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INTERNAL REVENUE BULLETIN

CUMULATIVE BULLETIN 1954-1

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FINDING LIST

FINDING LIST—Continued

INTRODUCTION

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for the announcement of official Internal Revenue rulings, and for the publication of Treasury Decisions, Executive orders, legislation, and court decisions pertaining to Internal Revenue matters.

It is the policy of the Service to publish in the Bulletin all substantive and procedural rulings of importance or general interest, the publication of which is considered necessary to promote a uniform application of the laws administered by the Service. It is also the policy to publish all rulings which revoke, modify, amend, or affect any published ruling. Rulings relating solely to matters of internal management are not published. The rulings are prepared in the various divisions of the National Office, including the Office of the Chief Counsel for the Internal Revenue Service. All published rulings have received the consideration and approval of the Chief Counsel.

Revenue Rulings reported in the Bulletin do not have the force and effect of Treasury Department Regulations (including Treasury Decisions), but are published to provide precedents to be used in the disposition of other cases, and may be cited and relied upon for this purpose. However, since each published ruling represents the conclusion of the Service as to the application of the law to the entire state of facts involved, Revenue officers and others concerned are cautioned against reaching the same conclusion in other cases unless the facts and circumstances are substantially the same. In applying rulings published in the bulletin, personnel of the Service will, of course, consider the effect of subsequent legislation, regulations, court decisions, and rulings.

Each ruling is designated as a "Revenue Ruling" and should be cited by reference to the Bulletin and page where reported. Thus, Revenue Ruling No. 54–80 should be cited as "Rev. Rul. 54–80, C. B. 1954–1, 11." Rulings are keyed to the applicable sections of the Internal Revenue Code and regulations.

Internal Revenue Cumulative Bulletin 1954–1, contains all rulings, decisions, and legislation pertaining to Internal Revenue matters published in the weekly Internal Revenue Bulletins 1 to 26, inclusive, for the period January 1 to June 30, 1954. It also contains a cumulative list of announcements relating to decisions of The Tax Court of the United States, published in those Bulletins.

This Cumulative Bulletin is printed in five parts, Part I, Current Rulings, Decisions, etc.; Part II, Rulings and Decisions Under Prior Regulations; Part III, Alcohol Tax Rulings and Decisions; Part IV, Legislation and Treaties; and Part V, Administrative and Miscellaneous Matters.

ABBREVIATIONS

The following abbreviations in current use and formerly used will appear in material published in the Bulletin:

A, B, C, etc.—The names of individuals.
A. T.—Alcohol and tobacco tax ruling.
B. T. A.—Board of Tax Appeals.
C. B.—Cumulative Bulletin.
Ct. D.—Court Decision.
D. C.—Treasury Department circular.
E. O.—Executive Order.
E. T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
FAAA.—Federal Alcohol Administration Act.
G. C. M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I. R. B.—Internal Revenue Bulletin.
IR-Mim.—Published IR-Mimeograph.
I. T.—Income tax ruling.
M, N, X, Y, Z, etc.—The names of corporations, places, or businesses according to context.
M. T.—Miscellaneous tax ruling.
Mim.—Published Mimeograph.
P. L.—Public Law.
Rev. Rul.—Revenue Ruling.
S. T.—Sales tax ruling.
T. C.—The Tax Court of the United States.
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 TAX COURT OF THE UNITED STATES

CUMULATIVE LIST OF ANNOUNCEMENTS RELATING TO DECISIONS OF THE TAX COURT OF THE UNITED STATES PUBLISHED IN THE INTERNAL REVENUE BULLETIN FROM JANUARY 1, 1954, TO JUNE 30, 1954, INCLUSIVE

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not to acquiesce in a decision of The Tax Court of the United States which disallows a deficiency in tax determined by the Commissioner to be due. Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government. Decisions so acquiesced in should be relied upon by officers and employees of the Internal Revenue Service as precedents in the disposition of other cases. (No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.)

The Commissioner acquiesces in the following decisions:

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B			
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Blyth, Martha J	40636	21	275
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Boston and Maine Railroad [2]	5756	16	1517
Brennen, James	39129	20	495
Brockman Building Corp., Inc	34866	21	175
Bus Leasing Corporation	35412	20	849

[1] Estate tax decision.
[2] Acquiescence relates to the issue whether petitioner sustained losses in the year claimed with respect to a number of pieces of property.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
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D			
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Denton, John R	36853	21	295
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E			
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Edwards Trust, Ann	25471	20	615
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Emerzian, Zabelle	39109	20	825
F			
Farmers Creamery Co. of Fredericksburg, Va.[7]	20716	14	879
Fenton, Leslie	35203	21	15
First National Corporation of Portland, The [8]	108224 109642	2	549
Fry, W. N	758	5	1058
G			
Gatto, Anne, transferee	37206	20	830
Glasgow, F. Ewing	35921	21	211
Graham, M. H.[3]	38350	[a] 26	301
Guaranty Trust Co. of New York, ancillary executor of estate of George McNaught Lockie [9] [10]	32102	21	64

[a] Board of Tax Appeals.

[3] Nonacquiescence published in Cumulative Bulletin XI-2, p. 13, insofar as it relates to the issue of petitioners' liability as transferees under sec. 322 of the Civil Code of California, withdrawn.

[4] Nonacquiescence published in Cumulative Bulletin 1952-2, p. 5, withdrawn.

[5] Acquiescence relates only to whether $7,023 reported as dividend income in petitioner's 1945 tax return was realized in 1945 or 1946.

[6] Nonacquiescence published in the Cumulative Bulletin 1938-2, p. 42, withdrawn.

[7] Acquiescence relates only to the issues whether expenditures for restoration of building should be capitalized or deducted as ordinary expenses; whether customer's payments for bottles represented deposits or taxable income; and whether a voluntary payment for violation of O. P. A. regulations is deductible.

[8] Nonacquiescence published in Cumulative Bulletin 1952-2, p. 4, withdrawn.

[9] Estate tax decision.

[10] Acquiescence relates to result only in the issues of whether the value of shares of stock of the Bank of Nova Scotia owned by decedent at date of death is includible in his gross estate, and whether the value of British Treasury certificates owned by decedent at the time of death is includible in his gross estate.

ACQUIESCENSES—Continued

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J			
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K			
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Laster, Carolyn Faust, transferee [13]	97714	[a]43	159
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M			
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MacMurray, Frederick [16]	40292	21	15
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Mellon National Bank & Trust Co., et al., executors of estate of John C. Morrow [14]	36554	19	1068
Moore, G. H.[11]	38351	[a]26	301
Morrow, John C., estate of [14]	36554	19	1068

[a] Board of Tax Appeals.

[11] Nonacquiescence published in Cumulative Bulletin XI-2, p. 13, insofar as it relates to the issue of petitioners' liability as transferees under sec. 322 of the Civil Code of California, withdrawn.

[12] Acquiescence as to result only.

[13] Nonacquiescence published in Cumulative Bulletin 1952-2, p. 5, withdrawn.

[14] Estate tax decision.

[15] Acquiescence relates to result only in the issues of whether the value of shares of stock of the Bank of Nova Scotia owned by decedent at date of death is includible in his gross estate, and whether the value of British Treasury certificates owned by decedent at the time of death is includible in his gross estate.

[16] Frederick M., Frederick, and Fred MacMurray are the same petitioner.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
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O			
Occidental Life Insurance Co., transferee of The First National Corporation of Portland [19]	108367 109644	2	549
P			
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Providence Trust Co. of Philadelphia, et al., executors of estate of Frank W. Thacher [17]	17382	20	474
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Richards, Aaron, executor of estate of Louis Richards [24]	34013	20	904
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Ross, Harold W., estate of	36148	18	1013
Roundup Coal Mining Co., The [22]	36709	20	388
S			
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Stone, Mrs. H. C., executrix [23]	38335	[a] 26	301
Sutter, Richard A	37277	21	170
Sutter, Richard A., et ux	37278	21	170
Swain, Samuel G	31163	20	1022

[a] Board of Tax Appeals.

[17] Estate tax decision.

[18] Nonacquiescence published in Cumulative Bulletin 1952-2, p. 5, withdrawn.

[19] Nonacquiescence published in Cumulative Bulletin 1952-2, p. 4, withdrawn.

[20] Nonacquiescence published in Cumulative Bulletin XIV-1, p. 35, and Cumulative Bulletin 1937-1, p. 45, withdrawn.

[21] Nonacquiescence published in Cumulative Bulletin 1952-1, p. 6, withdrawn.

[22] Acquiescence relates only to whether petitioner is entitled to a deduction in 1943 for catastrophe insurance.

[23] Nonacquiescence published in Cumulative Bulletin XI-2, p. 13, insofar as it relates to the issue of petitioners' liability as transferees under sec. 322 of the Civil Code of California, withdrawn.

ACQUIESCENCES—Continued

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Triple E Development Co	26008	20	619
W			
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Western Transmission Corporation [23]	29490	18	818
Woody, Rhett E., et ux	36396	19	350
Woody, Rhett W	36397	19	350
Z			
Zachry Realty Co	35413	20	849

[24] Estate tax decision.
[23] Nonacquiescence published in Cumulative Bulletin 1952-2, p. 4, withdrawn.
[25] Nonacquiescence published in Cumulative Bulletin 1952-2, p. 6, withdrawn.

The Commissioner does NOT acquiesce in the following decisions:

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Cramer, Emma	39447	20	679
Cramer, Everett L., Trust	39448	20	679
Cramer, Jeanne L., Trust	39449	20	679
Cramer, Jessie N	39450	20	679
Cramer, Russell E	39451	20	679
Cramer, Russell E., Jr	39455	20	679
Cramer, Stanley S	39454	20	679
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F			
Farmers Creamery Co. of Fredericksburg, Va.[3]	20716	14	879
Fox, Maurice	39458	20	1094
G			
Godley, Ida S., estate of	35057	19	1082
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Goff, Henrietta B	34643	20	561
H			
Hirschwald, Rebecca	34644	20	561
M			
Markle, et ux., Thomas V	34645	20	561
N			
New McDermott, Inc., The [4]	99360	[a] 44	1035
O			
Obear-Nester Glass Co	36271	20	1102
R			
Rosen, David	34646	20	561
Roundup Coal Mining Co., The [5]	36709	20	388

[a] Board of Tax Appeals.

[1] Nonacquiescence relates to issue whether, under the retirement system of accounting, retirement losses must be reduced by pre-1913 depreciation and should ICC cost of reproduction new less depreciation be reduced by the amount of engineering costs included therein.

[2] Acquiescence published in Cumulative Bulletin 1951-1, p. 2, insofar as it relates to whether petitioner, on accrual basis, may deduct from gross income in 1946 and 1947 amounts representing additional Massachusetts excise-tax liabilities for those years when subsequent to close of such years it was indirectly disputing such liabilities, withdrawn.

[3] Nonacquiescence relates only to the issue whether an extraordinary loss on bottles and crates not adequately offset by the usual depreciation is deductible.

[4] Acquiescence published in Cumulative Bulletin 1953-1, p. 5, withdrawn.

[5] Nonacquiescence relates to whether the expenditures made by petitioner in 1944 for an air shaft, fan, and compressor are allowable as current business expenses or capital expenditures.

NONACQUIESCENCE—Continued

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T			
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Tyree, Wilhelmina C., executrix of estate of Joseph E. Tyree	43589	20	675
W			
West Flagler Amusement Co., Inc	24598	21	486

PART I.—CURRENT RULINGS, DECISIONS, ETC.

INTERNAL REVENUE CODE

CHAPTER 1.—INCOME TAX

SUBCHAPTER B.—GENERAL PROVISIONS

PART I.—RATES OF TAX

SECTION 11.—NORMAL TAX ON INDIVIDUALS

REGULATIONS 118, SECTION 39.11-2: Citizens or residents of the United States liable to tax.

Foreign students in the United States. (See Rev. Rul. 54-87, p. 155.)

SECTION 12.—SURTAX ON INDIVIDUALS

REGULATIONS 118, SECTION 39.12-1: Surtax on individuals.

Foreign students in the United States. (See Rev. Rul. 54-87, p. 155.)

PART II.—COMPUTATION OF NET INCOME

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

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income.

Rev. Rul. 54-80

The portion of a political contribution received by a political organization or a candidate for political office which is diverted from political campaign purposes to the personal use of the candidate or other individual constitutes taxable income to such candidate or other individual.

I. T. 3276, C. B. 1939-1 (Part 1), 108, modified.

Advice is requested whether that part of the political contributions received by a political organization or an individual seeking political office which is diverted to the personal use of the candidate or other individual constitutes taxable income to such candidate or other individual.

Contributions to political organizations are customarily made with the intent and understanding that they be used for the expenses of a political campaign or for some similar purpose. Such contributions are not deductible for Federal income tax purposes by the donor. See I. T. 3276, C. B. 1939-1 (Part 1), 108.

Where a political gift is received by an individual or a political organization and it is held or used for the purposes intended, i. e., for present or future expenses of a political campaign or for some similar purpose, it is not taxable income to the recipient. See I. T. 3276, *supra*. However, any amount diverted from the channel of campaign activities and used by a candidate or other individual for personal use constitutes taxable income to such candidate or other individual for the year in which the funds are so diverted. For example, a candidate seeking political office receives contributions totaling $1,000 from individuals and organizations for use in his campaign for election to such office. During the campaign the candidate expends $600 of the contributed funds for campaign purposes. He uses the balance of the campaign funds to reduce the mortgage on his personal residence. In such a case the candidate will be required to include in his taxable income the $400 which represents the portion of the fund which he diverted to his personal use. Such amount will be includible in taxable income in the year in which so diverted.

I. T. 3276, *supra*, is modified to the extent that it is inconsistent with the views expressed herein.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. Rev. Rul. 54-105
(Also Section 116, Section 39.116-1.)

Gains realized on the sale of items of property, which are the personal property of the taxpayer, such as personal automobiles or television sets, in a foreign country by a United States citizen living abroad are not exempt from Federal income tax under the provisions of section 116(a) of the Internal Revenue Code which relates to the exclusion of earned income from sources without the United States in the case of citizens who are residing abroad. Such gains are includible in gross income under the provisions of section 22(a) of the Code, and inasmuch as they result from the sale of capital assets are subject to the limitations provided in section 117(b) of the Code. For the purpose of determining the gain, the cost and selling price of the property should be expressed in American currency at the rate of exchange prevailing as of the date of the purchase and the date of the sale, respectively. *Cf.* Rev. Rul. 291, C. B. 1953-2, 42.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. Rev. Rul. 54-143
(Also Section 42, Section 39.42-1.)

Interest (increment in value) earned on a Series E United States savings bond registered in the names of two natural persons in the alternative as coowners but purchased entirely with the funds of one is all his income, even though he gratuitously permits the other to redeem the bond and retain the entire proceeds.

Where the purchase price of such a savings bond registered in the names of a husband and his wife in the alternative as coowners was contributed in part by each and the bond is reissued in the names of the hubsand and their daughter in the alternative as coowners, any interest that accrues (as earned) thereon thereafter while she remains such coowner is her income in proportion to the wife's contribution to the purchase price. Such proportion of any interest that had accrued on the bond before its reissue is income of the wife. Interest earned on the bond, whether it had accrued before the reissue or accrues thereafter while the husband continues to be the other coowner, is his income in proportion to his contribution to the purchase price.

Advice is requested regarding to whom interest (increment in value) earned on a United States savings bond, Series E, registered in the names of two natural persons in the alternative as coowners is income, for Federal income tax purposes, where the bond was purchased entirely with funds of one coowner but he gratuitously permits the other coowner to redeem the bond and retain as hers the entire proceeds. Advice is also requested regarding to whom interest earned on such a savings bond is income where its purchase price was contributed in part by a husband and in part by his wife and it was originally registered in their names in the alternative as coowners but, in order to effect a gift by the wife of her coownership therein to their daughter, is reissued so as to substitute her name as coowner in place of the wife, with the husband continuing as the other coowner.

The amounts and time of increases in redemption values of such savings bonds generally are indicated by tables of redemption values shown thereon. With respect to extended Series E bonds issued prior to May 1, 1942, the periodical increases in their redemption values after their original maturity are indicated in a table in Department Circular 885, C. B. 1951-2, 32. With respect to extended Series E bonds issued on or after May 1, 1942, the periodical increases in their redemption values after their original maturity are indicated in tables A and C in Department Circular 653 (3d Rev.) dated April 29, 1952, a copy of which may be obtained from any Federal Reserve Bank, or the Bureau of the Public Debt, Washington 25, D. C. Such increments in value do not accrue on the bonds ratably, but occur (become earned) only in specific amounts at the end of the first year held after their issue date (except where issued on or after May 1, 1952, the first increment occurs at the end of 6 months after issue date) and at the end of each following half-year period to original or extended maturity or earlier redemption (except where issued on or after May 1, 1952, the final increment period before original maturity is only 2 months). For example, in the case of a Series E savings bond purchased for $75 and bearing an issue date of May 1, 1941, the first, second, and third increments in value occurred (became earned) on May 1, 1942, November 1, 1942, and May 1, 1943, in the amounts of $0.50, $0.50, and $0.50, respectively; and, in the case of a Series E savings bond of the same issue price but bearing an issue date of May 1, 1952, the first, second, and third increments in value occurred on November 1, 1952, May 1, 1953, and November 1, 1953, in the amounts of $0.40, $0.80, and $1, respectively.

As provided with respect to such savings bonds in section 22(d) of the Second Liberty Bond Act (as amended by the Public Debt Act of 1941, C. B. 1941-1, 546), "For the purposes of taxation increment in value represented by the difference between the price paid and the redemption value received (whether at or before maturity) for savings bonds * * * shall be considered as interest."

In I. T. 3301, C. B. 1939-2, 75, it was held that, where such savings bonds are registered in the names of two natural persons in the alternative as coowners, for example, "Mr. John Jones or Mrs. Mary Jones," interest (increment in value) earned thereon is income, for Federal income tax purposes, of the coowner whose funds were used to purchase the bonds; and that, if the purchase price was furnished in part by each, the interest is income of each in proportion to his or her respective contribution to the purchase price, provided, however, that coowners who are husband and wife domiciled in a State having community property laws should ordinarily include one-half of the interest as each spouse's income if the bonds are held as community property.

It is held that, where such a savings bond registered in the names of two natural persons in the alternative as coowners was purchased entirely with the funds of one of the coowners, all the interest (increment in value) earned thereon is his income, even though he gratuitously permits the other coowner to redeem the bond (whether at or before its maturity) and retain as hers the entire proceeds. Such holding is consistent with holdings in O. D. 120, C. B. No. 1, 84 (1919); I. T. 3011, C. B. XV-2, 132 (1936); I. T. 3097, C. B. 1937-2, 219; *Helvering* v. *Paul R. G. Horst*, 311 U. S. 112, Ct. D. 1472, C. B. 1940-2, 206; and I. T. 3486, C. B. 1941-2, 76, regarding to whom assigned interest income is taxable for Federal income tax purposes.

It is further held that, where the purchase price of such a savings bond registered in the names of a husband and his wife in the alternative as coowners was contributed in part by each spouse and the bond is reissued in the names of the husband and their daughter in the alternative as coowners, the wife's coownership in the bond is then transferred to the daughter. Therefore, whether such transfer was for valuable consideration or as a gift, any interest (increment in value) that accrues (as earned) on the bond thereafter while the daughter remains such coowner is her income in proportion to the wife's contribution to the purchase price, whereas such proportion of any interest that had accrued on the bond before its reissue is income of the wife. Since the husband continued as the original other coowner, interest earned on the bond, whether it had accrued before the reissue or accrues thereafter while he so continues, is his income in proportion to his contribution to the purchase price.

For rules relative to when interest (increment in value) on such savings bonds is returnable, for Federal income tax purposes, see G. C. M. 15875, C. B. XIV-2, 100 (1935); Mimeograph 6327, C. B. 1948-2, 12; and D. C. 885, *supra* (the latter relating, *inter alia*, to Series E bonds held after their original maturity). In regard to by whom and when interest on such savings bonds held in trust by a bank is returnable, see I. T. 3575, C. B. 1942-2, 113.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income.

Amounts received in settlement of claims under the New Jersey "Death by Wrongful Act" statute. (See Rev. Rul. 54-19, p. 179.)

REGULATIONS 118, SECTION 39.22(a)-2: Compensation for personal services.
(Also Section 22(b), Section 39.22(b)(2)-2; Section 113(a), Section 39.113(a)(5)-1; Regulations 105, Section 811(c), Section 81.17.)

Rev. Rul. 54-144

Treatment for Federal income tax purposes of retirement pay and annuity benefits received by retired members of the uniformed services of the United States and their beneficiaries under elections provided by the Uniformed Services Contingency Option Act of 1953, 67 Stat. 501, whereby a member may elect to receive retirement pay in a lesser amount than that to which he is entitled under the provisions of the Career Compensation Act of 1949 and other retirement laws in order to provide one or more annuities payable after his death to his widow, child or children.

Advice is requested with respect to the tax status of the reduced retired pay and the annuities in the hands of the recipients thereof where a member of the uniformed services elects under the Uniformed Services Contingency Option Act of 1953, 67 Stat. 501, to receive retired pay in a lesser amount than that to which he is entitled under the provisions of the Career Compensation Act of 1949, 63 Stat. 802, and other retirement laws in order to provide one or more annuities payable after his death to his surviving spouse, child or children.

The 1953 Act provides a plan whereby an active or retired member of the uniformed services may elect to receive a reduced amount of retired pay in order to provide one or more annuities payable after his death to his widow, child or children. Members of the uniformed services are not compelled to provide annuities for their dependents. It is entirely voluntary whether they participate in the plan. However, they must elect to participate in the plan within a specified period of time or be barred from the annuity program. The act further sets up provisions relative to modification or revocation of the election, and provides for the operation of the act in various eventualities.

The questions with respect to which advice is requested are set forth below.

(A) Will a member's awarded statutory retired or retirement pay or the reduced retired pay constitute his gross income for Federal income tax purposes?

T. D. 5208, C. B. 1943, 65, holds that the amounts deducted and withheld pursuant to the Civil Service Retirement Act of 1930, as amended, from the basic salary pay or compensation of those employees in the civil service of the United States are payments made toward the purchase of annuities under the act and are not allowable deductions for income tax purposes. In like manner the amounts deducted from the retired pay of members of the uniformed services to provide annuities are not allowable deductions for Federal income tax purposes. It is recognized that in some cases the retired pay received by a member will be entirely exempt from Federal income tax and in some cases it will be partially exempt. See Rev. Rul. 256, C. B. 1953-2, 13. Under the provisions of section 22(b)(5) of the Internal Revenue Code amounts received in taxable years beginning after December 31, 1941, as a pension, annuity or similar allowance for personal injuries or sickness resulting from active services in the Armed Forces of any country are exempt from Federal income tax.

(B) Are the annuities includible in the gross income of the annuitants as provided for in section 22(b)(2) of the Internal Revenue Code?

Section 22(b)(2)(A) of the Internal Revenue Code provides that amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income in respect of such annuity equals the aggregate premiums or consideration paid for such annuity.

(C) Will the fair market value of an annuity be includible in the gross estate of a deceased member of the uniformed services for Federal estate tax purposes?

Section 811(c)(3) of the Code provides, in part, that a transfer of an interest in property by the decedent after October 7, 1949, is includible in the gross estate under section 811(c)(1)(C) (whether decedent did or did not retain any right or interest in the property transferred) if possession or enjoyment can through ownership of such interest be obtained only by surviving the decedent. Therefore, the value of the annuity payable to the widow or other survivors of the retired member is includable in his gross estate for Federal estate tax purposes under section 811(c)(3).

(D) Is the cost of an annuity the aggregate of the amounts by which the decedent's retired pay was reduced or the fair value of the annuity to the annuitant determined under section 113(a)(5) of the Code, which is relative to the adjusted basis of property transmitted at death?

The amendments of section 22(b)(2) and section 113(a)(5) of the Code by section 303 of the Revenue Act of 1951 relate to joint and survivor annuities. The annuity involved in the instant case is devoid of any joint and survivorship features. The widow or child or children are the primary and only annuitants. Therefore, the annuity involved is not a survivorship annuity and the "substituted" cost basis provision of section 22(b)(2) and section 113(a)(5) are not applicable. The annuitant's basis, however, would be determined under section 113(a)(2) of the Code relating to the basis of property acquired by gift.

(E) Will the annuity be subject to the $5,000 exclusion from gross income provided for by section 22(b)(1)(B) of the Code?

Section 22(b)(1)(B) of the Code, as amended by section 302(a) of the Revenue Act of 1951, provides that there shall not be included in gross income and that there shall be exempt from income tax the amounts received under a contract of an employer providing for payment of such amounts to the beneficiaries of an employee, paid by reason of the death of the employee, whether in a single sum or otherwise. The aggregate of the amounts thus excludable by all of the beneficiaries of the employee under all such contracts of any one employer may not exceed $5,000. Section 22(b)(1)(B) of the Code contemplates the case where money is paid by the employer in consideration of past services. The annuity payments under the Uniformed Services Contingency Option Act of 1953 to beneficiaries of retired members are made in consideration of annuity premiums paid by retired members, rather than in consideration of past services. The Government in this case acts like the issuer of an annuity policy. Accordingly, the annuities paid to beneficiaries under the Uniformed Services Contingency Option Act of 1953 are not entitled to the exclusion provided in section 22(b)(1)(B) of the Code.

(F) Will the fact that the decedent's retired pay was excluded from his gross income, in whole or in part, under section 22(b)(5) of the Code, have any effect on the taxable status of the annuity paid to his beneficiaries?

Notwithstanding the fact that the deductions from the decedent's retired pay, which were used for the purpose of providing annuities for the wife or other survivors, flowed from either partially or fully tax-exempt income, the annuity payments to the survivors are subject to tax under the 3 percent rule of section 22(b)(2) of the Code. The survivor will, under the 3 percent rule be entitled to recover as tax exempt, the cost or other basis of the annuity contract, but any income flowing from the annuity contract after the survivor has fully recovered the basis is subject to tax.

(G) Are the annuities subject to withholding under section 1622 of the Code?

Withholding is not required under section 1622(a) of the code on the annuities payable to the widow, child or children. Section 406.207(b) of Regulations 120 provides in part as follows:

> In general, pensions and retired pay are wages subject to withholding. However, no withholding is required with respect to amounts paid to an employee upon retirement which are taxable as annuities under the provisions of section 22(b)(2).

(H) Are the annuities subject to withholding under section 143(b) of the Code where the annuitant is a nonresident alien?

Section 143(b) of the Code specifically requires the withholding of Federal income tax at the source on amounts paid to nonresident alien individuals as annuities and the amount of the annuity includible in gross income is subject to withholding tax at the rate of 30 percent unless this rate is reduced by treaty provisions.

REGULATIONS 118, SECTION 39.22(a)-2: Compensation for personal services.

Taxability of pension benefits received by union members. (See Rev. Rul. 54-190, p. 46.)

REGULATIONS 118, SECTION 39.22(a)-3: Compensation for personal services. Rev. Rul. 54-165

Where the premiums required to purchase group term life insurance for employees are paid out of contributions from both employer and employees and the payments made by the employer provide

only current insurance protection, the amounts paid by the employer are not includible in the gross income of the benefited employees notwithstanding the fact that the insurance policies permit conversion, under certain circumstances, into permanent types of life insurance.

Advice is requested whether employer contributions towards premiums for the purchase of employees' group term life insurance is includible in the gross income of the benefited employees where the insurance policies, under certain circumstances, may be converted by the individual employees into permanent types of life insurance.

In accordance with the provisions of the group term life insurance policy in the instant case the amount of insurance on the life of each employee is determined by the employee's basic rate of pay. The insurance premiums are paid for by contributions from both employer and employee. The insurance is group term life insurance, containing a permanent total disability provision. An employee who terminates his employment is entitled to have issued to him, without evidence of insurability, an individual policy of life insurance without disability or other supplemental benefits, on which he must pay the premiums. Such employee may date his individual policy as of the effective date of his insurance under the group policy, provided he pays the differences between the amount of premiums paid under the group policy and the premiums that would have been due under the individual policy, with interest, or the cash value of the individual policy, whichever is greater.

Section 39.22(a)-3 of Regulations 118, relating to compensation paid other than in cash, provides in part that premiums paid by an employer on policies of group life insurance covering the lives of his employees, the beneficiaries of which are designated by the employees, are not income to the employees.

The tax consequence of the purchase of group life insurance are set forth in Mim. 6477, C. B. 1950-1, 16. Under the provisions of section 29.22(a)-3 of Regulations 111 (now section 39.22(a)-3 of Regulations 118) as interpreted by Mim. 6477, *supra*, premiums paid by an employer on policies of group term insurance covering the lives of his employees are not income to the benefited employees. Premiums paid by an employer for permanent forms of insurance on the lives of his employees under group permanent life insurance policies constitute income to the employees, except that under paragraph 5 of Mim. 6477, *supra*, such premiums do not constitute income if the employees' right to permanent insurance, or equivalent benefits, other than current term insurance, is forfeitable in case of subsequent separation from service. The question presented is whether the provisions of paragraph 5 of Mim. 6477, *supra*, apply in the instant case in view of the fact that the benefited employees have, under the terms of the policy, the right on termination of employment to convert the policies into permanent types of life insurance.

The facts in the case presented lead to the conclusion that the premiums paid by the employer only provide current insurance protection and that the costs of any permanent or nonforfeitable features of the policy are borne by the employees.

It is held that where the premiums required to purchase group term life insurance for employees are paid out of contributions from both employer and employees and the payments made by the employer provide only current insurance protection, the amounts paid by the employer are not includible in the gross income of the benefited employees notwithstanding the fact that the insurance policies permit conversion, under certain circumstances, into permanent types of life insurance.

REGULATIONS 118, SECTION 39.22(a)-5: Gross income from business. Rev. Rul. 54-222
(Also Section 117(j), Section 39.117(j)-1; and Section 23 (l), Section 39.23(l)-2.)

The policy of the Internal Revenue Service regarding the Federal income tax treatment of "demonstrator" automobiles in the hands of an automobile dealer, as set forth in I. T. 4062, C. B. 1951-2, 61, is not affected by the acquiescence of the Service in *Latimer-Looney Chevrolet, Inc.* v. *Commissioner*, 19 T. C. 120, acquiescence C. B. 1953-1, 5. That decision with respect to the Federal income tax treatment of "company cars" in the hands of an automobile dealer is distinguished on the basis of the facts in that case. The distinction between "demonstrator" cars and "company cars" in the hands of a dealer is determined on the basis of the facts in each particular case.

Advice is requested whether the income tax treatment of profits on the sale of demonstrator cars, as set forth in I. T. 4062, C. B. 1951-2, 61, is changed as a result of the acquiescence of the Internal Revenue Service in the court decision of *Latimer-Looney Chevrolet, Inc.* v. *Commissioner*, 19 T. C. 120, acquiescence C. B. 1953-1, 5, previous nonacquiescence, page 7, withdrawn.

In I. T. 4062, C. B. 1951-2, 61, it is held that motor vehicles acquired by a dealer in the usual course of purchase for resale and temporarily used as "demonstrators" are presumably held for sale to customers in the ordinary course of the dealer's business. Consequently, no depreciation is allowable with respect to such vehicles, they are not property used in the trade or business, and gain on their sale may not be treated as capital gain under section 117(j) of the Internal Revenue Code. It was stated that a dealer in motor vehicles is presumed to hold all such vehicles owned by him primarily for sale to customers in the ordinary course of his trade or business but that this presumption may be overcome where a dealer can establish that a certain vehicle was acquired and used in the operation of the business.

The case of Latimer-Looney Chevrolet, Inc., *supra*, dealt with the tax treatment of profits on sales of certain vehicles which the petitioner contended were "company cars" used in its business. The Commissioner argued that they were "demonstrators." The court found, as a fact, that the vehicles were "company cars" held primarily for use in the petitioner's business and held, consequently, that gain from their sale was subject to the provisions of section 117(j) of the Code. A contrary finding of fact was made as to certain cars in the case of *W. R. Stephens Company* v. *Commissioner*, Tax Court Memorandum Opinion August 8, 1951, affirmed 199 Fed. (2d) 665, which were found to be "demonstrators" held primarily for sale to customers in the ordinary course of business.

There is no conflict between the cases insofar as the law is concerned. The decision by the court in each instance was based entirely on its findings of fact. While the Revenue Service does not necessarily concur in the findings of fact in the Latimer-Looney case, such findings are not subject to review by appellate courts, therefore, no appeal was taken. The acquiescence entered in the Latimer-Looney decision is an acceptance of the determination in that case only.

The decision in the Latimer-Looney case does not necessitate any modification of the ruling in I. T. 4062, *supra*, and that ruling continues to express the position of the Revenue Service.

Whether a particular vehicle is a "demonstrator" or a "company car" is a question of fact dependent upon the circumstances. Some of the factors to be considered are: the method by which it is financed, the registration of the vehicle, the manner in which it is insured, the nature, duration, and extent of its use by the dealer, and the requirements of the manufacturer as to its treatment. The mere occasional use by a dealer of a "demonstrator" car will not make it a "company car." In order to qualify for treatment as property used in the trade or business, a vehicle must have been acquired for that purpose and devoted, *bona fide*, to use in the business (other than for demonstration purposes) of the taxpayer.

Where the facts in a particular case establish that a vehicle qualifies as a "company car," depreciation is allowable for the period of time it is held for such use. Any gain from the sale of such car so held and used for more than six months is subject to the provisions of section 117(j) of the Code.

REGULATIONS 118, SECTION 39.22(a)–21: Trust income taxable to the grantor as substantial owner thereof. — Rev. Rul. 54–9

(Also Section 23(a), Section 39.23(a)–10; Section 1000, Section 86.2, Regulations 108.)

The transfer of real property to a trust for a 10-year period for the benefit of grantor's children with his wife as one of two trustees, with the corpus to go to the grantor's wife in the event of his death prior to the expiration of the 10-year period, and with a privilege of leasing back such property from the trustees constitutes a transfer in form rather than substance. Rental payments made to the trust by the grantor will not constitute deductible business expenses. The grantor will remain the owner of the property during the term of the trust for purposes of Federal income and gift taxes and the rental payments when made will constitute gifts.

Advice is requested as to the Federal income and gift tax consequences resulting from the transfer of property to a trust under circumstances hereinafter described.

The grantor owns and operates a restaurant on property which he proposes to transfer in trust for the benefit of his children naming his wife as one of two trustees to hold title to the property. Trust income may at the discretion of the trustees be distributed or accumulated. At the expiration of 10 years the corpus of the trust will revert to the grantor if he is living and in the event of his death the corpus will go to the grantor's wife. Upon termination of the trust any accumulated income will be paid to the beneficiaries. During the term of the trust the grantor by prearrangement has the privilege of renting the restaurant property constituting the corpus of the trust from the trustees at a rental to be determined by reputable real estate experts.

The conveyance of property to the trust by the grantor in the instant case for the benefit of his children with a privilege of renting back such property, presents a form of reallocation of income within a family group. Attempts at reallocation of family income have been sought to be accomplished in the form of a trust, *Helvering* v. *George B. Clifford*, 309 U. S. 331, Ct. D. 1444, C. B. 1940-1, 105; family partnership, *Commissioner* v. *Francis E. Tower*, 327 U. S. 280, Ct. D. 1670, C. B. 1946-1, 11; *Commissioner* v. *William O. Culbertson, Sr. et ux.*, 337 U. S. 733, Ct. D. 1723, C. B. 1949-2, 5; assignment of income, *Helvering* v. *Paul R. G. Horst*, 311 U. S. 112, Ct. D. 1472, C. B. 1940-2, 206; or royalty payments to members of a family corporation, *Ingle Coal Corporation* v. *Commissioner*, 10 T. C. 1199, affirmed, 174 Fed. (2d) 569. The Supreme Court examined the practical effects of the transfer in each instance to determine whether the transferor retained control or enjoyment of the income or property transferred. The controlling consideration in intrafamily assignments has been the tax consequences flowing from the substance of a transaction rather than from its form. See *Commissioner* v. *Joseph Sunnen*, 333 U. S. 591, Ct. D. 1698, C. B. 1948-1, 7. Economic fact is emphasized rather than legal title and technicalities, *Higgins* v. *John Thomas Smith*, 308 U. S. 473, Ct. D. 1434, C. B. 1940-1, 127.

The promise to pay "rent" is analogous to the promise to pay "interest." In *F. Coit Johnson* v. *Commissioner*, 86 Fed. (2d) 710, Ct. D. 1228, C. B. 1937-1, 187, where the taxpayer gave his wife money which she placed in trust to be loaned back to him, the Court stated that the "interest" paid by the husband to the wife by way of a trust constituted gifts and were not deductible as a business expense. The husband had not made a gift of the money placed in trust but merely had made gratuitous promises to pay interest. Similar results were reached in two recent district court opinions in *George L. Sall et ux.* v. *Francis R. Smith*, D. C., E. D., Pa., October 28, 1952, and in *Henry Kirschenmann et ux.* v. *Harry C. Westover*, D. C., S. D., Calif., June 30, 1952 (pending appeal).

In the Sall case the taxpayer transferred certain sums of money to three trusts set up for the benefit of his children. Immediately thereafter the money was loaned by the trusts to a partnership controlled by the taxpayer, and the trusts received three binding promissory notes and an agreement to pay, in lieu of interest, a percentage of the partnership profits. In his instructions to the jury, the District Court judge noted the factors of reallocation of income in a family transaction, the legal and binding effect of the notes, the gift of the money on the condition that it be reinvested in the partnership, and the fact that a majority of the trustees were not family members and had a right to exercise their independent judgment and invest the money in any way they thought proper. The jury returned a verdict in favor of the collector who had disallowed the so-called interest deductions. In the Kirschenmann case the taxpayer purchased farmland for which he had been paying a rental of about $4,500 for a term of 5 years. The taxpayer then made a "gift" of the land to his 12-year old daughter. The taxpayer's brother, who was appointed guardian for the daughter, leased the land to the taxpayer for a term of 5 years. Some $19,000 was paid as "rent" during the first year of the lease. While the high "rent" figured in the decision of the court in denying the deduction, it is also noted that the court found that the taxpayer exercised the same possession and control over the land after the gift and the setting up of the guardianship as he had prior thereto.

