there had been a general claim for refund without statement of the grounds. The taxpayer tried to turn it by amendment into a claim for a special assessment under section 210 of the Revenue Act of 1917. The amendment was upheld. We pointed out, in upholding it, that "section 210 of the Act of 1917 is the precursor of section 327(a) of the Act of 1918, and is not at all the analogue of section 327(d)." Under section 210 of the earlier Act, as under section 327(a) of the later Act, there is a challenge to the valuation of invested capital which opens up the whole subject for revision and readjustment.

We think procedural analogies and administrative practice sustain the contention of the petitioner that the claim as amended does not differ in matter of substance from the claim as first presented.

1. If we look to the analogy of pleadings in a lawsuit, the conclusion is not doubtful. The claim at first presented gives notice to the Commissioner that assets of great value have been omitted from invested capital. It tells him what those assets are, and even estimates their value, though imperfectly and roughly. There is no failure to make disclosures of the substance of the grievance, no dearth of information as to the facts that should be the prelude to inquiry. What is subject to criticism is this and nothing more, that the claim is niggardly, and hence defective, in its prayer for relief. It asks for a special assessment under sections 327 and 328. It should have asked for this, and in the alternative that invested capital be reexamined and increased. But for the purpose of determining the limits of permissible amendment, a change of the legal theory of a suit, "a departure from law to law," is no longer accepted as a test of general validity. (*United States* v. *Memphis Cotton Oil Co.*, supra, and cases there cited.) Still weaker is a test derived from the prayer for relief, the mere demand for judgment. The rule is now general that at a trial upon the merits the suitor shall have the relief appropriate to the facts that he has pleaded, whether he has prayed for it or not.[1] (Cf. equity rules 19 and 22.) A claim for refund is not a pleading, and analogies borrowed from the forms and methods of a lawsuit will be applied to these administrative remedies "in due subordination to differences of end and aim." (*United States* v. *Memphis Cotton Oil Co.*, supra.) Even so, they will have their place of influence, which may turn out to be controlling, if differences of end and aim are obscure or indecisive.

[1] For a summary of the decisions see Clark on Code Pleading, page 184.

2. In this case administrative practice reenforces the suggestions of procedural analogies, and bids us follow where they point.

When a claim such as the one in controversy is submitted to a Commissioner, there is only one way in which it is possible for him to deal with it. He must look into the omitted items, and determine their effect upon the assessment he has made. If he finds that items have been omitted, and that by reason of their nature they make it impossible for him to determine the value of the capital, he will order a special assessment, for there will be nothing else to do. If he finds that they have been omitted, but that he is able to appraise them, he will have learned in the course of the investigation that the assessment is erroneous in a determinable amount. Justice will then require that it be changed to that extent. In amending the claim by a prayer for alternative relief, a taxpayer is not forcing the inquiry into an unexplored territory, into strange and foreign paths. He is asking the Commissioner to take action upon discoveries already in the making or perhaps already made. There is no transfiguring amendment, such as we found in the Prentiss case, with its attempted change from a discretionary to a justiciable remedy. There is an adaptation of the relief to a case already proved.

The brief for the Government describes the division of functions between one section and another of the Bureau of Internal Revenue. A claim which appears on its face to be one for a special assessment is sent to the special assessment section. A claim for the revaluation of invested capital is sent to a section of the field audit review division. From this it ensues, we are told, that claims may be handled by different persons, and to some extent in different ways, according to the end in view. More than that must be shown to make out the contention that the substantial identity of the claim will be changed by this amendment. Whatever the distribution of labor may be between one division and another, it is impossible for any of them to pass upon a claim under section 327(a) without also passing upon the question whether the valuation of the invested capital is wrong, and, if so, whether in a determinable or an indeterminable amount. Once let it be ascertained that the amount is determinable, and all that follows is an incident. At that point discovery has gone on to such a stage that the Commissioner may not rid himself of the duty of pressing forward to the end. He can not in good conscience be satisfied with less. There may be need to take the case out of one section and transfer it to another before revision will be complete. All this is quite irrelevant when once a wrong is brought to light. There can be no stopping after that until justice has been done.

The judgment is reversed.

ARTICLE 1351: Suits for recovery of taxes erroneously collected. XII-23-6213 Ct. D. 676

(Also Section 284, Article 1304.)

INCOME TAX—REVENUE ACT OF 1924—DECISION OF SUPREME COURT.

1. SUIT—PROTEST AS PREREQUISITE—ABOLITION OF REQUIREMENT.

Suit was properly brought against a collector, after the enactment of the Revenue Act of 1924, to recover tax paid in 1923 without protest. That Act abolished the formality of protest as a condition precedent to recovery where the action was not then pending, though the tax payment was made before its enactment.

2. REFUND—TIMELY CLAIM—AMENDMENT.

A timely claim for refund which gives notice in general terms of error in computing net income may be amended, before rejection, by a claim amplifying and making more specific the statements of the original claim as to income. *United States* v. *Memphis Cotton Oil Co.* (288 U. S., 62 [Ct. D. 626, page 307, this Bulletin]) and *United States* v. *Factors & Finance Co.* (id., page 89 [Ct. D. 628, page 315, this Bulletin]) followed.

3. DECISION REVERSED.

The decision of the Circuit Court of Appeals, Fifth Circuit (61 Fed. (2d), 605) reversed.

SUPREME COURT OF THE UNITED STATES.

George Moore Ice Cream Co., Inc., petitioner, v. *J. T. Rose, Collector of Internal Revenue for the District of Georgia.*

On writ of certiorari to the Circuit Court of Appeals for the Fifth Circuit.

[May 8, 1933.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the court.

The petitioner, a corporation, brought suit against the respondent, a collector of internal revenue, to recover income and profits taxes alleged to have been wrongfully collected. A demurrer by the collector was sustained in the district court upon two grounds; first, that the payment of the taxes had been made without protest; and second, that the original claim for refund filed with the Commissioner was defective and that amendment came too late. The circuit court of appeals upheld the decision upon the second ground without passing on the first. (61 F. (2d), 605.) The case is here on certiorari.

On April 1, 1918, the petitioner filed its return for the year 1917, disclaiming any tax liability. The Commissioner of Internal Revenue, auditing the return, found a tax liability in the sum of $6,871.18, and assessed a tax accordingly. The respondent, after notice of the assessment, made demand upon the taxpayer, giving notice that there would be distraint and sale unless payment was made within 10 days. On November 5, 1923, the taxpayer yielded to the demand, moved by the desire to avoid the seizure of its property, but without protest to the collector that the tax was illegal, either wholly or in part. Four years later, on November 5, 1927, it filed a claim for refund with the Commissioner, and on November 13, 1928, an amended claim, amplifying and making more specific the statements of the first one. The claims were rejected by the Commissioner, though a revenue agent had reported that a refund was due in the sum of $4,551.01. The petitioner alleges that the payment was excessive to that extent and sues the collector for the moneys overpaid.

1. At common law, and for many years under the Federal statutes, protest at the time of payment was a condition precedent to the recovery of a tax. (*Elliott* v. *Swartwout*, 10 Pet., 137, 153; *Curtis's Adm'x* v. *Fiedler*, 2 Black, 461; *Chesebrough* v. *United States*, 192 U. S., 253; *United States* v. *New York & Cuba Mail S. S. Co.*, 200 U. S., 488.) The rule persisted till 1924, when it was abolished by the Revenue Act of that year, with a proviso that pending suits should be unaffected by the change. (Revenue Act of 1924, ch. 234, 43 Stat., 253, 343, section 1014, amending R. S. section 3226;[1] 26 U. S. C., section 156.) This suit was not begun till March, 1931, and is thus outside of the proviso. Even so, the payment to be recovered was made in 1923, when protest was still necessary. The petitioner contends that the new rule applies to all suits begun after the adoption of the amendment. The Government contends that the old rule survives if the payment was before the amendment, though the suit was begun afterwards.

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[1] SEC. 1014. (a) Section 3226 of the Revised Statutes, as amended, is amended to read as follows:

"SEC. 3226. No suit or proceeding shall be maintained in any court for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress. No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim unless the Commissioner renders a decision thereon within that time, nor after the expiration of five years from the date of the payment of such tax, penalty, or sum, unless such suit or proceeding is begun within two years after the disallowance of the part of such claim to which such suit or proceeding relates. The Commissioner shall within 90 days after any such disallowance notify the taxpayer thereof by mail."

(b) This section shall not affect any proceeding in court instituted prior to the enactment of this Act.

We think the intention of the Congress was to remove the requirement of protest in any suit thereafter brought, irrespective of the date of the underlying payment.[2]

The tokens of intention are within the statute and outside of it.

Of the tokens within the statute, the saving clause, (b), is entitled to a leading place. "This section shall not affect any proceeding in court instituted prior to the enactment of this Act." The implication is that any proceeding not covered by the exception is to be subject to the rule. (*Moses* v. *United States*, 61 F. (2d), 791, 794. Cf. *Brown* v. *Maryland*, 12 Wheat., 419, 438.) But there are other tokens, and tokens still within the statute, that point the same way. The phraseology of the section in all its parts imports a regulation of procedure. No suit "shall be maintained" until a claim for refund or credit has been filed with the Commissioner. If such a claim has been filed, suit may be "maintained," though there was neither protest nor duress. Even pending actions would commonly be covered by such words. "To maintain a suit is to uphold, continue on foot, and keep from collapse a suit already begun." (*Smallwood* v. *Gallardo*, 275 U. S., 56, 61.) If suits already begun are taken out by an exception, to "maintain" can mean no less than to prosecute with effect, without reference to the date of the transaction at the root. (*Collector* v. *Hubbard*, 12 Wall., 1, 14.) In saying this we speak of the inference to be drawn when the balance is not shifted by countervailing weights. None can be discovered here. There could be no denial by anyone that transactions antedating the statute would be subject to the rule that the suit is not maintainable without the filing of a claim. The inference is cogent that the same transactions are covered when it is said in the same sentence that the suit *may* be maintained without evidence or averment of protest or duress. There is a unity of verbal structure that is a symptom of an inner unity, a unity of plan and function. The field of operation is not shifted between the clauses of a sentence.

If we turn to extrinsic tokens of intention, and view the statute in the light of its history and aims, the signposts are the same. The requirement of protest as it stood before the statute was not limited to suits against a collector of internal revenue or other public officer. It extended and was often applied to suits against the Government itself. Even in suits against the collector, the United States was almost always the genuine defendant, the liability of the nominal defendant being formal rather than substantial. In this situation the Government was unjustly enriched at the expense of the taxpayer when it held on to moneys that had been illegally collected, whether with protest or without. So at least the lawmakers believed, and gave expression to that belief, not only in the statute, but in congressional reports. (Senate Report No. 398, Sixty-eighth Congress, first session, pages 44, 45;[3] House Report No. 179, Sixty-eighth Congress, first session, pages 33, 34.) The amendment was designed to right an ancient wrong. It did not draw a distinction between suits against the body politic and suits against a public officer who was to be paid out of the public purse. It put them in a single class, and made them subject to a common rule. A high-minded Government renounced an advantage that was felt to be ignoble, and set up a new standard of equity and conscience. There was no thought to discriminate between payments made and those to come. A fine sense of honor had brought the statute into being. We are to read it in a kindred spirit. (*United States* v. *Emery*, 237 U. S., 28, 32.)

The argument is made that power was lacking, though intention be assumed. Defect of power is not suggested where the claim for restitution is against

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[2] In the lower Federal courts the decisions are conflicting. Most of them have taken the view adopted here. (*Beatty* v. *Heiner*, 10 F. (2d), 390; *Warner* v. *Walsh*, 24 F. (2d), 449; *Hyatt Roller Bearing Co.* v. *United States*, 43 F. (2d), 1008; *Weir* v. *McGrath*, 52 F. (2d), 201 [T. D. 4210, C. B. VII–2, 338]; *Electric Storage Battery Co.* v. *McCaughn*, 52 F. (2d), 205; cf. *Winant* v. *Gardner*, 29 F. (2d), 836; *Moses* v. *United States*, 61 F. (2d), 791. Contra, *Warner* v. *Walsh*, 27 F. (2d), 952.)

[3] The Senate Report contains the following:

"Section 1114: The provisions of section 1318 of existing law have been amended to provide that after the enactment of the bill it shall not be a condition precedent to the maintenance of a suit to recover taxes, sums, or penalties paid, that such amounts shall have been paid under protest or duress. The fact protest was made has little bearing on the question whether the tax was properly or erroneously assessed. The making of such protest becomes a formality so far as well advised taxpayers are concerned and the requirements of it may operate to deny the just claim of a taxpayer who was not well informed."

the Government itself. The case assumes another aspect, we are told, when the suit is against an officer who is to be personally charged. Until 1924, a collector was not liable to a taxpayer for a tax illegally collected unless protest gave him notice that he was a party to a wrong. The Government suggests that there is an infraction of the fifth amendment, a denial of due process, if liability is cast upon him after the event. There is a subsidiary point that at least the doubt is so great as to canalize construction along the course of safety. (*United States* v. *La Franca*, 282 U. S., 568, 574; *United States* v. *Jin Fuey Moy*, 241 U. S., 394, 401.) "A statute must be construed, if fairly possible, so as to avoid not only the conclusion that it is unconstitutional, but also grave doubts upon that score." (*United States* v. *Jin Fuey Moy*, supra.) But avoidance of a difficulty will not be pressed to the point of disingenuous evasion. Here the intention of the Congress is revealed too distinctly to permit us to ignore it because of mere misgivings as to power. The problem must be faced and answered.

As applied to this respondent in the circumstances of his official action stated in the record, the statute is constitutional though its effect is to broaden liability both for the past and for the future. As the law stood before later statutes, the taxpayer's protest was notice to a collector that suit was about to follow, and was warning not to pay into the Treasury the moneys collected. (*Elliott* v. *Swartwout*, supra; *Smietanka* v. *Indiana Steel Co.*, 257 U. S., 1, 4 [Ct. D. 17, C. B. 5, 251].) Statutes first enacted in 1839 (Act of March 3, 1839, ch. 82, section 2, 5 Stat., 348) and progressively broadened (R.S. section 3210; 26 U. S. C., section 140) made it the duty of collectors to pay the money over to the Government, whether there had been protest or no protest. At first this was thought to have relieved them of personal liability (*Cary* v. *Curtis*, 3 How., 236; *Smietanka* v. *Indiana Steel Co.*, supra), but later Acts of Congress established a different rule, though maintaining the duty to make remittance to the Treasury. (*Philadelphia* v. *Collector*, 5 Wall., 720, 731; *Curtis's Adm'x* v. *Fiedler*, 2 Black, 461, 479; *Collector* v. *Hubbard*, supra; *Arnson* v. *Memphis*, 109 U. S., 238, 241; 5 Stat., 727; 12 Stat., 434, 725, 729; 12 Stat., 741, section 12; 13 Stat., 239, 14 Stat., 329, section 8.) Along with the duty there went a pledge of indemnity by the Government itself, a pledge not absolute, it is true, but subject to a condition. (12 Stat., 741, section 12; *United States* v. *Sherman*, 98 U. S., 565; *Philadelphia* v. *Collector*, supra, page 733; *Smietanka* v. *Indiana Steel Co.*, supra.) The condition was that a certificate be granted by the court either (a) that there was probable cause for the act done by the collector or other officer, or (b) that he acted under the directions of the Secretary of the Treasury or other proper officer of the Government. (12 Stat., 741, section 12; Act of March 3, 1863.) In that event no execution was to issue upon the judgment, but the amount of the recovery was to be paid out of the Treasury. The pledge of indemnity was carried forward into the Revised Statutes with only verbal changes (R. S., 989), and stands upon the books to-day. (28 U. S. C., section 842.[4]) The effect of the certificate, when given, is to convert the suit against the collector into a suit against the Government. (*United States* v. *Sherman*, supra.)

This collector did act under the directions of the Secretary of the Treasury, or other proper officer of the Government in the collection of the tax. The complaint shows upon its face that the tax had been duly assessed by the Commissioner of Internal Revenue. In that situation the collector was under a ministerial duty to proceed to collect it. (R. S., section 3182; 26 U. S. C., section 102; *Erskine* v. *Hohnbach*, 14 Wall., 613.) There was nothing left to his discretion. Other duties less definitely prescribed may leave a margin for judgment and for individual initiative. (Cf. *Agnew* v. *Haymes*, 141 F., 631.) There was no such margin here. His duty being imperative, he is protected by the command of his superior from liability for trespass (*Erskine* v. *Hohnbach*, supra; *Haffin* v. *Mason*, 15 Wall., 671, 675; *Harding* v. *Woodcock*, 137 U. S., 43, 46), and is entitled as of right to a certificate converting the suit against him into one against the Government. (*United States* v. *Sherman*, supra.)

[4] SEC. 842. When a recovery is had in any suit or proceeding against a collector or other officer of the revenue for any act done by him, or for the recovery of any money exacted by or paid to him and by him paid into the Treasury, in the performance of his official duty, and the court certifies that there was probable cause for the act done by the collector or other officer, or that he acted under the directions of the Secretary of the Treasury, or other proper officer of the Government, no execution shall issue against such collector or other officer, but the amount so recovered shall, upon final judgment, be provided for and paid out of the proper appropriation from the Treasury.

His position could be no better if there had been protest at the time of payment. He would still have been under a duty to obey the command of his superior and collect the tax assessed. Also he would still have been under a duty to make prompt remittance to the Treasury. There had been confided to him no power to review or to revise. (*Erskine* v. *Hohnbach*, supra; *Harding* v. *Woodcock*, supra.) The case is not one for a certificate of probable cause, as it might be if the officer had trespassed under a mistaken sense of duty. In such circumstances a certain latitude of judgment may be accorded to the certifying judge, though even then it is enough that a seizure has been made upon grounds of reasonable suspicion. (*Locke* v. *United States*, 7 Cranch, 339; *Agnew* v. *Haymes*, supra; *Carroll* v. *United States*, 267 U. S., 132, 149 [T. D. 3686, C. B. IV–1, 377]; *Dumbra* v. *United States*, 268 U. S., 435, 441.) One does not speak of probable cause when justification is complete. Here the certifying judge will be subject to a specific duty upon the facts admitted by the demurrer to relieve the collector of personal liability and to shift the burden to the Treasury. This court has often held that a pledge of the public faith and credit will permit the seizure of property by right of eminent domain, though what is due for compensation must be ascertained thereafter. (*Sweet* v. *Rechel*, 159 U. S., 380; *Crozier* v. *Krupp*, 224 U. S., 290; *Joslin Co.* v. *Providence*, 262 U. S., 668, 677; *Dohany* v. *Rogers*, 281 U. S., 362, 366; *Hurley* v. *Kincaid*, 285 U. S., 95, 104, 105.) The assurance of indemnity is as ample, the reparation prompter and more summary, upon the facts before us here.

A suit against a collector who has collected a tax in the fulfillment of a ministerial duty is to-day an anomalous relic of bygone modes of thought. He is not suable as a trespasser, nor is he to pay out of his own purse. He is made a defendant because the statute has said for many years that such a remedy shall exist, though he has been guilty of no wrong, and though another is to pay. (*Philadelphia* v. *Collector*, supra, page 731.) There may have been utility in such procedural devices in days when the Government was not suable as freely as now. (*United States* v. *Emery*, supra; *Ex parte Bakelite Corp.*, 279 U. S., 438, 452; Act of February 24, 1855, ch. 122, 10 Stat., 612, sections 1 and 9; Judicial Code, section 145; 28 U. S. C., section 250; Judicial Code, section 24(20); 28 U. S. C., section 41(20).) They have little utility to-day, at all events where the complaint against the officer shows upon its face that in the process of collecting he was acting in the line of duty, and that in the line of duty he has turned the money over. In such circumstances his presence as a defendant is merely a remedial expedient for bringing the Government into court.

The case comes down to this: In its application to this collector the amendment of 1924 has left the law the same as it had been for many years. There has been no change to his detriment in the definition of rights and wrongs. His conduct must have been the same though the statute had been on the books from the beginning. There has not even been any change to his detriment in the law of remedies. Execution can never issue against him upon any judgment recovered in favor of the taxpayer. The Government has enlarged the remedy against itself by dispensing with what was once an indispensable formality. As to subordinate officials who have acted in the line of duty it has made the change innocuous by assuming liability. One who is brought before the court as a formal party only will not be heard to object that there has been a denial of due process in enlarging the liability to be borne by some one else. Enough that the legislation is valid as to him, whether it be valid or invalid in its bearing upon others.

The decision of this case does not require us to determine whether the Act of 1924 would affect the respondent's liability if the certificate of the court converting the suit into one against the Government were dependent upon controverted facts, or upon facts permitting different inferences or calling upon the judge to exercise discretion. No such situation is presented by the record now before us. Indeed, no such situation, it would seem, can ever be presented where a collector has done no more than accept payment of a tax assessed by a superior who has been invested by the statute with power to command. Our duty does not require us to deal with problems merely hypothetical. If a case should develop where a certificate might issue as a matter of discretion, other questions would be here. There would then be need to consider whether the objection of a denial of due process would be open to a collector until a request for the certificate had been made and refused. "Due process requires

that there be an opportunity to present every available defense; but it need not be before the entry of judgment." (*American Surety Co.* v. *Baldwin*, 287 U. S., 156, 168; *York* v. *Texas*, 137 U. S., 15, 20.) There would be need also to consider whether in its application to an officer acting of his own motion, and not in the fulfillment of the command of a superior, the requirement of protest is a procedural limitation upon the remedy for a wrong, or one of the substantive elements of the wrong itself. We leave those questions open.

2. The Government contends that the claim for refund filed by the petitioner with the Commissioner of Internal Revenue was not subject to amendment after the time had gone by when a claim wholly new would have been barred by limitation.

The claim in its original form gave notice of specific errors in the adjustment of invested capital. It gave notice also in general terms that aside from any errors in the adjustment of the capital there had been an erroneous assessment of net income at the sum of $16,940.18, when in fact there had been a loss. We think the statements as to income were subject to amendment. (*United States* v. *Memphis Cotton Oil Co.*, 288 U. S., 62; *United States* v. *Factors & Finance Co.*, 288 U. S., 89.)

The judgment is reversed.

ARTICLE 1351: Suits for recovery of taxes erroneously collected. XII-23-6214 Ct. D. 677

INCOME TAX—REVENUE ACT OF 1921—DECISION OF SUPREME COURT.

1. SUIT—LIMITATION—ACCOUNT STATED.

Where a provisional and tentative notice was mailed to the petitioner of deficiencies and overpayments of income taxes, and petitioner at no time assented to the result of the audit nor was there ever delivered to him a certificate of overassessment or schedule of refunds and credits, and where a check was made out in favor of petitioner for the net difference but was later canceled and the net overpayments credited upon excess profits taxes due from a partnership of which petitioner was a member, suit by the petitioner brought nearly six years after the signing of the schedule was too late, the 5-year limitation within which suit for the recovery of taxes might be instituted (section 3226 of the Revised Statutes as amended by the Revenue Act of 1921) having expired, and the more extended period of limitation on an account stated not applying since the essentials of such an account were entirely lacking.

2. CASES DISTINGUISHED.

Bonwit Teller & Co. v. *United States* (283 U. S., 258 [Ct. D. 334, C. B. X-1, 328]) and *United States* v. *Kaufman* (96 U. S., 567) distinguished.

3. DECISION AFFIRMED.

The decision of the Court of Claims (59 Fed. (2d), 842, Ct. D. 596, C. B. XI-2, 373) affirmed.

SUPREME COURT OF THE UNITED STATES.

David Daube, petitioner, v. *The United States, respondent.*

On writ of certiorari to the Court of Claims.

[May 8, 1933.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the court.

The petitioner brought suit in the Court of Claims upon a claim that for two years, 1918 and 1919, he had overpaid his income tax. As to the tax for 1918, the claim was dismissed upon the merits. As to the tax for 1919, it was

dismissed upon the ground that suit had not been brought within the time prescribed by law. (59 F. (2d), 842; 1 F. Supp., 771.) A writ of certiorari, restricted to the assessment for 1919, brings the case here.

The Commissioner upon an audit of the petitioner's returns found underassessments for 1916, 1917, and 1920, and overassessments for 1918 and 1919. A notice of the result of the audit was mailed to the petitioner on November 10, 1923, the notice by its terms being provisional and tentative. Later, and on January 31, 1924, the Commissioner signed a schedule of overassessments, $22,151.88 for 1918, and $2,628.26 for 1919, and forwarded the schedule to the collector of the district of Oklahoma, the petitioner's residence. In accordance with the practice of the Bureau, the collector was instructed to examine the accounts of the taxpayer and apply the excess payments as a credit against taxes due for other years. Upon such examination the collector found that there were additional assessments, still unpaid, for 1916, 1917, and 1920, in the sum of $11,277.24. This left an excess for 1918 of $10,874.64, and one of $2,628.26 for 1919, a total of $13,502.90. Upon that basis the collector made out a schedule of refunds and credits, which he returned to the Commissioner with the schedule of overassessments.

At this stage complications developed by reason of the tax liability of a partnership of which petitioner was a member. The partnership owed the Government more than $50,000, the amount of an excess profits tax for 1917, though the precise extent of the indebtedness was still undetermined. In anticipation of an assessment, petitioner had filed with the Bureau an agreement and direction that any refund due to him individually for the year 1918 (but without mention of any other year) should be applied as a credit upon the taxes owing from the partnership. When the schedule of refunds and credits came back from the collector, the Commissioner overlooked the order, then on file in his office, for the merger of the two accounts, and dealt with them as separate. He made an additional assessment against the partnership for $53,012.47. On the same day, March 29, 1924, he signed an approval of the schedule of refunds and credits without applying any part of the overpayment to the partnership liability, and made out a check to the order of the petitioner for $13,502.90, which he mailed to the collector. The collector discovered the mistake, and instead of delivering the check returned it to the Commissioner. Thereupon the Commissioner canceled the check, revoked his earlier instructions, and ordered the collector to apply the overpayments made by the petitioner individually upon the deficiency then owing from the members of the partnership. This order was proper to the extent of $10,874.64, the 1918 overpayment, for the credit to that extent was in accordance with the petitioner's agreement. It was an error in so far as it included the 1919 overpayment ($2,628.26), for the petitioner's agreement did not cover that year. The collector did what the Commissioner commanded. No notice, however, of his action was transmitted to the taxpayer. There was no delivery to the taxpayer of a certificate of overassessment. There was no delivery of a copy of any schedule of refunds and credits. Six years went by, almost to the day, without demand or protest. Then on March 28, 1930, the petitioner began this suit, asking judgment for $24,780.14 with interest. He repudiated all the credits against the partnership deficiency, as well as other credits which there is no need to go into, for he allowed them later on. At the trial the contest narrowed down to two items. The first $10,874.64, is the overpayment for 1918, as it stood before it was applied upon the partnership assessment. The second, $2,628.26, is the overpayment for 1919. The writ of certiorari brings up the second item to the exclusion of any other.

By section 3226 of the Revised Statutes as amended by the Revenue Act of 1921, no suit may be maintained for the recovery of any internal revenue tax erroneously or illegally assessed or collected unless begun within five years from the date of payment. (Revenue Act of 1921, ch. 136, 42 Stat., 268, section 1318, amending Revised Statutes section 3226; 26 U. S. Code, section 156.) This suit was not brought within the time so limited. It is therefore too late, if it is a suit for the recovery of a tax within the meaning of the statute. The petitioner insists that it is not such a suit, but one upon an account stated. The statement of an account gives rise to a new cause of action with a new term of limitation. (*Bonwit Teller & Co.* v. *United States*, 283 U. S., 258, 265.) We are thus brought to the question whether there was such a statement here.

If the traditional tests, familiar to the law of contracts, are to be accepted as our guide, there was no account stated between Government and taxpayer. No balance was arrived at as the result of computation and agreement. *Volkening* v. *DeGraaf*, 81 N. Y., 268, 271.) The Commissioner did not inform the taxpayer that the tax had been overpaid in a determinate amount. The taxpayer did not give assent either expressely or by silence to the outcome of the audit. The essentials of an account stated in any strict or proper sense are lacking altogether. (*Toland* v. *Sprague*, 12 Pet., 300, 333; *Nutt* v. *United States*, 125 U. S., 650, 655; *Volkening* v. *DeGraaf*, supra; *Newburger-Morris Co.* v. *Talcott*, 219 N. Y., 505, 511, 512.) A different situation was disclosed in the Bonwit Teller case, supra. There the certificate of overassessment had been delivered to the taxpayer. "Upon delivery of the certificate to plaintiff, there arose the cause of action on which this suit was brought." (*Bonwit Teller & Co.* v. *United States*, supra, page 265. Cf. *W. J. Friday & Co., Inc.*, v. *United States*, 61 F. (2d), 370.)

The argument is made, however, that the allowance of the schedule of refunds and credits on March 29, 1924, was something near to an account stated, something "equivalent" thereto, though not the standard article to be marked by the standard label. This doctrine of equivalence is borne out, we are told, by cases in this court and elsewhere, which were cited in the Bonwit Teller case and are again pressed upon us now. (*United States* v. *Kaufman*, 96 U. S., 567, 575; *United States* v. *Savings Bank*, 104 U. S., 728; *First National Bank of Greencastle* v. *United States*, 15 Ct. Cls., 225.) They fall short by a great deal of teaching such a lesson. The Kaufman case will serve as typical of the others, for they vary little in their facts. The Commissioner of Internal Revenue had been authorized by statute to make allowance to brewers for the value of tax stamps lost or wasted. He did make such an allowance, and certified his ruling to the Comptroller of the Treasury. The claimant suing in the Court of Claims to recover the amount of the award was met by the objection that he must prove his claim anew. This court held that the allowance by the Commissioner was effective without more to make out a *prima facie* case, and spoke of it as at least "equivalent to an account stated between private parties, which is good until impeached for fraud or mistake." There was no question in the case as to the effect of the allowance in lifting the bar of a statute of limitations. The claim had been seasonably filed and diligently pressed. There was no question as to the effect of revocation or rescission. (Cf. *Ridgway* v. *United States*, 18 Ct. Cls., 707, 714, 715.) What had been done by the Commissioner had never been undone. There was only the question as to the probative force of an adjudication by an officer who had been appointed to decide and had definitely decided. The statute had given him the position of an administrative tribunal. He had done all that he could do. He had made the allowance and had certified his action to the disbursing agents of the Treasury, whose duty was not to revise, but merely to obey. Notice of his action had been given to the claimant, who had accepted and approved it. (*Kaufman* v. *United States*, 11 Ct. Cls., 659, 662.) The suit was on an award which had all the finality and authority that an award could ever gain.

A very different situation is laid before us here. No definitive adjudication in favor of this taxpayer was ever made by the Commissioner or by other competent authority. The transaction never went beyond the stage of intra-departmental conference and parley. The Commissioner had put his hand, it is true, to a schedule of refunds and credits, and had transmitted a check to one of his subordinates to be delivered to the claimant. By none of these acts had he so divested himself of control as to generate rights or interests in favor of the taxpayer if there was revocation or rescission in advance of notice or delivery. There had been messages back and forth between the officers and branches of an administrative bureau. There had been none to the outer world. The Commissioner, after signing the schedule, might scratch out his signature, and declare it inadvertent. (Cf. *Ridgway* v. *United States*, supra; *Austin Co.* v. *Commissioner*, 35 F. (2d), 910 [Ct. D. 189, C. B. IX-1, 332].) This in substance is what he did. After signing a check and mailing it to his agent, he might cancel the check while the agent still held it, and revoke the authority improvidently granted. The matter was still *in fieri*.

High public interests make it necessary that there be stability and certainty in the revenues of government. These ends are not susceptible of attainment if periods of limitation may be disregarded or extended. By the ruling in the Bonwit Teller case a specific limitation applicable to claims for the recovery

of taxes is set aside and superseded whenever the statement of an account sustains the inference of an agreement that the tax shall be repaid. As soon as this appears, a fresh term of limitation is born and set in motion. It is a ruling not to be extended through an enlargement of the concept of an account stated by latitudinarian construction.

Girard Trust Co. v. *United States* (270 U. S., 163 [T. D. 3919, C. B. V–2, 209]) and *United States* v. *Swift & Co.* (282 U. S., 468 [Ct. D. 290, C. B. X–1, 283]) are pressed upon us by counsel as helpful to the taxpayer. They do not touch the case at hand. In the case of the Girard Trust Co., a statute called for interest on the amount of the refund to the date of allowance. The claimant made the point that allowance was not perfected unless accompanied by payment, and that interest on the refund should be correspondingly extended. The court rejecting that contention held that allowance was complete within the meaning of the statute when the schedule of refunds was approved by the Commissioner. In the case of Swift & Co., a like ruling was made as to the effect of the approval of a credit. In neither case was there any question as to the existence of an account stated, or as to the effect of an improvident allowance, unknown to the taxpayer.

The judgment is affirmed.

SECTION 1116.—INTEREST ON REFUNDS AND CREDITS.

ARTICLE 1371: Interest on refunds and credits. XII–9–6049
Ct. D. 634

INCOME AND EXCESS PROFITS TAX—REVENUE ACTS OF 1926 AND 1932—DECISION OF COURT.

1. CREDIT—WHEN ALLOWED.

A credit of any income or profits tax is allowed under section 1116 of the Revenue Act of 1926 on the first date on which the Commissioner signs the schedule of overassessment in respect to such credit.

2. SAME—SCHEDULE OF OVERASSESSMENTS.

Section 1104 of the Revenue Act of 1932 was not intended as a legislative construction of section 1116 of the Revenue Act of 1926 or to change the rule with reference to the date of allowance of a refund or credit, but was enacted because of a change in procedure after the enactment of the Revenue Act of 1928, whereby the use of a schedule of refunds and credits was discontinued and the only schedule prepared and signed by the Commissioner was the schedule of overassessments. It was intended to make it clear that credits or refunds are to be considered as allowed on the date on which the Commissioner first signed the schedule of overassessments, provided the schedule was signed after May 28, 1928.

3. MOTION DENIED.

Motion for new trial denied. For original opinion see 59 Fed. (2d), 281 (Ct. D. 569, C. B. XI–2, 339).

COURT OF CLAIMS OF THE UNITED STATES. No. L–477.

Consolidated Paper Co., plaintiff, v. *The United States, defendant.*

On motion for a new trial.

[December 5, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

Plaintiff makes a motion for a new trial and insists that the conclusion of the court in this case that the credit was allowed by the Commissioner under section 1116 of the Revenue Act of 1926 when he signed the first schedule of over-

assessment is contrary to the decisions in *United States* v. *Swift & Co.* (282 U. S., 468 [Ct. D. 290, C. B. X–1, 283]), *United States* v. *Boston Buick Co.* (282 U. S., 476 [Ct. D. 293, C. B. X–1, 335]), *Pottstown Iron Co.* v. *United States* (282 U. S., 479 [Ct. D. 291, C. B. X–1, 301]), and *Atlas Powder Co.* v. *United States* (69 C. Cls., 558 (40 Fed. (2d), 136); it is also insisted that, in view of section 1104 of the Revenue Act of 1932, the credit in this case was not allowed within the meaning of section 1116 of the Revenue Act of 1926 until the Commissioner finally approved the schedule of refunds and credits.

The court considered the cases cited and the provision of the Revenue Act of 1932 referred to, and concluded that they had no controlling effect upon the question presented in the instant case. Particular stress is laid upon the statement by this court in *Atlas Powder Co.* v. *United States*, supra, that "a credit is taken within the meaning of section 1019 of the Revenue Act of 1924 and section 1116 of the Revenue Act of 1926 when it has finally been made effective, and this does not occur until the Commissioner of Internal Revenue has finally determined that there has been an overpayment, which can be credited, and has approved the schedules certified to him by the collector of internal revenue." This statement must be viewed in the light of the question involved in that case in which the Commissioner had signed both the schedule of overassessments and the schedule of refunds and credits prior to the enactment of section 1116 of the Revenue Act of 1926. The certificates of overassessments, however, were not mailed to the plaintiff until after the effective date of the 1926 Act.

The Government contended that the credit was taken within the meaning of the 1926 Act when the certificates of overassessment were mailed to the taxpayer, and the plaintiff contended that the credit had been accomplished under the Revenue Act of 1924 and that the credit had been taken when the collector made the entries on his books pursuant to the schedule of overassessment. Both parties in that case contended that the date on which a credit was "taken" was a date other than the date on which the Commissioner signed the schedule of overassessments or the schedule of refunds and credits.

In addition to the statement above quoted upon which the plaintiff relies, this court pointed out that both the plaintiff and the Government were mistaken in the positions taken and that "the law takes the credit when the Commissioner has performed the act necessary to make the credit effective under the statute, and, *in the absence of any statutory provision to the contrary*, the credit is taken and is made effective when the Commissioner finally acts by approving the schedule certified to him by the collector." In the Atlas Powder Co. case the court did not intend to hold, and it is clear that the opinion in that case did not hold and is not authority for the proposition that where the Commissioner signs both the schedule of overassessments and the schedule of refunds and credits after the effective date of the Revenue Act of 1926, the credit is allowed and taken when he signs the second schedule.

Section 1104 of the Revenue Act of 1932 provides that "Where the Commissioner has (before or after the enactment of this Act) signed a schedule of overassessments in respect of any internal revenue tax imposed by this Act or any prior Revenue Act, the date on which he first signed such schedule (if after May 28, 1928) shall be considered as the date of allowance of refund or credit in respect of such tax." We think this section was not a legislative construction of the Revenue Act of 1926 that a refund or credit, under section 1116 of that Act, should be considered as allowed on the date on which the Commissioner signed the schedule of refunds and credits as was the case under section 1019 of the Revenue Act of 1924. After the enactment of the Revenue Act of 1928 the Treasury Department changed its practice and no longer used a schedule of refunds and credits and the only schedule prepared and signed by the Commissioner was the schedule of overassessments. Section 1104 of the 1932 Act was not intended to change the rule with reference to the date of allowance of a refund or credit provided by section 1116 of the 1926 Act or to construe that section as providing that the approval of the schedule of refunds and credits should be the date of the allowance. The Revenue Act of 1926 had not been so construed either by the Treasury Department or by the courts, and the provision in the 1932 Act was only intended, as stated in committee report No. 1492, Seventy-second Congress, first session, page 28, to make "it clear that credits or refunds are to be considered as allowed on the date on which the Commissioner first signed the schedule of overassessments, provided the schedule was signed after May 28, 1928."

The motion for a new trial is overruled.

SECTION 1122.—JURISDICTION OF COURTS.

XII–25–6241
Ct. D. 683

INCOME TAX—REVENUE ACTS OF 1918, 1921, AND 1924—DECISION OF SUPREME COURT.

1. SUITS AGAINST COLLECTOR AND UNITED STATES—SAME QUESTION BUT FOR DIFFERENT YEARS—RES ADJUDICATA.

A ruling of the Board of Tax Appeals denying the taxpayer deduction for 1918 and 1919 of amortized proportion of discount on sales of bonds by predecessor corporations having been reversed, a like deduction for the years 1920–1925 was later in issue in actions brought by the taxpayer against the collector and the United States. *Held:* The doctrine of res adjudicata applied, the parties being concluded as to the right or question adjudicated respecting the taxes for the earlier years. Nor may the collector or the United States escape the effect of a former adjudication by showing an inadvertent or erroneous concession made therein, the facts and the questions presented thereon being then before the court. A former adjudication against the Commissioner, the official representative of the United States, is binding upon the collector.

2. DECISION AFFIRMED.

The decision of the Circuit Court of Appeals, Fourth Circuit (62 Fed. (2d), 933), affirming district court decision (53 Fed. (2d), 211), affirmed.

SUPREME COURT OF THE UNITED STATES.

Galen L. Tait, Collector of Internal Revenue, petitioner, v. *Western Maryland Railway Co.*

On writ of certiorari to the Circuit Court of Appeals for the Fourth Circuit.

[May 29, 1933.]

OPINION.

Mr. Justice ROBERTS delivered the opinion of the court.

Between the years 1902 and 1908 the Western Maryland Railroad Co., a Maryland corporation, sold and issued at a discount, large amounts of its first mortgage bonds. In foreclosure proceedings under a second mortgage its entire property was sold to a reorganization committee representing second mortgage bondholders, and a new company formed under the name The Western Maryland Railway Co. took title to all the assets and operated the railroad. In 1911 the latter issued and sold at a discount additional bonds secured by the first mortgage of the original corporation.

In 1917 the Western Maryland Railway Co. was consolidated, pursuant to Maryland statutes, with some seven subsidiaries. The new corporation so formed, named Western Maryland Railway Co., recognized as its own obligations the outstanding first mortgage bonds issued by its two predecessors. In computing this company's income tax for the years 1918 and 1919 the Commissioner of Internal Revenue refused to allow as a deduction from gross income an amortized proportion of the discount on the sales of bonds by the first and second companies. The Board of Tax Appeals sustained the ruling.[1] The Circuit Court of Appeals for the Fourth Circuit reversed the decision of the Board.[2]

In returns for 1920, 1921, and 1922 the company neglected to take any deduction for amortization of the bond discount in question. It made timely claim for refund for all three years, and, upon denial, brought a suit for the amount

[1] 12 B. T. A., 889.
[2] 33 F. (2d), 695.

claimed against the petitioner, as collector; and also sued the United States for refund of the alleged overpayment for 1920. Deductions taken on the same ground for 1923, 1924, and 1925 were disallowed by the Commissioner, the resulting deficiencies in tax were paid under protest, claims for refund filed and disallowed, and suit brought against the petitioner as collector. The district court consolidated the cases and tried them without a jury on an agreed stipulation. That court found that no facts were presented which had not been before the Board of Tax Appeals in the litigation over the 1918 and 1919 taxes, that the parties were concluded by the former decision, and rendered judgment for the respondent,[3] which the circuit court of appeals affirmed.[4]

The petitioner seeks a reversal on the merits, asserting that a judgment in a suit concerning income tax for a given year can not estop either of the parties in a later action touching liability for taxes of another year. He urges further, that, if this position is not well taken, he is not concluded by the former judgment because neither the proofs nor the parties are the same as in the prior proceeding.

1. The scope of the estoppel of a judgment depends upon whether the question arises in a subsequent action between the same parties upon the same claim or demand or upon a different claim or demand. In the former case a judgment upon the merits is an absolute bar to the subsequent action. In the latter the inquiry is whether the point or question to be determined in the later action is the same as that litigated and determined in the original action. (*Cromwell* v. *County of Sac*, 94 U. S., 351, 352–353; *Southern Pacific R. R. Co.* v. *United States*, 168 U. S., 1, 48; *United States* v. *Moser*, 266 U. S., 236, 241.) Since the claim in the first suit concerned taxes for 1918 and 1919 and the demands in the present actions embraced taxes for 1920–1925, the case at bar falls within the second class. The courts below held the lawfulness of the respondent's deduction of amortized discount on the bonds of the predecessor companies was adjudicated in the earlier suit. The petitioner, admitting the question was in issue and decided in respect of the bonds issued by the second company, and denying, for reasons presently to be stated, that this is true as to the bonds of the first company, contends that as to both the decision of the court of appeals is erroneous, for the reason that the thing adjudged in a suit for one year's tax can not affect the rights of the parties in an action for taxes of another year.

As petitioner says, the scheme of the Revenue Acts is an imposition of tax for annual periods, and the exaction for one year is distinct from that for any other. But it does not follow that Congress in adopting this system meant to deprive the Government and the taxpayer of relief from redundant litigation of the identical question of the statute's application to the taxpayer's status.

This court has repeatedly applied the doctrine of *res judicata* in actions concerning State taxes, holding the parties concluded in a suit for one year's tax as to the right or question adjudicated by a former judgment respecting the tax of an earlier year. (*New Orleans* v. *Citizens' Bank*, 167 U. S., 371; *National Bank of Louisville* v. *Stone*, 174 U. S., 432; *Baldwin* v. *Maryland*, 179 U. S., 220; *Deposit Bank* v. *Frankfort*, 191 U. S., 499. Compare *United States* v. *Stone & Downer Co.*, 274 U. S., 225, 230–231.) The public policy upon which the rule is founded has been said to apply with equal force to the sovereign's demand and the claims of private citizens. Alteration of the law in this respect is a matter for the lawmaking body rather than the courts. (*New Orleans* v. *Citizens' Bank*, 398–399.) It can not be supposed that Congress was oblivious of the scope of the doctrine, and in the absence of a clear declaration of such purpose, we will not infer from the annual nature of the exaction an intent to abolish the rule in this class of cases.

We are not persuaded that the operation of the principle of the thing adjudged in tax cases will, as petitioner insists, produce serious inequalities, or result in great confusion; but any adverse consequence in the administration of the law furnishes no sufficient reason for the abandonment of a rule founded in sound policy, to the enforcement of which suitors are in justice entitled.

We can not agree that the decision in *United States* v. *Stone & Downer* requires a reversal of the judgment. The Court of Customs Appeals had from its organization consistently held the rule of *res judicata* inapplicable to its decisions as to the classification of imported commodities for the imposition of tariff duties. For some years that court's jurisdiction of customs cases was

[3] 53 F. (2d), 211.
[4] 62 F. (2d), 933.

exclusive and final, and its practice, in this respect, had come to be settled. After Congress granted a right of review we were urged to overturn the practice and to apply the doctrine of estoppel by judgment in this class of litigation. The court refused to do so, not only because of the settled practice, but also on account of the unique character of the questions presented under the tariff Acts. The ruling was justified by considerations which are absent in tax litigation; and the court mentioned and recognized the authority of the precedents for estoppel by judgment in the latter.

2. Is the question or right here in issue the same as that adjudicated in the former action? The pertinent language of the Revenue Acts is identical;[5] the regulations issued by the Treasury remained unchanged;[6] and of course the facts with respect to the sale of the bonds and the successive ownership of the railroad property were the same at the time of both trials. The petitioner suggests, however, that significant facts were stipulated in the present case which were not made to appear in the former proceeding. He shows that in the earlier case the Commissioner inadvertently stipulated that the first company "may be taken as identical" with the second, whereas in the present suit the exact devolution of title from the first to the second through the foreclosure and reorganization is definitely exhibited by the stipulation of the parties. From this he concludes that the circuit court of appeals might well have reached a different result on the merits, if the former case had been more fully and accurately presented. But the circuit court of appeals has found that all the facts stipulated in the present cause were before it in the former one, and we accept this finding. It holds also that the former decision was based on a view of the law quite as pertinent to the bonds sold by the first company as to those marketed by the second. The petitioner may not escape the effect of the earlier judgment as an estoppel by showing an inadvertent or erroneous concession as to the materiality, bearing or significance of the facts, provided, as in the case here, the facts and the questions presented on those facts were before the court when it rendered its judgment. Compare *Deposit Bank* v. *Frankfort* (191 U. S., 499, 510–511). The very right now contested arising out of the same facts appearing in this record, was adjudged in the prior proceeding.

3. As we have seen, the demand for refund of 1918–19 taxes was against the Commissioner of Internal Revenue. The present suits are against the United States and the collector. Are the parties the same or in such privity that the claimed estoppel binds them? The petitioner concedes that the former judgment is, so far as identity of parties is concerned, conclusive in the suits in which the United States is now the defendant, since the Commissioner acted in the earlier suit in his official capacity and as representative of the Government. This leaves for consideration the question whether the Commissioner and the collector are for purposes of application of the rule of estoppel, to be regarded as different parties.

In a suit for unlawful exaction the liability of a collector is not official but personal. (*Sage* v. *United States*, 250 U.S., 33; *Smietanka* v. *Indiana Steel Co.*, 257 U. S., 1 [Ct. D. 17, C. B. 5, 251]; *Graham & Foster* v. *Goodcell*, 282 U. S., 409, 430 [Ct. D. 287, C. B. X–1, 91].) And for this reason a judgment in a suit to which he was a party does not conclude the Commissioner or the United States. (*Bankers Pocahontas Coal Co.* v. *Burnet*, 287 U. S., 308, 311 [Ct. D. 531, C. B. XI–2, 275].) We think, however, that where a question has been adjudged as between a taxpayer and the Government or its official agent, the Commissioner, the collector, being an official inferior in authority, and acting under them, is in such privity with them that he is estopped by the judgment. (See *Second National Bank of Saginaw* v. *Woodworth*, 54 F. (2d), 672 [Ct. D. 470, C. B. XI–1, 331]; *Bertelsen* v. *White*, 58 F. (2d), 792 [Ct. D. 539, C. B. XI–2, 402].)

4. These views render unnecessary any consideration of the merits of the controversy.

Judgment affirmed.

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[5] Revenue Act of 1918, section 234(a)2 (40 Stat., 1057, 1077); Revenue Act of 1921, section 234(a)2 (42 Stat., 227, 254); Revenue Act of 1924, section 234(a)2 (43 Stat., 253, 283); U. S. C., Title 26, section 986.

[6] Regulations 45 (1920 edition), article 544(a)3; article 563. Regulations 62 and 65, articles 545(a)3; article 563.

ESTATE TAX RULINGS.

TITLE III.—ESTATE TAX. (1926)

REGULATIONS 70(1929), ARTICLE 19: Power to change enjoyment. XII-14-6114 Ct. D. 647

ESTATE TAX—REVENUE ACT OF 1926—DECISION OF SUPREME COURT.

1. TRANSFER—AMENDABLE TRUSTS.

Transfers in trust, made by decedent in 1918 and 1919, with the reservation to himself of a power to alter or modify the trust instruments at any time and in any manner except in favor of himself or his estate, were subject to tax under the provisions of section 302(d) of the Revenue Act of 1926 applying to transfers where enjoyment of the property was subject at decedent's death to any change through the exercise of a power to alter, amend, or revoke.

2. DECISION AFFIRMED.

The decision of the Circuit Court of Appeals, Second Circuit (60 Fed. (2d), 673), affirming 23 B. T. A., 1016, affirmed.

SUPREME COURT OF THE UNITED STATES.

Esther Jackson Porter, as Executrix, and Richard L. Davisson, as Surviving Executor of the Estate of William H. Porter, Deceased, petitioners, v. *Commissioner of Internal Revenue.*

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[March 13, 1933.]

OPINION.

Mr. Justice BUTLER delivered the opinion of the court.

The question presented is whether for the purpose of determining the tax liability of the estate of the deceased, section 302(d) of the Revenue Act of 1926[1] requires that there shall be included in the value of the gross estate certain bonds that he had transferred in trust.