A contrary result was reached in *A. A. Skemp* v. *Commissioner*, (1948) 168 Fed. (2d) 598, reversing 8 T. C. 415, and *Helen C. Brown, et al.* v. *Commissioner*, (1950) 180 Fed. (2d) 926, reversing 12 T. C. 1095, cert. den. 340 U. S. 814. However, see *E. Field White* v. *Fitzpatrick* (1951) 193 Fed. (2d) 398, cert. den. 343 U. S. 928, in which the Skemp and Brown cases were distinguished. It is believed that the Skemp and Brown opinions in the Court of Appeals conflict in principle with the leaseback decisions in *Helvering* v. *Lazarus and Co.* 308 U. S. 252, Ct. D. 1430, C. B. 1939-2, 208 (sale and leaseback in reality a loan and security for the loan); *W. H. Armston Co., Inc., et al.* v. *Commissioner*, (1951) 188 Fed. (2d) 531; *Stearns Magnetic Manufacturing Co.* v. *Commission*, T. C. Memo. Op. Docket No. 23509, dated May 29, 1952; Ingle Coal Corporation, *supra;* and *58th Street Plaza Theater, Inc.* v. *Commissioner* (1952) 195 Fed. (2d) 724 (sublease to wife of principal stockholder by family corporation).

In applying the foregoing principles to the instant case it is evident that the transaction will be carried out under a prearranged plan. The independence of the trustee in reality disappears under circumstances where the transaction is prearranged. The grantor of the proposed trust will merely transfer the property to the trust with control reserved, thereby retaining the use and enjoyment of the property. The business of the grantor and the property in which it is conducted will remain undisturbed; there has been no parting with a real interest in the property involved which is requisite to the passage of a gift. In substance the grantor remains the owner of the property.

Accordingly, it is held that the transfer of real property to a trust for a 10-year period for the benefit of grantor's children with his wife as one of two trustees, with the corpus to go to the grantor's wife in the event of his death prior to the expiration of a 10-year period, and with a privilege of leasing back such property from the trustees constitutes a transfer in form rather than substance. Rental payments made to the trust by the grantor will not constitute deductible business expenses. The grantor will remain the owner of the property during the term of the trust for purposes of Federal income and gift taxes, and the rental payments when made will constitute gifts.

REGULATIONS 118, SECTION 39.22(a)-21: Trust income taxable to the grantor as substantial owner thereof. Rev. Rul. 54-41

The income of a trust created under an instrument which (1) vests in the grantor-trustee the power to distribute from trust income or corpus such amounts at such time as he in his sole discretion shall determine to be necessary for certain needs of the beneficiary and (2) provides that upon death of the beneficiary the remainder shall be paid over to a designated educational organization constitutes taxable income to the grantor under section 22(a) of the Internal Revenue Code.

Advice is requested whether the income of a trust created under an instrument the provisions of which are set forth below constitute taxable income to the grantor.

In the case presented, the taxpayer created a trust naming himself as trustee of certain personal property which he then owned. The trust instrument provides that the principal and income of the trust shall be paid to the taxpayer's mother during her lifetime in such amounts and at such time as the trustee, in his sole discretion, shall determine necessary for her care, comfort, support, maintenance, benefit, and best interests. The trust is to terminate upon the mother's death and the balance of the principal and income remaining in the hands of the trustee is to be paid over to a designated educational organization to be added to certain scholarship funds. The grantor-trustee has unlimited power to invest and reinvest the principal and income of the trust in such investments as he may choose in the exercise of his judgment and discretion. He has full power and authority to change investments, and to sell, grant, convey, pledge, or mortgage any property, real or personal, of which the trust fund may at any time, in whole or in part, consist. The general administrative powers vested in the trustee are to be exercised primarily for the benefit of the beneficiary of the trust. Furthermore, the trust instrument does not vest in any person the power to borrow or to acquire the trust corpus or income for less than adequate consideration.

Section 39.22(a)-21 of Regulations 118 provides in pertinent part that the income of a trust is taxable to the grantor under section 22(a) of the Internal Revenue Code, although not payable to the grantor himself and not to be applied in satisfaction of his legal obligations, if he has retained a control of the trust so complete that he is still in practical effect the owner of its income. Such section further provides that a grantor has retained control so complete as to render the income of a trust taxable to him, whatever the duration of the trust, if the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable in any capacity (except a power exercisable in one of certain ways set forth in the regulations, none of which are present here), by the grantor or any person not having a substantial adverse interest in the beneficial enjoyment of the corpus or income, whichever is subject to the power, or both.

Under the trust instrument, the grantor-trustee has the power to distribute to his mother during her lifetime from trust income or corpus such amounts at such time as he shall, in his sole discretion, determine to be necessary for her care, comfort, support, maintenance, benefit, and best interests. By virtue of such power, he also determines the amount of income and corpus paid over to the designated educational organization upon termination of the trust. Accordingly, beneficial enjoyment of the corpus and the income therefrom is subject to the power of disposition by the grantor within the purview of section 39.22(a)-21 of Regulations 118.

In view of the foregoing, it is held that the income of the trust is taxable to the grantor under section 22(a) of the Internal Revenue Code.

REGULATIONS 118, SECTION 39.22(a)-21: Trust income taxable to the grantor as substantial owner thereof. Rev. Rul. 54-48
(Also Regulations 111, Section 29.22(a)-21.)

In *Commissioner* v. *Ruth S. Clark et al.*, 202 Fed. (2d) 94, the Court held, on the facts presented, that the income of the trust there involved was not taxable to the grantor under the 10-year short-term trust rule set forth in section 29.22(a)-21(*c*) of Regulations 111 (now sec. 39.22(a)-21(c) of Regulations 118) the facts being that (1) the trust was created prior to promulgation of that section of the regulations, (2) the trust was extended prior to promulgation of such regulations so that its total term was 10 years, and (3) the beneficiary of the trust was a charitable corporation. The Internal Revenue Service will follow that decision in the disposition of other cases only if the issue and the facts in such cases are identical to those in the Clark case. Section 29.22(a)-21 of Regulations 111 was promulgated December 29, 1945. See T. D. 5488, C. B. 1946-1, 19.

REGULATIONS 118, SECTION 39.22(a)-23: Allocations by cooperative associations; tax treatment as to patrons. Rev. Rul. 54-10

Allocations of cooperative associations and tax treatment as to patrons of amounts distributed in document form.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to set forth the policy of the Service and to furnish instructions to the district directors and other employees concerned, with respect to the tax treatment in the hands of patrons, of amounts allocated in document form by cooperative associations.

SEC. 2. MEANING OF TERMS.

For the purpose of this Revenue Ruling the terms "cooperative association," "patron," "allocation," and "patronage dividend" have the meaning ascribed to them in section 39.101(12)-2(b) of Regulations 118. As so defined the term "allocation" includes patronage dividends and other distributions made by a cooperative association in any manner whereby there is disclosed to the patron the dollar amount apportioned on the books of the association for the account of such patron. The term "patronage dividend" as defined does not include amounts allocated on a patronage basis in document form which are fixed without reference to earnings of the association. However, the rules set forth in section 6 herein, as to the tax treatment of amounts allocated in document form, apply not only to patronage dividends but to all allocations made by a cooperative association in document form.

SEC. 3. BACKGROUND.

.01 Treasury Decision 6014, approved May 29, 1953, C. B. 1953-1, 110, added section 29.22(a)-23 to Regulations 111 (now 39.22(a)-23 of Regulations 118), prescribing rules for the tax treatment as to patrons of allocations by cooperative associations. Section 39.22(a)-

23(b)(1) of Regulations 118 sets forth the extent of taxability of amounts allocated to a patron on a patronage basis by a cooperative association with respect to products marketed for such patron, or with respect to supplies, equipment, or services the cost of which is deductible by the patron under section 23 of the Code. These regulations provide in part to the effect that if the allocation is in the form of capital stock, revolving fund certificates, certificates of indebtedness, letters of advice, retain certificates or similar documents, the amounts allocated shall be included in the computation of the gross income of the patron to the extent of the face amount of such documents provided the allocation is made in fulfillment and satisfaction of a valid obligation of such association to the patron, which obligation was in existence prior to the receipt by the cooperative association of the amount allocated.

.02 These provisions as to the tax treatment of allocations in the hands of the patron where there is a contractual obligation involved do not represent a departure from rules previously in effect, but set forth in regulation form a policy of the Service which has been long established.

.03 The regulations also set forth rules for the treatment of an allocation in document form where the allocation was not made pursuant to a valid obligation of the association to the patron. Normally in such case amounts so allocated are included in the gross income of the patron to the extent of cash or merchandise received in redemption or satisfaction of the document for the year in which the cash or merchandise is received. An exception is where the document is a negotiable instrument, in which case the amount to be included in the gross income of the patron in the year of receipt is the fair market value of the document.

.04 The foregoing described treatment of allocations to patrons is consistent with the theory under which patronage dividends are treated by cooperative associations. A cooperative association may exclude from its gross income true patronage dividends when made pursuant to a prior agreement between the cooperative organization and its patrons. The justification for this treatment rests upon the fact that these patronage dividends represent either an additional consideration due the patron for goods sold through the association or a reduction in the purchase price of supplies or equipment purchased by the patron. The amounts which may be excluded as patronage dividends are not limited to the distributions made in cash but include amounts distributable but retained by the cooperative and distributed in forms other than cash. However, where a cooperative makes a distribution which it is not obligated to make under a preexisting agreement, it is not entitled to exclude such distribution from gross income even though the distribution is made on a patronage basis. Moreover, for taxable years beginning after December 31, 1951, in the case of exempt cooperatives and for all years in the case of cooperatives not exempt, any receipts of a cooperative association which it fails to allocate to its patrons must be included in the taxable income of the association to the same extent as in the case of commercial corporations generally. This is true of any amounts set up in a reserve account as well as net margins remaining after provision for reserves. It is also true of amounts which are considered to be in partial payment of produce, held back from patrons by a marketing cooperative, even though the association considers such amounts as fixed without reference to earnings.

.05 The theory under which a cooperative association may make an allocation in document form is that the patron by express contract or by doing business with the cooperative agrees to allow the association to retain funds to which the patron is entitled. Allocations other than cash or merchandise usually take the form of certificates denoting an investment in the capital of the association or of certificates of indebtedness by the cooperative. Where the document has been issued in accordance with a preexisting agreement, the form of the document is immaterial as to its taxability to the patron. It is considered that the patron has in effect received in money the face amount of the document and has either reinvested such amount in the capital of the association or allowed the association the use of the money. In either event there is justification for including the face amount of the document in the patron's gross income. This justification exists by reason of the preexisting legal obligation of the cooperative to distribute all of its net savings to its patrons each year and by the agreement between the cooperative and its patrons, which agreement is ordinarily set out in a marketing agreement or the association's charter, bylaws, or both, whereby the patrons agree to accept other than cash or merchandise for their share of the net savings.

.06 An important problem regarding the treatment of allocations in document form has arisen in those cases where an allocation has been made by a cooperative association but the patron has failed to report the entire face amount of the document on his return as income. Of particular concern is the treatment of amounts received in redemption of documents issued in prior years where the period of limitations has expired for the year of allocation. The issue in such cases is the basis of the document to be used by the patron upon redemption, sale, or other disposition.

.07 There are precedents for holding that when a taxpayer has failed to include in his return property which he receives and which represents income to him he cannot in a subsequent related transaction shift his position so as to establish a basis for such property in excess of the amount carried into income in the year of receipt. A close analogy to the case of unreported noncash distributions by a cooperative association is found in decisions in which a taxpayer receives shares of stock representing income in the year of receipt. An important case illustrating this principle is *Continental Oil Company* v. *Jones*, 177 Fed. (2d) 508, certiorari denied on the issue of duty of consistency 339 U. S. 931.

SEC. 4. STATEMENT OF POLICY.

In line with the decision in the Continental Oil Company case and other supporting cases the Service has adopted the following policy:

When a patron of a farmers' marketing or purchasing cooperative receives capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or similar documents representing an allocation to him pursuant to a preexisting contractual obligation, or in any case in which the dollar amount of such allocation to him is disclosed in any other manner, and the patron reports the face amount of such allocation, the basis upon redemption, sale or other disposition of the evidence of such allocation is the face amount. In any such case in which the cash or merchandise received by the patron is less than the face amount, the patron may establish a loss under applicable provisions of the Internal Revenue Code. On the other hand when a patron receives similar evidence of an allocation to him and reports less than the face amount of the certificate or other document, his basis will be limited to the amount reported in income in the year of receipt thereof. Upon redemption, sale or other disposition of the evidence of the allocation the excess amount over the amount reported will represent gross income to the patron in the year of such redemption, sale or other disposition.

SEC. 5. EXCEPTION TO GENERAL RULE.

Although the general rule just stated will apply in the great majority of cases where the patron has failed to report the entire face amount of an allocation in document form, there are situations in which an exception should be made. These are cases in which the period of limitations for the year of allocation has expired and before such expiration the Internal Revenue Service was on notice that the patron had included in his income an amount less than the face amount of his certificate or other evidence of allocation. As an example this notice might consist of information given in the patron's return from which the Service could have known that the patron received patronage dividends in document form and failed to include them in his gross income. In any such exceptional case the Service will not insist that there be included in income the amount by which the payment received in the year of redemption exceeds the amount reported in the year of allocation. However, in this type of case if the amount received upon redemption exceeds the face amount of the document, the excess would be included in income.

SEC. 6. COURSE OF ACTION.

.01 As a summary of the foregoing, the following rules should be used in determining the extent to which amounts allocated in document form by a cooperative association should be included in the computation of the patron's gross income.

1. Where an allocation was made pursuant to a preexisting agreement:

a. If the period of limitations has not expired for the patron's taxable year in which the allocation was made, the amount of the allocation should be included in the patron's gross income to the extent of the face amount of the documents.

b. If the period of limitations has expired for the patron's taxable year in which the allocation was made, the difference, if any, between the amount reported in the year of allocation and the amount received upon redemption, sale, or other disposition of the documents should be included in the patron's income for the taxable year in which the redemption, sale, or other disposition took place.

2. Where an allocation was made which was not in pursuance to a preexisting agreement and the document issued was not a negotiable instrument the amount received upon redemption, sale, or other disposition of the document should be included in gross income for the patron's taxable year in which received.

3. Where an allocation was made which was not in pursuance to a preexisting agreement and the document issued was a negotiable instrument:

a. If the period of limitations has not expired for the taxable year of the patron in which the allocation was made, the fair market value of the instrument should be included in the patron's gross income.

b. If the period of limitations has expired the difference between the amount reported in the year of allocation and the amount received upon surrender, sale, or other disposition of the instrument should be included in the patron's gross income.

.02 An exception to the rule stated in l.b. above will be recognized in any case in which the Internal Revenue Service had knowledge, prior to the expiration of the period of limitations, of the fact that the patron has included in his income in the year of allocation an amount less than the face amount of his certificate or other evidence of allocation. However, in any such case the Internal Revenue Service will be charged only with knowledge of the facts reflected in the taxpayer's return or discovered upon an investigation thereof.

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

REGULATIONS 118, SECTION 39.22(b)(2)-2: Annuities.

Tax status of annuities provided by an election by a member of the uniformed services under the Uniformed Services Contingency Option Act of 1953. (See Rev. Rul. 54–144, p. 15.)

REGULATIONS 118, SECTION 39.22(b)(3)-1: Gifts and bequests. Rev. Rul. 54–110

A Pulitzer prize award for distinguished editorial writing published in a United States newspaper is an award made in recognition of past achievement or present abilities. In these respects the Pulitzer awards for journalism are distinguishable from the Reichhold award made for musical compositions which the Supreme Court of the United States held to be taxable in the case of *Robertson* v. *United States*, 343 U. S. 711, Ct. D. 1746, C. B. 1952-2, 66. There is no discharge of a contractual obligation as in the payment of a prize to a winner in a contest; there is no acceptance of a contract as between sponsor and contestant; and there is no payment for services rendered. An award made in accordance with the established plan for the award of Pulitzer prizes constitutes a gift within the meaning of section 22(b)(3) of the Internal Revenue Code and is not required to be included in gross income.

REGULATIONS 118, SECTION 39.22(b)(4)-1: Interest upon State obligations. Rev. Rul. 54–106

Bonds duly issued by or in behalf of a municipality for the purpose of financing the acquisition or construction of municipally owned industrial plants for lease to private enterprises constitute obligations of a political subdivision within the meaning of section 22(b)(4) of the Internal Revenue Code. Interest paid on such bonds is exempt from Federal income tax under the provisions of section 22(b)(4) of the Code notwithstanding the purpose for which they were issued or the fact that the promise to pay is limited to the revenue to be derived from leasing the property to be acquired or erected with the proceeds of the bonds. It is not necessary for purposes of section 22(b)(4) that the obligation be a general one, pledging the general credit of the municipality or the use of its taxing power.

REGULATIONS 118, SECTION 39.22(b)(5): Statutory provisions; exclusions from gross income; compensation for injuries or sickness. Rev. Rul. 54-1

A self-insured plan established by an employer in compliance with the New York State Disability Benefits Law providing for the payment of nonoccupational disability benefits to employees, under which (1) the benefits paid are closely correlated to regular wages, (2) employees contribute only a part of the cost of the benefits, and (3) there is no separate entity into which the employer pays specified sums in advance and from which employees receive benefits, is not in itself a plan of insurance within the purview of section 22(b)(5) of the Internal Revenue Code.

Advice is requested whether nonoccupational disability benefits received by employees under a self-insured plan, established by an employer in compliance with the New York State Disability Benefits Law under which (1) the benefits paid are closely correlated to regular wages, (2) employees contribute only a part of the cost of the benefits, and (3) there is no separate entity into which the employer pays specified sums in advance and from which employees receive benefits, are excludable from the gross income of the recipients as accident or health insurance under section 22(b)(5) of the Internal Revenue Code.

In the case under consideration regular salaried and hourly employees who are necessarily absent from work because of illness or accident, other than absences covered by workmen's compensation laws, receive cash benefits which equal regular wages or one-half of regular wages for a stated maximum period. The employer deducts from its employees' regular payroll the amounts authorized under the State law as employee contributions. These amounts are credited on the employer's books to the Employees' Trust Fund for New York State Disability Law, and this account is charged with the amounts paid as disability benefits to employees. The cost of the benefits in excess of employee contributions is paid by the employer.

Section 22(b)(5) of the Code provides in part as follows:

"(b) EXCLUSIONS FROM GROSS INCOME.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter [chapter 1 of the Code]:

* * * * * * *

(5) COMPENSATION FOR INJURIES OR SICKNESS.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 23(x) in any prior taxable year, amounts received,

through accident or health insurance * * * as compensation for personal injuries or sickness * * *;"

An examination of the facts in the instant case does not reveal the existence of insurance within the meaning of section 22(b)(5), *supra*. See G. C. M. 23511, C. B. 1943, 86. The fact that a plan complies with State law does not by itself make the plan one of insurance. See I. T. 4107, C. B. 1952–2, 73. The contribution of only a part of the cost of the benefits by the employees does not in itself convert a plan into insurance. In Revenue Ruling 208, C. B. 1953–2, 102, the employee contributions covered the entire cost of the benefits paid. Further, the benefits paid under the instant plan are closely correlated to the regular wages of the covered employees and not to the degree of disability. There is no arrangement apart from normal payroll procedure, such as a fund, trust, or association, under which the employer, as well as the employees, contributes specified sums in advance and from which disability benefits will at some future time be paid. Although the books of the employer reflect a credit to a trust fund account, as a matter of fact, the employer has not established an independent entity for the administration of this program. There is nothing to distinguish the benefits received under the instant plan from the continuation of regular compensation in whole or in part during a period of disability. See Rev. Rul. 209, C. B. 1953–2, 104. In view of the foregoing, it is held that the plan of the instant employer is not a plan of insurance within the purview of section 22(b)(5) of the Internal Revenue Code.

For the extent to which benefits received under such plan are subject to Federal income tax and to withholding, see Rev. Rul. 54–2, page 30, this Bulletin.

REGULATIONS 118, SECTION 39.22(b)(5): Statutory provisions; exclusions from gross income; compensation for injuries or sickness. Rev. Rul. 54–2

Nonoccupational disability payments equal to a recipient employee's contributions to a self-insured plan are excludable from the employee's gross income, but the excess is includible in his gross income and subject to withholding of income tax at the source on wages. The Internal Revenue Service invites views, comments, and suggestions regarding method for determining the extent of the recipient employees' contributions to such plans which are not subject to tax.

Revenue Ruling 54–1, page 29 of this Bulletin, holds the plan there involved is not a plan of insurance within the purview of section 22(b)(5) of the Internal Revenue Code. Therefore, payments received thereunder are not to be excluded from the gross income of the recipient employee unless they represent a return of his contributions to the plan. The purpose of this Revenue Ruling is to prescribe the extent to which payments from such a plan (1) constitute gross income to the employees and (2) are subject to withholding of income tax at the source on wages.

With respect to the taxability of the benefits received under such a plan, it is held that benefits equal to all of the recipient employee's contributions to the plan are excludable from gross income as a recovery of capital. To the extent that any benefits received exceed all of the employee recipient's contributions to the cost of the benefits, they are includible in the gross income of the recipient and are subject to withholding of income tax at the source on wages under section 1622 of the Code on and after January 1, 1953, as prescribed in I. T. 4107 or on and after such date an employer has been specifically notified by the Revenue Service to begin withholding, or on and after November 1, 1953, as prescribed in Revenue Ruling 209, C. B. 1953–2, 104, whichever is applicable. The employer shall withhold as follows:

1. If records of the contributions of individual employees are maintained by an employer, he shall use the records to determine what part of each disability payment is a return of an employee's contributions and is not subject to withholding under section 1622 of the Code. The amount of all contributions, whenever made, by an employee to the disability plan of his present employer shall be recovered free from taxation before there is any withholding on any disability payments.

2. In the event that records of individual employee contributions are not maintained by an employer, the employer may consider the total contributions of an employee to be the product of the amount authorized by the New York State Disability Benefits Law, i. e., one-half of 1 percent of wages not to exceed, however, 30 cents per week, 60 cents per 2-week period, and 65 cents per semimonthly payroll period, times the number of such payroll periods during which the plan has been in effect up to the date of disability.

The above conclusions are not limited to plans covered by the New York State Disability Benefits Law but are applicable as a matter of principle to plans under the laws of other States having comparable provisions.

Notice is hereby given that the Internal Revenue Service is giving further study to the method by which the amount of the employee's contribution may be determined for the purpose of excluding such amounts from withholding. The provisions of paragraph numbered 2 above represent a method which the Revenue Service will currently recognize but which is not intended as a substitute for the keeping of accurate records by employers for the future. Before reaching any conclusion as to the requirements to be prescribed, however, the Revenue Service will give consideration to any views, comments, or suggestions received by it as to the method for determining the employee's contribution not subject to tax. Such consideration is expected to include the extent to which previously computed total contributions of an employee should be reduced by nontaxable disability benefits paid to him. Also to be considered is the extent to which employees' contributions should be determined on the basis of the actual weekly or other payments made by the employee or the period of time he was actually on the payroll of the employer, rather than the maximum amount authorized during the period which the plan was in effect. All views, comments, or suggestions should be submitted before March 1, 1954, and addressed to the Commissioner of Internal Revenue, Washington 25, D. C. (Attention: T:R:I).

Pending a further issuance of a ruling on this matter, the provisions of this Revenue Ruling shall be taken to reflect the position of the Internal Revenue Service but beginning January 1, 1954, the employer shall keep records of disability benefits paid to individual employees and shall, for purposes of withholding, reduce the previously computed total contributions of an employee by the disability benefits paid to him on or after January 1, 1954, which were not taxable because they constituted a return of the employee's contributions.

SECTION 22(d).—GROSS INCOME: [INVENTORIES—ELECTIVE METHOD]

REGULATIONS 118, SECTION 39.22(d)-1: Last-in first-out inventories. Rev. Rul. 54-49

A "specialty store," as defined in Rev. Rul. 23, C. B. 1953-1, 34, using the cost inventory method may employ, under the elective inventory method prescribed by section 22(d) of the Internal Revenue Code, cost price indexes which are derived from the department store inventory (retail) price indexes, published by the Bureau of Labor Statistics, by the use of appropriate ratios based on cost percentages for the respective departments.

Advice is requested whether a specialty store that keeps its inventory records on the basis of cost, and desires to adopt the elective inventory method prescribed by section 22(d) of the Internal Revenue Code, may employ cost price indexes derived from the department store inventory (retail) price indexes published by the United States Bureau of Labor Statistics, if it meets the requirements of Rev. Rul. 23, C. B. 1953-1, 34, with the exception of employing the retail inventory method.

Rev. Rul. 23 *supra*, holds that a retail establishment known in the trade as a "specialty store" may, without further proof, qualify as a "department store" for use of the department store inventory price indexes published by the Bureau of Labor Statistics, under the elective inventory method prescribed by section 22(d) of the Internal Revenue Code, if it employs the retail inventory method and carries a variety and a reasonably full line of merchandise covering a reasonable field of the groups included in such indexes.

The group indexes published by the Bureau of Labor Statistics under the title "Department Store Inventory Price Indexes" measure changes in the retail prices of the classes of goods described thereunder. They do not purport to measure changes in wholesale or cost prices to a retail department or specialty store. They are not directly applicable, therefore, for use by a specialty store using the cost inventory method for determining the adjustment for price changes subsequent to the close of the preceding taxable year under Treasury Decision 5605, C. B. 1948-1, 16. However, under certain circumstances appropriate cost price indexes for a specialty store using the cost inventory method may be derived from the Bureau of Labor Statistics department store inventory (retail) price indexes by reference to the changes in the cost complements of the gross profit margins of the individual specialty store for appropriate classes of goods.

The difference between the movements of wholesale (or cost) and retail prices for any given year must be reflected in a change in the markon percentage, since cost and retail prices would necessarily change by the same relative amount if the markon were uniform. The change in the net markon percentage, or its complement, the cost percentage, may therefore be used to derive a cost index from a retail price index for a given department. The cost index between two dates is equal to the retail price index between these two dates multiplied by the fraction representing the ratio between the cost percentages at the first and second dates, respectively, as illustrated below:

Department A

	Dec. 31, 1950	Dec. 31, 1951	Dec. 31, 1952
1. Retail price index (appropriate group index)	100.0	150.0	160.0
2. Net markon percentage (see Note A)	40.2%	42.7%	38.5%
3. Cost percentage (complement of line 2)	59.8%	57.3%	61.5%
4. Ratio of cost percentages (current year over base year)	59.8/59.8	57.3/59.8	61.5/59.8
5. Cost price index (line 1 times line 4)	100.0	143.7	164.5

NOTE A.—To be determined by the taxpayer for each department on the basis of its own average for the taxable year.

A specialty store on the cost inventory method does not ordinarily compute the net markon percentages for its respective departments, for this is a tool of the retail inventory method. It does, however, compute its gross profit percentages for its respective departments, essentially the same quantity. The only material difference between the two is that the former is computed on the year's purchases, and the latter on the year's sales, and this difference will average out over a few years. It is, therefore, appropriate to derive a cost index by reference to the ratio between cost percentages derived by taking the complements of the gross profit ratios for a department.

A simplified method of computing is available, particularly for use when the base date for the retail price index is prior to the year of adoption of the elective inventory method by the taxpayer. This may be illustrated as follows:

Department B

	Jan. 1, 1950	Jan. 1, 1951	Jan. 1, 1952
1. Retail price index (Jan. 1, 1941=100) (B. L. S. Group I)	191.3	216.4	211.7
2. Gross profit percentage (see Note A)	41.2%	40.7%	41.5%
3. Cost percentage (complement of line 2)	58.8%	59.3%	58.5%
4. Adjusted price index (line 1 multiplied by line 3)	112.4844	128.3252	123.8445
5. Cost price index (Jan. 1, 1950=100) (line 4 divided by 112.4844 and multiplied by 100)	100.0	114.1	110.1

NOTE A.—To be determined by the taxpayer for each department on the basis of its own average for the taxable year.

The use of derived cost price indexes, as described above, by specialty stores on the cost inventory method will be subject to all the conditions of Mimeograph 6244, C. B. 1948-1, 21, and Rev. Rul. 23, C. B. 1953-1, 34, except the condition that the taxpayer employ the retail inventory method.

REGULATIONS 118, SECTION 39.22(d)-1: Last-in first-out inventories. Rev. Rul. 54-63

Price indexes and data published by the Bureau of Labor Statistics under date of December 9, 1953, for use by variety stores employing the retail and elective inventory methods and the conditions under which the use of such indexes will be acceptable in the filing of Federal income tax returns.

The purpose of this Revenue Ruling is to describe the set of special retail price indexes which have been prepared by the United States Bureau of Labor Statistics (sometimes hereinafter referred to as

BLS) representing price changes in the inventories carried by variety stores, and the conditions under which the use of these indexes will be acceptable in the filing of income tax returns of taxpayers employing the elective inventory method of section 22(d) of the Internal Revenue Code.

For the purpose of this Revenue Ruling the term "variety stores," following the practice of the United States Bureau of the Census, is defined as meaning retail establishments primarily engaged in selling a variety of merchandise in the low and popular price ranges, such as stationery, gift items, women's accessories, toilet articles, light hardware, toys, housewares, confectionery, etc. These stores frequently are known as "5 and 10 cent" stores and "5 cents to a dollar" stores, although merchandise is usually sold outside these price ranges. Sales usually are made on a cash-and-carry basis, with the open selling method of display and customer selection of merchandise. (U. S. Census of Business—1948, Trade Series, Variety Stores; Bureau of the Census, Bulletin No. 3—3, p. 4.)

As described in Mimeograph 6244, C. B. 1948-1, 21, the Internal Revenue Service has accepted, for use by individual department store taxpayers on a countrywide basis, the department store inventory price indexes, prepared and published semiannually by the United States Bureau of Labor Statistics for this purpose, in connection with the filing of income tax returns employing the elective inventory method.

Arrangements have now been made by representatives of the limited price variety stores to have the Bureau of Labor Statistics prepare and publish semiannually a similar set of index numbers representing retail price changes of groups of departmental inventories of variety stores, exclusive of food, candy, and tobacco departments. Subject to proper application under the elective inventory method, as described below, these BLS variety store inventory price indexes will be accepted by the Internal Revenue Service on a countrywide basis for use by individual variety stores employing the retail inventory method, as representing price changes for the respective departments covered by such group indexes.

The use of such indexes published by the Bureau of Labor Statistics is not mandatory; indexes may be prepared by an individual taxpayer based upon his own data on prices and inventory quantities, if adequate, and if proof is submitted that sound statistical methods have been employed that assure reliable indexes, not only for the particular year in question, but for subsequent years. There may be no selective use of such indexes, however, combining the use of certain of the BLS indexes with respect to given departments and the use of other individual indexes with respect to other departments, except in the case of food, candy, and tobacco departments. Neither will alternate use of BLS indexes and individual indexes in successive taxable years be permitted.

Both for purposes of the application of the elective inventory method itself, and for the use of the published indexes, it is essential that only reasonably homogeneous or similar goods be included in each dollar value pool or department. It is also essential to employment of the published BLS indexes that goods be included in each department or LIFO pool that have been included by the BLS in the construction of the indexes. The classifications shown in table II have been proposed by representatives of the trade, to represent a reasonable minimum standard departmentalization of similar goods. If a taxpayer has consistently maintained merchandising records, for purposes of the retail inventory method, of more detailed subdivisions than the 27 departments listed, these should be retained as the basis of LIFO pools. On the other hand, however, no broader LIFO pools will be accepted than the 27 individual departments listed. A taxpayer will not be permitted, for example, to set up a LIFO pool consisting of departments 1 and 2 together, piece goods and domestics. Merchandise records will be required which will allow the identification of inventory values, purchases, net markon, etc. for piece goods and domestics separately. In applying the BLS indexes under the elective inventory method, a variety store taxpayer will employ each group index with respect to each of the individual departments named thereunder.

As is the case with other taxpayers, a variety store must specify (in its application to use the elective inventory method) which goods shall be included under the method, and may omit the goods in certain departments. If a taxpayer wishes, however, to use the BLS variety store inventory price indexes, this election must be made with respect to all departments under a single group index. Since each group index has been designed to be representative of the price movements of all the departments included thereunder, a group index will not be considered to be representative of only a portion of the departments to the exclusion of others. For example, if a taxpayer wishes to specify piece goods (department 1 in group I) as included under the elective method, domestics and laces and ribbons (departments 2 and 3 in group I) must also be specified if carried by the taxpayer. At the same time, however, the five departments under group index II may be omitted from such specification.

Similarly, a taxpayer may specify in connection with its election to include only store stocks (countertop, undercounter, and stockroom inventories) and exclude warehouse stocks. In order to invoke the provisions of section 22(d)(6) of the Internal Revenue Code, however, relating to the involuntary liquidation and replacement of inventory, stocks of similar goods in all locations, including warehouse stocks, must be considered together.

As provided in Treasury Decision 5605, C. B. 1948-1, 16, since the elective inventory method requires the use of cost, the retail selling prices must be adjusted, through the annual departmental markon percentages, for markdowns as well as markups. In other words, net markons rather than gross markons must be employed in deriving the cost of a departmental inventory from its retail value. The method of applying retail price indexes to three hypothetical departments under the retail inventory method and the elective inventory method is illustrated in exhibits A through D of Mimeograph 6244, *supra.*

The BLS variety store inventory price indexes will represent price changes semiannually, as of June 15 and December 15. Such indexes will be considered as representative of either the beginning or end of such months. The indexes are expected to be published by the BLS about the first of September and March, respectively, and will be reproduced subsequently in the Internal Revenue Bulletin. The indexes for June 1953 on a base of December 1952 as 100, are reproduced below.

TABLE I.—*Bureau of Labor Statistics, variety store inventory price indexes by department groups*

[December 1952=100]

Index group	June 1953	Percent change from Dec. 1952 to June 1953
I. Dry goods (depts. 1-3)	100.3	+0.3
II. Apparel (depts. 4-8)	100.5	+0.5
III. Jewelry (dept. 9)	101.0	+1.0
IV. Toilet goods (dept. 10)	100.7	+0.7
V. Hardware (depts. 11-13)	100.8	+0.8
VI. House decorations and furniture (dept. 14)	100.2	+0.2
VII. China, glassware, and plasticware (dept. 15)	101.3	+1.3
VIII. Stationery (depts. 16-19)	99.9	-0.1
IX. Notions (depts. 20-23)	99.5	-0.5
X. Toys (depts. 24-25)	99.6	-0.4
XI. Miscellaneous (depts. 26-27)	97.6	-2.4
Store total	100.2	+0.2

NOTE.—Department numbers refer to departments as listed in table II.

TABLE II

Variety store index groups and departmental classification

Index groups	*Departments and subdepartments*
I. Dry goods	1. Piece goods
	A. Dress yardage
	B. Drapery and upholstery yardage
	C. Sheeting, toweling, plastics, oilcloth
	2. Domestics
	A. Table linens
	B. Towels
	C. Bath accessories
	D. Bedding
	E. Closet accessories
	F. Curtains and drapes
	G. Drapery hardware
	H. Cushion, paddings, rugs, mats, etc.
	3. Laces and ribbons
II. Apparel	4. Men's and boys' wear
	A. Outerwear
	B. Underwear
	C. Accessories
	5. Ladies' and girls' wear
	A. Outerwear
	B. Underwear
	C. Accessories
	6. Hosiery
	A. Men's and boys' socks
	B. Ladies' and girls' hose
	C. Infants' and children's anklets
	7. Infants' wear
	A. Outerwear
	B. Underwear
	C. Bedding, bath goods, bottles, rattles, teething rings, etc.
	8. Shoes, shoe repairs and accessories
	A. Men's and boys' shoes and slippers
	B. Ladies' and girls' shoes and slippers
	C. Infants' footwear
	D. Shoe repairs
	E. Shoe brushes, polishes, bags, etc.

TABLE II—Continued

Variety store index groups and departmental classification—Continued

Index groups	*Departments and subdepartments*
III. Jewelry	9. Jewelry
IV. Toilet goods	10. Toilet goods A. Bath goods B. Cosmetics C. Drugs (for medication) D. Dental goods E. Hair creams, lotions, etc.
V. Hardware	11. Builders' hardware and electrical supplies A. Carpentry supplies B. Plumbing supplies C. Paint and painting products D. Knives, nails, trowels, keys, thermometers, etc. E. Cooking supplies F. Bulbs and fuses G. Fixtures and accessories H. Lamps and shades I. Flashlights, fans, irons, clocks, etc.
	12. Exterminators, sanitary, and household hardware A. Sprays and sprayers B. Traps and swatters C. Poisons, flakes, crystals, balls, etc. D. Furniture and floor polish E. Furniture and floor wax F. Metal polishes G. Brooms, brushes, mops, etc. H. Scouring pads, disinfectants, lighter fluid and flints, etc. I. Woodenware (brushes, boards, pins, etc.) J. Window awnings, shades, ventilators, etc. K. Rubber mats, gloves, bottles, treads, etc.
	13. Tinware A. Aluminumware B. Enamelware C. Ironware D. Wireware E. Cutlery
VI. House decorations and furniture	14. Mirrors, pictures, frames, and furniture
VII. China, glassware, and plasticware	15. China, glassware, and plasticware A. China and crockery B. Glassware C. Plasticware
VIII. Stationery	16. Greeting cards
	17. Decorations, party favors, picnic equipment, and wrapping paper A. Decorations B. Party favors and playing cards C. Picnic equipment D. Wrapping paper E. Seasonal paper goods
	18. Office and school supplies A. Paper goods B. Wooden goods C. Metal goods D. Miscellaneous (erasers, glue, inks, stamp pads, chalk, etc.)

TABLE II—Continued

Variety store index groups and departmental classification—Continued

Index groups	*Departments and subdepartments*
VIII. Stationery	19. Reading matter and music
	A. Reading matter (books, magazines, comics)
	B. Music (phonographs, records, etc.)
IX. Notions	20. Billfolds, purses and luggage
	A. Bags and purses
	B. Wallets and billfolds
	C. Luggage
	21. Souvenirs and novelties
	A. Souvenirs
	B. Novelties (umbrellas, pipes, incense, etc.)
	C. Artificial flowers
	22. Sewing goods
	A. Art needlework
	B. Dressmaking supplies
	C. Mending supplies
	23. Hair goods and optical goods
	A. Hair accessories (combs, curlers, brushes)
	B. Optical goods
X. Toys	24. Toys and sporting goods
	A. Dolls
	B. Sporting goods
	C. Metal toys
	D. Plastic toys
	E. All other toys
	F. Games
	25. Seasonal ornaments and decorations other than paper
XI. Miscellaneous	26. Pets and pet supplies
	27. Horticulture

NOTE.—There is available on request to the U. S. Bureau of Labor Statistics (Washington 25. D. C.) a tabulation showing in detail the merchandise content of each of the departments and subdepartments shown.

REGULATIONS 118, SECTION 39.22(d)-1: Last-in first-out inventories. Rev. Rul. 54-145

Price indexes for December 1953, published by the Bureau of Labor Statistics on March 15, 1954, for use by variety stores employing the retail inventory and elective inventory methods.

The following price indexes for December 1953, published by the Bureau of Labor Statistics on March 15, 1954, for use by variety stores employing the retail inventory and elective inventory methods, are accepted by the Internal Revenue Service pursuant to Treasury Decision 5605, C. B. 1948-1, 16, and Mimeograph 6244, C. B. 1948-1, 21, for appropriate application to inventories for taxable years of 12 months ended on November 30, 1953, and December 31, 1953. Conditions under which variety stores may employ these indexes and a list of departments included in each index group are set forth in Revenue Ruling 54-63, page 33, this Bulletin.

REGULATIONS 118, SECTION 39.22(d)-1: Last-in first-out inventories. Rev. Rul. 54-146

Price indexes for January 1954, published by the Bureau of Labor Statistics on March 5, 1954, for use by department stores employing the retail inventory and elective inventory methods.

The following price indexes for January 1954 published by the Bureau of Labor Statistics on March 5, 1954, for use by department stores employing the retail inventory and elective inventory methods, are accepted by the Internal Revenue Service pursuant to Treasury Decision 5605, C. B. 1948-1, 16, and Mimeograph 6244, C. B. 1948-1, 21, for appropriate application to inventories for taxable years of 12 months ended on December 31, 1953, and January 31, 1954.

The present indexes are for 20 revised departmental groupings, instead of for 10 groups as formerly. However, each of the 20 revised groups is tied to one of the former 10 groups to maintain continuity on the base period of January 1941 as 100. No revisions were made in the indexes previously published.

Index numbers for the soft lines, hard lines, and store total are continued in the present indexes. As in former indexes, the store total includes all departments in the store except for food, candy, liquor, tobacco, wallpaper, and paint. Contract departments are also excluded as previously.

Table I shows the relationship of each of the 20 revised groups to the former 10 groups. Table II shows the definitions of the 20 revised groups in terms of the Controllers' Congress departments. Table III shows the recent and current indexes for each such department.

Bureau of Labor Statistics, variety store inventory price indexes, by department groups

[December 1952=100]

Index group	Variety store inventory price indexes		Percent change from Dec. 1952 to Dec. 1953
	Dec. 1952	Dec. 1953	
I. Dry goods	100.0	99.8	−0.2
II. Apparel	100.0	100.4	+0.4
III. Jewelry	100.0	98.9	−1.1
IV. Toilet goods	100.0	100.8	+0.8
V. Hardware	100.0	101.6	+1.6
VI. House decorations and furniture	100.0	101.2	+1.2
VII. China, glassware, and plasticware	100.0	99.2	−0.8
VIII. Stationery	100.0	100.0	0
IX. Notions	100.0	99.8	−0.2
X. Toys	100.0	99.5	−0.5
XI. Miscellaneous	100.0	103.5	+3.5
Store total	100.0	100.5	+0.5

Table I.—*Bureau of Labor Statistics, department store inventory price indexes*

January 1954

Old department groups	Index Jan. 1941=100		Revised department groups	Index Jan. 1941=100			Percent change to Jan. 1954 from	
	Jan. 1953	July 1953		Jan. 1953 [1]	July 1953 [1]	Jan. 1954	Jan. 1953	July 1953
I. Piece goods, domestics and draperies	202.8	203.3	I. Piece goods	202.8	203.3	204.1	+0.6	+0.4
			II. Domestics and draperies	202.8	203.3	197.0	−2.9	−3.1
II. Shoes	211.2	212.1	III. Women's and children's shoes	211.2	212.1	213.3	+1.0	+0.6
			IV. Men's and boys' shoes	211.2	212.1	213.1	+0.9	+0.5
III. Ladies' underwear	173.9	172.7	V. Infants' wear	173.9	172.7	170.2	−2.1	−1.4
			VI. Women's underwear	173.9	172.7	172.5	−0.8	−0.1
			VII. Women's and girls' hosiery	173.9	172.7	173.7	−0.1	+0.6
X. Ladies' accessories	168.9	170.6	VIII. Women's and girls' accessories	168.9	170.6	170.1	+0.7	−0.3
IV. Ladies' outerwear and girls' wear	179.2	179.2	IX. Women's outerwear and girls' wear	179.2	179.2	180.1	+0.5	+0.5
V. Men's and boys' wear	200.9	201.6	X. Men's clothing	200.9	201.6	204.4	+1.7	+1.4
			XI. Men's furnishings	200.9	201.6	201.3	+0.2	−0.1
			XII. Boys' clothing and furnishings	200.9	201.6	203.2	+1.1	+0.8
IX. Notions and toilet articles	161.7	163.8	XIII. Jewelry	161.7	163.8	164.3	+1.6	+0.3
			XIV. Notions	161.7	163.8	161.7	0	−1.3
			XV. Toilet articles and drugs	161.7	163.8	164.0	+1.4	+0.1
VI. Furniture and bedding	206.1	210.4	XVI. Furniture and bedding	206.1	210.4	211.4	+2.6	+0.5
VII. Homefurnishings	193.7	195.8	XVII. Floor coverings	193.7	195.8	192.9	−0.4	−1.5
			XVIII. Housewares	193.7	195.8	197.7	+2.1	+1.0
VIII. Major appliances	158.4	157.8	XIX. Major appliances	158.4	157.8	154.3	−2.6	−2.2
			XX. Radios and TV sets	158.4	157.8	157.0	−0.9	−0.5
Total, Groups I-V, IX, X	188.8	189.3	Total, Groups I-XV	188.8	189.3	188.8	0	−0.3
Total, Groups VI, VII, VIII	188.4	190.6	Total, Groups XVI-XX	188.4	190.6	190.6	+1.2	0
Store total	188.6	189.6	Store total	188.6	189.6	189.2	+0.3	−0.2

[1] The January and July 1953 indexes for each of the 20 revised groups are the same as the indexes for the former group of which the revised group was a part. For example, the July 1953 index for former group I has become the July 1953 index for revised groups I and II.

TABLE II.—*Revised Grouping of Controllers' Congress Departments*

Revised Department Group		*Controllers' Congress Department*	
No.	Name	No.	Name
I.	Piece goods	11.	Silks, velvets, and synthetics
		12.	Woolen dress goods
		13.	Wash goods and linings
II.	Domestics and draperies	14.	Linens
		15.	Domestics—Muslins, sheetings, etc.
		18.	Blankets, comfortables, and spreads
		74.	Draperies, curtains, and upholstery
III.	Women's and children's shoes	47.	Women's and children's shoes
IV.	Men's and boys' shoes	67.	Men's and boys' shoes
V.	Infants' wear	43.	Infants' wear and infants' furniture
VI.	Women's underwear	36.	Corsets and brassieres
		38.	Knit underwear
		39.	Silk and muslin underwear and slips
		42.	Negligees and robes
VII.	Women's and girls' hosiery	37.	Women's and children's hosiery
VIII.	Women's and girls' accessories	31.	Neckwear and scarfs
		33.	Handkerchiefs
		35.	Women's and children's gloves
		46.	Handbags and small leather goods
IX.	Women's outerwear and girls' wear	34.	Millinery
		51.	Women's and misses' coats and suits
		52.	Junior miss coats, suits, and dresses
		53.	Women's and misses' dresses
		54.	Blouses, skirts, and sportswear
		55.	Girls' wear
		57.	Aprons, housedresses, and uniforms
		59.	Furs
X.	Men's clothing	61.	Men's clothing
XI.	Men's furnishings	62.	Men's furnishings
		65.	Men's hats
XII.	Boys' clothing and furnishings	66C.	Boys' clothing
		66F.	Boys' furnishings
XIII.	Jewelry	25S.	Silverware and clocks
		25C.	Costume jewelry
		25F.	Fine jewelry and watches
XIV.	Notions	21.	Laces, trimmings, and ribbons
		23.	Notions
		26.	Umbrellas
		27.	Art needlework
XV.	Toilet articles and drugs	24.	Toilet articles and drug sundries
XVI.	Furniture and bedding	71M.	Mattresses, springs, and studio beds
		71U.	Upholstered furniture
		71O.	Other furniture
XVII.	Floor coverings	72.	Oriental rugs
		73.	Domestic floor covering
XVIII.	Housewares	76.	China and glassware
		78.	Housewares
		79.	Gift shop
		81.	Pictures, frames, and mirrors

TABLE II.—*Revised Grouping of Controllers' Congress Departments*—Continued

Revised Department Group		Controllers' Congress Department	
No.	Name	No.	Name
XIX.	Major appliances	75.	Lamps
		77.	Major appliances
XX.	Radios and TV sets	84.	Radios, TV, phonographs, and records
XXI.	No separate index computed	28.	Books and stationery
		91.	Toys and games
		92S.	Sporting goods
		92C.	Cameras and photographic equipment
		93	Luggage

TABLE III.—*Group indexes applicable to each department as classified under old and revised grouping*

Deparment		Indexes—Old groups Jan. 1941=100			Indexes—Revised groups Jan. 1941=100	
No.	Description	Group	Jan. 1953	July 1953	Group	Jan. 1954
11	Silks, velvets, and synthetics	I	202.8	203.3	I	204.1
12	Woolen dress goods	I	202.8	203.3	I	204.1
13	Wash goods and linings	I	202.8	203.3	I	204.1
14	Linens	I	202.8	203.3	II	197.0
15	Domestics—Muslins, sheetings, etc	I	202.8	203.3	II	197.0
18	Blankets, comfortables, and spreads	I	202.8	203.3	II	197.0
21	Laces, trimmings, and ribbons	IX	161.7	163.8	XIV	161.7
23	Notions	IX	161.7	163.8	XIV	161.7
24T	Toilet articles	IX	161.7	163.8	XV	164.0
24D	Drug sundries	IX	161.7	163.8	XV	164.0
25S	Silverware and clocks	IX	161.7	163.8	XIII	164.3
25C	Costume jewelry	IX	161.7	163.8	XIII	164.3
25F	Fine jewelry and watches	IX	161.7	163.8	XIII	164.3
26	Umbrellas	IX	161.7	163.8	XIV	161.7
27	Art needlework	IX	161.7	163.8	XIV	161.7
28B	Books	XI	(1)	(1)	XXI	(1)
28S	Stationery	XI	(1)	(1)	XXI	(1)
31	Neckwear and scarfs	X	168.9	170.6	VIII	170.1
33	Handkerchiefs	X	168.9	170.6	VIII	170.1
34	Millinery	IV	179.2	179.2	IX	180.1
35	Women's and children's gloves	X	168.9	170.6	VIII	170.1
36	Corsets and brassieres	III	173.9	172.7	VI	172.5
37C	Children's hosiery	III	173.9	172.7	VII	173.7
37W	Women's hosiery	III	173.9	172.7	VII	173.7
38	Knit underwear	III	173.9	172.7	VI	172.5
39	Silk and muslin underwear and slips	III	173.9	172.7	VI	172.5
42	Negligees and robes	III	173.9	172.7	VI	172.5
43	Infants' wear and infants' furniture	III	173.9	172.7	V	170.2
46H	Handbags	X	168.9	170.6	VIII	170.1
46S	Small leather goods	X	168.9	170.6	VIII	170.1
47C	Children's shoes	II	211.2	212.1	III	213.3
47W	Women's shoes	II	211.2	212.1	III	213.3
51C	Women's and misses' coats	IV	179.2	179.2	IX	180.1
51S	Women's and misses' suits	IV	179.2	179.2	IX	180.1
52C	Junior miss coats and suits	IV	179.2	179.2	IX	180.1
52D	Junior miss dresses	IV	179.2	179.2	IX	180.1
53	Women's and misses' dresses	IV	179.2	179.2	IX	180.1
54	Blouses, skirts, and sportswear	IV	179.2	179.2	IX	180.1
55	Girls' wear	IV	179.2	179.2	IX	180.1
57	Aprons, housedresses, and uniforms	IV	179.2	179.2	IX	180.1
59	Furs	IV	179.2	179.2	IX	180.1
61	Men's clothing	V	200.9	201.6	X	204.4
62	Men's furnishings	V	200.9	201.6	XI	201.3
65	Men's hats	V	200.9	201.6	XI	201.3
66C	Boys' clothing	V	200.9	201.6	XII	203.2
66F	Boys' furnishings	V	200.9	201.6	XII	203.2
67	Men's and boys' shoes	II	211.2	212.1	IV	213.1
71M	Matresses, springs, and studio beds	VI	206.1	210.4	XVI	211.4
71U	Upholstered furniture	VI	206.1	210.4	XVI	211.4
71O	Other furniture	VI	206.1	210.4	XVI	211.4
72	Oriental rugs	VII	193.7	195.8	XVII	192.9
73	Domestic floor covering	VII	193.7	195.8	XVII	192.9
74	Draperies, curtains, and upholstery	I	202.8	203.3	II	197.0
75	Lamps	VIII	158.4	157.8	XIX	154.3
76	China and glassware	VII	193.7	195.8	XVIII	197.7
77	Major appliances	VIII	158.4	157.8	XIX	154.3
78	Housewares	VII	193.7	195.8	XVIII	197.7
79	Gift shop	VII	193.7	195.8	XVIII	197.7
81	Pictures, frames, and mirrors	VII	193.7	195.8	XVIII	197.7
84	Radios, TV, phonographs, and records	VIII	158.4	157.8	XX	157.0
91	Toys and games	XI	(1)	(1)	XXI	(1)
92S	Sporting goods	XI	(1)	(1)	XXI	(1)
92C	Cameras and photographic equipment	XI	(1)	(1)	XXI	(1)
93	Luggage	XI	(1)	(1)	XXI	(1)

[1] No separate index computed.

SECTION 22(n).—GROSS INCOME: DEFINITION OF "ADJUSTED GROSS INCOME"

REGULATIONS 118, SECTION 39.22(n)-1: Adjusted gross income.

Oklahoma cigarette tax paid by consumer in connection with cigarettes used in trade or business. (See Rev. Rul. 54-50, p. 55.)

REGULATIONS 118, SECTION 39.22(n)-1: Trade and business deductions.

Effect of net operating loss deduction on maximum allowance for charitable and other contributions. (See Rev. Rul. 54-56, p. 64.)

REGULATIONS 118, SECTION 39.22(n)-1: Adjusted gross income.

Massachusetts cigarette taxes paid by consumer in connection with cigaretter used in trade or business. (See Rev. Rul. 54-132, p. 57.)

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

REGULATIONS 118, SECTION 39.23(a)-1: Business Expenses. Rev. Rul. 54-27

"Kickback" payments made to induce employees or agents to promote purchases by their employers or principals from the taxpayers making the payments, under certain conditions, are not allowable deductions for Federal income tax purposes when made by taxpayers subject to the Federal Trade Commission Act, as amended, or the Packers and Stockyards Act, 1921, as amended.

Advice is requested relative to the deductibility under section 23(a)(1)(A) of the Internal Revenue Code of "kickback" payments made by a taxpayer to employees and purchasing agents of his customers to induce the employees and purchasing agents to promote purchases by their employers or principals from the taxpayer making the payments.

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

(a) EXPENSES.—
  (1) TRADE OR BUSINESS EXPENSES.—
    (A) IN GENERAL.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

In I. T. 4096, C. B. 1952-2, 91, it is held that payments made by a surgeon on a split-fee basis to other physicians who refer patients to him are deductible under section 23(a)(1)(A) of the Code, *supra*, provided they are normal, usual, and customary in the profession and in the community; are appropriate and helpful in obtaining business; and do not frustrate sharply defined National or State policies evidenced by a governmental declaration proscribing particular types of conduct.

Under section 5 of the Federal Trade Commission Act, as amended, 38 Stat. 717, which provides in part that unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce are unlawful, the Federal Trade Commission is empowered and directed to prevent persons, partnerships, or corporations, except certain of those subject to other regulatory acts, including those subject to the Packers and Stockyards Act, 1921, from using unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce.

Sections 202 and 312 of the Packers and Stockyards Act, 1921, as amended, 42 Stat. 159, make it unlawful, among other things, for any person subject to the Act to engage in or use any unfair, unjustly discriminatory, or deceptive practice or device in commerce. Sections 203 and 312 of the Act authorize the Secretary of Agriculture, after notice and hearing, to issue orders requiring any such person to cease and desist from engaging in or using any such practice or device.

The Federal Trade Commission has informed the Internal Revenue Service that it is the position of the Commission that under certain conditions the practice by sellers subject to the provisions of the Federal Trade Commission Act, as amended, of paying money or making gifts to employees or agents of customers or prospective customers, or to employees or agents of competitors' customers or prospective customers, is an unfair method of competition in violation of section 5 of the Federal Trade Commission Act, as amended. The conditions are (1) that such payments or gifts be made to induce the employees or agents to promote purchases by their employers or principals from the sellers making the payments or gifts, or to induce the employees or agents to influence their employers or principals to refrain from purchasing from competitors of the sellers making the payments or gifts; and (2) that the payments or gifts be made without the knowledge or consent of the employers or principals of the employees or agents.

The Department of Agriculture has informed the Internal Revenue Service that it is the position of that Department that such practice by persons who are subject to the Packers and Stockyards Act, 1921, as amended, is in violation of the provisions of sections 202 and 312 of such Act if the payments (1) are not ordinary and customary in the industry, (2) are made without the knowledge and consent of the customer, or (3) are made to employees of only certain of the seller's customers.

In view of the foregoing it is held that "kickback" payments made by taxpayers who are subject to the Federal Trade Commission Act, as amended, to employees or purchasing agents of their customers or prospective customers are not deductible, for Federal income tax purposes, unless the following conditions are met: The payments (1) must be normal, usual, and customary in the industry and in the community, (2) must be appropriate and helpful in obtaining business, and (3) must be made with the knowledge and consent of the customer or prospective customer. In the case of taxpayers subject to the Packers and Stockyards Act, 1921, as amended, in addition to the conditions set forth above, such payments must be made without unjust discrimination between the taxpayer's customers.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses.

Expense incurred in connection with the sale of time payment installment accounts receivable. (See Rev. Rul. 54-43, p. 119.)

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses.
(Also Section 22(a), Section 39.22(a)-2.)

Rev. Rul. 54-190

Payments of union assessments for the support of an old age pension fund which are required to be made by union members in order to remain in the union and hold a union job are ordinary and necessary business expenses of the union members which are deductible from adjusted gross income under section 23(a)(1)(A) of the Internal Revenue Code, if they elect to itemize their deductions for Federal income tax purposes.

Pension benefits paid to union members from the old age pension fund constitute taxable income to the recipient under section 22(a) of the Code.

Advice is requested relative to the Federal income tax treatment of (1) payments of union assessments which union members are required to make for the support of an old age pension fund maintained by the union and (2) pension benefits received by union members from the pension fund.

The constitution of the union requires the payment of a per capita assessment from every union member for the support of an old age pension fund. The assessments are based on a stated percentage of the earnings of members. During limited periods of sickness or disability however, members are exempt from the payment of the assessments.

The constitution provides for the payment of stated weekly pension benefits to any union member who has reached the age of 60, has had at least 25 years of continuous membership in the union, and is unable to continue his employment or secure sustaining employment because of age or disability. However, other union members may receive the pension benefits if they have had a continuous membership in the union for 20 years, are totally incapacitated for work by reason of an affliction, and have been denied admission to a home for the aged maintained by the union (on the basis that the home is not able to care for persons so afflicted). Although the constitution permits pensioned union members to engage in gainful employment while receiving benefit payments, the payments will cease during stated periods if their earnings from such employment reach a certain level.

The administration of the pension fund is the responsibility of an executive committee. The committee has the authority to change the benefits from the fund at will, and may review the case of any pensioned member and disbar him from further participation in the fund, if in its opinion the circumstances warrant such action.

The first question is whether the assessments paid by these union members may be deductible by them as ordinary and necessary business expenses under section 23(a)(1)(A) of the Internal Revenue Code. Ordinary dues and initiation fees required to be paid by individual members to an organized labor union are deductible business expenses for Federal income tax purposes. See O. D. 450, C. B. 2, 105 (1920); I. T. 3634, C. B. 1944, 90; and I. T. 2888, C. B. XIV-1, 54 (1935). A member must pay his assessments to remain in the union and keep a union job, and it does not appear that the personal value of each member's interest in the pension fund ordinarily approximates what he pays into the fund so as to make his assessment payment a personal expense or consideration for an annuity. The member actually has no vested interest in any right to a pension, even though the assessments are paid with the expectation of participation in the fund.

Accordingly, it is held that payments of union assessments for the support of the old age pension fund which are required to be made by union members under the above circumstances are ordinary and necessary business expenses of the union member which are deductible from his adjusted gross income under section 23(a)(1)(A) of the Code if he elects to itemize his deductions for Federal income tax purposes.

The second question is whether the pensions paid from the pension fund are taxable to the union members. Since it appears that the pensions paid to members are directly attributable to their employment as members of the union and to their payment of union assessments in previous years, the pensions cannot be said to be paid without consideration and are not gifts. Accordingly, it is held that the pension benefits paid to union members from the old age pension fund constitute taxable income to the recipients under section 22(a) of the Code.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses. Rev. Rul. 54-195*

Guides to be used by internal revenue officers in determining, in accordance with commonly-recognized business practices, the allowability and also the amount of travel, entertainment and other business expenses.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to clarify Internal Revenue Service policy so as to promote uniformity in the application of the law and regulations to questions relating to the substantiation and allowance of deductions claimed under section 23(a)(1) of the Internal Revenue Code.

SEC. 2. PERSONAL AND FICTITIOUS EXPENSE DEDUCTIONS.

It appears that some taxpayers are erroneously claiming personal, living, or family expenses as business deductions. Also, instances have been found in which taxpayers have claimed fictitious deductions, or have otherwise made excessive claims with willful intent to defraud.

*Originally issued as IR-Mimeograph No. 54-92, dated May 25, 1954.

Since the law specifically provides that only ordinary and necessary trade or business expenses properly may be claimed as deductions under section 23(a)(1), it follows that each taxpayer has the responsibility to claim as deductions only those items which the law so describes. It follows also that each representative of the Commissioner of Internal Revenue has the responsibility to make certain that no nondeductible items are allowed. Thus, each internal revenue agent is charged with the duty of closely scrutinizing claimed deductions for business expense and dealing appropriately with instances where personal expenses are claimed as business deductions. In any instance in which the examination of an income tax return reveals that fictitious deductions have been claimed, the case will be dealt with in accordance with the appropriate established procedures.

SEC. 3. ORDINARY AND NECESSARY BUSINESS EXPENSES.

.01. In the verification of deductions claimed for expenses paid or incurred in connection with a taxpayer's trade or business, problems constantly arise with respect to the verification of those deductions which are based upon a substantial number of small items of expenditure since they often are not susceptible of complete substantiation by documentary evidence. Typical of the deductions in which such questions arise are those for traveling and entertainment expense.

.02 This Revenue Ruling is not intended to require or permit that the taxpayer be relieved of the burden of proof in such matters nor to sanction any failure to comply with the record-keeping requirements of the law and regulations. It deals primarily with problems of evidence and its evaluation that are encountered in every day, practical administration of the tax laws. In connection with the consideration of deductions for items such as traveling and entertainment expense, the examining officer should exercise careful judgment which will permit reasonable determinations under the law and regulations, provided he is satisfied that there is a proper basis for some allowance. This will involve consideration of such matters as the extent to which detailed verification is required, the papers or records essential to adequate substantiation, and the weight to be accorded oral statements and explanations. Such elements necessarily will vary according to the nature and relative tax importance of the items involved and the general circumstances surrounding the entire case.

.03 Close approximations of items not fully supported by documentary proof can very frequently be reached by reconstruction through resort to reliable secondary sources of information and collateral evidence. For example, in connection with a claimed item of traveling expense it might be possible for a taxpayer to satisfy the examiner that he was in a travel status a certain number of days out of each month or year but impossible for him to establish the details of all his various items of travel expense by documentary proof. In such a case rail fares or plane fares can be ascertained with exactness and automobile costs approximated on the basis of mileage covered. A reasonable approximation of meals and lodging might be based upon receipted hotel bills or by applying a daily rate (determined upon the basis of actual costs prevailing in the particular community for comparable accommodations) to the provable days of travel. Items such as tips, taxi fares, and the like can be based upon a reasonable approximation.

.04 In connection with the determination of factual matters of this type, due consideration should be given to the reasonableness of the taxpayer's stated expenditures for the claimed purposes in relation to his reported income, to the reliability and accuracy of his records in connection with other items more readily lending themselves to detailed record-keeping, and to the general credibility of his statements in the light of the entire record in the case. Disallowing amounts claimed for such items merely because there is available no documentary evidence which will establish the precise amount beyond any reasonable doubt ignores commonly-recognized business practice as well as the fact that proof may be established by credible oral testimony. On the other hand, it is not Service policy to allow a percentage or other arbitrarily-computed portion of deductions of this character merely for the purpose of settlement.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses. Rev. Rul. 54-204

Where a taxpayer makes a payment to the United States in an agreed settlement of a claim by the Office of Price Administration for alleged overcharges on sales of commodities in violation of regulations issued by that office covering price ceilings, under section 205(e) of the Emergency Price Control Act of 1942, 56 Stat. 23, 34, such payment is a deductible business expense under section 23(a)(1)(A) of the Internal Revenue Code where the violation is neither willful, intentional, nor the result of the failure to take practical precautions.

I. T. 3627, C. B. 1943, 111; I. T. 3630, C. B. 1943, 113; I. T. 3799, C. B. 1946-1, 56; and I. T. 3800, C. B. 1946-1, 82, modified.

Advice is requested whether the payment by a taxpayer to the United States in an agreed settlement of a claim by the Office of Price Administration for alleged violation of section 205(e) of the Emergency Price Control Act of 1942, 56 Stat. 23, 34 (hereinafter referred to as the Act), Office of Price Administration regulations, orders or price schedules, is deductible as an ordinary and necessary business expense under section 23(a)(1)(A) of the Internal Revenue Code.

I. T. 3627, C. B. 1943, 111, holds that in cases of actions by the Price Administrator, where the consumer is not entitled to bring action, (1) amounts paid to the United States in satisfaction of judgments or settlements of suits brought by the Price Administrator under section 205(e) of the Act for violation of a regulation, order or price schedule are in the nature of penalties for law violation, even though the action is a civil one, and are not deductible; (2) amounts paid to the United States where the United States is the consumer or user pursuant to a judgment under section 205(e) of the Act, or amounts paid in compromise of pending or contemplated litigation in such cases, are in effect punishment for injury to the general public and are not deductible; (3) amounts paid pursuant to judgments in favor of consumers or tenants (other than the United States) in consumer actions under section 205(e) of the Act, and amounts paid in compromise of pending or contemplated litigation of such cases, are considered remedial in nature and are deductible as ordinary or necessary expenses under section 23(a)(1)(A) of the Code; and (4) voluntary payments made to the United States on account of price ceiling violations during the 6-months period from January 30, 1942, on which date the Act was approved, to July 3, 1942, on which date section 205(e) thereof became effective, are deductible under section 23(a)(1)(A) of the Code.

In I. T. 3630, C. B. 1943, 113, it is held that payments to the United States in cases where the consumers had a right of action against the seller, were deductible. After the amendment of section 205(e) of the Act by section 108(c) of the Stabilization Extension Act of 1944, 58 Stat., 632, 640, in I. T. 3799, C. B. 1946-1, 56, was issued in which it is held that payments to the United States by virtue of an action by the Price Administrator, where the consumer has a right of action and fails to bring an action, whether or not the violations were willful or the result of failure to take practicable precautions to prevent their occurrence, were not deductible. See also, I. T. 3800, C. B 1946-1, 82.

Since the adoption of the position taken in the above-mentioned rulings, the courts have held that where the violation is found to be unintentional and not willful, the payments made to the United States are deductible. See *Jerry Rossman Corporation* v. *Commissioner*, 175 Fed. (2d) 711; *National Brass Works, Inc.* v. *Commissioner*, 182 Fed. (2d) 526; *Commissioner* v. *Pacific Mills*, 207 Fed. (2d) 177; *Hershey Creamery Co.* v. *United States*, 101 Fed. Supp. 877; *Benjamin Marantz et al.* v. *Yoke*, 113 Fed. Supp. 536 and *Farmers Creamery Company of Fredericksburg, Virginia*, 14 T. C. 879.

In *Commissioner* v. *S. B. Heininger*, 320 U. S. 467, Ct. D. 1596, C. B. 1944, 484, and *Thomas B. Lilly et ux.* v. *Commissioner*, 343 U. S. 90, Ct. D. 1741, C. B. 1952-1, 16, it was held that the criterion for deductibility of business expenses, which otherwise are ordinary and necessary, is whether the allowance would frustrate sharply defined National or State policies proscribing particular types of conduct evidenced by some Governmental declaration of them. Although it seems clear that the policy of a criminal statute would be frustrated by the allowance of a deduction of a fine or penalty, it is necessary to look beyond the mere violation of a civil statute and to ascertain whether its policy is frustrated by allowance of the deduction. See *Burroughs Building Material Co.* v. *Commissioner*, 47 Fed. (2d) 178, Ct. D. 297, C. B. X-1, 397 (1931); National Brass Works, Inc. v. Commissioner, *supra*, and I. T. 4042, C. B. 1951-1, 15.

The courts have held uniformly that the policy of the Act was to draw a sharp line of distinction between innocent violators on the one hand, and those who either had violated the said Act willfully or had failed to take practical precautions to comply therewith on the other hand. The question resolves itself into proof, with the burden resting on the claimant. See National Brass Works, Inc., *supra*, and *Henry Watterson Hotel Co.* v. *Commissioner*, 194 Fed. (2d) 539. The fact that a settlement with the Office of Price Administration has been effected does not constitute an administrative determination of innocent violation. See *George Schaefer and Sons, Inc.* v. *Commissioner*, 209 Fed. (2d) 440.

Upon reconsideration of this question, in the light of the above-cited courts decisions, it is held that payments made to the United States for violation of the Emergency Price Control Act of 1942, 56 Stat. 23, 34, Office of Price Administration regulations, orders, or price schedules, are deductible as business expenses, under section 23(a)(1)(A) of the Internal Revenue Code, if the taxpayer proves that the violation was neither willful, intentional, nor the result of the failure to take practical precautions.

I. T. 3627, C. B. 1943, 111; I. T. 3630, C. B. 1943, 113; I. T. 3799, C. B. 1946-1, 56; and I. T. 3800, C. B. 1946-1, 82, are hereby modified to the extent inconsistent with the views expressed herein.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses. Rev. Rul. 54-219

The Federal excise tax on wagers under section 3285(d) of the Internal Revenue Code and the special tax under section 3290 of the Code paid by persons engaged in receiving wagers are deductible, for Federal income tax purposes, as ordinary and necessary business expenses under section 23(a) of the Internal Revenue Code, provided the taxpayer is engaged in the business of accepting wagers or conducting wagering pools or lotteries, or is engaged in receiving wagers for or on behalf of any person liable for the tax under section 3285(d) of the Code.

REGULATIONS 118, SECTION 39.23(a)-2: Traveling expenses. Rev. Rul. 54-147

Treatment of expenses incurred by professional baseball players, managers, coaches, and trainers for travel, meals and lodging while away from home in connection with their baseball duties.

Advice is requested concerning the deductibility, for Federal income tax purposes, of expenses incurred for travel, meals and lodging by professional baseball players, managers, coaches, and trainers, while away from their permanent residences in connection with the performance of their baseball duties.

The baseball season, in the major leagues, ordinarily runs for five and one-half months, during which period 154 games are played. One-half, or 77, of the games are played at the "club town," and 11 games are played in each of the seven other "club towns" in the league. In addition, the major league clubs begin spring training approximately one and one-half months prior to the season opening at locations distant from the "club town." Thus, the personnel of the major leagues are employed for approximately 7 months in each year in baseball activity. A substantial percentage of such personnel are also engaged, during the taxable year, in business other than professional baseball.

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

> (a) EXPENSES.—
> (1) TRADE OR BUSINESS EXPENSES.—
> (A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including * * * traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; * * *.

In *Commissioner* v. *J. N. Flowers*, 326 U. S. 465, Ct. D. 1659, C. B. 1946-1, 57, the court said that—

Three conditions must be satisfied before a traveling expense deduction may be made under section 23 (a) (1) (A):

(1) The expense must be a reasonable and necessary traveling expense, as that term is generally understood. This includes such items as transportation fares and food and lodging expenses incurred while traveling.

(2) The expense must be incurred "while away from home."

(3) The expense must be incurred in pursuit of business. This means that there must be a direct connection between the expenditure and the carrying on of the trade or business of the taxpayer or of his employer. Moreover, such an expenditure must be necessary or appropriate to the development and pursuit of the business or trade.

It is the well established position of the Internal Revenue Service that the term "home" as used in section 23(a) (1) (A) of the Code means the taxpayer's principal place of business, post of duty, or place of employment. In *Mort L. Bixler* v. *Commissioner*, 5 B. T. A. 1181, the court said that a taxpayer may not keep his place of residence at a point where he is not engaged in carrying on a trade or business and take a deduction from gross income for his living expenses while away from home. Therefore, I. T. 3314, C. B. 1939-2, 152, must be applied in the case of taxpayers whose only business or employment is that as professional baseball players, managers, coaches, or trainers. Such taxpayers are entitled to deduct their traveling expenses, including meals and lodging, when away from the "club town" in pursuit of such business or employment.

Where a taxpayer is engaged in more than one trade or business and such businesses require a division of his time between two distant cities, he may deduct his traveling expenses incurred in discharging his duties at that city which is removed from his principal post of duty. *Walter F. Brown* v. *Commissioner*, 13 B. T. A. 832, acquiescence, C. B. VIII-1, 6 (1929); *Joseph W. Powell* v. *Commissioner*, 34 B. T. A. 655 (appealed on other issues); *Joseph H. Sherman, Jr. et ux.* v. *Commissioner*, 16 T. C. 332, acquiescence, C. B. 1951-2, 4. In other words, where a taxpayer has more than one place of business or employment his principal place of business or employment constitutes his "home" to serve as the point of origin for determining his deduction for traveling expenses.

In those cases, therefore, where baseball players, managers, coaches, or trainers also engage in another trade or business during the taxable year a factual determination must be made as to the situs of the taxpayer's principal business post, i. e., his tax "home." The more important factors to be considered in making a factual determination regarding the location of the taxpayer's principal place of business or tax "home" are the total time ordinarily spent by the taxpayer at each of his business posts, the degree of business activity at each such post, and whether the financial return in respect of each post is significant or insignificant. No one factor is determinative, although the point last mentioned should be given great weight in cases where all services are performed as an "employee" or in those instances where a player for nominal consideration does some work for others primarily for the purpose of maintaining suitable physical condition. For the purpose of determining the situs of the major post of a professional baseball player, it is believed proper, insofar as the time factor is concerned, to consider only the period during which the player is at the business headquarters of his employer, i. e., the "club town."

In the case of professional baseball personnel who engage in a trade or business in addition to baseball during the taxable year, and whose principal place of business is found under the above tests to be located at a distance from the headquarters of the baseball club with which they are affiliated during the playing season, such taxpayers are entitled to deduct the cost of meals and lodging while at the "club town." On the other hand, where the "club town" is the taxpayers' principal place of business, such taxpayers are entitled to deduct their traveling expenses, including meals and lodging, while traveling away from their principal place of business, even though their permanent residence is located at the minor business post. In the latter case, only that portion of such expenses at his residence which is directly attributable to the taxpayer himself is a deductible expense for Federal income tax purposes.

REGULATIONS 118, SECTION 39.23(a)-10: Rentals.

Rental payment by the grantor of a trust to the trustees not a business expense. (See Rev. Rul. 54-9, p. 20.)

REGULATIONS 118, SECTION 39.23(a)-11: Expenses of farmers.

Expenditures for maintenance and repair of earthen terraces to prevent soil erosion. (See Rev. Rul. 54-191, p. 68.)

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

REGULATIONS 118, SECTION 39.23(b)-1: Interest. Rev. Rul. 54-94

Amounts claimed as "interest" in connection with certain so-called tax savings plans the purpose of which is to obtain an interest deduction for Federal income tax purposes are not deductible under section 23(b) of the Internal Revenue Code.

The attention of the Internal Revenue Service has been called to several situations where taxpayers are attempting to derive supposed tax benefits in connection with transactions designed to obtain interest deductions, for Federal income tax purposes. The question is whether the amounts designated as "interest" are deductible under section 23(b) of the Internal Revenue Code. The following two examples are illustrative:

Example 1. M Insurance Company has sold to the taxpayer an "annuity savings bond" (herein called the "bond") under the following conditions: Taxpayer "pays" to M a single cash premium of $100,000. To finance the premium, taxpayer pays $100 to M in cash and "borrows" $99,900 from M on a note that bears "interest" at the rate of 5 percent the first year and 3 percent thereafter. Taxpayer is not personally liable on the note, M's sole recourse being against the bond.

The bond has a maturity of 30 years. The "cash value" of the bond is $100,000 at the time the bond is issued and the "cash value" increases at the rate of 2½ percent a year compounded annually. At maturity taxpayer will be entitled to an annuity based on the "net cash value" of the bond at that time, i. e., the excess of the "cash value" over the unpaid balance on taxpayer's note to M. Taxpayer has the election at maturity to receive in cash the "net cash value" of the bond, and if taxpayer dies before maturity a beneficiary named by him is entitled to the then "net cash value".

(In some cases of this type it is provided that the taxpayer may surrender the bond at any time after 1 year and receive the "net cash value" thereof at such time. In some cases it is provided that the taxpayer may at any time borrow the "net cash value" on the bond on a nonrecourse note without surrendering the bond. In such cases there may be no "net cash value" at maturity and if so no annuity will be paid. In some cases it is provided that the taxpayer may at any time suspend payment of "interest" except to the extent of one-sixteenth of 1 percent without surrendering the bond, and the "cash value" of the bond will cease to increase during such suspension.)