October 18, 1918, and again on February 1, 1919, decedent transferred to the Bankers Trust Co. certain bonds for the benefit of his daughter and her son. Contemporaneously he made similar transfers of bonds to the same trustee for the benefit of his son and his son's daughter. November 27, 1926, in order to make provision for two children of his daughter born after the creation of these trusts, he sent the trust company letters purporting to revoke the trusts of which she was a beneficiary, to terminate the interest of all persons therein and to direct it to deliver the principal and income to itself as trustee according to a new deed then delivered. Each of the five trust agreements included provisions governing the management, investment, and disposition of principal and income, and contained a paragraph reserving to the donor power at any time to

[1] 44 Stat., 71; 26 U. S. C., section 1094(d).

alter or modify the indenture and any or all of the trusts in any manner but expressly excepting any change in favor of himself or his estate.[2]

Deceased died November 30, 1926. The Commissioner of Internal Revenue included in the gross estate the value of the property described in the last deed and petitioners sought redetermination. The Board of Tax Appeals, because of the reserve power to alter and amend, held section 302(d) applied, and included the corpus of all the trusts in the gross estate. (23 B. T. A., 1016.) The Circuit Court of Appeals affirmed that ruling. (60 F. (2d), 673.) Its decision being in conflict with that of the Circuit Court of Appeals for the First Circuit in *Brady* v. *Ham* (45 F. (2d), 454 [Ct. D. 184, C. B. IX–1, 359]) and that of the Court of Appeals of the District of Columbia in *Cover* v. *Burnet* (53 F. (2d), 915), we granted a writ of certiorari. (287 U. S., 591.)

By the trust agreements, decedent divested himself of all interest in the bonds and, subject only to the reserved power, transferred full title to the trustee and beneficiaries. The reservation is broad; evidently he intended to be free at any time and from time to time to alter or modify the disposition of the property as he might see fit, subject to the restriction above mentioned. The power did not amount to an estate or interest in the property. It was much like, and for the purposes of this case may be deemed the substantial equivalent of, a general power of appointment by will. (Cf. *United States* v. *Field*, 255 U. S., 257, 263; *Patterson* v. *Lawrence*, 83 Ga., 703, 707; *Clapp* v. *Ingraham*, 126 Mass., 200.)

The Act, section 301(a), imposes a tax "upon the transfer of the net estate of every decedent." The net estate as there used does not mean an amount to be ascertained as such under any general rule of law or under statutes governing the administration of estates, but is the gross estate as specifically defined in section 302 less deductions permitted by section 303. The former section declares that "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—(a) To the extent of the interest therein of the decedent at the time of his death."

(b) To the extent of any interest therein of the surviving spouse as or in lieu of dower or curtesy. (c) To the extent of any interest therein of which the decedent has at any time made a transfer by trust or otherwise in contemplation of or intended to take effect in possession or enjoyment at or after his death.

(d) "To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend or revoke. * * *"

(e) To the extent of the interest therein held by decedent as a joint tenant or as a tenant by the entirety. (f) To the extent of any property passing under a general power of appointment exercised by the decedent by will or by deed in contemplation of or intended to take effect in possession or enjoyment at or after death. (g) To the extent of the amount of life insurance receivable as specified. Subdivision (h) requires the interests defined in (b) to (g) inclusive to be included whether transfer was made before or after the passage of the Act.

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[2] Paragraph tenth in each of the transfers is as follows:

"Notwithstanding anything to the contrary herein contained, the donor at any time during the continuance of the trust herein provided for may, by instrument in writing executed and acknowledged or proved by him in the manner required for a deed of real estate (so as to enable such deed to be recorded in the State of New York) delivered to the trustee, or its successor, modify or alter in any manner this indenture, and any or all of the trusts then existing and the limitations and estates and interest in property hereby created and provided for subsequent to such trusts; and in case of such modification or alteration said instrument shall direct the revised disposition to be made of the trust fund or the income thereof, or that part of the trust fund or the income thereof affected by such modification or alteration, and upon the delivery of such instrument to the trustee or its successor said instrument shall take effect according to its provisions, and the trustee or its successors shall make and execute all such instruments, if any, and make such conveyance, transfers or deliveries of property as may be necessary or proper in order to carry the same into effect, and no one, born or unborn shall have any right, interest, or estate under this indenture except subject to the proper modification or alteration thereof; but this power to modify or alter is not intended and shall not be construed to include the right to the donor to make such modification or alteration in his own favor or in favor of his estate, but shall apply only so far as the interest of third parties may be concerned."

Petitioners contend that the only thing taxed is the transfer of the net estate at death and that property in which the decedent then held no interest or power of enjoyment must be excluded. They rely on *Reinecke* v. *Northern Trust Co.* (278 U. S., 339 [T. D. 4261, C. B. VIII–1, 305]). But that case is not in point. It involved seven trusts created by the decedent. Two were held taxable because subject to a power of revocation in him alone. In each of the others he reserved power to alter, change or modify, to be exercised in four by joint action of himself and a single beneficiary and in the remaining one by himself and a majority of the beneficiaries acting jointly. As the title was put beyond his control, we held these transfers not taxable. And petitioners assume, as held in *White* v. *Erskine* (47 F. (2d), 1014), that (a) is a limitation upon (d) and argue that the gross estate includes property only to the extent of the "interest therein of the decedent at the time of his death" and that, as before his death he had divested himself of all title, the property so transferred is not to be included in the gross estate. But the construction thus taken for granted can not be sustained. Subdivision (a) does not in any way refer to or purport to modify (d) and, in view of the familiar rule that tax laws are to be construed liberally in favor of taxpayers, it can not be said that, if it stood alone, (a) would extend to the transfers brought into the gross estate by (d). (*United States* v. *Field*, supra, 264.) Moreover, Congress has progressively expanded the bases for such taxation. Comparison of section 302 with corresponding provisions of earlier Acts warrants the conclusion that (d) is not a mere specification of something covered by (a) but that it covers something not included therein. (Cf. *Chase National Bank* v. *United States*, 278 U. S., 327 [Ct. D. 40, C. B. VIII–1, 308]; *Tyler* v. *United States*, 281 U. S., 497 [Ct. D. 190, C. B. IX–1, 883]; *Gwinn* v. *Commissioner*, 287 U. S., 224 [Ct. D. 617, page 360, this Bulletin]; *Burnet* v. *Guggenheim*, 288 U. S., 280 [Ct. D. 636, page 374, this Bulletin].)

The net estate upon the transfer of which the tax is imposed is not limited to property that passes from decedent at death. Subdivision (d) requires to be included in the calculation all property previously transferred by decedent, the enjoyment of which remains at the time of his death subject to any change by the exertion of a power by himself alone or in conjunction with another. Petitioner argues that, as decedent was without power to revoke the transfers or to alter or modify the trusts in favor of himself or his estate, the property is not covered by subdivision (d). But the disjunctive use of the words "alter," "modify" and "amend" negatives that contention. We find nothing in the context or in the policy evidenced by this and prior estate tax laws or in the legislative history of subdivision (d) to suggest that conjunctive use of these words was intended, or that "alter" and "modify" were used as equivalents of "revoke" or are to be understood in other than their usual meanings. We need not consider whether every change, however slight or trivial, would be within the meaning of the clause. Here the donor retained until his death power enough to enable him to make a complete revision of all that he had done in respect of the creation of the trusts even to the extent of taking the property from the trustees and beneficiaries named and transferring it absolutely or in trust for the benefit of others. So far as concerns the tax here involved, there is no difference in principle between a transfer subject to such changes and one that is revocable. The transfers under consideration are undoubtedly covered by subdivision (d).

Petitioners contend that so construed section 302(d) is repugnant to the due process clause of the fifth amendment. They insist, and we assume, that the measures taken by means of decedent's letter to the trustee and the new deed of November 27, 1926, operated merely to alter and modify but did not supersede the earlier trusts made for the benefit of his daughter and her son. They maintain that inclusion of the transfers in question would be to measure decedent's tax by property belonging to others, a thing condemned in *Heiner* v. *Donnan* (285 U. S., 312 [Ct. D. 473, C. B. XI–1, 324]), and *Hoeper* v. *Tax Commission* (284 U. S., 206), and would be to tax gifts *inter vivos* that were fully consummated prior to the enactment of subdivision (d) and therefore would be confiscatory under *Nichols* v. *Coolidge* (274 U. S., 531 [T. D. 4072, C. B. VI–2, 351]) and *Heiner* v. *Donnan*, supra.

They treat as without significance the power the donor reserved unto himself alone and ground all their arguments upon the fact that deceased, prior to such enactment, completely divested himself of title without power of revocation. It is true that the power reserved was not absolute as in the transfer considered in *Burnet* v. *Guggenheim*, supra, in which this court, in the absence of any

provision corresponding to subdivision (d), held that the donor's termination of the power amounted to a transfer by gift within the meaning of section 319 of the Revenue Act of 1924 (43 Stat., 313). But the reservation here may not be ignored for, while subject to the specified limitation, it made the settlor dominant in respect of other dispositions of both corpus and income. His death terminated that control, ended the possibility of any change by him, and was, in respect of title to the property in question, the source of valuable assurance passing from the dead to the living. That is the event on which Congress based the inclusion of property so transferred in the gross estate as a step in the calculation to ascertain the amount of what in section 301 is called the net estate. Thus was reached what it reasonably might deem a substitute for testamentary disposition. (*United States* v. *Wells*, 283 U. S., 102, 116 [Ct. D. 340, C. B. X–1, 475].) There is no doubt as to the power of Congress so to do. (*Reinecke* v. *Northern Trust Co.*, supra; *Chase National Bank* v. *United States*, supra; *Tyler* v. *United States*, supra, 502; *Klein* v. *United States*, 283 U. S., 231 [Ct. D. 333, C. B. X–1, 462]; *Gwinn* v. *Commissioner*, 287 U. S., 224.)

Judgment affirmed.

Mr. Justice CARDOZO concurs in the result.

REGULATIONS 70(1929), ARTICLE 101: Power to compromise or remit. XII–8–6039 Ct. D. 633

FEDERAL ESTATE TAX—COMPROMISE—DECISION OF COURT.

1. SUIT—COMPROMISE.

Where, after suit commenced in the Court of Claims, plaintiffs offered to settle for a sum less than that claimed, which offer was accepted by the Bureau, the claim for refund reopened and allowed in the amount agreed upon, and by agreement between the parties and the Attorney General the pending suit was dismissed and thereafter the Secretary of the Treasury consented to the compromise, such action constitutes a compromise and settlement within the meaning of section 3229 of the Revised Statutes.

2. SAME—CONSENT OF SECRETARY OF THE TREASURY.

Section 3229, Revised Statutes, does not limit the time within which the Secretary of the Treasury must evidence his advice and consent to a settlement, nor does it indicate the form of such consent. Written consent given by the Secretary after the case was dismissed in the Court of Claims and after issue joined in the instant suit, in the absence of fraud, is sufficient.

3. SAME—ESTOPPEL.

Where a suit in the Court of Claims has been dismissed because of a contract between the parties to settle for a less sum than that claimed, and by virtue of the performance of and long-continued acquiescence in such contract the status of the parties has been changed and has not been restored, plaintiff is estopped from maintaining suit in district court for the balance of the claimed amount.

UNITED STATES DISTRICT COURT, DISTRICT OF NEW JERSEY.

Frederic C. Reynolds, Robert D. Reynolds, and Ethel R. Smith, Executors of the Will of James E. Reynolds, Deceased, plaintiffs, v. *Edward E. Gnichtel, Individually and as a former United States Collector of Internal Revenue for the Fifth Collection District of New Jersey, defendant.*

[November 3, 1932.]

OPINION.

FAKE, District Judge: This case is submitted upon an agreed statement of facts.

Among other things, the defendant asserts that plaintiffs are estopped from maintaining the suit. The record discloses, in this connection, that a claim for a refund of $265,873.83 of an estate tax was filed in behalf of plaintiffs with the collector of internal revenue. He rejected the claim and a few months later plaintiffs brought suit in the Court of Claims against the United States to recover the amount. The Government answering denied liability. While the status of plaintiffs' claim remained in this posture, plaintiffs' counsel addressed a communication to General Counsel of the Bureau of Internal Revenue under date of November 12, 1926, offering to settle the claim upon the terms and conditions therein set forth, saying:

"In view of the fact that this matter has been pending for a number of years and of the desire of the estate to dispose of the case without the expense and the delay which would be involved in further litigation, we are authorized to make the following proposal on behalf of the estate, provided we can get prompt action thereon, as time is of the essence of this proposal:"

Then follows the gist of the offer which it is not pertinent to go into for present purposes. The foregoing offer was in effect repeated by counsel for plaintiffs in another letter dated the next day, and thereafter conferences were held between General Counsel for the Bureau of Internal Revenue and counsel for plaintiffs, culminating in a meeting on November 27, 1926, when an understanding was reached and thereafter on November 29, 1926, counsel for plaintiffs addressed a communication to the Commissioner of Internal Revenue confirming the terms and conditions of the aforesaid understanding and it contains the following paragraph:

"This letter is to confirm the offer made by the estate on November 27, 1926, and is in lieu of the offers theretofore made. The estate will agree to an inclusion in the gross estate of the following:"

Then follows the details of the offer, and this further material statement:

"Upon the acceptance of this offer and reopening and allowance of the claim for refund on the basis above stated, the estate will dismiss the case pending in the United States Court of Claims, in which a judgment is sought in the sum of $265,873.83 with interest * * *."

On January 10, 1927, counsel for the estate again wrote to the Commissioner and among other things said:

"This letter is to confirm the offer made by the estate on November 27, 1926, and is in lieu of the offers theretofore made. * * *

"If you will reopen the refund claim heretofore filed and allow the same to the extent of $146,629.58, we will dismiss the action pending in the United States Court of Claims."

On the 24th day of January, 1927, counsel for the Bureau wrote to counsel for the estate in answer to the last above letter, agreeing to a refund of $146,629.58 as above offered and indicated that the division had been requested to reopen and allow the same. Thereafter, proceedings on the claim were reopened and the claim was allowed and paid and accepted in conformity with the terms of the offer.

This then accounted for $146,629.58 of the total of $265,873.83 claimed, leaving a balance of $119,244.25 rejected in conformity with the offer of settlement. And it is for the latter sum that the present suit is instituted.

By agreement between the parties and the Attorney General through one of his assistants, the suit pending in the Court of Claims was dismissed on plaintiffs' motion filed August 5, 1927, and allowed October 17, 1927, "for the reason that a settlement has been reached with the Commissioner of Internal Revenue."

From the foregoing no other conclusion can be arrived at than that both parties intended to close the matter for all time and firmly believed that such would be the effect of their writings and their conduct concerning the same. Thus the matter rested until April 5, 1929, when this suit was instituted.

In the interim the United States Supreme Court handed down its opinion in *Botany Worsted Mills* v. *United States* (278 U. S., 282 [Ct. D. 39, C. B. VIII–1, 279]) in which it appears that the Mills had agreed to a settlement of certain income taxes after negotiations with the Commissioner of Internal Revenue, and after paying the tax, the Mills filed a claim for a refund which was disallowed, and then instituted suit in the Court of Claims where the peti-

tion was dismissed upon the ground that the tax in question was imposed under an agreement of settlement which prevented a recovery. Upon certiorari the Supreme Court reversed the Court of Claims on this point because the provisions of section 3229 of the Revised Statutes had not been fully complied with, holding:

"It is plain that no compromise is authorized by this statute which is not assented to by the Secretary of the Treasury. (*Leach* v. *Nichols* (C. C. A.), 23 Fed. (2d), 275, 277 [Ct. D. 467, C. B. XI–1, 334].) For this reason, if for no other, the informal agreement made in this case did not constitute a settlement which in itself was binding upon the Government or the Mills. And, without determining whether such an agreement, though not binding in itself, may when executed become, under some circumstances, binding on the parties, by estoppel, it suffices to say that here the findings disclose no adequate ground for any claim of estoppel by the United States.

"We therefore conclude that the Mills was not precluded by the settlement from recovering any portion of the tax to which it may otherwise have been entitled."

This leads us in the instant case to an examination of section 3229 of the Revised Statutes. That Act clearly provides certain safeguards relating to the settlement of cases after suit commenced: (1) The Commissioner must act. (2) The advice and consent of the Secretary of the Treasury must be had, and (3) the recommendation of the Attorney General must appear. (4) When a compromise is made the Solicitor of Internal Revenue must file an opinion stating his reasons for the compromise. Thus we find four factors which must be present in a valid compromise.

(1) We find here that the Commissioner acted April 7, 1927, allowing the refund of $146,629.58 and rejecting the balance of the claim $119,244.25. (2) We find the Secretary of the Treasury advised and consented to the compromise of the case on July 8, 1930, which, it should be noted, is a date long after the dismissal of the case before the Court of Claims and also after issue joined in the instant suit. (3) The recommendation of the Attorney General, it is urged, is found in certain correspondence relating to the dismissal of the suit pending before the Court of Claims and also in the conduct of the Attorney General in holding the motion to dismiss and later filing the same upon the written consent of the plaintiffs.

Section 3229, R. S., does not limit the time within which the Secretary of the Treasury must evidence his advice and consent to such a settlement as was entered into here, nor does it indicate the form. There is nothing here to negative the thought that there may have been an oral consent, but however that may be, the delay in filing the written consent was a mere oversight on the part of some officer of the Government, which in the absence of fraud, the plaintiff can not take advantage of. It could have been filed earlier without any impropriety and it now evidences the advice and consent of the Secretary required by the statute.

The approval of the Attorney General appears by his letters of February 1, 1927, and July 1, 1927, and also by his subsequent conduct in aid of the dismissal of the suit before the Court of Claims. The letters indicate the matter had received his attention and that he had advised with the Commissioner and formed conclusions as to the subject matter, all of which amount to the recommendation required by the statute.

Aside from the conclusion that the statutory requirements have been met by the defendant, I am of the opinion that the writings, coupled with the conduct of the parties, presents a situation, where as between man and man, the plaintiff would be estopped from maintaining this suit. The same principles should apply when it appears that the interests of the Government are affected, unless it is patent that the reasoning is in conflict with sound public policy, and no such conflict occurs here.

The writings spell out a contract. The parties changed their status by virtue of it. It was fully performed on both sides. They acquiesced in it for upward of a year. The status quo ante has not been restored and the plaintiff now in effect seeks to disregard the contract upon the theory that it was founded upon a mistake in law. Such a mistake is unavailing to him, and the foregoing factors are sufficient to and do set up an estoppel against him.

Judgment will be entered in favor of the defendant.

TITLE III.—ESTATE TAX. (1924)

PROPERTY HELD JOINTLY.

REGULATIONS 68, ARTICLE 22: Property held jointly or as tenants by the entirety. XII-1-5972 Ct. D. 617

ESTATE TAX—REVENUE ACT OF 1924—DECISION OF SUPREME COURT.

GROSS ESTATE—JOINT TENANCIES—ACQUISITION BEFORE PASSAGE OF ANY ESTATE TAX ACT.

Where decedent and her son acquired by equal contributions certain property, as joint tenants with the right of survivorship, before the enactment of the first Revenue Act that imposed an estate tax, which property they continued to so hold until the decedent's death, the value of one-half the property is properly included in determining the value of the decedent's gross estate under section 302(e) of the Revenue Act of 1924.

SUPREME COURT OF THE UNITED STATES.

J. H. Gwinn, Beneficiary of the Estate of M. A. Gwinn, Deceased, petitioner, v. *Commissioner of Internal Revenue.*

On writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[December 5, 1932.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the court.

June —, 1915, J. H. Gwinn, the petitioner here, and his mother, Mrs. M. A. Gwinn, residents of California, acquired by equal contributions certain property, as joint tenants with the right of survivorship, which they continued to hold until her death, October 5, 1924. He is the beneficiary of the estate and in possession of its assets.

The Revenue Act approved June 2, 1924 (ch. 234, 43 Stat., 253, 304 (U. S. C., Title 26, section 1094)), provides—

"SEC. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated— * * *

"(e) To the extent of the interest therein held as joint tenants by the decedent and any other person, or as tenants by the entirety by the decedent and spouse, or deposited, with any person carrying on the banking business, in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than a fair consideration in money or money's worth: * * *

"(h) Subdivisions (b), (c), (d), (e), (f), and (g) of this section shall apply to the transfers, trusts, estates, interests, rights, powers, and relinquishment of powers, as severally enumerated and described therein, whether made, created, arising, existing, exercised, or relinquished before or after the enactment of this Act."

When he appraised the gross estate of Mrs. Gwinn for taxation under the Act of 1924, the Commissioner of Internal Revenue included the value of one-half the property which she and her son had acquired as stated. This was challenged as error. The Board of Tax Appeals upheld the Commissioner and the Circuit Court of Appeals affirmed its order.

The petitioner maintains—

That the word "before" in subdivision (h), section 302, supra, should be construed as referring only to the period between June 2, 1924, and September 8, 1916, when the first of recent Federal estate tax statutes (39 Stat., 777) became effective.

That under the tenancy created in June, 1915, each party acquired immediate joint ownership in the whole property; that his interest therein then became

completely vested and no change in title or transfer of interest occurred by reason of the cotenant's death. No interest ceased or passed at the death. The Commissioner is attempting, arbitrarily, capriciously and in violation of the due process clause of the fifth amendment, to tax something created, transferred and vested in the survivor prior to the first (1916) Federal estate tax law.

The clear language of the 1924 statute repels the notion that it has no application to joint tenancies created prior to September 8, 1916. (*Nichols* v. *Coolidge*, 274 U. S., 531 [T. D. 4072, C. B. VI–2, 351].) The contrary view is not aided (as claimed) by *Phillips* v. *Dime Trust & Safe Deposit Co.* (284 U. S., 160 [Ct. D. 426, C. B. X–2, 420]).

The Estate of Gurnsey (1918) (177 Cal., 211) is relied upon to support the postulate that under the laws of California no novel tax can be laid on account of rights accruing to the survivor by an enactment subsequent to the creation of the joint tenancy. There the death occurred February 9, 1915. Claiming authority under the act of 1913, the State controller sought to collect an inheritance tax upon a bank deposit credited to the joint account of the decedent and another in April, 1911. The court declared the transfer to the joint account was complete and the title to the fund became vested in the joint tenants when the deposit was made. Also, "the rule on the subject is that the question of liability to inheritance taxes must be determined by the law in force at the time the title vests in virtue of the transfer." And, the conclusion was that the law in force in 1911 "did not undertake to impose a tax upon the rights accruing to a surviving joint tenant upon the death of his cotenant." The claim of the State controller was accordingly rejected and the fund declared not liable to taxation under the act of 1913.

This opinion recognizes that some rights accrue "to a surviving joint tenant upon the death of his cotenant," and the possibility of taxation by reason of this fact. But it apparently affirms that under the rule approved in California liability for such taxation must be determined according to law in force when the cotenancy is established.

To support its affirmation concerning this rule the court cited only *Hunt* v. *Wicht* (174 Cal., 205). That cause grew out of an effort, after the grantor's death in 1913, to impose a tax under the statute of 1911 on account of the absolute transfer made in 1905 of a present title to real property subject only to a life estate. The ruling was that a tax based on that transaction could not be laid by an afterenacted statute. There was no suggestion that the doctrine there accepted could have application of the imposition had relation only to circumstances which would arise in the future. But in no view could the supposed rule limit the power of Congress in respect of Federal taxation.

In *Tyler* v. *United States* (281 U. S., 497, 503, 504 [Ct. D. 190, C. B. IX–1, 383]), where the question at issue was similar to the one now presented, this court declared—

"The question here, then, is, not whether there has been, in the strict sense of that word, a 'transfer' of the property by the death of the decedent, or a receipt of it by right of succession, but whether the death has brought into being or ripened for the survivor, property rights of such character as to make appropriate the imposition of a tax upon that result (which Congress may call a transfer tax, a death duty or anything else it sees fit), to be measured, in whole or in part, by the value of such rights. * * *

"At his (the cotenant's) death, however, and because of it, she (the survivor) for the first time, became entitled to exclusive possession, use and enjoyment; she ceased to hold the property subject to qualifications imposed by the law relating to tenancy by the entirety, and became entitled to hold and enjoy it absolutely as her own; and then, and then only, she acquired the power, not theretofore possessed, of disposing of the property by an exercise of her sole will. Thus the death of one of the parties to the tenancy became the 'generating source' of important and definite accessions to the property rights of the other. These circumstances, together with the fact, the existence of which the statute requires, that no part of the property originally had belonged to the wife, are sufficient, in our opinion, to make valid the inclusion of the property in the gross estate which forms the primary base for the measurement of the tax."

Although the property here involved was held under a joint tenancy with the right of survivorship created by the 1915 transfer, the rights of the possible survivor were not then irrevocably fixed since under the State laws the joint estate might have been terminated through voluntary conveyance by either

party, through proceedings for partition, by an involuntary alienation under an execution. (Calif. Code Civ. Procedure, section 752; *Green* v. *Skinner*, 185 Cal., 435; *Hilborn* v. *Soale*, 44 Cal. App., 115.) The right to effect these changes in the estate was not terminated until the cotenant's death. Cessation of this power after enactment of the Revenue Act of 1924 presented proper occasion for imposition of the tax. The death became the generating source of definite accessions to the survivor's property rights. (*Tyler* v. *United States*, supra. See *Saltonstall* v. *Saltonstall*, 276 U. S., 260; *Chase National Bank* v. *United States*, 278 U. S., 327 [Ct. D. 40, C. B. VIII–1, 308]; *Reinecke* v. *Northern Trust Co.*, 278 U. S., 339 [T. D. 4261, C. B. VIII–1, 305].)

Nichols v. *Coolidge* (274 U. S., 531); *Untermyer* v. *Anderson* (276 U. S., 440 [T. D. 4157, C. B. VII–1, 326]), and *Coolidge* v. *Long* (282 U. S., 582), are inapplicable. In them the rights of the survivors became finally and definitely fixed before the passage of the Act—nothing was added as the result of death.

The judgment below must be affirmed.

REGULATIONS 68, ARTICLE 50: Situs of property of nonresident decedents. XII–14–6115 Ct. D. 648

ESTATE TAX—REVENUE ACT OF 1924—DECISION OF SUPREME COURT.

1. GROSS ESTATE—NONRESIDENT—SITUS OF PROPERTY.

Where decedent, a British subject and a resident of Cuba not engaged in business in the United States, owned at the time of his death stocks and bonds of foreign corporations, bonds of foreign governments and of domestic corporations and municipalities which were held by his agents in New York City for the purpose of collecting the income therefrom and depositing it to the credit of decedent's checking account, such securities were situated in the United States within the meaning of section 303(b) of the Revenue Act of 1924.

2. POWER TO IMPOSE TAX—CONSTITUTIONALITY.

Congress has the power to impose a tax upon securities owned by a nonresident but physically located in this country. The constitutional limitation on the taxing power of the States is in view of the relation of the States to each other, and has no bearing upon the taxing power of the Federal Government. The Constitution creates no such relation between the United States and foreign countries as it creates between the States themselves.

3. DECISION REVERSED.

The decision of the Circuit Court of Appeals, Second Circuit (60 Fed. (2d), 890), which affirmed 22 B. T. A., 71, reversed.

SUPREME COURT OF THE UNITED STATES.

David Burnet, Commissioner of Internal Revenue, petitioner, v. *Ernest Brooks, Harold Wilson Brooks, and Walter Douglas Brooks, as Executors of the Will of Ernest Augustus Brooks.*

On writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[March 13, 1933.]

OPINION.

Mr. Chief Justice HUGHES delivered the opinion of the court.

Respondents contested the determination of the Commissioner of Internal Revenue in including in the gross estate of decedent certain intangible property. Decedent, who died in October, 1924, was a subject of Great Britain and a resident of Cuba. He was not engaged in business in the United States. The property in question consisted of securities, viz, bonds of foreign corporations, bonds of foreign governments, bonds of domestic corporations and of a domestic municipality, and stock in a foreign corporation, and also of a balance of a

cash deposit.[1] Some of the securities, consisting of a stock certificate and bonds, were in the possession of decedent's son in New York City, who collected the income and placed it to the credit of decedent in a New York bank. Other securities were in the possession of Lawrence Turnure & Co. in New York City who collected the income and credited it to decedent's checking account, which showed the above mentioned balance in his favor. None of the securities was pledged or held for any indebtedness. Finding these facts, the Board of Tax Appeals decided that the property should not be included in the decedent's gross estate for the purpose of the Federal estate tax (22 B. T. A., 71), and the decision was affirmed by the Circuit Court of Appeals. (60 F. (2d), 890.) This court granted certiorari (287 U. S., 594).

The provisions governing the imposition of the tax are found in the Revenue Act of 1924 (ch. 234, 43 Stat., 253, 303–307), and are set forth in the margin.[2] Two questions are presented—(1) whether the property in question is covered by these provisions, and (2) whether, if construed to be applicable, they are valid under the fifth amendment of the Federal Constitution. The decisions below answered the first question in the negative.

First. The first question is one of legislative intention. In the case of a nonresident of the United States, that part of the gross estate was to be returned and valued "which at the time of his death is situated in the United States." In interpreting this clause, regard must be had to the purpose in view. The Congress was exercising its taxing power. Defining the subject of its exercise, the Congress resorted to a general description referring to the situs of the property. The statute made no distinction between tangible and intangible property. It did not except intangibles. It did not except securities. Save as stated, it did not except debts due to a nonresident from resident debtors. As to tangibles and intangibles alike, it made the test one of situs, and we think it is clear that the reference is to property which, according to accepted principles, could be deemed to have a situs in this country for the purpose of the exertion of the Federal power of taxation. Again, so far as

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[1] The property was scheduled as follows:

(a) Bonds of foreign corporations and accrued interest	$24,384.97
(b) Bonds of foreign governments and accrued interest	55,610.49
(c) Bonds of domestic corporations and accrued interest	460,315.32
(d) Bonds of a domestic municipality and accrued interest	15,073.57
(e) Stock in a foreign corporation (Cuban)	50,000.00
(f) Cash on deposit with Lawrence Turnure & Co	14,517.98

[2] SEC. 301. (a) In lieu of the tax imposed by Title IV of the Revenue Act of 1921, a tax equal to the sum of the following percentages of the value of the net estate (determined as provided in section 303) is hereby imposed upon the transfer of the net estate of every decedent dying after the enactment of this Act, whether a resident or nonresident of the United States: [Rates follow.]

* * * * * * *

SEC. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

(a) To the extent of the interest therein of the decedent at the time of his death which after his death is subject to the payment of the charges against his estate and the expenses of its administration and is subject to distribution as part of his estate; * * *.

SEC. 303. For the purpose of the tax the value of the net estate shall be determined—

(a) In the case of a resident, by deducting from the value of the gross estate—

* * * * * * *

(b) In the case of a nonresident, by deducting from the value of that part of his gross estate which at the time of his death is situated in the United States—

(1) That proportion of the deductions specified in paragraph (1) of subdivision (a) of this section which the value of such part bears to the value of his entire gross estate, wherever situated, but in no case shall the amount so deducted exceed 10 per centum of the value of that part of his gross estate which at the time of his death is situated in the United States; * * *.

(c) No deduction shall be allowed in the case of a nonresident unless the executor includes in the return required to be filed under section 304 the value at the time of his death of that part of the gross estate of the nonresident not situated in the United States.

(d) For the purpose of Part I of this title, stock in a domestic corporation owned and held by a nonresident decedent shall be deemed property within the United States. * * *.

(e) The amount receivable as insurance upon the life of a nonresident decedent, and any moneys deposited with any person carrying on the banking business, by or for a nonresident decedent who was not engaged in business in the United States at the time of his death, shall not, for the purpose of Part I of this title, be deemed property within the United States.

* * * * * * *

SEC. 304. (a) * * * The executor shall also, at such times and in such manner as may be required by regulations made pursuant to law, file with the collector a return under oath in duplicate, setting forth (1) the value of the gross estate of the decedent at the time of his death, or, in case of a nonresident, of that part of his gross estate situated in the United States; * * *.

the intention of the Congress is concerned, we think that the principles thus impliedly invoked by the statute were the principles theretofore declared and then held. It is quite inadmissible to assume that the Congress exerting Federal power was legislating in disregard of existing doctrine, or to view its intention in the light of decisions as to State power which were not rendered until several years later.[3] The argument is pressed that the reference to situs must, as to intangibles, be taken to incorporate the principle of *mobilia sequuntur personam* and thus, for example, that the bonds here in question though physically in New York should be regarded as situated in Cuba where decedent resided. But the Congress did not enact a maxim. When the statute was passed it was well established that the taxing power could reach such securities in the view that they had a situs where they were physically located. As securities thus actually present in this country were regarded as having a situs here for the purpose of taxation, we are unable to say that the Congress in its broad description, embracing all property "situated in the United States," intended to exclude such securities from the gross estate to be returned and valued.

The general clause with respect to the property of nonresidents "situated in the United States" is found in the provisions for an estate tax of the Revenue Act of 1916 (section 203(b), 39 Stat., 778), and was continued in the Revenue Acts of 1918 (section 403(b), 40 Stat., 1098); of 1921 (section 403(b), 42 Stat., 280); and of 1924 (section 303(b)), the provision now under consideration. Before the phrase was used in the Act of 1916, this court, in passing upon questions arising under the inheritance tax law of June 13, 1898 (section 29, 30 Stat., 464) (in a case where the decedent had left "certain Federal, municipal and corporate bonds" in the custody of his agents in New York), recognized that the property would not have escaped the tax, had it been imposed in apt terms, in the view that the property was intangible and belonged to a nonresident. (*Eidman* v. *Martinez*, 184 U. S., 578, 582.) While that statute was found to be inapplicable, as the property had not passed, within the limitations of the statute, "by will or by the intestate laws of any State or Territory," the opinion conceded the power of Congress "to impose an inheritance tax upon property in this country, no matter where owned or transmitted." (Id., page 592.) We see no reason to doubt that it was with this conception of its power that the Congress enacted the later provision for an estate tax in the case of nonresidents. And before the Revenue Act of 1921 was passed, we had stated the principles deemed controlling in *DeGanay* v. *Lederer* (250 U. S., 376), in construing the provision of the income tax law of 1913 (38 Stat., 166), imposing a tax upon the net income, "from all property owned * * * in the United States by persons residing elsewhere." The decision was upon a certified question with respect to the income of a citizen and resident of France from stocks, bonds, and mortgages secured upon property in the United States, where the owner's agent in the United States collected and remitted the income and had "physical possession of the certificates of stock, the bonds and the mortgages." The court said—"The question submitted comes to this: Is the income from the stock, bonds and mortgages, held by the Pennsylvania company (the agent), derived from property owned in the United States? A learned argument is made to the effect that the stock certificates, bonds and mortgages, are not property, that they are but evidences of the ownership of interests which are property; that the property, in a legal sense, represented by the securities, would exist if the physical evidences thereof were destroyed. But we are of opinion that these refinements are not decisive of the congressional intent in using the word 'property' in this statute. Unless the contrary appears, statutory words are presumed to be used in their ordinary and usual sense, and with a meaning commonly attributable to them. To the general understanding and with the common meaning attached to such descriptive terms, bonds, mortgages, and certificates of stock are regarded as property. By State and Federal statutes they are often treated as property, not as mere evidences of the interests which they represent." Having no doubt "that the securities, herein involved, are property," the court proceeded to the question: "Are they property within the United States? It is insisted that the maxim *mobilia sequunter personam* applies in this instance and that the situs of the property was at the domicile of the owner in France. But this court has frequently declared that the maxim, a

[3] The case of *Blackstone* v. *Miller* (188 U. S., 189) was not overruled until 1930. (See *Farmers' Loan & Trust Co.* v. *Minnesota*, 280 U. S., 204, 209.)

fiction at most, must yield to the facts and circumstances of cases which require it; and that notes, bonds and mortgages may acquire a situs at a place other than the domicile of the owner, and be there reached by the taxing authority." Then, describing the location of the certificates of stock, bonds and mortgages in question in the possession of the agent in Philadelphia, the court concluded that the securities constituted "property within the United States within the meaning of Congress as expressed in the statute under consideration." The reference in the statement of this conclusion to the authority of the agent to sell, invest and reinvest was by way of emphasis and is not to be taken as importing a necessary qualification. The court answered the certified question in the affirmative. (Id., pages 380–383.)

Under the Revenue Act of 1916, the Commissioner of Internal Revenue ruled "that Congress has the power and evidenced an intention" in that Act "to impose a tax upon bonds, both foreign and domestic, owned by a nonresident decedent, which bonds are physically situate in the United States" and that "such bonds must be returned as a portion of his gross estate." (T. D. 2530.) The regulations promulgated by the Treasury Department under the Revenue Act of 1918, interpreting the words "situated in the United States," contained the following: "The situs of property both real and personal, for the purpose of the tax is its actual situs. Stock in a domestic corporation, and insurance payable by a domestic insurance company, constitute property situated in the United States, although owned by, or payable to, a nonresident. A domestic corporation or insurance company is one created or organized in the United States. Bonds actually situated in the United States, moneys on deposit with domestic banks and moneys due on open accounts by domestic debtors constitute property subject to tax." (Regulations No. 37, article 60, T. Ds. 2378, 2910, 3145.) This provision, in substance, as to bonds and moneys due (other than insurance moneys and bank deposits which were made the subject of a special statutory provision), was repeated in the regulations under the Revenue Act of 1921, as follows: "Bonds actually within the United States, moneys due on open accounts by domestic debtors, and stock of a corporation or association created or organized in the United States, constitute property having its situs in the United States." (Regulations No. 63, article 53, T. D. 3384.) We find no ground for questioning the intention of the Congress, when in the Revenue Act of 1924 it reenacted the provision as to the property of nonresidents "situated in the United States," to impose the tax with respect to bonds physically within the United States and stock in domestic corporations. (*Brewster* v. *Gage*, 280 U. S., 327, 337 [Ct. D. 148, C. B. IX–1, 274].)

The argument is pressed that the regulations above quoted are silent as to stock owned by nonresidents in foreign corporations when the certificates of stock are held within the United States. We think that the omission is inconclusive. It may be more fairly said that the express terms of these regulations did not go far enough, rather than that, so far as they did go, they failed to express the legislative intent. In the view which identifies the property interest with its physical representative, no sufficient reason appears for holding that bonds were intended to be included, and not certificates of stock, if these were physically in the United States at the time of death. (See *DeGanay* v. *Lederer*, supra; *Disconto-Gesellschaft* v. *United States Steel Corporation*, 267 U. S., 22, 28, 29.) The regulations adopted under the Revenue Act of 1924 expanded the provisions as to the "situs of property of nonresident decedents" so as to include stock in foreign corporations when the certificates were held here, by providing—"Real estate within the United States, stocks and bonds physically in the United States at date of death, moneys due on open accounts by domestic debtors, and stock of a corporation or association created or organized in the United States, constitute property having a situs in the United States." (Regulations No. 68, article 50, T. D. 3683.) The Revenue Act of 1926 (section 303(b), 44 Stat., 73) reenacted the provision as to property of nonresidents "situated in the United States," and the regulation under that Act expressly embraces "certificates of stock, bonds, bills, notes, and mortgages, physically in the United States at date of death" as property "having a situs in the United States," in addition to the clause relating to stock of domestic corporations. (Regulations No. 70, article 50.) And these provisions have been continued. (Id., 1929 edition.)

We do not find that the qualifying provisions of sections 303 (d) and (e) of the Revenue Act of 1924 are inconsistent with the departmental construction. Section 303(d) provided that "stock in a domestic corporation owned

and held by a nonresident decedent shall be deemed property within the United States." Respondents point to the absence of a similar provision as to bonds and as to stock in foreign corporations and invoke the maxim *expressio unius est exclusio alterius*. But the argument seems to prove too much. It is not to be supposed that the Congress intended that stock owned by a nonresident in a domestic corporation, where the certificates of stock were held in the United States, were to be subject to the tax, and that bonds of the same corporation similarly owned and physically in the United States, were to be excepted. (See T. D. 2530.) We think that the Government's construction of the provision is the more reasonable one, that the place where the stock was held was not an element in the application of section 303(d), and that this provision was designed to insure the inclusion of the stock of a domestic corporation in all cases whether the certificates were physically present in the United States or not. (Compare *Corry* v. *Baltimore*, 196 U. S., 466, 473, 474.)

Section 303(e) provided: "The amount receivable as insurance upon the life of a nonresident decedent, and any moneys deposited with any person carrying on the banking business, by or for a nonresident decedent who was not engaged in business in the United States at the time of his death," are not to be deemed "property within the United States." The Revenue Act of 1918 (section 403(b)3) had provided that the amount receivable as insurance, where the insurer is a domestic corporation, should be regarded as property within the United States, and this was repealed by the substituted provision of the Revenue Act of 1921 (section 403(b)3) to the contrary effect, the latter being carried forward in the Revenue Act of 1924. It is a matter of common knowledge that American life insurance companies were engaged in business abroad, and no clear inference with respect to the question now under consideration may be drawn either from the original provision or from its repeal.[4] But the significance of the remaining clause of the Act of 1921, reenacted in 1924, is apparent. This provided for the exclusion from the gross estate of bank deposits in this country, in the circumstances stated—deposits which, as constituting property of nonresidents situated in the United States, had theretofore been subject to the estate tax.[5] The Congress evidently thought it necessary to make this express exception, in order to exclude such deposits from the tax, but did not provide any exception with respect to bonds and certificates of stock physically here.

As to decedent's deposit balance in the instant case, the Board of Tax Appeals did not make an explicit finding that Lawrence Turnure & Co., with whom the decedent had a checking account, was "carrying on the banking business." The Board thought that the point was not material. (22 B. T. A., 87.) If that firm was engaged in the banking business, the statute required the exclusion of the deposit balance from the gross estate. As to the securities, in view of the legislative history and departmental construction, we find no basis for holding that the statute, if valid in this application, did not require their inclusion.

Second. The question of power to lay the tax. As a Nation with all the attributes of sovereignty, the United States is vested with all the powers of government necessary to maintain an effective control of international relations. (*Fong Yue Ting* v. *United States*, 149 U. S., 698, 711; *Knox* v. *Lee*, 12 Wall., 457, 555, 556.) "We should hesitate long," we said in *Mackenzie* v. *Hare* (239 U. S., 299, 311), "before limiting or embarrassing such powers." So far as our relation to other nations is concerned, and apart from any self-imposed constitutional restriction, we can not fail to regard the property in question as being within the jurisdiction of the United States—that is, it was property within the reach of the power which the United States by virtue of its sovereignty could exercise as against other nations and their subjects without violating any established principle of international law. This view of the scope of the sovereign power in the matter of the taxation of securities physically within the territorial limits of the sovereign is sustained by high authority and is a postulate of legislative action in other countries. The subject was considered by the House of Lords in *Winans* v. *Attorney-General*

[4] See House Rept. No. 767, Sixty-fifth Congress, second session, page 22; Senate Rept. No. 275, Sixty-seventh Congress, first session, page 25; House Rept. No. 350, Sixty-seventh Congress, first session, page 15.

[5] See Senate Rept. No. 275, Sixty-seventh Congress, first session, page 25.

(1910) (A. C., 27). The question was as to the liability to estate duty, under the British Finance Act, 1894, of bonds and certificates when these were physically situated in the United Kingdom at the death of the owner, who was a citizen of the United States and domiciled here. The securities were payable to bearer, marketable on the London Stock Exchange, and passed by delivery. The executors insisted that "the property did not pass by the law of the United Kingdom but by the law of the deceased's domicile"; that "the presence in the United Kingdom of the documents of title to the property did not create a liability to estate duty"; that "all the debtors on the bonds and certificates were at the time of the death and all material times outside the United Kingdom and beyond its jurisdiction"; that "the marketability of a piece of paper in the United Kingdom was not sufficient to make the debt of which it was evidence liable to estate duty"; and that "the property was not situate in the United Kingdom." The House of Lords was not convinced by these contentions. The Lord Chancellor observed that "the property received the full protection of British laws—which is a constant basis of taxation—and can only be transferred from the deceased to other persons by the authority of a British court." (Id., page 30.) Lord Atkinson referred to the status of the securities under international law. "Being physically situated in England at the time of their owner's death," said his lordship, "they were subject to English law and the jurisdiction of English courts, and taxes might therefore *prima facie* be leviable upon them. * * * There does not appear, a priori, to be anything contrary to the principles of international law, or hurtful to the polity of nations, in a State's taxing property physically situated within its borders, wherever its owner may have been domiciled at the time of his death." (Id., page 31.) And Lord Shaw of Dunfermline summed up the application of the British acts as follows: "In the case of an English citizen all his property 'wheresoever situate,' subject to the exception in the act, is aggregated, and into that aggregation—to confine oneself to the matter in hand—all personal property situate out of the United Kingdom must come, unless legacy or succession duty would not have been payable in respect thereof. In the case of the foreign citizen no taxation, of course, falls, except upon property situate within the United Kingdom, and I know no reason either under the law of nations, by the custom of nations, or in the nature of things why property within the jurisdiction of this country, possessed and held under the protection of its laws, should not, upon transfer from the dead to the living, pay the same toll which would have been paid by property enjoying the same protection but owned by a deceased British subject." (Id., pages 47, 48.) In this view, the securities were held to be subject to the estate duty.[6]

In *Disconto-Gesellschaft* v. *United States Steel Corporation* (267 U. S., 22), a somewhat analogous question of jurisdiction arose in relation to the title to shares of stock of an American corporation, which were owned by German corporations, and the certificates of which had been seized in London by the British public trustee appointed to be custodian of enemy property during the late war. As was found to be usual with shares which it was desired to deal in abroad, the shares had been registered on the books of the American corporation in the name of an English broker or dealer who had indorsed the certificates in blank. The German corporations had bought the shares and held the certificates in London. Their suit here was to establish title, to cancel outstanding certificates and to have new certificates issued to them. They based their claim on the proposition that seizure of the certificates in Great Britain did not constitute a seizure of the shares; that the presence of the certificates did not bring the share within the territorial jurisdiction of Great Britain. This court took a different view and sustained the title of the British public trustee. The court thus stated the basis of its ruling: "New Jersey having authorized this corporation like others to issue certificates that so far represent the stock that ordinarily at least no one can get the benefits of ownership except through and by means of the paper, it recognizes as owner anyone to whom the person declared by the paper to be owner has transferred it by the indorsement provided for, wherever it takes place. It allows an indorsement in blank, and by its law as well as by the law of England an indorsement in blank authorizes any-

[6] See, also, as to taxation in Italy, United States Department of Commerce's pamphlet entitled "Taxation of Business in Italy, Trade Promotion Series—No. 82 (1929)"; subtitle "Tax on Successions" (page 105); as to taxation in France, see "French Fiscal Legislation" (Neurrisse and Bezoz (1928), pages 151–153).

one who is the lawful owner of the paper to write in a name, and thereby entitle the person so named to demand registration as owner in his turn upon the corporation's books. But the question who is the owner of the paper depends upon the law of the place where the paper is. It does not depend upon the holder's having given value or taking without notice of outstanding claims but upon the things done being sufficient by the law of the place to transfer the title. An execution locally valid is as effectual as an ordinary purchase. (*Yazoo & Mississippi Valley R. R. Co.* v. *Clarksdale*, 257 U. S., 10.) The things done in England transferred the title to the public trustee by English law." The court thought it "so plain that the public trustee got a title good as against the plaintiffs by the original seizure" that it was deemed unnecessary to advert to the treaties upon which the public trustee also relied or upon the subsequent dealings between England and Germany. (Id., pages 28, 29.)

As jurisdiction may exist in more than one government, that is, jurisdiction based on distinct grounds—the citizenship of the owner, his domicile, the source of income, the situs of the property—efforts have been made to preclude multiple taxation through the negotiation of appropriate international conventions. These endeavors, however, have proceeded upon express or implied recognition, and not in denial, of the sovereign taxing power as exerted by governments in the exercise of jurisdiction upon any one of these grounds. For many years this subject has been under consideration by international committees of experts and drafts of conventions have been proposed, the advantages of which lie in the mutual concessions or reciprocal restrictions to be voluntarily made or accepted by powers freely negotiating on the basis of recognized principles of jurisdiction.[7] In its international relations, the United States is as competent as other nations to enter into such negotiations, and to become a party to such conventions, without any disadvantage due to limitation of its sovereign power, unless that limitation is necessarily found to be imposed by its own Constitution.

Respondents urge that constitutional restriction precluding the Federal estate tax in question is found in the due process clause of the fifth amendment. The point, being solely one of jurisdiction to tax, involves none of the other considerations raised by confiscatory or arbitrary legislation inconsistent with the fundamental conceptions of justice which are embodied in the due process clause for the protection of life, liberty and property of all persons—citizens and friendly aliens alike. (*Russian Volunteer Fleet* v. *United States*, 282 U. S., 481, 489; *Nichols* v. *Coolidge*, 274 U. S., 531, 542 [T. D. 4072, C. B. VI–2, 351]; *Heiner* v. *Donnan*, 285 U. S., 312, 326 [Ct. D. 473, C. B. XI–1, 324].) If in the instant case the Federal Government had jurisdiction to impose the tax, there is manifestly no ground for assailing it. (*Knowlton* v. *Moore*, 178 U. S., 41, 109; *McCray* v. *United States*, 195 U. S., 27, 61; *Flint* v. *Stone Tracy Co.*, 270 U. S., 107, 153, 154; *Brushaber* v. *Union Pacific R. R. Co.*, 240 U. S., 1, 24; *United States* v. *Doremus*, 249 U. S., 86, 93.) Respondents reliance is upon the decisions of this court with respect to the limitation of the taxing power of the States under the due process clause of the fourteenth amendment. (*Farmers Loan & Trust Co.* v. *Minnesota*, 280 U. S., 204; *Baldwin* v. *Missouri*, 281 U. S., 586; *Beidler* v. *South Carolina Tax Commission*, 282 U. S., 1; *First National Bank of Boston* v. *Maine*, 284 U. S., 312.) They insist that the like clause of the fifth amendment imposes a corresponding restriction upon the taxing power of the Federal Government.