Taxpayer claims that for Federal income tax purposes he may deduct the "interest" that he "pays" on the amount that he has "borrowed" on the bond, but that he realizes capital gain if he sells the bond. If this is so, and if taxpayer's surtax rate is sufficiently high, he will make a "profit" on the transaction notwithstanding that he pays 3 percent "interest" for a $2\frac{1}{2}$ percent investment.

Example 2. In July 1952 taxpayer, an individual who is not a dealer in securities, purported to "purchase" $5,000,000 United States Treasury $1\frac{3}{8}$ percent notes due March 15, 1954, at $99. Taxpayer financed the "purchase" by making a small down payment and purported to "borrow" the balance from the N Company, a dealer in securities, on a $2\frac{1}{4}$ percent nonrecourse note maturing March 15, 1954, depositing the Treasury notes as sole security for the principal and interest on the note. N thereupon sold short the same amount of Treasury notes of the same series, and with taxpayer's consent N covered the short sale with the deposited Treasury notes, thereby receiving the funds which it had "loaned" to the taxpayer. Taxpayer may direct the sale of his Treasury notes at any time. It is contemplated that at or before maturity taxpayer will direct the sale of his Treasury notes, and N will purchase $5,000,000 of such notes at the then market price to cover its short sale.

(In some cases of this type the taxpayer "pays" part of the "interest" on the note to N with money "borrowed" from N on an additional nonrecourse note.)

Since the taxpayer will "pay" more "interest" on the note to N than the total of the interest and appreciation that he will realize on the Treasury notes, taxpayer will realize no profit on the transaction apart from the effect of the transaction on his Federal income tax. However, taxpayer, whose surtax rate is sufficiently high, seeks to make a "profit" by deducting the "interest" that he pays from ordinary income and reporting the gain on the sale of the Treasury notes as capital gain.

It is the view of the Internal Revenue Service that amounts paid by taxpayer and designated as "interest" in the above examples are not interest within the meaning of section 23(b) of the Code, and are not deductible for Federal income tax purposes. Cf. *Old Colony Railroad Co.* v. *Commissioner*, 284 U. S. 552, Ct. D. 456, C. B. XI-1, 274 (1932), where the Supreme Court indicated that interest is "the amount which one has contracted to pay for the use of borrowed money."

In the above examples the amounts paid by the taxpayer are not in substance payments for the use of borrowed money. As a matter of substance the taxpayer does not borrow any money, hence there is no "debt" on which he pays "interest." An instrument that is called a "note" will not be treated as an indebtedness where it does not in fact represent an indebtedness. See *Talbot Mills* v. *Commissioner*, 326 U. S. 521, Ct. D. 1660, C. B. 1946-1, 191; *Matthiessen, et al.* v. *Commissioner*, 194 Fed. (2d) 659. In example 1, part of the "interest" paid by the taxpayer will be returned to him through the increase in the value of the bond and the remainder represents a payment to M for arranging the transaction so that taxpayer may derive a supposed tax benefit. If it is possible to regard the transaction as an annuity transaction at all, the "interest" payments in reality represent the premiums paid for the annuity. If the transaction is regarded as an endowment contract, the "interest" deduction is to be disallowed under section 24(a)(6) of the Code. In example 2, taxpayer in substance pays a sum of money to the N Company for arranging a transaction lacking commercial substance so that taxpayer may derive a supposed tax benefit; taxpayer does not expect to make a cash profit on the transaction independent of Federal income tax consequences, nor does taxpayer risk the money that he "borrows." Cf. *Commissioner* v. *Transport Trading & Terminal Corp.*, 176 Fed. (2d) 570, 572, where the Court of Appeals for the Second Circuit emphasized that "in construing words of a tax statute which describe commercial or industrial transactions we are to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation."

REGULATIONS 118, SECTION 39.23(b)-1: Interest.

Expense incurred in connection with sale of time payment installment accounts receivable. (See Rev. Rul. 54-43, p. 119.)

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

REGULATIONS 118, SECTION 39.23(c)-1: Taxes. Rev. Rul. 54-50
(Also Section 22(n), Section 39.22(n)-1.)

The cigarette tax imposed by title 68, Oklahoma Statutes 1951, section 586a, as amended, effective June 10, 1953, is deductible on and after June 10, 1953, under section 23(c)(1) of the Internal Revenue Code by the vendee, user, consumer, or possessor of the cigarettes who pays the tax to the retailer; however, in the case of an individual who elects the optional standard deduction (see sec. 23(aa) of the Code), no deduction is allowable unless the cigarette tax is attributable to a trade or business carried on by him. If the tax is attributable to a trade or business carried on by the individual, the amount of the tax is deductible from gross income in computing adjusted gross income. See section 22(n)(1) of the Code.

Advice is requested whether the tax on cigarettes imposed by the State of Oklahoma under the provisions of title 68, Oklahoma Statutes 1951, section 586a, as amended, effective June 10, 1953, is deductible for Federal income tax purposes by the consumer.

Section 23(c)(1) of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Section 39.23(c)-1 of Regulations 118 provides that in general taxes are deductible only by the person upon whom they are imposed.

In I. T. 2919, C. B. XIV-2, 86 (1935), it is held that the Oklahoma cigarette (stamp) tax imposed by the laws of the State of Oklahoma is an allowable deduction as a tax in the return of the first seller within the State of cigarettes to which he has affixed the stamps, or the consumer of cigarettes to which he has affixed the stamps as required by the statutes.

The Revenue Service has also held that the Oklahoma cigarette (stamp) tax is not a retail sales tax within the meaning of section 23(c)(3) of the Code, and the amount of the tax is not deductible by the purchaser under that section of the Code. Such position has been sustained by the United States Court of Appeals, Tenth Circuit, in *Commissioner* v. *Willard Thompson et ux.*, 193 Fed (2d) 586, Ct. D. 1744, C. B. 1952-1, 26.

Section 586a, chapter 16, title 68, Oklahoma Statutes 1951, as amended by the act (H. B. 912) effective June 10, 1953, now reads, in part as follows:

> The tax hereby levied shall be in lieu of all forms of tax on cigarettes, general or local, and shall be paid only once on any cigarettes sold, used, received, possessed or consumed in this State. Such tax shall be evidenced by stamps which shall be furnished by and purchased from the Tax Commission or by an impression of such tax by the use of a metering device when authorized by the Tax Commission as provided in this Act and said stamps or impression shall be securely affixed to one end of each package in which cigarettes are contained or from which consumed.
>
> The impact of the tax levied by this Act is hereby declared to be on the vendee, user, consumer, or possessor of cigarettes in this State and when said tax is paid by any other person such payment shall be considered as an advance payment and shall thereafter be added to the price of the cigarettes and recovered from the ultimate consumer or user. In making a sale of cigarettes in this State a wholesaler or jobber may separately state and show upon the invoice covering such sale the amount of tax on cigarettes sold. The tax shall be evidenced by appropriate stamps attached to each package of cigarettes sold. Every retailer who makes sales of cigarettes within this State to persons for use or consumption shall separately show the amount of tax as evidenced by appropriate stamps to each package of cigarettes sold and the tax shall be collected by the retailer from the user or consumer. The provisions of this Section shall in no way affect the method of collection of such tax on cigarettes as now provided by existing law.

In view of the above-quoted amendment and apparent intent of the Legislature of the State of Oklahoma to impose the cigarette tax upon the vendee, user, consumer, or possessor of cigarettes in the State of Oklahoma, it is held that the cigarette tax imposed by the State of Oklahoma under the provisions of chapter 16, title 68, Oklahoma Statutes 1951, section 586a, as amended, effective June 10, 1953, is deductible on and after June 10, 1953, under section 23(c)(1) of the Code by the vendee, user, consumer, or possessor of the cigarettes who pays the tax to the retailer; however in the case of an individual who elects the optional standard deduction (see sec. 23(aa) of the Code), no deduction is allowable unless the cigarette tax is attributable to a trade or business carried on by him. If the tax is attributable to a trade or business carried on by the individual, the amount of the tax is deductible from gross income in computing adjusted gross income. See section 22(n)(1) of the Code.

On and after June 10, 1953, no deduction is allowable to the first person who sells the cigarettes on account of the purchase of the cigarette stamps from the State, and, accordingly, the portion of the price received for the cigarettes which represents the Oklahoma cigarette tax is not includible in gross income.

REGULATIONS 118, SECTION 39.23(c)-1: Taxes. Rev. Rul. 54-132
(Also Section 22(n), Section 39.22(n)-1.)

The cigarette taxes imposed by chapter 64C, Massachusetts General Laws, as amended, are, on and after the effective date of the amendment by chapter 246, section 13, Acts of 1953, deductible under section 23(c)(1) of the Internal Revenue Code by the consumer, except in the case of an individual who elects the optional standard deduction or the short-form 1040, no deduction is allowable unless the cigarette tax is attributable to a trade or business carried on by him. If the tax is attributable to a trade or business carried on by the individual, the amount of the tax is deductible from gross income in computing adjusted gross income. See section 22(n)(1) of the Code.

Advice is requested whether the taxes on cigarettes imposed by the Commonwealth of Massachusetts under the provisions of chapter 64C of the General Laws, as amended on and after the effective date of the amendment by the Acts of 1953, chapter 246, section 13, approved April 13, 1953, are deductible for Federal income tax purposes by the consumer.

Section 23(c)(1) of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Section 39.23(c)-1(a) of Regulations 118 provides that in general taxes are deductible only by the person upon whom they are imposed.

I. T. 3670, C. B. 1944, 114, held that inasmuch as the Massachusetts cigarette tax is imposed by the Commonwealth of Massachusetts on vendors other than retailers (sec. 6, ch. 417, Acts of 1941), such tax is not deductible for Federal income tax purposes by the consumer.

Under chapter 64C of the Massachusetts General Laws prior to its amendment by section 13, chapter 246, Acts of 1953, an excise tax on cigarettes sold is imposed by the Commonwealth of Massachusetts on vendors other than retailers. Cigarettes upon which the excise tax has once been imposed and has not been refunded, if paid, are not subject to other tax upon a subsequent resale.

Section 13, chapter 246, Acts of 1953, which amends chapter 64C of the Massachusetts General Laws, reads as follows:

In addition to the excise tax imposed by chapter sixty-four C of the General Laws, and in addition to the additional excise tax imposed by section nine of chapter seven hundred and thirty-one of the acts of nineteen hundred and forty-five, there is hereby imposed a further additional excise tax of one half mill for each cigarette sold, used, received as gift or gifts, or through exchange or barter in the commonwealth during the two-year period beginning September first, nineteen hundred and fifty-three, the same to be levied and collected as provided in said chapter sixty-four C, and the provisions of said chapter shall apply to said further additional excise to the same extent as to the normal excise levied thereunder. All the provisions of said chapter sixty-four C relative to the collection, verification and administration of the tax thereunder imposed shall, insofar as pertinent, be applicable to the tax imposed by this act. All cigarette taxes paid in pursuance of this act and other statutes of the general or special laws shall conclusively be presumed to be a direct tax on the retail consumer, pre-collected for the purpose of convenience and facility only.

In view of the above-quoted amendment and apparent intent of the Legislature of the Commonwealth of Massachusetts to impose the cigarette tax upon the consumer, it is held that the cigarette taxes imposed by the Commonwealth of Massachusetts under the provisions of chapter 64C, Massachusetts General Laws, as amended, are deductible on and after the effective date of the amendment by chapter 246, section 13, Acts of 1953, under section 23(c)(1) of the Internal Revenue Code by the consumer, except in the case of an individual who elects to use the optional standard deduction or the short-form 1040, (first sheet of Form 1040), no deduction is allowable unless the cigarette tax is attributable to a trade or business carried on by him. If the tax is attributable to a trade or business carried on by the individual, the amount of the tax is deductible from gross income in computing adjusted gross income. See section 22(n)(1) of the Code.

On and after the effective date of the amendment by section 13, chapter 246, Acts of 1953, no deduction for the cigarette taxes is allowable to the licensees paying the taxes to the Commonwealth of Massachusetts. Accordingly, the portion of the price paid by the consumer to the licensees for cigarettes which represent the Massachusetts cigarette taxes is not includible in the gross income of such licensees.

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

REGULATIONS 118, SECTION 39.23(e)-1: Losses by individuals. Rev. Rul. 54-85

Losses sustained to residential property as a result of subsoil shrinkage during a period of drought constitute casualty losses within the meaning of section 23(e)(3) of the Internal Revenue Code.

Advice is requested whether losses sustained to residential property as a result of subsoil shrinkage during a period of drought constitute casualty losses under section 23(e)(3) of the Internal Revenue Code.

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

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

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft * * *

Court decisions and rulings of the Internal Revenue Service have established standards for the application of section 23(e) of the Code. They have developed the concept that a "casualty" as that term is used in section 23(e) of the Code must include an identifiable event fixing a point at which loss to the owner of the damaged property can be measured, and must also be unexpected or unusual in the context in which it occurs. Rev. Rul. 79, C. B. 1953-1, 41; *Harry Johnston Grant* v. *Commissioner*, 30 B. T. A. 1028. This concept of what is a casualty excludes damage or loss resulting from progressive deterioration through a steadily operating cause. See *Hugh M. Matheson et al.* v. *Commissioner*, 54 Fed. (2d) 537, Ct. D. 510, C. B. XI-2, 392 (1932); *Charles J. Fay* v. *Helvering*, 120 Fed. (2d) 253; and *Ray Durden* v. *Commissioner*, 3 T. C. 1.

It is understood that in a considerable group of cases there has been a relatively rapid and severe subsoil shrinkage resulting from unusually severe drought which has weakened either vertical or lateral support for building foundations. Such conditions are understood to have produced extensive cracking of walls and other serious damage to buildings in the area which can be attributed neither to faulty construction nor to such gradual settlement or subsidence as may normally occur over a period of years.

In view of the above, it is held that such losses sustained with respect to residential buildings constitute "casualty" losses within the meaning of section 23(e)(3) of the Code. The burden of proving that any damage to property is of the character indicated in the preceding paragraph and the amount of the resulting loss rests on the individual taxpayer.

The amount allowable as a "casualty" loss is the difference between the value of the property immediately preceding the casualty and its value immediately after the casualty, but not in excess of an amount equal to the adjusted basis of the property, reduced by any insurance or compensation received. See I. T. 4032, C. B. 1950-2, 21. Improvements to the property destroyed or damaged should be considered as an integral part of the entire property and no separate basis apportioned thereto in determining the loss sustained. See G. C. M. 21013, C. B. 1939-1 (Part 1), *Harry Johnston Grant* v. *Commissioner*, *supra*.

REGULATIONS 118, SECTION 39.23(e)-1: Losses by individuals.

Redemption of corporate obligations issued without interest coupons or not in registered form. (See Rev. Rul. 54-66, p. 128.)

REGULATIONS 118, SECTION 39.23(e)-1: Losses by individuals.

Excess of salary contributions to partnership from an elective public office over partnership distribution. (See Rev. Rul. 54-167, p. 152.)

SECTION 23(f).—DEDUCTIONS FROM GROSS INCOME: LOSSES BY CORPORATIONS

REGULATIONS 118, SECTION 39.23(f)-1: Losses by corporations.

Losses arising out of sale of time payment installment accounts receivable. (See Rev. Rul. 54–43, p. 119.)

REGULATIONS 118, SECTION 39.23(f)-1: Losses by corporations.

Redemption of corporate obligations issued without interest coupons or not in registered form. (See Rev. Rul. 54–66, p. 128.)

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

REGULATIONS 118, SECTION 39.23(k)-5: Reserve for bad debts. Rev. Rul. 54–133

Mim. 6209, C. B. 1947-2, 26, relating to the reserve method of accounting for bad debts in the case of banks, contemplates that where a bank has been in existence for 20 years, including the taxable year, it may compute its moving average percentage of actual bad debt losses to outstanding loans, upon which its reserve for bad debts is based, on the basis of its own independent data, including any losses it has sustained on loans taken over when certain assets of another bank (which continued in business) were acquired and some of its liabilities assumed.

The bad debt experience factor which covers the experience of a 20-year period, including that of the current taxable year, will, when applied to loans outstanding at the close of the year, provide for anticipated losses as they occur on the loans acquired. Under the provisions of Mim. 6209, it is not permissible to use the experience of the bank from which the loans were acquired for the purpose of computing additions to the reserve for bad debts.

REGULATIONS 118, SECTION 39.23(k)-5: Reserve for bad debts. Rev. Rul. 54–148 *

A bank, in computing a reasonable addition to its reserve for bad debts, may use an average experience factor based on any 20 consecutive years of experience after 1927, in lieu of a moving average experience factor determined on a basis of 20 years including the taxable year.

Com.-Mimeograph Coll. No. 6209, C. B. 1947–2, 26, supplemented.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to supplement Com.-Mimeograph Coll. No. 6209 dated December 8, 1947 (C. B. 1947-2, 26),

*Originally issued as IR Mimeograph No. 54-55, dated April 8, 1954.

which authorizes, in the case of banks, a special method for computing a reasonable addition to the reserve for bad debts under section 23(k)(1) of the Internal Revenue Code and the regulations promulgated thereunder.

SEC. 2. BACKGROUND.

The Service has carefully reexamined the provisions of Mimeograph 6209, *supra*, in the light of experience developed thereunder and, as a result of such reexamination, has approved an alternative method for the use of banks in computing the annual addition to the reserve for bad debts and the maximum amount permitted to be accumulated in such reserve, as set forth in section 4 hereunder.

SEC. 3. DEFINITION OF TERMS.

The term "banks" as used herein means banks or trust companies incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts. Such term as used in Mimeograph 6209 and herein does not include mutual savings banks not having capital stock represented by shares, domestic building and loan associations, or cooperative banks without capital stock organized and operated for mutual purposes and without profit.

SEC. 4. ALTERNATIVE METHOD.

.01 In lieu of the moving average experience factor provided in paragraph 3 of Mimeograph 6209, which is determined on a basis of 20 years including the taxable year, a bank may use an average experience factor based on any 20 consecutive years of its own experience after the year 1927. Such average experience factor, representing the percentage of bad debt losses to loans for the period selected, applied to loans outstanding at the close of the taxable year, determines the maximum permissible addition to the reserve for the year.

.02 The amounts permitted to be added in each taxable year to the bad debt reserve under (.01) above may not exceed an amount which will bring the accumulated total in the bad debt reserve at the close of the taxable year to a ceiling equal to three times the average experience factor applied to outstanding loans: Provided,

1. That for the first taxable year beginning after December 31, 1953, the amount of the addition therein to the reserve computed under (.01) above may not exceed one-third of the difference between the ceiling so computed and the accumulated total in the reserve at the close of the year before the addition; and
2. That for the second taxable year beginning after December 31, 1953, the amount of the addition therein to the reserve computed under (.01) above may not exceed one-half of the difference between the ceiling so computed and the accumulated total in the reserve at the close of the year before the addition.

.03 Consistent with the provisions of Mimeograph 6209 which permit newly organized banks and banks without sufficient years' experience of their own to set up a reserve commensurate with the average experience of other similar banks with respect to the same type of loans, preferably in the same locality, banks which select a 20-year period under (.01) above which extends back into years for which they have no experience of their own will be permitted to fill in such years with similar comparable data.

.04 The provisions of paragraph 6 of Mimeograph 6209 relating to the treatment of specific bad debt losses and recoveries, and all other rules utilized in the application of Mimeograph 6209 shall, to the extent not inconsistent, be applicable to the alternative method.

SEC. 5. EFFECT ON OTHER DOCUMENTS.

This Revenue Ruling merely supplements Mimeograph 6209 by providing an additional or alternative method for computing the annual addition to a reserve for bad debts and the maximum amount permitted to be accumulated in such reserve. Banks which are now using the moving average method provided in Mimeograph 6209 may continue to use that method if they so desire, and such method is still available to any other banks using or changing to the reserve method of accounting for bad debts.

SEC. 6. BANKS ON SPECIFIC CHARGE-OFF METHOD.

Where a bank on the specific charge-off method of accounting for bad debts desires to avail itself of the provisions of this Revenue Ruling and change to the reserve method, application to make such change must be made in the manner prescribed by section 39.23(k)-1, Regulations 118.

SEC. 7. EFFECTIVE DATE.

The provisions of this Revenue Ruling are applicable only for taxable years beginning after December 31, 1953.

Approved by M. B. Folsom, Acting Secretary of the Treasury, April 8, 1954.

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

REGULATIONS 118, SECTION 39.23(l)-2: Depreciable property.

Motor vehicles used as "demonstrators" or "company cars" by dealers. (See Rev. Rul. 54–222, p. 19.)

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

REGULATIONS 118, SECTION 39.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.
(Also Section 114, Section 39.114–1.)

Rev. Rul. 54–109

Determination of the processes properly included in the term "ordinary treatment processes" as set forth in section 39.23(m)-1(f)(3) of Regulations 118, and section 114(b)(4)(B) of the Internal Revenue Code, with respect to the manufacture of brick and tile from shale and brick and tile clay.

Advice has been requested as to the processes in the manufacture of brick and tile and kindred products from shale and brick and tile clay that are included under the term "ordinary treatment processes" as used in section 39.23(m)-1(f) of Regulations 118, and section 114(b)(4)(B) of the Internal Revenue Code.

The various treatment processes involved in the manufacture of such products are as follows:

(1) The mineral is first extracted from the earth, usually from open pits.

(2) It is transported to the plant, generally by dumpcars or trucks.

(3) The mineral is there dumped into bins or sheds for storage or directly into a crusher or granulator where the large chunks are reduced to small workable sizes.

(4) In some cases, secondary grinding is required.

(5) The mineral is then conveyed to a pugmill where it is mixed to the proper consistency usually with the addition of water and/or other materials.

(6) The mixed product is then formed into the shape desired, usually by an extrusion or molding machine.

(7) These raw forms are then processed for the removal of excessive moisture and are then burned in kilns.

(8) Finally, the finished products are drawn from the kiln and loaded for shipment or storage.

Based on these facts, the first four processes are "ordinary treatment processes" within the meaning of section 114(b)(4)(B) of the Code, and section 39.23(m)-1(f) of Regulations 118. The mixing of the mineral in the pugmill with water where this is done to separate out sand or other materials from the clay or shale is also considered to be an "ordinary treatment process"; other actions in the pugmill, as well as the succeeding processes listed above, are not considered to be "ordinary treatment processes."

As to the computation of the gross and net income from the property for percentage depletion purposes after the costs of mining and manufacturing have been segregated, see sections 29.23(m)-1 (f) and (g) of Regulations 111, and sections 39.23(m)-1 (e) and (g) of Regulations 118.

Regulations 118, Section 39.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements. Rev. Rul. 54-241

Sod and balled nursery stock are not assets of a character subject to the allowance for depletion within the meaning of section 23(m) of the Internal Revenue Code.

Advice has been requested as to the deduction of depletion for Federal income tax purposes on income received from the sale of sod or balled nursery stock.

Sod consists of the top stratum of soil that is filled with roots of grass, herbs, etc. Balled nursery stock consists in part of a mass of earth and roots that is moved with a transplanted tree, shrub, or herb.

After the removal of sod or balled nursery stock it is possible to restore the productivity of the land by the addition of other soil, and by various ground conditioning procedures such as planting, fertilization, sedimentation, etc. The activity of growing and selling sod and balled nursery stock is essentially a farming operation. See Regulations 118, section 39.60-1. For Federal income tax purposes a deduction is not permitted for the "depletion" of soil incident to farming operations; but the farmer is permitted to deduct as a business expense the cost of maintaining the productivity of the land.

Accordingly, it is held that no depletion is allowable upon removal and sale of sod or balled nursery stock from fee owned or rental land. Cf. Regulations 118, section 39.23(l)-2. Revenue Ruling 78, C. B. 1953-1, 18, is not applicable to this situation.

REGULATIONS 118, SECTION 39.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.

Regulations 118 amended. (See T. D. 6059, p. 80.)

REGULATIONS 118, SECTION 39.23(m)-16: Charges to capital and to expense in case of oil and gas wells. Rev. Rul. 54-42
(Also Section 183, Section 39.183-1.)

The election to charge to expense intangible drilling and development costs incurred in connection with the oil operations of a partnership that files its return and computes its income on Form 1065 is exercisable by the partnership. The partnership election is controlling irrespective of the elections of the individual partners as to their own operations. See *Bentex Oil Corporation* v. *Commissioner*, 20 T. C. 565; I. T. 3713, C. B. 1945, 178.

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

REGULATIONS 118, SECTION 39.23(o)-1: Contributions or gifts by individuals. Rev. Rul. 54-11
(Also Section 23(q), Section 39.23(q)-1.)

The Oklahoma Educational Television Authority, created by an act of the Oklahoma Legislature, approved May 18, 1953, is an instrumentality of the State of Oklahoma and contributions or gifts made to the authority, which is to provide a statewide educational television system are deductible by the donors in the manner and to the extent provided by section 23 (o) and (q) of the Internal Revenue Code.

REGULATIONS 118, SECTION 39.23(o)-1: Contributions or gifts by individuals. Rev. Rul. 54-56
(Also Section 122, Section 39.122-1; Section 22(n), Section 39.22(n)(1).)

Under the provisions of section 23(o) of the Internal Revenue Code, in computing the net income for a year to which a net operating loss deduction is applicable, the deduction for charitable contributions must be computed on the basis of the revised adjusted gross income after allowance of the net operating loss carryback. (See Rev. Ruls. 287 and 286, C. B. 1953-2, pp. 21 and 22, respectively.)

REGULATIONS 118, SECTION 39.23(o)-1: Contributions or gifts by individuals. Rev. Rul. 54-220
(Also Section 23(q), Section 39.23(q)-1, Regulations 118; Section 812(d), Section 81.44, Regulations 105; Section 1004, Section 86.13, Regulations 108.)

The Pacific War Memorial Commission is an agency of the Territory of Hawaii. Contributions, gifts, legacies, bequests, devises, or transfers thereto are deductible for Federal income tax and estate and gift tax purposes in the manner and to the extent provided by the Internal Revenue Code.

Advice is requested whether the Pacific War Memorial Commission is an agency of the Territory of Hawaii and whether contributions, gifts, legacies, bequests, devises, or transfers thereto are deductible for Federal income tax and estate and gift tax purposes.

The Pacific War Memorial Commission was created by Act 288 of the Legislature of the Territory of Hawaii, approved May 17, 1949. The Commission is composed of seven persons appointed by the Governor of Hawaii in accordance with the provisions of section 80 of the Organic Act, 31 Stat. 141. It is authorized to create and maintain a living war memorial commemorating the sacrifices of the heroic dead of World War II and those who have recently given and in the future may give their lives for their country, and to accept for the accomplishment of its objectives, gifts and contributions from governmental agencies and private persons. The Commission is the sole official agency of the Territory of Hawaii for the purpose of Act 288. It is required to submit to the Legislature of the Territory of Hawaii at the beginning of each regular session a full report on its activities together with such recommendations as it may deem advisable. All moneys expended under the Act shall be paid by the Territorial treasurer, upon warrants issued by the auditor, upon vouchers approved by the Chairman of the Commission. A sum of money has been appropriated out of the general revenues of the Territory for the purpose of defraying the expenses of the Commission.

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

(o) CHARITABLE AND OTHER CONTRIBUTIONS.—In the case of an individual, contributions or gifts payment of which is made within the taxable year to or for the use of:

(1) the United States, any State, Territory, of any political subdivision thereof or the District of Columbia, or any possession of the United States, for exclusively public purposes;

Section 23(q)(1) of the Code provides for the deduction of similar contributions in the case of a corporation.

Section 812 of the Code provides that for the purpose of the estate tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate—

(d) TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES.—The amount of all bequests, legacies, devises, or transfers, * * * to or for the use of the United States, any State, Territory, any political subdivision thereof, or the District of Columbia, for exclusively public purposes, * * *.

Similar provision for the estates of nonresident aliens is made by section 861(a)(3) of the Code.

Section 1004 of the Code provides that in computing net gifts for any calendar year there shall be allowed as deductions:

(a) RESIDENTS.—In the case of a citizen or resident—

* * * * * * *

(2) CHARITABLE, ETC., GIFTS.—The amount of all gifts made during such year to or for the use of—

(A) the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

Similar provision is made in the case of a nonresident alien by subdivision (b)(1) of section 1004 of the Code.

It is held that the Pacific War Memorial Commission is an agency of the Territory of Hawaii. Accordingly, contributions thereto are deductible by the donors in computing their taxable net income for Federal income tax purposes in the manner and to the extent provided by section 23 (o) and (q) of the Internal Revenue Code. Bequests, legacies, devises, or transfers to or for the use of the Commission are deductible in computing the value of the net estate of a decedent for Federal estate tax purposes in the manner and to the extent provided by sections 812(d) and 861(a)(3) of the Code. Gifts of property to the Commission are deductible in computing net gifts for Federal gift tax purposes in the manner and to the extent provided in sections 1004(a)(2)(A) and 1004(b)(1) of the Code.

REGULATIONS 118, SECTION 39.23(o)-1: Contributions or gifts by individuals.

Contributions to separate funds of organizations exempt under section 101 of the Code. (See Rev. Rul. 54-243, p. 92.)

SECTION 23(p).—DEDUCTIONS FROM GROSS INCOME: CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OR ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED-PAYMENT PLAN

REGULATIONS 118, SECTION 39.23(p)-1: Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan; in general.

Contributions by an employer in form of pensions paid to retired employees. (See Rev. Rul. 54-152, p. 149.)

SECTION 23(q).—DEDUCTIONS FROM GROSS INCOME: CHARITABLE AND OTHER CONTRIBUTIONS BY CORPORATIONS

REGULATIONS 118, SECTION 39.23(q)-1: Contributions or gifts by corporations.

Contributions to Oklahoma Educational Television Authority. (See Rev. Rul. 54-11, p. 64.)

REGULATIONS 118, SECTION 39.23(q)-1: Contributions or gifts by corporations.

Contributions made to the Pacific War Memorial Commission an agency of the Territory of Hawaii. (See Rev. Rul. 54–220, p. 65.)

REGULATIONS 118, SECTION 39.23(q)-1: Contributions or gifts by corporations.

Contributions to separate funds of organizations exempt under section 101 of the Code. (See Rev. Rul. 54–243, p. 92.)

SECTION 23(x).—DEDUCTIONS FROM GROSS INCOME: MEDICAL, DENTAL, ETC., EXPENSES

REGULATIONS 118, SECTION 39.23(x)-1: Medical, dental, etc., expenses. Rev. Rul. 54-57
(Also Section 24(a), Section 39.24(a)-2.)

Amounts expended in the construction of a swimming pool or the installation of an elevator on property owned by a taxpayer, even though the pool or elevator was constructed or installed for reasons of health, pursuant to the recommendations of a physician, constitute expenditures for permanent improvements or betterments which increase the value of the property, and may not be deducted as medical expenses under section 23(x) of the Internal Revenue Code. See section 24(a)(2) of the Code and *John L. Seymour* v. *Commissioner*, 14 T. C. 1111.

SECTION 23(bb).—DEDUCTIONS FROM GROSS INCOME: CIRCULATION EXPENDITURES

REGULATIONS 118, SECTION 39.23(bb)-1: Circulation expenditures. Rev. Rul. 54-3

Amounts paid by a newspaper publisher to a charitable organization as a result of an offer made in a telephone campaign for additional subscribers that a portion of the price of every subscription received during the campaign would be paid to such organization, plus the amount of the compensation to the contractor in charge of the solicitation, telephone costs, verifications, and other overhead connected with the campaign, constitute expenditures to maintain or increase the circulation of the newspaper and are deductible in full under section 23(bb) of the Internal Revenue Code.

Advice is requested relative to the proper treatment for Federal income tax purposes of certain expenditures incurred by a newspaper publisher in a circulation campaign.

In order to meet competition from a rival newspaper in the same city the taxpayer started a telephone campaign for additional subscribers to its daily and Sunday newspaper, offering as an inducement to new subscribers to make a payment of a portion of the subscription price to a charitable organization. The taxpayer entered into an agreement with the charitable organization under the terms of which it agreed that the organization would receive a certain percentage of the subscription price paid in return for the privilege of stating that fact in connection with the solicitation. All soliciting costs, such as telephone charges, mailing of acknowledgments, and the compensation of the contractor engaged to conduct the campaign, were to be paid by the taxpayer.

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

(bb) CIRCULATION EXPENDITURES.—Notwithstanding section 24(a), all expenditures (other than expenditures for the purchase of land or depreciable property or for the acquisitions of circulation through the purchase of any part of the business of another publisher of a newspaper, magazine, or other periodical) to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical; * * *

It is held that that portion of the price of every subscription received by a newspaper publisher during a telephone campaign for additional subscriptions and paid to a charitable organization as a result of an offer made during the campaign, plus the amount of the compensation to the contractor in charge of solicitation, telephone costs, verifications, and other overhead connected with the campaign, constitute expenditures to maintain or increase the circulation of the newspaper within the meaning of section 23(bb) of the Internal Revenue Code and are deductible in full in computing net income for Federal income tax purposes.

SECTION 24(a).—ITEMS NOT DEDUCTIBLE: GENERAL RULE

REGULATIONS 118, SECTION 39.24(a)-2: Capital expenditures. Rev. Rul. 54-191

(Also Section 23(a), Section 39.23(a)-11.)

The costs of original construction of earthen terraces to prevent soil erosion ordinarily are expenditures for permanent improvements or betterments which increase the value of the property on which they are constructed, and, as such, are nondeductible capital expenditures. Expenditures for maintenance and repair of such terraces are deductible as ordinary and necessary business expenses under section 23(a)(1)(A) of the Internal Revenue Code.

Advice is requested relative to the treatment, for Federal income tax purposes, of costs of original construction and of maintenance and repair of earthern farm terraces, in view of the decision in *J. H. Collingwood et ux.* v. *Commissioner*, 20 T. C. No. 132, acquiescence, page 4, this Bulletin. In that case the court found as a fact, based on the evidence presented, that construction of the terraces on the taxpayer's farm lands did not increase the value of the lands. It concluded that the cost of their construction was a deductible expense.

The principle announced in the Collingwood case will be followed by the Internal Revenue Service in the disposition of other cases only if the facts are found to be substantially similar to those in that case.

Generally, expenditures by a taxpayer for the construction of earthern terraces on land owned by him are not deductible expenses within the meaning of section 23(a) of the Internal Revenue Code, but are capital expenditures, the deduction of which is prohibited by section 24(a)(2) of the Code. Ordinarily, the construction of earthen terraces for the prevention of soil erosion increases the value of the property on which they are constructed. In the absence of convincing evidence to the contrary, it will be presumed, therefore, that terrace construction of this type is an improvement, the cost of which is properly chargeable to capital account. However, expenses for their maintenance and repair are deductible as ordinary and necessary expenses under section 23(a)(1)(A) of the Code.

Regulations 118, Section 39.24(a)-2: Capital expenditures.

Amounts expended in the construction of a swimming pool or the installation of an elevator on property owned by the taxpayer to be used in the care or treatment of a physical disability. (See Rev. Rul. 54-57, p. 67.)

SECTION 25.—CREDITS OF INDIVIDUAL AGAINST NET INCOME

Regulations 118, Section 39.25-2: Credits of individuals for purpose of normal tax and surtax. Rev. Rul. 54-70

Under the adoption statutes of Maryland and Virginia, a child is "legally adopted" for the purpose of the exemption for dependents provided by section 25(b) of the Code when the interlocutory decree of adoption is entered. The adoption statutes of Missouri, however, do not provide for an interlocutory decree and a child is not "legally adopted" within the purview of section 25(b) of the Code until the decree of adoption is entered.

Advice is requested relative to when, under the respective laws of Maryland, Virginia, and Missouri, a child is considered to be "legally adopted" for the purpose of the exemption for dependents provided by section 25(b) of the Internal Revenue Code.

Section 25(b)(3) of the Code provides that the term "dependent" means any person within certain specified relationships to the taxpayer, including a son or daughter of the taxpayer, over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer. Such section further provides that a "legally adopted" child of a person shall be considered a child of such person by blood.

It was stated in *Burnet* v. *Henry Harmel*, 287 U. S. 103, Ct. D. 611, C. B. XI-2, 210 (1932), that the exertion of the plenary power of Congress under the Constitution to tax income is not subject to state control. The court went on to say, "It is the will of Congress which controls, and the expression of its will in legislation, in the absence of language evidencing a different purpose, is to be interpreted so as to give a uniform application to a nation-wide scheme of taxation. * * * State law may control only when the operation of the Federal taxing act, by express language or necessary implication, makes its own operation dependent upon state law." Congress did not define "adopted" in section 25(b)(3) of the Code except to specify that an adopted child shall be considered a child by blood. It can only be assumed that the qualification "legally" refers to the laws of the States. The Court in the Harmel case, *supra*, recognized that such an expressed or implied intent cannot be superseded by an administrative policy which is grounded only upon uniform application of tax law. See *Davies Warehouse Company* v. *Bowles*, 321 U. S. 144, and *Estate of Henry W. Putnam et al.* v. *Commissioner*, 324 U. S. 393, Ct. D. 1638, C. B. 1945, 345.

The pertinent provisions of the Maryland State statutes are contained in article 16 of Flack's Annotated Code of Maryland, 1951, section 85 of which provides that an interlocutory decree shall be issued granting petitioners temporary custody of the child for a limited period of time, not to exceed 1 year; the court retaining jurisdiction of the case. Section 86 provides that the legal effect of an outstanding interlocutory decree of adoption is to make the person adopted the child of the petitioner. Section 87 merely provides that the legal effect of an interlocutory order shall be confirmed and continued in the final decree.

Similarly, section 63-357 of the Code of Virginia, 1950, provides that any child adopted shall be, from and after the entry of the interlocutory order, to all intents and purposes, the child of the person or persons so adopting him.

Sections 453.020 and 453.070 of the Missouri Revised Statutes of 1949, in part, provides for the proper filing of a petition for adoption, with the appointment by the court of a guardian *ad litem* and an investigation of suitability. Section 453.080 provides that if the trial period of at least 9 months has been completed, a decree shall be entered making the child, for all legal intents and purposes, the child of the petitioner.

From the foregoing, it is apparent that under Maryland and Virginia statutes the effect of an outstanding interlocutory decree is a legal adoption, since the statutory "trial period" imposes parental obligations upon the adopting parents which are greater than if they were only holding the child in temporary custody as a guardian. During such period, the obligations and privileges are the same as if a final decree were entered. Under Missouri law, however, there is no legal adoption during the "trial period." The adopting parents do not assume the full rights, privileges and obligations which are created by the issuance by a proper tribunal of an adoption decree. Indeed, the 9-month rule eliminates speedy adoption and a child is not the child of adopting parents, for all legal intents and purposes, until the 9 months' trial period has been completed and the adoption decree entered.

Accordingly, it is held that under the adoption statutes of Maryland and Virginia, a child is "legally adopted" for the purpose of the exemption for dependents provided by section 25(b) of the Code when the interlocutory decree of adoption is entered. It is further held that under the adoption statutes of Missouri, a child is not "legally adopted," within the purview of section 25(b) of the Code, until the decree of adoption is entered, there being no provision for an interlocutory decree.

SECTION 26(b).—CREDITS OF CORPORATIONS: DIVIDENDS RECEIVED

REGULATIONS 118, SECTION 39.26(b)-1: Credit for dividends received.

Computation of credit for the purpose of determining the alternative tax. (See Rev. Rul. 54-28, p. 123.)

SECTION 26(h).—CREDITS OF CORPORATIONS; CREDIT FOR DIVIDENDS PAID ON CERTAIN PREFERRED STOCK

REGULATIONS 118, SECTION 39.26(h)-1: Credit for dividends paid on preferred stock of public utilities.

Computation of credit for the purpose of determining the alternative tax. (See Rev. Rul. 54-28, p. 123.)

SECTION 26(i).—CREDITS OF CORPORATIONS: WESTERN HEMISPHERE TRADE CORPORATIONS

REGULATIONS 118, SECTION 39.26(i)-1: Credit of Western Hemisphere trade corporations.

Computation of credit for the purpose of determining the alternative tax. (See Rev. Rul. 54-28, p. 123.)

SECTION 27(g).—CORPORATION DIVIDENDS PAID CREDIT: DISTRIBUTIONS IN LIQUIDATIONS

REGULATIONS 118, SECTION 39.27(g)-1: Dividends paid credit for distributions in liquidation.

Rev. Rul. 54-71

A corporation, having a preexisting deficit, will be entitled to a dividends paid credit under section 27(g) of the Internal Revenue Code, only to the extent that distributions in complete or partial liquidation from current year's earnings exceed such preexisting deficit.

I. T. 3067, C. B. 1937-1, 91, revoked.

Further consideration has been given to I. T. 3067, C. B. 1937-1, 91, which involved the question whether a corporation upon its liquidation in 1936 is entitled to a dividends paid credit under section 27(f) of the Revenue Act of 1936 where its operating deficit at the beginning of the year 1936 exceeded its earnings and profits for that year to the date of liquidation. Section 27(f) of the 1936 act, which allowed a dividends paid credit against the undistributed profits surtax imposed by section 14 of the same act, provided as follows:

DISTRIBUTIONS IN LIQUIDATION.—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid.

I. T. 3067, *supra*, held that the corporation was entitled to a dividends paid credit under section 27(f) of the 1936 act to the full extent of the earnings and profits for that year which were distributed, regardless of the fact that the corporation had an operating deficit at the beginning of the taxable year in excess of the earnings and profits for that year.

A similar problem arises under section 27(g) of the Internal Revenue Code, which corresponds to section 27(f) of the Revenue Act of 1936, in connection with the surtax imposed by section 500 of the Code upon undistributed subchapter A net income computed under section 504 of the Code. Section 27(g) of the Internal Revenue Code provides as follows:

DISTRIBUTIONS IN LIQUIDATION.—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the basic surtax credit under this section, be treated as a taxable dividend paid.

The question has been litigated with respect to section 27(f) of the 1936 act in *Addressograph-Multigraph Corporation et al.*, Tax Court Memorandum Opinion, dated February 5, 1945, and *Shellabarger Grain Products Company* v. *Commissioner*, 146 Fed. (2d) 177, affirming 2 T. C. 75, and opinions contrary to I. T. 3067, *supra*, were rendered. See also *Foley Securities Corporation* v. *Commissioner*, 38 B. T. A. 1036, affirmed 106 Fed. (2d) 731, *Gaston & Company, Inc.*, 39 B. T. A. 640, and *Brooklyn National Corporation* v. *Commissioner*, 157 Fed. (2d) 450, affirming 5 T. C. 893.

In view of the decisions in the Shellabarger and Addressograph cases, *supra*, it is concluded that a corporation, with impaired capital, should be allowed a dividends paid credit within the meaning of section 27(g) of the Internal Revenue Code only to the extent that distributions in complete or partial liquidation from current year's earnings exceed the existing deficit. I. T. 3067, *supra*, is hereby revoked.

Pursuant to the authority contained in section 3791(b) of the Internal Revenue Code, this ruling will be applied without retroactive effect to distributions in complete or partial liquidation made prior to March 1, 1954, except that no credit or refund will be allowed with respect to any such distribution.

PART III.—CREDITS AGAINST TAX

SECTION 35.—CREDIT FOR TAX WITHHELD ON WAGES

REGULATIONS 118, SECTION 39.35-2: Credit for "special refunds" of employee social security tax. Rev. Rul. 54-221
(Also Section 1401(d)(3), Section 408.802, Section 1421, Section 408.801, Regulations 128.)

Employee tax withheld with respect to more than $3,600 of an employee's wages, under the provisions of the Federal Insurance Contributions Act, by reason of the employee having received wages from two or more employers during calendar year, may be claimed as a credit against the employee's income tax liability in the same manner as though it were deducted and withheld as income tax at the source.

Employee tax erroneously withheld with respect to more than $3,600 of wages paid by a single employer during a calendar year, however, may not be so credited, but should be adjusted by the employer with the employee. If such an over-collection cannot be so adjusted, a claim for credit or refund of the amount may be filed within the period of limitation upon refunds and credits.

Mim. 5142, C. B. 1940-2, 238, and Mim. 6198, C. B. 1947-2, 145, are inapplicable with respect to wages paid after December 31, 1950.

Advice is requested whether an employee receiving "wages" in excess of $3,600 during the calendar year by reason of his having performed services for *two* or more employers is entitled to credit against his income tax liability the excess over $54 ($72 after 1953) of employee tax imposed by the Federal Insurance Contributions Act and withheld by his employers with respect to such "wages," including an amount which was erroneously deducted by one of the employers with respect to remuneration in excess of $3,600.

If, during any calendar year commencing after December 31, 1950, an employee receives wages in excess of $3,600 from two or more employers, the employee is entitled to a special refund of the amount, if any, by which the employee tax imposed under the Federal Insurance Contributions Act with respect to such wages and deducted therefrom exceeds the employee tax with respect to the first $3,600 of such wages.

An employee who is entitled to a special refund of employee tax with respect to wages received during a calendar year and who is also required to file an income tax return for such calendar year may obtain the benefits of such refund only by claiming credit therefor in the same manner as though it were an amount deducted and withheld as income tax at the source under section 1622 of the Internal Revenue Code.

An employee who is entitled to a special refund and who is not required to file an income tax return for the taxable year involved may obtain the refund by filing a claim establishing his right thereto. The claim should be filed on Form 843 with the District Director of Internal Revenue for the district in which the employee resides. The employee shall submit with the claim, as a part thereof, a statement setting forth the reason why he is entitled to claim the special refund including the following information, with respect to each employer from whom he received wages during the calendar year: (1) the name and address of such employer, (2) the account number of the employee and the employee's name as reported by the employer on his returns, (3) the amount of wages received during the calendar year to which the claim relates, (4) the amount of employee tax on such wages deducted by the employer, and (5) the amount of such tax, if any, which has been refunded or otherwise returned to the employee. Form SS-9, Revised, may be used in supplying this information.

The procedure set forth above is applicable only with respect to an employee who has received wages from two or more employers and only with respect to the tax deducted by each employer on the first $3,600 of the employee's total wages. Such procedure does not apply to employee tax which is erroneously deducted from remuneration exceeding $3,600 during a calendar year received by an employee for employment performed for only *one* employer.

If the employee tax is erroneously withheld with respect to wages in excess of $3,600 paid by a single employer, the employer should adjust the overcollection of employee tax with the employee. (Sec. 1401(c) of the Act.) If the overcollection cannot be so adjusted, a claim for refund or credit may be filed in accordance with the provisions of section 1421 of the Act relating to erroneous or illegal collections of tax. Pursuant to such section the employee may authorize the employer to file a claim and receive refund or credit of the overpayment or the employee may file such claim on his own behalf. Each claim for refund shall be made on Form 843 in accordance with instructions relating to such form and shall have attached as a part of the claim a complete statement in support thereof. Credit may be claimed by the employer on his return, Form 941, Employer's Quarterly Federal Tax Return, in accordance with the instructions thereon.

The evidence in support of an employer's claim shall include the statement (1) that the employer has repaid the tax to the employee or has secured the written consent of such employee to allowance of the refund or credit, and (2) that the employer has obtained from the employee a written statement that the employee has not claimed and will not claim refund or credit of the amount of the overcollection. In every case, the employer shall maintain as part of his records the written receipt of the employee, showing the date and amount of the repayment, or the written consent of the employee, whichever is used in support of the claim, and the written statement of the employee that he has not claimed and will not claim refund or credit of the amount of the overcollection.

An employee's claim shall be supported by (1) a statement setting forth whether the employee has claimed credit against, or refund of, his income tax by reason of a special refund for the calendar year of such overcollection, and the amount, if any, so claimed and (2) a statement setting forth the extent, if any, to which the employer has reimbursed the employee in any manner for the overcollection, the amount, if any, of credit or refund of such overpayment claimed by the employer or authorized by the employee to be claimed by the employer, and such facts as will establish that the overpayment is not adjustable by and between the employer and employee. The employee shall obtain the latter statement, if possible, from the employer, who should include in such statement the fact that it is made in support of a claim to be filed by the employee for refund of employee tax paid by such employer to the District Director of Internal Revenue. If the employer's statement is not submitted with the claim, the employee shall make the statement to the best of his knowledge and belief, and shall include therein an explanation of his inability to obtain the statement from the employer.

No refund or credit will be allowed after the expiration of the applicable statutory period of limitation upon refunds and credit.

Mim. 5142, C. B. 1940-2, 238, and Mim. 6198, C. B. 1947-2, 145, are inapplicable with respect to wages paid after December 31, 1950.

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SECTION 41.—GENERAL RULE

REGULATIONS 118, SECTION 39.41-2: Bases of computation and changes in accounting methods. Rev. Rul. 54-4

A modification of a taxpayer's accounting procedures whereby pennies would be eliminated from certain internal financial transactions by increasing or decreasing the amount to the nearest dollar will be acceptable for Federal income tax purposes provided such procedures, once adopted, are maintained with reasonable consistency.

Advice is requested whether a proposed modification of a taxpayer's accounting procedures whereby pennies would be eliminated from certain internal transactions by increasing or decreasing the amount to the nearest dollar will be acceptable for Federal income tax purposes.

Under the proposed plan pennies would be eliminated in the processing of figures relating to certain internal transactions such as accounts payable distributions, sales distributions, and payroll distributions. Balance sheet accounts, including balances due to and from employees, and others, would be kept on an exact amount basis. However, in the internal distributions, pennies would be eliminated at the earliest stage of the accounting operations. If an amount ends in 50 cents or more, it would be rounded upward to the next dollar, and if less than 50 cents, the pennies would be dropped. The net variances resulting from penny eliminations should be minor since the pennies added and dropped would tend to offset each other. Such variances will be recorded as debits or credits in a penny elimination account which will be maintained for balancing purposes. At the end of the taxable year, this account will represent additional income or expense depending upon its balance.

In view of the foregoing, it is held that the proposed modification of the taxpayer's accounting procedures whereby pennies would be eliminated from certain internal financial transactions is acceptable for Federal income tax purposes provided that such procedures, once adopted, are maintained with reasonable consistency.

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

REGULATIONS 118, SECTION 39.42-1: When included in gross income.

Increment in value of a United States saving bond, Series E, registered in the names of coowners, which is reissued to substitute a new coowner in place of one of the original coowners. (See Rev. Rul. 54-143, p. 12.)

SECTION 44.—INSTALLMENT BASIS

REGULATIONS 118, SECTION 39.44-1: Sale of personal property on installment plan. Rev. Rul. 54-111

A regular dealer in personal property may elect to report income from installment sales on the installment basis and continue to report income from sales on open account on the accrual basis. Such a dealer is not required to include amounts received on account of sales on open account in determining its net income from installment sales, even though the sales on open account may have been made prior to election by the taxpayer to report income from installment sales on the installment basis.

Advice is requested whether a dealer in personal property who is entering into a program of installment selling in addition to selling on open account may adopt the installment basis of reporting income as to its installment sales and continue to report its sales on open account on the accrual basis. Advice is also requested whether collections from sales on open account made in a prior taxable year, the profit on which was reported on the accrual basis for such prior year, will again be subject to taxation in the current taxable year, under the provisions of section 44(c) of the Internal Revenue Code and section 39.44-1 of Regulations 118.

Section 44 of the Code provides in part as follows:

(a) DEALERS IN PERSONAL PROPERTY.—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

* * * * * * *

(c) CHANGE FROM ACCRUAL TO INSTALLMENT BASIS.—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

Section 39.44-1(b) of Regulations 118 provides in part as follows:

* * * a person who regularly sells or otherwise disposes of personal property on the installment plan, whether or not title remains in the vendor until the property is fully paid for, may return as income therefrom in any taxable year

that proportion of the installment payments actually received in that year which the total or gross profit (that is, sales less cost of goods sold) realized or to be realized when the property is paid for, bears to the total contract price. Thus, the income of a dealer in personal property on the installment plan may be ascertained by taking as income that proportion of the total payments received in the taxable year from installment sales (such payments being allocated to the year against the sales of which they apply) which the total or gross profit realized or to be realized on the total installment sales made during each year bears to the total contract price of all such sales made during that respective year. No payments received in the taxable year shall be excluded in computing the amount of income to be returned on the ground that they were received under a sale the total profit from which was returned as income during a taxable year or years prior to the change by the taxpayer to the installment basis of returning income. * * *

The Internal Revenue Code or the regulations promulgated thereunder do not prohibit a taxpayer who otherwise meets the requirements for reporting the profit on installment sales on the installment basis from adopting the installment method of reporting such profit and at the same time continuing to report the profit from sales on open account on the accrual basis.

The provisions of section 44(c) of the Code, *supra*, and section 39.44-1 of Regulations 118, requiring a taxpayer to include in the computation of its net income from installment sales for the year of change from the accrual to the installment basis or any subsequent year amounts received on account of sales made in a year prior to the change, are applicable only in a situation where a taxpayer making sales on the installment plan elects to change its method of reporting installment sales income from the accrual to the installment basis. Furthermore, such provisions have reference only to amounts received on account of installment sales made in prior years, not to amounts received on account of sales on open account.

Accordingly, it is held that a regular dealer in personal property may elect to report income from installment sales on the installment basis and continue to report income from sales on open account on the accrual basis. It is further held that such a dealer is not required to include in income amounts received on account of sales on open account in determining its net income from installment sales, even though the sales on open account may have been made prior to election by the taxpayer to report income from installment sales on the installment basis.

A dealer who desires to report the income from installment sales on the installment basis must maintain books of account in such a manner as to enable an accurate computation to be made of such income on that basis in accordance with the provisions of section 39.44-1 of Regulations 118.

Regulations 118, Section 39.44-5: Gain or loss upon disposition of instalment obligations.

Regulations 118 amended. (See T. D. 6059, p. 80.)

PART V.—RETURNS AND PAYMENT OF TAX

SECTION 51.—INDIVIDUAL RETURNS

REGULATIONS 118, SECTION 39.51–1: Individual returns.

Application of the exclusion provided by section 251 of the Internal Revenue Code with respect to community income of spouses in community property law States. (See Rev. Rul. 54–16, p. 157.)

SECTION 52.—CORPORATION RETURNS

REGULATIONS 118, SECTION 39.52–1: Corporation returns.

Schedule PS (Form 1120) prepared for use by taxpayers in 1951 will be utilized in the preparation of returns for calendar year 1953 and fiscal years ending in 1954. (See Rev. Rul. 54–18, p. 165.)

SECTION 53.—TIME AND PLACE FOR FILING RETURNS

REGULATIONS 118, SECTION 39.53–2: Extension of time for filing returns.
(Also Section 56, Section 39.56–2; Section 101, Section 39.101(12)–1.)

Rev. Rul. 54–81*

Time extended for filing exempt cooperative association income tax return, Form 990–C (for farmers' cooperative marketing and purchasing association under section 101(12) of the Internal Revenue Code).

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to extend the time for filing the Exempt Cooperative Association Income Tax Return, Form 990–C, and the time for payment of the income tax due by a farmers' cooperative marketing and purchasing association.

SEC. 2. AUTHORITY.

The extension of time for filing Form 990–C and paying the income tax due is granted pursuant to the authority contained in sections 53(a)(2) and 56(c)(1), respectively, of the Internal Revenue Code.

SEC. 3. SCOPE.

This extension is granted to farmers' cooperative marketing and purchasing associations exempt under section 101(12) with respect to taxable years beginning in 1953.

SEC. 4. EXTENDED DATE.

The time for filing Form 990–C and the time for paying the income tax due by such an association for a taxable year beginning in 1953 is hereby extended to and including the 15th day of the 9th month following the close of such taxable year.

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*Originally issued as IR Mimeograph No. 54–19, dated February 5, 1954.

SEC. 5. ACCUMULATION OF INTEREST.

Interest at the rate of 6 percent per annum will be assessed and collected on the amount determined as the tax from the original due date for payment of the tax, the 15th day of the 3d month following the close of the taxable year, until it is paid. However, the payment of the tax, or any installment thereof, made in advance of the filing of the return will stay the accumulation of interest on the amount of such payment from the time it is paid. Accordingly, any association desiring to minimize the accumulation of such interest may make such advance payments in full or on the installment basis as provided in section 56 of the Internal Revenue Code to the District Director of Internal Revenue with whom such return will be filed, clearly identifying such payments in order to aid the District Director in the proper application of such payments and in computing interest on deferred payments.

REGULATIONS 118, SECTION 39.53-2: Extension of time for filing returns. Rev. Rul. 54-86*

Extension of time for filing corporation income tax returns.

Rev. Rul. 22, C. B. 1953-1, 84, superseded.

SECTION 1. PURPOSE.

The following instructions are issued in order to simplify the procedure in connection with applications for extensions of time for filing income tax returns of corporations by combining in one form the application for extension of time and the statement in lieu of a tentative return.

SEC. 2. PROCEDURE TO BE FOLLOWED.

.01 District Directors of Internal Revenue are hereby authorized to grant extensions of time of 90 days for filing corporate income tax returns pursuant to applications for such extensions which are made by a person authorized by the corporation to do so, and who is either (*a*) an officer of the corporation, or (*b*) a person currently enrolled to practice before the Treasury Department.

.02 Any such person may file Form 7004 (Rev. Feb. 1954), "Application for Extension of Time to File U. S. Corporation Income Tax Return, and Statement in Lieu of Tentative Return," in place of a request for an extension and the tentative return otherwise required to be filed by the taxpayer corporation on or before the statutory filing date.

.03 The form must be prepared in duplicate. The original must be filed with the District Director for the district in which the corporation is required to file its tax return. It must be filed on or before the 15th day of the third month following the close of the taxable year and must be accompanied by a remittance of an estimated amount not less than would be required as the first installment should the taxpayer elect to pay the tax in installments as provided by law. As evidence of the extension, the duplicate must be attached to the completed return when it is filed.

*Originally issued as IR-Mimeograph No. 54-20, dated February 12, 1954.

.04 Provided that the requirements of Form 7004 have been met, the extension requested is to be considered as having been granted. Any further extension, beyond that automatically granted by filing Form 7004, must be applied for in writing and specifically granted.

.05 District Directors of Internal Revenue will be furnished a limited number of these forms which will be available in their offices. Any person requiring a substantial number of these forms should supply his own. Reproductions should be similar in size and color, and on paper substantially of the same weight and quality as the prescribed Form 7004. Typewritten reproductions are permissible.

.06 While the purpose of this Revenue Ruling is to ease the burden of corporation taxpayers in connection with applications for extensions of time for filing their income tax returns, it is not intended that the change in procedure should affect the existing policy of District Directors in considering applications for extensions of time for filing returns of taxpayers other than corporations.

SEC. 3. EFFECT ON OTHER DOCUMENTS.

This Revenue Ruling supersedes Rev. Rul. 22, C. B. 1953-1, 84. All prior instructions in conflict with the provisions of this Revenue Ruling are hereby revoked.

REGULATIONS 118, SECTION 39.53-3: Extensions of time in the case of foreign organizations, certain domestic corporations, and citizens of United States residing or traveling abroad. (Also Section 23(m), Section 39.23(m)-1; Section 44, Section 39.44-5; Section 112(b), Section 39.112(b)(6)-3; Section 112(f), Section 39.112(f)-1; Section 131(c), Section 39.131(c)-2; Section 143, Section 39.143-7.) T. D. 6059

TITLE 26—INTERNAL REVENUE—CHAPTER I, SUBCHAPTER A, PART 39.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1951

Regulations 118 amended to incorporate the changes made to Regulations 111 by Treasury Decision 6041, and for other purposes.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

Regulations 118 (26 CFR, pt. 39) are amended as follows:

PARAGRAPH 1. Section 39.23(m)-1(e)(4) is amended by striking the first sentence thereof.

PAR. 2. Section 39.53-3 is amended to read as follows:

SEC. 39.53-3. *Extensions of time in the case of foreign organizations, certain domestic corporations, and citizens of United States residing or traveling abroad.*—An extension of time for filing returns of income is hereby granted up to and including the fifteenth day of the sixth month following the close of the taxable year in the case of:

(a) Foreign partnerships, regardless of whether they maintain an office or place of business within the United States;

(b) Foreign corporations which maintain an office or place of business within the United States;

(c) Domestic corporations which transact their business and keep their records and books of account abroad;

(d) Domestic corporations whose principal income is from sources within the possessions of the United States; and

(e) American citizens residing or traveling abroad, including persons in military or naval service on duty outside the United States.

In all such cases a statement must be attached to the return showing that the person for whom the return is made is a person described in this section. Taxpayers who take advantage of this extension of time will be charged with interest at the rate of 6 percent per annum on the first installment of tax, if any, from the original due date until paid.

PAR. 3. Section 39.44-5 is amended by inserting immediately after the second sentence of paragraph (c) thereof the following new sentence:

On and after September 1, 1953, the functions of the Commissioner with respect to such bonds shall be performed by the district director of internal revenue for the internal revenue district in which the last return of the decedent is filed, and any bond filed on or after such date shall be filed with such district director.

PAR. 4. Section 39.112(b)(6)-3 is amended as follows:

(A) By striking from the first sentence of paragraph (a)(2) thereof the words "for transmittal to the Commissioner".

(B) By striking the first sentence of paragraph (a)(3) thereof and inserting in lieu of such sentence the following:

For each of the taxable years which falls wholly or partly within the period of liquidation, the recipient corporation may be required to file a bond, the amount of which shall be fixed by the district director of internal revenue.

(C) By inserting at the end of paragraph (a)(3) thereof the following sentence:

On and after September 1, 1953, the functions of the Commissioner with respect to such bonds shall be performed by the district director of internal revenue for the internal revenue district in which the return was filed, and any bond filed on or after such date shall be filed with such district director.

PAR. 5. Section 39.112(f)-1(c)(3) is hereby amended by striking the part which follows the first sentence and inserting in lieu thereof the following:

Such application shall be made prior to the expiration of the one year after the close of the first taxable year in which any part of the gain from the conversion is realized, and shall contain all of the details in connection with the involuntary conversion. Such application, if made before Septemer 1, 1953, shall be made to the Commissioner, or, if made on or after September 1, 1953, shall be made to the district director of internal revenue for the internal revenue district in which the return is filed for the first taxable year in which any of the gain from the involuntary conversion is realized. No extension of time shall be granted pursuant to such application unless the taxpayer can show reasonable cause for not being able to replace the converted property within the required period of time.

PAR. 6. Section 39.131(c)-2 is amended by inserting after the last sentence thereof the following new sentence:

On and after September 1, 1953, the functions of the Commissioner with respect to such bonds shall be performed by the district director of internal revenue, and any bond filed on or after such date shall be filed with the district director.

PAR. 7. Section 39.143-7(b) is amended by striking the last sentence thereof.

Because this Treasury Decision merely amends Regulations 118 to incorporate therein the changes made to Regulations 111 (26 CFR, pt.

29) by Treasury Decision 6041 (18 F. R. 5515), approved September 9, 1953, and to correct certain clerical errors, it is found unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said act.

(This Treasury Decision is issued under the authority contained in secs. 62 and 3791 of the Internal Revenue Code (53 Stat. 32, 467; 26 U. S. C. 62, 3791).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved January 8, 1954.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 13, 1954, 8:46 a. m.)

SECTION 54.—RECORDS AND SPECIAL RETURNS

REGULATIONS 118, SECTION 39.54-1: Records and income tax forms. Rev. Rul. 54-64

(Also Section 821, Regulations 105, Section 81.65; Section 1006, Regulations 108, Section 86.23.)

Certain Federal tax return forms and schedules may be reproduced and used for filing purposes, in lieu of the applicable official forms, subject, however, to prescribed conditions and requirements.

Rev. Rul. 5, C. B. 1953-1, 87, superseded.

The purpose of this Revenue Ruling is to restate the policy of the Internal Revenue Service relating to acceptance of reproductions of Federal tax return forms and schedules, for filing purposes, in lieu of the official forms and schedules printed by the Government Printing Office, and to supersede Rev. Rul. 5, C. B. 1953-1, 87.

Subject to the conditions and requirements hereinafter described, the Service will accept, for filing purposes, reproductions of any of the following forms and schedules:

U. S. Estate Tax Return, Form 706.
U. S. Gift Tax Return, Form 709.
Gift Tax: Donee's or Trustee's Information Return of Gifts, Form 710.
Life Insurance Statement, Form 712.
Claim, Form 843.
U. S. Exempt Cooperative Association Income Tax Return, Form 990-C.
U. S. Individual Income Tax Return, Form 1040.
U. S. Individual Income Tax Return, Form 1040A.
Profit (or Loss) from Business or Profession, Schedule C (Form 1040).
Gains and Losses from Sales or Exchanges of Property, Schedule D (Form 1040).
U. S. Departing Alien Income Tax Return, Form 1040C.
Declaration of Estimated Tax, Form 1040-ES.
Schedule of Farm Income and Expenses, Form 1040F.
U. S. Fiduciary Income Tax Return, Form 1041.
U. S. Partnership Return of Income, Form 1065.
Statement in Support of Credit Claimed by Domestic Corporation for Taxes Paid or Accrued to a Foreign Country or a Possession of the United States, Form 1118.

U. S. Corporation Income Tax Return, Form 1120.

Schedule of Gains and Losses from Sales or Exchanges of Property, Schedule D (Form 1120).

Computation of U. S. Corporation Excess Profits Tax, Schedule EP (Form 1120).

Return of Information and Authorization and Consent of Subsidiary Corporation Included in a United States Consolidated Income Tax Return, Form 1122.

Statement for the Purpose of Extending Time for Payment of Taxes By Corporations Expecting Carry-Backs, Form 1138.

Application for Tentative Carry-Back Adjustment, Form 1139.

In order to be acceptable for filing purposes, reproductions of such forms must meet the following conditions and requirements:

1. Reproductions must be facsimiles of the complete official form, produced by photo-offset, photoengraving, photocopying, or other similar reproduction process.

2. Reproductions must be on paper of substantially the same color, weight and texture, and of quality at least as good as that used in the official form.

3. The color and quality of the reproduction of the printed matter must be substantially the same as that of the official form, and the filled-in information must be entirely legible.

4. Reproductions must be of the same size as that of the official form, both as to the overall dimensions of the paper and the image reproduced thereon.

5. Reproduction of page 3 of Schedule C (Form 1040) must be on properly preperforated paper of substantially the same weight, color and texture as that used in the official form.

The Internal Revenue Service does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms, but requires only that the reproduced forms satisfy the stated conditions. It should be noted, however, that photostats do not meet all of the above conditions.

While it is preferred that both sides of the paper be used in making reproductions, resulting in the same page arrangement as that of the official form, the Service will not object if only one side of the paper is used, or if the reproduction has a different fold than that provided on the official form.

Reproductions of forms may be made after insertion of the tax computations and other required information. However, all signatures on forms to be filed with the District Director of Internal Revenue must be original signatures, affixed subsequent to the reproduction process.

The Internal Revenue Service will, upon application, furnish black and white proofs to be used for intermediate photographic steps in reproducing forms requiring colored ink.

REGULATIONS 118, SECTION 39.54-1: Records and income tax returns. Rev. Rul. 54-166

In Rev. Rul. 54-64, page 82, this Bulletin, the reproduction of certain Federal tax forms was authorized. Attention is directed to the provisions of section 8 of title 17 and section 58 of title 44 of the United States Code which provide that Government publications are not subject to copyright. Accordingly, no copyright may be obtained by a private person for any Federal tax form or any reproduction of such form. Persons reproducing these forms commercially for sale to the public should not include in advertising matter, issued to promote such sale, anything which gives the impression that these forms have been made the subject of a copyright.

SECTION 55.—PUBLICITY OF RETURNS

EXECUTIVE ORDER 10527

INSPECTION OF INCOME, EXCESS-PROFITS, DECLARED VALUE EXCESS-PROFITS, CAPITAL STOCK, ESTATE, AND GIFT TAX RETURNS BY THE SENATE COMMITTEE ON BANKING AND CURRENCY

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), it is hereby ordered that any income, excess-profits, declared value excess-profits, capital stock, estate, or gift tax return for the years 1942 to 1953, inclusive, shall, during the Eighty-third Congress, be open to inspection by the Senate Banking and Currency Committee, or any duly authorized subcommittee thereof, for the purpose of its investigation of loan projects under section 608 of Title VI of the National Housing Act, as added by the Act of May 26, 1942 (56 Stat. 303), as amended, and the amounts of the mortgages, the cost of construction, and the cost of land of such projects, in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in Treasury Decision 6064, relating to the inspection of returns by certain committees of the Congress, approved by me February 11, 1954.

This Executive order shall be effective upon its filing for publication in the Federal Register.

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
April 19, 1954.

(Filed with the Division of the Federal Register April 20, 1954, 9:55 a. m.)

T. D. 6064

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

Inspection of certain returns by committees of Congress other than those enumerated in section 55(d) of the Internal Revenue Code.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

SEC. 458.321. INSPECTION OF RETURNS BY COMMITTEES OF CONGRESS OTHER THAN THOSE ENUMERATED IN SECTION 55(d).—(*a*) (1) Pursuant to the provisions of sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), any income, excess-profits, declared value excess-profits, capital stock, estate, or gift tax return for any taxable year shall be open to inspection by any committee of the Congress, or any subcommittee of a committee of the Congress, specially authorized to inspect such returns by an Executive order issued under the aforementioned statutory provisions on or after the date of the approval of this Treasury Decision. Such inspection shall be subject to the conditions and restrictions imposed by the Executive order and the rules and regulations hereinafter prescribed.

(2) The inspection of any of the aforementioned returns may be made by the committee of the Congress, or the subcommittee of a committee of the Congress, authorized as provided in subparagraph (1) of this paragraph, acting directly as a committee or as a subcommittee, or by or through such examiners or agents as such committee or subcommittee may designate or appoint in its written request hereinafter mentioned. Upon written request by the chairman of such committee or of such subcommittee to the Secretary of the Treasury, giving the names and addresses of the taxpayers whose returns it is necessary to inspect and the taxable periods covered by the returns, the Secretary of the Treasury or any officer or employee of the Treasury Department, with the approval of the Secretary of the Treasury, shall furnish such committee or subcommittee with any data relating to or contained in any such return or shall make such return available for inspection by such committee or subcommittee or by such examiners or agents as such committee or subcommittee may designate or appoint. Such data shall be furnished, or such return shall be made available for inspection, in an office of the Internal Revenue Service. Any information thus obtained by such committee or subcommittee shall be held confidential: *Provided, however*, That any portion thereof relevant or pertinent to the purpose of the investigation may be submitted by the investigating committee to the appropriate house of the Congress.

(3) This section shall not be applicable to any committee authorized by section 55(d) of the Internal Revenue Code to inspect returns.

(*b*) Because this Treasury Decision constitutes a general statement of policy and establishes a rule of Departmental practice and procedure, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that act.

(*c*) This Treasury Decision shall be effective upon its filing for publication in the Federal Register.

M. B. Folsom,
Acting Secretary of the Treasury.

Approved February 11, 1954.
Dwight D. Eisenhower,
The White House.

(Filed with the Division of the Federal Register February 12, 1954, 11:13 a. m.)

EXECUTIVE ORDER 10518

INSPECTION OF RETURNS BY THE SPECIAL COMMITTEE OF THE HOUSE OF REPRESENTATIVES AUTHORIZED BY HOUSE RESOLUTION 217, EIGHTY-THIRD CONGRESS, TO INVESTIGATE TAX-EXEMPT FOUNDATIONS

By virtue of the authority vested in me by section 55(a) of the Internal Revenue Code (53 Stat. 29; 54 Stat. 1008; 55 Stat. 722; 26 U. S. C. 55(a)), any return on Form 990-A made by an organization exempt from tax under section 101(6) of the Code (53 Stat. 33; 64 Stat. 959; 26 U. S. C. 101(6)), for the years 1950 to 1953, inclusive, shall, up to and including January 3, 1955, be open to inspection by the special committee of the House of Representatives authorized by House Resolution 217, Eighty-third Congress, agreed to July 27, 1953, to investigate tax-exempt foundations, for the purpose of carrying out the provisions of such Resolution, subject to the conditions stated in the Treasury Decision relating to the inspection of returns by certain committees of the Congress, approved by me this date.

This Executive order shall be effective upon its filing for publication in the Federal Register.

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
February 11, 1954.

(Filed with the Division of the Federal Register February 12, 1954, 11:13 a. m.)

SECTION 56.—PAYMENT OF TAX

REGULATIONS 118, SECTION 39.56-2: Extension of time for payment of the tax or part or installment thereof.

Time extended for filing exempt cooperative association income tax return, Form 990-C. (See Rev. Rul. 54-81, p. 78.)

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT A.—RATES OF TAX

SECTION 101.—EXEMPTIONS FROM TAX ON CORPORATIONS

REGULATIONS 118, SECTION 39.101-1: Proof of exemption; annual returns. T. D. 6060

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 39.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1951

Regulations 118 amended regarding requirements for filing and approving applications for exemption from income tax; annual returns by farmers' cooperative marketing and purchasing associations.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

In order to authorize certain changes in the processing of applications for exemption from income tax under section 101 of the Internal Revenue Code and to prescribe rules respecting annual returns in the case of farmers' cooperative marketing and purchasing associations exempt under section 101(12) of the Code, Regulations 118 [26 CFR, pt. 39] are hereby amended as follows:

Section 39.101-1 is amended as follows:

(A) By striking "(4), except a bona fide credit union," from the third sentence of (a) thereof.

(B) By striking "under section 101 (4), except bona fide credit unions, Form 1027;" from the fourth sentence of (a) thereof.

(C) By striking ", including bona fide credit unions," from the fifth sentence of (a) thereof.

(D) By revising (c) thereof to read as follows:

(c) *Duties of district director with respect to proof of exemption.*—The district director of internal revenue shall take steps to insure that the application and other papers are complete and in order and shall take such other action as may be prescribed leading to a determination whether the organization is exempt under section 101.

(E) By inserting immediately following the second sentence of (e) thereof, which sentence ends with the words "with the requirements of this section and of § 39.153-1", the following new sentence:

In the case of a farmers' cooperative marketing and purchasing association exempt under section 101(12), such association shall file annually Form 990-C in lieu of Form 990.

(F) By striking the words "Forms 990 and 990-A" from the third sentence of (e) thereof, and inserting in lieu thereof "Forms 990, 990-A, and 990-C".

(G) By striking the words "Form 990 or Form 990-A" from the last sentence of (e) thereof, and inserting in lieu thereof "Form 990, Form 990-A, or Form 990-C".

(H) By inserting immediately preceding the first sentence of (f) thereof the following new sentence:

The provisions of this paragraph shall be inapplicable in the case of a farmers' cooperative marketing and purchasing association exempt under section 101(12).

(I) By adding immediately after the last sentence of (g) thereof the following new sentence:

However, Form 990-C, applicable under (e) above, to a farmers' cooperative marketing and purchasing association, shall be filed in accordance with the provisions of section 53 and the regulations prescribed thereunder.

(J) By striking the words "Form 990 or Form 990-A" from (i) thereof, and inserting in lieu thereof "Form 990, Form 990-A, or Form 990-C".

Because this Treasury Decision establishes a rule of Department practice and makes further amendments of a technical nature only, it is hereby found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that act.

(This Treasury Decision is issued under the authority contained in secs. 62 and 3791 of the Internal Revenue Code (53 Stat. 32, 467; 26 U. S. C. 62, 3791).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved January 12, 1954.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 15, 1954, 8:49 a. m.)

REGULATIONS 118, SECTION 39.101-1: Proof of exemption. Rev. Rul. 54-134

Rulings of the Internal Revenue Service which hold corporations exempt under section 101 of the Internal Revenue Code are generally effective as of the date of incorporation, or the date when organized and operated for exempt purposes, provided the requirements of exemption have been compiled with during the entire period. However, when prior to incorporation an organization was formed and operated in an exempt manner and its incorporation merely had the effect of changing the form of organization from that of an unincorporated organization to a corporation, the ruling would include the period during which the organization operated in an unincorporated status. In such cases there is incorporated in the ruling a statement with respect to the period covered.

REGULATIONS 118, SECTION 39.101-1: Proof of exemption; annual returns. Rev. Rul. 54 164*

Existing procedures clarified and certain new procedures prescribed with respect to certain organizations claiming exemption, from Federal income tax, under section 101 of the Internal Revenue Code.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to clarify certain procedures and prescribe new procedures for compliance by organizations claiming exemption under section 101 of the Internal Revenue Code.

SEC. 2. FILING OF APPLICATION FOR EXEMPTION.