The argument is specious, but it ignores an established distinction. Due process requires that the limits of jurisdiction shall not be transgressed. That requirement leaves the limits of jurisdiction to be ascertained in each case with appropriate regard to the distinct spheres of activity of State and Nation. The limits of State power are defined in view of the relation of the States to each other in the Federal Union. The bond of the Constitution qualifies their jurisdiction. This is the principle which underlies the decisions cited by respondents. These decisions established that proper regard for the relation of the States in our system required that the property under consideration should be taxed in

[7] Publication entitled "Double Taxation Relief," Bureau of Foreign and Domestic Commerce, Department of Commerce (January, 1928), pages 20, 21; "Double Taxation and Tax Evasion," Report of the General Meeting of Government Experts to League of Nations, Document C. 562, M. 178, 1928, II, 49, pages 22–24; Fifth General Congress, International Chamber of Commerce, Amsterdam, 1929, Resolution No. 1, Annex, page 11; Washington Congress, 1931, International Chamber of Commerce, Resolution No. 10, pages 20–22. See, also, "Taxation of Foreign and National Enterprises" (League of Nations, Geneva, 1932).

only one State and that jurisdiction to tax was restricted accordingly. In *Farmers Loan & Trust Co.* v. *Minnesota*, supra, the court applied the principle to intangibles, and referring to the contrary view which had prevailed, said (page 209): "The inevitable tendency of that view is to disturb good relations among the States and produce the kind of discontent expected to subside after establishment of the Union. (The Federalist, No. VII.) The practical effect of it has been bad; perhaps two-thirds of the States have endeavored to avoid the evil by resorting to reciprocal exemption laws." It was this "rule of immunity from taxation by more than one State," deducible from the decisions in respect of various and distinct kinds of property, that the court applied in *First National Bank* v. *Maine*, supra, page 326.

As pointed out in the opinion in the First National Bank case, the principle has had a progressive application. In *Louisville & Jeffersonville Ferry Co.* v. *Kentucky* (188 U. S., 385) the question related to a ferry franchise granted by Indiana to a Kentucky corporation which Kentucky attempted to tax. Despite the fact that the tax was laid upon a property right belonging to a domestic corporation, the court held that the fourteenth amendment precluded the imposition. (Id., page 398.) In *Union Refrigerator Transit Co.* v. *Kentucky* (199 U. S., 194) the principle was applied to the attempted taxation by Kentucky of tangible personal property which was owned by a domestic corporation but had a permanent situs in another State. The court decided that where tangible personal property had an actual situs in a particular State, the power to subject it to State taxation rested exclusively in that State regardless of the domicile of the owner. By *Frick* v. *Pennsylvania* (268 U. S., 473) the rule became definitely fixed that as to tangible personal property the power to impose a death transfer tax was solely in the State where the property had an actual situs, and could not be exercised by another State where the decedent was domiciled. (See *First National Bank* v. *Maine*, supra, 322.) The decision in *Farmers Loan & Trust Co.* v. *Minnesota*, supra, overruling *Blackstone* v. *Miller* (188 U. S., 189), carried forward the principle by applying it to intangibles. The court was of the opinion that "the general reasons declared sufficient to inhibit taxation of them (tangibles) by two States apply under present circumstances with no less force to intangibles with taxable situs imposed by due application of the legal fiction. Primitive conditions have passed; business is now transacted on a national scale. A very large part of the country's wealth is invested in negotiable securities whose protection against discrimination, unjust and oppressive taxation is matter of the greatest moment." (280 U. S., 211, 212.)

But it has been as decisively maintained that this principle, thus progressively applied in limiting the jurisdiction of the States to tax, does not restrict the taxing power of the Federal Government. The distinction was clearly and definitely made in *United States* v. *Bennett* (232 U. S., 299). The question arose under section 37 of the Tariff Act of August 5, 1909 (36 Stat., 112), imposing a tax upon the use of foreign built yachts, owned or charted by citizens of the United States. The levy of the tax with respect to a yacht owned by a citizen of the United States, domiciled here, but which was not used within the jurisdiction of the United States and had its permanent situs in a foreign country, was resisted under the due process clause of the fifth amendment. The objector invoked the doctrine, already established, which denied to a State, under the fourteenth amendment, jurisdiction to tax personal property which had a permanent situs in another State. (*Union Refrigerator Transit Co.* v. *Kentucky*, supra.) Under that doctrine, as we have seen, it made no difference that the owner of property was a citizen of, or domiciled in, the State which attempted to lay the tax. The argument was pressed that the Federal statute should not be so construed as to apply to the use of a yacht wholly beyond the territorial limits of the United States since if so interpreted it would be repugnant to the Constitution. But the court thought that to apply that rule of interpretation would be to cause "an imaginary doubt" as to the constitutionality of the statute, and would render it necessary to give the statute "a wholly fictitious and unauthorized meaning." We found nothing "of such gravity in the asserted constitutional question" as to justify departing from the evident legislative intention. Speaking through Chief Justice White, and fully recognizing the principle applicable to the taxing power of the States, the court observed that the argument involved a misapprehension, not as to what had actually been decided, but "in taking for granted that because the doctrine stated has been applied and enforced in many decisions with

respect to the taxing power of the States, that the same principle is applicable to and controlling as to the United States in the exercise of its powers." "The confusion results"—the court continued—"from not observing that the rule applied in the cases relied upon to many forms of exertion of State taxing power is based on the limitations on State authority to tax resulting from the distribution of powers ordained by the Constitution. In other words, the whole argument proceeds upon the mistaken supposition, which is sometimes indulged in, that the calling into being of the government under the Constitution, had the effect of destroying obvious powers of government instead of preserving and distributing such powers. The application to the States of the rule of due process relied upon comes from the fact that their spheres of activity are enforced and protected by the Constitution and therefore it is impossible for one State to reach out and tax property in another without violating the Constitution, for where the power of the one ends the authority of the other begins." "But this," the court added, "has no application to the Government of the United States so far as its admitted taxing power is concerned," for that power "embraces all the attributes which appertain to sovereignty in the fullest sense. * * * Because the limitations of the Constitution are barriers bordering the States and preventing them from transcending the limits of their authority and thus destroying the rights of other States and at the same time saving their rights from destruction by the other States, in other words of maintaining and preserving the rights of all the States, affords no ground for constructing an imaginary constitutional barrier around the exterior confines of the United States for the purpose of shutting that government off from the exertion of powers which inherently belong to it by virtue of its sovereignty." (Id., 305, 306.)

This distinction between the limitations of State jurisdiction to tax and the broad authority of the Federal Government, was restated and applied in *Cook* v. *Tait* (265 U. S., 47, 55, 56 [T. D. 3594, C. B. III–1, 73]), and was again explicitly recognized in *Frick* v. *Pennsylvania*, supra, page 491.

The distinction can not be regarded as limited to tangible property. It has equal application to intangibles. It does not rest upon the question whether the property is of the one sort or the other, but upon the fact that the limitation of State jurisdiction to tax does not establish the limitation of Federal jurisdiction to tax. If the Federal Government may rest its jurisdiction to lay its tax upon the fact of the citizenship and domicile in this country of the owner of tangible property, wherever that property may be situated, although the State may not impose a like tax with respect to property having a permanent location outside the State, the Federal Government can not be regarded as restrained in its power to tax securities owned by a nonresident, but physically in this country, merely because the State is debarred from laying such a tax with respect to a nonresident of the State. The decisive point is that the criterion of State taxing power by virtue of the relation of the States to each other under the Constitution is not the criterion of the taxing power of the United States by virtue of its sovereignty in relation to the property of nonresidents. The Constitution creates no such relation between the United States and foreign countries as it creates between the States themselves.

Accordingly, in what has been said, we in no way limit the authority of our decisions as to State power. We determine national power in relation to other countries and their subjects by applying the principles of jurisdiction recognized in international relations. Applying those principles we can not doubt that the Congress had the power to enact the statute, as we have construed and applied it to the property in question. The securities should be included in the gross estate of the decedent; the inclusion of the balance of the cash deposit will depend, under the statute, upon the finding to be made with respect to the nature of the business of the concern with which the deposit was made.

The judgment is reversed and the cause is remanded for further proceedings in conformity with this opinion.

It is so ordered.

Mr. Justice BUTLER is of opinion that the statute does not extend to the transfer of the foreign or other securities effected by the death of decedent, Ernest Augustus Brooks, a British subject resident of and dying in Cuba, and that the conclusions of the Board of Tax Appeals and Circuit Court of Appeals are right and should be affirmed.

TITLE XIV.—GENERAL PROVISIONS. (1918)

REGULATIONS 37 (1919), ARTICLE 116: Remedies for collection of tax. XII-23-6215

ESTATE TAX—REVENUE ACT OF 1917—DECISION OF COURT.

COMPROMISE AND SETTLEMENT—BAR TO SUBSEQUENT SUIT.

The compromise of a suit brought against executors by the United States for additional estate taxes upon a determination by the Commissioner of Internal Revenue of the amount of the gross estate and the allowable deductions therefrom, the compromise being of any and all liabilities of the estate and of the executors as such and as individuals in connection with the pending suit and with the estate tax, bars a subsequent suit by the executors based upon claims for further deductions.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

James C. Ayer et al., Executors, plaintiffs, appellants, v. *Thomas W. White, Collector of Internal Revenue, defendant, appellee.*

Appeal from the District Court of the United States for the District of Massachusetts.

[January 3, 1933.]

OPINION.

WILSON, J.: This is an action at law brought in the United States District Court for the District of Massachusetts by the executors of the will of Frederick Ayer, who died in March, 1918, to recover estate taxes alleged to have been illegally assessed and collected to the amount of $95,879.35.

Briefly, the facts which form the basis of this litigation are as follows: On or about September 8, 1919, in pursuance of the Federal estate tax law approved September 8, 1916, as amended by the Acts approved March 3, 1917, and October 3, 1917, the plaintiffs as executors of the will of Frederick Ayer filed the following return with the collector of internal revenue, which showed an estate tax of $661,871.48, which was paid to the defendant's predecessor in office (see *United States* v. *Ayer*, 12 Fed. (2d), 194, 195 [T. D. 3869, C. B. V-1, 397]):

Real estate		$1,084,935.70
Gifts and transfers		120,000.00
Stocks and bonds		3,565,019.11
Shares in jointly owned property		
Mortgages, notes and miscellaneous		1,392,381.45
Total gross estate		6,162,336.26
Funeral expense	$5,618.42	
Administration expense:		
Executor's fee	15,000.00	
Attorney's fee	25,000.00	
Miscellaneous	11,409.87	
Claims against estate:		
Mortgages		
Debts of decedent	$1,167,133.06	
Net losses during administration		
Support of dependents		
State inheritance tax		
Other charges allowed by local law		
Specific exemption	50,000.00	
Total deductions		$1,274,161.35
Net estate		4,888,174.91

Having determined upon information furnished him that the return filed by the executors did not represent the true amount of the gross and net estate, the Commissioner of Internal Revenue afterwards determined that the true amount of the gross and net estate of the decedent and of the additional estate tax due was as follows:

Real estate	$1,080,935.70
Gifts and transfers	13,103,948.26
Stocks and bonds	3,612,921.04
Mortgages, notes and miscellaneous	1,409,914.45
Total gross estate	19,207,719.45
Total deductions	1,284,049.71
Net estate	17,923,669.74
Total tax	3,183,614.77
Total tax discharged on basis of return	661,871.48
Additional tax due	2,521,743.29

In October, 1923, the Commissioner brought an action against the executors to recover what he thus determined to be the additional tax due from this estate.

To his declaration the executors filed a demurrer, which was sustained by the district court, but was overruled by this court on April 23, 1926 (see *United States* v. *Ayer et al.*, supra), and the case was remanded with leave for the defendants to plead to the merits.

In January, 1927, without pleading to the merits, the executors made a written offer of $596,155.41 in compromise of the suit and in settlement of the liability set forth in the declaration, which was refused. The important part of said offer as bearing on the issues in the case now before this court is as follows:

"It is alleged in said suit that a series of transfers by the estate of the undersigned were made in contemplation of death, and that certain valuations were in fact greater than those returned.

"The undersigned, as their defense, assert, *inter alia*, that said transfers were none of them made in contemplation of death under the provisions of law applicable thereto, and that the valuations returned were the correct valuations; * * * by reason whereof the executors say that under the terms of the Revenue Act of 1918, section 407, they have paid to the Internal Revenue Department the entire tax for which either the estate of the undersigned, either individually or as executors, are liable.

"After conference with the attorneys having charge of said suit, and having been advised of the privilege of submitting an offer in compromise of the alleged liability which it is sought in said suit to enforce, the sum of $596,155.41 is hereby tendered voluntarily with the request that it be accepted as a compromise offer and that release be granted the undersigned from entire liability for the claim represented in said suit No. 2245 in said district court."

March 27, 1927, the executors made an additional offer of compromise in writing of $403,844.59, making its total compromise offer in settlement of the tax liability of the estate and of this action, $1,000,000. The important part of the second offer is as follows:

"* * * making a total offer of $1,000,000, in compromise of the liabilities in the suit by the United States against James C. Ayer et al., executors of the estate of Frederick Ayer, deceased, now pending in the United States District Court for the District of Massachusetts, at law No. 2245, to recover estate taxes, interest and penalties alleged to be due from the defendants, and any liability against said executors, as such, or as individuals, and said estate, in connection with the estate tax under any Revenue Act imposed upon the transfer of the net estate of Frederick Ayer, deceased, as more particularly shown on the above mentioned previous offer on Form 656, heretofore submitted and made a part hereof."

This compromise offer of $1,000,000 was accepted by the Commissioner of Internal Revenue in a letter dated April 1, 1927, the terms of which are as follows:

"WASHINGTON, *April 1, 1927.*

"MESSRS. JAMES C., CHARLES F., AND FREDERICK AYER,
"141 Milk Street, Boston, Mass.

"SIRS: The Commissioner of Internal Revenue has considered the proposition submitted by you on March 24, 1927, through the collector of internal revenue, Boston, Mass., as compromise of liabilities on account of alleged additional estate tax due from the estate of Frederick Ayer, deceased, under the Revenue Acts of 1916 and 1917, in the amount of $2,521,743.29, and accrued interest from March 14, 1919; of the liability of the estate and of the executors, individually and as executors; and in settlement of the suit now pending in the United States District Court for the District of Massachusetts, same being No. 2245 on the law docket thereof, entitled *United States* v. *James C. Ayer et al.* and has decided, with the advice and consent of the Secretary of the Treasury and the concurrence of the Attorney General, to close the case by the acceptance of the following terms:

"$1,000,000 in lieu of the alleged additional tax and accrued interest; in lieu of the liability of the estate and of the defendants, individually and as executors; and in settlement of the above-mentioned suit."

On March 24, 1931, the present action was brought by the executors under section 51 of the Judicial Code to recover Federal estate taxes collected *by the defendant* from the plaintiffs, and wrongfully and illegally withheld from the plaintiffs under instructions of the Commissioner of Internal Revenue.

The plaintiffs' declaration sets forth the above facts as to the suit by the United States and the several offers of compromise and the final acceptance and settlement and dismissal of the action brought by the United States.

To the declaration the defendant demurred, and as grounds of demurrer sets forth that the offer of compromise and its acceptance settled the entire tax liability of the estate of Frederick Ayer, and in effect settled not only the gross but the net estate for determining the tax liability, including all permissible deductions.

The defendant also contends that the only tax collected by him as an estate tax was the sum paid in consequence of the acceptance of the compromise offer, and the executors can not recover any part of a sum voluntarily paid, with full knowledge of the facts, as a compromise settlement of an action brought by the United States to collect a tax; and as to any sum originally paid in September, 1919, upon the filing of the return, the statute of limitations bars an action for recovery; and to recover a sum paid to a former collector, the action must be against the United States.

We think the judgment of the district court must be affirmed.

The original return discloses that the executors claimed therein deductions for counsel fees and administration expenses. The fact that no claim was then made for State inheritance taxes may be explained by the fact that at that time, according to the ruling of the Treasury Department, payments for State inheritance taxes were not proper deductions. The significant fact, however, is that the executors claimed deductions to an amount which presumably they considered sufficient to cover all proper sums for the deductible items enumerated.

Under the declaration in the action by the United States to collect additional estate taxes in determining the net estate on which the additional tax liability was computed, the Commissioner allowed all the deductions which had been claimed by the executors up to that time, and nearly $10,000 additional. That suit, therefore, was not merely to collect additional taxes by reason of certain alleged gifts in contemplation of death, though that was the chief basis for the large amount of the additional tax liability, but included the adjustment of the entire tax liability by a redetermination of the gross estate by reason of the alleged gifts in contemplation of death, and of the net estate by subtracting all the allowable deductions of which the Commissioner had notice up to that time. The account set forth in the declaration in that action showed a complete readjustment of the tax liability of the estate, and from the form of the compromise offers and the letter of acceptance, we think the parties understood that the entire tax liability of the estate was thereby extinguished, and all claims for deductions were also adjusted.

The executors, of course, knew from the statement in the declaration that the Commissioner, in determining the additional tax liability, had allowed nearly $10,000 as additional deductions to that claimed in the executors' original return. They must also have known at the time of the compromise

offer that there were expenses of administration in addition to those claimed as deductions in their original return. They had already paid certain State inheritance taxes. With this knowledge they made an offer of compromise of a suit brought, not merely to recover an estate tax on certain gifts in contemplation of death, but to recover a sum, as an estate tax, in addition to what had already been paid, and determined by deducting from the gross estate all allowable deductions then claimed by the executors and made known to the Commissioner, and applying the rates fixed by law to the net estate thus determined.

The offer of the executors was tendered with the request that it be accepted, and a release be granted the executors from entire liability for the claim presented in the action by the Government, or, as stated in the second offer, "in compromise of the liabilities asserted in the suit by the United States against James C. Ayer et al., executors of the estate of Frederick Ayer, deceased, now pending in the United States District Court for the District of Massachusetts, at law No. 2245, to recover estate taxes, interest and penalties alleged to be due from the defendants, and any liability against said executors, as such, or as individuals, and said estate, in connection with the estate tax under any Revenue Act imposed upon the transfer of the net estate of Frederick Ayer, deceased."

This offer was accepted by the Government in lieu of the liability of the estate and of the defendants individually and as executors, and in settlement of the above mentioned suit.

We do not think the executors can now say that they made this offer with a reservation—not disclosed to the Government—of a right to make claims for further deductions made up of expenses of administration and State inheritance taxes, a part of which, at least, had already been determined and paid.

It is unnecessary to consider the other grounds urged by the defendant in support of its demurrer.

The judgment of the district court is affirmed.

TITLE III. PART II.—GIFT TAX. (1924)

TRANSFERS SUBJECT TO TAX.

REGULATIONS 67(1924), ARTICLE 1: Transfers reached. XII-9-6050 Ct. D. 636

GIFT TAX—REVENUE ACT OF 1924—DECISION OF SUPREME COURT.

DEEDS OF TRUST—POWER TO ALTER, AMEND, OR REVOKE—CANCELLATION OF POWER.

Where settlor in 1917 executed deeds of trust, reserving to himself an unrestricted power to modify, alter, or revoke the trusts, except as to income received or accrued, which power was canceled and surrendered in 1925, such cancellation of the power constitutes a transfer subject to the gift tax imposed by sections 319 and 320 of the Revenue Act of 1924.

SUPREME COURT OF THE UNITED STATES.

David Burnet, Commissioner of Internal Revenue, petitioner, v. *Murry Guggenheim, respondent.*

On writ of certiorari to the Circuit Court of Appeals for the Second Circuit.

[February 6, 1933.]

OPINION.

Mr. Justice CARDOZO delivered the opinion of the court.

The question to be decided is whether deeds of trust made in 1917, with a reservation to the grantor of a power of revocation became taxable as gifts under the Revenue Act of 1924 when in 1925 there was a change of the deeds by the cancellation of the power.

On June 28, 1917, the respondent, a resident of New York, executed in New Jersey two deeds of trust, one for the benefit of his son, and one for the benefit of his daughter. The trusts were to continue for 10 years, during which period part of the income was to be paid to the beneficiary and part accumulated. At the end of the 10-year period the principal and the accumulated income were to go to the beneficiary, if living; if not living, then to his or her children; and if no children survived, then to the settlor in the case of the son's trust, and in the case of the daughter's trust to the trustees of the son's trust as an increment to the fund. The settlor reserved to himself broad powers of control in respect of the trust property and its investment and administration. In particular, there was an unrestricted power to modify, alter or revoke the trusts except as to income, received or accrued. The power of investment and administration was transferred by the settlor from himself to others in May, 1921. The power to modify, alter or revoke was eliminated from the deeds, and thereby canceled and surrendered, in July, 1925.

In the meanwhile Congress had passed the Revenue Act of 1924 which included among its provisions a tax upon gifts. "For the calendar year 1924 and each calendar year thereafter * * * a tax * * * is hereby imposed upon the transfer by a resident by gift during such calendar year of any property wherever situated, whether made directly or indirectly," the tax to be assessed in accordance with a schedule of percentages upon the value of the property. (43 Stat., 253, 313, ch. 234, sections 319, 320; 26 United States Code, sections 1131, 1132.)

At the date of the cancellation of the power of revocation, the value of the securities constituting the corpus of the two trusts was nearly $13,000,000. Upon this value the Commissioner assessed against the donor a tax of $2,465,681, which the Board of Tax Appeals confirmed with a slight modification due to a mistake in computation. The taxpayer appealed to the Court of Appeals for the Second Circuit, which reversed the decision of the Board and held the gift exempt. (58 F. (2d), 188.) The case is here on certiorari.

On November 8, 1924, more than eight months before the cancellation of the power of revocation, the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, adopted and promulgated the following regulation:

"The creation of a trust where the grantor retains the power to revest in himself title to the corpus of the trust, does not constitute a gift subject to tax, but the annual income of the trust which is paid over to the beneficiaries shall be treated as a taxable gift for the year in which so paid. Where the power retained by the grantor to revest in himself title to the corpus is not exercised, a taxable transfer will be treated as taking place in the year in which such power is terminated." (Regulations 67, article 1.)

The substance of this regulation has now been carried forward into the Revenue Act of 1932, which will give the rule for later transfers. (Revenue Act of 1932, ch. 209; 47 Stat., 169, 245; section 501(c).[1])

We think the regulation, and the later statute continuing it, are declaratory of the law which Congress meant to establish in 1924.

"Taxation is not so much concerned with the refinements of title as it is with the actual command over the property taxed—the actual benefit for which the tax is paid." (*Corliss* v. *Bowers*, 281 U. S., 376, 378 [Ct. D. 188, C. B. IX–1, 254]. Cf. *Chase National Bank* v. *United States*, 278 U. S., 327 [Ct. D. 40, C. B. VIII–1, 308]; *Saltonstall* v. *Saltonstall*, 276 U. S., 260; *Tyler* v. *United States*, 281 U. S., 497, 503 [Ct. D. 190, C. B. IX–1, 383]; *Burnet* v. *Harmel*, 287 U. S., 103; *Palmer* v. *Bender*, 287 U. S. 551.) While the powers of revocation stood uncanceled in the deeds, the gifts, from the point of view of substance, were inchoate and imperfect. By concession there would have been no gift in any aspect if the donor had attempted to attain the same result by the mere delivery of the securities into the hands of the donees. A power of revocation accompanying delivery would have made the gift a nullity. (*Basket* v. *Has-*

[1] SEC. 501. (c) The tax shall not apply to a transfer of property in trust where the power to revest in the donor title to such property is vested in the donor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such property or the income therefrom, but the relinquishment or termination of such power (other than by the donor's death) shall be considered to be a transfer by the donor by gift of the property subject to such power, and any payment of the income therefrom to a beneficiary other than the donor shall be considered to be a transfer by the donor of such income by gift.

sel, 107 U. S., 602.) By the execution of deeds and the creation of trusts, the settlor did indeed succeed in divesting himself of title and transferring it to others (*Stone* v. *Hackett*, 12 Gray (Mass.), 227; *Van Cott* v. *Prentice*, 104 N. Y., 45; *National Newark & Essex Banking Co.* v. *Rosahl*, 97 N. J. Eq., 74; *Jones* v. *Clifton*, 101 U. S., 225), but the substance of his dominion was the same as if these forms had been omitted. (*Corliss* v. *Bowers*, supra.) He was free at any moment, with reason or without, to revest title in himself, except as to any income then collected or accrued. As to the principal of the trusts and as to income to accrue thereafter, the gifts were formal and unreal. They acquired substance and reality for the first time in July, 1925, when the deeds became absolute through the cancellation of the power.

The argument for the petitioner is that Congress in laying a tax upon transfers by gift made in 1924 or in any year thereafter had in mind the passing of title, not the extinguishment of dominion. In that view the transfer had been made in 1917 when the deeds of trust were executed. The argument for the Government is that what was done in 1917 was preliminary and tentative, and that not till 1925 was there a transfer in the sense that must have been present in the mind of Congress when laying a burden upon gifts. Petitioner and Government are at one in the view that from the extinguishment of the power there came about a change of legal rights and a shifting of economic benefits which Congress was at liberty, under the Constitution, to tax as a transfer effected at that time. (*Chase National Bank* v. *United States*, supra; *Saltonstall* v. *United States*, supra; *Tyler* v. *United States*, supra; *Corliss* v. *Bowers*, supra.) The question is not one of legislative power. It is one of legislative intention.

With the controversy thus narrowed, doubt is narrowed too. Congress did not mean that the tax should be paid twice, or partly at one time and partly at another. If a revocable deed of trust is a present transfer by gift, there is not another transfer when the power is extinguished. If there is not a present transfer upon the delivery of the revocable deed, then there is such a transfer upon the extinguishment of the power. There must be a choice, and a consistent choice, between the one date and the other. To arrive at a decision, we have therefore to put to ourselves the question, Which choice is it the more likely that Congress would have made? Let us suppose a revocable transfer made on June 3, 1924, the day after the adoption of the Revenue Act of that year. Let us suppose a power of revocation still uncanceled, or extinguished years afterwards, say in 1931. Did Congress have in view the present payment of a tax upon the full value of the subject matter of this imperfect and inchoate gift? The statute provides that upon a transfer by gift the tax upon the value shall be paid by the doner (43 Stat., 316, ch. 234, section 324), and shall constitute a lien upon the property transferred. (43 Stat., ch. 234, sections 315, 324.) By the Act now in force, the personal liability for payment extends to the donee. (Act of June 6, 1932, ch. 209, section 510; 47 Stat., 249; 26 United States Code, section 1136(j).) A statute will be construed in such a way as to avoid unnecessary hardship when its meaning is uncertain. (*Hawaii* v. *Mankichi*, 190 U. S., 197, 214; *Sorrells* v. *United States*, 287 U. S., 435.) Hardship there plainly is in exacting the immediate payment of a tax upon the value of the principal when nothing has been done to give assurance that any part of the principal will ever go to the donee. The statute is not aimed at every transfer of the legal title without consideration. Such a transfer there would be if the trustees were to hold for the use of the grantor. It is aimed at transfers of the title that have the quality of a gift, and a gift is not consummate until put beyond recall.

The petitioner invokes the rule that in the construction of a taxing Act doubt is to be resolved in favor of the taxpayer. (*United States* v. *Merriam*, 263 U. S., 179 [T. D. 3535, C. B. II–2, 87]; *Gould* v. *Gould*, 245 U. S., 151.) There are many facets to such a maxim. One must view them all, if one would apply it wisely. The construction that is liberal to one taxpayer may be illiberal to others. One must strike a balance of advantage. It happens that the taxpayer before us made his deeds in 1917, before a transfer by gift was subject to a tax. We shall alleviate his burden if we say that the gift was then complete. On the other hand, we shall be heightening the burdens of taxpayers who made deeds of gift after the Act of 1924. In making them, they had the assurance of a Treasury regulation that the tax would not be laid, while the power of revocation was uncanceled, except upon the income paid from year to year. They had good reason to suppose that the tax upon the principal would not be due until the power was extinguished or until the principal was paid. If we disappoint their expectations, we shall be illiberal to them.

The tax upon gifts is closely related both in structure and in purpose to the tax upon those transfers that take effect at death. What is paid upon the one is in certain circumstances a credit to be applied in reduction of what will be due upon the other. (43 Stat., 315, section 322, 26 U. S. C., section 1134.) The gift tax is Part II of Title III of the Revenue Act of 1924; the estate tax is Part I of the same title. The two statutes are plainly *in part materia*. There has been a steady widening of the concept of a transfer for the purpose of taxation under the provisions of Part I. (*Tyler* v. *United States*, supra; *Chase National Bank* v. *United States*, supra; *Saltonstall* v. *Saltonstall*, supra; cf. *Bullen* v. *Wisconsin*, 240 U. S., 625.) There is little likelihood that the lawmakers meant to narrow the concept, and to revert to a construction that would exalt the form above the substance, in fixing the scope of a transfer for the purposes of Part II. We do not ignore differences in precision of definition between the one part and the other. They can not obscure identities more fundamental and important. The tax upon estates, as it stood in 1924, was the outcome of a long process of evolution; it had been refined and perfected by decisions and amendments almost without number. The tax on gifts was something new. Even so, the concept of a transfer, so painfully developed in respect of taxes on estates, was not flung aside and scouted in laying this new burden upon transfers during life. Congress was aware that what was of the essence of a transfer had come to be identified more nearly with a change of economic benefits than with technicalities of title. The word had gained a new color, the result, no doubt in part, of repeated changes of the statutes, but a new color none the less. (Cf. *Towne* v. *Eisner*, 245 U. S., 418, 425; *Int. Stevedoring Co.* v. *Haverty*, 272 U. S., 50; *Gooch* v. *Oregon Short Line Co.*, 258 U. S., 22, 24; *Hawks* v. *Hamill*, 288 U. S., 52.)

The respondent finds comfort in the provisions of section 302(d) of the Act of 1924, governing taxes on estates.[2] He asks why such a provision should have been placed in Part I and nothing equivalent inserted in Part II, if powers for purposes of the one tax were to be treated in the same way as powers for the purposes of the other. Section 302(d) of the Act of 1924 is in part a reenactment of a section of the Revenue Acts of 1918 and 1921, though it has been changed in particulars. (40 Stat., 1097, ch. 18, section 402(c); 42 Stat., 227, ch. 136, section 402(c). Cf. *Reinecke* v. *Northern Trust Co.*, 278 U. S., 339 [T. D. 4261, C. B. VIII-1, 305].) It is an outcome of that process of development which has given us a rule for almost every imaginable contingency in the assessment of a tax under the provisions of Part I. No doubt the draftsman of the statute would have done well if he had been equally explicit in the drafting of Part II. This is not to say that meaning has been lost because extraordinary foresight would have served to make it clearer. Here as so often there is a choice between uncertainties. We must be content to choose the lesser. To lay the tax at once, while the deed is subject to the power, is to lay it on a gift that may never become consummate in any real or beneficial sense. To lay it later on is to unite benefit with burden. We think the voice of Congress has ordained that this be done.

Precedents are cited as opposed to our conclusion. We find none of them decisive.

United States v. *Field* (255 U. S., 257) holds that under the Revenue Act of 1916 (39 Stat., 777, ch. 463) the subject of a power created by another is not a part of the estate of the decedent to whom the power was committed. It does not hold that a revocable conveyance *inter vivos* is a perfected transfer by gift that will justify the immediate imposition of a tax upon the value. There was no such question in the case.

Jones v. *Clifton* (101 U. S., 225) holds that a power of revocation in a deed of conveyance from a husband to his wife does not avail without more to invalidate the transaction as one in fraud of creditors. A transfer within the meaning of a taxing Act may or may not be one within the statute of Elizabeth.

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[2] By section 302(d), the gross estate of a decedent is to be taken as including the subject of any trust which he has created during life "where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of death, except in case of a bona fide sale for a fair consideration in money or money's worth."

By section 302(h), the foregoing subdivision (d) as well as many others, is declared to "apply to the transfers, trusts, estates, interests, rights, powers, and relinquishments of powers, as severally enumerated and described therein, whether made, created, arising, existing, exercised or relinquished before or after the enactment of this Act."

We are referred to cases in the State courts, from Pennsylvania and New Jersey. *In re Dolan's Estate* (279 Pa. St., 582); *In re Hall's Estate* (99 N. J., Law 1). In neither did the court decide that a conveyance *inter vivos* was taxable as a present gift when the conveyance was subject to revocation at the pleasure of the grantor. No such statute was involved. In each the ruling was that upon the death of the grantor the subject of the conveyance was not taxable as part of his estate, and hence not taxable at all. The ruling might have been different if a choice had been necessary between taxing the conveyance, or its subject, while the power was outstanding, and taxing it later on. New channels of thought cut themselves under the drive of a dilemma.

A decision of the Court of Claims (*Means* v. *United States*, 69 C. Cls., 539) upholds the contention of the Government that within the meaning of the Act of Congress the termination by a settlor of the power to revoke a trust is a transfer of the property and as such subject to taxation.

The argument for the respondent if pressed to the limit of its logic would carry him even farther than he has claimed the right to go. If his position is sound that a power to revoke does not postpone for the purpose of taxation the consummation of the gift, then the income of these trusts is exempt from the tax as fully as the principal. What passed to the beneficiaries was the same in either case, an interest inchoate and contingent till rendered absolute and consummate through receipt or accrual before the act of revocation. Congress did not mean that recurring installments of the income, payable under a revocable conveyance which had been made by a settlor before the passage of this statute, should be exempt, when collected, from the burden of the tax.

The judgment is reversed.

SALES TAX RULINGS.

TITLE IV.—MANUFACTURERS' EXCISE TAXES. (1932)

SECTION 601.—EXCISE TAXES ON CERTAIN ARTICLES.

LUBRICATING OILS.

REGULATIONS 44, ARTICLE 11: Scope of tax. XII-11-6071
S. T. 647

Sales tax-free under exemption certificate.

Advice is requested concerning the taxability, under section 601(c)1 of the Revenue Act of 1932, of sales of lubricating oil upon the furnishing of an exemption certificate.

The X Company is a manufacturer or producer of lubricating oil and is making sales of this oil to a customer tax-free under exemption certificates showing a registration number issued by the collector of internal revenue. The company has reason to believe that this product which is sold ostensibly for further manufacture is not being used in the manner contemplated by the exemption certificate, and requests that the Bureau advise the customer of his liability for the payment of the taxes imposed under section 601(c)1 of the Act.

Where a customer shows a registration number as a manufacturer on his exemption certificate and the X Company has reason to believe that the customer is erroneously using such exemption certificate in making tax-free purchases, the company should immediately notify the collector of internal revenue who issued the registration number of the sale of such oil, with the name and address of such customer, in order that the customer may be properly advised with regard to his liability before a large amount of tax is incurred.

In all cases where a manufacturer or producer makes tax-free sales of lubricating oil, he is required to use reasonable diligence to satisfy himself that a sale under the exemption certificate furnished him is warranted. Where a person fraudulently or through misunderstanding buys lubricating oil tax-free under an exemption certificate under circumstances where exemption is not warranted, such person is liable for the tax upon his sale or use. If the original vendor has knowledge that the oil purchased is not intended for further manufacture by the vendee, the former is liable for the tax and is not relieved of responsibility by tender from the vendee of an exemption certificate.

Where a vendee purchases oil tax-free, for the bona fide purpose of further manufacture into a taxable product, and finds that due to business conditions, or a change in his product, he is overstocked with the tax-free oil purchased for further manufacture, which he

can not so use, he is then permitted to resell it in the same form in which he purchased it. However, under such circumstances the resale of the oil by such a vendee does not subject the original vendor to any liability for tax on his sale, since, in such a case, the vendee is treated, under the provisions of section 620, as the manufacturer and becomes fully responsible for payment of tax unless the exempt character of the resale is established as provided in the regulations.

On the other hand, the Bureau holds that the sale of oil for the sole purpose of resale by the vendee without further manufacture is subject to tax, even though the resale be for further manufacture.

REGULATIONS 44, ARTICLE 11: Scope of tax. XII–11–6077
T. D. 4362

Tax on lubricating oils—Section 601(c), Revenue Act of 1932.

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

To Collectors of Internal Revenue and Others Concerned:

The last paragraph of article 11 of Regulations 44, approved June 18, 1932, as amended by Treasury Decision 4339, approved July 16, 1932 [C. B. XI–2, 446], is hereby amended to read as follows:

A person who renovates or re-refines used or waste lubricating oil by a method or process which removes the soluble oxidation products and produces an oil with substantially all the physical and chemical characteristics of new lubricating oil, is a manufacturer or producer, and the tax attaches to the oil so produced when sold or used by him for lubrication.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved March 3, 1933.

OGDEN L. MILLS,
Secretary of the Treasury.

BREWER'S WORT, LIQUID MALT, MALT SIRUP, AND MALT EXTRACTS.

REGULATIONS 44, ARTICLE 13: Scope of tax. XII–9–6051
S. T. 642

Taxability of liquid malt.

Advice is requested whether the tax imposed by section 601(c)2 of the Revenue Act of 1932 should be based upon the weight of solids which the products contain or upon the entire weight of the finished malts.

In the case of liquid malt, malt sirup, and malt extract the tax attaches to the weight of the entire product and is not restricted to the percentage of solids which it contains. If a manufacturer produces liquid malt containing 15 per cent or more of solids by weight and packs it in 5-gallon cans, it will not be permissible to separate the solids from the liquid for tax purposes and pay the tax on the solids only. A tax of 3 cents per pound must be paid on the entire 5 gallons.

REGULATIONS 44, ARTICLE 14: Exempt sales. XII–18–6158
S. T. 663

Taxability of malt sirup when sold to a brewer.

Advice is requested concerning the taxability of malt sirup when sold to a brewer licensed to produce cereal beverages having an alcoholic content of not more than 3.2 per cent by weight.

Section 601(c)2 of the Revenue Act of 1932 imposes a tax upon the manufacturer's sale of malt sirup, except when sold for certain uses, one of which is the production of cereal beverages.

Beer and other beverages made of cereals, having an alcoholic content of not more than 3.2 per cent by weight, are cereal beverages within the meaning of section 601(c)2 of the Revenue Act of 1932. A manufacturer of malt sirup may sell such sirup tax-free to a manufacturer of cereal beverages provided he procures, prior to or at the time of sale, a certificate from the purchaser to the effect that such purchaser is a manufacturer of cereal beverages and will use the malt sirup in the manufacture of cereal beverages, as required by article 14 of Regulations 44.

SECTION 602.—TIRES AND INNER TUBES.

REGULATIONS 46, ARTICLE 14: Exchanges, etc. XII–10–6061
S. T. 644

Taxability of tire replacements.

Advice is requested concerning the tax imposed by section 602 of the Revenue Act of 1932 as applied to the replacement of defective tires under a guaranty contract.

The position taken by the Bureau with respect to the tax involved in several types of replacement transactions is indicated by the following answers:

Question. Where a taxable article sold under warranty as to quality or service proves defective and is replaced without charge in accordance with the terms of the warranty?

Answer. The replacement is not regarded as a sale and, accordingly, the tax will not attach. (See S. T. 613, C. B. XI–2, 454.)

Question. Where a taxable article is sold under a warranty as to quality or service and the manufacturer replaces it with a new article of the same type, model, and quality by the payment of an additional amount, which, however, is less than the regular price of the second article?

Answer. Under the circumstances recited the second article is deemed to be sold at a reduced price by reason of the warranty affecting the sale of the first article. If the tax involved is based upon the sale price, it should be computed upon the amount actually charged or paid for the new article.

If the tax is based upon weight or volume it should be computed upon that proportion of the total weight or volume of the second article which the actual sale price bears to the regular sale price of the second article. For example, if an automobile tire is guaranteed to run 20,000 miles and after failing at 10,000 miles is replaced by the manufacturer in consideration of the payment of one-

half of the regular purchase price of the new tire, the tax on the new tire should be computed on the basis of one-half its weight.

Question. Where a taxable article is sold by the manufacturer and, subsequent to the expiration of any period of warranty, is returned either to the original manufacturer or some other manufacturer and is accepted as part payment of the purchase price of either a similar article or some other article also subject to tax, the balance of the purchase price being paid in cash?

Answer. The tax, if based on the sale price, should be computed on the actual price for which sold—that is, the sum of the "trade-in allowance" plus the cash payment agreed on. If the tax is based on weight or volume, the tax should be based on the total weight or volume of the second article.

REGULATIONS 46, ARTICLE 19: Scope of tax. XII–3–5993
G. C. M. 11410

Taxability of tires and tubes when leased under so-called mileage contracts.

An opinion is requested concerning several questions which have arisen in connection with so-called mileage contracts between the X Rubber Co. and the Y Tire & Rubber Co. and bus companies. Under these contracts the rubber companies, as manufacturers, agree to furnish tires and tubes to operators of buses at a specified rate per mile. The manufacturer also agrees to service the tires and retains title thereto. The operator of the buses agrees, upon termination of the contract, unless a new contract is entered into, to purchase the tires on the basis of the manufacturer's price list, less the amount already paid under the mileage contract. In the case of damage by accident, abuse, or fire the cost of repair is to be borne by the bus company. In the case of destruction by accident, abuse, or fire the bus company is to be charged at the manufacturer's list price, less mileage paid.

Section 602 of Title IV of the Revenue Act of 1932 imposes a tax on tires and inner tubes sold by the manufacturer, producer, or importer. Section 618 of the Act provides that:

For the purposes of this title, the lease of an article shall be considered the sale of such article.

The questions on which an opinion is requested are as follows:

Question 1. Should these contracts be considered sales contracts or leases?

Question 2. How should the tax be computed?

Question 3. What are the answers where a similar contract was entered into prior to May 1, 1932, and is still in force?

Question 4. Should the tax fall upon the tire manufacturer or the lessee?

The word "lease" is broad in its scope. Some of the definitions embodied in court decisions are as follows:

A lease is nothing but a contract, and is governed by the same rules that other contracts are. (*Hinsdale* v. *McCune*, 135 Ia., 682, 113 N. W., 478.)

A lease is a contract by which one person divests himself, and another takes the possession of, lands or chattels for a term, whether long or short. (Wood Landl. & Ten., section 203.)

The word "lease" has a settled technical import. It imports a contract by which one person, either natural or artificial, divests himself or itself of, and another person takes possession of, lands or chattels for a term. (*Moorshead* v. *United Railways Co.*, 96 S. W., 261, 272, 203 Mo., 121.)

Other cases have defined a lease as a grant of the use and possession, in consideration of something to be rendered. (35 C. J., 1140, citing *Coney Island Co.* v. *McIntyre-Paxton Co.*, 200 Fed., 901.)

It is necessary to the relation of landlord and tenant that a reversionary interest remain in the landlord, a conveyance of the landlord's entire term being an assignment rather than a lease. * * * although it has been held that the conventional relationship of landlord and tenant may arise under a conveyance in fee reserving to the grantor a perpetual rent with a right of reentry on default of payment. (35 C. J., 952, section 5, citing *Kavanaugh* v. *Cohoes Power, etc., Corp.*, 114 Misc., 590, 187 N. Y. Supp., 216.)

The word "lease" is, by common use, applied to certain kinds of contracts, some of which amount to a conditional sale and others to a bailment for use, under which goods are delivered by one person to another. (*Cadwallader* v. *Wagner* (Pa.), 7 Kulp, 465, 466.)

These definitions support the view that tires delivered under the contracts in question are leased. It is evident that the possession of the equipment by the bus companies constitutes a bailment for use. The fact that the objects of the bailment, tires and tubes, are subject to exhaustion or consumption in use would make no difference in principle. There is little personal property which is not consumed or worn out by use during a long or short period. The fact that it will be necessary, under the contracts in the instant case, to supply new articles as the old ones wear out makes no difference in the application of the rule. It is still true that while the tires and tubes are in use they are held by the bus company under a bailment for use and that the manufacturers of the tires and tubes retain title thereto.

The bailments accomplished by the contracts in question are within the purpose of the statute. The tax is primarily on sales. Leases were also made taxable because of their similarity to sales. On page 41 of Senate Report No. 398, relative to the Revenue Act of 1924, it is said:

Section 704(a): Since bailors frequently dispose of goods under a form of contract termed a "lease," which in reality is a contract for a sale with payment by installments, it has been expressly provided that the tax herein levied applies to such transactions.

Section 618 of the Revenue Act of 1932 provides that for the purposes of Title IV the lease of an article shall be considered to be the sale of such article. On page 44 of Senate Report No. 665, relating to that measure, it is stated that the foregoing section was retained in the law so that the tax could not be evaded by a lease contract which does not involve passage of title.

The transactions in the instant case may also be viewed as contracts for the sale of tires with payment by installments measured by the mileage covered. By the contracts in question the parties get practically the same results that sales would produce. The bus company gets the use of the equipment and the manufacturer receives a money compensation approximating, it may be assumed, the sale price of the equipment.

It is urged, as a reason for holding that the contracts under which the tires are delivered are not leases, that ordinarily a lease covers

a specific property, whereas such contracts do not specify any particular property. It is true that the particular tires delivered are not specified in the contracts but they are nevertheless identified. It is the practice of manufacturers of tires to place serial numbers thereon. Identification of the tires must be necessary in order to execute the terms of the contracts.

But even if the tires delivered were not identified, such circumstance could not change the status of the articles otherwise existing as subjects of lease. It would still be true that, under agreement, articles belonging to one person had been delivered to another for the latter's use over a considerable period of time in consideration of payments passing from the bailee to the bailor. This seems sufficient to constitute a lease.

It is the opinion of this office that tires and tubes covered by the contracts are leased within the intent of the Revenue Act and are taxable. This answers the first question. The answers to the second and fourth questions are indicated by S. T. 496 (C. B. XI-2, 455). It is stated therein:

> The tax on tires and tubes supplied under a mileage contract is incurred at the time when such tires and tubes are delivered by the tire manufacturer to his customer and should be computed on the full weight of such articles.

The tax is on the manufacturer. The answers thus indicated by S. T. 496 are, in the opinion of this office, correct.

The provision of section 625(a) of the Act, as amended, making the vendee, rather than the vendor, liable for the tax in certain contingencies, applies only where the contract made prior to May 1, 1932, neither permits nor prohibits addition of the tax to the amount to be paid under the contract. The contract form of the Y Tire & Rubber Co. specially provides on its face that any tax on the tires shall be assumed, paid, or reimbursed by the operating company. In the case of the X Rubber Co. the same result is achieved by a rider attached to the printed form. Under these conditions of the contracts section 625(a) does not operate, and, therefore, the manufacturers are required to pay the tax due to the collector. The matter of reimbursement for the tax is one for adjustment between the parties.

C. M. Charest,
General Counsel, Bureau of Internal Revenue.

Regulations 46, Article 19: Scope of tax. XII-11-6072
S. T. 648

Taxability of retreaded and rebuilt tires.

Advice is requested whether retreaded and rebuilt tires are subject to the tax imposed by section 602 of the Revenue Act of 1932.

The X Company purchases used tires from which the old rubber, tread, and side walls (including the name) are buffed off; the carcasses are then retreaded or rebuilt by the use of new and/or reclaimed rubber and sold under various trade names, marked "Retreaded" on the side walls as a protection against any claim by the purchaser that they were sold as "new" tires. The old tires lose their identity in the process of retreading or rebuilding. Other used tires are retreated by merely resurfacing or replacing the actual tread

down to the tread line, the side walls showing the original name and the serial number not being disturbed.

The test of taxability where old material or material partly old and partly new is used in producing a tire suitable for use is whether the work done constitutes the manufacture of a tire or is merely a repair job. If the former, the tax is legally due. If the latter, no tax is involved. It is held that where the identity of the old tire is lost in the process the manufacture of a taxable tire results.

For example, where old tires are rebuilt from old carcasses by the use of either raw or reclaimed rubber, to the extent that the tires so produced are not identifiable as the original tires, they are subject to tax when sold, on the basis of the full weight thereof, as provided by section 602 of the Revenue Act of 1932.

Where tires are retreaded or rebuilt to order for customers who retain title to the old tires or carcasses, the person retreading the tires is not subject to tax.

The retreading of old tires by resurfacing or replacement of the actual tread down to the tread line, without altering the side walls or destroying the original identity of the tire, does not constitute the manufacture of a taxable article.

REGULATIONS 46, ARTICLE 19: Scope of tax. XII-17-6147
S. T. 660

Distinction between tires and imitations.

Advice is requested relative to the taxability of imitations of tires under section 602 of the Revenue Act of 1932.

The term "tire" is defined in Webster's New International Dictionary as "A hoop or band forming the tread of a vehicle wheel." It is believed that this is the meaning which Congress intended by its use of the term. The term "vehicle" is defined as that in or on which any person or thing is or may be carried. In *Stevenson* v. *United States Express Co.* (221 Pa., 59, 70 Atl., 275) the court held that wheeled or rolling chairs are vehicles. In *Conder* v. *Griffith* (61 Ind. App., 218, 111 N. E., 816) the court held that "A 'vehicle' is any carriage or conveyance used or capable of being used as a means of transportation on land * * *."

It is held that a tire is a rubber hoop or band which fits or forms the tread for the wheel of any article which is capable of use as a means for transporting any person or burden, including molded tires as well as those made from rubber tiring. Small articles, commonly referred to as toys, but which are so constructed that they may carry a child, are deemed to be vehicles, and tires therefor are taxable. An example of such a vehicle is a toy dump truck, 2 feet long and 10 inches high, upon which is mounted a seat so that a child may ride it. Examples of other vehicles are wheel chairs, tea tables, doll carriages, scooters, velocipedes, tricycles, baby walkers, bassinets, industrial trucks of either the push or motor-driven type, boy's wagons, wheelbarrows, and similar articles. Tires attached to any of these vehicles are taxable. However, the term "vehicle" does not include imitations of vehicles which by their construction or design are not suitable as a means of transportation. For example, miniature toys of cast iron, tin, wood, or other mate-

rial which are pulled with a string by children are not vehicles and tires therefor are not subject to tax.

Tires which may be used both on vehicles and on articles which are not vehicles are nevertheless subject to the tax, even though they have this dual use.

REGULATIONS 46, ARTICLE 19: Scope of tax. XII-17-6148
S. T. 661

Taxability of tires made in part of rubber.

Advice is requested concerning the taxability under section 602 of the Revenue Act of 1932 of tires made in part of rubber.

The tax imposed by section 602 of the Revenue Act of 1932 attaches to the manufacturer's sales or use, after the effective date of the Act, of completely manufactured tires made wholly or in part of rubber. The tax on use attaches when such tires are placed upon the vehicle. Tires placed upon vehicles by the tire manufacturer prior to the effective date of the Act are not subject to the tax imposed by section 602. Tires placed for the first time upon a vehicle by the tire manufacturer after the effective date of the Act are subject to the tax regardless of the actual date of manufacture.

Tires which are constructed so that by inserting a wire into a length of rubber tiring the ends may be fastened together are not completely manufactured before assembly, nor do they become taxable until the wire is inserted. The person who produces tires by so combining the wire and tiring is the manufacturer of the tire and is liable for the tax upon his sale or use thereof.

The wire used in the manner indicated becomes an integral and necessary part of the tire and, consequently, the weight thereof should be included in computing the tax. In such a case if the wire were removed the article would not be a tire but would become merely a length of rubber tiring which the Bureau holds is raw material and not subject to tax.