.01. *General requirements.*—Any organization claiming exemption under section 101 of the Internal Revenue Code, unless already in receipt of a determination letter or ruling letter from the Internal Revenue Service establishing exemption, is required by Treasury Department regulations to file an application for exemption with the District Director of Internal Revenue for its district. (Sec. 39.101-1 of Regs. 118, as amended by T. D. 6060 [p. 86, this Bulletin], approved

*Originally issued as IR-Mimeograph No. 54-73, dated April 28, 1954.

Jan. 12, 1954.) If any such application is filed with the National Office or with a field office other than as prescribed by the regulations, it will, without any action thereon, be forwarded immediately to the appropriate District Director's office.

.02 *Organizations with less than 12 months' operation.*

1. In view of the statutory requirements for exemption and the administrative responsibilities of the Service in the field of exempt organizations, a determination or ruling on an application for exemption will generally not be made with respect to a newly formed organization until it has actually operated for such a period and to such an extent as to clearly demonstrate a bona fide operation for the purposes specified in the exemption statute. Exceptions to this general rule are stated in section 5.

2. Except as otherwise provided in section 5, an application for exemption should not be filed by an organization until it has had at least 12 months of active operation (not mere existence) for the purposes for which it was created, that is, actual operation for such a period and to such an extent as will clearly demonstrate that in fact the organization is conducted for purposes within the exemption provisions of the statute. Attention is invited to the applicable provisions of the regulations and the information called for on the application forms to be filed by organizations claiming exemption.

Sec. 3. Classification of Applications for Exemption.

Applications are classified in the following categories in the District Director's office:

.01 *District Director's cases.*—Cases of a routine nature in which the application of section 101 of the Internal Revenue Code to the facts shown on the exemption application is clear under the regulations and rulings of the National Office and which do not present involved or questionable issues will be classified as "District Director's cases." For further details, see sections 4 and 5.

.02 *Incomplete application cases.*—Exemption applications in the case of newly formed organizations as to which determinations or rulings will not be made (as provided in section 2.02 subject to the exceptions under section 5) and in other cases where the required information is not given on the exemption application will be classified as "incomplete application cases." In such cases the application will be returned to the organization with an appropriate letter of explanation.

.03 *National Office cases.*—Cases which present involved or questionable issues and do not fall within the category of District Director's cases or incomplete application cases will be classified as "National Office cases." Exemption applications so classified will be referred to the National Office for ruling, which will be made to the organization.

Sec. 4. Action on Applications for Exemption.

.01 District Directors are authorized to issue determination letters in "District Director's cases" as defined in section 3, including tentative determinations of status in cases within the scope of section 5. Such letters will be issued over the District Director's signature, either concluding that the organization is exempt or that it is not exempt. Such determination letters will represent the determination (or tentative determination as authorized under section 5) of the District Director as to the status of an organization based on the application to the facts of the case of established precedents and principles set forth in the regulations and rulings of the National Office. The National Office will continue to issue rulings (or tentative rulings) on exempt organizations in cases referred to the National Office by District Directors as described in section 3.03 and section 5.02.

.02 Types of organizations whose exemption applications normally present clear-cut situations on which the District Director is authorized to issue determination letters include (but are not restricted to) the following:

101(1). Labor unions (other than group).
101(4). Credit unions (State chartered).
101(6). Churches of well-known denominations. (Applications generally not required.)
Community chests, including each participating agency.
Local organizations of Salvation Army and similar organizations.
4-H clubs.
Public libraries.
Educational organizations having a student body, instructors, etc.
101(7). Chambers of commerce, boards of trade, real-estate boards, etc.
101(8). Local veterans' organizations (other than group).
101(10). Mutual ditch or irrigation companies.
Mutual telephone companies.

SEC. 5. EXCEPTIONS TO THE GENERAL RULE REQUIRING ACTIVE OPERATION FOR A PERIOD OF NOT LESS THAN 12 MONTHS AS A CONDITION PRECEDENT TO THE ISSUANCE OF A DETERMINATION OR RULING.

.01 Tentative determination letters will be issued by District Directors to newly formed organizations with less than 12 months of active operation in a case in which an affirmative showing is made (in or in connection with the exemption application) that the organization is of the community or public type. Tentative rulings will be issued by the National Office upon the same standards in National Office cases. Factors which characterize a community or public organization include responsible public representation on its board of directors or trustees, financial support provided by public contributions, or required reporting to a governmental or public body assuring the organization's adherence to the purposes for which it was formed, such as periodical reporting to a State agency or political subdivision. Examples of organizations of the community or public type are set forth below:

1. Nonprofit organizations formed by well-known religious denominations in furtherance of their religious, charitable, and educational purposes and activities;

2. Charitable organizations such as hospitals, orphanages and the like, publicly supported and managed, which clearly serve a present public need;

3. Veterans' or charitable organizations having for their purpose the promotion of the welfare of persons in the Armed Forces or who have been in the Armed Forces, provided that such organizations establish that they intend presently to begin active operation for the purposes specified in section 101(6) or section 101(8);

4. Educational organizations such as schools and colleges which normally have a regular faculty, curriculum, and student body, as described in section 54(f)(2) of the Code; and

5. Other organizations which are clearly public in character or which represent a community-wide project or undertaking.

.02 Any case in which the facts in the exemption application, although persuasive of the conclusion that the organization is of the community or public type, present involved or questionable issues on which the District Director is in doubt will be classified as a "National Office case" and processed as provided in section 3. Where the facts clearly establish that the organization is of the community or public type, the District Director is authorized to issue a *tentative* determination letter with the requirement that the organization at the termination of its first full year of operation shall submit a new application, together with complete supporting data as specified in the application form or in the applicable regulations.

.03 The provisions of this section shall not be deemed to limit the existing authority of the District Director, in cases where the liability of an organization for certain other Federal taxes is dependent on a determination under, or similar to that under, section 101 (such as in the case of certain exemptions under the admissions tax), to make a tentative determination of the status of the organization for purposes of such other taxes, pending and subject to a determination or ruling on the organization's application for exemption under section 101. However, for income tax purposes, unless the exemption application filed under such circumstances by an organization with less than 12 months of active operation makes an affirmative showing that the organization is of the community or public type, it will be returned as incomplete and a determination or ruling as to the status of the organization under section 101 will not be made until the organization has had at least 12 months of active operation.

.04 Determination letters allowing exemption under section 101(4) of the Code will be issued to State chartered credit unions at any time after their formation if they operate under uniform bylaws approved by the State.

SEC. 6. REVIEW AND CONFERENCES.

.01 The National Office shall conduct such review of determination letters issued by District Directors' offices (including tentative determination letters) as is considered necessary to assure conformity with the interpretations and policies of the Revenue Service. It is the general policy of the Internal Revenue Service to limit the revocation of a ruling with respect to an organization previously held to qualify under section 101 to a prospective application only, if the organization has acted in good faith in reliance upon the ruling issued to it and a retroactive revocation of such ruling would be to its detriment. Any ruling issued as to the exempt status of an organization will not be considered controlling where there has been a misstatement or omission of a material fact or where the operations of the organization are conducted in a manner materially different from that represented. A revocation may be effected by a notice to the organization or by a ruling or other statement published in the Internal Revenue Bulletin applicable to the type of organization involved. The same policy will be applicable to determination letters issued by District Directors.

.02 With respect to any case coming under the provisions of this Revenue Ruling which is referred to the National Office for issuance of a ruling, or where the National Office proposes to take a different view as to the qualification of the organization for exemption under section 101 than that reflected in a determination letter issued by the District Director, conferences in the National Office will be granted in accordance with the procedure for conferences on requests for rulings or technical advice. See Rev. Rul. 10, C. B. 1953-1, 488, and Mimeograph 6293, C. B. 1948-2, 59.

Sec. 7. Effective Date.

The provisions of this Revenue Ruling shall become effective May 24, 1954.

Regulations 118, Section 39.101(6)-1: Religious, charitable, scientific, literary, and educational organizations and community chests. Rev. Rul. 54-243

(Also section 23(o), Section 39.23(o)-1; Section 23(q), Section 39.23(q)-1.)

Organizations which are exempt under section 101 of the Internal Revenue Code, other than section 101(6) of the Code, may establish a separate fund exclusively for religious, charitable, scientific, literary, or educational purposes, apart from their other funds. If such separate fund is operated exclusively for such purposes, separate books and accounts are maintained, and it otherwise meets the requirements for exemption under section 101(6) of the Code, contributions to the fund are deductible by donors in computing their taxable net income in the manner and to the extent provided in section 23(o) or 23(q) of the Code. A fund of this character should be organized in such a manner that its assets cannot be used, upon dissolution or otherwise, for the general purposes of the organization creating it but must be used for purposes similar to those of the fund itself. The status of such a fund should be established in the manner provided under section 39.101-1 of Regulations 118.

Regulations 118, Section 39.101(6)-1: Religious, charitable, scientific, literary, and educational organizations and community chests.

Income received by a tax-exempt organization from research activities. (See Rev. Rul. 54-73, p. 160.)

REGULATIONS 118, SECTION 39.101(6)-1: Religious, charitable, scientific, literary, and educational organizations and community chests.

Exemption of a charitable foundation making distributions to other tax-exempt organizations. (See Rev. Rul. 54-137, p. 289.)

REGULATIONS 118, SECTION 39.101(12)-1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 101(12)(A). Rev. Rul. 54-12

Sales made by a farmers' cooperative association, engaged in the production and distribution of petroleum products, on the open market of byproducts such as heavy fuel oils and distillates not usable by its farmer patrons, and the value of petroleum products exchanged with other refineries in order to utilize its output and effect a savings in transportation costs shall, for the purpose of determining exemption under section 101(12)(A) of the Internal Revenue Code, be disregarded in determining whether the purchases made for persons who are neither members nor producers exceed 15 percent of the value of all purchases.

Advice is requested whether sales of heavy petroleum products made on the open market by a farmers' cooperative association and the value of petroleum products exchanged with other refineries shall be disregarded in determining whether the value of all purchases made for persons who are neither members nor producers exceeds the statutory limitation of 15 percent, as provided in section 101(12)(A) of the Internal Revenue Code.

In the instant case, a petroleum refining company is a wholly owned subsidiary of an association which has been held to be exempt from Federal income tax as a farmers' cooperative marketing and purchasing association under the provisions of section 101(12)(A) of the Code. In earlier years the cooperative association purchased petroleum products in the open market for its member associations. In order to assure a continued supply of such products the association acquired by purchase the refining company here involved. Such company was reorganized for the purpose of engaging in any activity on a cooperative basis in connection with the acquisition, development, production, and distribution of oil, gas, petroleum, asphaltum, and other minerals and byproducts thereof. The primary purpose of the refining company is the production of petroleum fuels required by farmers in the production of agricultural products. In the production of light petroleum products used by farmers, certain byproducts such as heavy fuel oils and distillates are produced which its farmer patrons do not use. These products are disposed of to railroads, steel mills or in whatever market is available at the prevailing market price of such products. Further, in order to utilize its output to the best advantage by effecting a savings in transportation costs, it is the practice of the refinery to make exchanges of products with other refineries which in turn deliver a like quantity of the same products to the distributing agency of the association from their stocks located at points convenient to its farmer patrons.

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Section 101(12)(A) of the Internal Revenue Code provides, in part, for the exemption from Federal income tax of farmers, fruitgrowers, or like associations organized and operated on a cooperative basis for the purpose of purchasing supplies and equipment for the use of members or other persons and turning over such supplies and equipment to them at cost, plus necessary expenses, provided they meet the other requirements of that section. Such associations may purchase supplies and equipment for nonmembers provided that the value of supplies and equipment purchased for nonmembers does not exceed the value of supplies and equipment purchased for members and provided further that the value of supplies and equipment purchased for persons who are neither members nor producers of agricultural products does not exceed 15 percent of the value of all its purchases.

It is held that sales made by a farmers' cooperative association, engaged in the production and distribution of petroleum products, on the open market of byproducts such as heavy fuel oils and distillates not usable by its farmer patrons, and the value of the petroleum products exchanged with other refineries in order to utilize its output and effect a savings in transportation costs shall, for the purpose of determining exemption under section 101(12)(A) of the Internal Revenue Code, be disregarded in determining whether the value of purchases made for persons who are neither members nor producers exceeds 15 percent of the value of all its purchases.

REGULATIONS 118, SECTION 39.101(12)–1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 101(12)(A).

Time extended for filing exempt cooperative association income tax return, Form 990–C. (See Rev. Rul. 54–81, p. 78.)

SECTION 107.—COMPENSATION FOR SERVICES RENDERED FOR A PERIOD OF THIRTY-SIX MONTHS OR MORE AND BACK PAY

REGULATIONS 118, SECTION 39.107–1: Personal services. Rev. Rul. 54–206

INTERNAL REVENUE CODE

For the purposes of section 107(a) of the Internal Revenue Code a husband and wife who reside in a noncommunity property State may not split income which constitutes compensation received by the husband for personal services rendered by him during taxable years beginning prior to January 1, 1948, the effective date of section 12(d) of the Code.

Advice is requested relative to the manner of determining the amount of Federal income tax under section 107(a) of the Internal Revenue Code, attributable to compensation received for personal services under the facts and circumstances set forth below.

In 1953, the taxpayer-husband received more than 80 percent of his total compensation for personal services he rendered to one individual during the period 1942 to 1947. He and his wife propose to file a single return jointly for the taxable year 1953. The taxpayers have at all times since 1941 resided in a noncommunity property State, and have filed their returns on the calendar year basis.

The pertinent provisions of the Code are as follows:

Section 12(d) provides:

(d) TAX IN CASE OF JOINT RETURN.—In the case of a joint return of husband and wife under section 51(b), the combined normal tax and surtax under section 11 and subsection (b) of this section shall be twice the combined normal tax and surtax that would be determined if the net income and the applicable credits against net income provided by section 25 were reduced by one-half.

Section 51(b)(1) provides:

(b) HUSBAND AND WIFE.—

(1) IN GENERAL.—A husband and wife may make a single return jointly. Such a return may be made even though one of the spouses has neither gross income nor deductions. If a joint return is made the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several.

Section 107(a) provides:

(a) PERSONAL SERVICES.—If at least 80 per centum of the total compensation for personal services covering a period of thirty-six calendar months or more * * * is received or accrued in one taxable year by an individual or a partnership, the tax attributable to any part thereof which is included in the gross income of any individual shall not be greater than the aggregate of the taxes attributable to such part had it been included in the gross income of such individual ratably over that part of the period which precedes the date of such receipt or accrual.

Section 12(d) and section 51(b)(1) were not applicable for calendar years prior to 1948.

The services for which the compensation under consideration was received were performed prior to the effective date of the income-splitting provisions of section 12(d) of the Code, and the compensation was received after the effective date of that section. Therefore, the question arises whether the provisions of section 107(a) of the Code shall be applied to such compensation without regard to the provisions of section 12(d) of the Code or whether the compensation shall be split equally between the husband and wife before applying the provisions of section 107(a) of the Code.

For the purposes of section 107(a) of the Code, the sole fact that the wife performed no services is not determinative. It is important, however, to determine who received or accrued the compensation, for in computing the tax attributable to income subject to the provisions of section 107(a) it is necessary to determine the tax that would have been paid on such income had it actually been included in the recipient's gross income ratably in the prior years. See *Edward C. Thayer et ux.* v. *Commissioner*, 12 T. C. 795, acquiescence, C. B. 1950-1, 5; *Arthur T. Schmidt* v. *Commissioner*, 10 T. C. 746, acquiescence, C. B. 1949-1, 3; *William F. Knox* v. *Commissioner*, 10 T. C. 550, acquiescence, C. B. 1949-1, 3; and IR-Mim. 43, C. B. 1952-2, 112. Accordingly, if within the meaning of section 107(a) of the Code the compensation was all "received" by the taxpayer-husband the computation under section 107(a) must be made as though the husband alone received the compensation in the prior years, and the taxpayers may not split such compensation in determining the tax attributable thereto unless they could have done so in the prior years had it actually been received then.

A wife in a noncommunity property State does not receive or accrue one-half of the income of her husband. It does not follow from sections 12(d) and 51(b) of the Code that a husband and wife each receive or accrue one-half their combined income for Federal income tax purposes, but merely that if they are permitted to and do file a joint return their tax shall be computed as if they each received one-half of their combined income. Thus, a husband and wife in a noncommunity property State may not split their income if they file separate returns. Section 51(b) of the Code itself indicates that a wife does not "receive" one-half of her husband's income, for that section states that a joint return may be filed even though a spouse has no gross income and the tax shall be computed on the "aggregate" income.

Accordingly, it is held that for the purposes of section 107(a) of the Code a husband and wife who reside in a noncommunity property State may not split income which constitutes compensation received by the husband for personal services rendered by him during a taxable year prior to the effective date of section 12(d) of the Code. The tax attributable to such income must be determined as though it were included in the recipient's gross income ratably during the period in which the services were rendered.

In view of the foregoing, the Internal Revenue Service is constrained not to follow the decision in *Hofferbert* v. *R. E. Lee Marshall et ux.*, 200 Fed. (2d) 648.

The opinions expressed herein in no way conflict with the decisions in *Maurice H. Van Bergh* v. *Commissioner*, 18 T. C. 518, acquiescence in the decision on the issue related here, C. B. 1953-1, 6, or *Federico Stallforth* v. *Commissioner*, 6 T. C. 140. The Van Bergh decision holds that section 107(a) income is included in "gross income" for the purpose of section 275(c) of the Code in the year it is received or accrued, notwithstanding that the tax is computed as if it were received pro rata in the prior years. This decision follows from the fact that section 107(a) affects only the computation of the tax. The Stallforth decision holds that in computing the tax attributable to prior years, section 107(a) income is not exempt merely because it would have been exempt if received in the prior year. In other words, the character of section 107(a) income is determined in the year it is received or accrued, but in computing the tax attributable to the prior year the taxpayer must follow the method of computation of the prior year.

REGULATIONS 118, SECTION 39.107-3: Back pay attributable to prior taxable years. Rev. Rul. 54-138

That part of a lump sum payment received during 1953 by a member of the Fleet Reserve attributable to an increase in retired pay computed under the provisions of Public Law 720, Seventy-ninth Congress, 60 Stat. 993, approved August 10, 1946, which represents payment for the period beginning with the day following such member's release to inactive service to August 10, 1946, does not constitute back pay within the meaning of section 107(d) of the Internal Revenue Code. The balance of the payment constitutes back pay, and the Federal income tax liability for the year in which received may be computed in accordance with the provisions of section 107(d)(1) of the Code, provided such amount exceeds 15 percent of the gross income for that year.

Advice is requested whether a lump sum payment received during 1953 by a member of the Fleet Reserve attributable to increased retirement pay computed under the provisions of Public Law 720, Seventy-ninth Congress, 60 Stat. 993, approved August 10, 1946, constitutes back pay within the meaning of section 107(d) of the Internal Revenue Code.

Public Law 720, *supra*, amended the Naval Reserve Act of 1938, 52 Stat. 1175, by providing that an enlisted man of the Regular Navy who transferred to the Fleet Reserve after completing more than 16 years' total naval service and thereafter performed active duty which, when added to his prior service, equaled 20 or more years' naval service was, upon his subsequent release from active service, entitled to have his retainer or retired pay computed on the same basis as an enlisted man who originally transferred to the Fleet Reserve after completion of 20 or more years service. Inasmuch as Public Law 720, approved August 10, 1946, contained a retroactive feature, an enlisted man transferring to the Fleet Reserve became entitled to an increase in his retainer or retired pay computed from the day following his release to inactive service.

The manner in which this payment was to be computed was not finally determined until 1953 when a settlement agreement was reached on the basis of the decision of the United States Court of Claims in *Christopher C. Sanders* v. *United States*, 120 Ct. Cls. 501. Accordingly, such enlisted men did not receive the increase to which they were entitled under Public Law 720 until 1953, at which time they received a lump sum representing an adjustment in the retired pay dating from the day following their release to inactive service.

Section 107(d)(1) of the Code provides, in part, as follows:

> IN GENERAL.—If the amount of the back pay received or accrued by an individual during the taxable year exceeds 15 per centum of the gross income of the individual for such year, the part of the tax attributable to the inclusion of such back pay in gross income for the taxable year shall not be greater than the aggregate of the increases in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for the taxable years to which such portions are respectively attributable, * * *.

Section 107(d)(2) of the Code defines "back pay" for the purpose of the application of section 107(d)(1) of the Code as remuneration, including wages, salaries, retirement pay, and other similar compensation which is received or accrued during the taxable year by an employee for services performed prior to the taxable year for his employer and which would have been paid prior to the taxable year except for the intervention of certain specified events which events include "(ii) dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings; * * *."

Section 39.107-3 of Regulations 118 provides in part that back pay does not include additional compensation for past services where there was no prior agreement or legal obligation to pay such additional compensation. In the instant case there was no legal liability to make this payment until the approval of Public Law 720, *supra.*

In view of the foregoing it is held that that part of a lump sum payment received during 1953 by a member of the Fleet Reserve attributable to an increase in retired pay computed under the provisions of Public Law 720, *supra*, which represents payment for the period beginning with the day following such member's release to inactive service to August 10, 1946, does not constitute back pay within the meaning of section 107(d) of the Internal Revenue Code. The balance of the payment constitutes back pay, and the Federal income tax liability for the year in which received may be computed in accordance with the provisions of section 107(d)(1) of the Code, provided such amount exceeds 15 percent of the gross income for that year, which includes the entire amount of the lump sum payment received.

SUPPLEMENT B.—COMPUTATION OF NET INCOME

SECTION 111.—DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS

REGULATIONS 118, SECTION 39.111-1: Computation of gain or loss. Rev. Rul. 54-95

When a residential estate, which has been acquired and held by a taxpayer for a number of years as a single unit, is sold in two parcels during the taxable year, the sale of each parcel is treated as a separate transaction and the gain realized or loss sustained is computed separately on each sale. Any losses sustained on the sale of a personal residence are not deductible.

Advice is requested whether a residential estate sold in two parcels during a taxable year is treated as one transaction or two separate transactions for Federal income tax purposes.

In the instant case, the taxpayer purchased 245 acres of land in 1927 for approximately 25*x* dollars for the purpose of building a home thereon. Immediately thereafter the taxpayer caused to be built thereon a large manor house, together with a manager's residence and other extensive improvements at a total cost of approximately 425*x* dollars. The property at all times thereafter was held by the taxpayer solely for personal residential purposes as a single integrated unit, and not for the purpose of investment, resale, or the production of income. In 1952 the taxpayer attempted to sell the property as a whole and single unit, but was unsuccessful. In the early part of 1953, the taxpayer negotiated a sale of approximately 50 acres of the property containing the manor home and all the improvements made on the property for approximately 175*x* dollars, and in the latter part of the same taxable year he sold the remaining acreage to a separate purchaser for approximately 380*x* dollars.

Assessment of Federal income taxes is made on the basis of an annual accounting period. *Burnett* v. *Canford & Brooks Co.*, 282 U. S. 359, Ct. D. 277, C. B. X-1, 363 (1931); *United States* v. *Ellis R. Lewis*, 340 U. S. 590, Ct. D. 1738, C. B. 1951-1, 21. However, this does not permit separate sales and legal transfers of property to be treated as one transaction merely because such sales occur in the same taxable year. Under the facts in this case to permit the taxpayer to treat the separate sales of his residential estate as one integrated transaction would in effect, alter the rule set forth in section 39.23(e)-1(e) of Regulations 118, that losses on personal residences are not deductible. Further, if these sales had been made within a 3-day period which spanned 2 taxable years different tax results would necessarily be reached under the rule of accounting by annual periods. There is no legal or equitable basis for treating such sales as one integrated transaction.

Accordingly, it is held that when a residential estate, which has been acquired and held by a taxpayer for a number of years as a single unit, is sold in two parcels during the taxable year, the sale of each parcel is treated as a separate transaction and the gain realized or loss sustained is computed separately on each sale. Any losses sustained on the sale of a personal residence are not deductible.

SECTION 112(b).—RECOGNITION OF GAIN OR LOSS: EXCHANGES SOLELY IN KIND

(Also Section 371, Section 39.371-2, Regulations 118.) Rev. Rul. 54-192

Under a proposed plan to integrate and simplify the taxpayer's holding company system, pursuant to an order issued by the Securities and Exchange Commission, a recapitalization of a subsidiary, the exchange of its stock incidental thereto, and the distribution of the subsidiary's stock to the stockholders of the parent together with the dissolution of another subsidiary and the transfer of its assets to the taxpayer, will constitute nontaxable transactions under sections 112(b) (8) and 371 of the Code.

Advice is requested with respect to the tax consequences for Federal income tax purposes of certain proposed transactions to be consummated pursuant to a plan approved by the Securities and Exchange Commission.

X Corporation, a registered holding company under the Public Utility Holding Company Act of 1935, has outstanding only one class of capital stock consisting of 1,000 shares par value $6 per share. X Corporation owns 14 subsidiaries, 2 of which are the Y Corporation and the Z Corporation. Y Corporation, a gas utility company, has outstanding 400 shares of common stock, par value $10 per share, all of which are directly owned by X Corporation, and has first mortgage bonds, all of which are owned by the public. Z Corporation's sole business is the operation and maintenance of Y Corporation's interurban distribution system. Its securities consist of 10 shares of no par value common stock, all directly owned by X Corporation.

Pursuant to an order of the Securities and Exchange Commission that satisfies the conditions of section 371(f) of the Code, it is proposed that Y Corporation will amend its certificate of incorporation to increase its authorized common stock from 500 shares, par value $10 per share, to 1,100 shares of par value of $5 per share. Y Corporation will issue 1,000 shares of such $5 par value common stock to X Corporation in exchange for 400 shares of $10 par value common stock now held by X Corporation and will increase its capital account from $4,000 to $5,000 by transferring thereto $1,000 from its earned surplus account. After the receipt by X Corporation of the new common stock of Y Corporation, X Corporation will transfer and distribute such stock, on a share for share basis, to its stockholders via a transfer agent. Z Corporation will be dissolved and X Corporation will acquire all of its then remaining assets and will assume all of its liabilities to creditors in an amount not exceeding the value of the assets acquired.

Section 112(b)(8) of the Internal Revenue Code, in conjunction with sections 371, 372, and 373 (supplement R) of the Code, provides for nonrecognition of gain or loss and adjustment to basis in the case of certain exchanges and distributions ordered by the Securities and Exchange Commission under the provisions of Section 11(b) of the Public Utility Holding Company Act of 1935 (15 U. S. C. 79K(b)).

Section 112 of the Internal Revenue Code relating to the recognition of gain or loss provides in part as follows:

(b) EXCHANGES SOLELY IN KIND.—

* * * * * * *

(8) EXCHANGES AND DISTRIBUTIONS IN OBEDIENCE TO ORDERS OF SECURITIES AND EXCHANGE COMMISSION.—In the case of any exchange or distribution described in section 371, no gain or loss shall be recognized to the extent specified in such section with respect to such exchange or distribution.

Section 371 of the Internal Revenue Code relating to the nonrecognition of gain or loss on exchanges or distributions in obedience to orders of the Securities and Exchange Commission provides in part as follows:

(a) EXCHANGES OF STOCK OR SECURITIES ONLY.—No gain or loss shall be recognized to the transferor if stock or securities in a corporation which is a registered holding company or a majority-owned subsidiary company are transferred to such corporation or to an associate company thereof which is a registered holding company or a majority-owned subsidiary company solely in exchange for stock or securities * * * and the exchange is made by the transferee corporation in obedience to an order of the Securities and Exchange Commission.

* * * * * * *

(c) DISTRIBUTION OF STOCK OR SECURITIES ONLY.—If there is distributed, in obedience to an order of the Securities and Exchange Commission, to a shareholder in a corporation which is a registered holding company or a majority-owned subsidiary company, stock or securities * * * without the surrender by such shareholder of stock or securities in such corporation, no gain to the distributee from the receipt of the stock or securities so distributed shall be recognized.

(d) TRANSFERS WITHIN SYSTEM GROUPS.—(1) No gain or loss shall be recognized to a corporation which is a member of a system group (A) if such corporation transfers property to another corporation which is a member of the same system group in exchange for other property, and the exchange by each corporation is made in obedience to an order of the Securities and Exchange Commission, * * *.

Section 39.371-2 of Regulations 118 states, in part, that the general rule is that the entire amount of gain or loss from the sale or exchange of property is to be recognized under section 112(a) and that the entire amount received as a dividend is to be included in gross income under the provisions of sections 22(a) and 115 of the Code. One of the exceptions to the general rule is provided in section 112(b)(8) with respect to exchanges, sales, and distributions specifically described in section 371 of the Code. In the instant case, since the order of the Securities and Exchange Commission states that these transactions are "necessary or appropriate to effectuate the provisions of Section 11(b) of the act" and such order otherwise satisfies the conditions of section 371(f) of the Code, the transactions meet the requirements of sections 371, 372, and 373.

Accordingly, it is held that no gain or loss will be recognized to Y Corporation as a result of its increasing and changing its outstanding capital stock; increasing its capital account by a transfer out of its earned surplus account; and issuing new certificates representing increased shares to X Corporation or its designees in exchange for such certificates now held by X Corporation. No gain or loss will be recognized to X Corporation as a result of the exchange by it of old shares for new shares of stock of Y Corporation. No gain or loss will be recognized to X Corporation as a result of the distribution by it to its stockholders of shares of stock of Y Corporation, notwithstanding the fact that the value of such stock will be substantially greater than the basis of such stock in the hands of X Corporation. The transactions will not diminish the accumulated earnings and profits of Y Corporation available for the distribution of taxable dividends nor of X Corporation as a result of the distribution. No gain or loss will be recognized to the stockholders of X Corporation as a result of the receipt by them of the stock of Y Corporation transferred and distributed to them by X Corporation or the transfer agent pursuant to the plan. The cost or other basis of the stock of X Corporation in the hands of the stockholders, whether received from X Corporation or the transfer agent, must be apportioned between the stock of X Corporation and the stock of Y Corporation in proportion to the fair market value of each as of the effective date of the distribution by X Corporation. The holding period of the stock of Y Corporation received by a holder of stock of X Corporation on the distribution will include the period during which the stock of X Corporation was held. No gain or loss will be recognized to X Corporation as a result of complete liquidation of Z Corporation and the transfer of its assets, subject to its liabilities, to X Corporation. The basis of the assets of Z Corporation in the hands of X Corporation will be the same as the basis of such assets in the hands of Z Corporation immediately prior to the liquidation.

Withdrawal shares in a Federal savings and loan association exchanged for withdrawal shares in a State building and loan association, a party to a reorganization. (See Rev. Rul. 54-193, p. 106.)

REGULATIONS 118, SECTION 39.112(b)(2)-1: Stock for stock of same corporation. Rev. Rul. 54-65
(Also Section 112(g), Section 39.112(g)-1.)

Special stock of one series exchanged for special stock of another series issued by the same corporation operating as a regulated investment company, where each series is wholly dependent for its earnings and liquidating value upon entirely different underlying assets, gives rise to a taxable gain or deductible loss on the exchange. The fact that a plan of reorganization provides that such conversion may be made within 90 days after the effective date of a corporate recapitalization will not make the exchange nontaxable under the provisions of section 112(b)(3) of the Internal Revenue Code.

Advice is requested relative to the effect, for Federal income tax purposes, of an exchange by a holder of special stock of one series in a regulated investment company for special stock in another series issued by the same company under circumstances set forth below.

The certificate of incorporation of the M Company, organized and registered as a regulated investment company as defined in section 361 of the Internal Revenue Code, authorizes the issuance of $1x$ shares of common stock and 1000x shares of special stock, the latter to be issued in one or more series pursuant to action by the Board of Directors. The Board of Directors subsequently authorized the issuance of the special stock in several series. Each share of each class of stock has equal voting rights with all other shares of all other classes. Each series is named for the type of investments purchased with the funds obtained from the sale of the special stock of that series. The underlying assets of each series, representing the investment of the proceeds from the sale of shares and the undistributed earnings and profits therefrom are segregated upon the books of account. The holders of shares of any designated series have no interest in the assets or income of any other series. Each series is charged with its equitable proportions of the expenses and liabilities of the corporation. Shares of any series are redeemable at their current net asset value and are also convertible into shares of any other series at their relative net asset values.

Pursuant to a plan of reorganization the management of the M Company proposes to eliminate the various series of the old special stock by reclassifying the capital structure into three general management series. The shares of all previously existing series of special stock will be reclassified according to the type of investment represented thereby into shares of one of the three new categories. The conversion privileges of the old series will be eliminated. However, the plan provides that for a limited period of 90 days after the effective date of the recapitalization a holder of shares of any of the three new series may convert them into shares of either of the other series at net asset value. Immediately prior to the reorganization all accumulated income and net realized capital gain in each of the old series will be declared payable to the stockholders as ordinary income and as capital gain dividends.

The question presented is whether (1) the reclassification of the existing classes of special stock at the date of recapitalization and (2) the conversion of the new stock into shares of either of the other series of new stock within 90 days after the effective date of the recapitalization will constitute exchanges of property within the meaning of sections 112 (a), (b)(2), and (b)(3) of the Code which read as follows:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) GENERAL RULE.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) EXCHANGES SOLELY IN KIND.—

* * * * * * *

(2) STOCK FOR STOCK OF SAME CORPORATION.—No gain or loss shall be recognized 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.

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a 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.

On the basis of the foregoing it is held that the reclassification of the existing classes of special stock pursuant to the plan described will constitute a reorganization within the meaning of section 112(g) of the Code. Accordingly, under the provisions of section 112(b)(3) of the Code, no taxable gain or deductible loss will be recognized to a holder of special stock as the result of the exchange by him, pursuant to the plan, of such stock for the new reclassified stock, except that gain will be recognized in an amount not in excess of cash received in lieu of fractional shares.

With respect to the rights granted under the plan of reorganization to convert new stock into either of the other series of new stock within 90 days after the effective date of the recapitalization it is held that such exchanges will not qualify for tax-free treatment under section 112(b)(3) of the Code. Section 39.112(g)-1 of Regulations 118 provides in part that a plan of reorganization must contemplate a transaction specifically described as a reorganization in section 112(g) to claim nonrecognition under section 112(b)(3). In the instant case the conversion privilege granted to holders of new stock to exchange such stock for other stock of a different series within a limited time after the effective date of the plan does not appear to be an essential part of the plan of reorganization but rather an independent transaction whereby the stockholders are given the election to exchange their holdings for others of their choice. In this connection see *ACF-Brill Motors Co.* v. *Commissioner*, 14 T. C. 263, affirmed 189 Fed. (2) 704, certiorari denied, 342 U. S. 886, and *American Bantam Car Co.* v. *Commissioner*, 11 T. C. 397, affirmed, 177 Fed. (2d) 513, certiorari denied, 339 U. S. 920.

It is held further that the exchange of the new stock in the instant case for new stock of another series does not meet the requirements of section 112(b)(2) of the Code. The right of conversion granted by the plan of reorganization is not the right to convert the stock held, share for share, for stock of another series, but only the right to obtain the number of shares of another series equal in value to the market value of the shares to be exchanged. Moreover, the exception to recognition of gain or loss provided by section 112(b)(2) of the Code is applicable only when common or preferred stock is exchanged for like stock in the same corporation.

The special stock in the instant case, both before and after the recapitalization is not common stock since the holders thereof do not share ratably either in the earnings of the corporation or in its assets on liquidation, it being specifically provided that the holders of shares of any designated series have no interest in the assets or income of any other series. Furthermore, the certificate of incorporation provides for the issuance of common stock, which stock has the normal characteristics of common stock and is entirely separate and distinct from any of the classes of special stock therein considered. Neither is the special stock a preferred stock since the holders thereof are not preferred as to dividends out of the entire earnings of the corporation and are restricted to the earnings of the segregated assets representing his particular class of special stock. Likewise the holder of special stock has no preference in the general assets of the corporation on liquidation, excepting the right to share ratably with other members of his class in the segregated assets representing that particular class of special stock. Consequently an exchange of special stock for special stock of a different series represents a taxable exchange of property, the gain or loss from which would not be precluded from recognition for Federal income tax purposes by section 112(b)(2) of the Internal Revenue Code.

REGULATIONS 118, SECTION 39.112(b)(5)-1: Transfer of property to corporation controlled by transferor.

Transfer of property to a corporation controlled by transferor as the first step in the execution of a transaction in which the transferor loses control of such a corporation. (See Rev. Rul. 54-96, p. 111.)

REGULATIONS 118, SECTION 39.112(b)(6)-3: Liquidations covering more than one taxable year.

Regulations 118 amended. (See T. D. 6059, p. 80.)

REGULATIONS 118, SECTION 39.112(b)(7)-4: Treatment of gain. Rev. Rul. 54-244

The taxpayer has obtained the majority of the capital stock of a growers' marketing cooperative association which was incorporated in the State in which it operates and which has been held to be exempt for Federal income tax purposes under the provisions of section 101(12) of the Internal Revenue Code. The taxpayer proposes to liquidate the corporation. The books of the association show no earned surplus but there is capital stock outstanding which was issued to growers pursuant to a revolving fund agreement. In accordance with such agreement the association each year retained portions of amounts due growers for crops and issued stock therefor having par value equal to the retained portion. The association then used such retentions in its business. Growers have reported the face amount of the stock received as part of income from crops each year. *Held*, that the value of the above-described stock does not represent earnings and profits of the association within the meaning of section 112(b)(7)(E) of the Code.

REGULATIONS 117, SECTION 39.112(b)(11)-2: Limitations upon the application of section 112(b)(11).

No gain or loss will be recognized to either corporation a party to a reorganization or to their shareholders. (See Rev. Rul. 54-139, p. 105.)

SECTION 112(f).—RECOGNITION OF GAIN OR LOSS: INVOLUNTARY CONVERSION

REGULATIONS 118, SECTION 39.112(f)-1: Involuntary conversion where disposition of the converted property occurred after December 31, 1950.

Regulations 118 amended. (See T. D. 6059, p. 80.)

SECTION 112(g).—RECOGNITION OF GAIN OR LOSS: DEFINITION OF REORGANIZATION

Regulations 118, Section 39.112(g)-1: Purpose and scope of exception of reorganization exchanges.
(Also Section 112(b), Section 39.112(b)(11)-2; Section 113(a), Sections 39.113(a)(7)-1, 39.113(a)(23)-1; Section 115(a), Section 39.115(a)-3.)

Rev. Rul. 54-139

M Corporation has outstanding 2,500 shares of common stock, all of which is owned by one stockholder. It is engaged in two diverse fields of manufacturing endeavor which the corporation feels should be separated in order to insulate each endeavor from the liabilities of the other. M Corporation proposes to organize a new corporation and transfer to it all of the assets used in one line of endeavor, subject to certain liabilities, in exchange for all of the new corporation's stock. Such stock will be distributed to the sole stockholder of M Corporation, who has no present intention of liquidating either corporation or disposing of its stock. *Held*, such transfer and exchange will constitute a reorganization within the meaning of section 112(g)(1)(D) of the Internal Revenue Code.

Advice is requested with respect to the tax consequences for Federal income tax purposes of a proposed "spin-off" reorganization hereinafter described.

M Corporation has outstanding 2,500 shares of common stock, all of which is owned by one stockholder. It is engaged in two diverse fields of endeavor, each of which is operated as a branch of the corporation. One branch manufactures specially designed electronic products for the United States Government; the other branch manufactures and sells air conditioners. The air conditioner branch has a separate sales force and separate production workers. M Corporation feels that the two branches should be separated in order to insulate each from the liabilities of the other. The electronics branch is volatile in nature and depends upon Government contracts, economic conditions, and changes in world affairs. The air conditioner branch is subject to litigation involving claims of patent infringement.

M Corporation proposes to organize a new corporation and transfer to it the assets of one of the branches in exchange for all the capital stock (consisting solely of common stock) of the new corporation. Such stock will then be distributed to the sole stockholder of M Corporation without the surrender by him of any of his stock in the latter corporation. The sole stockholder has no present intention of selling or otherwise disposing of any of the stock of either corporation or of liquidating either corporation.

Both corporations will continue to operate as separate entities, and in general they will have separate personnel and facilities. However, M Corporation will continue to manufacture a small proportion of the parts used by the new corporation, and in the event of common use of facilities and employees the costs and salaries will be allocated between the two corporations on an equitable basis. Any sales by M Corporation to the new corporation will be effected at fair market prices.

Section 112 of the Internal Revenue Code provides in part as follows:

(g) DEFINITION OF REORGANIZATION.—As used in this section * * *

(1) The term "reorganization" means * * * (D) 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 shareholders or both are in control of the corporation to which the assets are transferred * * *

Section 39.112(g)-1 of Regulations 118 provides in part that the purpose of the reorganization provisions of the Internal Revenue Code is to except from the general rule with respect to the recognition of gain or loss certain specifically described exchanges incident to readjustment of corporate structures as are required by business exigencies and which effect only a readjustment of continuing interests in property under modified corporate forms. Requisite to a reorganization under the Code are a continuity of the business enterprise under the modified corporate form, and a continuity of interest therein on the part of those persons who were the owners of the enterprise prior to the reorganization.

It is held that the transfer by M Corporation of the assets of one of its branches, subject to liabilities pertaining to that branch, to the new corporation in exchange solely for all of the stock of the latter will constitute a reorganization under section 112(g)(1)(D) of the Internal Revenue Code. No gain or loss will be recognized to either corporation as a result of the reorganization; and no gain or loss will be recognized as a result of the receipt by the sole shareholder of the stock of the new corporation. The basis of the assets acquired by the new corporation will be the same as the cost or other basis in the hands of M Corporation; and the cost or other basis to the sole shareholder of the stock of M Corporation will be allocated between the stock of M Corporation and the stock of the new corporation acquired as a result of the transaction. A proportionate part of the accumulated earnings and profits of M Corporation will be allocable to the new corporation. See Revenue Ruling 270, C. B. 1953-2, 35.

REGULATIONS 118, SECTION 39.112(g)-1: Purpose and scope of exception of reorganization exchanges. Rev. Rul. 54-193

(Also Section 112(b); Section 113(a), Section 39.113(a)(6)-1; Section 115(a), Section 39.115(a)-3.)

The M Association, for bona fide business reasons, proposes to convert itself from a Federal savings and loan association into a building and loan association under the laws of California pursuant to the provisions of the Building and Loan Association Act, as amended, Chapter 269, Statutes of California, and section 5(i) of the Home Owners' Loan Act of 1933, as amended, 48 Stat. 128. *Held*, the conversion of M Association into a State association will constitute a nontaxable reorganization within the purview of section 112(g)(1)(F) of the Internal Revenue Code.

Advice is requested with respect to the tax consequences, for Federal income tax purposes, of a proposed reorganization hereinafter described.

The M Association, a Federal savings and loan association, chartered pursuant to the Home Owners' Loan Act of 1933, as amended, 48 Stat. 128, desires to convert itself into a building and loan association under the laws of California, pursuant to the provisions of section 12.12 of the Building and Loan Association Act, Chapter 269, Statutes of California, 1931, as added by Chapter 527, Statutes of California, 1939, and section 5(i) of the Home Owners' Loan Act of 1933, *supra*, as amended by Public Law 895, Eightieth Congress, second session, 62 Stat. 1239. The members of the association are those persons having money deposited (investor members) and persons who have borrowed money from it (borrower members). The interests of investor members are evidenced by investment share account certificates or by saving share account books (which will both be referred to herein as share accounts).

By vote of approximately 80 percent of all members of M Association entitled to vote, a plan of conversion into a State association has been adopted and duly approved by the Home Loan Bank Board, the Federal Saving and Loan Insurance Corporation, and the building and loan commissioner of California. This plan is, in substance, as follows: The M Association will issue to its members, in lieu of their present share accounts, withdrawable shares provided for by section 3.02 of the Building and Loan Association Act, in the same withdrawal value as their interests in the Federal association, and all borrower members of the Federal association will become borrower members of the State association. The amended charter will provide for additional capital secured by the sale, after the conversion to a State association, of guarantee capital stock, as authorized by section 4.01 of the Building and Loan Association Act. The withdrawable shares after conversion will continue to have voting rights, but the owners of guarantee capital stock will have sufficient voting right to elect a majority of the board of directors.

The guaranteed capital stock will be of par value of $100 per share and offered at $110 per share, subject to the following preemptive rights of owners of share accounts:

(*a*) For a period of 60 days after notice, each of the owners of share accounts who were such owners of record on the day the permit to convert is applied for shall be entitled to subscribe at $110 per share to any number of shares of the guarantee stock.

(*b*) Stock purchase warrants are to be issued to share account holders for use in the event of an oversubscription for the guarantee capital stock, but not otherwise. Each share account holder will receive warrants for the purchase of guarantee stock of a par value equal to 2 percent of the withdrawal value of his share account with fractional warrants issued down to $\frac{1}{100}$ of a share. However, on subscription, only full shares of guarantee capital stock can be purchased. These warrants are assignable without restriction during the 60-day period open for preemptive subscription by share account holders. Thereafter, the warrants may be sold only to share account holders who have subscribed for the guarantee stock. Subscriptions based upon warrants must be at $110 per share.

(*c*) Guaranteed shares not allocable pursuant to warrants will be allocated to subscribing share account holders in the ratios of the values of their share accounts to the share accounts of other subscribing share account holders, adjusting for subscription warrants which these subscribing share account holders have received.

(*d*) If there is an under subscription to the guarantee stock by the share account holders at the end of the 60-day period allowed them for preemptive action, then the unsubscribed-for stock may be sold as the directors of the converted association may direct, but at $110 per share.

After the sale of guarantee stock has been completed, there will be issued to each share account holder a Certificate of Contingent Interest in Conversion Surplus. These certificates will be issued in the amounts of each share account holder's pro rata share in the accumulated surplus of the association at the date of conversion to a State association. The certificate holders will have a right to have this surplus set apart as a special reserve, usable by the association but not distributable to shareholders until after 15 years from the date of the conversion to a State association. If at any time during this 15-year period the association is liquidated, or its assets are sold in bulk, then each certificate holder who is at such time a holder of withdrawable shares in the association shall be entitled to receive, in addition to his withdrawable share in the funds of the association, that part of the conversion surplus reserve represented by his certificate of contingent interest. These certificates are not assignable separately from the withdrawable shares in connection with which they are issued.

Section 5(i) of the Home Owners' Loan Act, *supra*, as amended, provides in part that a Federal savings and loan association may convert itself into a State-chartered institution upon an equitable basis, subject to approval by regulations, or otherwise, by the Home Loan Bank Board and by the Federal Savings and Loan Insurance Corporation. Section 12.12 of the Building and Loan Association Act, *supra*, as amended, provides in part that any Federal savings and loan association may convert itself into a building and loan association under the laws of California upon a vote of 51 percent or more of the votes of members of such Federal savings and loan association cast at any regular or special meeting called to consider such action.

Section 12.12 of the Building and Loan Association Act, *supra*, as amended, further provides that the conversion to a State association becomes effective upon the taking out of a charter under such act and giving the requisite notices. Thereafter, the association ceases to be a Federal savings and loan association and ownership of all of its properties vests by operation of law in the State association without any transfer of title or other conveyance. It is expressly declared in such section that the State building and loan association shall be merely a continuation of the Federal savings and loan association under a new name and a new jurisdiction.

Section 112(g) of the Internal Revenue Code provides in part as follows:

> (g) DEFINITION OF REORGANIZATION.—As used in this section * * *
> (1) The term "reorganization" means * * * (F) a mere change in identity, form, or place of organization, however effected.

In the instant case the conversion of the M Association into a State association meets the requisites of a nontaxable reorganization within the meaning of section 112(g)(1)(F) of the Code, and will result in no gain or loss to either association. Cf. G. C. M. 24423, C. B. 1945, 145. The assets will have the same basis in the hands of the State association as in the hands of the Federal association.

No gain or loss will be realized by the investor members of the Federal association upon the issuance to them of the withdrawable shares of the State association, together with the certificates of contingent interest in the conversion surplus of the association. In cases where subscription rights are not exercised or sold, the basis of the withdrawable shares in the State association and the certificates in conversion surplus will be the same as the cost or other of the share accounts converted. In cases where subscription rights or warrants are exercised or sold, the cost or other basis of the share accounts converted will be apportioned between (1) the withdrawable shares in the State association and the certificates in conversion surplus (they being not assignable separately), and (2) the subscription rights or warrants which are exercised or sold, in proportion to the respective values thereof at the time the rights or warrants are issued. No gain or loss will be realized by the investor members of the Federal association upon receipt of the subscription rights or warrants to purchase guarantee capital stock of the State association, at the time the warrants become operative, or at the time the subscription rights or warrants are exercised. The basis of the guarantee stock purchased by an investor will be measured by the subscription price thereof plus the basis of the share accounts of the Federal association which is apportionable to the subscription rights or warrants exercised. The investor members of the Federal association who purchase subscription rights or warrants will realize no gain or loss upon receipt of such rights or warrants or upon the exercise of such rights or warrants. The earnings or profits of the Federal association at the conversion date will become earnings or profits of the State association available for dividends.

REGULATIONS 118, SECTION 39.112(g)-1: Purpose and scope of exception of reorganization exchanges.

Exchange of special stock in a regulated investment company for special stock in another series issued by the same company. (See Rev. Rul. 54-65, p. 101.)

REGULATIONS 118, SECTION 39.112(g)-2: Definition of terms. Rev. Rul. 54-13

(Also Section 112(b)(3), Section 39.112(b)(3)-(5); Section 113(a)(6), Section 39.113(a)-(6)-1.)

The rearrangement of the capital structure of M Corporation in order to increase the common stock interest of one of its younger executives, in accordance with a proposed plan of reorganization under which the corporation will issue new second preferred stock in exchange for common stock held by a certain group of present shareholders, will constitute a "recapitalization" and, therefore, a reorganization within the meaning of section 112(g)(1)(E) of the Internal Revenue Code.

Advice is requested relative to the treatment for Federal income tax purposes of a proposed reorganization of the M Corporation.

The M Corporation manufactures women's highly styled shoes. The capital stock of the M Corporation consists of $100 par value 4 percent nonvoting cumulative preferred stock, and $100 par value common stock. A owns approximately 30 percent of each class of stock. B owns approximately 56 percent of each class of stock and three members of B's family who are not active in the management of the corporation own an additional 14 percent of the stock. B is 65 and A is 47 years old.

A and B have both been with the company since its incorporation. The operation of the corporation requires considerable management skill and ability, and the growth of the corporation is due largely to A's efforts and abilities. A's abilities and continued interest are considered necessary to the future success of the company. A is dissatisfied with the fact that his common stock equity in the corporation is less than B's notwithstanding that he makes at least as great a contribution to the success of the company. In view of the fact that the company desires to retain A's services and the fact that the present arrangement is not conducive to maximum effort on A's part or to his continuing with the company, it is proposed to increase A's common stock interest in the corporation to 40 percent at this time. (The stockholders have also agreed that after B's death A's common stock interest will be increased to 50 percent through a rearrangement of the capital stock at such time.) In order to rearrange the capital structure of the corporation to effect an increase of A's common stock interest to approximately 40 percent at this time, the following transaction is proposed:

(1) The corporation will amend its charter to authorize the issue of a number of shares of a new 4 percent cumulative second preferred stock having a par value of $100. The preferred stock presently authorized will be designated as "first preferred stock." The second preferred stock will be entitled to cumulative dividends of 4 percent per annum and will be callable at, and entitled in liquidation to, par value plus accrued dividends. The second preferred stock will be subordinate to the first preferred stock but preferred over the common stock as to dividends and assets in liquidation.

(2) The corporation will issue the new second preferred stock to the other four stockholders (in proportion to the common stock held by each) in exchange for a sufficient number of their shares of common stock to effect an increase in A's common stock interest to 40 percent of the common stock outstanding after the exchange. The exchange will be made on the basis of one share of second preferred stock for an amount of common stock representing $100 of book value on the date the plan is made effective. No change will be made in the number of shares of stock held by A.

(3) The corporation will transfer from its earned surplus account to its capital stock account an amount sufficient to reflect the increase in the par value of its outstanding stock resulting from the exchange.

Section 112(g) (1) of the Internal Revenue Code provides in part as follows:

(g) DEFINITION OF REORGANIZATION.—As used in this section * * *
(1) The term "reorganization" means * * * (E) a recapitalization * * *.

Section 39.112(g)-1 of Regulations 118 provides in part that the purpose of the reorganization provisions of the Internal Revenue Code is to except from the general rule certain specifically described exchanges incident to readjustment of corporate structures which effect only a readjustment of continuing interests in property under modified corporate forms. Requisite to a reorganization under the

Code are a continuity of the business enterprise under the modified corporate form, and a continuity of interest therein on the part of those persons who were the owners of the enterprise prior to the reorganization.

It is held that issuance by the M Corporation of the newly authorized second preferred stock in exchange for part of its common stock will constitute a reorganization under section 112(g)(1)(E) of the Code. No gain or loss will be recognized to the stockholders as a result of the receipt by them of the second preferred stock in exchange for a portion of their common stock (sec. 112(b)(3) of the Code); also, no gain will be recognized to A. The basis to the recipients of the new second preferred stock will be the same as the cost or other basis of the common stock exchanged therefor (sec. 113(a)(6) of the Code). The reorganization will not diminish the accumulated earnings and profits of the corporation available for dividends within the meaning of section 115(a) of the Code.

This ruling shall not be considered as in any way affecting the possible application of section 102 of the Code. Furthermore, opinion is reserved whether the proposed transaction will constitute a gift from the other stockholders to A or from A to the other stockholders or the payment of compensation to any of the stockholders of the Corporation in the event it is ultimately determined that on the date that the exchange is consummated there is a disparity in value between the stock surrendered and the stock received in exchange therefor. Opinion is also reserved on the treatment for Federal income tax purposes of any sale or transfer (other than by bona fide hypothecation) by a shareholder of all or any part of the new second preferred stock issued by the company, or of a redemption of such stock in the hands of either the original holder or a purchaser or transferee thereof.

REGULATIONS 118, SECTION 39.112(g)-2: Definition of terms. Rev. Rul. 54-96
(Also Section 112(b), Section 39.112(b)(5)-1.)

A series of prearranged and integrated steps by which a corporation transfers part of its assets to a new corporation in exchange for all the stock of the new corporation and then transfers such stock to an unrelated corporation for 20 percent of the voting stock of such corporation is treated, for Federal income tax purposes, as a single transaction, and does not constitute a nontaxable reorganization as defined in section 112(g)(1)(D) of the Internal Revenue Code or a nontaxable transfer under section 112(b)(5) of the Code.

Advice is requested whether the transaction described below constitutes either a nontaxable reorganization under section 112(g)(1)(D) of the Internal Revenue Code or a tax-free exchange under section 112(b)(5).

X Corporation was engaged in two separate businesses. In 1951 X Corporation organized a new corporation, the Y Corporation, and transferred to it all the assets pertaining to one of such businesses (subject to applicable liabilities) in exchange for all of the stock of Y. X thereupon, and as a part of a prearranged plan, transferred all of the stock of Y to the Z Corporation, an unrelated corporation that has been engaged in business for many years, in exchange for which Z issued to X 20 percent of Z's voting stock.

Section 112(g)(1)(D) of the Internal Revenue Code provides that the term "reorganization" includes 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 shareholders or both are in control of the corporation to which the assets are transferred. Section 112(b)(5) provides in part that 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. Section 112(h) defines the term "control" to mean the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

The two steps of the transaction described above were part of a prearranged integrated plan, and may not be considered independently of each other for Federal income tax purposes. See *Helvering* v. *Bashford*, 302 U. S. 454, Ct. D. 1299, C. B. 1938-1, 286; *Minnesota Tea Co.* v. *Helvering*, 302 U. S. 609, Ct. D. 1305, C. B. 1938-1, 288; and *Bassick* v. *Commissioner*, 85 F. (2d) 8 (2nd Cir. 1936), cert. den. 299 U. S. 592.

Since as a result of the whole transaction the X Corporation was not in control of the Y Corporation after transferring a part of its assets to that corporation, the transaction did not constitute a reorganization as defined in section 112(g)(1)(D), nor did it constitute a tax-free transfer under section 112(b)(5). Similarly, section 112(g)(1)(B) is not applicable, for in net effect X transferred part of its assets to Z in exchange for a part of the Z stock, rather than all the stock of a previously existing corporation. It is immaterial whether the transaction is treated as consisting of two taxable steps (a taxable exchange by X of part of its assets for the stock of Y followed by a taxable exchange by X of Y stock for Z stock) or whether it is treated as a single taxable transaction (in substance a taxable transfer by X of part of its assets to Z in exchange for 20 percent of Z's stock, followed by a nontaxable transfer by Z of the newly acquired assets to Y in exchange for Y's stock). In either case the X Corporation has realized a gain or loss measured by the difference between the fair market value of the Z stock received by it and the basis in its hands of the assets transferred. The basis of the stock of Z in the hands of X will be equal to the fair market value of said stock at the time it is received. The basis of the stock of Y in the hands of Z will be its fair market value at the time it is received by Z. The basis to Y Corporation of the assets received by Y will be their fair market value at the time of receipt.

SECTION 112(n).—RECOGNITION OF GAIN OR LOSS: GAIN FROM SALE OR EXCHANGE OF RESIDENCE

Regulations 118, Section 39.112(n)-1: Gain from sale or exchange of residence. Rev. Rul. 54-156

Where a taxpayer sells the land on which his principal residence is located, and within the period beginning 1 year prior to the date of the sale and ending 1 year after such date he purchases another lot and moves the old house to the new lot and uses it as his principal residence, the provisions of section 112(n) of the Internal Revenue Code, relating to the nonrecognition of gain from the sale or exchange by a taxpayer of his principal residence, are applicable to the sale of the land. The gain realized from such sale will be recognized only to the extent that the selling price of the land exceeds the cost of purchasing the new lot, plus the cost of moving the house, the construction of necessary foundation supports, plumbing and electrical installations, as well as the cost of other improvements at the new location made within the period beginning 1 year prior to the date of sale and ending 1 year after such date.

SECTION 113.—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS

REGULATIONS 118, SECTION 39.113(a)-2: General rule.

Basis of time payment installment accounts receivable. (See Rev. Rul. 54-43, p. 119.)

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

REGULATIONS 118, SECTION 39.113(a)(5)-1: Basis of property acquired by bequest, devise, or inheritance.

Rev. Rul. 54-97

For the purpose of determining the basis under section 113(a)(5) of the Internal Revenue Code of property transmitted at death (for determining gain or loss on the sale thereof or the deduction for depreciation), the value of the property as determined for the purpose of the Federal estate tax shall be deemed to be its fair market value at the time of acquisition. Except where the taxpayer is estopped by his previous actions or statements, such value is not conclusive but is a presumptive value which may be rebutted by clear and convincing evidence. *Cf.* Rev. Rul. 54-10, p. 24.

REGULATIONS 118, SECTION 39.113(a)(5)-1: Basis of property acquired by request, devise, or inheritance.

Basis of an annuity provided by an election of a member of the uniformed services under the Uniformed Services Contingency Option Act of 1953. (See Rev. Rul. 54-144, p. 15.)

REGULATIONS 118, SECTION 39.113(a)(6)-1: Property acquired upon a tax-free exchange.

Withdrawable shares of a State building and loan association received in exchange for withdrawable shares in a Federal savings and loan association pursuant to a tax-free reorganization of the association. (See Rev. Rul. 54-193, p. 106.)

REGULATIONS 118, SECTION 39.113(a)(7)-1: Property acquired by corporation in reorganization after December 31, 1917.

Basis of assets acquired by new corporation in a reorganization under section 112(g)(1)(D) of the Internal Revenue Code. (See Rev. Rul. 54-139, p. 105.)

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION

REGULATION 118, SECTION 39.114-1: Basis for allowance of depreciation and depletion.

Meaning of the term "ordinary treatment processes" in the manufacture of brick from shale and brick and tile clay. (See Rev. Rul. 54-109, p. 62.)

SECTION 115.—DISTRIBUTIONS BY CORPORATIONS

REGULATIONS 118, SECTION 39.115(c)-1 AND 39.115(i): Distributions in liquidations.

Rev. Rul. 54-230

The redemption of capital stock of a corporation pursuant to an agreement with its stockholders whereby the proceeds of certain insurance policies purchased by the corporation on the life of each stockholder will be used by the corporation to redeem the capital stock held by the estate of the stockholder, in case of death, will constitute a partial liquidation within the meaning of section 115 (c) and (i) of the Internal Revenue Code. The amount received by the estate upon surrender of the capital stock will be treated as in payment in exchange for the stock as provided by section 115(c) and gain or loss will be determined under section 111, subject to the provisions of section 117 of the Code. The excess of the insurance proceeds received by the corporation over the aggregate sum of the premiums paid will constitute earnings and profits of the corporation available for distribution within the meaning of section 115 (a) and (b) of the Code.

Advice is requested with regard to the effect, for Federal income tax purposes, of a proposed redemption by a corporation of that portion of its capital stock held by the estate of a deceased stockholder.

At the time of death the decedent owned 4,420 shares of stock of the corporation. In addition to the stock now held in the decedent's estate, each of the five brothers of the decedent owns 4,420 shares of stock of the corporation, and the remaining 7,530 shares of the corporation are owned by X Corporation. Each of the five brothers owns

16⅔ percent of the stock in X Corporation and the remaining 16⅔ percent is owned by the estate of the decedent.

The corporation had entered into an agreement with its stockholders for the acquisition of that portion of its capital stock held by a deceased stockholder at time of death. Pursuant to the agreement each stockholder agrees to sell and the corporation agrees to purchase as much of its capital stock belonging to a deceased stockholder as the proceeds of the insurance policies purchased by the corporation on the life of such stockholder, together with accrued dividends and unearned premiums, will purchase at the price per share fixed by the agreement.

The capital stock held directly and indirectly by the estate of the deceased stockholder represents approximately 15 percent of the total outstanding capital stock of the corporation; therefore, the redemption does not involve a majority stockholder.

Section 115 of the Internal Revenue Code provides in part as follows:

(a) DEFINITION OF DIVIDEND.—The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year * * * without regard to the amount of the earnings and profits at the time the distribution was made. * * *

(b) SOURCE OF DISTRIBUTIONS.—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

(c) DISTRIBUTIONS IN LIQUIDATION.—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 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed * * * in partial liquidation * * * the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits.

* * * * * * *

(i) DEFINITION OF PARTIAL LIQUIDATION.—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

Accordingly, it is held (1) that the proposed redemption of that portion of the capital stock of the corporation held by the estate of the deceased stockholder, pursuant to the agreement whereby the proceeds of certain insurance policies on his life will be used by the corporation to redeem the capital stock held by his estate, in case of death, will constitute a partial liquidation within the meaning of section 115 (c) and (i) of the Internal Revenue Code; (2) that the total amount received by the estate upon surrender of the capital stock will be treated, for Federal income tax purposes, as in payment in exchange for the stock as provided in section 115(c) and gain or loss will be determined under section 111 of the Code subject to the provisions of section 117 of the Code; and (3) that the excess of the insurance proceeds received by the corporation over the aggregate sum of the premiums paid will constitute earnings and profits available for distribution within the meaning of section 115 (a) and (b) of the Code.

SECTION 115(a).—DISTRIBUTIONS BY CORPORATIONS: DEFINITION OF DIVIDEND

REGULATIONS 118, SECTION 39.115(a)-1: Dividends. Rev. Rul. 54-140

The distribution by a national bank of the stock of a wholly-owned subsidiary corporation to a trust created for the purpose of holding the stock for the pro rata benefit of shareholders of the bank with control vested in the majority of such shareholders constitutes a taxable dividend within the meaning of section 115(a) of the Internal Revenue Code to the extent of earnings and profits of the bank available for dividends even though the disposition of the stock is tied to existing stock ownership in the bank.

Advice is requested as to the effect for Federal income tax purposes of a distribution by a taxpayer corporation of the entire capital stock of a wholly-owned subsidiary to a trust for the benefit of the corporation's stockholders under the circumstances set forth below.

The taxpayer corporation is a national bank which was organized under the national banking laws. It has for many years owned all the stock of a subsidiary corporation whose assets consist primarily of cash and real estate and whose activities consist of dealings in various properties and transactions which are not permitted to the bank.

Because of changes in the National Banking Act and the rulings and requirements of the Comptroller of the Currency whereby national banks are restricted in regard to the extent and manner in which they may deal in investment securities, and the acquisition of stock in other corporations for their own accounts, it became necessary for the taxpayer bank to eliminate the stock of the subsidiary from its assets. The bank accomplished this by distributing the stock to a trust which was organized to hold the stock for the pro rata benefit of the stockholders of the bank.

The trust agreement provides that the trustees shall exercise all rights and privileges of absolute owners of the stock including, but not limited to, the right to vote the stock for any purpose whatsoever, to receive all dividends, to sell or transfer the stock, provided that any action so taken shall be first authorized by beneficiaries owning at least a majority of the beneficial interest in the assets of the trust.

No papers were distributed to the stockholders of the bank evidencing their beneficial interest in the stock of the subsidiary, therefore, they received nothing they can dispose of separately from the bank stock. Under the arrangement, the stock of the bank and the beneficial interest in stock of the subsidiary may not be transferred separately. If and when any shares of stock of the bank are transferred, the pro rata interest of the stockholders of the bank in the stock of the subsidiary to the extent of the shares so transferred will automatically be transferred along with the transfer of the bank's stock without the execution of any separate papers. No notation appears on the bank stock certificates evidencing the beneficial interest in the stock of the subsidiary.

Inasmuch as the trust agreement provides that no action may be taken by the trustees without the consent of a majority of the holders of the beneficial interests, ownership of the stock of the subsidiary was in effect transferred from the bank to the bank's stockholders, who thereby became free to control such stock without fear of inter-position of the bank's creditors, depositors, and other third parties.

Section 115(a) of the Internal Revenue Code provides in part as follows:

> * * * The term "dividend" when used in this chapter [ch. 1] * * * means any distribution made by a corporation to its shareholders, whether in money or other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of earnings and profits at the time the distribution was made. * * *

The bank in the instant case did not undergo a reorganization. It already owned the stock of the subsidiary. By the transaction here considered this stock was severed from the assets of the bank and the beneficial interest thereof passed to the bank's shareholders. The result of such transaction is not different from what it would be if the stock of the subsidiary had been distributed directly to the shareholders of the bank and they in turn placed it in a trust for their benefit. The fact that the stock of the subsidiary is tied up with the bank stock so that nothing may be received by the shareholders of the bank which can be disposed of separately from the bank stock does not serve to render the transaction nontaxable.

In view of the foregoing, it is held that the distribution of the stock of the subsidiary to the trust for the benefit of the shareholders of the bank, measured by the fair market value of the stock at the time of the distribution, represents a taxable dividend to the shareholders of the bank within the meaning of section 115(a) of the Internal Revenue Code, limited, however, to the earnings and profits of the bank available for dividends.

Regulations 118, Section 39.115(a)-3: Effect on earnings or profits of certain tax-free exchanges and tax-free distributions.

Proportionate part of the undistributed earnings and profits of M Corporation will be allocable to the new corporation. (See Rev. Rul. 54-139, p. 105.)

Regulations 118, Section 39.115(a)-3: Effect on earnings or profits of certain tax-free exchanges and tax-free distributions.

The earnings and profits of the Federal savings and loan association converted into a State building and loan association. (See Rev. Rul. 54-193, p. 106.)

SECTION 116.—EXCLUSIONS FROM GROSS INCOME

Regulations 118, Section 39.116-1: Earned income from sources without the United States.

Rev. Rul. 54-72

Where a taxpayer meets the requirements of section 116(a)(2) of the Internal Revenue Code regarding presence in a foreign country or countries during at least 510 full days during any period of 18 consecutive months, but receives compensation attributable to such period in a taxable year ending subsequent to December 31, 1952, no portion of which falls within the 18 month period, no portion of such compensation received in such taxable year is excludable from his gross income.

Advice is requested as to the application of section 116(a)(2) of the Internal Revenue Code (as amended by sec. 204 of the Technical Changes Act of 1953, Public Law 287, 83d Cong., C. B. 1953–2, 485) and Regulations 118 as amended by Treasury Decision 6039, C. B. 1953–2, 162, with respect to amounts received after December 31, 1952, attributable to earned income from sources outside the United States under the following circumstances:

Taxpayer worked abroad and met the requirements of section 116(a)(2) of the Internal Revenue Code regarding presence in a foreign country or countries during at least 510 full days during a period of 18 consecutive months. He returned to the United States at the end of 1952. In his taxable year 1953, no part of which fell within the 18 month period, he received compensation attributable to such period in the amount of $10,000.

Section 39.116-1(b) of Regulations 118, as amended by T. D. 6039, *supra*, which is applicable to amounts constituting earned income as defined by section 116(a)(3) of the Code, from sources outside the United States, provides in part as follows:

(1) Amounts constituting earned income as defined in section 116(a)(3) shall be excluded from gross income in the case of an individual citizen of the United States who during any period of 18 consecutive months is present in a foreign country or countries during a total of at least 510 full days, if such amounts are (i) from sources without the United States, (ii) attributable to such period, and (iii) not paid by the United States or any agency or instrumentality thereof. If attributable to a period of 18 consecutive months in respect of which the citizen qualifies for the exemption from tax thus provided, the amounts shall be excluded from gross income irrespective of when they are received.

(2) For taxable years ending before January 1, 1953, there is no limitation upon the amount which may be excluded from gross income pursuant to subparagraph (1). For taxable years ending after December 31, 1952, but only with respect to amounts received after such date, the amount excluded from gross income under the provisions of section 116(a)(2) shall not exceed $20,000 if the 18 month period includes the entire taxable year. If the 18-month period does not include the entire taxable year, the amount excluded from gross income under such section for such taxable year shall not exceed an amount which bears the same ratio to $20,000 as the number of days in the part of the taxable year within the 18-month period bears to the total number of days in such year * * *

Subparagraph (1) quoted above is subject to the limitation set forth in subparagraph (2).

To illustrate the application of this point to the facts in the instant case, subparagraph (1) of the regulations quoted above, standing alone, indicates that the $10,000 would be excluded from gross income since it is earned income from sources outside the United States and is attributable to a period of 18 consecutive months during which the taxpayer was present in a foreign country for at least 510 full days. However, since no part of the taxable year in which the $10,000 was received falls within the 18-month qualifying period, the application of the limitation set forth in subparagraph (2) results in a figure of zero and no portion of the $10,000 received in 1953, even though attributable to the qualifying period, is excludable from gross income.

The formula for such computation may be stated as follows, but refers only to taxable years ending after December 31, 1952, and only with respect to amounts received after such date:

$$\frac{\text{Number of days in that part of the taxable year of receipt falling within the 18-month period}}{\text{Number of days in the taxable year of receipt}} \times \$20{,}000 = \text{Maximum amount excludable.}$$

Application of the above formula to the facts in this case is illustrated as follows:

$$\frac{0}{365} \times \$20{,}000 = \text{Zero} = \text{Maximum amount excludable.}$$

In view of the foregoing, it is held that where a taxpayer meets the requirements of section 116(a)(2) of the Internal Revenue Code regarding presence in a foreign country or countries during at least 510 full days during any period of 18 consecutive months, but receives compensation attributable to such period in a taxable year ending subsequent to December 31, 1952, no portion of which falls within the 18-month period, no portion of such compensation received in such taxable year is excludable from his gross income.

REGULATIONS 118, SECTION 39.116-1: Earned income from sources without the United States.

Gain on sale of personal property in a foreign country by a United States citizens living abroad. (See Rev. Rul. 54-105, p. 12.)

SECTION 117(a).—CAPITAL GAINS AND LOSSES: DEFINITIONS

REGULATIONS 118, SECTION 39.117(a)-1: Meaning of terms. Rev. Rul. 54-43

(Also Section 23(a), Section 39.23(a)-1; Section 23(b), Section 39.23(b)-1; Section 23(f), Section 39.23(f)-1; Section 113(a), Section 39.113(a)-2.)

Transactions by a merchant under a certain "commitment agreement" with several banks, whereby it "sells" to them at the end of each monthly period at a "discount" its installment accounts receivable arising out of current sales of merchandise, instead of holding the accounts for collection for itself, constitute actual sales thereof and not loans thereon. The accounts so sold were property held by the merchant primarily for sale to customers in the ordinary course of its trade or business. Accordingly, losses from the sales are deductible by it in full.

Where the merchant, under its option in the "commitment agreement," repurchases defaulted accounts at their unpaid balances, they again become part of its installment accounts receivable and its basis of each account is its repurchase price.

In computing additions to the merchant's reserve for bad debts, any installment accounts receivable which have been, or forthwith are to be, sold under the "commitment agreement" shall not be considered.

"Commitment fees" incurred by the merchant under the "commitment agreement," being current charges by the banks for making business funds available to it on a standby basis and not for the use of funds, do not represent interest incurred but are deductible by it as ordinary and necessary business expenses.

Advice is requested relative to the Federal income tax consequences to a merchant of its transactions, under a "commitment agreement" with several banks, whereby it "sells" to them at the end of each monthly period at a "discount" its installment accounts receivable arising out of current sales of merchandise, instead of holding the accounts for collection for itself.

In the instant case, funds which the merchant had obtained from bank and other loans were insufficient to finance its rapidly increasing installment sales, and provisions of long-term loans outstanding prevented further borrowing. Therefore, it negotiated a "commitment agreement" with several banks, under which they agreed to "purchase," at the end of each monthly period for 5 years, its installment accounts receivable offered for sale to them thereunder arising out of current sales of merchandise, provided and to the extent their aggregate holdings thereof will not exceed certain amounts. The accounts are payable in monthly or other installments and mature not more than 24 months from the date of delivery of the merchandise, title to which does not pass to the customers until full payment of their installment obligations.

The "purchase price" to be paid by the banks for such accounts shall be equal to the aggregate amount owing thereon by the merchandise customers, less "discount" at a certain percent per annum. The banks will pay 85 percent (referred to as the "purchase percentage") of such purchase price to the merchant on each monthly "settlement date" and the balance of 15 percent (referred to as the "deferred payment") thereof upon completion of payments owed by the merchandise customers on the sold accounts. If the merchant does not offer for sale to the banks such installment accounts equal to their aforesaid "purchase commitments," it is required to pay to them quarterly a "commitment fee" computed at a certain fractional percent per annum on the average daily unused amount. The merchant may each month, on at least 30-days prior written notice to the banks, reduce their "purchase commitment."

As agent for the banks, though without any special charge therefor, the merchant will retain physical possession of the installment paper sold by it to them, receive payments thereon from the merchandise customers, and on each monthly settlement date pay any net amount due to the banks. All such paper, and records pertaining thereto, will be appropriately identified as property of the banks. In the event of defaults by merchandise customers in their accounts "owned" by the banks, the merchant "may, at its option", on each monthly settlement date, "repurchase" such defaulted paper at the amount owing thereon by the merchandise customers, whereupon the banks will "reassign" it to the merchant "without recourse." If the merchant does not exercise its option to repurchase such defaulted paper, the banks may forthwith cancel the entire "commitment agreement." The merchant, however, is not obligated to repurchase such defaulted paper, nor does it have full liability therefor as debtor, endorser, or guarantor, but has liability, in effect as guarantor, only to the extent of the "deferred payment" of 15 percent of the purchase price of the sold accounts which the banks are not required to pay until completion of installment payments owed thereon by the merchandise customers. The merchant keeps its books on the accrual method of accounting, and has not elected to return income from its installment payment merchandise sales on the installment basis. Under its method of accounting, it includes in its gross income, upon consummation of an installment payment sale of merchandise, the amount of the selling price thereof, and any carrying charges, covered by the installment obligation received. Deductions, from gross income, on account of bad debts, are accomplished by the merchant through a reserve for bad debts.