The language of section 602 of the Revenue Act of 1932 clearly warrants the view that where wire is used in this type of tire both commodities must be combined in computing the tax due. The tax is imposed upon "tires wholly or in part of rubber." However, provision is made in the statute for the exclusion of metal rims and rim bases. It was a matter of common knowledge at the time this legislation was under consideration that pneumatic tires were almost invariably made with wire cables imbedded in the bead of such tires, and if Congress had intended to exempt the weight of such wire cables or the wire used in solid tires language indicating that intention would have been adopted.

Wire, as such, is not subject to the tax but, as already indicated, where a piece of wire constitutes an integral part of a tire composed in part of rubber, the tax must be computed upon the total weight of the tire, including any such material as wire, staples, darts, clips, or other material or fastening device which forms a part of the tire or is required for its use. Where the length of rubber tiring is merely cemented to the wheel or to a metal rim, the weight of such wheel or rim should not be included in computing the tax, due to the fact that section 602 of the Revenue Act of 1932 expressly excludes from the tax metal rims or rim bases.

SECTIONS 602 AND 606.—TIRES AND TUBES, AUTOMOBILES, ETC.

REGULATIONS 46, ARTICLES 19 AND 36: Scope of tax. XII-3-5994
S. T. 626

Taxability of fire-fighting apparatus and equipment.

Fire trucks and fire-fighting apparatus are not in themselves subject to tax under the Revenue Act of 1932. However, the tires used thereon, as well as spark plugs, storage batteries, leaf springs, coils, timers, and tire chains, unless purchased direct from the manufacturers thereof by a State or its political subdivision, are *not exempt* from tax. They are specifically taxed by sections 602 and 606(c) of the Revenue Act of 1932.

SECTION 603.—TOILET PREPARATIONS, ETC.

REGULATIONS 46, ARTICLE 4: Who is a manufacturer or producer. XII-9-6052
G. C. M. 11522

An opinion is requested relative to who should be regarded as the manufacturer within the meaning of the law imposing the tax on toilet preparations.

The X Company makes retail sales of toilet preparations by mail, a majority of the articles handled by the company being actually produced by the Y Company. The X Company does not have a set form of carrying on its business with the Y Company. However, its transactions with the Y Company may be generally classified as follows:

1. In some cases the X Company provides the Y Company with containers. The X Company retains title to these containers and the Y Company packs the articles it manufactures in the containers for the X Company. No charge is made for the containers.

2. In other cases the X Company purchases material in bulk from the Y Company and then repacks the bulk material into smaller packages.

3. In a third class of cases the X Company furnishes the Y Company with ingredients for the finished material and/or with containers for the packaging of the finished material.

The Bureau has held heretofore that in each of these instances the X Company was the manufacturer of the taxable article and that, therefore, the tax should be computed on its sales.

In holding the X Company to be the manufacturer under the first class of cases, particular stress was laid on that portion of section 619 of the Revenue Act of 1932 which provides:

> (a) In determining, for the purpose of this title, the price for which an article is sold, there shall be included *any charge for coverings and containers of whatever nature* * * *. [Italics supplied.]

Predicated on the presumption that the furnishing of containers is the furnishing of material to be used in the manufacture of a taxable article, and further relying on the above-quoted language of section 619, which in effect provides that in determining the sales price there shall be included any charge for containers of whatever

nature, it was concluded that the X Company should be regarded as the manufacturer. Upon further consideration it is not now believed that section 619 in any way affects the general issue of "who is the manufacturer." The furnishing of a glass jar in which the manufacturer of a taxable article places such article is in no way related to the furnishing of one of the component materials used in the manufacture or production of the taxable article. While section 619 does provide that in determining the sales price there shall be included "*any charge for the containers*," the situation presented in the instant case is not one where a charge is made for the containers. That portion of section 619 referred to was placed in the law for the purpose of preventing a manufacturer from billing the taxable article and the containers separately and computing the tax upon the basis of the selling price of the article alone.

Accordingly, this office is of the opinion that, under the circumstances stated in the first class of cases mentioned, the Y Company is the manufacturer and not the X Company, which merely furnished the containers in which the Y Company placed the taxable article.

With reference to the second class of cases, the Bureau, as stated above, took the position that where the X Company purchases material in bulk from the Y Company and repacks the bulk material into smaller packages, the X Company is the manufacturer. Article II of Regulations 44, issued under the Revenue Act of 1917, contains the following language:

> * * * A "manufacturer" is a person who prepares an article in final marketable form and sells or markets it. If goods partly manufactured by one person are further manufactured by another before being marketed to consumers for use, the latter is the manufacturer for the purpose of the tax. This applies, for example, to bulk goods that require to be bottled or otherwise prepared in order to put them into salable condition. * * *

Article 5 of Regulations 52, under the Revenue Act of 1918, repudiated that portion of Article II of Regulations 44, hereinbefore quoted, and provided in substance that if "A" manufactured a beverage and sold it to "B" in a form suitable for sale as a beverage, without further process of manufacture, and "B" bottled the beverage prior to its resale, the taxable sale was the one made by "A." This example appears to be practically identical with the class of cases now being considered. Under this provision, where the Y Company sells a toilet preparation complete as to its component parts and ready to be used as a toilet preparation, within the meaning of article 5 of Regulations 52 of the Revenue Act of 1918, the taxable transaction is the sale by the Y Company.

Neither the definition of the manufacturer contained in article 7 of Regulations 47, 1919 edition, nor the definition contained in article 7 of Regulations 47, revised December, 1920, in any way invalidates the statement contained in article 5 of Regulations 52 of the Revenue Act of 1918. Article 7 of Regulations 47, revised in 1920, contains the following general definition:

> A manufacturer is generally a person who (1) actually makes a taxable article, or (2) by changes in the form of an article produces a taxable article, or (3) by the combination of two or more articles produces a taxable article. * * *

Article 7 of Regulations 47, revised December, 1921, article 7 of Regulations 47, revised August, 1924, article 6 of Regulations 47,

revised March, 1926, and article 6 of Regulations 47, revised October, 1928, contain a similar statement.

Article 4 of Regulations 46, relating to the manufacturers' excise taxes under the Revenue Act of 1932, provides:

> As used in the Act, the term "producer" includes a person who produces a taxable article by processing, manipulating, or changing the form of an article, or produces a taxable article by combining or assembling two or more articles.
>
> Under certain circumstances, as where a person manufactures or produces a taxable article for a person who furnishes materials and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.
>
> A manufacturer who sells a taxable article in a knockdown condition, but complete as to all component parts, shall be liable for the tax under Title IV and not the person who buys and assembles a taxable article from such component parts.

From the foregoing it appears that the only justification for holding that the X Company is a manufacturer where it purchases bulk material complete as to its component parts and repackages the same is Article II of Regulations 44, supra, and section 619 of the Revenue Act of 1932. Subsequent to the promulgation of Regulations 44 under the Revenue Act of 1917, the Treasury Department has issued eight separate regulations, each containing a definition or definitions of "who is the manufacturer or producer." Beginning in article 7 of Regulations 47, revised in 1920, the Bureau has generally defined a manufacturer to be a person who actually makes a taxable article, or by changes in the form of the article produces a taxable article, or by the combination of two or more articles produces a taxable article. In the second class of cases under consideration, the X Company does not manufacture a taxable article, change the form so as to produce a taxable article, or combine two articles into a taxable article. As hereinbefore pointed out, section 619 deals merely with computation of the sales price and can lend no weight in deciding who is the manufacturer.

In view of the foregoing, it is the opinion of this office that the purchase of bulk material by the X Company and the repackaging and sale thereof by it does not constitute the further manufacture of a taxable article by the X Company.

In the third class of cases the X Company furnishes the Y Company with ingredients going into the finished material and with containers for the packaging of the finished material. Here the X Company should be considered the manufacturer. This conclusion is based on the view that the person who furnishes the ingredients, which are a component part of the taxable article, to the physical manufacturer actually controls the manufacturing process. However, a container is not a component part of the taxable article and, as hereinbefore pointed out, the mere furnishing of containers by the X Company would not make that company liable for the manufacturers' excise tax.

All previous rulings, in so far as inconsistent with the foregoing opinion, are hereby revoked.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

REGULATIONS 46, ARTICLE 22: Scope of tax. XII-13-6101
S. T. 655

Tests of taxability of articles having dual uses.

The question presented concerns the tests of taxability under section 603 of the Revenue Act of 1932 of two products sold under the trade names of "X" and "Y."

The product "X" is admittedly taxable under section 603 of the Act, being advertised and held out for specific use as a mouth wash and also for general use as a toilet preparation after shaving, as a remedy for loose dandruff, as a gargle, and as a deodorant. It is contended that the chief use of "X" is as a mouth wash. The question presented is whether it should be taxable under the statute at the 5 per cent rate as a mouth wash or at the 10 per cent rate as a toilet preparation.

Section 603 of the Revenue Act of 1932 imposes a tax of 10 per cent on the price for which the manufacturer, producer, or importer sells certain enumerated articles and any similar substances, articles, or preparations by whatever name known or distinguished, "which are used or applied or intended to be used or applied for toilet purposes," except that the rate of tax is 5 per cent in the case of tooth and mouth washes, dentifrices, tooth pastes, and toilet soaps.

In deciding whether certain imported articles were dutiable under the tariff laws which imposed duties according to the use of an article, the courts have taken the position that where an article is subject to more than one classification and different tariff rates are applicable to the different classifications, the chief use is the criterion of its classification. (See *Magone* v. *Wiederer*, 159 U. S., 555; *Hartranft* v. *Langfeld*, 125 U. S., 128; *Robertson* v. *Edelhoff*, 132 U. S., 614; *Walker* v. *Seeberger*, 149 U. S., 541; *Hartranft* v. *Meyer*, 149 U. S., 544; and *Smith* v. *U. S.* (C. C. A. Second Circuit), 93 Fed., 194).

In the last-named case the article under consideration was called "crocus," used chiefly as a polishing powder but to some extent as a painter's color. Painter's colors were dutiable and polishing powders were not. It was contended on behalf of the importer that the "chief use" rule was applicable and that the article was not dutiable if the rule applied. The court held the article dutiable as painter's colors, saying in part:

> If the importations were not capable of use as colors, they would not be dutiable * * * because they would not have been colors in fact. But because they were adapted also for some other use, though that were the predominant use, they were none the less colors. The test of predominant use is only resorted to in those cases where it is necessary to find the proper location of a dutiable article which falls within two or more classifications, either of which, standing alone, would adequately describe it, and in those cases in which an article is enumerated by reference to its use. Thus, if a duty were imposed by the Act upon "polishing powder," and another upon "colors," and there were no other provisions indicative of the legislative intent, the importations now in controversy would be described by both, and it would be appropriate to resort to that test; and, because the predominant use of crocus is as a polishing powder, it would be more appropriately located for duty under that provision.

The tax imposed by section 603 is applicable generally to toilet preparations and specifically to mouth washes at the rates of 10 per cent and 5 per cent, respectively, the test of taxability under that

section being the use or intended use of a product. Where an excise tax is imposed according to the use of the article, as under section 603, the principles enunciated in the customs cases cited may be considered as controlling, if there be no other laws or extraneous facts warranting a disregard of those principles. The product "X" must, therefore, be classified according to its chief use in order to determine the rate of tax applicable. If its chief use is as a mouth wash, the product will be subject to tax at the 5 per cent rate, but if the chief use is for other toilet purposes, tax at the 10 per cent rate is applicable. The burden of establishing the chief use of an article, preparation, or substance falls upon the manufacturer, producer, or importer, where it may be taxable under one of two or more provisions in the law.

The second product under consideration, referred to as "Y," is advertised and held out for a number of uses more or less of a medicinal nature. It is also held out for such toilet purposes as being suitable for use after shaving and for tired feet. It is alleged that the chief use of "Y" is as a medicine and that it is, therefore, not taxable. However, it is also advertised, held out, used, and intended to be used for toilet purposes. It has a wide medicinal use but is also used as a toilet preparation within the meaning of section 603. Under this dual use, the question arises as to whether the medicinal or the toilet use should govern in determining its classification.

Referring again to the doctrine of chief use as applied by the courts in construing tariff laws, the cases of *Smith* v. *U. S.*, supra, and *Dodge & Olcott* v. *U. S.* (130 Fed., 624) support the view that if an article comes under a general class enumerated in the tariff Act as dutiable according to its use, the duty will be imposed, even though the use under the classification is minor and the predominant or chief use would place it on the free list. The Dodge case arose under a tariff Act which imposed a duty on "medicinal preparations." In that case the court used the following language:

> * * * It is very true that by far the largest use of these articles is not for such medicinal purposes. It is true that in many decisions the rule has been followed that an article is to be classified for duty according to its predominant use. In all those cases, however, so far as I recollect them and so far as they have been cited here, the question arose upon an apparent double enumeration of an article in the tariff, as to where it should be placed, and that question was determined by the predominant use. * * *

The court, after reviewing the identical cases relied on by the taxpayer in this case relative to chief use, then continued:

> * * * I do not find in these decisions authority for the proposition that where an article is enumerated, either specially or generally, only once in the enumerating paragraphs of the tariff, it is to be held to be a nonenumerated article simply because it is used comparatively little for the purposes described in the enumerating clause * * *.

It is evident from the customs decisions cited above that the "chief use" rule is applied by the courts only in cases where the rate of duty is to be determined in connection with an article described in two or more classifications in the tariff law and is not applied in determining whether an article is or is not subject to tariff duty.

The rule so established under those customs cases is applicable to questions of the same character arising under the revenue laws in all cases in which use is the test of taxability. In this connection article 22 of Regulations 46, relating to the tax imposed by section 603 of the Revenue Act of 1932, provides in part:

* * * The fact that any particular product, preparation, or substance coming within the scope of the Act may have, or be held out to have, a medicinal, stimulating, remedial, or curative value does not exempt it from the tax, if it is commonly used as an adjunct to the toilet or for toilet purposes.

Even though the product "Y" has a primary use as a medicine, the fact that it is also held out and used, or intended to be used, for toilet purposes, even in a minor degree, warrants the conclusion that it is also a toilet preparation within the meaning of the law. Consequently, it is subject to the tax imposed by section 603 of the Revenue Act of 1932 at the rate of 10 per cent of the price for which sold by the manufacturer, producer, or importer.

SECTION 604.—FURS.

REGULATIONS 46, ARTICLE 24: Scope of tax. XII–5–6014
T. D. 4361

Tax on furs—Section 604 of the Revenue Act of 1932.—Article 24 of Regulations 46 amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 24 of Regulations 46, approved June 18, 1932, is hereby amended to read as follows:

ART. 24. *Scope of tax.*—The tax is imposed upon the sale by the manufacturer of (1) articles made of fur on the hide or pelt and (2) articles of which fur on the hide or pelt is the component material of chief value.

The tax is not confined to the sale of articles of fur used as wearing apparel but also attaches to articles susceptible of other uses, such as rugs, robes, etc. Raw fur is not subject to the tax.

The tax attaches to the sale by the manufacturer of any article if such article is made of fur on the hide or pelt, or if the component material of chief value of such article is fur on the hide or pelt. To determine whether fur is the component material of chief value, the respective values of the various materials, including the fur, should be compared. The comparison should be made immediately prior to the assembling of the materials after they have been completely prepared and nothing remains to be done to make the completed article except assembling the component parts. Labor charges for assembling the fur or other materials shall not be taken into consideration in determining the value of the fur or other materials. If the fur is not exceeded in value by any other single material, the fur is considered the component material of chief value and the sale price of the completed article is subject to the tax.

In the case of fur-lined gloves, the value of the fur lining at the time it is ready for assembly with a leather shell or other outer casing, shall be compared with the value of such leather shell or outer casing immediately prior to assembly with the fur lining. The tax will attach to the sale of the completed glove if it is found that the value of the fur lining exceeds the value of the leather shell or casing immediately prior to assembly.

Fur collars, fur cuffs, fur trimmings, fur linings for gloves and similar completed articles of fur are taxable when sold by the manufacturer thereof even though to be incorporated into other articles of which fur is not the component material of chief value. (For credit provisions see articles 26 and 71.)

DAVID BURNET,
Commissioner of Internal Revenue.

Approved January 25, 1933.
OGDEN L. MILLS,
Secretary of the Treasury.

REGULATIONS 46, ARTICLE 25: Repairs. XII-8-6040
S. T. 639

Taxability of fur used in repair work.

Where new fur is used in repair work, the sale price of the new fur so used is subject to the tax imposed by section 604 of the Revenue Act of 1932.

The price paid for the repair job will be presumed to be the price for which the fur is sold unless the price of the fur is billed separately from the charges for labor and other materials. Where the price attributable to the new fur is properly invoiced on the customer's bill as well as on the repairer's records and books of account as a separate item the tax attaches to the sale price of the new fur only.

For the purpose of ascertaining whether fur used in repair work is taxable, new fur is deemed to be that which is not a part of the garment repaired nor fur furnished by the owner of the garment but has reference to any fur supplied by the repairer irrespective of whether previously used in another garment or purchased unused from a manufacturer.

SECTION 605.—JEWELRY, ETC.

REGULATIONS 46, ARTICLE 28: Scope of tax. XII-8-6041
S. T. 640

Articles made of semiprecious stones.

Advice is requested concerning the taxability, under section 605 of the Revenue Act of 1932, of ash trays and similar articles made of semiprecious stones.

The tax attaches to all precious or semiprecious stones, whether real or imitation, cut or uncut, whether drilled, mounted, matched, or carved, and regardless of whether the articles produced are classifiable as articles of jewelry.

Therefore, ash trays and similar articles made of semiprecious stones are subject to the tax when sold by the manufacturers, producers, or importers thereof for $3 or more.

The tax attaches to all sales of such articles made of semiprecious stones or imitations thereof, regardless of whether they are subject to duty under the customs laws.

REGULATIONS 46, ARTICLE 31: Articles other than jewelry, made of, or ornamented, mounted, or fitted with, precious metals or imitations thereof, or ivory.

XII-14-6116
G. C. M. 11660

Taxability of articles plated with precious metal.

An opinion is requested whether articles within the scope of section 605 of the Revenue Act of 1932 are subject to the tax imposed thereunder when ornamented, mounted, or fitted with precious metals or imitations thereof by the electrolytic and other plating processes.

Article 31 of Regulations 46 provides, in part, as follows:

> The term "precious metals" includes platinum, gold, or silver, and other metals of similar or greater value. The term "imitations thereof" includes platings (except in the case of silver-plated ware) and alloys of such metals. In order that an article may be subject to the tax by reason of its ornamentation with precious metal, etc., such ornamentation must be *substantial;* for example, glassware, china, pottery, and like articles would be subject to the tax if gold or silver is used in their ornamentation as a filigree, but the mere gilding of such articles or their decoration by means of gold leaf or silver leaf would not bring them within the taxable class. Picture frames and books are not subject to the tax merely by reason of adornment with gilt or gold leaf or silver leaf. [Italics supplied.]

The provision that the ornamentation must be substantial can not be construed to mean that plated articles, other than silver-plated ware, will be exempt from tax. The use of the word "substantial" is intended to exclude from the taxing provisions articles having a slight ornamentation, such as the gilded articles enumerated in the regulations. The ornamentation upon such articles is not plating. Gold leaf and silver leaf are in the nature of gold paint. Articles so treated may be said to be "gilded" rather than "plated." It will be noted that if an article is actually ornamented with precious metals, such as gold filigree or any other precious metal, it nevertheless will be subject to tax if the article itself is within the scope of the law.

For convenience gold only is referred to, but what is here said applies equally to platings of all precious metals, except silver-plated ware. The Bureau of Standards advises that gold is usually placed upon articles by three different processes known as (1) the cyanide gold bath, (2) the cyanide gold bath with an electric current passed through, known as electroplating, and (3) welding or soldering.

These processes are referred to by various terms, but the fact that coatings of precious metal may sometimes be called a gold dip, gold flash, or gold wash does not exclude them from classification as platings. The technical terms are merely descriptive of the process of plating. Welded or soldered articles usually have more precious metal upon them than articles treated by the other plating processes, but neither the law nor the regulations make a distinction as to the thickness of plating required to produce an article which is an imitation of precious metal.

For these reasons, it is the opinion of this office that all articles plated with precious metal (other than silver-plated ware), irrespective of the thickness of the plating, are taxable when sold by the manufacturer, producer, or importer for $3 or more.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

REGULATIONS 46, ARTICLE 33: Opera glasses, lorgnettes, marine glasses, field glasses, and binoculars. XII-14-6117 S. T. 657

Taxability of telescopes.

Advice is requested whether telescopes are taxable under section 605 of the Revenue Act of 1932.

Section 605 of the Revenue Act of 1932 imposes a tax on opera glasses, lorgnettes, marine glasses, field glasses, and binoculars when sold by the manufacturer, producer, or importer thereof for $3 or more.

Portable telescopes come within the classes of articles specified in the law and are, therefore, subject to the tax when sold by the manufacturer, producer, or importer thereof for $3 or more. However, telescopes, which by reason of their size or weight are ordinarily mounted upon tripods or other bases, are not subject to the tax imposed by section 605.

REGULATIONS 46, ARTICLE 35: Rate of tax. (Also Section 619(b), Regulations 46, Article 15.) XI-21-6194 S. T. 672

Fair market price of school class rings and pins.

Advice is requested concerning the fair market price of school class rings and pins under section 619 of the Revenue Act of 1932, to be used in determining liability for tax under section 605 of that Act.

After careful consideration of the data submitted, including the results of a field investigation, the Bureau has determined that 67 per cent of the retail sales price of such school class rings and pins represents the fair market price thereof under section 619 for the purpose of computing the tax under section 605 of the Revenue Act of 1932, except as otherwise hereinafter indicated.

The foregoing ruling is to be applied only in cases (1) where the manufacturer, producer, or importer of school class rings and pins sells such articles only at retail and where no sales of the same or similar articles are made by other manufacturers, producers, or importers at wholesale (or through jobbers or retail dealers): and (2) where, under (1) above, the total amount of materials and supplies, direct labor, overhead, and such portions of the selling and administrative expenses as are ordinarily applicable to sales at wholesale, plus a reasonable profit thereon, is less than 67 per cent of the retail sales price of such articles.

Where a manufacturer of class rings and pins sells such articles at wholesale, as well as at retail, the taxable price of the respective articles sold at wholesale will be the actual price for which sold, whereas, with respect to the sale of such articles at retail, the taxable price will be the price for which the same or similar articles are ordinarily sold by him in the smallest wholesale lots (which price is usually the highest wholesale price obtained by such manufacturer).

Where a manufacturer, producer, or importer has no sales of such articles at wholesale and similar articles are not sold at whole-

sale by other manufacturers, producers, or importers thereof, and the total amount of materials and supplies, direct labor, overhead, and such portions of the selling and administrative expenses as are applicable to sales at wholesale, plus a reasonable profit thereon, exceeds 67 per cent of the retail sales price, then such manufacturer, producer, or importer must compute the tax on the total of such items and not on the basis of 67 per cent of such retail sales price.

Where the manufacturer's fair market price so determined is less than $3, no tax will attach under section 605 of the Revenue Act of 1932.

SECTION 606.—AUTOMOBILES, ETC.

REGULATIONS 46, ARTICLE 41: Definition of parts or accessories. XII–16–6138 S. T. 659

Automobile parts and accessories distinguished from commercial commodities and raw materials.

Advice is requested concerning the taxability of certain articles under section 606 of the Revenue Act of 1932 as parts or accessories.

Article 41 of Regulations 46 provides in part as follows:

> The term "parts or accessories" for an automobile truck or other automobile chassis or body, or motor cycle, includes (*a*) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article, (*b*) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, or (*c*) any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.

The major parts of an automobile chassis, such as the frame, engine, wheels, axles, springs, transmission, steering gear, and electrical units, are primarily designed and adapted for use on automobiles, and are actually so used. The major parts of an automobile chassis, when sold by the manufacturer, producer, or importer, are, therefore, clearly taxable under the law and regulations. Likewise, major body parts are taxable. The regulations make no distinction between parts and accessories and any statement made relative to parts is deemed to apply equally to accessories. In the case of the *Universal Battery Co. et al.* v. *United States* (281 U. S., 580, Ct. D. 220, C. B. IX–2, 422) the Supreme Court had occasion to decide the taxability of a part of an automobile part. In its decision the court used the following language:

> * * * the articles sold were gears, flexible shafts and flexible housings, all being replacement parts for speedometers used on motor vehicles. It is conceded that speedometers are accessories; but it is insisted that parts of a speedometer can not be such. We think they can. The finding is that these parts were specially designed, manufactured and sold for use on automobiles and are not adapted to any other purpose or use. It is not questioned that when sold they had reached such a stage of manufacture that they were adapted for ready replacement and use; so it is not as if the process of manufacture were not complete. A speedometer consists of distinct and separate parts, and we perceive no reason why one or more of these when manufactured and sold for the purpose shown by the finding should not take the same classification as speedometers. * * *

The conclusion reached by the court with respect to speedometers and parts thereof applies with equal force to parts or accessories for engines, axles, steering gears, etc., used on automobiles. All such

articles are, therefore, taxable. However, this rule does not apply to articles which are not primarily either parts or accessories but are general commercial commodities or raw materials.

The term "commercial commodities" includes such articles as ball and roller bearings, bolts (except shackle and king bolts), nuts, washers, screws, nails, tacks, rivets, pins, studs, cotters, pipe fittings such as plugs, tees, ells, and elbows, drain cocks, grease cups, oilers, etc.

The term "raw material" includes such articles as cloth, leather, matting, linoleum, and similar articles sold by the yard; also materials sold in rolls or by the foot, such as brake lining, antisqueak, tape, binding, wires, cables, tubing (both metal and rubber), packing, conduits, etc.

The foregoing enumeration of commercial commodities and raw material is given merely for the purpose of illustration and is not intended to be exhaustive.

SECTION 607.—RADIO RECEIVING SETS, ETC.

REGULATIONS 46, ARTICLE 44: Scope of tax. XII–9–6053
S. T. 643

Taxability of automobile radio receiving sets.

Advice is requested whether automobile radio sets sold by a manufacturer are subject to the tax imposed by section 606 or by section 607 of the Revenue Act of 1932 when sold to an automobile manufacturer or to a dealer.

Automobile radio sets specially designed and primarily adapted for use in automobiles are considered automobile accessories within the meaning of section 606(c) of the Revenue Act of 1932 and are taxable, when sold by the manufacturer, at the rate of 2 per cent under that section, instead of at the rate of 5 per cent under section 607, imposing a tax on certain component parts of radio receiving sets.

Under section 606(c) of the Act such radio receiving sets may be sold free of tax to a manufacturer of automobiles, who becomes liable for the tax in the same manner as the manufacturer if the sets are resold by him otherwise than on or in connection with, or with the sale of, taxable automobiles.

In view of the provisions of section 620 of the Revenue Act of 1932, a manufacturer or assembler of such automobile radio sets may purchase taxable radio chassis, cabinets, tubes, reproducing units, or power packs tax free from the manufacturer thereof, for use as parts of such sets only, provided he furnishes with his purchase order an exemption certificate, in the form prescribed in article 7 of Regulations 46 of the Revenue Act of 1932, to the effect that such articles are purchased for use as material in the manufacture or production of an article by the purchaser which will be taxable under Title IV or sold free of tax by virtue of section 620 of the Revenue Act of 1932. If radio chassis, cabinets, tubes, reproducing units, or power packs purchased tax free under such a certificate are resold by the vendee otherwise than as parts of radio receiving sets specially designed and primarily adapted for use in automobiles, such resale is taxable under section 607 as if made by the manufacturer or producer.

REGULATIONS 46, ARTICLE 44: Scope of tax. XII-11-6073
S. T. 649

Taxability of radio receiving sets suitable for receiving code messages only.

Advice is requested concerning the taxability, under section 607 of the Revenue Act of 1932, of radio receiving sets manufactured by the X Company, which are suitable for receiving by code only.

The tax imposed by section 607 of the Revenue Act of 1932 attaches to the sale by the manufacturer of all chassis, cabinets, tubes, reproducing units, and power packs suitable for use in connection with or as part of radio receiving sets or combination radio and phonograph sets.

Article 44 of Regulations 46, relating in part to the tax imposed under section 607, provides that the tax attaches to the sale by the manufacturer of the articles enumerated in section 607 if such articles are suitable for use in connection with or as part of a radio receiving set, regardless of the actual use of such articles.

It does not appear from a review of the legislative history of the section that there may be attributed to Congress an intent to distinguish the component parts of radio receiving sets designed for the home reception of broadcast programs from the component parts of radio receiving sets designed solely for the reception of code messages. If Congress had intended to have the tax apply only in the case of radio receiving sets designed for home use it must be presumed that the proper language to express this intention would have been used. For example, in section 608 of the Revenue Act of 1932, relating to the tax on mechanical refrigerators, it is specifically provided that the tax shall be applicable to "household type" refrigerators, although component parts suitable for use in household type refrigerators may be sold tax-free to manufacturers of any type of refrigerators or refrigerating or cooling apparatus.

It is held that the tax imposed by section 607 of the Revenue Act of 1932 is applicable to the articles specified therein, even though such articles are actually used in the assembly of radio receiving sets designed solely for the reception of code messages.

REGULATIONS 46, ARTICLE 45: Radio apparatus. XII-4-6003
S. T. 629

Sales of radio components under exemption certificates. Definition of chassis, reproducing units, and power packs.

Advice is requested whether sales of radio components may be made under exemption certificates and also as to the definition of chassis, reproducing units, and power packs.

Section 607 of the Revenue Act of 1932 imposes a tax, not on radio receiving sets, but on chassis, cabinets, tubes, reproducing units, power packs, and phonograph mechanisms suitable for use in connection with or as part of radio receiving sets, or combination radio and phonograph sets, including in each case parts or accessories sold therewith.

A radio cabinet is an article subject to tax as such and may not be sold under an exemption certificate at any time, since it can not

be used as a component part of any other article taxable under section 607 or under any other section of the Revenue Act of 1932.

The mere insertion of a shelf in a completed cabinet or the cutting of holes to fit the dials and controls of a radio chassis is not a manufacturing process, and the fact that the cabinet will be so treated will not permit the purchase of a cabinet under an exemption certificate.

The term "chassis" includes all types of radio receiving apparatus. A tuning unit, or a tuning unit and amplifier, may be a chassis. Ordinarily the combination of tuning unit, amplifier, and power pack is considered a chassis, but in some instances a chassis includes all of the parts of a radio receiving set except the cabinet.

The term "reproducing units" includes all apparatus for the amplification or reproduction of sound suitable for use as part of, or with, radio receiving sets or combination radio and phonograph sets. A loud speaker is a reproducing unit. An amplifier is also a reproducing unit. Any assembly of which a loud speaker or an amplifier is the major component part is a reproducing unit in its entirety and the entire sale price is subject to the tax in question.

The term "power packs" includes all devices which are suitable for converting ordinary commercial or domestic voltage into electric current suitable for operating radio receiving sets or combination radio and phonograph sets. For example, a combination A & B eliminator is a power pack.

REGULATIONS 46, ARTICLE 46: Phonograph records. XII-12-6084
S. T. 651

Taxability of records for phonographs.

Advice is requested whether records for phonographs are subject to the tax imposed by section 607 of the Revenue Act of 1932.

Records for phonographs have for many years been produced by the "hill-and-dale" or vertical transcription process. Certain types of home phonographs were and are produced equipped to play that type of record only. For some years there have been available tone arms constructed to reproduce either vertically or laterally transcribed records.

Modern combination radio and phonograph sets are equipped with a motor which will revolve the turntable at 78 or 33⅓ revolutions per minute, as the operator desires.

The method of reproducing records or electrical transcriptions for broadcasting purposes whereby no sound is audible in the studio is a peculiarity of the machine rather than the record. The same record can be used on a combination radio and phonograph set where the sound is immediately reproduced.

Motion picture records of the "sound-on-disk" type are nothing more than records for phonographs or electrical transcriptions, the only unusual feature being the subject matter transcribed on such records.

It is held that records for phonographs or electrical transcriptions, regardless of the speed at which recorded, the type or subject matter of the recording or transcription, the material from which constructed, the size in which made or the purpose for which used, are

within the scope of section 607 of the Revenue Act of 1932 and are subject to the tax imposed thereby when sold or used by the manufacturer, producer, or importer.

Blank records and "sound-on-film" recordings are not records for phonographs and are not subject to the tax imposed by section 607 of the Act.

SECTION 608.—MECHANICAL REFRIGERATORS.

REGULATIONS 46, ARTICLE 51: Application of tax. XII-21-6195
(Also Section 619(b), Regulations 46, Article 15.) S. T. 673

Taxability of intercompany sales.

Advice is requested concerning the application of the tax imposed by section 608 of the Revenue Act of 1932 to the following transaction:

A has been purchasing completely assembled electrical refrigeration units ready for installation from the X manufacturer, who now proposes to set up a sales company and invoice the refrigerators to this sales company at approximately the cost of production, the sales company in turn selling the articles to A at the regular contract price. A asks on what basis or price the tax should be computed.

Under the provisions of section 619(b) of the Revenue Act of 1932, if an article is sold (otherwise than through an arm's length transaction) at less than the fair market price the tax shall (if based on the price for which the article is sold) be computed on the price for which such article is sold in the ordinary course of trade by manufacturers or producers thereof, as determined by the Commissioner. Article 15 of Regulations 46 provides in part that—

> Where, through the existence of special arrangements between a manufacturer and a purchaser (as in the case of intercompany transfers at cost or at a fictitious price), the price for which articles are sold by the manufacturer does not reflect a fair market price, the sale is regarded as one made "otherwise than through an arm's-length transaction. * * *"

Sales by a manufacturer to his selling company will be regarded prima facie as made otherwise than through an arm's-length transaction.

Under the circumstances stated the fair market price is the price at which the manufacturer originally agreed to sell to A, provided A is an independent and unaffiliated purchaser. Under such circumstances the manufacturer will be required to pay tax covering sales to his selling company for the month in which the sale is made on the basis of the price received by the selling company, which price is held to be the fair market price.

SECTION 609.—SPORTING GOODS.

REGULATIONS 46, ARTICLE 17: Sales to the United States Government or to a State. XII-12-6085 G. C. M. 11501

Taxability of articles sold to a political subdivision of a State for maintenance and operation of public parks or playgrounds.

An opinion is requested whether the X Manufacturing Co. is subject to the tax imposed on sporting goods by section 609 of the Revenue Act of 1932, upon the sale to the city of Y of footballs used in connection with its public parks program.

The city of Y claims that no tax should be asserted against the X Manufacturing Co. in this case for the reason that the tax will in effect be paid by the city of Y. It is also claimed that the transaction is exempt under article 17, Regulations 46, which reads in part as follows:

> The tax does not attach to sales of any articles to States or political subdivisions thereof to be used in the exercise of an essential governmental function, provided such sales are made direct by the manufacturer to a State or political subdivision thereof without any intervening sale to a dealer or distributor.

The taxpayer's claim for exemption is based on the contention that the maintenance and operation of a public park or playground constitute the exercise of an essential governmental function. This contention is in conflict with the position consistently taken by the Bureau. (See Mim. 3838, C. B. IX–2, 137, and I. T. 2627, C. B. XI–1, 119.) In I. T. 2627 a number of court decisions are cited and language quoted therefrom in support of the Bureau's position, including decisions in the cases of *Augustine* v. *Town of Brant* (249 N. Y., 198, 163 N. E., 732); *Proprietors of Mount Hope Cemetery* v. *City of Boston* (158 Mass., 509, 33 N. E., 695); and *State ex rel. Wood, Attorney General*, v. *Schweickardt et al.* (109 Mo., 496, 19 S. W., 47).

It is clear that the decisions of the Supreme Court of the State of Washington are not in harmony with the decisions of the other States referred to herein, in that the Washington decisions hold that the operation, maintenance, or improvement of a public park, not for profit, is the exercise of a governmental function. This position does not, however, appear to be in accord with the weight of authority.

Regardless of the conflict in decisions, in deciding whether any particular activity in which a State or municipality may be engaged is an essential governmental function for internal revenue purposes, the attitude of the Federal rather than the State authorities must govern. (See *St. Louis Cotton Compress Co.* v. *Arkansas*, 260 U. S., 346; *Boston & Maine Railroad* v. *United States*, 265 Fed., 578; and *Boise Title & Trust Co.* v. *Evans*, 295 Fed., 223.) In the absence of a Federal decision on the particular question in issue, this office has followed the line of decisions of those States which hold that the maintenance and operation of public parks and playgrounds do not constitute the exercise of a strictly governmental function. An entirely inconsistent administration of the Federal tax laws would result unless the same rule is applied in all the States.

The following language from the decision of the United States Supreme Court in the case of *Flint* v. *Stone Tracy Co.* (220 U. S., 107) sets forth the general basis for Federal taxation of State operations:

> The true distinction is between the attempted taxation of those operations of the States essential to the execution of its governmental functions, and those activities which are of a private character. The former, the United States may not interfere with by taxing the agencies of the State in carrying out its purposes; the latter, although regulated by the State, and exercising delegated authority, such as the right of eminent domain, are not removed from the field of legitimate Federal taxation.

The case of the *Indian Motocycle Co.* v. *United States* (283 U. S., 570 [Ct. D. 354, C. B. X–1, 439]), cited in support of the position advanced, holding that a sale of motor cycles to a State agency, such as a municipal corporation, for use in its police service, is exempt from the excise tax imposed by section 600 of the Revenue Act of 1924, is clearly distinguishable in that the articles sold by the manufacturer in that case were to be used in the exercise of a strictly governmental function.

For the reasons indicated it is the opinion of this office that the sales of footballs by the X Manufacturing Co. to the city of Y for use in its public parks program are not exempt from the tax on sporting goods imposed by Title IV, section 609 of the Revenue Act of 1932.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

REGULATIONS 46, ARTICLE 55: Games. XII–7–6030
S. T. 636

Taxability of pool tables. S. T. 533 (C. B. XI–2, 481) modified.

Reference is made to S. T. 533 (C. B. XI–2, 481), which holds that any article constructed in the semblance of a pool table, in substantially the usual proportions of such a table and of similar characteristics, which is more than 30 inches long (outside measurements) is a pool table within the meaning of section 609 of the Revenue Act of 1932 and taxable as such.

The question of the taxability of such articles under section 609 of the Revenue Act of 1932 has been reconsidered. Section 609 imposes a tax on pool tables, without regard to size, and also on games, except children's toys and games. There are on the market certain articles made of metal or wood which resemble pool tables but which are not susceptible of use in playing the regular game of pool or any similar game. The taxability of these articles depends on whether they are pool tables or adult games, within the meaning of the law, or whether they are merely imitations of pool tables designed for use by children and subject to classification as children's toys or games.

Just when an article is a pool table or adult game and when a children's toy or game is a question of fact. As a general rule the size of an article is not the only test in determining such a question. However, it being impossible to inspect every article placed on the market and advertised as a pool table, this office, in order to secure uniformity in the enforcement of the law and to draw a more reasonable line of demarcation with respect to these articles, holds that any article constructed in the semblance of a pool table, in substantially the usual proportions of such a table and of similar characteristics, which is more than 45 inches long (outside measurement) is a pool table or adult game within the purview of section 609 of the Revenue Act of 1932 and taxable as such. Tables 45 inches or less in length will not be regarded as pool tables or adult games, and, therefore, are not subject to tax. S. T. 533, supra, is modified to conform to the conclusion reached herein.

REGULATIONS 46, ARTICLE 55: Games. XII–17–6149
S. T. 662

Taxability of baseball pool tickets and pari-mutuel tickets. S. T. 287 revoked in part.

Advice is requested concerning the taxability of baseball pool tickets and pari-mutuel tickets as part of a game under section 609 of the Revenue Act of 1932.

A similar question was considered by the Bureau in 1921 in S. T. 287 (Cumulative Bulletin of Sales Tax Rulings, July-December, 1921, page 43), where it was held that "such devices as consist of tickets with the names of clubs of various baseball leagues printed thereon to be operated for the purpose of playing in combination" were taxable as parts of games under section 900(5) of the Revenue Act of 1918. This ruling has been reconsidered since the effective date of the Revenue Act of 1932 and this office is now of the opinion that the conclusion reached in S. T. 287, supra, is erroneous.

It is well settled that baseball pool is a game. (The Century Dictionary and Encyclopedia; *People* v. *Weithoff*, 51 Mich., 203, 16 N. W., 442.) The markers in question are not, however, parts of the game. They serve merely as a record of the play, their function being closely analogous to that of score cards used in bridge whist. Bridge whist score cards were, however, specifically held not to be parts of games within the meaning of section 600 of the Revenue Act of 1917. It follows that the markers in question are not parts of games and hence are not taxable.

The Bureau, therefore, recedes from the position previously taken under section 609 of the Revenue Act of 1932 and now holds that baseball pool tickets are not parts of a game within the meaning of the present law. S. T. 287 is, accordingly, revoked so far as it is inconsistent herewith.

In this respect the word game, as used in section 609 of the Revenue Act of 1932, refers to the instrumentalities used in playing a game. The instrumentalities used in playing baseball, for example, are a bat, shoes, uniforms, balls, gloves, etc. Tickets or devices used in betting on a baseball game form no part of the game itself and are not taxable.

In this same sense a horse race is a game, but pari-mutuel tickets are certainly no part of the race. They are nothing more than evidence of the holder's right to participate in a fund or pool if a certain horse designated by the ticket should win. In this interpretation of the word game, it follows that pari-mutuel tickets are not parts of a game and are not subject to the tax imposed by section 609 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 55: Games. XII–22–6204
S. T. 675

Jigsaw and die-cut picture puzzles. (S. T. 567 affirmed.)

An opinion is requested concerning the propriety of a previous ruling (S. T. 567, C. B. XI–2, 481) relative to the taxability of jigsaw and die-cut picture puzzles under section 609 of the Revenue Act of 1932.

The ruling has been further considered and the Bureau has reached the conclusion that it embodies a proper interpretation of the law.

Accordingly, the ruling (S. T. 567) holding that jigsaw or die-cut picture puzzles containing more than 50 pieces are games and that sales of such games by the manufacturers, producers, or importers thereof are subject to tax under section 609 of the Revenue Act of 1932, is affirmed. Jigsaw or die-cut picture puzzles which contain 50 pieces or less will be regarded as children's games and, therefore, exempt from the tax imposed under section 609 of the Revenue Act of 1932. Manufacturers should file returns and pay the tax on the basis indicated.

SECTION 610.—FIREARMS, SHELLS, AND CARTRIDGES.

REGULATIONS 46, ARTICLE 59: Exempt sales. XII–26–6257
(Also Regulations 46, Article 17.) S. T. 685

Taxability of sales of firearms or ammunition by a dealer or jobber for the use of a governmental agency.

Advice is requested whether a sale of firearms or ammunition to governmental agencies is exempt from tax under article 59 of Regulations 46 under the Revenue Act of 1932 when such sale is made from a dealer's or jobber's stock.

Section 610 of the Revenue Act of 1932 reads as follows:

> There is hereby imposed upon firearms, shells, and cartridges, sold by the manufacturer, producer, or importer, a tax equivalent to 10 per centum of the price for which so sold. The tax imposed by this section shall not apply (1) to articles sold for the use of the United States, any State, Territory, or possession of the United States, any political subdivision thereof, or the District of Columbia, or (2) to pistols and revolvers.

To be entitled to exemption under this section of the law the articles must not only be sold for the use of the United States, a State, Territory, or possession of the United States, any political subdivision thereof, or the District of Columbia, but it must also be established that the manufacturer knew at the time of his sale that they were to be sold for such use.

The manufacturer is not entitled to the exemption provided in section 610 unless, at the time of his sale, the dealer or jobber furnishes a statement establishing that all of the articles included in the order are to be sold later to a governmental agency for its own use. In the absence of such a preliminary statement firearms and ammunition sold by a dealer or jobber from his stock to the United States or to a State or political subdivision thereof are subject to the tax. It should be noted that this refers to a specific exemption provided in section 610 of the Revenue Act of 1932 and does not apply to sales of articles taxed under other sections of Title IV of that Act.

SECTION 613.—CANDY.

REGULATIONS 46, ARTICLE 63: Scope of tax. XII–10–6062
S. T. 645

Taxability of stuffed fruits as candy.

Advice is requested whether stuffed fruits are subject to the tax on candy imposed by section 613 of the Revenue Act of 1932.

It is held that a fig, date, or other fruit prepared for market by removing the seed and inserting in place thereof a nut, after which the fig, date, or other fruit is sprinkled with sugar to prevent adhering or sticking together when packed, is not candy within the meaning of section 613 of the Revenue Act of 1932, and is not, therefore, subject to the tax. However, if the fig, date, or other fruit is glazed, candied, or crystallized, and sold for use as candy, it is deemed to be subject to the tax imposed by the law.

SECTION 615.—SOFT DRINKS.

REGULATIONS 44, ARTICLE 23: Registration. XII–20–6186
T. D. 4366

Tax on soft drinks—Registration—Section 615(c), Revenue Act of 1932.—Article 23, Regulations 44, amended.

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

To Collectors of Internal Revenue and Others Concerned:

The first paragraph of article 23 of Regulations 44, approved June 18, 1932, as amended by Treasury Decisions 4343 [C. B. XI–2, 486] and 4352 [C. B. XI–2, 486], approved July 27, 1932, and August 29, 1932, respectively, is further amended to read as follows:

Every manufacturer of cereal beverages; of unfermented grape juice; of unfermented fruit juices or imitations thereof; of still drinks; of natural or artificial mineral waters or table waters, or imitations thereof; of finished or fountain sirups; of carbonic acid gas who sells such gas to a manufacturer of carbonated beverages, or to a person conducting a soda fountain, ice cream parlor, or other similar place of business; of carbonic acid gas who uses such gas in the production of carbonated beverages; of carbonated beverages made with concentrates, essences, or extracts; of carbonated beverages made by use of finished or fountain sirups manufactured by such manufacturer; every dealer in carbonic acid gas who sells such gas to any of the manufacturers named above; and every person conducting a soda fountain, ice cream parlor, or other similar place of business who manufactures any sirups of the kind mentioned in article 37, if not registered on the required form, shall, within 10 days after commencing business, make application for registry to the collector in whose district his place of business is located.

P. R. BALDRIDGE,
Acting Commissioner of Internal Revenue.

Approved May 8, 1933.

W. H. WOODIN,
Secretary of the Treasury.

REGULATIONS 44, ARTICLE 26: Scope of tax. XII–14–6118
S. T. 658

Taxability of unfermented grape juice used in the production of wine, grape jelly, etc.

Advice is requested concerning the taxability of unfermented grape juice under section 615(a)2 of the Revenue Act of 1932 when used for purposes indicated hereinafter.

Section 615(a)2 of the Revenue Act of 1932 imposes a tax of 5 cents per gallon upon unfermented grape juice, in natural or concentrated form (whether or not sugar has been added), containing 35 per cent or less of sugars by weight, when sold by the manufacturer, producer, or importer.

The questions which arise with respect to the administration of this section of the law necessitate a determination of what constitutes a natural unfermented grape juice and at what point during the manufacture or production of wine, grape jelly, and grape juice the tax of 5 cents per gallon shall attach.

It is understood that juice as pressed from the grapes contains a considerable quantity of pulp, tartaric acid, tannin, and yeast cells, and that in the wine industry this product is known as "must" and not as grape juice. Fermentation sets in rapidly after the grapes are pressed, so the "must" is immediately removed to the fermenters where the process takes place under favorable conditions. The undesirable acids and argols are removed naturally through the process of fermentation so that no special processing of the "must" is necessary in order to accomplish this result in manufacturing wine. When the process of fermentation is completed the wine is allowed to age, during which time the pulpy material which was present in the "must" settles to the bottom of the vats and the wine becomes clarified.

The methods used in producing what is commonly or commercially known as grape juice are substantially different from those used in producing wine. After the grapes are pressed the juice is pasteurized and immediately placed in sterilized containers hermetically sealed, in order to prevent fermentation, and stored in a dark, cool place where the undesirable acids and argols precipitate along with other solid materials. After several months of storage the juice is racked or drawn off, filtered, and sugar is usually added to produce the desired taste. The juice is then placed in a container, sealed, and again pasteurized, after which it is ready for market as commercial grape juice.

The grapes which are to be used in the manufacture of grape jelly are pressed by methods similar to those used in producing wine and commercial grape juice. The juice is then pasteurized or otherwise treated in order to prevent further fermentation. Inasmuch as sugar must be added to the juice in order to produce jelly, the manufacturer sometimes adds sugar before the juice is placed in sterilized containers and stored away for the natural precipitation of the undesirable acids, argols, and other solid materials. When the juice has been thus treated additional sugar is added to bring the sugar content by weight to a maximum of 50 per cent, and the mixture is then concentrated to a suitable consistency resulting in the production of a semisolid gelatinous product. When the juice is deficient in natural pectin a small amount of this substance is added.

Section 601(c)3 of the Revenue Act of 1932 provides that grape concentrate, evaporated grape juice, and grape sirup, if containing more than 35 per cent of sugars by weight, may be sold tax-free to food manufacturers for use in the manufacture of food products. In all cases where a manufacturer sells grape concentrate, evaporated grape juice, or grape sirup, containing more than 35 per cent of sugars

by weight, to manufacturers for use in the production of food products, such products may be sold tax-free, provided the manufacturer of the grape concentrate, evaporated grape juice, or grape sirup has in his possession at the time the sale is made a certificate to the effect that the purchaser is a manufacturer of food products and that all such products purchased under exemption certificates will be used by him in the manufacture of food products.

The tax imposed by section 615(a)2 of the Revenue Act of 1932 on grape juice containing 35 per cent or less of sugars by weight does not attach where grape wine or grape jelly is made from the grapes in one continuous process. If a sale is made between the time the juice is pressed from the grapes and the time the finished grape wine or grape jelly is produced, this circumstance will destroy the continuity of the process. Thus where a manufacturer presses the juice from the grapes and sells it to a wine manufacturer or to a manufacturer of grape jelly or for any other purpose, the sale of such grape juice containing 35 per cent or less of sugars by weight will be considered the sale of a natural unfermented grape juice within the meaning of section 615(a)2 of the Revenue Act of 1932, and subject the product to a tax of 5 cents per gallon. A manufacturer who presses his own grapes as a part of one continuous process performed entirely by him in the production of grape wine or of grape jelly may do so without incurring tax liability under this section of the law.

REGULATIONS 44, ARTICLE 32: Scope of tax. XII–13–6102
S. T. 656

Small restaurant, hotel, and soda fountain operators may compute the tax on orange juice on the basis of 60 oranges to the gallon.

Advice is requested whether the small restaurant, hotel, and soda fountain operators can not be relieved of the burden of keeping detailed records of orange juice dispensed to each customer as the basis for computing the tax imposed thereon by section 615(a)4 of the Revenue Act of 1932.

It is stated that a strict application of section 615(a)4 of the Revenue Act of 1932 to orange juice sold at soda fountains and other places where the juice is served at the counter or table to be consumed there by the customer imposes a burden of keeping cumbersome records which almost makes the sale of such juices prohibitive. There are hundreds of small operators upon whom this burden is placed and who, it is stated, will discontinue serving orange juice unless some ruling is promulgated which will reduce the work now required in keeping records and paying such taxes.

This office has conducted a survey in order to determine the average number of oranges of all sizes required to produce 1 gallon of orange juice. The information upon which the following figures are based was obtained from the Florida Citrus Exchange, from the California Fruit Growers Exchange, and from tests conducted in several of the large chain drug stores throughout the country. It has been found that on an average 2¼ ounces of orange juice are obtained from each orange used in the production of orange juice.

Upon this basis it would require approximately 57 oranges to produce 1 gallon of juice. In order to make allowance for variations, which include spillage and waste, small restaurant, hotel, and soda fountain operators will be permitted to compute the tax on the basis of 60 oranges for the production of 1 gallon of orange juice. The only record which will be required of these operators will be a record of the number of oranges purchased and used for making orange juice, and for each 60 oranges so used a tax of 2 cents will be due the Government.

This ruling is applicable only to the small operators referred to and can not be applied generally throughout the industry. S. T. 534 (C. B. XI–2, 491), relating to large chain organizations, should be followed by such organizations in computing and paying the tax due under section 615(a)4 of the Revenue Act of 1932.

A manufacturer or producer of orange juice who places his product in containers is liable for a tax of 2 cents per gallon upon his sales of such product. In all cases where soda fountains, hotels, and restaurants purchase such juice in containers no additional tax is imposed upon the operator serving the same. Order blanks and invoices indicating that such operators have purchased the orange juice, in preference to extracting such juice themselves, will be sufficient evidence to prevent the assessment of any additional tax upon such product.

REGULATIONS 44, ARTICLE 35: Scope of tax. XII–3–5995
S. T. 627

Taxability of plain carbonated water known as seltzer water.

Advice is requested relative to the taxability of certain carbonated waters under section 615(a)5 of the Revenue Act of 1932.

Spring water, whether plain or carbonated, sold in bottles or other closed containers at over 12½ cents per gallon, is taxable under section 615(a)5 as a mineral or table water.

Plain carbonated water is frequently sold in bottles or syphons under the name of seltzer water, for drinking purposes. When so sold it is considered an artificial mineral or table water and taxable under section 615(a)5, if sold for more than 12½ cents per gallon by the bottler or producer.

Some soda fountain proprietors do not have carbonating machines and do not use carbonic acid gas in tanks or drums. Their practice is to purchase from producers of, or dealers in, carbonic acid gas 10-gallon tanks of carbonated water and to use the same at the soda fountain in dispensing drinks. Reports reaching the Bureau indicate that a large portion of the carbonated water sold in 10-gallon tanks to soda fountains does not sell for more than 12½ cents per gallon, and that it is not feasible for individual consumers to purchase it in that form for drinking purposes.

Under similar provisions of the Revenue Act of 1921, seltzer water sold in bottles for more than 12½ cents per gallon was taxed as a mineral or table water, while carbonated water sold in tanks to soda fountains was taxed on the carbonic acid gas used in making such water. The Bureau adheres to the position so taken under the Revenue Act of 1921.

With respect to the words "closed containers," used in section 615(a)5, attention is invited to Sales Tax Ruling 583 (C. B. XI–2, 489).

REGULATIONS 44, ARTICLE 41: Scope of tax. XII–6–6020
S. T. 633

Advice is requested concerning the application of the tax imposed upon carbonic acid gas under section 615(a)7 of the Revenue Act of 1932.

S. T. 568 (C. B. XI–2, 493) provides that a manufacturer of carbonated beverages taxable under section 615(a) (1), (3), or (5) of the Revenue Act of 1932 may take credit for the amount of tax paid upon the carbonic acid gas used in producing such beverages. Inquiry is made whether it was intended that this credit may be taken by a taxpayer who produced beverages from finished or fountain sirups, which sirups are taxable under section 615(a)6.

The credit allowed for carbonic acid gas in S. T. 568 only applies in those cases where the finished beverage is subject to tax; that is, where the beverage is directly manufactured, compounded, or mixed by the use of concentrate, essence, or extract, without passing through the stage of a finished or fountain sirup, as distinguished from those beverages produced from a finished or fountain sirup. The beverages produced from finished or fountain sirups are not as such subject to tax but the tax is levied upon the sirup and also upon the carbonic acid gas used in producing such beverages. Section 615(a) (1), (3), and (5) imposes taxes upon three classes of carbonated beverages and only manufacturers producing such taxable beverages are entitled to a credit for any tax paid by the carbonic acid gas manufacturer or dealer on that portion of the gas used in the further manufacture of the taxable beverages, as outlined in section 621(a)1 of the Revenue Act of 1932.

A manufacturer who produces carbonated beverages, which are not subject to tax as such, by using taxable finished or fountain sirups is not authorized by the provisions of section 621(a)1 to take credit for the amount of tax paid on the carbonic acid gas used in the production of such beverages, nor may he purchase carbonic acid gas tax-free under section 620 for such use.

SECTION 616.—ELECTRICAL ENERGY.

REGULATIONS 42, ARTICLE 40: Scope of tax. XII–7–6031
S. T. 637

Electrical energy furnished to farmers and dairies.

Advice is requested concerning the tax on electrical energy imposed by section 616 of the Revenue Act of 1932 when furnished to a farmer who runs a dairy and sells milk to a commercial dairy which distributes the milk on a retail basis.

It is held that electrical energy furnished in the general operations of farming, such as lighting the homes or dwellings, barns, and other farm buildings; ensilage cutters; cream separators; oat crushers; threshing machines; water pumps; etc., and for the operation of

other miscellaneous machinery such as is used in general farming operations, is domestic or commercial in its scope and, therefore, is subject to the tax imposed by section 616 of the Revenue Act of 1932.

A dairy which obtains milk and converts it into use for retail purposes is held to be engaged in a business commercial in character. Electrical energy used in such operations will be subject to tax.

Electrical energy furnished to dairies which are engaged in the manufacture and sale of butter, cheese, and similar dairy products is not subject to the tax imposed by section 616 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 40: Scope of tax. XII–8–6042
S. T. 641

Taxability of electrical energy furnished to closed industrial plants. S. T. 590 (C. B. XI–2, 503) modified.

In S. T. 590 (C. B. XI–2, 503) it was held that electrical energy furnished to an industrial plant during a period when its industrial activities have temporarily or permanently ceased is subject to the tax imposed by section 616 of the Revenue Act of 1932.

With respect to this question evidence has been submitted to the effect that many industrial plants, quarries, mines, etc., which have closed down, are furnished a minimum amount of electrical energy by power companies on an industrial rate basis. The plants of some of these industries are closed down temporarily or permanently because of depressed economic conditions, while in other cases, particularly with respect to quarries and mines, the industrial activities cease over a period of months merely because of seasonable circumstances surrounding the production and sale of their product.

It is pointed out that S. T. 590 operates to exempt an industrial consumer from the tax during full time operation but subjects the same consumer to the tax when the same operations are curtailed by business or seasonable conditions.

This office has carefully reconsidered the question in the light of the facts submitted, and is now of the opinion that where a user of electrical energy, such as a manufacturing plant, quarry, mine, etc., establishes its predominant character as an industrial consumer and its right to exemption from the tax, this exemption will remain in effect until such time as the character of the operations changes from industrial to commercial, irrespective of whether the plant is operating at full time or part time or is temporarily closed.

Accordingly, electrical energy furnished to an industrial plant for consumption during a period of time when its industrial activities have temporarily ceased, for the purpose of maintaining the plant in an operating condition, or for protective purposes during its inoperative period, there being no effort to change the nature of the business, is not furnished for domestic or commercial consumption and is not subject to the tax imposed by section 616 of the Revenue Act of 1932. However, electrical energy furnished to an industrial plant during a period when all of its industrial activities have been permanently discontinued and the property is used for commercial purposes or is held for future sale is subject to the tax.

S. T. 590 is modified accordingly.

REGULATIONS 42, ARTICLE 40: Scope of tax. XII-11-6074
S. T. 650

Taxability of electrical energy furnished Federal employees.

Advice is requested whether electrical energy furnished Federal employees living in quarters owned or controlled by the Government is subject to the tax imposed by section 616 of the Revenue Act of 1932.

The tax imposed by that section is based upon all amounts paid for electrical energy furnished for domestic or commercial consumption, to be paid by the person paying for such energy and to be collected by the vendor. The tax does not apply to sales of electrical energy other than sales for consumption. Every person purchasing electrical energy for resale is required to register as a reseller of electrical energy and to collect and return the tax to the collector of internal revenue. It is provided by section 616(c) that electrical energy furnished to the United States or to any State or political subdivision thereof, or the District of Columbia, is not subject to the tax.

Where electrical energy is furnished by the United States Government to employees residing in Government quarters, for domestic consumption, and a specific charge is made therefor, which charge is either collected in cash or is deducted from the employee's salary at the time when payment of such salary is made, it is held that this constitutes a resale of electrical energy by the Government for domestic consumption and that the purchase of such energy by the employee is subject to the tax imposed by the law.

Where electrical energy is furnished by the United States Government to employees under an arrangement whereby quarters, heat, and light are furnished free, and where no specific charge is made against or collected from such employees, it is held that there is no resale of electrical energy as such by the Government and the tax imposed by section 616 of the Revenue Act of 1932 does not attach even though the salaries of the employees have been determined by taking into consideration the quarters, heat, and light furnished by the Government.

REGULATIONS 42, ARTICLE 40: Scope of tax. XII-12-6086
S. T. 652

Taxability of electrical energy used in warehouses of chain stores.

Advice is requested by the X Company, operating chain stores, concerning the taxability of electrical energy used in connection with the warehousing and distribution of its products under section 616 of the Revenue Act of 1932.

It is held that electrical energy furnished for direct consumption to the X Company for use in receiving, repacking, and distribution of goods to stores; operating freight elevators, refrigeration, electric trucks, blowers, conveyors, and smaller appliances; and operating motors on bakery machinery, elevators, air conditioners, pumps, and necessary lighting thereto is commercial in its scope and incidental to the carrying on of a business whose predominant character is commercial, and, therefore, is subject to the tax imposed by section 616 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 40: Scope of tax. XII-20-6181
S. T. 669

Taxability of payments for electrical energy which are in arrears.

Advice is requested whether the tax imposed by section 616 of the Revenue Act of 1932 applies both to the amount billed for current electrical energy and to the amount billed for electrical energy which is in arrears, and, if so, how the tax should be computed.

Section 616 of the Revenue Act of 1932 imposes a tax of 3 per cent "of the amount paid on or after the fifteenth day after the date of the enactment of this Act" (June 21, 1932) for electrical energy for domestic or commercial consumption "furnished after such date * * * to be paid by the person paying for such electrical energy and to be collected by the vendor."

Every person receiving payments for electrical energy furnished for domestic or commercial consumption is required under the express provisions of the law to collect the tax imposed on such payments and to make proper returns of the tax to the collector of internal revenue.

The Bureau has held that where an amount is added to a bill for failure to make payment within a prescribed period, the tax will attach to the amount actually paid, since the measure of the tax is the amount paid for electrical energy as distinguished from the amount of energy used.

There is, however, no authority whereby a power company may include in the computation of the tax due on one bill any tax included in the total amount of a previous bill. The tax can only be computed on the amount paid on or after June 21, 1932, for electrical energy furnished for domestic or commercial consumption after such date. Consequently, electrical energy furnished before June 21, 1932, is not taxable even though the bill therefor is rendered after that date.

REGULATIONS 42, ARTICLE 40: Scope of tax. XII-21-6196
S. T. 674

Taxability of electrical energy furnished a cemetery.

Advice is requested relative to the applicability of the tax on electrical energy imposed by section 616 of the Revenue Act of 1932 to the following circumstances:

The X Company is furnishing electrical energy to light a garage located in a private cemetery in the city of Y. The garage is used to store trucks, tools, etc., used in the upkeep and operation of the cemetery.

The trustees of the cemetery have advised the power company with respect to such tax, as follows:

> The garage is a part of the cemetery. The cemetery in no sense of the word is organized for profit in any way. It was chartered by an act of the legislature exempting it from all taxes. We do not make an income tax report and, therefore, are not liable to the Government in any way for tax.

The tax on electrical energy imposed under section 616 is applicable to electrical energy furnished for domestic or commercial use. In the instant case it is obvious that the energy is not furnished for domestic use but the question remains as to whether a commercial use is involved.

Commerce includes barter and sale with the incidents thereof, such as communication and transportation. It includes intercourse for the purpose of trade in all its forms. A corporation organized for the operation and maintenance of a cemetery is ordinarily engaged in the business of selling space in the cemetery and furnishing a service in connection with the use of that space. In this manner the operation of a cemetery is a commercial venture. The fact that the business may not be operated for profit or that it may be conducted by an organization which is not permitted to distribute profits, does not change the nature of the business carried on, which is deemed to be commercial in its scope.

Electrical energy furnished a cemetery must be regarded as furnished for commercial use and, therefore, subject to tax as such. There is no basis for drawing a distinction between electrical energy furnished to an organization operated for profit and such energy furnished to an organization the profits of which are not subject to distribution, if, in both cases, the particular use of electricity is one which is ordinarily regarded as a commercial use.

It is held, therefore, that electrical energy furnished a cemetery for use in lighting a garage used in connection with the upkeep and operation of the cemetery is subject to the tax imposed under section 616 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 41: Exemptions. XII-2-5981
S. T. 623

Taxability of irrigation companies.

Advice is requested relative to the liability of irrigation companies for the taxes imposed by Titles IV and V of the Revenue Act of 1932.

Under Treasury Decision 4342, approved July 26, 1932 [C. B. XI-2, 495, 505], electrical energy furnished for direct consumption by irrigation companies in their operations as such is not for domestic or commercial consumption and is not, therefore, subject to the tax imposed by section 616 of the Revenue Act of 1932.

It is contended that irrigation districts are political subdivisions and as such are exempt from the taxes imposed on sales of lubricating oil by section 601; on sales of tires and inner tubes by section 602; on sales of gasoline by section 617; on telegraph and telephone services by section 701(a)1; and on checks by section 751 of the Revenue Act of 1932. Even if irrigation districts could properly be considered as political subdivisions they would be subject to tax because their functions are proprietary rather than essentially governmental in their character. (See Mim. 3838, C. B. IX-2, 141.) Therefore, transactions with or by such districts are not exempt from the taxes imposed by those sections of the law.

SECTION 617.—GASOLINE.

REGULATIONS 44, ARTICLE 43: Scope of tax. XII-26-6258
S. T. 686

Taxability of gasoline when sold by a producer who has temporarily discontinued producing activities.

Advice is requested whether sales made by a producer of gasoline whose producing activities have been temporarily discontinued are subject to the tax imposed by section 617 of the Revenue Act of 1932.

A company actively engaged in its business as a producer of gasoline, within the meaning of section 617 of the Revenue Act of 1932, does not cease to be a producer upon the temporary discontinuance of producing activities for such reasons as adverse business conditions, excess inventories, etc. In cases such as this, where it intends to resume the production, blending, or compounding of gasoline, it retains the status of a producer, with all the rights and liabilities accompanying such status.

Where a producer of gasoline disposes of its producing equipment and abandons its producing operations for all time it will nevertheless for tax purposes be regarded as a producer of any gasoline sold by it which was produced, compounded, blended, or purchased tax-free by it during the period in which it was actively producing, compounding, or blending gasoline. After permanently abandoning its producing operations, it would, of course be improper for it to continue purchasing gasoline tax-free under an exemption certificate as a producer.

REGULATIONS 44, ARTICLE 44: Use of terms. XII–22–6205
S. T. 676

Taxability of natural or casinghead gasoline and industrial benzol. (S. T. 554 revoked.)

Advice is requested concerning the application of the tax imposed by section 617 of the Revenue Act of 1932 to the products known as natural or casinghead gasoline and industrial benzol.

Section 617 of the Revenue Act of 1932 imposes a tax on gasoline sold by the importer thereof or by a producer of gasoline. Section 617(c)2 provides that "the term 'gasoline' means gasoline, benzol, and any other liquid the chief use of which is as a fuel for the propulsion of motor vehicles, motor boats, or aeroplanes." In Internal Revenue Cumulative Bulletin XI–2, page 507, the Bureau issued a ruling (S. T. 554) which was predicated upon the premised that the tax imposed by section 617 of the Revenue Act of 1932 is applicable only to such products as are suitable for use as a fuel for the propulsion of motor vehicles, motor boats, and aeroplanes. In accordance with that view the Bureau held that sales of industrial benzol which had not reached a state of compounding, blending, or processing so as to be suitable for use as a fuel for the propulsion of motor vehicles, motor boats, or aeroplanes are not subject to the tax imposed by section 617 of the Revenue Act of 1932.

Upon reconsideration of this question with particular reference to the definition of "gasoline" embodied in the law, the conclusion has been reached that the previous ruling exempting from the tax imposed by section 617 sales of industrial benzol, is not warranted by the grammatical and legal construction of section 617(c)2, supra.

Accordingly, it is held that the tax imposed by section 617 of the Revenue Act of 1932 is applicable to sales of all products commonly or commercially known as gasoline or benzol, including natural or

casinghead gasoline and industrial benzol, regardless of classification or use.

S. T. 554, in so far as inconsistent with the conclusion reached herein, is, therefore, revoked.

SECTION 619.—SALE PRICE.

REGULATIONS 46, ARTICLE 10: Charges for coverings, containers, etc. XII–2–5982 S. T. 624

Taxability of charges for boxes containing articles taxable at different rates.

Advice is requested concerning the taxability of boxes used as containers of toilet articles subject to tax under section 603 of the Revenue Act of 1932.

Where a manufacturer ships in one container two articles, one taxable at 5 per cent and the other at 10 per cent of the manufacturer's sale price, if a separate charge is made for the container the tax rate applicable to each article will attach to the charge for the container in proportion to the space occupied by each article, rather than according to the respective value of the articles. For example, if a bottle of toilet water, to which the 10 per cent rate of tax applies, occupies one-half of the container, and 3 cakes of toilet soap, to which the 5 per cent rate of tax applies, occupy the other half, the 10 per cent rate of tax will apply to one half the charge made for the container and the 5 per cent rate of tax will apply to the other half of such charge.

REGULATIONS DF, ARTICLE 13: Discounts and adjustments. XII–3–5996 S. T. 628

Method of handling trade discounts.

Trade discounts are ordinarily discounts granted unconditionally by the seller at the time of sale by reason of the purchase in wholesale lots or for similar reasons. For instance, a manufacturer may sell an article at retail for $1, but he will sell the same article at wholesale for 40 per cent off the retail price, or 60 cents. This 40 per cent trade discount may properly be deducted from the list price on wholesale sales before computing the tax where it is unconditionally allowed at the time of sale.

For method of handling cash discounts see S. T. 616 (C. B. XI–2, 512).

REGULATIONS 46, ARTICLE 13: Discounts and adjustments. XII–23–6216 S. T. 678

Expenses and commissions.

Advice is requested whether a demonstrator's expenses and commissions may be deducted from the net sale price of merchandise in computing the tax due.

It is stated that when the manufacturer closes a sale with a department store and it requests a demonstrator it is necessary for the manufacturer to furnish one free of charge and pay expenses and a commission of 10 or 15 per cent on all retail sales made during the

demonstrator's stay at the store. The question is asked whether such expenses and commissions are deductible for tax purposes.

The tax imposed by section 619 of the Revenue Act of 1932 is upon the sale price of the manufacturer, producer, or importer. Salaries, commissions, etc., paid to employees are not deductible in computing the tax, since they constitute a part of the selling expense.

Consequently, where a manufacturer sells merchandise to a department store and furnishes the store with a demonstrator, paying all expenses, plus commissions, the expenses and commissions may not be deducted from the sale price of the merchandise.

SECTION 622.—USE BY MANUFACTURER, PRODUCER, OR IMPORTER.

REGULATIONS 44, ARTICLE 9: Exempt sales to States and political subdivisions thereof. XII-19-6169 T. D. 4364

Sales to States or political subdivisions thereof, or to the United States.—Article 9, Regulations 44, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 9 of Regulations 44, approved June 18, 1932, is hereby amended to read as follows:

ART. 9. *Sales to States or political subdivisions thereof, or to the United States.*—No tax will attach to the sale of articles to States or political subdivisions thereof if (1) such articles are to be used in the exercise of an essential governmental function and (2) the sales are made direct by the manufacturer to the State or political subdivision thereof without an intervening sale to a dealer or distributor. Sales made to a dealer or distributor are subject to the tax even though the manufacturer may have knowledge that the articles are destined for ultimate use by, or resale to, a State or political subdivision thereof.

In order that a manufacturer may make sales of articles to States or political subdivisions thereof without incurring liability to tax, a certificate must be furnished such manufacturer stating that the articles are to be used in the exercise of an essential governmental function, and the certificate must include an agreement that if any of such articles are used otherwise than in the exercise of an essential governmental function, or if any of such articles are resold to employees or others, the State or political subdivision thereof will report such fact to the manufacturer. The tax applicable to such articles shall be included by the manufacturer in his return for the month during which such report is made.

A form of certificate which may be accepted by manufacturers for the purpose of making tax-free sales to States or political subdivisions thereof, when such certificate is properly executed by an authorized officer of the State or political subdivision thereof, follows:

(Date.) _____

EXEMPTION CERTIFICATE.

FOR USE BY STATES OR POLITICAL SUBDIVISIONS THEREOF.

The undersigned hereby certifies that he is the _____ (Title of Officer.) of _____ (State, City, etc.), and that the article or articles specified in the accompanying order are purchased for use by the _____ (Department.) in the exercise of essential governmental functions.

It is understood that the exemption from tax in the case of sales of articles to States or political subdivisions thereof is limited to articles purchased for use in the exercise of essential governmental functions, and it is agreed that where articles purchased tax free under this exemption certificate are used for purposes other than in the exercise of essential governmental functions or are sold to employees or others, the vendee will report such fact to the vendor.

---------- (Signature.)
(Title of Officer.)

Where it is impracticable to furnish a separate certificate with each order, the manufacturer may accept a single certificate covering all orders between given dates; such period, however, not to exceed one month.

Sales to the Government of the United States, the District of Columbia, or to the Government of a Territory or possession of the United States are taxable, except as provided in articles 4 and 57.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved April 28, 1933.
W. H. WOODIN,
Secretary of the Treasury.

REGULATIONS 46, ARTICLE 17: Sales to the United States Government or to a State. XII-19-6170 T. D. 4365

Sales to States or political subdivisions thereof, or to the United States.—Article 17, Regulations 46, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 17 of Regulations 46, approved June 18, 1932, is hereby amended to read as follows:

ART. 17. *Sales to States or political subdivisions thereof, or to the United States.*—No tax will attach to the sale of articles to States or political subdivisions thereof if (1) such articles are to be used in the exercise of an essential governmental function and (2) the sales are made direct by the manufacturer to the State or political subdivision thereof without an intervening sale to a dealer or distributor. Sales made to a dealer or distributor are subject to the tax even though the manufacturer may have knowledge that the articles are destined for ultimate use by, or resale to, a State or political subdivision thereof.

In order that a manufacturer may make sales of articles to States or political subdivisions thereof without incurring liability to tax, a certificate must be furnished such manufacturer stating that the articles are to be used in the exercise of an essential governmental function, and the certificate must include an agreement that if any of such articles are used otherwise than in the exercise of an essential governmental function, or if any of such articles are resold to employees or others, the State or political subdivision thereof will report such fact to the manufacturer. The tax applicable to such articles shall be included by the manufacturer in his return for the month during which such report is made.

A form of certificate which may be accepted by manufacturers for the purpose of making tax-free sales to States or political subdivisions thereof, when such certificate is properly executed by an authorized officer of the State or political subdivision thereof, follows:

(Date.) _____

EXEMPTION CERTIFICATE.

FOR USE BY STATES OR POLITICAL SUBDIVISIONS THEREOF.

The undersigned hereby certifies that he is the _____
(Title of Officer.)
of _____, and that the article or articles specified in the
(State, City, etc.)
accompanying order are purchased for use by the _____
(Department.)
in the exercise of essential governmental functions.

It is understood that the exemption from tax in the case of sales of articles to States or political subdivisions thereof is limited to articles purchased for use in the exercise of essential governmental functions, and it is agreed that where articles purchased tax free under this exemption certificate are used for purposes other than in the exercise of essential governmental functions or are sold to employees or others, the vendee will report such fact to the vendor.

_____ (Signature.)
(Title of Officer.)

Where it is impracticable to furnish a separate certificate with each order, the manufacturer may accept a single certificate covering all orders between given dates; such period, however, not to exceed one month.

Sales to the Government of the United States, the District of Columbia, or to the government of a Territory or possession of the United States are taxable except with respect to articles taxable under section 610, relating to the tax on firearms, etc. (However, see articles 3 and 76.)

DAVID BURNET,
Commissioner of Internal Revenue.

Approved April 28, 1933.

W. H. WOODIN,
Secretary of the Treasury.

SECTION 623.—SALES BY OTHERS THAN MANUFACTURER, PRODUCER, OR IMPORTER.

REGULATIONS 46, ARTICLE 6: Sales of taxable articles by persons other than the manufacturer thereof. XII–2–5983 S. T. 625

Sale by a bank of jewelry pledged as collateral by a manufacturer or importer.

Advice is requested concerning the tax imposed by section 623 of the Revenue Act of 1932 under the following circumstances:

Prior to June 21, 1932, and after that date, a certain bank came into possession of imported and manufactured jewelry on account of the default by the importers and manufacturers in making payments due pursuant to an agreement under the terms of which the jewelry was pledged as collateral.

Section 623 provides that:

In case any person acquires from the manufacturer, producer, or importer of an article, by operation of law or as a result of any transaction not taxable under this title, the right to sell such article, the sale of such article by such person shall be taxable under this title as if made by the manufacturer, producer, or importer, and such person shall be liable for the tax.

The question raised is whether any tax would become due on the sale of such jewelry by the bank.

The bank contends that the word "acquires," as used in section 623, is prospective in its application and may properly be applied

only to such articles as were acquired on or after the effective date of the law.

The contention that the word "acquires," as used in the law, means acquired after the effective date of the law is not supported by the terms of the Act. This section is supplemental to other provisions in the law and must be so considered. When the section is read in connection with such other provisions, it becomes apparent that the word "acquires" is used in a broad, general sense and should be interpreted to mean acquired at any time, provided the acquisition resulted from a transaction which is not taxable under Title IV of the Act. The phrase "as a result of any transaction not taxable under this title" is simply a method of defining the transactions under which the acquisition resulted, and the classification of transactions in this manner has no bearing on the question of whether the excise tax law was in existence at the time. In other words, the statute is drafted so that if the legal successor of a manufacturer sells an article on or after June 21, 1932, the tax shall be imposed upon such sale as if the article were made and sold by the manufacturer himself.

Even without this provision it is probable that a legal successor of a manufacturer could be taxed as the manufacturer, because under the common law, as well as under the statutes of most States, the legal successor "stands in the shoes" of his predecessor for all purposes. He is liable for the debts of his predecessor and can maintain a suit to recover moneys owing to his predecessor. In this case the obligation was not imposed upon the manufacturer from whom the bank acquired the jewelry, but on the bank's sale as successor and as agent for the manufacturer.

Under the facts as stated the situation is not dissimilar to the acquisition of the bankrupt business of a jewelry manufacturer by a receiver prior to the effective date of the Act. As a matter of law the receiver is the legal successor of the bankrupt owner of the business. The receiver "stands in the shoes" of the bankrupt manufacturer and if he sells jewelry on or after June 21, 1932, which was manufactured by the bankrupt owner either before or after June 21, 1932, the receiver is liable for the tax. The bank does not "stand in the shoes" of the insolvent manufacturer in any lesser degree under the excise tax law than the receiver, because the bank, like a receiver, became the successor as the result of a transaction not taxable under Title IV.

It is, therefore, held that upon a sale of such jewelry after June 20, 1932, the bank is liable for the tax imposed by section 605 of the Revenue Act of 1932, to the same extent as if the sale had been made by the manufacturer, producer, or importer.

TITLES IV AND V.—MANUFACTURERS' EXCISE AND MISCELLANEOUS TAXES. (1932)

SECTIONS 615, 617, AND 751: Soft drinks, gasoline, and checks, respectively. XII-1-5968 S. T. 620

Tax liability of post exchanges and similar agencies.

An opinion is requested relative to the application of the taxes imposed by sections 615(a)6, soft drinks; 617, gasoline; and 751(a),

checks, etc., of the Revenue Act of 1932 to post exchanges and other agencies established and operated pursuant to Army regulations.

Three questions are presented: (1) The application of section 751(a) to checks drawn against certain funds, namely, post exchange funds, unit funds (company, troop, and battery), hospital funds, recreation funds, mess officers' accounts, and patients' funds; (2) the application to post exchanges of section 615(a)6; (3) the application of section 617 with respect to gasoline purchased by a post exchange for resale.

Section 751(a) imposes a tax on checks and other instruments drawn upon any bank, banker, or trust company, the tax to be paid by the maker or drawer. Section 615(a)6 imposes a tax upon finished or fountain sirups sold by the manufacturer, producer, or importer, the tax to be paid by the manufacturer, producer, or importer. Section 617 imposes a tax on gasoline sold by the importer or producer, the tax to be paid by such importer or producer.

The Department consistently held that post exchanges, being governmental agencies, were exempt from the taxes imposed by various Revenue Acts in the past where such taxes would have been imposed directly upon the post exchange as the taxpayer, on the ground that it is not the policy of the Government to tax its own enterprises. In this connection see Treasury Decision 19994, August 31, 1898, retail liquor dealers; Treasury Decision 632, March 4, 1903, special tax on dealers in oleomargarine; Treasury Decision 2439, January 27, 1917, special tax on billiard and pool tables; Treasury Decision 2584, November 20, 1917, floor tax on cigars, tobacco, and cigarettes; section 78(c)3 of Regulations 9, revised June, 1923, and August, 1925, special tax on sales of oleomargarine; O. D. 35, Sales Tax Rulings Cumulative Bulletin, January–June, 1921, page 48, tax on jewelry sold by dealers; and S. T. 369, Cumulative Bulletin I–1, page 431, beverages and constituent parts where the tax was imposed on the manufacturer. This position was affirmed by the Court of Claims in *Dugan* v. *United States* (34 C. Cls., 458), where the court held:

> * * * such exchanges, though conducted without financial liability to the Government, are, in their creation and management, governmental agencies. * * *
>
> It has never been the policy of the Government to tax its own enterprises or its own manner or method of doing business; and inasmuch as post exchanges are established and maintained by it for the mental and physical betterment of its troops in garrisons and posts, with resulting, if not immediate, benefit to itself, we think such exchanges are exempt from the payment of special tax for the sale of such articles as the regulations permit.
>
> * * * the claimant, as officer in charge of the exchange in the line of his official duty, for the neglect of which he would have been subject to discipline under the Army regulations, was not, nor was the post exchange of which he was the officer in charge, a retail dealer in liquors within the meaning of section 18, Act of March 1, 1879 * * *.

In *Henry Woog, Administrator*, v. *United States* (48 C. Cls., 80) the principles of the Dugan case were applied to post and company funds. It appears that other agencies are established, operated, and regulated under and pursuant to the same authority and are similar in character to post exchanges in so far as their public or governmental functions are concerned.

The Department also consistently held that where the post exchange was not the taxpayer and the tax was imposed upon some

other person, there was no exemption merely because the post exchange was one of the parties to the transaction. See Treasury Decision 2893, July 17, 1919, sales of ice cream and soft drinks, where the tax was imposed on the purchaser. In other words, where the United States or its agencies merely purchase an article, the sale of which is taxable to the manufacturer, producer, or importer, the tax applies in the absence of any statutory provision to the contrary. This is illustrated by article 9 of Regulations 44, relating to the tax on lubricating oil, gasoline, etc., under the Revenue Act of 1932, holding sales to the United States taxable.

Based upon the foregoing considerations, it is held (1) that checks drawn upon the funds of the agencies mentioned are not subject to the tax imposed by section 751(a) of the Revenue Act of 1932; (2) that finished or fountain sirups manufactured and used by a post exchange in the preparation of soft drinks are not subject to the tax imposed by section 615(a)6 of that Act; and (3) that gasoline sold by producers and importers to post exchanges, whether for resale or consumption, is subject to the tax imposed by section 617 of that Act.

TITLE V.—MISCELLANEOUS TAXES. (1932)

SECTION 701.—TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES.

REGULATIONS 42, ARTICLE 2: Transmission. XII–19–6171
S. T. 667

Taxability of charges for services rendered by a messenger.

Advice is requested whether the tax imposed on telephone conversations under section 701(a)1(A) applies to the charge made for messenger service in summoning the recipient of a message to the telephone.

Article 2 of Regulations 42, under the Revenue Act of 1932, relating to the taxes on telephone, telegraph, radio, and cable facilities, provides in part as follows:

> The term "transmission" as used in these regulations (1) includes all services rendered and facilities provided which are incidental to transmission by telephone, telegraph, cable, or radio, such, for example, as messenger service utilized in transmitting any information for which a toll is charged * * *.

If a charge is made by a telephone company for services rendered, by a messenger in paging and bringing a recipient of a message to the telephone, such charge is for a transmission service, within the meaning of article 2 of Regulations 42, and the tax attaches to the total charge made by the telephone company for services so rendered.

On the other hand, if the messenger service is not rendered by a telephone company but by a hotel or some other similar organization, such charge is not a charge made for the transmission of a message by a telephone company and no tax attaches to the extra charge under section 701(a)1(A) of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 7: Liability for tax. XII–6–6021
S. T. 634

Taxability of private messages transmitted over facilities subscribed for by the United States Government for official use.

Advice is requested relative to the tax imposed under section 701 (a) 1 (B) of the Revenue Act of 1932, with respect to private messages transmitted from points where telegraph facilities are subscribed for by the Government for official use.

Where telegraph facilities are subscribed for by the Government there is no way by which the telegraph company can distinguish private messages originating at such points from official messages, and, therefore, all messages transmitted from such points are treated as official and the governmental agency is billed accordingly.

Under the rulings of the General Accounting Office, where telegraph facilities are subscribed for by the Government for official use, the accountable officer of such agency is required to collect the regular charges in all cases where unofficial messages are sent for private individuals.

As the accountable officer of the governmental agency involved is the only person who can distinguish private and official messages, and since such officer collects the charges from the individuals liable therefor, the same officer should also be required to collect the tax on such private messages and to report and pay the tax so collected to the collector of internal revenue for the district in which the principal place of business of the telegraph company in question is located.

In all such cases the telegraph company may, for the purpose of its records, treat all messages originating at such points as though they are official and exempt from tax and let the accountable officer of the United States at such point assume full liability for collecting and reporting the taxes on all unofficial messages.

This ruling is in accord with General Regulations No. 40, Supplement No. 3, issued by the Office of the Comptroller General of the United States under date of October 28, 1932, which holds accountable officers of the United States responsible for collecting and reporting tax on all amounts collected by them for unofficial messages transmitted from points where telegraph facilities are subscribed for by the Government for official use.

REGULATIONS 42, ARTICLE 20: Public press. XII–10–6063
S. T. 646

Taxability of messages transmitted otherwise than in the collection of news for the public press.

Advice is requested concerning the taxability, under section 701 of the Revenue Act of 1932, of messages sent or received by newspapers and news agencies not relating strictly to the collection of news for the public press or to the dissemination of news through the public press.

Under article 20 of Regulations 42, as amended by Treasury Decision 4345 (C. B. XI–2, 520), exemption from the tax authorized with respect to payments received for services or facilities of this character applies only to the amount charged to newspapers or press associations for messages which deal exclusively with the collection of news for the public press or with the dissemination of news through the public press. This exemption is limited to messages from one newspaper or press association to another newspaper or press association, or to or from their bona fide correspondents which deal exclusively with the collection and dissemination of news items for publication through the public press, and does not extend to messages covering information or items for publication in magazines, periodicals, trade and scientific publications, published for information on certain subjects or of interest to certain groups, which are not strictly news in the commonly accepted meaning of the term. The exemption does not apply to administrative messages of newspapers or press associations.

The method of establishing the exempt status of messages sent or received by a newspaper is to be arranged between the telegraph company and the newspaper. The law requires, however, that in order to establish exemption the charges for messages must be billed in writing to the person paying such charges, provided such person is known to the carrier as being engaged in the business of collecting and disseminating news through the public press, and such person certifies in writing that the services and facilities are so utilized.

SECTION 711.—ADMISSIONS.

REGULATIONS 43, ARTICLE 1: Basis, rate, and computation of tax. XII–20–6182 S. T. 670

Taxability of a multiple or combination ticket.

Advice is requested concerning the taxability of a certain ticket of admission to dances and whether the entire amount paid for such a ticket is subject to the tax.

The ticket, which is perforated into three sections, is to be sold as one ticket. The first section is good for admission to the lounge, carrying a 40-cent charge; the second section is good for dance No. 1, which includes all dances until the intermission, carrying a charge of 20 cents; and the third section is good for the last dances, carrying a charge of 40 cents, making a total of $1.

The Bureau has consistently held that where, after paying one admission charge, subsequent charges are made for accommodations which are essentially an extension of the accommodations granted in return for the payment of the first admission, the tax attaches to the total amount paid for the combination ticket.

As each person attending the dance in the instant case pays the sum of $1 for admission and dancing, the total amount of $1 paid for the multiple or combination ticket is subject to a tax of 10 cents. The management is liable for the collection of such tax.

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REGULATIONS 43, ARTICLE 2: Meaning of the term "place." XII-18-6159 S. T. 664

Taxability of tickets for sight-seeing trips by aircraft.

Advice is requested concerning the taxability under section 711(a) of the Revenue Act of 1932 of charges for sight-seeing trips by aircraft.

The tax under section 711(a) of the Revenue Act of 1932 is based on "the amount paid for admission to any place." "Place" is a word of very broad meaning, and while it is not defined or otherwise limited by the Act, yet the idea it conveys is that of a definite location. The phrase "to any place" does not narrow the meaning of the word "admission," except to the extent that it implies that the admission is to a definite location.

Since transportation is not confined to a definite location, it is held that charges made for a ride in an aircraft, which is not affixed to the earth but moves through the atmosphere in any desired direction, are not amounts paid for admission to a "place" and are not, therefore, subject to the tax imposed by section 500(a) of the Revenue Act of 1926, as amended by section 711(a) of the Revenue Act of 1932.

REGULATIONS 43, ARTICLE 12: Admissions to which exemption applies. XII-4-6005 S. T. 631

Taxability of charitable organizations.

Advice is requested concerning the extent of the exemption from admissions tax which is applicable to charitable institutions.

It appears that a charitable organization purchases from a theater a number of seats and pays therefor the ordinary price fixed by the theater. All of the proceeds from this sale inure to the benefit of the theater. The charitable organization then sells the seats for a sum in excess of the price paid and this excess inures exclusively to the benefit of the charitable organization.

The question presented is whether the tickets are subject to tax when sold to the charitable organization by the theater and whether the excess charges are subject to tax when the tickets are again sold by the charitable organization to subscribers.

The exemptions in the law, as far as this particular question is concerned, provide that no tax shall be levied in respect of—

(1) Any admissions all the proceeds of which inure (A) exclusively to the benefit of * * * charitable institutions, societies, or organizations, * * *.

Article 12 of Regulations 43 provides, among other things:

Two classes of taxes are imposed by sections 500(a)1, 500(a)2, and 500(a)3. A tax on admissions proper which is to be paid by the person paying for admission (see ch. 1), and a tax on charges in excess of the regular or established price, which is to be paid by the person selling or disposing of tickets or cards of admission at prices in excess of the regular or established price thereof (see ch. 2).

In each case, it is necessary in order to give effect to the intent of the law with respect to the exemption to ascertain whether the charge for admissions proper or the excess charges inure exclusively to the benefit of a charitable organization. If the proceeds of either the

admissions or the excess charges inure exclusively to the benefit of a charitable organization, the exemption provisions are applicable to that portion.

In this case all the proceeds from the sale of the tickets by the theater, a nonexempt organization, were exclusively for the benefit of the theater and hence such sale is subject to tax, the exemption relating to charitable organizations not being applicable.

When the tickets are resold by the charitable organization all the proceeds of the excess charges inure exclusively to the benefit of the charity, an exempt organization, and hence such excess charges are exempt from tax, even though amounts paid for the admissions proper are taxable under section 500(a)1. See example (3), article 12, Regulations 43.

SECTION 721.—STAMP TAX ON ISSUES OF BONDS, ETC.

REGULATIONS 71, ARTICLES 5, 7, 125(d): Bonds, debentures, and certificates of indebtedness. XII–23–6218 G. C. M. 11794

Taxability of "judgment bond."

An opinion is requested whether an instrument designated as a "judgment bond" is subject to the stamp tax imposed by Schedule A–1 of Title VIII of the Revenue Act of 1926, as amended by section 721(a) of the Revenue Act of 1932.

Schedule A–1 imposes a stamp tax on all bonds, debentures, certificates of indebtedness, and all instruments, however termed, issued by any corporation, known generally as corporate securities, but the stamp tax does not apply to such instruments issued by individuals. The question has arisen whether this tax applies in the case of certain unincorporated associations in the State of R.

The tax applies to those instruments issued by corporations which are "known generally as corporate securities." Consequently, in order to be taxable, the instrument must not only be issued by a corporation (or an association within the meaning of the law and regulations, article 125(d) of Regulations 71) but the instrument so issued must be known generally as a corporate security. In other words, instruments taxable under Schedule A–1 are such corporate bonds, debentures, certificates of indebtedness, and other instruments as are ordinarily evidence of security for money and of the kind usually issued by corporations.

The instrument submitted in the case of the "A" congregation is executed in favor of the "B" National Bank by a single trustee, bishop of the diocese, who holds the mortgaged property in trust for the congregation known as "A." This congregation is a collection of individuals, unincorporated, and joined together for church purposes. The instrument is given, together with accompanying mortgage on the property, as collateral security for advances to be made up to $100,000 to the congregation on notes signed by the pastor of the church. Title to the property mortgaged is held by the bishop of the diocese in his official capacity and passes to his successor in office.

Under these facts it appears that the congregation has merely the use of the property for church purposes, with none of the elements of control over the trust or the conduct of a business enterprise such as are characteristic of associations. The instrument in question is not, therefore, one which is "known generally as a corporate security." Consequently, this instrument is not subject to the tax imposed by Schedule A–1.

The instrument submitted in the case of the M Lodge is executed by the trustees of the lodge in favor of the W Building and Loan Association and is accompanied by a mortgage. The lodge is not incorporated. The instrument in question evidences a loan to the trustees by the building and loan association. The title to the property is held by the trustees.

The same facts are true with respect to the instrument executed by the trustees of O Chapter, N Fraternity, with accompanying mortgage in favor of the W Building and Loan Association. Title to this property is held by the trustees of O Chapter.

The instruments referred to, executed by the trustees of M Lodge and the O Chapter, N Fraternity, in favor of the W Building and Loan Association, are similar to an instrument considered by the Circuit Court of Appeals for the Seventh Circuit in the case of *Wilkinson* v. *Mutual Building and Savings Association* (13 Fed. (2d), 997), construing section 1107, subdivision 1, Schedule A, Title XI of the Revenue Act of 1921, which imposed a tax upon the issuance of bonds, debentures, etc., by *any person*, and all instruments, however termed, issued by *any corporation* with interest coupons or in registered form, known generally as corporate securities.

In that case the court concluded that the words "generally known as corporate securities" must be held, not only by reason of the subject matter of the section but also by reason of the punctuation, to refer to bonds, debentures, or certificates of indebtedness, as well as to those instruments specifically referred to as being issued by corporations. The court held in effect that for a bond to be taxable it must be an instrument issued in the nature of a corporate security as distinguishable from the kind of an instrument used to evidence a loan between a small borrower and his building association.

The position taken by the court has been followed by the Bureau. Accordingly, in order to be subject to the tax imposed by Schedule A–1, instruments of indebtedness must not only (1) fall within one of the four classes of instruments described in the statute, namely, (*a*) bonds, (*b*) debentures, (*c*) certificates of indebtedness, and (*d*) instruments bearing interest coupons or in registered form, but must also (2) be such as are known generally as corporate securities.

The authority to tax, under Schedule A–1, instruments issued by associations is embodied in section 2(a)2 of the Revenue Act of 1926, which provides that "the term 'corporation' includes associations, joint-stock companies, and insurance companies." In order to hold an instrument issued by an unchartered group (as in the instant cases) subject to the issuance tax the entity issuing the instrument must meet the test of an association laid down in article 125(d) of Regulations 71. It is evident that neither of the organizations here in question has the characteristics or employs the form and procedure of a corporation in conducting a business enterprise. In view of the

foregoing it is held that the instruments in question, each evidencing a casual loan by a building and loan association to the trustees of an unincorporated organization, as borrowing members, are not subject to the tax imposed by Schedule A–1 of the Revenue Act of 1926, as amended by section 721 of the Revenue Act of 1932.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 722.—STAMP TAX ON ISSUES OF STOCK, ETC.

REGULATIONS 71, ARTICLE 29: Issues not subject to tax. XII–2–5984 G. C. M. 11387

Advice is requested whether the issue of stock by a certain national bank in exchange for the certificates of stock in a predecessor, a trust company organized under State laws, will incur stamp tax liability. The letter forwarded by the collector in which this question was raised reads as follows:

> This bank was recently converted from a trust company to a national bank and we are about to exchange the stock certificates of the trust company for new certificates of the national bank, no change in the value of the certificates, and we should like to know whether it will be necessary to apply revenue stamps in this exchange.

Schedule A–2 of Title VIII of the Revenue Act of 1926, as amended by section 722(a) of the Revenue Act of 1932, imposes a stamp tax—

> On each original issue, whether on organization or reorganization, of shares or certificates of stock, * * * by any corporation * * *.

The statute appears to be broad enough to include practically every original issue of stock. The question to be decided is whether the statute is applicable to the conversion of a State bank into a national bank and the issue of stock of the latter in exchange for the former. Section 5154 of the Revised Statutes, as amended by section 8 of the Federal Reserve Act, approved December 13, 1913 (38 Stat. L., 258), provides, in part, as follows:

> Any bank incorporated by special law of any State or of the United States or organized under the general laws of any State or of the United States and having an unimpaired capital sufficient to entitle it to become a national banking association under the provisions of the existing laws may, by the vote of the shareholders owning not less than 51 per centum of the capital stock of such bank or banking association, with the approval of the Comptroller of the Currency be converted into a national banking association * * *.

There are many State and Federal court decisions interpreting the foregoing section of the Revised Statutes. The leading case on the subject is that of the *Metropolitan National Bank* v. *Claggett* (141 U. S., 520). In that case it was material whether the Metropolitan National Bank was the same entity as the Metropolitan Bank of New York or was a new and different corporation. The State court held that it was the same corporation as the one from which it was converted. The Supreme Court said:

> * * * the change or conversion of the Metropolitan Bank into the Metropolitan National Bank did not "close its business of banking" nor destroy its identity or its corporate existence, but simply resulted in a con-

tinuation of the same body with the same officers and stockholders, the same property, assets, and banking business under a changed jurisdiction; that it remained one and the same bank and went on doing business uninterruptedly * * *.

This decision is so manifestly correct that it needs no argument to sustain it * * *.

Again, in *Coffey* v. *National Bank* (46 Mo., 140), it was held that upon the conversion of a State bank into a national bank the organization remains substantially the same institution under another name; that the transition does not disturb the relation of either the stockholders or officers of the corporation nor enlarge or diminish the assets of the institution, and that these all remain the same under the national as they were under the State organization. In the case of *Casey* v. *Galli* (94 U. S., 673) the Supreme Court held that by its conversion into a national bank every holder of shares of the capital stock of the State bank becomes a shareholder of the capital stock of the new bank to the amount of his shares, and as such is subject to the liabilities of such shareholders.

Under the foregoing decisions it may not properly be held that any taxable issue of stock occurs when the national bank issues its certificates of stock in exchange for the stock of the State bank. This view is embodied in S. T. 3–21–197: O. D. 82, published in the Cumulative Bulletin of Sales Tax rulings for the period January-June, 1921, page 71, and reading as follows:

When a State bank becomes a national bank by conversion neither the issue nor the surrender of stock incident to that conversion is subject to tax. Under the national banking laws the identity of the corporation and of its stock continues when by conversion it becomes a national bank. In such a case the stock outstanding of the State bank may merely be stamped to indicate the new name, and issue of new certificates and surrender of the old are not necessary.

The foregoing ruling was an interpretation of the stamp tax provision of the Revenue Act of 1918, which is substantially the same as that embodied in existing law. This ruling has been in force for more than 10 years. Since that ruling was published there has been no material change in existing law on the subject. The position taken therein is supported by the court decisions cited.

For the reasons stated, it is the opinion of this office that no stamp tax liability will be incurred through the issue of stock by the national bank in question in exchange for the certificates of stock in the trust company.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 723.—STAMP TAX ON TRANSFER OF STOCKS, ETC.

REGULATIONS 71, ARTICLE 29: Issues not subject to tax. XII–12–6088 S. T. 654

(Also Section 724, Regulations 71, Article 35.)

Taxability of sales or transfers of stocks or bonds by diplomatic representatives of foreign governments in the United States.

Advice is requested concerning the application of the stamp taxes imposed under Schedule A of Title VIII of the Revenue Act of 1926, as amended by sections 723 and 724 of the Revenue Act of 1932, on the sale or transfer of stocks or bonds where such sales or transfers are made by diplomatic representatives of foreign governments in the United States.

Under the application of the principles of international law, ambassadors, ministers, and other duly accredited diplomatic representatives of foreign governments, together with the members of their families, living with them, and members of their household, including attachés, secretaries, clerks, and servants, are entitled to exemption from the taxes imposed on transfers of stocks and bonds, if not citizens of the United States. The exemption is of such a character that it extends not only to the tax but also to the burden resulting directly from the tax and hence the taxes so imposed are without application to transfers by those enjoying exemption and may not, therefore, be assessed against the transferee or other party to the transaction.

REGULATIONS 71, ARTICLE 34: Sales or transfers subject to tax. XII-1-5969 S. T. 621

Advice is requested relative to the stamp tax liability incurred, under section 723(a) of the Revenue Act of 1932, on the transfer of stock certificates under the following conditions:

During the early part of 1932 one of the stockholders of a corporation caused a certificate standing in his own name to be exchanged for a new certificate in the names of himself and wife as joint tenants. Upon being advised that the transaction was taxable, the individual now desires to have another certificate issued in his own name.

The question raised is whether, in view of the fact that the original transfer was made through ignorance of the fact that such a transfer was taxable, the transfer which the individual now wishes to make will incur the transfer tax.

The transfer of the stock from the name of the individual and his wife as joint tenants to the name of the original owner clearly involves a transfer of legal title, which transfer is subject to the tax imposed by the law.

REGULATIONS 71, ARTICLE 34: Sales or transfers subject to tax. XII-12-6087 S. T. 653

Taxability of sales or transfers of stock of a foreign corporation.

Advice is requested concerning the application of the stamp tax imposed under Schedule A-3 of Title VIII of the Revenue Act of 1926, as amended by section 723(a) of the Revenue Act of 1932, to the following statement of facts:

X is holding in escrow certificates for shares of the capital stock of a Canadian corporation subject to various options in favor of a resident of New York. The option agreement between the company whose shares X holds and the resident of New York was executed in Canada. Pursuant to this agreement the certificates for

the shares in question were deposited with X in New York by the two parties to the agreement of option, who addressed a letter of instructions to X by the terms of which X is requested to make delivery of certain of the certificates from time to time to the optionee against payment to X for the account of the corporation of the specified price of option. The shares of stock are transferable only in Canada.

Article 34(p) of Regulations 71 provides that the sale or transfer within the territorial jurisdiction of the United States, of stock of a foreign corporation is subject to tax. This regulation, however, refers to the sale, transfer, or delivery, in the United States of stock of a foreign corporation where the transaction is made on books maintained in the United States, or the transfer is effected between parties in the United States. Since the "call" was executed in Canada and the agreement to sell concerned stock of a Canadian corporation, transferable only in Canada, it is held that the delivery of the certificates by X to the optionee upon exercise of his option right did not incur the tax imposed by Schedule A–3 of Title VIII of the Revenue Act of 1926, as amended by section 723(a) of the Revenue Act of 1932.

REGULATIONS 71, ARTICLE 34: Sales or transfers subject to tax. XII–18–6160 S. T. 665

It is held that where shares of stock are transferred from the name of a bank, as trustee of a revocable inter vivos trust, to the name of the same bank as executor of the estate of the grantor of the trust, the transfer is subject to the tax imposed by Schedule A–3, Title VIII of the Revenue Act of 1926, as amended by section 723(a) of the Revenue Act of 1932.

REGULATIONS 71, ARTICLE 34: Sales or transfers subject to tax. XII–21–6197 G. C. M. 11693

Taxability of voting trust certificates representing common stock issued under voting trust agreement.

Advice is requested whether liability to the stamp tax imposed by Schedule A–3 of Title VIII of the Revenue Act of 1926 was incurred in connection with the issuance of common stock of a corporation to voting trustees.

Pursuant to the action taken at a meeting of the board of directors of a new corporation it was proposed to issue shares of common stock to voting trustees under a voting trust agreement and to offer for sale to the stockholders of an old corporation voting trust certificates representing such common stock issued under the voting trust agreement. The proposal was adopted and three certificates, aggregating 67 shares of the stock, were issued to three persons as assignees of the incorporators. Pursuant to the authorization by the board of directors warrants for voting trust certificates were mailed to the stockholders of the old corporation. The voting trust agreement was signed by the voting trustees and the officers of the new corporation. On the same day the assignees of the three incorporators, pursuant to the provisions of the voting trust agreement,

transferred their certificates of stock to the voting trustees, such certificates being canceled and a new certificate for 67 shares being issued to the voting trustees.

From time to time thereafter, as payments were received from the subscribing warrant holders through the exercise of the rights to acquire voting trust certificates, the proceeds were applied by the new corporation as payments for stock, the corporation issuing the stock certificates in the names of the voting trustees and the voting trustees issuing voting trust certificates in the names of the subscribing warrant holders, that is, those who had paid the money for the stock so held in trust. At a meeting of the board of directors of the new corporation its officers were instructed to plan for an additional issue of its common stock to the extent of 50 per cent of that already outstanding, and to offer to holders of voting trust certificates the right to subscribe for voting trust certificates for such additional shares on the theory that the holders of the certificates were, in equity, the real stockholders of the corporation and, as such, entitled to subscribe for the additional stock. An offer was thereupon made to the then holders of voting trust certificates to acquire voting trust certificates representing this additional stock. The amounts paid for such additional voting trust certificates were accepted and treated by the corporation as the subscription price for the additional stock, the issuance of voting trust certificates being governed by the voting trust agreement hereinbefore referred to. Thereafter as payments were received, the stock and voting trust certificates were issued in the manner stated.

The stock transfer tax is an excise tax and, so far as the issue here involved is concerned, is laid upon "transfers of legal title to shares or certificates of stock * * * or to rights * * * to receive such shares or certificates * * * whether entitling the holder in any manner to the benefit of such stock * * * or rights, or not * * *." The tax is aimed at the transfer of legal title to stock and the obvious intent is to include not only actual transfers of legal title but also constructive transfers where the person having the legal right to receive the stock transfers such right to another, thus constructively transferring to such other person the legal title to the stock. It is designed to reach the transfer by the purchaser of stock of his right to take legal title in his own name. It is immaterial under the statute whether the person to whom the legal title to the stock, or to the right to receive the same, is transferred, is thereby entitled to any equitable or beneficial interest therein.

It is contended that under the express terms of the voting trust agreement the voting trustees were the subscribers for the stock and, as such, had the legal title to the right to receive the same and to have the certificates evidencing such legal title issued in their names; that the subscribing warrant holders acquired only the right to receive voting trust certificates; and that, not having any right to receive the stock or stock certificates, they could not have transferred that which they did not possess. The argument in support of this position is that the subscribing warrant holders subscribed not for stock but for voting trust certificates and that the amounts paid therefor, although actually paid to the corporation, were in reality payments to the voting trustees, the corporation merely acting as agent for the voting trustees who thereupon directed the

corporation to retain the payments as subscriptions for the stock, thus giving them the right, as subscribers, to have the stock issued in their names. The argument rests upon the theory that under the voting trust agreement the subscribing warrant holders had no right to subscribe for the stock, and that they did not subscribe for any stock.

The position thus taken is regarded as untenable. It rests upon the erroneous assumption that the voting trustees were the subscribers for the stock. As a matter of fact the voting trustees furnished no part of the purchase price of the stock and thus acquired no right to receive the same, except as acquired from the subscribing warrant holders. It is true that under the terms of the voting trust agreement the subscribing warrant holders parted with the right to have the certificates of stock issued in their names, but they and not the voting trustees were the subscribers for the stock. Obviously the only right of the voting trustees to have the stock issued in their names was that conferred by the voting trust agreement, to which, under its provisions, the subscribing warrant holders became parties upon their agreement to accept voting trust certificates. Thus the right so acquired by the voting trustees was acquired from the subscribing warrant holders through their assent to the voting trust agreement.

Corporate stock is deemed to be issued as and when subscriptions therefor are received and accepted by the corporation. It is immaterial when or whether stock certificates are executed or delivered. Of course, a voting trust agreement is effective only in respect of stock already issued and outstanding, the owner of which is a party to the agreement. In the instant case the stock, with the exception of the 67 shares subscribed for by the incorporators, was issued when and as the payments by the subscribing warrant holders were received and accepted by the corporation. Those payments constituted the consideration for the stock. Having furnished the consideration for the stock, the subscribing warrant holders thus became the owners of the stock, possessed of full proprietary right therein, except as they had otherwise provided. By becoming parties to the voting trust agreement they transferred to the voting trustees their right to receive certificates of stock, agreeing to accept voting trust certificates. That the subscribing warrant holders and not the voting trustees were the actual subscribers for the stock is demonstrated by the issuance in their names of these voting trust certificates as evidence of their beneficial interest in the stock. Whatever the voting trustees may have done in connection with the subscription for the stock they necessarily did as agents for the subscribing warrant holders to whom voting trust certificates were to be issued. Although there would appear to be no room for controversy on this point it is apparent that the position taken by the corporation, that the voting trustees in subscribing for the stock acted as principals and not as agents for the subscribing warrant holders, would afford no avenue of escape from the tax, for, if the voting trustees were entitled to the issuance of the stock in their names on the theory that they and not the subscribing warrant holders were the subscribers for the stock, obviously, the issuance of voting trust certificates by the voting trustees to the subscribing warrant holders could be regarded in no other light than as a transfer to the subscribing warrant holders of the beneficial interests rep-

resented thereby, which would be subject to the tax as a transfer of "legal title to * * * certificates * * * of profits or of interest in property or accumulations in any corporation * * *."

With respect to the question as to who is liable for the payment of the tax, the Bureau has consistently taken the position that under the provisions of section 800 of the Revenue Act of 1926, and the corresponding provisions of the prior Revenue Acts, transfer tax liability is incurred not only by the transferor but also by the transferee and the corporation whose stock is the subject of the transfer. Under the express language of the statute the tax in respect of the matters therein described is imposed upon "any person who makes, signs, issues, sells, removes, consigns, or ships the same, or for whose use or benefit the same are made, signed, issued, sold, removed, consigned, or shipped * * *." In this connection see case of *Granby Mercantile Co.* v. *Webster* (98 Fed., 604); also case of *Home Title Insurance Co. of New York* v. *Keith* (230 Fed., 905).

There can be no question in the instant case that the corporation was a party "for whose use or benefit" its stock was issued in the names of the voting trustees. Under the decisions referred to the corporation is subject to the tax as well as the transferors and transferees.

It is, therefore, the opinion of this office that the receipt and acceptance by the corporation of the payments made by the subscribing warrant holders operated as an issuance of its stock to such subscribers; that such subscribers were entitled to all the proprietary rights, both legal and equitable, in and to such stock, except as the subscribers might have otherwise authorized and directed; that by agreeing to accept the voting trust certificates they authorized and directed that the stock be deposited in the voting trust which was evidenced by the issuance of the stock certificates in the names of the voting trustees; that the evidence of their rights in and to such stock so deposited in trust lay in the voting trust certificates which entitled the holders thereof to receive the certificates of stock upon the termination of the trust; that such authorization and direction on their part and compliance on the part of the corporation by depositing the stock with the voting trust for the subscribers, operated as a transfer on their part of the legal title to such stock or a transfer on their part of the legal right to have the stock certificates issued in their names; that such transfer is subject to the tax imposed by subdivision 3, Schedule A, Title VIII of the Revenue Act of 1926; and that the corporation, as one of the parties interested in and benefited by the transaction, is liable for the payment of the tax.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

REGULATIONS 71, ARTICLE 34: Sales or transfers subject to tax. XII-24-6230 S. T. 680

Advice is requested whether the following transaction requires the payment of more than one transfer tax imposed by Schedule A-3 of Title VIII of the Revenue Act of 1926, as amended by section 723(a) of the Revenue Act of 1932.

A resident of the State of R died, leaving a will in which he bequeathed all of his property to his widow. The instrument was declared void by the court for the reason that the testator failed to mention two living sons. Among the assets of the estate were shares of stock. The sons of the deceased desired that their mother receive the entire estate and filed the necessary stipulation. The securities were divided into three equal parts. While the sons did not, in fact, take possession of any stock, certificates were prepared in their names and they, in turn, made an assignment of the stock to their mother immediately after issuance of the certificates.

It is held that under the terms of the law two transfer taxes are payable, one on the transfer of the shares from the estate of the deceased to the sons and mother, and the other on the transfer of the shares from the sons to their mother. The tax on each transfer should be computed at the rate of 4 cents on each $100 of face value or fraction thereof.

REGULATIONS 71, ARTICLE 34: Sales or transfers subject to tax. (Also Regulations 71, Article 79.) XII-25-6244 G. C. M. 11904

Stamp taxes on transfer of realty in corporate reorganization, and on right to receive stock.

An opinion is requested concerning stamp tax liability involved in the transactions described herein.

In the year 1932 a corporation was doing business in the State of T. Its charter was about to expire. Its directors and stockholders desired to continue the business and took the necessary steps to accomplish the purpose by forming a new corporation. The new corporation and the old corporation are identical in name, purpose, domicile, and membership. Two questions are raised, (1) whether the stamp tax on conveyances applies to the transfer of real estate by the old corporation to the new corporation, and (2) whether the issuance of stock in the new corporation directly to the stockholders involves a taxable transfer of the old corporation's right to receive such stock. These questions will be considered in the order given.

Schedule A-8 of Title VIII of the Revenue Act of 1926, as added by section 725 of the Revenue Act of 1932, imposes a stamp tax on conveyances, including 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, * * *.

In order to be taxable under the law the instrument must be a conveyance of realty "sold." Article 79 of Regulations 71 provides that—

The term "sold" imports the transfer of the absolute or general title for a valuable consideration or price.

Article 89 of those regulations provides that—

Stock in a corporation is a valuable consideration for the transfer of real property.

In the instant case the old corporation held the legal title to the real property. It transferred this property to the new corporation. The stockholders of the old corporation subscribed for stock in the new corporation in the same number of shares held by them in the old corporation. The evidence shows that these subscriptions were paid for by the transfer to the new corporation by the old corporation of all its assets. The transfer was made for a valuable consideration. The corporations were separate legal entities. Execution of the conveyance operated as a transfer of legal title and was required to effect such transfer. The instrument whereby the property was transferred resulted in a conveyance of real property and, in the opinion of this office, is subject to the stamp tax on conveyances imposed by the law.

Schedule A–3 of Title VIII of the Revenue Act of 1926, as amended by section 723(a) of the Revenue Act of 1932, imposes a stamp tax—

> On all sales, or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to any of the shares or certificates mentioned * * * in subdivision 2, or to rights to subscribe for or to receive such shares or certificates * * *.

In considering whether any stock transfer tax is involved in the transaction described, it is clear that the old corporation held legal title to all the assets. As the owner thereof it had the primary right to receive the consideration for the sale of such assets. Its stockholders went through the form of subscribing for stock in the new corporation, but the subscriptions were paid for by the transfer to the new corporation of the assets of the old corporation. The old corporation, as owner of the assets, had the primary right to receive the consideration therefor, namely, the new stock. The stockholders' right to the new stock thus came to them through the old corporation. When such stock was issued directly to them there was necessarily involved in the transaction a transfer of the old corporation's right to receive the new stock in exchange for its assets. It is, therefore, the opinion of this office that a taxable transfer of the old corporation's right to receive the stock is involved in the direct issuance of such stock to the stockholders. (See G. C. M. 7542, C. B. IX–1, 392.)

C. M. Charest,
General Counsel, Bureau of Internal Revenue.

Regulations 71, Article 35: Sales or transfers not subject to tax. XII–7–6032 S. T. 638

It is held that the transfer of stock standing in the name of two parties as joint tenants with right of survivorship to the name of the survivor upon the death of either party does not incur the tax imposed by Schedule A–3 of Title VIII of the Revenue Act of 1926, as amended by section 723 of the Revenue Act of 1932. Where a transfer is effected to either one or the other of the parties while they are both living, the tax imposed by Schedule A–3 will be incurred.

REGULATIONS 71, ARTICLE 35: Sales or transfers not subject to tax. (Also Section 722, Regulations 71, Article 28.)

XII-16-6139
G. C. M. 11699

Taxability of the surrender of old certificates of stock for extinguishment and the issue of new certificates.

An opinion is requested concerning the applicability of the stamp tax imposed by section 723(a) of the Revenue Act of 1932 to the transaction described hereinafter.

On October 24, 1931, the X Bank was in financial difficulties and was closed by State authorities. Its affairs were taken over by the State finance commissioner to preserve its assets for the benefit of creditors and depositors. On this date the bank had an authorized capital of $75,000, a surplus of $25,000, and undivided profits of $10,000. The finance commissioner called upon the stockholders to surrender all their certificates of stock, which was done. He decided that the bank could not reopen unless $100,000 in cash could be raised. This amount was secured by the sale of the stock previously surrendered and the bank reopened June 23, 1932. The old stockholders were granted the privilege of purchasing the new certificates. Some did so but there were some new stockholders. The stockholders held a meeting and elected a new board of directors. The president and cashier were the same. The authorized capital of the bank was the same. The procedure followed was suggested by the State finance commissioner in order to avoid the expense which would be involved in securing a new charter and transferring assets.

The first question to be decided is whether the surrender of the old certificates of stock was subject to the stamp tax imposed on sales or transfers of stock under Schedule A-3 of Title VIII of the Revenue Act of 1926, as amended by section 723(a) of the Revenue Act of 1932.

Article 35(f) of Stamp Tax Regulations 71 provides that the surrender of stock for extinguishment is not subject to the transfer tax. In a letter to the collector dated November 10, 1932, a representative of the bank stated, in part, as follows:

> The old stock was canceled on the books of the corporation and entirely new stock was issued. All that the old stockholders have, who did not buy any stock in the new bank is the right of participation in the dividends which may be declared at some future time from the collection of the assets which were cast out and segregated and listed by the finance commissioner. These assets are being collected and separated and used as secondary assets and can not be distributed until after joint approval by the board of directors and the finance commissioner.

Upon surrender of the old certificates the stockholders relinquished all their right, title, and interest in them. Their status as stockholders thereupon ceased. Upon cancellation of the certificates all evidence of ownership was wiped out. The transaction was not a sale or transfer but a surrender. The certificates were not transferred but were extinguished. There was no purchase of the stock for the benefit of the corporation, as exists in some cases. The State officials evidently forced the surrender. It is the opinion of this office that the release of ownership of the certificates of stock followed

by their cancellation was not a sale or transfer within the meaning of the law and is not subject to the stamp tax.

The second question raised concerns the taxability of the issue of the new certificates. Schedule A–2 of Title VIII of the Revenue Act of 1926, as amended by section 722(a) of the Revenue Act of 1932, imposes a stamp tax on each original issue of shares or certificates of corporate stock, whether on organization or reorganization of the company.

An original issue of stock has reference to stock never before issued. In the instant case there was no change in the authorized amount of capital, but, as already shown, the old capital was withdrawn from the assets of the X Bank and set aside for the benefit of the bank's creditors and depositors at the time when it was closed. The new certificates represented ownership in the new capital and were never before issued. The plan followed was a reorganization of the bank. For the reasons indicated it is the opinion of this office that the issue of the new certificates constituted an original issue of shares of stock upon the reorganization of the bank and were, therefore, subject to the issue tax.

C. M. Charest,
General Counsel, Bureau of Internal Revenue.

Regulations 71, Article 35: Sales or transfers not subject to tax. XII–20–6183 S. T. 671

Advice is requested concerning the application of the stamp tax to the transfer of certificates of stock where such stock is worthless.

It is stated that the estate of X, deceased, is selling stock certificates which have no value; that these certificates are grouped with some other property; but that no actual consideration is being received for the certificates.

If the issuing corporation has actually gone out of business, either through surrendering its charter or having its charter revoked by the State of its incorporation for nonpayment of taxes, etc., it is held that no stock exists. The corporation having been dissolved, the certificates are really not certificates of corporate stock because the corporation is no longer in existence.

On the transfer of certificates formerly issued by such dissolved corporation, no transfer stamp tax liability will be incurred. However, if the corporation is still in existence the transfer of the certificates is taxable under the law even though the certificates are otherwise worthless.

SECTION 724.—STAMP TAX ON TRANSFER OF BONDS, ETC.

Regulations 71, Article 120: Basis of tax. XII–1–5970 S. T. 622

Acquisition of bonds by a trustee of a sinking fund constitutes a surrender of the bonds for extinguishment or retirement and is not taxable as a sale to the trustee.

Advice is requested concerning stamp tax liability involved in the acquisition of bonds of the X Corporation by the trustee of the

sinking fund established by the corporation under the terms of a trust indenture between the corporation and the Y Bank, as trustee.

Under the provisions of the trust indenture, the trustee of the sinking fund can acquire bonds only by one of three ways, namely, (1) from the corporation, (2) by offers duly made by holders after public advertisement, or (3) by selecting certain bonds, by lot, for redemption. Each bond acquired by the trustee for the sinking fund is required by the trust indenture to be stamped in either of two ways, as the case may be, namely, "Redeemed for the sinking fund. Not negotiable," or "Purchased for the sinking fund. Not negotiable." There is no authority in the trustee to go into the open market to buy the bonds of the corporation for the sinking fund.

The transfer of bonds directly to the corporation, e. g., where the corporation purchases the bonds in the open market, is a taxable transfer within the provisions of Schedule A–9, Title VIII, of the Revenue Act of 1926, as added by section 724(a) of the Revenue Act of 1932, and is also within the provisions of article 34(i) and article 120 of Regulations 71.

The acquisition of bonds by the trustee of the sinking fund in accordance with the provisions of article 4 of the trust indenture constitutes a surrender of the bonds for extinguishment or retirement and is not a sale to the trustee. This is so (1) whether the bonds called for redemption are immediately canceled and extinguished, or (2) whether the bonds are surrendered for immediate cancellation pursuant to accepted tenders, or (3) whether the bonds acquired by the trustee are held uncanceled in the sinking fund, but stamped "Purchased for the sinking fund. Not negotiable."

REGULATIONS 71, ARTICLE 120: Basis of tax. XII–5–6012
S. T. 632

Transfer of legal title to bonds.

Advice is requested concerning several questions which have arisen regarding the stamp tax liability imposed by Schedule A of Title VIII of the Revenue Act of 1926, as amended by section 724 of the Revenue Act of 1932, on the transfer of legal title to bonds. The questions and answers are as follows:

Question. Whether a transfer by executors of an estate to themselves as residuary trustees is subject to tax.

Answer. The transfer is taxable. (See G. C. M. 7188, C. B. IX–1, 399.)

Question. Whether a transfer of a bond held by X as trustee for A to an account where X is trustee for B is subject to tax.

Answer. The transfer is taxable.

Question. Whether a transfer from a decedent to the executor of his will is a taxable transfer.

Answer. Transfer is not taxable, because it is effected wholly by operation of law.

Question. Whether a transfer of bonds from A to X as trustee for A under a revocable trust is subject to transfer tax. Here the legal ownership changes although subject to revocation.

Answer. The transfer is taxable.

Question. Whether upon revocation of a revocable trust the transfer of bonds is subject to a stamp tax.

Answer. The transfer of bonds from the name of a trustee to the name of trustor upon revocation of the trust constitutes a taxable transfer of legal title.

Question. Whether the situation is changed in either of the foregoing cases by the fact that the trust may be irrevocable.

Answer. No.

SECTION 725.—STAMP TAX ON CONVEYANCES.

REGULATIONS 71, ARTICLE 84: What constitutes real property determinable by law of State where located. XII–20–6184 G. C. M. 11732

Royalty deeds.

Advice is requested whether so-called "royalty deeds," used by the X Company in the State of Oklahoma, are subject to stamp tax as conveyances under Schedule A–8 of Title VIII of the Revenue Act of 1926, as added by section 725 of the Revenue Act of 1932.

It is stated that when the X Company sells a royalty interest in a lease or tract of land not under development the title to the land never passes and that the deed does not convey a fee title but conveys only an undivided interest in and to all of the oil, gas, and other minerals in and under, and that may be produced from, the land. The question to be decided is whether, under the law of Oklahoma, such an instrument is a conveyance of lands, tenements, or other realty, and, as such, is subject to tax under the law.

As an incident to the ownership of the land the owner has the right to drill for oil or gas and reduce to possession any oil or gas that he finds. This right to drill may be granted or reserved. But in some States, when such right is granted or reserved, there is not created a separate corporeal estate or interest in the oil and gas, but there is carved out of the fee an "incorporeal interest" or right to use the surface for drilling and for reducing to possession any oil or gas found, but this incorporeal interest attaches not to the oil and gas but to the land itself. This right may be designated as a profit a prendre.

Among the States which hold that oil and gas are not susceptible of ownership in place are Indiana and Oklahoma. (See Mills and Willingham, Law of Oil and Gas, page 45, section 31.) The leading case on this question is the case of *Ohio Oil Co.* v. *Indiana* (177 U. S., 190). The decisions in Oklahoma are in complete accord with, and rely for their authority on, the Ohio Oil Co. case. The leading case in Oklahoma is the case of *Rich* v. *Doneghey* (71 Okla., 204, 177 Pac., 86), and this case has been consistently followed in Oklahoma. (See *Dunlap* v. *Jackson*, 92 Okla., 246, 219 Pac., 314, 318; *Dill* v. *Rockwell*, 94 Okla., 25, 220 Pac., 620 (1923); *Kolachny* v. *Galbreath*, 26 Okla., 772, 110 Pac., 902, 906; and compare *Frank Oil Co.* v. *Belleview Gas & Oil Co.*, 29 Okla., 719, 119 Pac., 260, 261, 262.) These decisions make it clear that under the laws of Oklahoma a royalty

deed, which purports to convey, in perpetuity, oil and gas in place, is, in reality, a grant of part of the fee, that is, the exclusive right to drill for oil and gas on the land described and to reduce to possession any oil and gas so found. Such royalty deed, when unlimited in duration and being a conveyance of part of the fee, is a conveyance of lands, tenements, and other realty within the meaning of Schedule A–8 of Title VIII of the Revenue Act of 1926, as added by section 725 of the Revenue Act of 1932.

Further advice is requested relative to the taxability of such deeds, when, by their terms, the right to explore for and extract oil and gas is limited to a specified number of years. While a conveyance of oil and gas in place, with duration limited to a few years, is often referred to as a "royalty deed," it may be doubted whether it is in effect a deed. In practical effect it is not much more than a lease of the land to explore for and extract oil and gas. For purposes of identification, however, and not of description, these conveyances, of limited duration, will be designated as "royalty deeds."

The term "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. (See Bouvier's Law Dictionary, defining real property, freehold, chattel, estate for years, and fee. See also *First National Bank* v. *Dunlap*, 254 Pac. (Okla.), 729, and Tiffany, Real Property, volume 1, page 98, section 38.)

Schedule A–8 of Title VIII of the Revenue Act of 1926, as added by section 725 of the Revenue Act of 1932, imposes a tax on any deed, instrument, or writing, whereby any "lands, tenements, or other realty sold" are granted, assigned, transferred, or otherwise conveyed, etc.

A determinable fee (base or qualified fee) is distinguished from a life estate by the fact that, while the former may last forever, the latter terminates absolutely on the death of the life tenant. A base or determinable fee is distinguished from an estate for years by the fact that the latter terminates at the end of a fixed and definite period. (See 21 C. J., page 924, section 18; Bouvier's Law Dictionary, defining fee; Mills and Willingham, Law of Oil and Gas, page 60, section 43; and *Rich* v. *Doneghey*, supra.)

Applying these legal principles to this case it is apparent:

1. That a royalty deed of unlimited duration is a conveyance of real property.

2. That a so-called royalty deed for a limited number of years (or months), and thus having a definite time for termination, is a conveyance of an estate for years, that is, it is a chattel real or personal property.

3. That if a so-called royalty deed contains what is known as an "extension" or "thereafter" clause, whereby the grantee of the deed may explore for and extract oil and gas for a definite term and "thereafter as long as gas or oil is produced" or "thereafter as long as gas or oil is produced in paying quantities," or similar extension of the time limited in the deed, such "royalty deed" conveys a determinable fee and constitutes a conveyance of real property.

A royalty deed that falls within class (1) or class (3) is taxable under the statute as a conveyance of "lands, tenements, or other realty." One that falls within class (2) is not so taxable, inasmuch as it is a conveyance of personal property.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 731.—TRANSPORTATION OF OIL BY PIPE LINE.

REGULATIONS 42, ARTICLE 25: Effective period. XII–25–6242
S. T. 683

Taxability of oil in course of transportation at midnight on June 20, 1932.

Advice is requested whether oil which was in the originating pipe-line system at midnight on June 20, 1932, and later moved through other connecting pipe lines is subject to the tax imposed by section 731(a) of the Revenue Act of 1932.

It is stated that three pipe-line systems owned by separate corporations are connected for the transportation of oil in interstate commerce; that the oil in question was tendered to a pipe-line company prior to June 20, 1932, with instructions for delivery at the terminus of the third pipe-line company; that the transportation was continuous; and that the ownership of the oil did not change during the transportation.

The mere tender of oil to carriers for transportation can not be considered as originating the actual transportation by pipe line, within the meaning of the law. Transportation *originates* when the oil starts moving through the pipe lines of the originating carrier for a continuous movement to its consigned destination. Where transportation of oil actually originated prior to midnight of June 20, 1932, no tax attached to any continuous movement thereof, regardless of the number of carriers handling such oil in order to deliver it to its consigned destination, provided there was no break in the continuity of the movement.

A break occurs or the oil comes to rest when, as it moves from its point of origin to a consigned destination, it reaches a place where, at the instance of the shipper or consignee, or their agent, it is stopped for a business purpose, such as a sale, storage, refining or other manufacture, reconsignment, or reshipment, having no connection with the process of transportation. Instances of a break in the continuity of a movement are, (1) oil sent to a consignee at a certain place where the consignee, upon receipt of the oil, refines, mixes, or accumulates it for the purpose of selling it, or (2) oil consigned to a definite destination and, prior to its reaching that place, it is reconsigned to another destination. In this event a break occurs at the point where the reconsignment takes place. In each case the oil is stopped for a business purpose. The movement is not, therefore, a continuous one from the point of origin to the ultimate destination.

As previously indicated, the movement of the oil from the point of origin to its final destination must be continuous. If a break occurs at any point in transit, the first movement of the oil is complete and the transportation thereof is not taxable, provided the oil actually started moving through the pipe line prior to midnight of June 20, 1932.

REGULATIONS 42, ARTICLE 26: Basis of tax. XII-23-6217
S. T. 679

Export oil shipments.

Advice is requested concerning the taxability, under section 731 of the Revenue Act of 1932, of certain export oil shipments and the proper method of handling the same for tax purposes.

The X Company is a producer of crude oil. The Y Company of Canada is a refiner. The X Company sells to the Y Company a certain quantity of oil and arranges for its delivery to the refiner through the pipe lines of several companies. The question has arisen whether such shipments of oil are taxable.

Under the constitutional inhibition against taxing exports, the tax imposed by section 731 on the transportation of oil by pipe line does not apply to oil which is in course of exportation. Oil is in course of exportation when it has been started on its final voyage, or has been delivered to a carrier for continuous movement, to a point beyond the boundaries of the United States.

The test of tax exemption on transportation by pipe line of oil intended for exportation, is the continuity of the movement from the point of origin in the United States to its foreign destination. The mere fact that oil transported by pipe line is finally exported does not necessarily mean that it was continuously in course of exportation after it was started on its movement from its point of origin.

In order for a tender of oil to be considered as being in the course of exportation and exempt from tax, it must be shown (1) that prior to commencement of the movement the shipper had in his possession a contract or order calling for delivery of the oil beyond the boundaries of the United States, and (2) that subsequently there was delivered at a point of origin in the United States the amount and quality of oil covered by the contract or order, to be transported by a continuous movement to the destination beyond the boundaries of the United States.

In order to be exempt as an export shipment, there must be no break in the movement, the oil must not come to rest en route. In case there is a break in continuity, the first movement is domestic in its character and amounts paid for the transportation are taxable.

The mere tender of oil to carriers for transportation can not be considered as originating the transportation by pipe line. Transportation originates and the export movement begins when the oil starts moving through the pipe lines of the originating carrier for a continuous movement to its foreign destination. Where transportation of oil so originates, for export, no tax will attach to any continuous movement thereof, regardless of the number of carriers handling such oil in order to deliver it to its foreign destination. However, as

already indicated, there must be no break in the continuity of the movement, except in accommodation to the means of transportation.

A break occurs or the oil comes to rest when, as it moves from its point of origin to a foreign destination, it reaches a place where, at the instance of the shipper or consignee, or their agent, it is stopped for a business purpose, such as a sale, storage, refining or other manufacture, reconsignment, or reshipment, and not in accommodation to the means of transportation instituted by the carriers themselves. Instances of a break in the continuity of an export movement are, (1) oil sent to a consignee at a certain place within the United States en route to a foreign destination where the consignee, upon receipt of the oil, refines, mixes, or accumulates it for the purpose of selling it, or (2) oil consigned to a definite foreign destination and, prior to its reaching such destination, it is reconsigned at a point in the United States to another destination. In this event a break occurs at the point where the reconsignment takes place. In each case the oil is stopped for a business purpose. The movement is not, therefore, a continuous one from the point of origin in the United States to the foreign destination. After each break a new movement begins. Accordingly, the export movement free from tax is the one from the last point in the United States where the shipment is broken or the oil comes to rest.

The fact that the shipper is unable to identify, during the movement, the particular units of oil which are to be exported, does not destroy the export character of the shipment. Where a shipper holds orders for the sale of oil in foreign countries, and at that time a quantity of such oil to fill the order is being transported by pipe line without a break in the movement from an inland point to a port of exportation, and where *after arrival at the port of exportation* the necessary amount of oil called for by the foreign order is actually exported within the prescribed time, it is held that an amount of oil so transported, equivalent in quantity and quality to that actually exported, was in course of exportation for tax purposes.

Even though, in such cases, the oil which is shipped for export can not be identified as the oil actually delivered to the foreign customer, nevertheless the exemption will apply if it can be shown that, pursuant to the foreign order, the shipper tendered the oil called for in such order for transportation to such foreign customer, and that the oil so tendered was actually transported by pipe line, and reached the port of exportation on a continuous movement prior to the time that an equivalent amount and grade of oil was actually delivered to the foreign customer.

In all cases the person claiming exemption from the tax must retain in his files, in accessible condition, proof of the export character of the shipment. His files must show that at the time the oil started a contract, order, or other evidence of intention to export the oil for delivery at a place beyond the boundaries of the United States existed; that the oil so started was continuously transported; and that it was finally delivered to the foreign consignee.

The conclusions reached in this memorandum should be followed in determining the taxability of such oil shipments originating prior to June 21, 1932, and on or after that date.

SECTION 751.—CHECKS, ETC.

REGULATIONS 42, ARTICLE 36: Scope of tax. XII-4-6004
S. T. 630

Taxability of checks issued by schools, school districts, etc.

Advice is requested whether the tax imposed by section 751 of the Revenue Act of 1932 is applicable to checks issued by school districts of the State of Kansas.

Checks, drafts, or orders drawn by (1) officers of a State or political subdivision (2) in their official capacities, (3) against public funds, (4) standing to their official credit, (5) in furtherance of duties imposed upon them by law, and (6) in the exercise of an essential governmental function, are not subject to the tax. (Article 36, Regulations 42.)

School districts in the State of Kansas are a part of the system of public education of the State. The county superintendents of public instruction name the boundaries of school districts; the State board of education prescribes the courses of study for the public schools within the district; and the county superintendent, after receiving from the State superintendent of public instruction advice as to the amount of the State fund to be apportioned to the county, allocates the fund among the school districts and parts of districts in the county. The funds of the districts, whether received from the State or raised by the districts, are disbursed through boards of directors, duly elected by the voters of each district.

These boards consist of a director, a clerk, and a treasurer, whose duties are enumerated by the laws of the State, and a report of each board must be made annually to the county superintendent as well as to the voters of the district at a yearly meeting.

The members of the boards are officers in the State or political subdivision and act in official capacities in the disbursement of public funds standing to their official credit and in furtherance of duties imposed upon them by law.

The Supreme Court of the United States has held, in the case of *Burnet* v. *Coronado Oil & Gas Co.* (285 U. S., 393) that the State has a duty with respect to its public schools, and that the performance of that duty is the exercise of a function strictly governmental in character.

It is held, therefore, that the tax imposed by section 751 of the Revenue Act of 1932 is not applicable to instruments drawn by members of the boards of directors of school districts in Kansas acting in their official capacities in the disbursement of public funds.

On the other hand, checks drawn against receipts which are not strictly public funds but which are deposited in separate accounts and expended under the supervision of the school board for social, recreational, or extracurriculum activities, etc., such as receipts from school or class entertainments, athletic contests, cafeterias, school bands, donations, etc., would not come within the exemption accorded checks drawn against public funds, and are, therefore, taxable under section 751 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 36: Scope of tax. XII–22–6206
S. T. 677

Taxability of checks issued by a conservator.

Advice is requested whether the tax imposed by section 751 of the Revenue Act of 1932 is applicable to checks issued and charged to the account of a conservator of a National or State bank.

The immunity from taxation afforded insolvent banks by section 570, Chapter IV, Title 12, United States Code Annotated (March 1, 1879, ch. 125, section 22, 20 Stat., 351; March 3, 1883, ch. 121, section 1, 22 Stat., 488), applies only to banks which have ceased to do business because of insolvency or bankruptcy. (*Jackson* v. *United States* (1885), 20 Ct. Cl., 298; *Johnston* v. *United States* (1881), 17 Ct. Cl., 157.)

Checks issued by a conservator are subject to the tax imposed by section 751 unless and until the bank is actually insolvent, and it is shown that the imposition of the tax in question would diminish the assets of the bank necessary for the full payment of all its depositors.

REGULATIONS 42, ARTICLE 37: Liability. XII–13–6103
G. C. M. 11611

Claims of the United States against an insolvent bank on account of taxes collected on checks.

An opinion is requested whether taxes on checks collected under section 751 of the Revenue Act of 1932 prior to the date a bank fails or becomes insolvent should be regarded by the receivers for such banks as preferred claims or as general claims.

The attention of this office has been directed to certain rulings, which are claimed to be conflicting, relating to the collection of taxes from insolvent banks. In an unpublished ruling dated September 1, 1932, it was held that the Government's claims against certain insolvent national banks for check taxes had no priority over the claims of general creditors, whereas in S. T. 604 (C. B. XI–2, 539) and I. T. 2644 (C. B. XI–2, 120) it was held that the Government's claims for taxes collected before certain State banks became insolvent had priority over the claims of general creditors under section 3466 of the Revised Statutes.

The unpublished ruling of September 1, 1932, points out that section 3466 of the Revised Statutes, which provides that the United States shall have a preferred claim with respect to debts due from an insolvent bank, was held by the Supreme Court, in the case of *Cook County National Bank* v. *United States* (107 U. S., 445) to be inapplicable in respect of insolvent national banks. Accordingly, it was held that the Government's claim against an insolvent national bank covering taxes on checks collected under section 751 of the Revenue Act of 1932 is not a preferred claim and must be considered only as a general claim.

S. T. 604, supra, dealt with the question whether taxes on checks imposed by section 751 of the Revenue Act of 1932, collected by the X Bank, now insolvent, are Federal funds; and, if so, what steps

should be taken toward securing such funds from the State bank commissioner. It was held in that ruling that the bank which collects such taxes on checks is a debtor to the United States and that it and its representative must be dealt with as persons answerable for a debt under sections 3466 and 3467 of the Revised Statutes.

I. T. 2644, supra, the other ruling referred to, dealt with the question whether the M Bank, which was insolvent and which was being liquidated under the superintendent of banks of the State of X, was required to pay to the United States sums representing income taxes received by it as a withholding agent under an issue of tax-free covenant bonds. It was held that section 22 of the Act approved March 1, 1879 (20 Stat., 351), which deals with the exemption from the payment of Federal taxes of insolvent banks which are unable to pay their depositors in full, had no reference to the situation there presented, and that the bank was liable to the United States under section 3466 of the Revised Statutes with respect to the taxes so received by it before or after it was taken over by the superintendent of banks.

Although section 3466 of the Revised Statutes, as previously indicated, was held by the Supreme Court in *Cook County National Bank* v. *United States*, supra, to be inapplicable to insolvent *national* banks, section 3466 has been expressly held to be applicable to insolvent *State* banks. (Cf. *United States* v. *Brock*, 5 Fed. (2d), 265; *United States* v. *Adams*, 9 Fed. (2d), 624; *United States* v. *Porter*, 19 Fed. (2d), 541.) S. T. 604 and I. T. 2644, both of which deal with insolvent State banks, are, therefore, clearly distinguishable from the unpublished ruling which dealt with insolvent national banks.

The claim of the United States against an insolvent national bank on account of taxes on checks collected under section 751 of the Revenue Act of 1932 is to be regarded as a general claim and not as a preferred claim. Similarly, the claim of the United States against an insolvent national bank on account of income taxes collected by it as a withholding agent under an issue of tax-free covenant bonds is a general claim and not a preferred claim.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

SECTION 761.—TAX ON USE OF BOATS.

REGULATIONS 72, ARTICLE 6: Boats not subject to tax. XII-1-5971 G. C. M. 11351

An opinion is requested concerning several questions relative to the tax on the use of boats imposed by section 761 of the Revenue Act of 1932. The questions and the answers thereto are as follows:

Question 1. Does the tax apply to yachts which have never been to the United States but are owned by citizens who are using them in foreign waters?

Answer. Section 761 of the Revenue Act of 1932 imposes a tax upon the use of certain types of boats. The law affords no conclusive evidence concerning the intention of Congress with respect to

the place of use of the boats subject to the tax, but the Department has concluded that in order to be taxable the use of the boat must be within the jurisdiction of the United States. Consequently, the tax does not apply to yachts used solely in foreign waters but attaches to boats used in United States waters at any time during a taxable period.

Question 2. Is the tax applicable to a yacht which, after having repairs made to her engines by a builder or repairer, is run by the builder or repairer to determine whether the engines function properly, the yacht in question not being used by the owner during such trial and a successful trial being a part of the specification of the repair job?

Answer. The word "use," appearing in the law, must be considered as having reference to a normal use. If a yacht, after being repaired, is operated by the builder or repairer solely for the purpose of testing the efficiency of the repair job and of determining whether it is functioning properly, such operation is not deemed to be a taxable use.

Question 3. Will the Bureau of Internal Revenue, in construing the tax, follow the decisions of the Supreme Court under the Tariff Act of 1909?

Answer. The tariff law of 1909 (36 Stat. L., 11) authorized the collection of customs duties upon the use of every foreign built yacht "by any citizen or citizens of the United States." The customs duty being thus laid upon the use of a yacht by a citizen of the United States, the situs of the yacht was immaterial and the courts have so held. In construing the terms of section 761 of the Revenue Act of 1932 the Bureau will not follow the decisions interpreting that tariff law, because it imposes the customs duty on use by a citizen, whereas the revenue law imposes the tax merely on use irrespective of the citizenship of the user.

Question 4. Is this tax applicable to a yacht which is laid up, out of commission, alongside a pier with a skeleton crew on board for purposes of maintenance and protection of the vessel against fire and sinking? Compare *Pierce* v. *United States* (232 U. S., 290).

Answer. If, as indicated, there is no normal use of the yacht, no tax attaches.

Question 5. If a yacht is laid up, out of commission, but instead of being alongside a pier lies at anchor or mooring with a skeleton crew on board and is not used by the owner, does the tax apply?

Answer. The location of a yacht not in use is an immaterial factor for revenue purposes. However, the mere fact that it is not used by the *owner* does not warrant exemption from the tax. If it is used by anyone within the waters of the United States for even one day the tax attaches.

Question 6. Is a yacht which is in commission and capable of being used subject to the tax if in fact the owner does not use it?

Answer. Use in United States waters being the criterion of taxability, the mere fact that the yacht is in commission and ready for use does not warrant imposition of the tax. However, as already stated, use by anyone incurs tax liability.

Question 7. What local official will be charged with the duty of checking up on the use or nonuse of yachts?

Answer. Article 11 of Boat Tax Regulations 72 provides that every person liable for the tax shall file a return with the collector of internal revenue of the district in which he is located. The user of a boat should take the initiative in ascertaining his liability to tax under the law and should bring the matter to the attention of the collector of his district, who will take the necessary steps to determine tax liability. However, collectors of all districts bordering on United States waters have a measure of responsibiliy in this respect and should check up on boats used in their district in order to insure full compliance with the law.

Question 8. If an officer is designated to inspect a yacht with respect to use or nonuse and makes such inspection, will it be done without cost to the yacht owner or will the owner be required to pay the expenses of such officer?

Answer. Inspections of this character are made by revenue officers in the service of the United States and will usually be conducted solely at the expense of the Federal Government. However, the user of a boat will be expected to cooperate with revenue officers in accomplishing this object, even though such compliance involves some expense to him.

Question 9. Section 761(g) of the Revenue Act of 1932 refers to penalties imposed by section 702 of the Act of 1926. What are the penalties referred to in the Act of 1926 which will be applicable? We have found no specific lien against a vessel provided by either of the Acts of 1926 or 1932.

Answer. Section 761(g) of the Revenue Act of 1932 provides that—

> All provisions of law (including penalties) applicable in respect of the taxes imposed by section 702 of the Revenue Act of 1926 shall, in so far as applicable and not inconsistent with this Act, be applicable in respect of the taxes imposed by this section.

The penalty terms of law deemed to be particularly applicable to this tax are set forth under the miscellaneous provisions of Regulations 72 (revised July, 1932). The Bureau is not restricted to these laws, however, and may take action under any pertinent revenue law now in force in making collection of this tax, including section 3186 of the Revised Statutes, as amended, relating to liens for taxes.

Question 10. If a yacht is in fact not used, what obligation or necessity is there of making any return?

Answer. As already indicated, if a yacht is not used at any time during a taxable period, no tax liability is incurred. There being no tax liability, no return need be filed. However, attention is again called to the fact that use for even one day during a fiscal year incurs tax liability for the unexpired portion of the year in which the use occurs. (See article 3, Regulations 72.) Thus the possibility of use and the consequent liability for the tax are continuing and do not terminate until the close of the year.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

REGULATIONS 72, ARTICLE 6: Boats not subject to tax. XII-10-6064 G. C. M. 11519

Reference is made to General Counsel's Memorandum 11351 (page 446, this Bulletin), concerning 10 questions and answers relating to the tax imposed on the use of boats.

Reference is now made to answers to questions 4 and 5, previously considered, and the view is expressed that they indicate a different treatment for yachts which are laid up than for those having a skeleton crew and located at mooring or at anchor. Questions 4 and 5 and the answers thereto are as follows:

Question 4. Is this tax applicable to a yacht which is laid up, out of commission, alongside a pier with a skeleton crew on board for purposes of maintenance and protection of the vessel against fire and sinking? Compare *Pierce* v. *United States* (232 U. S., 290).

Answer. If, as indicated, there is no normal use of the yacht, no tax attaches.

Question 5. If a yacht is laid up, out of commission, but instead of being alongside a pier lies at anchor or mooring with a skeleton crew on board and not used by the owner, does the tax apply?

Answer. The location of a yacht not in use is an immaterial factor for revenue purposes. However, the mere fact that it is not used by the *owner* does not warrant exemption from the tax. If it is used by anyone within the waters of the United States for even one day the tax attaches.

The normal use of a yacht in United States waters is deemed to be the criterion of taxability under the law. If there be no normal use, no tax is due, irrespective of whether the yacht not being used is alongside a pier or moored at anchorage. In the answers to questions 4 and 5 the Bureau had that criterion in mind. The mere presence on a yacht at anchorage or elsewhere of a skeleton crew for the sole purposes of maintenance and of protection against fire or other hazard does not warrant the conclusion that the yacht is being used or that it is taxable under the law. If, however, this skeleton crew should take a cruise in the yacht, either with or without the owner, the tax would attach.

It is also suggested that the answers to questions 5 and 6 are inconsistent. Question 6 and the answer thereto are as follows:

Question 6. Is a yacht which is in commission and capable of being used subject to the tax if in fact the owner does not use it?

Answer. Use in United States waters being the criterion of taxability, the mere fact that the yacht is in commission and ready for use does not warrant imposition of the tax. * * *

Referring again to the rule that normal use is the criterion of taxability, it is immaterial whether the yacht is ready for use or not ready for use, whether in commission or out of commission, whether with a skeleton crew or without one, whether at anchorage in the stream or alongside a pier—none of these factors nor all of them combined constitute the use of a boat within the meaning of the law. This office agrees fully with the view that there is no more a use of a yacht under question 6 than under question 4 or 5. This office can see no inconsistency in the answers to questions 4, 5, and 6 as given.

Reference is made to the fact that the answer to question 3 contains the following sentence:

* * * In construing the terms of section 761 of the Revenue Act of 1932 the Bureau will not follow the decisions interpreting that tariff law, because it imposes the customs duty on use by a citizen whereas the revenue law imposes the tax merely on use irrespective of the citizenship of the user.

Inquiry is made whether the Bureau would impose the tax on the use in United States waters by an alien of a foreign-built yacht flying a foreign flag. It is suggested that collection of the tax in such a case might be construed as failure to extend to the yachts of friendly nations the reciprocal privileges contemplated by section 5 of the Act of May 28, 1908 (35 Stat., 425), which is reproduced in section 104 of Title 46, U. S. C. A. This section of the law relates to the reciprocal exemption of foreign yachts from certain charges and tonnage taxes. It provides, inter alia, that—

* * * the Secretary of Commerce may authorize and direct the customs authorities at the various ports and subports of entry of the United States to allow yachts from such foreign port belonging to any regularly organized yacht club thereof to arrive at and depart from any port or subport of the United States and to cruise in waters of the United States without the payment of any charges for entering or clearing, dues, duty per ton, or tonnage taxes * * *.

The charges and tonnage taxes referred to in that law are very different from the internal revenue excise tax imposed on the use of boats. The Secretary of Commerce is authorized to take action under the reciprocal exemption provisions quoted but he has no jurisdiction whatever over internal revenue excise taxes. These taxes come within the exclusive province of the Secretary of the Treasury. It is a well-established rule that a taxing statute allowing exemptions must be construed strictly in favor of the Government. (*Bank of Commerce* v. *Tenn.*, 161 U. S., 134.) Clearly exemption from tax may not be extended to yachts of friendly nations in the absence of legislation specifically granting such exemption. For many years a tax on the use of boats in United States waters has been collected, irrespective of whether the boats were owned by citizens or aliens. Provisions requiring collection of the tax on that basis have been embodied in each successive edition of the boat tax regulations. New revenue laws have been enacted by Congress since those provisions were first adopted but without any legislative change affecting those provisions. This course has long been recognized as an implied sanction by Congress of the interpretation adopted by the Treasury Department (*Brewster* v. *Gage*, 280 U. S., 327; *National Lead Co.* v. *United States*, 252 U. S., 140; *Logan-Gregg Hardware Co.* v. *Heiner*, 26 Fed. (2d), 131).

Article 6 of Regulations 72 provides that boats used by nonresident aliens which merely touch American ports or are operated only occasionally in United States waters are not used in such waters within the meaning of the law but that boats in general use in those waters are subject to the tax even though of foreign register or owned by nonresident aliens. This position is deemed to be fully warranted by the terms of the law and is as far as the Bureau may go in the matter of extending freedom from the tax to foreign-owned yachts. It is reasonable to presume that if Congress intended that the exemption embodied in section 104 of Title 46, U. S. C. A., should be applied to the excise tax on the use of boats it would have enacted legislation to that effect.

Advice is also requested concerning the taxability under the revenue law of launches or lifeboats which are long enough to be subject to the tax on the use of boats but are really a part of the equipment of yachts and which, as such, are not subject to the tariff imposed on yachts imported into this country. It is presumed that because no customs duty is collected on these launches or lifeboats, on the ground that they constitute a part of the equipment of dutiable yachts, the Bureau of Internal Revenue should, for the same reasons, exempt such craft from the excise tax on the use of boats.

Paragraph 370 in the Tariff Act of 1930 imposes duties upon certain specified articles, including motor boats. Section 446 of that Act provides that vessels arriving in the United States from foreign ports may retain on board the legitimate equipment of such vessels without payment of duty. It is stated that Mr. X has secured exemption from tariff duties for five lifeboats or launches comprising the equipment of two of his yachts. The correspondent cited a communication from the Treasury Department as authority for the exception which reads, in part, as follows:

> It is conceded by the company that the yacht itself was properly dutiable under paragraph 370 of the Tariff Act of 1922 but the company contends that the equipment is free of duty under section 446 of the Act which provides in part that legitimate equipment of vessels arriving in the United States from foreign ports may be retained on board without the payment of duty. This provision indicates that it was the attitude of Congress in passing this section that in the absence of some such provision such equipment even though retained on board the vessel would be subject to duty.
>
> In view of the foregoing the Department is of the opinion that the legitimate equipment is by the specific terms of section 446 not subject to duty. This conclusion is based in part upon the theory that in the opinion of Congress a vessel and its equipment are separate units and as paragraph 370 imposes a duty only on the motor boat it would appear reasonable to assume that the term should not be construed to include the equipment of the yacht.

The clear inference to be drawn from the foregoing statements is that the launches or lifeboats in question would have been dutiable under the tariff Act but for the exemption on the equipment of the yachts. The revenue law grants no exemption to the equipment of boats subject to tax. The facts that no duty was collected on the launches or lifeboats; that a duty was paid only on the yachts to which they belong; and that an internal revenue tax has also been paid on the yacht in use—none of these facts nor all of them combined warrant the exemption of these launches from such internal revenue tax. If none of the launches or lifeboats over 28 feet in length and with means of self-propulsion, comprising equipment of the yachts, are actually used in United States waters, no tax will be due on any of them; but, on the other hand, if one or more of them comes within the terms of the law as to use, length, and means of propulsion, the tax will be due, even though they do comprise a part of the equipment of the yachts and their use is secondary. In this connection it will be noted that the law grants exemption from the tax to any yacht or boat used without profit for benevolent, charitable, and other specified purposes. None of the exemptions can be so construed as to cover boats used as equipment unless it should also appear that their use is for one or more of the exempt purposes specified in the taxing measure.

C. M. Charest,
General Counsel, Bureau of Internal Revenue.

TITLE II.—MISCELLANEOUS TAXES. (1928)

PART II.—TAX ON DUES.

REGULATIONS 43 (1932), ARTICLE 36: Social clubs. XII-26-6256
Ct. D. 691

DUES TAX—REVENUE ACTS OF 1924, 1926, AND 1928—DECISION OF COURT.

FACULTY CLUB—WHETHER TAXABLE AS SOCIAL ORGANIZATION.

A club was organized primarily for members of the faculty of the University of Chicago, but membership was selective, depending upon election, and was not confined entirely to faculty members. The building it occupied was erected by the university upon its own property and leased to the club at a nominal rate, and was equipped with kitchen, dining and bed rooms, and facilities for entertainment and recreation. The by-laws specified that the public rooms should not be habitually used for transaction of business or as a place for work or study, and provided for an entertainment committee, which arranged many social affairs, as well as lectures and concerts, throughout the season. The club was properly classed as a social organization within the meaning of the applicable Revenue Acts, and its members were therefore subject to the taxes imposed upon dues, since its social features constituted a material purpose of its organization and were not merely subordinate and incidental, notwithstanding testimony of certain faculty members that the club was but an adjunct of the university and that its main purpose was to supply a convenient place for faculty members to meet and discuss their professional problems while dining.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Quadrangle Club, appellant, v. *The United States of America, appellee.*

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division.

[March 24, 1933.]

OPINION.

ALSHULER, Circuit Judge: Appellant sued to recover taxes collected on the dues of its members. Trial was by the court and judgment went for appellee.

The section of the Revenue Act whereunder the tax was levied specifies that there shall be paid a tax of 10 per cent of any amount paid "as dues or membership fees to any social, athletic, or sporting club or organization * * *." The applicable Treasury regulation is:

"Any organization which maintains quarters or arranges periodical dinners or meetings, for the purpose of affording its members an opportunity of congregating for social intercourse, is a 'social * * * club or organization' within the meaning of the Act, unless its social features are not a material purpose of the organization but are subordinate and merely incidental to the active furtherance of a different and predominant purpose, such as, for example, religion, the arts, or business. The tax does not attach to dues or fees of a religious organization, * * * chamber of commerce, commercial club, trade organization, or the like, merely because it has incidental social features, but, if the social features are a material purpose of the organization, then it is a 'social * * * club or organization' within the meaning of the Act."

Whether or not the social features of this club are "a material purpose of the organization" or are merely subordinate and incidental to a predominant purpose, must determine this appeal.

The club was chartered in 1895, for the object stated in the application of "the association of members of the faculties of the University of Chicago and other persons interested in literature, science, or art, for the purpose of mutual improvement and social recreation, * * *." Provision was made for

six classes of membership: "life, active, associate, nonresident, alumni, and quarterly" members. Active membership was limited to selected members of the faculties of the University of Chicago and these only were entitled to vote and to hold office, except that certain life members, limited in number, might have the privileges of active members; but all classes of members are entitled to the club privileges. The initiation fee for active members is $50, and the annual dues are $40. There are differing rates for the other classes of membership.

The club was located with convenient access to the university buildings. In 1916 the club deeded its club property to the university, and the university agreed to and did expend $100,000 in the erection of a new clubhouse on university property, which was leased to the club for 100 years at $1 per annum, with heat and hot water to be supplied at cost by the university.

The building there so constructed by the university and occupied by the club is a three-storied brick structure, containing a card room, billiard room (having six tables), library, writing room, chess room, sun porch, a main and a private dining room, stage, kitchen, help's dining room, 17 bed rooms, linen room, trunk room, offices, employees' bed rooms, store rooms, toilets, two lounges and dressing rooms, and gymnasium. There are also tennis courts on the premises for use of members.

Men eminent in their profession and high in the university faculty testified that the club was but an adjunct of the university, intended to supply a convenient and appropriate meeting place, primarily for the faculty members, who might there come together and discuss their problems while dining or lunching; and that every day there were such meetings of various groups in the faculty, and that the convenience of access of the club and its facilities enabled them to economize in time by dining or lunching at the same time that they conferred over their university problems. They testified that the social features of the club were merely incidental to this main purpose.

It is readily conceivable that the club, thus situated in the immediate vicinity of the university buildings, affords those conveniences and opportunities as was testified, and that the faculty members frequently availed themselves thereof. But all this does not negative the conclusion that the social features of the club may be a coordinate or even its predominating feature.

The fact alone that persons habitually gather at clubs to talk over business affairs does not minimize the relative importance of the club's social activities, nor relegate to insignificance the social features as an effective influence in drawing together persons who may there "over the teacups" discuss their common problems. Whether the persons who thus come together be of different professions or callings, or be largely of the same, or whether they are affiliated with the same or different institutions is not necessarily material, provided the usual club structure is present, with its members paying dues as in clubs generally.

Membership in the faculty does not of itself entitle one to club membership; club membership is selective, depending on election, as in most clubs. Frequency of attendance by nonmembers is limited by the by-laws, but interest in university problems is presumably not limited to the club-member part of the faculty; and so it is conceivable that at times there might be embarrassment amounting to impracticability in holding such meetings at this private club.

If the only purpose of the club were to serve as a place for considering university problems while lunching or dining, a mere dining room with kitchen attachment would likely suffice. But such a place would not be likely to attract many patrons. Here we have the complete lay-out of the ordinary social club, as the above specification would indicate, all for the delectation and comfort of the members, their families and their guests.

Several of the membership classifications are not even necessarily connected with the university faculty, and their connection with the club would no doubt be largely, if not entirely, social.

That this club, with its approximately 800 members, was not intended to be merely or mainly an intellectual workshop or clearing house for the university faculties is persuasively suggested by one of the club by-laws, which prescribes: "The public rooms of the clubhouse shall not be habitually used by members for the transaction of business or as a place for work or study."

The evidence of the specific social activities of the club during the period in question is strongly indicative that the social features are not merely incidental. One of the by-laws makes provision for a committee on "entertainment and games," and each season the committee publishes a list of affairs

to be given. Of these there were quite a number each month of such nature as dances, afternoon and Sunday teas, smokers, billiard and bridge tournaments, bridge nights, Christmas revels, children's parties, and ladies' nights—not to mention numerous lectures, talks, and concerts, which were in the main not less entertaining than cultural.

The club seems to have assumed its social status by paying the tax without protest from 1920 until 1929, when demand for refund was first made to the Commissioner. For most of the years demanded the statute of limitations had run, thereby reducing the claim from about $20,000, as filed, to about $9,000, which is now involved.

We considered circumstances quite similar in *Fleming* v. *Reinecke* (52 F. (2d), 449 [Ct. D. 369, C. B. X–2, 410]), reaching the conclusion that the Traffic Club of Chicago was taxable as a social club.

Peculiarly here applicable is the following quotation from *Faculty Club of the University of California* v. *United States* (65 Ct. Cls., 754 [T. D. 4228, C. B. VII–2, 335]):

"While this club undoubtedly serves an important administrative use by members of the faculty and officers of the university, and furnishes a medium for a wide range of academic activities, it is not an essential adjunct to the university. It is shown in the evidence that all the work now performed in the club could be done without such a club. However, a social club of this nature must unquestionably have a very definite value in the promotion of the general welfare of this great university. To hold that 'its social features are not a material purpose of the organization,' or that its purposes and activities are 'merely incidental to the active furtherance of a different and predominant purpose,' would be contrary to the declared purposes of its organization and to the usual and customary social activities of the club throughout the 26 years of its existence. The court has reached the conclusion that the Faculty Club of the University of California is a social club within the meaning of the taxing statutes."

We conclude that the district court correctly decided the case, and its judgment is affirmed.

REGULATIONS 43, ARTICLE 42: Life membership. XII–25–6243
S. T. 684

Liability to tax where life member resigns from club.

A question has been presented with respect to the liability of life members of a social, athletic, or sporting club or organization to the tax imposed by section 501(c) of the Revenue Act of 1926, as amended by section 413(a) of the Revenue Act of 1928.

During the past few years a number of life members of social, athletic, or sporting clubs or organizations have found that they are unable to pay the tax imposed by the above-mentioned section. Some of these life members prefer to resign from such clubs or organizations in order to escape liability for the tax. Question has arisen as to the liability of such members.

As long as a life member of a social, athletic, or sporting club or organization retains his status as such, he is liable to a tax in an amount equivalent to the tax paid on the dues of an active resident annual member of such club or organization. The tax is due whether or not the life member actually uses the club facilities. Where a life member relinquishes his membership through transfer thereof or by resignation, and his status as a life member is terminated by the club, his liability to the tax ceases. However, a life member is liable to the tax until his membership is terminated by appropriate action of the club or organization making the transfer or resignation effective.

PART V.—STAMP TAXES.

REGULATIONS 71, ARTICLE 53: Passage tickets issued to Federal and State officials, etc. XII–6–6022 S. T. 635

Advice is requested concerning the taxability of passage tickets sold to a State welfare department under the following circumstances:

The welfare department of the State of —— is paying the transportation for the return of indigent aliens to the country of their nativity.

The welfare department consists of various commissions. It was created by acts of the legislature of, and is supported by, the State. The welfare department being controlled and supported by direct appropriations of the State, and the care of indigent persons being an essential governmental function, it is held that the sale of passage tickets to such department is not subject to the tax imposed by Schedule A–5 of Title VIII of the Revenue Act of 1926, as amended by section 442 of the Revenue Act of 1928.

REGULATIONS 71, ARTICLE 53: Passage tickets issued to certain foreign representatives. XII–24–6231 S. T. 681

Exemption of diplomatic and consular officers from the tax on passage tickets.

Advice is requested with respect to the exemption of diplomatic and consular officers in this country from the tax imposed on passage tickets by Schedule A–5 of Title VIII of the Revenue Act of 1926, as amended by section 442 of the Revenue Act of 1928.

Under the application of the principles of international law, ambassadors, ministers, and other duly accredited diplomatic representatives of foreign governments, together with the members of their families, living with them, and members of their household, including attachés, secretaries, clerks, and servants, are entitled to exemption from the taxes imposed on passage tickets, if not citizens of the United States.

Consular officers are not of the diplomatic class and are not generally exempt from taxation in the absence of treaties between nations. The question of exemption from taxation of consular officers has been considered by this Bureau with respect to the following countries, and by reason of existing treaties between the United States and the countries enumerated, exemption from the tax on passage tickets applies to the following officers of these countries, provided such officers are not engaged in professional business, trade, manufacture, or commerce:

Argentina.—Consuls.
Austria.—Consular officers.
Belgium.—Consuls general, consuls, vice consuls, and consular agents.
Bolivia.—Consuls and vice consuls.
China.—Consular officers.
Colombia (New Granada).—Consuls and vice consuls.

Costa Rica.—Consuls.
Cuba.—Consular officers.
Denmark.—Consuls and vice consuls.
Estonia.—Consuls general, consuls, vice consuls, and consular agents.
France.—Consuls general, consuls, vice consuls, and consular agents.
Greece.—Consuls general, consuls, vice consuls, and consular agents.
Honduras.—Consular officers.
Hungary.—Consular officers.
Italy.—Consuls general, consuls, vice consuls, and consular agents.
Japan.—Consuls general, consuls, vice consuls, deputy consuls, and consular agents.
Latvia.—Consular officers.
Norway.—No exemption to September 13, 1932, on which date treaty became effective; consular officers since that date.
Paraguay.—Consuls.
Rumania.—Consuls general, consuls, vice consuls, and consular agents.
Siam.—Consuls general, consuls, vice consuls, and other consular officers or agents.
Spain.—Consular officers.
Sweden.—Consuls general, consuls, vice consuls general, vice consuls, deputy consuls general, deputy consuls, and consular agents.
Switzerland.—Consuls and vice consuls.
Yugoslavia.—Consuls general, consuls, vice consuls, and consular agents.

The term "consular officer" is defined by section 51 of Title 22 of the United States Code as including "consuls general, consuls, vice consuls, interpreters in consular offices, student interpreters, and consular agents, and none others," and this is the meaning with which the term is used in the foregoing enumeration.

Any exemption available to a consular officer extends to the members of his family if dependent upon him for support. It does not, however, extend to employees in the consulates.

The exemption applies whether the person using the facilities acts in an official or unofficial capacity, but does not apply where the consular officer, or dependent member of his family, is also engaged in professional business, trade, manufacture, or commerce.

REGULATIONS 71, ARTICLE 58: Passage tickets to ports not in the United States, Canada, Mexico, or Cuba. XII–13–6104 G. C. M. 11539

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.

An opinion is requested whether passage tickets sold or issued in the United States for use in connection with certain types of aircraft are subject to the tax on passage tickets imposed under Schedule A–5 of Title VIII of the Revenue Act of 1926, as amended by section 442 of the Revenue Act of 1928, when used for passage to foreign ports other than ports in Canada, Mexico, or Cuba.

In General Counsel's Memorandum 7152 [C. B. VIII–2, 429] the conclusion was reached that the stamp tax is not applicable to tickets for passage by land planes, but that it is applicable to tickets for passage on seaplanes, hydroplanes, or amphibians.

The case of *McBoyle* v. *United States* (1931) (283 U. S., 25) has been decided since the opinion of this office was promulgated. That case 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, motor cycle, or any other self-propelled vehicle not designed for running on rails. The conviction of McBoyle by the Federal district court was affirmed in the circuit court of appeals but reversed in the United States Supreme Court. Mr. Justice Holmes in his opinion stated:

* * * 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. * * *

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."

It is, therefore, the opinion of this office that passage tickets by aircraft (seaplanes, amphibians, and land planes) are not subject to the provisions of Schedule A–5 of Title VIII of the Revenue Act of 1926, as amended by section 442 of the Revenue Act of 1928.

General Counsel's Memorandum 7152 (C. B. VIII–2, 429) is modified accordingly.

C. M. Charest,
General Counsel, Bureau of Internal Revenue.

MISCELLANEOUS.

TAX ON FERMENTED LIQUOR.

XII–13–6107
Mim. 4010

Tax on fermented liquor.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., March 22, 1933.

Collectors of Internal Revenue:

1. Pursuant to the law authorizing the manufacture and sale of fermented liquor, it is necessary to issue instructions covering the tax payment of fermented liquor removed for bottling and storage pending the distribution of stamps.

2. By its terms the Act takes effect on the expiration of 15 days after the date of its enactment, except that fermented liquor taxable thereunder may be removed prior to the effective date for bottling and storage on the permit premises, provided that when removed from the place of manufacture to the bottling premises such fermented liquor shall be subject to tax at the rate of $5 per barrel.

3. The Commissioner of Industrial Alcohol will assign inspectors to breweries for which there are granted permits to bottle fermented liquor. The inspectors will superintend the transfer of such liquor from the brewery premises for bottling by means of pipe lines or conduits.

4. Each brewer granted a permit to bottle fermented liquor shall furnish the collector of internal revenue with an estimate of the quantity of such liquor he contemplates bottling during the 15-day period between the date of the enactment and the effective date of the Act. When an inspector is assigned and the brewer is authorized to begin bottling, the brewer should deposit with the collector of internal revenue for the district in which the brewery is located, a sum in the form of cash, post office money order, or certified check, computed at the rate of $5 for each 31 gallons, corresponding to the estimated quantity that will be bottled during any portion of the 15-day period. The collector of internal revenue will accept such remittance, deposit the amount received as an internal revenue collection, and set up an assessment in the name of the brewer in the appropriate section of the current miscellaneous tax list and furnish such brewer with a receipt on Form 1. The inspector on duty at the brewery shall be notified by the collector of internal revenue as to the amount credited to the account of the brewer. The brewer should not be permitted to commence bottling operations until such information has been received by the inspector from the collector. Under no circumstances will such inspectors be authorized to receive remittances from brewers covering the tax payment on fermented liquor.

5. The inspectors will maintain a record of the quantity of fermented liquor removed for bottling each 24 hours and will offset against the credit account of the brewer an amount sufficient to cover the quantity bottled at the rate of tax prescribed by law. When

this credit item is about to become exhausted, and if tax-paid stamps are still not available for purchase, the inspector will notify the brewer, who may transmit to the collector another remittance as prescribed in the foregoing paragraph. The collector will notify the inspector immediately upon receipt of the said remittance in order to avoid any interruption in the bottling operations.

6. Prior to the time a brewer begins bottling operations he must secure a permit from the Bureau of Industrial Alcohol, Treasury Department. As permits are issued to brewers, collectors of internal revenue will be advised thereof by the local supervisor of permits, and no special tax stamps will be issued, nor remittance covering commodity tax accepted, until such advice has been received by the collector. In making application for a special tax stamp, the brewer shall notify the collector of internal revenue of his permit number. A brewer must take out his special tax stamp on or before the last day of the month in which he commences business.

7. Collectors of internal revenue will not have in their possession during the month of March appropriate special tax stamps to be issued to the brewers who commence business this month. Upon receipt of an application with remittance from a brewer for a special tax stamp, the collector will issue a temporary special tax stamp on Form 1, on which the following notation will be typed:

This special tax stamp is temporary and shall be returned to the collector in exchange for a permanent stamp when available.

The brewer shall keep conspicuously posted in his establishment or place of business the stamp, whether temporary or permanent, denoting payment of said special tax, pursuant to the provisions of section 3239, R. S., amended. The new law imposes a special tax on brewers of $1,000 per year, which tax shall be reckoned proportionately from the 1st day of the month in which the liability to such special tax commenced to the 1st day of July following.

8. On the monthly statistical reports, Form 22, collections from the tax on legalized beer will be reported in the "fermented liquors section." Opposite abstract No. 17 collectors should report the tax on fermented liquors, which will be at the rate of $5 per barrel, instead of $6 per barrel, as now shown on the form. Should any collections be received from assessments made under the old $6 rate, they should be reported in the blank space above abstract No. 17, with the notation: "Collected at the $6 rate." Collections from the brewer's special tax at the rate of $1,000 instead of $100, as now shown on the Form 22, should be reported opposite abstract No. 19. The special tax collections from retail and wholesale dealers are to be reported opposite abstracts Nos. 20 and 21, the rates being the same as printed on the Form 22.

9. The following fermented liquor sheet stamps are now in course of preparation: ⅛ barrel, ⅙ barrel, ¼ barrel, ⅓ barrel, ½ barrel, 1 barrel, and hogshead. The following fermented liquor book stamps are also in course of preparation: 5 barrels, 10 barrels, and 25 barrels. There are also being prepared the following special tax stamps: Brewer at $1,000 a year, wholesale dealer in fermented liquors at $50 a year, and retail dealer in fermented liquors at $20 a year. It is requested that each collector, having in his district any brewers who contemplate immediate operations, submit to the Bureau

of Internal Revenue at the earliest practicable date a requisition for the stamps that will be needed in the course of the next three months. In order to prepare an accurate requisition for stamps, the collector should, if necessary, confer with the brewers, and with the inspectors attached to the Bureau of Industrial Alcohol on duty at the breweries. These requisitions for stamps will be honored by the Bureau at the earliest possible date.

DAVID BURNET,
Commissioner of Internal Revenue.
J. M. DORAN,
Commissioner of Industrial Alcohol.

(Bureau Circular No. 954.)

New stamps to be issued as result of tax on fermented liquor.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., March 22, 1933.

Collectors of Internal Revenue:

In view of the law authorizing the manufacture and sale (in those States where such action is not in conflict with local laws) of beer, lager beer, ale, porter, and other similar fermented liquors containing not more than 3.2 per cent of alcohol by weight, and levying a manufacturers' excise tax thereon of $5 per barrel of 31 gallons, the Bureau will supply collectors involved with new fermented liquor *barrel* stamps and *special tax* stamps for brewer, wholesale dealer in fermented liquor, and retail dealer in fermented liquor, as follows:

Denominations.	Value of 1 stamp.	Number to sheet or book.	Number stamps per package.		Value full package.
			Small package.	Full package.	
		Sheet.			
⅛ barrel	$0.625	20	2,000	20,000	$12,500.00
⅙ barrel	.833	20	2,000	20,000	16,666.66⅔
¼ barrel	1.25	20	2,000	20,000	25,000.00
⅓ barrel	1.666	20	2,000	20,000	33,333.33⅓
½ barrel	2.50	20	2,000	20,000	50,000.00
1 barrel	5.00	20	2,000	20,000	100,000.00
Hogshead	10.00	20	2,000	20,000	200,000.00
		Book.			
5 barrels	25.00	100	----------	2,000	50,000.00
10 barrels	50.00	100	----------	2,000	100,000.00
25 barrels	125.00	100	----------	2,000	250,000.00
SPECIAL TAX STAMPS.					
		Book.			
Brewer	$1,000.00	10	----------	100	$100,000.00
Wholesale dealer in fermented liquor	50.00	10	----------	100	5,000.00
Retail dealer in fermented liquor	20.00	10	----------	100	2,000.00

Initial supplies of these stamps may, if necessary, be requisitioned by wire. After the initial supply has been received, future requisi-

tions should be submitted on Form 100 in the usual manner, which form should be addressed to the Commissioner of Internal Revenue, Accounts and Collections Unit, Washington, D. C. All items must be listed under proper heads by kinds and denominations, giving the quantities desired in stamps, not in sheets or books. Extensions of value must be made and carried to the "value" column and the aggregate should be entered at the bottom thereof.

It is particularly important that all barrel stamps be requisitioned on one form and special tax stamps on another. In no case should either of these new stamps be included on a form requisitioning any other kind of stamps, such as tobacco, cigar, distilled spirits, documentary, etc., or other special tax stamps.

While all denominations of "barrel" stamps for fermented liquor will be furnished, only fiscal year 1933 special tax stamps in book form for brewer, wholesale dealer in fermented liquor, and retail dealer in fermented liquor will be supplied for issuance up to June 30 of this year. It is contemplated that these special tax stamps for the fiscal year 1934 will be provided later in sheet and book style, each sheet and each book containing 10 stamps. The sheet stamps, of course, will be scheduled for use as full fiscal year stamps, whereas the book (coupon) stamps will be used for less than a full year. None of the latter stamps should be requisitioned prior to June.

At the close of the current fiscal year, all special tax stamps, coupons, and stubs for the fiscal year 1933 should be scheduled on Form 97 and returned to the Accounts and Collections Unit in a T-lock pouch for credit and disposition. After June 30, 1933, special tax stamps for the fiscal year 1934 exclusively should be used.

It is of course expected that collectors will necessarily have to maintain reserve stocks of all of the foregoing barrel and special tax stamps to meet demands as they arise. However, it is important that requisitions for such stamps be conservative.

As each Form 100 is given a separate Bureau number and is complete in itself, the aggregate value should be shown at the bottom and should not be carried forward to another Form 100.

Each original Form 100 should be signed by the collector.

Inquiries relative to the instructions contained in this circular should refer to the number thereof and to the symbols A&C: Col.

DAVID BURNET, *Commissioner.*

XII–14–6119
Mim. 4011

Special taxes on dealers in fermented liquors.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., March 25, 1933.

Collectors of Internal Revenue:

1. Pursuant to the Act of March 22, 1933, authorizing the manufacture and sale (except in those localities where such action is in conflict with local laws) of fermented liquor, inquiries are being re-

ceived concerning special taxes imposed upon wholesale dealers and retail dealers in fermented liquors.

2. By its terms, nothing in the Act shall be construed as repealing any special tax or administrative provisions of the internal revenue laws applicable with respect to beer, ale, porter, and similar fermented liquors containing one-half of 1 per cent or more of alcohol by volume and not more than 3.2 per cent of alcohol by weight.

3. Upon receipt of inquiries concerning liabilities to special taxes as wholesale and retail dealers in fermented liquors, collectors should follow in general the provisions relative thereto contained in Regulations No. 1, entitled "Regulations concerning assessments," revised November 1, 1917, until such time as revised regulations are promulgated.

4. Such taxpayers should be required to file returns on Form 11, accompanied by the required amount of remittance in the form of cash, post office money order, or certified check, in accordance with the rates prescribed as follows:

SECTION 3244, REVISED STATUTES, AS AMENDED.

Retail dealers in malt liquors shall pay $20.

Every person who sells, or offers for sale, malt liquors in less quantities than 5 gallons at one time, but who does not deal in spirituous liquors, shall be regarded as a retail dealer in malt liquors.

Wholesale dealers in malt liquors shall pay $50.

Every person who sells, or offers for sale, malt liquors in quantities of not less than 5 gallons at one time, but who does not deal in spirituous liquors at wholesale, shall be regarded as a wholesale dealer in malt liquors.

* * * Brewers shall pay $1,000 in respect of each brewery. Every person who manufactures fermented liquors of any name or description for sale, from malt, wholly or in part, or from any substitute therefor, containing one-half of 1 per centum or more of alcohol by volume, shall be deemed a brewer.

5. The taxes referred to above shall be reckoned proportionately from the 1st day of the month in which the liability to such special taxes commenced to the 1st day of July following, as prescribed in section 3237, Revised Statutes, as amended.

6. The ad valorem and specific penalties imposed by sections 3176 and 3242, Revised Statutes, as amended, are applicable in respect to the delinquent filing of returns on Form 11 and payment of the tax as required by law.

7. A qualified wholesale dealer in malt liquor may also sell such liquor in retail quantities without incurring liability as a retail dealer. However, a qualified retail dealer in malt liquor can not sell such liquor in wholesale quantities of 5 gallons or more, to the same party at the same time, without incurring liability to special tax as a wholesale dealer.

8. Any qualified wholesale or retail dealer in spirituous liquor may sell malt liquors in wholesale or retail quantities respectively without incurring additional liability as a wholesale or retail dealer in malt liquor. However, a wholesale or retail dealer in malt liquor can not sell spirituous liquors at wholesale or retail without incurring special tax liability as a wholesale or retail dealer in spirituous liquor.

9. A brewer who holds the requisite special tax stamp may sell fermented liquor in the original kegs or barrels to which tax stamps have been affixed without incurring special tax as a dealer. A

brewer who is not required to pay special tax as a wholesale dealer in malt liquor for the sale of his product in original packages can not sell bottled goods without incurring special tax as a dealer for the reason that the exemption provision of the law applies only in cases of sales in the original stamped kegs or barrels. The quantity of bottled goods sold by a brewer fixes his liability as a wholesale or retail dealer in malt liquor according to the quantity sold irrespective of the keg beer sold at the same time.

10. In accordance with the provisions of section 3235, Revised Statutes, the payment of the special tax imposed shall not exempt from an additional special tax the person carrying on a trade or business in any other place than that stated in the collector's register and on the special tax stamps issued. A special tax stamp must be procured for each individual brewer, wholesale or retail dealer's place of business in accordance with existing laws.

11. As prescribed in section 3233(a), Revised Statutes, special tax stamps may be issued for the retail sale of fermented liquor on passenger railroad trains and upon steamboats or other vessels engaged in the business of carrying passengers, provided that such fermented liquor is sold only from one bar or a single room. Stamps denoting the payment of special tax for the retail sale of fermented liquor on such trains or vessels are to be issued as in "the United States" instead of at a specified address in view of the impracticability of repeated transfers of such stamps in the various districts and States through which such trains or vessels pass. Special tax stamps are not permitted to be issued for the retailing of fermented liquor on any boat or vessel that is not engaged in the business of carrying passengers.

12. The law does not provide for the peddling of fermented liquor from vehicles, going from place to place, and persons found selling the same in the manner of peddlers must be regarded as engaged in business not authorized by law and held liable as dealers in fermented liquors at each place where they make such sales.

13. Every brewer, wholesale dealer, and retail dealer in fermented liquor shall keep conspicuously posted in his establishment or place of business a stamp denoting payment of said special tax as provided by section 3239, Revised Statutes, as amended.

14. Pursuant to the provisions of section 3243, Revised Statutes, the payment of any tax imposed by the internal revenue laws for carrying on any trade or business shall not be held to exempt any person from any penalty or punishment provided by the laws of any State for carrying on the same within such State, or in any manner to authorize the commencement or continuance of such trade or business contrary to the laws of such State or in places prohibited by municipal law, nor shall the payment of any such tax be held to prohibit any State from placing a duty or tax on the same trade or business, for State or other purposes. Persons who engage in the sale of fermented liquor even though such business is a violation of the law of their State, are nevertheless required to pay a special tax under the internal revenue laws of the United States.

15. Correspondence in regard to the procedure outlined herein should refer to the number of this mimeograph and to the symbols MT:ST.

DAVID BURNET, *Commissioner.*

XII–14–6121
Mim. 4013

Special taxes on dealers in fermented liquors.—Supplemental to Mimeograph 4011 [page 461, this Bulletin].

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., March 30, 1933.

Collectors of Internal Revenue:

1. Paragraph 7 of Mimeograph 4011, dated March 25, 1933, is hereby amended to read as follows:

7. A qualified wholesale dealer in malt liquor can not sell such liquor in retail quantities of less than 5 gallons without incurring liability as a retail dealer. Likewise, a qualified retail dealer in malt liquor can not sell such liquor in wholesale quantities of 5 gallons or more, to the same party at the same time, without incurring liability to special tax as a wholesale dealer.

2. The last sentence of paragraph 11 of the above-mentioned mimeograph is hereby amended to read as follows:

11. * * * Special tax stamps are not permitted to be issued for the retailing of fermented liquor on any train or vessel that is not engaged in the business of carrying passengers.

3. Correspondence in regard to the procedure outlined herein should refer to the number of this mimeograph and to the symbols MT:ST.

P. R. BALDRIDGE,
Acting Commissioner.

XII–18–6161
S. T. 666

Issue of special tax stamps to dealers for sale of fermented malt liquors in those States where such sales are in violation of State law.

Advice is requested concerning the issuance of special tax stamps by collectors of internal revenue to dealers for the sale of fermented malt liquors containing one-half of 1 per cent or more of alcohol by weight, where the sale of such beverages would be in violation of the laws of a State. It is contended that the issuance of special tax stamps for the sale of such beverages would handicap the enforcement of State prohibition laws.

Section 3244, Revised Statutes of the United States (as amended), provides for the imposition of taxes on retail dealers and wholesale dealers in fermented malt liquors. Payment of these taxes is evidenced by special tax stamps issued by the collector of internal revenue for the district in which the business is located.

Section 3233, Revised Statutes, provides that every person engaged in a trade or business on which a special tax is imposed by law shall register with the collector of the district his name or style, place of residence, trade or business, and the place where such trade or business is to be carried on.

Section 3243, Revised Statutes, provides that the payment of any tax imposed by the internal revenue laws of the United States for carrying on any trade or business shall not be held to exempt any person from any penalty or punishment provided by the laws of any

State for carrying on the same within such State, or in any manner to authorize the commencement of any trade or business contrary to the laws of such State. The issuance of a special tax stamp by the Federal Government under an Act of Congress is no bar to an indictment under a State law prohibiting the sale of intoxicating liquors. (*License Tax Cases*, 5 Wall., 462; *Pervear* v. *The Commonwealth*, 5 Wall., 475; see also *Willingham* v. *United States*, 208 Fed., 137.) The courts have taken the position that persons who engage in the sale of intoxicating liquors, even though such business is in violation of the law of their State, are nevertheless required to pay a special tax imposed under the internal revenue laws of the United States.

The question here under consideration has been considered by the Bureau heretofore with reference to the use of special tax stamps under prior Revenue Acts. In Treasury Decision 1484, issued April 21, 1909, it was held that special tax stamps are merely receipts for the tax and carry no privileges except immunity from prosecution for nonpayment of the tax. In Treasury Decision 1826, issued January 7, 1913, it was held, with reference to the issue of special tax stamps to liquor dealers in prohibition territory, that the Bureau of Internal Revenue was without authority to refuse to issue the special tax stamps in cases where the conditions prescribed by Federal laws were satisfied.

Special tax stamps are not licenses but are merely receipts denoting the payment of internal revenue taxes. Accordingly, the possession of a special tax stamp will not protect the holder from prosecution, conviction, and sentence under a State law.

Attention is also directed to section 3240, Revised Statutes, as amended, which provides that each collector of internal revenue shall place and keep conspicuously in his office for public inspection a list of special-tax payers and, upon application of any prosecuting officer of any State, county, or municipality, shall furnish a certified copy thereof as a public record. Since the filing of a return and the payment of a special tax covering the sale of beverages containing more than one-half of 1 per cent of alcohol would be prima facie evidence that the person filing the return and paying the tax is engaged in the particular business, it would seem that the registration of wholesale or retail dealers in fermented malt liquors and the issuance of special tax stamps to such dealers would assist rather than handicap the enforcement of the State prohibition law.

The collection of the internal revenue taxes is mandatory upon the Bureau of Internal Revenue and, accordingly, a collector has no choice in the matter but must issue special tax stamps in the manner prescribed by law.

XII–19–6172
S. T. 668

Sales of fermented malt liquor by proprietor or concessionaire at baseball parks and hotels.

Advice is requested concerning liabilities to special taxes as retail dealers in fermented malt liquors incurred under the following circumstances. The questions and answers thereto are as follows:

Question. Fermented malt liquor is being sold in various quantities at a baseball park by boys who first pay cash for such liquor to a proprietor or concessionaire, after which they sell such liquor to consumers throughout the stands from baskets or similar containers carried on their arms. Under such circumstances who is liable for the special tax as a dealer in fermented malt liquor?

Answer. If there is but one proprietor or concessionaire who has the exclusive privilege of selling fermented malt liquors at the baseball park, the entire grounds composing the baseball park would be regarded as forming but one place of business so far as the special tax laws are concerned. One special tax stamp taken out by the one proprietor or concessionaire for retailing fermented malt liquors at the park in question is sufficient to cover all sales made by him and the boys referred to at any number of buildings, booths, or stands erected within the boundaries of the baseball park. However, if more than one proprietor or concessionaire has the privilege of selling such fermented malt liquor in the baseball park, each such proprietor or concessionaire would be liable for the special tax as a dealer in fermented liquor.

Question. A hotel is engaged in selling fermented malt liquor in retail quantities from several service bars located in various parts of its premises. How many special tax stamps as a retail dealer in fermented malt liquor are required to be purchased by the proprietor of a hotel?

Answer. If one proprietor of, or concessionaire at, a hotel has several bars or other places on the same premises from which fermented malt liquor is sold, that are connected by or can be reached through intercommunicating entrances, only one special tax stamp as a retail dealer in fermented malt liquor will be required from such proprietor or concessionaire. However, should such proprietor or concessionaire establish a number of separate bars or rooms for the retail sale of fermented malt liquor on his premises which have no inside intercommunication, and can be reached only from outside entrances from a street or public highway, a special tax stamp as a retail dealer in fermented malt liquor will be required for each separate bar or room. In the event that more than one proprietor or concessionaire is engaged in the business of retail sales of fermented malt liquor in the same hotel premises, each proprietor or concessionaire would be required to purchase a special tax stamp as a retail dealer in fermented malt liquor, irrespective of whether there is inside intercommunication.

XII–24–6232
S. T. 682

A distributor of fermented malt liquor who makes deliveries covered by prior orders is not a peddler of such liquor.

Advice is requested in connection with the sale of fermented malt liquor under the Act of March 22, 1933, relative to the restriction which prohibits the peddling of such liquor from trucks.

Section 3244 of the Revised Statutes, as amended, provides that wholesale dealers in fermented malt liquor shall pay special tax at the rate of $50 per year, and retail dealers at the rate of $20 per

year. Section 3238 of the Revised Statutes requires that payment of the tax be denoted by the posting of special tax stamps in the dealer's place of business.

Section 3233 of the Revised Statutes requires that every person engaged in any trade or business on which a special tax is imposed shall register with the collector of internal revenue for his district his name or style, place of residence, trade or business, and the place where such trade or business is carried on. Under section 3235 of the Revised Statutes a person carrying on such trade or business at any other place than the one recorded in the collector's register shall be liable for an additional special tax at each place where sales are made.

These provisions prohibit any person from loading his truck with fermented malt liquor "containing one-half of 1 per centum or more of alcohol by volume, and not more than 3.2 per centum of alcohol by weight," and peddling it from place to place without procuring a special tax stamp for each place where a sale is made.

The Bureau does not, however, class a wholesale or retail distributor as a peddler of fermented malt liquor when he makes deliveries of such liquor to his customers, provided he has on file in his office, where a special tax stamp is posted, prior orders from such customers for a specified quantity of fermented malt liquor, and does not deliver an amount to any customer in excess of his prior order. Under this ruling a customer is not required to take the full amount of his prior order every time he receives a delivery. Any distributor who deviates from this method of doing business will be regarded as a peddler engaged in selling fermented malt liquor in a manner not authorized by law, and will be penalized to the extent of his failure to qualify as a dealer in fermented malt liquor at each place where a sale is made.

CAPITAL STOCK TAX RULINGS.

TITLE VII.—SPECIAL TAXES. (1924)

REGULATIONS 64 (1924), ARTICLE 11: Basis of the tax: "Carrying on or doing business." XII-26-0259 Ct. D. 692

CAPITAL STOCK TAX—REVENUE ACTS OF 1921 AND 1924—DECISION OF COURT.

MASSACHUSETTS TRUST—TAXABLE AS ASSOCIATION—CARRYING ON BUSINESS.

A Massachusetts investment trust, established in 1919 to continue for a designated period, its assets consisting of stock in certain motion picture, insurance, and utility companies, and its provisions granting to the trustees broad powers of management and denying any power to the beneficiaries except the right to elect successor trustees in case of death, resignation, or inability of the trustees to act, and which, during the years 1920–1926, bought and sold securities, loaned and borrowed money, and distributed dividends, was subject to capital stock tax as an "association" which was "doing business" within the meaning of sections 2 and 1000 of the Revenue Act of 1921 and sections 2 and 700 of the Revenue Act of 1924; the determining factor being the active carrying on of some commercial enterprise as distinguished from the liquidation of a business or estate.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

Henry Ittleson, Phillip W. Haberman, and Blanche F. Ittleson, Trustees, plaintiffs, v. Charles W. Anderson, Collector of Internal Revenue, defendant.

[February 9, 1933.]

OPINION.

KNOX, D. J.: This is an action to recover $5,075, the amount paid by plaintiffs as Federal capital stock tax for the tax years ending June 30, 1921, to June 30, 1926, both inclusive. The question to be decided, upon cross motions for a directed verdict, is whether plaintiffs, as trustees of the Ittleson Investment Trust, are subject to capital stock taxes. This, in turn, depends upon whether the Ittleson Investment Trust, which is of the Massachusetts variety, was an "association" which was "doing business," within the meaning of sections 2 and 1000 of the Revenue Act of 1921, and sections 2 and 700 of the Revenue Act of 1924. These provisions of the respective Acts are identical, and read as follows:

"That when used in this Act— * * *

"(2) The term 'corporation' includes associations, joint-stock companies and insurance companies;

* * * * * * *

"Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1 for each $1,000 of so much of the fair average value of its capital stock for the preceding year ending June 30 as is in excess of $5,000. In estimating the value of capital stock the surplus and undivided profits shall be included."

There is no substantial dispute as to the facts. The trust in suit was established under an agreement and declaration of trust, dated December 31, 1919, providing that the trust should continue until three years after the death of the survivor of four named persons, unless sooner terminated by a majority of the trustees. Henry Ittleson transferred to himself, Phillip W. Haberman, and Blanche F. Ittleson, as trustees of the trust, a stock certificate for 727½ shares of the common stock of the Light & Development Co. of St. Louis. A few days later, he added to the corpus of the trust certain blocks of the common stock of Commercial Investment Trust Corporation, Moloney Electric Co., Goldwyn Pictures Corporation and American Auto Insurance Co. These holdings comprised the entire assets contributed to the trust.

The declaration of December 31, 1919, provided that there should be 500 "beneficial participation shares," and two instruments designated "certificate for beneficial participation shares," each covering 250 of such shares, were delivered by the trustees to Mr. Ittleson, who has never transferred them, or any part of them, to anyone else.

The "general purposes of this trust," as set forth in Article II of the trust agreement, were "to hold, manage, collect, dispose of, invest and reinvest, liquidate and distribute the trust estate and the income and profits thereof and additions thereto."

It was further stated that the trustees should have the power "to do all and singular such things as may be necessary or appropriate to effectuate such purposes in whole or in part and the trustees may engage in any business or undertaking or enterprise in their judgment reasonably necessary or desirable or adapted to the carrying out of said general purposes."

The trustees were also empowered to buy and sell all kinds of property, to lend money, and to make gifts.

Article III sets forth an extensive list of the specific powers of the trustees. In addition, subsection (r) of section 1, gives the trustees blanket authority "in all matters and respects, to deal with the trust estate and to manage and conduct the trust hereby created * * * as fully as if the trustees were the absolute owners of the trust estate. * * *"

The instrument also authorizes the trustees to appoint committees, and to adopt a seal, but neither of these powers was ever exercised. The trustees have held no formal meetings. While they came together occasionally, no minutes or other record of their action was preserved.

The beneficiaries of the trust are without power, except that, in case of the death, resignation or inability to act of *all* the trustees, they may elect successor trustees. There has been no need for any such action upon the part of the beneficiaries.

During the years 1920–1926, inclusive, the period in question, the trustees received dividends totaling $535,737.06; interest in the sum of $82,654.19, and a net profit from the sale of securities of $448.70. Out of this income, they paid taxes of $37,616.19, together with other charges or expenses in the sum of $5,010.16, thus leaving a net balance of income amounting to $576,213.60. This sum was depleted to the extent of $200,000, through a distribution thereof (in 1925 and 1926) to Mr. Henry Ittleson, as sole beneficiary. The remainder was loaned at interest by the trustees, for some years principally to Mr. Ittleson, and during the last two years principally to the Ittleson Securities Co., a corporation in which a substantial interest was held by the trustees.

The trust engaged in the following stock transactions:

December 31, 1919, to June 30, 1921.—The trust received the following stocks: Light & Development Co. of St. Louis, American Auto Insurance Co., Goldwyn Pictures capital stock, Moloney Electric Co., Commercial Investment Trust Corporation "A." During this fiscal period the trust sold the stock of the Goldwyn Pictures Corporation and the stock of American Auto Insurance Co. The sale of the thousand shares of Goldwyn resulted in a loss of $12,130 and the sale of 56½ shares of the American Auto stock resulted in a profit of $5,625, resulting in a net loss of $6,505.

July 1, 1921, to June 30, 1922.—In this period the trust received Commercial Investment Trust Corporation "A" stock as a stock dividend. It also sold 40 shares of the Moloney Electric Co. stock.

July 1, 1922, to June 30, 1923.—The trust received Moloney shares by way of stock dividend. The trust exchanged for its shares of Light & Development Co. of St. Louis proportionate stock shares in North American common, North American preferred and Union Electric Light & Power first preferred. The

trust also purchased during this period additional shares of Commercial Investment Trust Corporation "B" stock for the sum of $24,189. The money necessary for the purchase of this stock was borrowed from the Columbia Bank for the specific purpose of engaging in this stock purchase. Within this fiscal period the trust also bought and sold 600 shares of May Department Store common stock. This stock was apparently bought on margin through H. Content & Co., stock brokers. (See journal entries 130–132, 133 and ledger (Exhibit 4), page 199.) The trust also participated in a syndicate known as the Amster Oil Syndicate during this period. It also purchased bonds of the United States Public Service Co. It also purchased 7 per cent notes of Goldwyn Pictures Corporation. It also sold 61 shares of its Commercial Investment Trust Corporation "B" stock.

July 1, 1923, to June 30, 1924.—In this period the trust received by exchange shares of Commercial Investment Trust preferred and purchased shares of North American Co. common. Both of these stocks it exchanged for capital stock of the Ittleson Securities Corporation. The trust also exchanged shares of Moloney stock for shares of Ittleson Securities Corporation. It also exchanged Commercial Investment Trust "B" stock for Ittleson Securities Corporation stock. Later, in the same fiscal period the trustees exchanged Ittleson Securities Corporation stock for Ittleson Securities Co. stock. During this fiscal period the trustees also sold the United States Public Service bonds which had been purchased within the preceding fiscal year. It also sold the Goldwyn Pictures 7 per cent notes which had also been purchased within the preceding fiscal year. The trustees during this period also lent $2,000 to James A. Burr, the loan being secured by a chattel mortgage on objects of art in Florence, Italy.

July 1, 1924, to June 30, 1925.—In this period the trust sold 78 shares of Commercial Investment Trust preferred.

July 1, 1925, to June 30, 1926.—In this period the trust received $8,000 of the $10,000 which had been previously invested in the Amster Oil Syndicate.

The trustees also exercised rights to subscribe for 578 additional shares of Commercial Investment Trust Corporation "B" stock, paying therefor $34,680.

Upon the foregoing facts, was the Ittleson Investment Trust taxable as an "association" which was "doing business" within the meaning of the Revenue Acts? Two decisions by the Supreme Court of the United States are particularly pertinent to the inquiry, viz, *Crocker* v. *Malley* (249 U. S., 223), and *Hecht* v. *Malley* (265 U. S., 144 [T. D. 3595, C. B. III–1, 489]).

The Crocker case involved the question whether Crocker and his cotrustees were taxable as an "association" or as "trustees" under the Federal income tax law of 1913. The facts were as follows: A Maine corporation which owned eight paper mills conveyed seven of them to a Massachusetts corporation in exchange for all the stock of that company. The eighth mill was leased to the Massachusetts corporation for a long term. The stock received by the Maine corporation, together with the eighth mill, subject, of course, to the leasehold, were then transferred to Crocker and others, as trustees, in trust for the shareholders of the Maine corporation. The trustees issued certificates of beneficial ownership to these shareholders, and the Maine corporation, thereupon was dissolved.

The declaration of trust gave the trustees unlimited discretion to use any funds in their hands for the repair or development of the property held by them, or for the acquisition of other property. The beneficiaries were without control in the premises, except that, with their consent, the trustees could modify the terms of the trust instrument, fill vacancies in their number, or increase their compensation, which the declaration of trust had limited to an amount not exceeding 1 per cent of the gross income of the trust.

The trust instrument did not expressly mention the shares of stock, but the trustees held the same, collecting such dividends as accrued thereon. The function of the trustees was not to manage the mills, but simply to collect the rents and income of such property as might be in their hands.

When these facts were subjected to analysis by the Supreme Court, it was stated that "In Massachusetts, this arrangement would be held to create a trust and nothing more," citing *Williams* v. *Milton* (215 Mass., 1). Mr. Justice Holmes said that neither the trustees nor the beneficiaries, nor all together could be regarded as a joint-stock association, within the meaning of Section II G(a) of the income tax law of October 3, 1913; and that dividends upon the stock left with the trustees were not subject to extra tax imposed by that section. He then declared at pages 233, 234, that "it would be a wide departure

from normal usage to call the beneficiaries here a joint-stock association when they are admitted not to be partners in any sense, and when they have no joint action or interest and no control over the fund. On the other hand, the trustees by themselves can not be a joint-stock association within the meaning of the Act unless all trustees with discretionary powers are such, and the special provisions for trustees in D. is to be made meaningless. We perceive no ground for grouping the two—beneficiaries and trustees—together, in order to turn them into an association by uniting their contrasted functions and powers, although they are in no proper sense associates. It seems to be an unnatural perversion of a well-known institution of the law."

Under the specifications of this decision, the Ittleson Trust is not an association which was lawfully subject to taxes which are here sought to be recovered. Here, as in the Crocker case, the trustees were vested with complete and comprehensive power. There is a similar absence of control upon the part of the beneficiaries.

But, subsequent to the decision from which quotation has just been made, the character of the Crocker Trust was radically changed. As thus altered, it together with the Hecht Real Estate Trust and the Haymarket Trust, engaged the attention of the Supreme Court in the case of *Hecht* v. *Malley* (265 U. S., 144). It appears that the Crocker declaration of trust had been modified so as to empower the trustees to surrender the stock of the Massachusetts corporation in exchange for its entire property, and to carry on the paper business theretofore conducted by that company. Pursuant to this authorization, the trustees had taken over and were carrying on an extensive paper manufacturing business. Other changes which had occurred in the character of the trust led the trustees to admit that the trust was now an association within the statutes. This was clearly so under the test enunciated in the first Crocker case. But, in considering the questions raised as to the characteristics of the Hecht Real Estate Trust and the Haymarket Trust, the Supreme Court, it would seem, made some departure from its pronouncements in the original Crocker decision. In the later adjudication, the court employed the following language, at page 157:

"The word 'association' appears to be used in the Act in its ordinary meaning. It has been defined as a term 'used throughout the United States to signify a body of persons united without a charter, but upon the methods and forms used by incorporated bodies for the prosecution of some common enterprise.'

* * * * * * *

"We think that the word 'association,' as used in the Act clearly includes 'Massachusetts Trusts' such as those herein involved, having quasi corporate organizations under which they are engaged in carrying on business enterprises."

The court then went on to distinguish the situation confronting it from that which was present in the Crocker case. The points of difference were first, that the income tax Act of 1913 was there under consideration, and it "did not show a clear intention to impose upon the trustees as an 'association' a double liability in reference to the dividends on stock in the corporation that itself paid an income tax, when considered as 'trustees' they were by another provision of the Act exempt from such payment;" and second, that the trustees in that case "were, in substance, merely holding property for the collection of the income and its distribution among the beneficiaries, and were not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business."

Finally, the court said, at page 161:

"It results that *Crocker* v. *Malley* is not an authority for the broad proposition that under an Act imposing an excise tax upon the privilege of carrying on a business, a Massachusetts trust engaged in the carrying on of business in a quasi corporate form, in which the trustees have similar or greater powers than the directors in a corporation, is not an 'association' within the meaning of its provisions.

"We conclude, therefore, that when the nature of the three trusts here involved is considered, as the petitioners are not merely trustees for collecting funds and paying them over, but are associated together in much the same manner as the directors in a corporation for the purpose of carrying on business enterprises, the trusts are to be deemed associations within the meaning of the Act of 1918; this being true independently of the large measure of control exercised by the beneficiaries in the Hecht and Haymarket cases, which much exceeds that exercised by the beneficiaries under the Wachusett Trust."

Under the opinion from which the foregoing excerpts have been quoted, there appear to be three elemental requisites to a trust which, under the capital stock tax statutes, is to be regarded as an "association." (1) It should have a "quasi corporate form"; (2) its trustees should be "associated together in much the same manner as the directors in a corporation"; and (3) the trustees must be engaged in carrying on a business.

The perplexing problem of applying the foregoing criteria, and those which were stated in the original Crocker case (which has not been overruled), to particular facts, has arisen in a great number of suits in the lower Federal courts, and before the Board of Tax Appeals. See collection of cases in note on Taxation of Business Trusts, 42 Yale Law Journal, 270. No reconciliation can be made of all of the reasons advanced for decisions in the various opinions that these tribunals have expressed. Actually, however, trusts have been held to be taxable as "associations" wherever they carried on active commercial enterprises. (*Neal* v. *United States*, 28 F. (2d), 1022 (C. C. A. 1), cert. den., 273 U. S., 659; *Little Four Oil & Gas Co.* v. *Lewellyn*, 35 F. (2d), 149 (C. C. A. 3) [Ct. D. 118, C. B. VIII–2, 264]; *Trust No. 5833, Security-First National Bank* v. *Welch*, 54 F. (2d), 323 (C. C. A. 9) [Ct. D. 490, C. B. XI–1, 138]; *Tulsa Mortgage Investment Co.* v. *Commissioner*, 21 B. T. A., 735; *Mary L. Dutton* v. *Commissioner*, 18 B. T. A., 1151; *Rochester Theatre Trust Estate* v. *Commissioner*, 16 B. T. A., 1275; *E. A. Landreth Co.* v. *Commissioner*, 11 B. T. A., 1; *Anderson Steam Vulcanizer Co.* v. *Commissioner*, 6 B. T. A., 737.) The only trusts engaging in business activity, which have not been classified as "associations" have been those formed for the liquidation of concerns or estates (*White* v. *Hornblower*, 27 F. (2d), 777 (C. C. A. 1); *Blair* v. *Wilson Syndicate Trust*, 39 F. (2d), 43 (C. C. A. 5); *Gonzolus Creek Oil Co.* v. *Commissioner*, 12 B. T. A., 310), and real estate trusts where it was deemed that the trustees were merely holding property for the collection of income (*Landsdown Realty Trust* v. *Commissioner*, 50 F. (2d), 56 (C. C. A. 1); *Fisk* v. *United States*, 60 F. (2d), 665), and were not actively engaged in managing the property or buying and selling real estate. (See *C. W. Cowell Co.* v. *Commissioner*, 21 B. T. A., 127; cf. *Tyson* v. *Commissioner*, 54 F. (2d), 29 (C. C. A. 7). Apparently, the judicial emphasis has been placed upon the third element of the test set forth in the Hecht case, namely, that the trustees be engaged in carrying on a business, as distinguished from winding up a business or merely holding property and receiving and distributing its income. The question of whether the trust had a "quasi corporate form" or whether the directors were associated together like "the directors of a corporation" has been subordinated by the courts to the consideration of whether they should regard the control of the beneficiaries over the trustees, or the business activities of the trustees, as the decisive consideration. Results have been reached on both theories. See, for example, *White* v. *Hornblower*, supra, in the first circuit, where there was no control in the beneficiaries and the purpose of the trust was to liquidate a business. The majority of the court there held that the trust was not an association, because its function was not to carry on a business enterprise, but to bring about its liquidation. Bingham, J., concurred on the ground that the organization under analysis was a strict trust under Massachusetts law, and not an association, the beneficiaries having no control over the actions of the trustees. On the whole, it would appear that the weight of authority has regarded the business activity of the trustees as the controlling factor. See opinions in cases cited above.

The case of *United States* v. *Neal*, supra, in the Circuit Court of Appeals for the First Circuit, to which the Supreme Court denied certiorari, can be explained only on the "business activity" theory. There, the district court had held that the trust therein involved was not an "association," because it was an express trust and not an association under Massachusetts law, the beneficiaries of the trust having no control over the activities of the trustees. The court of appeals reversed this decision, per curiam, on the authority of *White* v. *Hornblower*, supra. The opinion of the court in that case had definitely stated at page 778: "The measure of the control over the trust vested in the beneficiaries does not seem to be the determining factor, but rather whether the trustees are conducting a business for profit or gain." The Neal case, therefore, clearly held that a trust constituted an "association" even where the beneficiaries had no control, if the trustees were engaged in business for profit.

That the trustees in the instant case were engaged in business for profit, admits of little doubt. Their activities consisted in some buying and selling of securities, and the lending of money at interest, in addition to receiving the

income from the trust properties and investing, reinvesting and distributing the same. The trust was admittedly conducted as a continuing business. It was not engaged in liquidating a business or estate. It was not acting merely as a passive conduit to receive money and pass it along to the beneficiary. It was continually making loans in large amounts. The fact that the number of stock transactions were relatively few does not obviate the fact that the trust was alive and functioning as a business enterprise; and under the "business activity" test of the Hecht and Neal cases, it was an "association." The fact that the beneficiary under the terms of the trust agreement has no control over the action of the trustees is not decisive. As pointed out in *White* v. *Hornblower*, supra, "The powers of the certificate holders, and the effect of the trust deed, i. e., whether it constitutes a partnership or a strict trust—are significant only as they tend to show whether what the interested parties did amounted to forming themselves into an association for carrying on a business enterprise in quasi corporate form for profit or gain."

The Neal case makes it clear that a trust may be deemed an association even where the beneficiaries have no control over the trustees. As a practical matter, this lack of control is a fiction in the present case since the sole beneficiary, who founded the trust, is one of the three trustees, and, admittedly, he dictates their actions and policies.

In addition, the following corporate advantages were secured by the trust, without incorporation: the trustees can do business in the name of the trust, they can sue or be sued as an entity under Massachusetts law, there is no individual liability upon the certificate holders, they are not liable to be called upon to put up additional capital, the trust does not terminate upon the death of a shareholder, the participation shares are transferable, and preferred shares have preference on dissolution.

These characteristics show that the trust in suit possesses the "quasi corporate form" referred to in the Hecht case, in sufficient degree for it to be classified as an association when it engages in business activity.

The business activity of the trustees must also be considered in connection with the question whether the trust was "doing business" within the meaning of the statutes. Upon this point, the activities of the trustees need not be reiterated. The extent of the activity required for this latter purpose appears to be much less than that which must be found in a business trust in order for it to be classified as an "association." If the corporation or association is doing more than acting as a passive holder of property or a conduit to carry over profits to persons entitled to them, it is "doing business" within the meaning of the statute. (*International Salt Co.* v. *Phillips*, 274 U. S., 718, reversing, per curiam, 9 Fed. (2d), 389 [T. D. 3673, C. B. IV–1, 328]; *Edwards* v. *Chile Copper Co.*, 270 U. S., 452, 455 [T. D. 3857, C. B. V–1, 410]; *Argonaut Consolidated Mining Co.* v. *Anderson*, 52 F. (2d), 55 (C. C. A. 2), cert. den., 284 U. S., 682 [Ct. D. 404, C. B. X–2, 441].) The trust in suit was clearly "doing business" within the definition of the scope of that term in the foregoing cases.

Defendant's motion for a directed verdict is granted.

NATIONAL INDUSTRIAL RECOVERY ACT.

XII–26–6262
T. D. 4368

Capital stock tax—National Industrial Recovery Act.—Extension of time for filing returns and paying tax.

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

To Collectors of Internal Revenue and Others Concerned:

Form 707 (revised) and Form 708 (revised) for the filing of returns of capital stock tax imposed under section 215 of the National Industrial Recovery Act, approved June 16, 1933, covering the period ended June 30, 1933, are required to be filed and the tax

paid on or before July 31, 1933, unless the period for filing returns and the payment of tax is extended under the provisions of section 215(d) of the aforementioned Act.

In accordance with the provisions of section 215(d) of the National Industrial Recovery Act, the period during which the returns of capital stock tax may be filed, and the tax paid, is hereby extended; and collectors of internal revenue are authorized to accept returns without the assertion of penalties for delinquency if the returns are filed and the tax paid on or before the dates indicated below:

1. Returns required to be filed in the continental United States, accompanied with the tax due, must be in the hands of the collectors of internal revenue on or before August 31, 1933.

2. Returns required to be filed with the collectors of internal revenue for the Territories of Alaska and Hawaii, accompanied with the tax due, must be filed with the collectors of internal revenue for those districts on or before September 20, 1933.

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved June 23, 1933.

DEAN ACHESON,
Acting Secretary of the Treasury.

MISCELLANEOUS RULINGS.

OLEOMARGARINE.

XII–2–5985
MS. 134

Schedule of oleomargarine produced and materials used during the month of November, 1932, as compared with November, 1931.

	November, 1932.	November, 1931.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 18,986,644	[2] 21,674,845
Total withdrawn tax-paid	19,134,769	
Ingredient schedule for uncolored oleomargarine:		
Butter	356	1,927
Cocoanut oil	11,863,417	13,160,021
Corn oil	1,097	6,593
Cottonseed oil	1,355,289	1,411,991
Derivative of glycerine	32,490	22,732
Lecithin	45	736
Milk	4,429,307	5,489,290
Neutral lard	781,019	1,028,037
Oleo oil	973,697	1,400,567
Oleo stearine	279,820	374,833
Oleo stock	30,586	41,738
Palm oil	16,800	8,500
Peanut oil	212,162	408,976
Salt	1,048,148	1,452,210
Soda (benzoate of)	6,766	8,100
Soya bean oil		1,049
Whale oil		112
Total	21,030,999	24,817,412
Total production of colored oleomargarine	[3] 179,446	[4] 462,718
Total withdrawn tax-paid	47,508	
Ingredient schedule for colored oleomargarine:		
Butter		354
Cocoanut oil	72,128	130,509
Color	204	540
Cottonseed oil	23,126	45,427
Derivative of glycerine	7	44
Milk	56,083	135,872
Mustard oil		225
Neutral lard	22,822	49,673
Oleo oil	41,247	131,209
Oleo stearine	2,685	4,630
Oleo stock	1,045	5,290
Palm oil	7,150	16,800
Peanut oil	2,945	5,086
Salt	15,376	38,783
Soda (benzoate of)	8	31
Total	244,826	564,473

[1] Of the amount produced, 16,798 pounds were reworked.
[2] Of the amount produced, 19,621 pounds were reworked.
[3] Of the amount produced, 128 pounds were reworked.
[4] Of the amount produced, 760 pounds were reworked.

XII–6–6023
MS. 135

Schedule of oleomargarine produced and materials used during the month of December, 1932, as compared with December, 1931.

	December, 1932.	December, 1931.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 19,878,688	[2] 22,636,989
Total withdrawn tax-paid	19,408,896	
Ingredient schedule for uncolored oleomargarine:		
Butter	680	2,619
Cocoanut oil	12,151,466	13,905,706
Corn oil	1,732	6,565
Cottonseed oil	1,483,383	1,457,925
Derivative of glycerine	32,427	24,107
Lecithin	60	1,503
Milk	4,664,112	5,786,098
Neutral lard	942,035	1,224,718
Oleo oil	1,169,827	1,373,927
Oleo stearine	271,482	334,558
Oleo stock	24,120	35,305
Palm oil	17,210	20,958
Peanut oil	204,603	389,726
Salt	1,144,822	1,519,649
Soda (benzoate of)	6,340	8,310
Soya bean oil		1,040
Whale oil		451
Total	22,114,299	26,093,165
Total production of colored oleomargarine	[3] 263,549	[4] 536,042
Total withdrawn tax-paid	56,897	
Ingredient schedule for colored oleomargarine:		
Butter		60
Cocoanut oil	82,710	121,033
Color	240	559
Cottonseed oil	35,266	72,037
Derivative of glycerine	5	28
Milk	72,010	162,321
Mustard oil		600
Neutral lard	26,398	62,336
Oleo oil	45,489	154,771
Oleo stearine	4,615	5,185
Oleo stock	200	7,917
Palm oil	15,190	19,238
Peanut oil	2,094	8,370
Salt	19,163	43,628
Soda (benzoate of)	13	46
Total	303,393	658,129

[1] Of the amount produced, 8,274 pounds were reworked.
[2] Of the amount produced, 16,352 pounds were reworked.
[3] Of the amount produced, 4,980 pounds were reworked.
[4] Of the amount produced, 922 pounds were reworked.

XII–11–6075
MS. 136

Schedule of oleomargarine produced and materials used during the month of January, 1933, as compared with January, 1932.

	January, 1933.	January, 1932.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 20,810,940	[2] 19,983,453
Total withdrawn tax-paid	20,852,156	
Ingredient schedule for uncolored oleomargarine:		
Butter	242	3,138
Cocoanut oil	13,357,454	12,631,090
Corn oil	1,297	4,913
Cottonseed oil	1,442,092	1,315,132
Derivative of glycerine	30,857	20,703
Lecithin	44	765
Milk	4,972,203	4,984,188
Neutral lard	715,235	855,111
Oleo oil	926,476	971,932
Oleo stearine	256,499	302,354
Oleo stock	21,875	32,292
Palm oil	16,649	11,313
Peanut oil	262,737	300,072
Salt	1,153,674	1,319,381
Soda (benzoate of)	8,534	7,263
Soya bean oil		629
Total	23,165,868	22,760,276
Total production of colored oleomargarine	[3] 211,601	[4] 404,562
Total withdrawn tax-paid	45,488	
Ingredient schedule for colored oleomargarine:		
Butter	120	
Cocoanut oil	76,860	117,710
Color	137	443
Corn oil	17	
Cottonseed oil	24,931	47,568
Derivative of glycerine	19	12
Lecithin		3
Milk	66,449	121,338
Mustard oil		170
Neutral lard	19,603	41,402
Oleo oil	34,611	96,317
Oleo stearine	1,965	4,333
Oleo stock	565	4,347
Palm oil	8,500	12,108
Peanut oil	2,808	5,326
Salt	16,618	32,765
Soda (benzoate of)	11	28
Total	253,264	483,870

[1] Of the amount produced, 8,171 pounds were reworked.
[2] Of the amount produced, 11,671 pounds were reworked.
[3] Of the amount produced, 126 pounds were reworked.
[4] Of the amount produced, 831 pounds were reworked.

XII–15–6130
MS. 137

Schedule of oleomargarine produced and materials used during the month of February, 1933, as compared with February, 1932.

	February, 1933.	February, 1932.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 17,071,153	[2] 16,852,520
Total withdrawn tax-paid	17,161,852	17,319,602
Ingredient schedule for uncolored oleomargarine:		
Butter	190	2,512
Cocoanut oil	10,639,930	10,243,566
Corn oil	2,499	1,289
Cottonseed oil	1,249,446	1,245,039
Derivative of glycerine	28,728	24,593
Lecithin	36	741
Milk	3,933,193	4,154,372
Neutral lard	687,529	765,189
Oleo oil	911,164	961,552
Oleo stearine	228,169	310,679
Oleo stock	17,730	19,744
Palm oil	11,025	8,925
Peanut oil	140,991	250,736
Salt	965,316	1,129,437
Soda (benzoate of)	5,831	5,420
Soya bean oil		626
Total	18,821,777	19,124,420
Total production of colored oleomargarine	174,943	[3] 379,416
Total withdrawn tax-paid	36,673	139,318
Ingredient schedule for colored oleomargarine:		
Butter		60
Cocoanut oil	66,309	117,231
Color	187	307
Cottonseed oil	24,148	52,337
Derivative of glycerine	16	11
Lecithin		3
Milk	55,209	111,075
Mustard oil		195
Neutral lard	15,980	34,544
Oleo oil	27,999	86,593
Oleo stearine	2,595	5,065
Oleo stock	275	7,223
Palm oil	7,300	25,235
Peanut oil	2,220	3,793
Salt	15,138	31,318
Soda (benzoate of)	10	14
Whale oil		292
Total	217,386	475,296

[1] Of the amount produced, 5,932 pounds were reworked.
[2] Of the amount produced, 10,252 pounds were reworked.
[3] Of the amount produced, 1,013 pounds were reworked.

XII–19–6173
MS. 138

Schedule of oleomargarine produced and materials used during the month of March, 1933, as compared with March, 1932.

	March, 1933.	March, 1932.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 21,066,488	[2] 18,558,957
Total withdrawn tax-paid	20,592,445	18,366,736
Ingredient schedule for uncolored oleomargarine:		
Butter	379	2,960
Cocoanut oil	13,402,390	11,309,380
Corn oil	6,299	4,114
Cottonseed oil	1,351,331	1,381,450
Derivative of glycerine	32,023	22,130
Lecithin	64	585
Milk	4,942,687	4,547,818
Neutral lard	701,089	905,361
Oleo oil	973,520	1,153,203
Oleo stearine	225,936	361,479
Oleo stock	26,035	24,608
Palm oil	42,946	10,500
Peanut oil	188,341	218,053
Salt	1,175,713	1,232,552
Soda (benzoate of)	7,888	6,446
Soya bean oil	3,480	471
Sugar	8,904	----------
Total	23,089,025	21,271,115
Total production of colored oleomargarine	320,952	[3] 414,163
Total withdrawn tax-paid	38,884	146,282
Ingredient schedule for colored oleomargarine:		
Butter	120	60
Cocoanut oil	95,591	119,870
Color	279	386
Corn oil	2	----------
Cottonseed oil	56,881	66,897
Derivative of glycerine	10	3
Lecithin	----------	1
Milk	98,090	123,488
Neutral lard	28,439	38,246
Oleo oil	54,451	107,435
Oleo stearine	6,263	4,448
Oleo stock	2,934	8,308
Palm oil	20,200	8,728
Peanut oil	2,466	4,876
Salt	26,473	31,586
Soda (benzoate of)	9	11
Sugar	60	----------
Total	392,268	504,343

[1] Of the amount produced, 5,635 pounds were reworked.
[2] Of the amount produced, 15,361 pounds were reworked.
[3] Of the amount produced, 354 pounds were reworked.

XII–23–6219
MS. 139

Schedule of oleomargarine produced and materials used during the month of April, 1933, as compared with April, 1932.

	April, 1933.	April, 1932.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 20,181,102	[2] 16,385,007
Total withdrawn tax-paid	20,722,788	16,407,772
Ingredient schedule for uncolored oleomargarine:		
Butter	400	2,668
Cocoanut oil	12,706,613	9,918,579
Corn oil	7,095	4,969
Cottonseed oil	1,340,689	1,193,117
Derivative of glycerine	33,984	26,445
Lecithin	92	355
Milk	4,783,090	4,019,611
Neutral lard	756,205	760,282
Oleo oil	1,061,581	1,054,002
Oleo stearine	274,785	320,700
Oleo stock	26,716	23,450
Palm oil	42,946	10,018
Peanut oil	201,897	222,254
Salt	1,151,290	1,047,344
Soda (benzoate of)	7,789	6,363
Soya bean oil	3,640	238
Sugar	10,272	
Total	22,409,084	18,610,395
Total production of colored oleomargarine	257,465	298,512
Total withdrawn tax-paid	35,180	110,644
Ingredient schedule for colored oleomargarine:		
Butter		60
Cocoanut oil	81,007	66,910
Color	225	199
Corn oil	30	
Cottonseed oil	41,510	51,981
Derivative of glycerine	58	65
Milk	75,041	87,107
Neutral lard	18,955	29,727
Oleo oil	46,465	71,353
Oleo stearine	7,605	5,562
Oleo stock	1,050	5,905
Palm oil	14,800	10,235
Peanut oil	2,001	4,950
Salt	19,868	25,946
Soda (benzoate of)	17	9
Sugar	24	
Total	308,656	359,109

[1] Of the amount produced, 7,857 pounds were reworked.
[2] Of the amount produced, 5,661 pounds were reworked.

S. J. RES. 167. PUBLIC RESOLUTION NO. 53, SEVENTY-SECOND CONGRESS.

Joint resolution to carry out certain obligations to certain enrolled Indians under tribal agreement.

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That any person duly enrolled as a member of an Indian tribe who received in pursuance of a tribal treaty or agreement with the United States an allotment of land which by the terms of said treaty or agreement was exempted partially or in total from taxation, and from which land the restrictions have been or have not been removed and who was required or permitted contrary to law to pay any illegal or unauthorized Federal inheritance tax or Federal income tax on the rents, royalties, or other gains arising from such allotted lands, and who under the law and rulings of the Treasury Department have secured a refund of the taxes so illegally or erroneously collected but who did not receive interest on such refunds in accordance with the laws and the regulations in force at the time the refund was secured and who have failed to file a claim for the allowance of such interest, shall be allowed one year after the approval of this Act within which to file such claim, and if otherwise entitled thereto may recover such interest on such illegally collected taxes in the same manner and to the same extent as if such claims for interest had been theretofore duly filed as required by law, it not being the policy of the Government to invoke or plead a statute of limitations to escape the obligations of agreements solemnly entered into with its Indian wards: *Provided, however*, That in the case of the death of any person any such interest on the refund of illegal taxes paid by him or on his account may in like manner be claimed and recovered by the person or persons who would have received such money had it constituted a part of his estate at the time of his death: *Provided further*, That no interest on such refunds shall be payable prior to the time provided by law for the payment of interest in any such similar cases: *Provided further*, That it shall be unlawful for any person acting as attorney or agent for any claimant to receive more than a total of 5 per centum of the amount collected under the provisions of this Act, and any person collecting a total amount from such claimant in excess of said 5 per centum shall be guilty of a misdemeanor and punished by a fine not exceeding $1,000 or imprisonment not exceeding six months, or both.

Approved, February 14, 1933.

XII–12–6089

H. R. 13520. PUBLIC, NO. 428, SEVENTY-SECOND CONGRESS.

An Act making appropriations for the Treasury and Post Office Departments for the fiscal year ending June 30, 1934, and for other purposes.

Be it enacted, etc. * * *

SEC. 14. Section 319 of Part II of the legislative appropriation Act, fiscal year 1933, is repealed as of June 30, 1932; and the rate of interest to be allowed upon judgments against the United States and overpayments in respect of internal-revenue taxes shall be the rate applicable thereto prior to the enactment of section 319 of such Act.

XII–12–6090

CONFERENCE AND PRACTICE REQUIREMENTS, BUREAU OF INTERNAL REVENUE, REVISION OF FEBRUARY, 1933.

QUALIFICATIONS FOR CONFERENCE.

I. Conferences may be accorded only to taxpayers or their duly authorized representatives. Any individual taxpayer, or member of a firm, or officer or authorized regular employee of a corporation may appear for himself or such firm or corporation solely upon adequate identification. All other persons appearing as attorneys or agents to represent taxpayers must exhibit evidence that the requirements of Department Circular No. 230 (revised), which contains the statutes and regulations governing practice before the Treasury Department, have been complied with, and must also conform with the following requirements:

POWER OF ATTORNEY TO BE FILED AND EVIDENCE OF ENROLLMENT TO BE SUBMITTED BEFORE RECOGNITION IS ACCORDED.

II. No attorney or agent representing a claimant or other person before any of the offices of the Bureau of Internal Revenue shall appear or be recognized in any case, matter, claim, or other proceeding or business pending in such office unless the attorney or agent representing the claimant presents and files a power of attorney, or a certified copy thereof, from his principal in proper form authorizing him to prosecute the case, claim, or matter in question. Such power of attorney shall always be filed and evidence of enrollment submitted before such attorney or agent is recognized. In the event, however, that an attorney or agent presents himself for conference who is not familiar with this requirement, or who can show that he has not had reasonable opportunity to obtain a power of attorney from his client, or who has not applied for enrollment, but is able to produce such evidence as will reasonably convince the Bureau's representative that he has authority to represent the taxpayer, such attorney or agent may be heard, with the understanding that a power of attorney in proper form and evidence of enrollment will be promptly forwarded to the Bureau and that until such power of attorney and evidence of enrollment shall have been filed the points raised at the conference by such attorney or agent will not be considered.

POWER OF ATTORNEY TO BE FILED PRIOR TO FINAL DETERMINATION OF TAX LIABILITY.

III. No power of attorney will be accepted which is filed after final determination of the tax liability, unless the power of attorney recites that the principal is cognizant of such settlement and of the amount of deficiency or overassessment determined upon. (See also title "Checks in payment of refunds." Paragraph XIX herein.)

Power of Attorney Requirements.

IV. Any power of attorney offered in evidence in any case will be accepted only if it is in regular form. Only one power of attorney shall be in effect in any case and there shall be included in such power of attorney the names and addresses of all attorneys or agents to whom the taxpayer has delegated authority to represent him.

A. TECHNICAL LANGUAGE UNNECESSARY.

It is considered necessary in all cases that the power of attorney contain language to convey the principal's intention, though not necessarily in strictly legal form.

B. ATTESTATION OF EXECUTION OF INSTRUMENT OR WITNESSES THERETO.

The power of attorney must be executed before a notary public, or, in lieu thereof, witnessed by two disinterested individuals. The notarial seal must be affixed unless such seal is not required under the laws of the State wherein the power of attorney is executed. No attorney or agent as notary public shall take acknowledgments, administer oaths, certify papers, or perform any official act in connection with matters pending before the Bureau in which he is employed as counsel, attorney, or agent, or in which he may be in any way interested. (See Act of June 29, 1906, 34 Stat., 622.)

C. EXTENT OF AUTHORITY DELEGATED.

The authority delegated to an attorney or agent in a power of attorney enumerating certain specific acts which may be done will be considered limited to those acts.

(A) SPECIFIC AUTHORITY REQUIRED FOR CERTAIN ACTS.

Specific authority to do the following acts must be granted and shown in the power of attorney or such acts will be considered beyond the scope of the agent's authority:

1. To receive but not to indorse and collect checks in settlement of any refund. (See section 3477 of Revised Statutes, which prohibits assignments of claims or portions thereof, and title "Checks in payment of refunds," Paragraph XIX herein.)
2. To delegate authority or to substitute another agent or attorney.
3. To execute consents agreeing to a later determination and assessment of taxes than is provided by statute of limitations.
4. To execute closing agreements relative to the tax liability.

D. SIGNATURE OF GRANTOR.

The power of attorney should be signed as follows:

a. In the case of an individual taxpayer, by such individual.

b. In the case of a partnership, either by all members or in the name of the partnership by one of the partners duly authorized to act.

c. In the case of a corporation, by an officer of the corporation having authority to bind same and be attested by the secretary of the corporation over the corporate seal.

1. A power of attorney granted by a corporation should state whether or not the corporation has a seal, and the seal should be affixed to the power in all cases where one is used by the corporation. If the power of attorney shows that the corporation has no seal, a certified copy of a resolution duly passed by the board of directors of the corporation giving its officers authority to sign the same should be submitted.

2. If the officer who signs the power of attorney is also secretary, another officer of the corporation, preferably the president, vice president, or treasurer, must also sign the instrument so that two different individuals' signatures will appear thereon.

d. In the case of an association, the same requirements shall apply as in the case of a corporation.

e. Special cases:
If the taxpayer is—
Dissolved,
Insolvent,
Deceased,
or has a similar status, the additional requirements beginning with Paragraph XIII herein should be followed.

E. CERTIFICATION OF COPIES OF POWERS OF ATTORNEY AND EVIDENCE FILED IN CONNECTION THEREWITH.

The certification of copies of powers of attorney or papers or documents filed in connection therewith must be made by a notary public, or other proper official, who should state that he has personally compared the copy with the original and finds it to be a true and correct copy. This certification applies to all copies of powers of attorney and related papers, including printed and photostatic copies.

SUBSTITUTION OF ATTORNEYS OR AGENTS.

V. Substitution of attorneys or agents may be effected only where the power of attorney, under which the attorney or agent of record is acting, expressly confers the right of substitution. Such attorney or agent, if in good standing before the Department, may by a duly executed substitute power of attorney, substitute another or others in his stead. The Bureau reserves the right to refuse recognition to a substituted attorney or agent where, in its opinion, such substitution will only delay the final adjustment of the case. Furthermore, the Bureau will not accept a substitute power of attorney granted by an attorney or agent, who is acting under a substitute power of attorney from the attorney or agent of record, unless specific authority is granted in the principal's power of attorney to the attorney or agent of record to pass on to his substitute the right of substitution. (See also title "Checks in payment of refunds," Paragraph XIX herein.)

NEW POWER OF ATTORNEY REQUIRED WHEN NEW OR ADDITIONAL ATTORNEYS OR AGENTS RETAINED.

VI. In any case in which a power of attorney has been filed and the taxpayer subsequently desires to authorize other or additional attorneys or agents to represent him before the Bureau with respect to the same case, a new power of attorney must be filed, which shall include the names of all attorneys or agents who are authorized to act for such taxpayer. Such new power of attorney shall contain a clause specifically revoking any and all powers of attorney previously filed with respect to the same case. However, the revocation by a principal or his legal representatives of authority to prosecute a matter will not be effective, in so far as this Bureau is concerned, without the assent of the Commissioner. Where consideration of a matter has been held in abeyance awaiting the furnishing of evidence for which a call has been made on an attorney or agent, failure on his part to take action thereon within three months from the date on which consideration of the matter was suspended may be deemed by the administrative officer before whom the case is pending cause for refusal to further recognize the authority of the attorney or agent, without notice to him. (See also title "Checks in payment of refunds," Paragraph XIX herein.)

EVIDENCE REQUIRED TO SUBSTANTIATE FACTS ALLEGED IN CONFERENCES.

VII. No reduction in taxes proposed nor increases in allowance of claims shall be made as the result of conferences unless the evidence upon which such action is taken is submitted in writing and over the sworn signature of the taxpayer. The affidavit of an attorney or agent will not be accepted unless it appears that such attorney or agent is the only person having actual knowledge of the facts presented. The sworn statement of facts must be submitted at least five days before the conference date and must meet all the issues raised by the Bureau which the taxpayer desires to contest: *Provided, however,* That this requirement shall not preclude the taxpayer from submitting within a reasonable time after such conference any evidence or contention necessary to meet any theory or position taken by the Bureau which could not reasonably have been anticipated prior to the conference.

Every affidavit, agreement, brief, or statement of facts prepared or filed by an attorney or agent as argument or evidence in the matter of a claim or tax matter pending before the Bureau shall have thereon a statement signed by such attorney or agent showing whether or not he prepared such document and whether or not the attorney or agent knows of his own knowledge that the facts contained therein are true.

CONFERENCE TO BE PREARRANGED AND ONLY ONE GRANTED.

VIII. Conferences with taxpayers or their representatives will not ordinarily be held without previous arrangement. Cases in which taxpayers or their representatives can submit some unusual reason for requesting an immediate conference without previous arrangement as required above will be given consideration by heads of division in the Bureau, who may, if the circumstances warrant, make an exception to the rule.

In order that the case under consideration may be closed at one conference, if at all possible, the requirements of Paragraph VII of this circular to the effect that the brief submitted in advance of conference must meet all issues raised will be strictly enforced, and another conference will not be granted on the same case except to meet new issues raised by the Bureau in the course of the first conference which could not have been anticipated prior to such conference.

RECOGNITION OF UNENROLLED EMPLOYEES OF QUALIFIED ATTORNEYS OR AGENTS.

IX. Unenrolled employees of enrolled attorneys or agents will not be recognized in any matter by offices of the Bureau except for the purpose of filing papers or securing information as to the status of cases. Recognition for the latter purpose will be given only when the employee presents in each case written authority from his employer to act as the latter's substitute in obtaining the information desired regarding status and when the power of attorney of his employer in each case provides for the substitution of such employee. To facilitate recognition of such employees, it is requested that the employee present at the time of making inquiry concerning any case the receipt for the power of attorney issued to his employer by the taxpayer in that case and the receipt for the substitute power of attorney issued to him. (These receipts are furnished when the powers of attorney are filed.)

POWERS OF ATTORNEY AND ENROLLMENT REQUIRED OF AGENTS AND ATTORNEYS HANDLING MATTERS BY CORRESPONDENCE.

X. Where recognition is desired through correspondence with the Department, enrollment and power of attorney requirements must be met by attorneys or agents even though no actual appearance is made before the Department. If a proper power of attorney is filed authorizing only one of the following acts by the attorney of agent, enrollment will not be required:

Authority to sign but not to prosecute any claim of the taxpayer.

Authority to inspect or receive copies of returns where Executive order or regulations permit such action by agent.

(NOTE.—The Commissioner reserves the right to withhold making the above exceptions in any specific case.)

If the power of attorney authorizes the attorney or agent to do one or both of the above acts and some other act or acts, enrollment will be considered necessary, notwithstanding that the agent or attorney does not expect to use all of the power conferred upon him.

LETTERS ARRANGING CONFERENCES TO ADVISE OF REQUIREMENTS.

XI. Letters arranging conferences will apprise the taxpayer or his representative of the requirements as to powers of attorney, the necessity of being enrolled to practice before the Department, to whom he should apply for enrollment, statements of facts, and briefs, unless it is known that the addressee is aware of the requirements. Owing to the expense involved, it will not be the practice, except in rare cases, to incorporate the above requirements in telegrams. Where sufficient time intervenes between the date of the telegram and the conference the telegram will be confirmed by letter and conference requirements stated.

PRACTITIONERS MUST CONDUCT THEMSELVES IN AN ETHICAL MANNER.

XII. Attorneys or agents representing taxpayers before the Bureau are expected at all times to conduct themselves in an ethical manner, and will be held strictly accountable for any deliberately false or misleading statement made for the purpose of securing a reduction in taxes, a refund of taxes, an exemption from taxation, or of securing the acceptance of an offer in compromise of taxes.

For gross misconduct the Commissioner may refuse to recognize any person as an attorney or agent in any particular case.

INSTRUCTIONS FOR EXECUTION OF POWERS OF ATTORNEY IN SPECIAL CASES WHICH MUST BE MET IN ADDITION TO GENERAL REQUIREMENTS.

XIII. *Dissolved partnership.*—A power of attorney to act with respect to matters involving the affairs of a dissolved partnership must be signed by all of the former partners. In case some of the partners are dead, their legal representatives must sign in their stead. If, however, under the laws of the particular State, the surviving partners at the time of the execution of the power of attorney have exclusive right to the control and possession of the firm's assets for the purpose of winding up its affairs, their signatures alone will be sufficient. If only the surviving partners sign the power of attorney, a copy of the pertinent provisions of the State law under which they claim authority, exclusive of the legal representatives of the deceased partners, should be noted and citation given thereto.

XIV. *Dissolved corporation.*—If a liquidating trustee, or trustee under dissolution, has been appointed, or if a trustee derives authority under a statute of the State in which the corporation was organized, the power of attorney should be executed by such trustee. If there is more than one trustee, all must join unless it is established that less than all have authority to act in the premises. The power of attorney must be accompanied by a copy of the instrument under which the trustee derives his authority, properly authenticated, or if the authority is derived under a State statute, the statute should be cited and quoted, and an affidavit by a third party, setting forth the facts required by the statute as a precedent to the vesting of the authority in said trustee must be furnished. It must also appear in the case of any trustee that his authority has not been terminated. If there is no trustee, then a power of attorney executed before a notary public by a sufficient number of individuals to make up a representation of a majority in the voting stock of the corporation at the date of dissolution will be accepted for purposes of conference and correspondence relating to the tax liability in the particular case. Such instrument must show the total number of outstanding shares of voting stock at the date of dissolution and the number held by each signatory to the power of attorney. The instrument must also contain positive averments as to the nonexistence of any trustee, and the date of dissolution must appear.

XV. *Insolvent taxpayer.*—A certificate from the court having jurisdiction over the insolvent should be furnished showing the appointment and qualification of the trustee or receiver, and it should appear that the authority has not terminated. In cases pending before the district court of the United States an authenticated copy of the order approving the bond of the trustee will meet this requirement. If an attorney has been appointed under authority of court for the trustee or receiver, a copy of the court order appointing such attorney (where he is to represent the trustee) should be furnished. If no attorney has been appointed, the trustee or receiver should execute the power of attorney, the acknowledgment or witnessing thereof to be the same as in the case of an individual, and the above-described evidence showing the appointment of the trustee or receiver furnished therewith. If the trustee or receiver does not wish to appoint an attorney, he will be recognized upon establishing his authority in the manner above described.

XVI. *Deceased taxpayer.*—The executor or administrator should execute the power of attorney, which must be accompanied by a short-form certificate (or authenticated copies of letters testamentary or letters of administration) showing that his authority is in full force and effect at the time such evidence is submitted. The executor or administrator will be recognized in his own right if he does not wish to appoint an attorney or agent, upon submission of the above-described court certificate, and such executor or administrator is not required to be enrolled to practice. In the event that the executor has been discharged and

a trustee under the will is acting, the power of attorney must come from the trustee and evidence of the discharge of the executor and of the appointment of the trustee must be submitted with the power of attorney. In such cases where the executor is discharged and the estate is distributed to the residuary legatees, the power of attorney must come from the legatees and be accompanied by a statement from the court certifying to the discharge of the executor and naming the residuary legatees and indicating the proper share to which each is entitled. In the event that the decedent died intestate and the administrator has been discharged or none was ever appointed, the power of attorney must come from the distributees and be accompanied by evidence of the discharge of the administrator, if one had been appointed, and affidavits and such other evidence as can be adduced tending to show the relationship to the deceased of the signatories to the power of attorney and the right of each of them to the respective shares claimed under the law of the domicile of the deceased.

XVII. *Guardians and other fiduciaries appointed by a court of record.*—The power of attorney should be executed by the fiduciary and must be accompanied by a court certificate or court order showing that such fiduciary has been appointed and that his appointment has not been terminated.

XVIII. *Trustee under deed, declaration, etc.*—Powers of attorney must be executed by the trustee and be accompanied by documentary evidence of the authority of the trustee to act. Such evidence may be either a copy of the trust instrument, properly certified, or a certified copy of extracts from the trust instrument, showing—

a. Date of instrument.

b. That it is or is not of record in any court.

c. The beneficiaries.

d. The appointment of the trustee, the authority granted, and such other information as may be necessary to show that such authority extends to Federal tax matters.

e. That the trust has not been terminated, and that the trustee appointed thereby is still acting.

Self-serving affidavits by the trustee in this connection are not acceptable. In the event that the trustee appointed in the original trust instrument is no longer acting and has been replaced by another trustee, documentary evidence of the appointment of the new trustee must be submitted. In cases where there are more than one trustee appointed, all must join unless it is shown that less than all have authority to act.

XIX. *Checks in payment of refunds.*—The Bureau is not bound to deliver any check in payment of refund of internal-revenue taxes, penalties, or interest to a representative of any taxpayer acting under authority evidenced by a power of attorney. However, it will be the general policy of the Bureau to mail such checks in care of an enrolled attorney or agent who has filed power of attorney from the principal, specifically authorizing him to receive but not to indorse such check, provided that such power of attorney shall have been filed in sufficient time for the section or division preparing the certificate of overassessment to show thereon the mailing address as "care of" the attorney or agent. Where an attorney or agent has more than one address, request to mail the check to another address than is shown in the power of attorney will not be granted, due to the unwarranted effort involved in changing Bureau records, unless the address shown in the power of attorney is no longer that of the attorney or agent. In the event that a power of attorney is filed specifically authorizing more than one attorney or agent to receive checks on the taxpayer's behalf and such attorneys or agents have different addresses, the Bureau will not mail the check in care of any of the attorneys or agents named in the power of attorney but will mail the check direct to the taxpayer, unless a statement is furnished, signed by all of the attorneys or agents named in the power of attorney, requesting that the check be mailed in care of one of their number. Furthermore, it will be the policy of the Bureau not to mail checks in payment of refunds to an attorney or agent who holds authority to receive such check by reason of a substitute power of attorney obtained from the attorney or agent designated by the taxpayer.

Requirements Applicable to Field Offices.

XX. The foregoing conference and practice requirements apply with equal force to the field offices of the Bureau.

David Burnet, *Commissioner.*

4767°—33——32

XII–24–6234
Mim. 4025

Form 1118 for 1931 to be corrected.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C., June 5, 1933.

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

Reference is made to Form 1118, Claim for credit on corporation income tax return for taxes paid or accrued to a foreign country or a possession of the United States, to be filed by a domestic corporation for the taxable year 1931. The third line under "Column B taxes" on page 3 of the form reads "Schedule D. Item 10." This line should read "Schedule D, Item 14." Taxpayers and others using this form should make the necessary correction in the line referred to, using either pen and ink or typewriter.

All inquiries concerning this mimeograph letter should refer to the number thereof and the symbols IT:E:RR.

P. R. BALDRIDGE,
Acting Commissioner.

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[1] XII–26–6261

Disbarments and suspensions from practice before Treasury Department of attorneys and agents.[2]

DISBARMENTS.

The Secretary of the Treasury, after due notice and opportunity for hearing, has ordered the disbarment from further practice before the Treasury Department of the following-named attorneys and agents:

Name.	Address.	Date of disbarment.	Cause.
Bacchus, Robert R.	Springfield, Ill.	Mar. 1, 1933	Charged with knowingly preparing false income-tax returns for two taxpayers. Charges found proven.
Barnett, Lewis	New York, N. Y.	Jan. 4, 1933	Charged with attempting to extort money from a client to settle an alleged deficiency in income tax. Charges found proven.
Beal, Henry W.	Boston, Mass.	Sept. 29, 1932	Charged with having been disbarred by the Superior Court of Suffolk County, Mass., for misappropriation of client's funds. Charges found proven.
Behrendt, Henry A.	Detroit, Mich.	Dec. 5, 1932	Charged with having been disbarred from practice as an attorney in courts of Michigan. Charges found proven.
Caldwell, Robert Lee.	Formerly Fort Worth, Tex., now Dallas, Tex.	Apr. 7, 1932	Charged with obtaining $225 from a client by fraudulent pretenses. Charges found proven.
Dow, William J.	Washington, D. C.	May 7, 1932	Charged with having been disbarred as an attorney by the Supreme Court of the District of Columbia. Charges found proven.
Ellis, F. L.	Council Bluffs, Iowa.	July 11, 1932	Charged with preparing false articles of copartnership showing 5 partners when there were but 2 and preparing false returns for such taxpayers. Charges found proven.

[1] This ruling (6261) includes also rulings Nos. 5973, 5986, 5997, 6007, 6013, 6024, 6033, 6043, 6054, 6065, 6076, 6091, 6105, 6120, 6131, 6140, 6150, 6162, 6174, 6185, 6198, 6207, 6220, 6233, and 6245. These rulings have been thus consolidated because publication of each one separately would be largely duplication.

[2] This list includes all attorneys and agents whose disbarment from practice before the Treasury Department was published during the 12-month period ended June 30, 1933, and all suspensions in effect during the 6-month period January 1–June 30, 1933, inclusive. It does not include those barred from practice by reason of disapproval of their application for enrollment.

Name.	Address.	Date of disbarment.	Cause.
Everett, S. H.	Formerly Valdosta, Ga., later Orlando, Fla.	Oct. 27, 1932	Charged with defrauding numerous persons by issuing worthless checks and drafts. Charges found proven.
Fewkes, John B.	Los Angeles, Calif.	Feb. 27, 1932	Charged with having been convicted of grand theft. Charges found proven.
Fox, Maurice.	Formerly New York, N. Y. now Brooklyn, N. Y.	June 22, 1932	Charged with having been convicted in the United States district court for unlawfully obtaining money from a taxpayer in a tax matter. Charges found proven.
Gorman, John J.	Chicago, Ill.	Feb. 23, 1933	Charged with having been disbarred by the Supreme Court of the State of Illinois. Charges found proven.
Johnson, Sven Elmer.	Formerly Chicago, Ill., later New Orleans, La.	Feb. 27, 1932	Charged with knowingly preparing a false Federal income tax return for a taxpayer. Charges found proven.
Keller, Al S.	Los Angeles, Calif.	Feb. 2, 1933	Charged with having been convicted and sentenced in a criminal case in a State court. Charges found proven.
Moore, J. Edward.	New Bedford, Mass.	Sept. 29, 1932	Charged with having unlawfully attempted to extort a large fee from a client by threats of disclosure. Charges found proven.
Moss, Clair D.	Pittsburgh, Pa.	Dec. 30, 1932	Charged with proposing to Federal prohibition agents that such agents furnish the respondent confidential information relative to complaints received in the Federal prohibition enforcement office against clients of the respondent, for which such clients would pay a reasonable sum of money through the respondent to such agents. Charges found proven.
Mueller, F. C.	Formerly Chicago, Ill.	Apr. 29, 1932	Charged with solicitation of employment in Federal tax matters from taxpayers with whom respondent had no previous association. Charges found proven.
Mulford, Elmer W.	Formerly Detroit, Mich.	May 7, 1932	Charged with having been disbarred as an attorney by the circuit court of Wayne County, Mich. Charges found proven.
Pickett, Thomas Y.	Dallas, Tex.	Feb. 23, 1933	Charged with having been convicted and sentenced in a criminal case in the United States District Court. Charges found proven.
Quereau, Edward E.	Formerly Cincinnati, Ohio, later St. Louis, Mo.	June 21, 1932	Charged with making a Federal income return for a taxpayer and receiving a check for the amount of tax due from the taxpayer; that he failed to file such return and appropriated the amount of such check to his own use and benefit; also charged with issuing bad checks; also charged with embezzling funds of a corporation of which he was secretary. Charges found proven.
Ransom, Don E.	Formerly Wichita, Kans., later Fort Worth, Tex.	Sept. 28, 1932	Charged with knowingly preparing a false offer of compromise in a tax matter. Charges found proven.
Sandler, Alvin M.	Formerly Tampa, Fla.	Dec. 5, 1932	Charged with having been convicted of a criminal offense in United States district court and disbarred as an attorney by such court. Charges found proven.
Saydman, Davis.	New York, N. Y.	June 23, 1932	Charged with offering money to a revenue agent to make a favorable report on the examination of the books and records of a taxpayer. Charges found proven.
Sites, E. S.	Formerly Charleston, W. Va.	Apr. 29, 1932	Charged with misappropriating funds of a client and with conspiracy to extort money from a client. Charges found proven.
Stone, Ralph W.	Formerly Chicago, Ill., how Middletown, Ill.	Nov. 2, 1932	Charged with giving money to prohibition officers to procure the approval of applications for permits for withdrawal of wine. Charges found proven.
Van Riper, Harold.	Formerly New York, N. Y.	Nov. 30, 1932	Charged with conviction in a criminal case in the United States District Court. Charges found proven.
Weinstein, Harry H.	Formerly New York, N. Y., now Brooklyn, N. Y.	June 29, 1932	Charged with filing false income tax returns for himself. Charges found proven.
Weiss, Henry M.	New York, N. Y.	Apr. 29, 1932	Charged with knowingly preparing fraudulent amended income tax return for a client. Charges found proven.
Wenger, George.	Paterson, N. J.	Apr. 29, 1932	Charged with having been convicted in United States District Court for conspiracy to conceal assets in a bankruptcy case. Charges found proven.
Wolford, H. C.	Erie, Pa.	Feb. 24, 1933	Charged with having been convicted and sentenced in a criminal case in the United States District Court. Charges found proven.

SUSPENSIONS.

The Secretary of the Treasury, after due notice and opportunity for hearing, has ordered the suspension from practice before the Treasury Department for the period stated in each case of the following-named attorneys and agents:

Name.	Address.	Period of suspension.	Cause.
Holcombe, J. LeRoy	Formerly Macon, Ga., later Atlanta, Ga.	1 year, from Dec. 30, 1932.	Charged with soliciting employment in Federal income tax matters. Charges found proven.

Resignations from enrollment to practice before the Treasury Department.

The following-named persons tendered their resignations from enrollment to practice before the Treasury Department. By direction of the Secretary of the Treasury their resignations were accepted and their names ordered stricken from the roll of attorneys and agents enrolled to practice before the Treasury Department. They are therefore no longer entitled to practice before the Treasury Department.

Name.	Address.	Designation.	Date of acceptance.	Remarks.
Laird, Charles A	Philadelphia, Pa	Agent	Apr. 8, 1933	
Selden, Charles B	Formerly Miami, Fla., now Tallahassee, Fla.	Agent	Feb. 8, 1933	With prejudice.

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