Upon the basis of the foregoing, it is held that the transactions by the instant merchant with the banks under their "commitment agreement," whereby it "sells" to them at the end of each monthly period at a "discount" its installment accounts receivable arising out of current sales of merchandise, instead of holding the accounts for collection for itself, constitute actual sales thereof and not loans thereon although entered into for financing purposes. This conclusion is supported by numerous decisions involving transactions under similar conditions and circumstances. See *Della Nickoll, et al.* v. *Commissioner*, Tax Court Memorandum Opinion entered September 11, 1951; *Thomas Goggin & Bro.* v. *Commissioner*, 45 B. T. A. 218; and decisions therein cited, including *Lucius H. Elmer* v. *Commissioner*, 65 Fed. (2d) 568, Ct. D. 759, C. B. XII-2, 172, and *Alworth-Washburn Co.* v. *Helvering*, 67 Fed. (2d) 694, Ct. D. 808, C. B. XIII-1, 208. *Cf. Fraser-Smith Co.* v. *Commissioner*, 14 T. C. 892; and I. T. 4072, C. B. 1952-1, 141. Such cases as *Brewster Shirt Corp.* v. *Commissioner*, 159 Fed. (2d) 227, Ct. D. 1724, C. B. 1949-2, 80; *Central Station Signals, Inc.* v. *Commissioner*, 10 T. C. 1015, affirmed, 174 Fed. (2d) 479; and *Southeastern Finance Co.* v. *Commissioner*, 4 T. C. 1069, affirmed, 153 Fed. (2d) 205 are clearly distinguishable, since therein there was positive unlimited liability on the part of the transferors of the accounts to repurchase or pay them in the event of default.

It is further held that the accounts sold by the instant merchant to the banks, under their "commitment agreement" which it negotiated with them for that purpose, were property held by it primarily for sale to customers in the ordinary course of its trade or business. Section 117(a)(1)(A) of the Internal Revenue Code, in defining "capital assets," excludes therefrom "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." It is recognized that installment accounts receivable constitute property. In *Graham Mill & Elevator Co.* v. *Thomas*, 152 Fed. (2d) 564, the collector of internal revenue was sustained in taking the position that losses from the sale by the petitioner in 1942 of notes and accounts receivable, along with the business of four branch establishments, at less than their face amounts, were not deductible in full as ordinary business losses under section 23(f) of the Internal Revenue Code but constituted losses from sales of "capital assets," as defined in section 117(a)(1) of the Code, deductions for which were limited to the amount of gains during the taxable year from sales or exchanges of capital assets. In the instant case, however, the merchant sold forthwith, regularly, and in great numbers, its installment merchandise sales accounts receivable arising from current merchandise sales to certain banks as its customers therefore under a "commitment agreement" obtained from them for that purpose for a 5-year term. It is evident, therefor, that such accounts were held by the merchant primarily for sale to customers in the ordinary course of its trade or business within the purview of section 117(a) (1) (A), *supra*, rather than primarily as investments for collection for itself as the notes and accounts receivable customarily were held by the petitioner in the *Graham Mill & Elevator Co.* case, *supra.* On the other hand, the decision on Issue 2 in the *Kanawha Valley Bank* v. *Commissioner*, 4 T. C. 252, is well in point in the instant case. The Commissioner was sustained in taking the position, where a bank, following customary practice in its business regularly carried on, subscribed for allotments of Government securities with the intention of disposing of them even prior to their delivery and not to hold them as investments, that such securities so disposed of in 1940 and 1941 were not "capital assets" within the purview of section 117 (a) (1) of the Internal Revenue Code, and the Court stated:

> With respect to petitioner's transactions in disposing of government securities allotted to it by the United States Treasury, we think the facts clearly demonstrate that these securities were never held by petitioner as investments, but were acquired for sale in the regular course of its business. It appears that these transactions have long been carried on by petitioner and that it has several firms as its usual customers for such securities. The plan to sell was arranged prior to the acquisition of the securities, which were transferred on issuance direct to petitioner's customers. The sale being coincident with the acquisition, the bonds in question were not an investment in petitioner's hands. Respondent is sustained in his treatment of the gain on their sale as ordinary income.

Accordingly, losses from the sales by the instant merchant of current installment accounts receivable to the banks under their "commitment agreement," consisting of the amount which the unpaid balances of the accounts sold exceeded the "purchase price" paid and payable therefor by the banks, are ordinary business losses deductible in full under section 23(f) of the Code.

Where the instant merchant, under its option in the "commitment agreement" with the banks, repurchases defaulted accounts at their unpaid balances, its basis of each repurchased account is its said repurchase price. Since such accounts, upon repurchase, again became part of the merchant's installment accounts receivable, they will be treated thereupon, for Federal income tax purposes, in the same manner as similar accounts which never were sold.

In the computation of additions to the merchant's reserve for bad debts, any installment accounts receivable which have been, or forthwith are to be, sold by it to the banks under their "commitment agreement" shall not be considered.

"Commitment fees" incurred by the merchant under the "commitment agreement," being current charges for making business funds available to it on a standby basis and not for the use of funds, do not represent interest incurred but are deductible to it as ordinary and necessary business expenses under section 23(a)(1)(A) of the Code.

REGULATIONS 118, SECTION 39.117(a)-1: Meaning of terms.

Treatment by estate of amount received from corporation in redemption of deceased shareholder's capital stock. (See Rev. Rul. 54-239, p. 234.)

SECTION 117(c).—CAPITAL GAINS AND LOSSES: ALTERNATIVE TAXES

REGULATIONS 118, SECTION 39.117(c)-1: Alternative tax in case net long-term capital gain exceeds net short-term capital loss.
(Also Section 26(b), Section 39.26(b)-1; Section 26(h), Section 39.26(h)-1; Section 26(i), Section 39.26(i)-1; Regulations 111, Section 29.26-5; Section 29.26-6, Section 29.26-7; Section 29.117-3.)

Rev. Rul. 54-28

For the purpose of computing the alternative tax of corporations, under section 117(c) of the Internal Revenue Code, the credits allowed corporations under section 26 (b), (h), and (i) of the Code must be determined upon the basis of net income reduced by the excess of the net long-term capital gain over the net short-term capital loss.

Section 117(c)(1) of the Internal Revenue Code provides that the alternative tax of corporations shall be the sum of (1) a partial tax computed upon the net income reduced by the amount of the excess of the long-term capital gain over the net short-term capital loss, at the rates and in the manner as if subsection 117(c) of the Code had not been enacted, plus (2) an amount equal to 25 per centum (26 per centum for taxable years beginning after March 31, 1951, and before April 1, 1954) of the excess of the net long-term capital gain over the net short-term capital loss.

The term "net income" is defined in section 21 of the Code as the gross income computed under section 22 less the deductions allowed under section 23. Thus, for the purpose of the alternative tax, the partial tax must be computed upon the net income reduced by the amount of the excess of the long-term capital gain over the short-term capital loss, with the credits allowed under Code section 26 (b), (h), and (i) determined accordingly.

Although Schedule D (Form 1120), Schedule of Gains and Losses From Sales or Exchanges of Property, for the taxable years 1950, 1951, and 1952 does not draw attention to the fact that corporations computing the alternative tax must determine the credits allowed under section 26 (b), (h), and (i) of the Code as set forth herein, employees of the Internal Revenue Service should redetermine such credits consistent herewith, if upon examination of a return it is found that such credits have not been so determined by the taxpayer.

SECTION 117(f).—CAPITAL GAINS AND LOSSES: RETIREMENT OF BONDS, ETC.

Redemption of corporate obligations issued without interest coupons or not in registered form. (See Rev. Rul. 54-66, p. 128.)

SECTION 117(j).—CAPITAL GAINS AND LOSSES: GAINS AND LOSSES FROM INVOLUNTARY CONVERSIONS AND FROM THE SALE OR EXCHANGE OF CERTAIN PROPERTY USED IN THE TRADE OR BUSINESS

REGULATIONS 118, SECTION 39.117(j)-1: Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business.

Rev. Rul. 54-229

Gain from the sale of automobiles held for rent or lease by taxpayers engaged in the business of renting and leasing automobiles will not be denied treatment under section 117(j) of the Internal Revenue Code, for Federal income tax purposes, where the attendant circumstances reveal that such automobiles are not also property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

Rev. Rul. 108, C. B. 1953 1, 185, modified.

Advice is requested relative to the application of Rev. Rul. 108, C. B. 1953-1, 185, to sales of automobiles held for rent or lease by taxpayers engaged in the business of renting and leasing automobiles, where the attendant circumstances reveal that the automobiles held for rental and lease purposes are not also property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

Rev. Rul. 108, *supra*, holds that a taxpayer who customarily buys automobiles at wholesale prices, or at fleet discounts, and, after leasing them for a period substantially less than their normal useful life, sells them at wholesale or retail prices, may not treat the gain or loss from such sales as gain or loss from the sale or exchange of "property used in the trade or business" of the taxpayer for the purposes of section 117(j) of the Internal Revenue Code.

In general, Rev. Rul. 108 is intended to apply to cases where dealers or other taxpayers acquire automobiles at wholesale or at "fleet" prices substantially less than retail, rent them for a brief period. and after deducting depreciation, sell them at retail, thus realizing substantial profits which are reported as capital gains.

It is recognized that there are many taxpayers who are engaged, *bona fide*, in the business of leasing or renting motor vehicles to others, and that these activities constitute their business. It is further recognized that such taxpayers must, as a sound business practice, dispose of vehicles at a time when it is no longer profitable to continue using them as rental property. Whether a particular taxpayer is engaged, *bona fide*, in the business of leasing or renting automotive vehicles, or whether he is also engaged in the business of selling such vehicles, is a question of fact which must be determined with regard to all of the circumstances surrounding his operations. It will not be presumed that a taxpayer is in the business of selling used vehicles solely because a major portion of his revenue for a given year is derived from such sales.

If a taxpayer sells vehicles at retail, or realizes a dealer's profit on the sale, that profit will necessarily be treated as income from the sale of property held primarily for sale in the ordinary course of the taxpayer's business. On the other hand, his vehicles which are sold, through wholesale channels or by similar arrangements, which do not contemplate a dealer's profit, will be treated as property used in his business, and not as property held primarily for sale to customers. Any profit which may result from the sale of such vehicles by a partnership, individual, or corporation controlled by the seller will be subject to allocation as provided in section 45 of the Code.

Consequently, Rev. Rul. 108, *supra*, will not be applied in respect of taxpayers:

(1) who are primarily engaged in the business of renting or leasing motor vehicles to others, and

(2) who sell their used vehicles at wholesale prices to dealers, wholesalers, or jobbers, and

(3) who do not maintain facilities for the retail sale of vehicles, such as showrooms, used car lots, or sales forces.

To the extent that it is in conflict with the foregoing, Rev. Rul. 108, C. B. 1953-1, 185, is modified.

REGULATIONS 118, SECTION 39. 117(j)-1: Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business.

Motor vehicles used as "demonstrators" or "company cars" by dealers. (See Rev. Rul. 54-222, p. 19.)

SECTION 119(e).—INCOME FROM SOURCES WITHIN UNITED STATES: INCOME FROM SOURCES PARTLY WITHIN AND PARTLY WITHOUT UNITED STATES

REGULATIONS 118, SECTION 39.119(e)-2: Transportation service.

Determination of United States and Canadian income of bus companies operating routes across the border. (See Rev. Rul. 54-5, p. 130.)

SECTION 122.—NET OPERATING LOSS DEDUCTION

REGULATIONS 118, SECTION 39.122-1: Net operating loss deduction.

Effect of net operating loss deduction on maximum allowance for charitable and other contributions. (See Rev. Rul. 54-56, p. 64.)

SECTION 124B.—AMORTIZATION DEDUCTION FOR GRAIN STORAGE FACILITIES

Rev. Rul. 54-33

A company proposes to construct a "public grain warehouse" adjacent to a "public grain warehouse" already owned by it and connect the two warehouses by means of overhead and underground conveyors. The receiving, elevating, conditioning, and loading out equipment in the present warehouse will be used in connection with the new warehouse. *Held*, if the construction or erection of the new warehouse is completed on or before December 31, 1956, it will constitute a grain storage facility within the meaning of section 124B of the Internal Revenue Code. The conclusion would be the same, in this case, had the existing "public grain warehouse" been constructed as an emergency facility under the provisions of section 124A of the Code.

Rev. Rul. 54-44

A grain warehouse or elevator that is licensed under the United States Warehouse Act is a public grain warehouse within the meaning of section 124B of the Internal Revenue Code.

Advice is requested whether a grain warehouse or elevator that is licensed under the United States Warehouse Act constitutes a public grain warehouse within the meaning of section 124B of the Internal Revenue Code.

In the instant case, the taxpayer is a processor of mixed feeds and the operator of a grain warehouse that is licensed under the United States Warehouse Act, 39 Stat. 486, as amended. It uses its present storage capacity both for public storage and for storage of grain for its own account and, to the limits of its capacity, accepts all grain offered for storage. The taxpayer plans to double its storage facilities by constructing a grain elevator which will be permanently equipped for receiving, elevating, conditioning, and loading out grain. The new grain elevator will also be licensed under the United States Warehouse Act. Since its existing facilities provide adequate storage for its own inventories, the taxpayer will not operate the new facility principally to store its own grain; however, some portions of the facility may, from time to time, be used for the storage of its own grain.

Section 124B of the Code provides, in part, as follows:

(d) Definition of Grain Storage Facility.—For the purposes of this section, the term "grain storage facility" means—

(1) Any corn crib, grain bin, or grain elevator, or any similar structure suitable primarily for the storage of grain, which crib, bin, elevator, or structure is intended by the taxpayer at the time of his election to be used for the storage of grain produced by him (or, if the election is made by a partnership, produced by the members thereof); and

(2) Any public grain warehouse permanently equipped for receiving, elevating, conditioning, and loading out grain, * * *.

It is held that a grain elevator constructed after December 31, 1952, and on or before December 31, 1956, under the circumstances indicated above, constitutes a grain storage facility entitled to the benefits of section 124B of the Internal Revenue Code.

Rev. Rul. 54-58

A grain elevator licensed under the laws of the State of Washington or under the laws of any other State having equivalent licensing provisions, and constructed and used for the storage of grain consistent with the terms of a five-year "occupancy contract" with the Commodity Credit Corporation, is a public grain warehouse within the meaning of section 124B of the Internal Revenue Code.

Advice is requested whether a grain elevator licensed under the laws of the State of Washington and constructed and used according to the terms of a 5-year "occupancy contract" with the Commodity Credit Corporation is a public grain warehouse within the meaning of section 124B of the Internal Revenue Code.

In the instant case the taxpayer operates grain storage facilities in the State of Washington that are licensed under the provisions of chapter 22.08 of the Revised Code of Washington. It uses those facilities both for public storage of grain and for storage of grain for its own account. As the result of a 5-year "occupancy contract" offered by the Commodity Credit Corporation, the taxpayer now plans to construct additional storage elevators. These will also be licensed under chapter 22.08 of the Revised Code of Washington. As permitted by the "occupancy contract," the taxpayer will use some of the space in the additional storage elevators for storage of grain acquired for its own use. However, under the "occupancy contract" the taxpayer will agree that it "shall at all times while the provisions of this contract are operative keep the facility permanently equipped, in good condition, and staffed and open for business during regular business hours as a public, commercial, grain elevator for the receipt, storage, shipment, purchase, sale and handling of grain. * * *"

Under the "occupancy contract," the Commodity Credit Corporation guarantees 75 percent occupancy of the additional facilities during the first three contract years and 40 percent thereof for the two remaining contract years. The guaranteed occupancy space would be subject to the control of that agency.

Section 124B of the Internal Revenue Code relating to the deduction for amortization of grain storage facilities provides, in part, as follows:

(d) DEFINITION OF GRAIN STORAGE FACILITY.—For the purposes of this section, the term "grain storage facility" means—

* * * * * * *

(2) any public grain warehouse permanently equipped for receiving, elevating, conditioning, and loading out grain,

the construction, reconstruction, or erection of which was completed after December 31, 1952, and on or before December 31, 1956. * * *

Chapter 22.08 of the Revised Code of Washington provides, in part, as follows:

22.08.010 Definition, as used in this chapter:
"Grain warehouse" includes any elevator, mill, warehouse, public grain warehouse, public warehouse, or other structure in which grain or other commodities are received from the public for storage, shipment or handling; * * *
"Warehouseman" means any person owning, operating, or controlling a grain warehouse; * * *.

* * * * * * *

22.08.160 Warehouseman's license. Every person operating any grain or terminal warehouse subject to the provisions of this chapter shall, on or before the first day of July of each year, procure from the director a license for each warehouse so owned or operated for the ensuing year before transacting business therein. * * *.

* * * * * * *

22.08.270 Duty of warehouseman to serve.
Every grain warehouseman shall receive for storage, handling, or shipment, insofar as the capacity of his warehouse will permit, all commodities included in the provisions of this chapter, in suitable condition for storage, tendered him in the usual course of business, and shall issue therefor a warehouse receipt or receipts * * *.

It is held that a grain elevator constructed after December 31, 1952, and on or before December 31, 1956, that is licensed under the laws of the State of Washington or under the laws of any other State having equivalent licensing provisions, and that is used for the storage of grain consistent with the terms of an "occupancy contract" with the Commodity Credit Corporation, is a public grain warehouse within the meaning of section 124B of the Internal Revenue Code.

SECTION 125.—AMORTIZABLE BOND PREMIUM

Regulations 118, Section 39.125(a)-1: In general. Rev. Rul. 54-66
(Also Section 117(f), Section 23(e), Section 39.23(e)-1; Section 23(f), Section 39.23(f)-1.)

Evidences of indebtedness issued by any corporation (including like obligations issued by a Government or political subdivision thereof) without interest coupons or not in registered form do not constitute "bonds" within the meaning of that term as used in section 125(d) of the Internal Revenue Code. Therefore, premiums paid upon the acquisition thereof are not amortizable under the provisions of section 125(b) of the Code. Neither are such evidences of indebtedness the type of obligations comprehended by section 117(f) of the Code. Consequently, any excess of cost or other basis over the amount realized upon redemption of such obligations is deductible as an ordinary loss under section 23(e) or section 23(f) of the Code.

SECTION 130.—LIMITATION ON DEDUCTIONS ALLOWABLE TO INDIVIDUALS IN CERTAIN CASES

Regulations 118, Section 39.130-1: Limitation on deductions allowable to individuals in certain cases. Rev. Rul. 54-178

In applying section 130 of the Internal Revenue Code, where the facts establish that for tax purposes a husband and wife are partners in the same trade or business or that each is participating independently of the other in the same trade or business with his or her own money, the losses of the husband and wife from that trade or business should be considered separately even though they file joint returns. Under such circumstances, where during a taxable year one spouse sustains a loss of $10,000 and the other a loss of $45,000, the provisions of section 130 of the Code will not be applicable since neither of their individual losses exceeds $50,000.

Regulations 118, Section 39.130-1: Limitation on deductions allowable to individuals in certain cases. Rev. Rul. 54-179

Where a taxpayer is engaged in a trade or business in a community property State under circumstances such that the income therefrom is considered to be community income, for the purpose of applying the $50,000 limitation provided in section 130 of the Internal Revenue Code taxpayer and his spouse are treated as two individuals and one-half of the deductions attributable to the trade or business is considered to be allowable to the taxpayer and one-half to the spouse. See *Fred MacMurray, et al.* v. *Commissioner*, 21 T. C. 15, acquiescence page 5, this Bulletin.

SUPPLEMENT C.—CREDITS AGAINST TAX

SECTION 131(a).—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES: ALLOWANCE OF CREDIT

Regulations 118, Section 39.131(a)-1: Analysis of credit for taxes. Rev. Rul. 54-14

The taxes imposed on corporations by Article 96, Brazilian Law No. 1474 of November 26, 1951, amending the Brazilian income tax law, fall within the United States concept of income taxes and are allowable as a credit against United States income tax to the extent provided by section 131(a) of the Internal Revenue Code, subject to the limitations contained in section 131(b) of the Code.

SECTION 131(b).—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES: LIMIT ON CREDIT

Regulations 118, Section 39.131(b)-1: Limitations on credit for foreign taxes. Rev. Rul. 54-15

The credit for taxes paid to a foreign country or a possession of the United States allowable under section 131(a) of the Internal Revenue Code will be limited in application only as expressly provided in section 131(b) of the Code.

G. C. M. 26062, C. B. 1949-2, 110, revoked; G. C. M. 25723, C. B. 1948-2, 131, reinstated.

Reconsideration has been given to G. C. M. 26062, C. B. 1949-2, 110, and G. C. M. 25723, C. B. 1948-2, 131, in the light of the Tax Court Memorandum Opinion in the case of *James H. Brace* v. *Commissioner*, entered August 27, 1952.

In G. C. M. 25723, *supra*, it was held that section 131(a) of the Revenue Act of 1934 (now sec. 131(a) of the Internal Revenue Code), allowing credit for taxes paid to a foreign country or a possession of the United States, should be limited in application only as expressly provided in section 131(b). This ruling was modified in G. C. M. 26062, *supra*, to limit the amount of income tax paid to a foreign country or possession of the United States for which credit could be taken, subject to the limitations of section 131(b), to that portion of the income tax paid to the foreign country or possession of the United States which was attributable to income taxed both in the foreign country or possession of the United States and in the United States.

Section 131(b) of the Internal Revenue Code provides, in part, as follows:

> (1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed, in the case of a taxpayer other than a corporation, the same proportion of the tax against which such credit is taken, *which the taxpayer's net income from sources within such country bears to his entire net income for the same taxable year,* * * * [Italics supplied]

In the case of James H. Brace, *supra*, the taxpayer was a citizen of the United States but a resident of Canada. He had income from Canadian sources, part of which was excluded from Federal income tax under section 116(a) of the Code. The Commissioner denied the taxpayer credit under section 131 of the Code for that portion of Canadian taxes allocable to excluded earned income. The Tax Court decided the case in favor of the taxpayer relying on the cases of *I. B. Dexter et ux.* v. *Commissioner*, 47 B. T. A. 285, acquiescence C. B. 1948-2, 1, and *Helvering* v. *Edward J. Nell*, 139 Fed. (2d) 865, which cases constituted the basis for G. C. M. 25723, *supra*. In reaching its decision the Tax Court stated:

> In the ten years which have intervened [since the decisions in the Dexter and Nell cases, *supra*], the Congress has had innumerable opportunities to correct any error of interpretation if one was made by the *Dexter* and *Nell* cases. Needless to say, no such action has occurred. * * *
>
> * * * * * * *
>
> We see no good purpose in questioning such longstanding precedents as the Dexter and Nell cases. On their authority, petitioner's position must be sustained.

In view of the foregoing, it is held that the credit for taxes paid to a foreign country or a possession of the United States allowable under section 131(a) of the Internal Revenue Code will be limited in application only as expressly provided in section 131(b) of the Code. Accordingly, G. C. M. 26062, C. B. 1949-2, 110 is hereby revoked and G. C. M. 25723, C. B. 1948-2, 131, reinstated.

SECTION 131(c).—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES: ADJUSTMENTS ON PAYMENT OF ACCRUED TAXES

REGULATIONS 118, SECTION 39.131(c)-1: Redetermination of tax when credit proves incorrect.
(Also Section 119(e), Section 39.119(e)-2.)

Rev. Rul. 54-5

Determination of United States and Canadian income of bus companies operating routes across the border.

1. *Purpose.*—The purpose of this Revenue Ruling is to outline the principles that have been agreed upon between the Internal Revenue Service and the Department of National Revenue of Canada for the determination of the Canadian income of United States bus companies operating routes which enter Canada, and Canadian bus companies operating routes which enter the United States. The use by the respective taxing authorities of uniform principles is necessary to prevent double taxation of income in contravention of Article XVI of the tax convention with Canada.

2. *Internal Revenue Code provisions affected.*—The principles herein promulgated will be followed by the Internal Revenue Service: (1) in the allowance of Canadian tax credits to domestic bus companies under section 131 of the Internal Revenue Code, including any redetermination of tax when the credit proves incorrect, as provided in section 39.131(c)-1 of Regulations 118 and corresponding provisions of prior regulations; and (2) in the determination, under section 119(e) of the Internal Revenue Code, of the taxable income of Canadian bus companies operating in the United States, including determinations under section 39.119(e)-2(h) of Regulations 118 and corresponding provisions of prior regulations.

3. *Definitions.*—For the purpose of this Revenue Ruling, a bus company is defined as a common carrier operating intercity highway passenger buses, along with the usual incidental baggage, express, mail, newspaper, and similar transportation services. An operating "division" is defined as the portion of the operations of a bus company between certain terminal cities or over certain highways, sometimes called a "route," for which separate revenue and expense accounts are maintained. In case a bus company does not maintain such divisional revenue and expense accounts, the entire company is considered an "operating division" for the purpose of this Revenue Ruling.

4. *Determination of Canadian income of a domestic bus company.*—In the absence of compelling reasons to the contrary, the portion of the net income of a domestic bus company operating in Canada, attributable to Canadian sources, will be determined by taking an allocable part of the net income of each division operating across the border, in accordance with the following principles:

(a) The portion of the divisional net income attributable to Canadian sources is the ratio of Canadian operating revenues to total operating revenues of such divisions operating across the border, determined as follows:

(1) passenger revenues allocated on a passenger-mile basis; and

(2) baggage, express, newspaper, and miscellaneous revenues allocated on either an actual or bus-mile basis, as appears reasonable.

(b) The taxable net income of each division entering Canada shall be determined as follows:

(1) Operating revenues allocated to divisions as follows:

(i) passenger revenues on a passenger-mile basis; and

(ii) baggage, express, newspaper, and miscellaneous revenues on either an actual or bus-line basis, as appears reasonable.

(2) Operating expenses, other deductions, nonoperating income and unallowable deductions of the company to be:

(i) allocated to divisions on a bus-mile basis, in general, unless specifically identified with a particular division or divisions;

(ii) specifically charged or credited to the appropriate division or divisions where thus identified; or

(iii) allocated on some other appropriate basis where clearly preferable to either of the above.

5. *Determination of United States income of a Canadian bus company.*—The principles set forth above in paragraph 4 apply similarly to a Canadian bus company operating in the United States, where an election is made as provided in section 39.119(e)-2(h) of Regulations 118, or corresponding provisions of prior regulations.

REGULATIONS 118, SECTION 39.131(c)-2: Credit for taxes accrued but not paid.

Regulations 118 amended. (See T. D. 6059, p. 80.)

SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX

SECTION 143.—WITHHOLDING OF TAX AT SOURCE

REGULATIONS 118, SECTION 39.143-1: Withholding tax at source. T. D. 6056

(Also Section 144, Section 39.144-1.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 7.—TAXATION PURSUANT TO TREATIES.—SUBPART—BELGIUM, REGULATIONS EFFECTIVE JANUARY 1, 1953

Release of excess tax withheld, and exemption from, or reduction in rate of, withholding under sections 143 and 144 of the Internal Revenue Code in the case of residents of Belgium and of Belgian corporations, as affected by the income tax convention between the United States and Belgium proclaimed by the President of the United States on September 23, 1953.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

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SECTION 7.1100. INTRODUCTORY.—The income tax convention between the United States and Belgium, signed October 28, 1948, as modified and supplemented by the supplementary convention between such Governments, signed September 9, 1952, and proclaimed by the President of the United States on September 23, 1953, hereinafter referred to as the convention, provides in parts as follows, effective with respect to income derived in taxable years beginning on or after January 1, 1953:

ARTICLE I

(1) The taxes which are the subject of the present convention are:

(a) In the case of the United States: The Federal income taxes.

(b) In the case of Belgium: The income taxes, the national crisis tax, and the personal complementary tax, including all additions to these taxes.

(2) The present convention shall apply also to any other taxes of a substantially similar character imposed by either contracting State subsequently to the date of signature of the present convention or by the government of any territory to which the present convention is extended under Article XXII.

(3) In the event of appreciable changes in the fiscal laws of either of the contracting States the competent authorities of the contracting States will consult together.

ARTICLE II

(1) In the present convention, unless the context otherwise requires:

(a) The term "United States" means the United States of America, and when used in a geographical sense means the States, the Territories of Alaska and of Hawaii, and the District of Columbia.

(b) The term "Belgium" when used in a geographical sense means the Kingdom of Belgium in Europe.

(c) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on in the United States by a citizen or resident of the United States or by a corporation or other juridical person created or organized in the United States or under the laws of the United States or of any State or Territory of the United States.

(d) The term "Belgian enterprise" means an industrial or commercial enterprise or undertaking carried on in Belgium by a citizen or resident of Belgium or by a corporation or other juridical person created or organized in Belgium or under the laws of Belgium.

(e) The terms "enterprise of one of the contracting States" and "enterprise of the other contracting State" mean a United States enterprise or a Belgian enterprise, as the context requires.

(f) The term "permanent establishment," when used with respect to an enterprise of one of the contracting States, means a branch, factory, mine, oil well, plantation, workshop, warehouse, installation, or other fixed place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has control over a stock of merchandise from which he regularly fills orders on behalf of such enterprise. An enterprise of one of the contracting States shall not be deemed to have a permanent establishment in the other contracting State merely because it carries on business dealings in such other contracting State through a *bona fide* commission agent or broker acting in the ordinary course of his business as such. When a corporation of one contracting State has a subsidiary corporation which is a corporation created or organized in the other contracting State or which is engaged in trade or business in such other contracting State, such subsidiary corporation shall not, merely because of that fact, be deemed to be a permanent establishment of its parent corporation.

(g) The term "industrial and commercial profits" shall not include the following:

(i) Income from real property;

(ii) Income from mortgages, from public funds, securities (including mortgage bonds), loans, deposits, and current accounts;

(iii) Dividends and other income from shares in a corporation;

(iv) Rentals or royalties arising from leasing personal property or from any interest in such property, including rentals or royalties for the use of, or for the privilege of using, patents, copyrights, secret processes and formulae, goodwill, trade-marks, trade brands, franchises, and other like property;

(v) Profit or loss from the sale or exchange of capital assets;

(vi) Compensation for labor or personal services.

Subject to the provisions of the present convention, the income referred to in subparagraphs (i) to (vi) shall be taxed separately or together with industrial and commercial profits in accordance with the laws of the contracting States.

(h) The term "competent authority" or "competent authorities" means, in the case of the United States, the Commissioner of Internal Revenue or his duly authorized representative; and in the case of Belgium, the Directeur General de l'Administration des Contributions Directes or his duly authorized representative; and, in the case of any territory to which the present convention is extended under Article XXII, the competent authority for the administration in such territory of the taxes to which the present convention applies.

(2) In the application of the provision of the present convention by either of the contracting States, any term which is not otherwise defined shall, unless the context otherwise requires, have the meaning which that term has under the laws of such contracting State relating to the taxes which are the subject of the present convention.

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Article VI

Income of whatever nature derived from real property shall be taxable only in the contracting State in which the real property is situated. This Article does not apply to income derived from mortgages or bonds secured by real property.

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Article VIII

(1) The rate of United States tax on dividends derived from sources within the United States by a resident or corporation or other entity of Belgium not having a permanent establishment within the United States shall not exceed 15 percent.

(2) Belgium shall not impose on dividends derived from sources within Belgium by a resident or corporation or other entity of the United States not having a permanent establishment within Belgium any tax in the nature of a personal complementary tax or surtax thereon, or any tax similar to that withheld at the source on dividends under United States law in the case of nonresident aliens and foreign corporations.

Article VIIIA

The rate of tax imposed by each of the contracting States upon interest (on bonds, notes, debentures, or on any other form of indebtedness) derived from sources within such State by a resident or corporation or other entity of the other State not having a permanent establishment within the former State shall not exceed 15 percent.

Article IX

(1) Rentals or royalties from real property or in respect of the operation of mines, quarries or other natural resources shall be taxable only in the contracting State in which such property, mines, quarries, or other natural resources are situated. A resident of Belgium, or a corporation or other juridical person created or organized in Belgium deriving such rentals or royalties from sources within the United States may elect for any taxable year to be subject to United States tax as if such resident, corporation, or entity were engaged in trade or business within the United States through a permanent establishment therein in such taxable year.

(2) Royalties derived from within one of the contracting States by a resident or by a corporation or other entity of the other contracting State as consideration for the right to use copyrights, patents, secret processes and formulae, trademarks, and other analogous rights shall be exempt from taxation in the former

State, provided such resident, corporation, or other entity does not have a permanent establishment there. The term "royalties" as used in this paragraph shall be deemed to include rentals in respect of motion picture films.

ARTICLE X

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(2) Private pensions and annuities derived from within one of the contracting States and paid to individuals residing in the other contracting State shall be exempt from taxation in the former State.

(3) The term "pensions" as used in this Article means periodic payments made in consideration for services rendered or by way of compensation for injuries received.

(4) The term "annuities" as used in this Article means a stated sum payable periodically at stated times, under an obligation to make the payments in consideration of money paid.

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ARTICLE XV

(1) The competent authorities of the contracting States shall exchange such information (being information available under the respective taxation laws of the contracting States) as is necessary for carrying out the provisions of the present convention or for the prevention of fraud or the administration of statutory provisions and regulations against legal avoidance in relation to the taxes which are the subject of the present convention.

(2) Documents and information contained therein, transmitted under the provisions of the present convention by one of the contracting States to the other contracting State shall not be published, revealed, or disclosed to any person except to the extent permitted under the laws of the latter State with respect to similar documents or information.

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ARTICLE XVII

Each of the contracting States shall collect taxes, which are the subject of this convention, imposed by the other contracting State (as though such tax were a tax imposed by the former State) as will ensure that the exemption, or reduced rate of tax, as the case may be, granted under the present convention by such other State shall not be enjoyed by persons not entitled to such benefits.

ARTICLE XVIII

(1) In no case shall the provisions of Articles XV, XVI, and XVII be construed so as to impose upon either of the contracting States the obligation

(a) to carry out administrative measures at variance with the regulations and practice of either contracting State, or

(b) to supply information or particulars which are not procurable under its own legislation or that of the State making the application.

(2) The State to which application is made for information or assistance shall comply as soon as possible with the request addressed to it. Nevertheless, such State may refuse to comply with the request for reasons of public policy or if compliance would involve violation of a business, industrial, or trade secret. In such case it shall inform, as soon as possible, the State making the application.

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ARTICLE XX

(1) The provisions of the present convention shall not be construed to restrict in any manner any exemption, deduction, credit, or other allowance accorded by the laws of one of the contracting States in the determination of the tax imposed by such State.

(2) Should any difficulty or doubt arise as to the interpretation or application of the present convention, the competent authorities of the contracting States shall settle the question by mutual agreement.

(3) Citizens or corporations or other juridical persons of one of the contracting States within the other contracting State shall not be subjected, as regards the taxes referred to in the present convention, to the payment of higher taxes than are imposed upon the citizens or corporations or other juridical persons of such other contracting State.

ARTICLE XXI

The competent authorities of the two contracting States may (in the case of the United States, with the approval of the Secretary of the Treasury, and in the case of Belgium, with the approval of the Minister of Finance) prescribe regulations necessary to carry out the provisions of the present convention. With respect to the provisions of the present convention relating to exchange of information and mutual assistance in the collection of taxes, such authorities may, by common agreement, prescribe rules concerning matters of procedure, forms of application and replies thereto, conversion of currency, disposition of amounts collected, minimum amount subject to collection, and related matters.

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ARTICLE XXIII

(1) The present convention shall be ratified and the instruments of ratification shall be exchanged at Brussels as soon as possible.

(2) The present convention shall become effective with respect to income derived in taxable years beginning on or after the 1st day of January of the calendar year in which the exchange of the instruments of ratification takes place, except that if such exchange takes place after the 30th day of September of such calendar year, Articles VIII and VIIIA and Article IX (2) shall become effective only with respect to payments made after the 31st day of December of such calendar year. It shall continue effective for a period of 5 years beginning with the 1st day of January of the calendar year in which such exchange takes place and indefinitely after that period, but may be terminated by either of the contracting States at the end of the 5-year period or at any time thereafter, provided that at least 6-month prior notice of termination has been given, the termination to become effective on the 1st day of January following the expiration of the 6-month period.

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As used in this Treasury Decision, any term defined in the convention shall have the meaning so assigned to it; any term not so defined shall, unless the context otherwise requires, have the meaning which such term has under the Internal Revenue Code.

SEC. 7.1101. DIVIDENDS.—(*a*) *General.*—The rate of United States tax imposed by the Internal Revenue Code upon dividends derived from sources within the United States in taxable years beginning on or after January 1, 1953, by a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of Belgium, or by a Belgium corporation or other entity, shall not exceed 15 percent under the provisions of Article VIII of the convention if such alien, corporation, or other entity at no time during the taxable year in which such dividends are derived has a permanent establishment within the United States. As to what consitutes a permanent establishment, see Article II(1)(f) of the convention. Thus, if a nonresident alien individual who is a resident of Belgium performs personal services within the United States during the taxable year, but has at no time during such year a permanent establishment within the United States, he is entitled to the reduced rate of tax with respect to dividends derived in that year from United States sources, as provided in Article VIII of the convention, even though under the provisions of section 211(b) of the Internal Revenue Code he has engaged in trade or business within the United States during such year by reason of his having performed personal services therein.

(*b*) *Effect of address in Belgium on withholding in the case of dividends.*—For the purpose of withholding of United States tax in the case of dividends every nonresident alien (including a nonresident alien individual, fiduciary, and partnership) whose address is in Belgium shall be deemed by United States withholding agents to be a nonresident alien who is a resident of Belgium not having a permanent establishment within the United States; and every foreign corporation whose address is in Belgium shall be deemed by such withholding agents to be a Belgium corporation not having a permanent establishment within the United States.

(*c*) *Rate of withholding.*—Withholding at source in the case of dividends derived from sources within the United States and paid on or after January 1, 1953, to nonresident aliens (including a nonresident alien individual, fiduciary, and partnership) and to foreign corporations, whose addresses are in Belgium, shall be at the rate of 15 percent in every case except that in which, prior to the date of payment of such dividends, the Commissioner of Internal Revenue has notified the withholding agent that the reduced rate of withholding shall not apply.

The preceding provisions respecting the application of the reduced withholding rate in the case of dividends paid to nonresident aliens and foreign corporations with addresses in Belgium are based upon the assumption that the payee of the dividend is the actual owner of the capital stock from which the dividend is derived and consequently is the person liable to United States tax upon such dividend. As to action by the recipient who is not the owner of the dividend, see section 7.1107.

The rate at which United States tax has been withheld from any dividend paid at any time after the expiration of the 30th day after the date on which this Treasury Decision is published in the Federal Register to any person whose address is in Belgium at the time the dividend is paid shall be shown either in writing or by appropriate stamp on the check, draft, or other evidence of payment, or on an accompanying statement.

SEC. 7.1102. INTEREST.—(*a*) *General.*—The rate of United States tax imposed by the Internal Revenue Code upon interest on bonds, securities, notes, debentures, or on any other form of indebtedness, including interest on obligations of the United States, obligations of instrumentalities of the United States, and mortgages and bonds secured by real property, which is derived from sources within the United States in taxable years beginning on or after January 1, 1953, by a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of Belgium, or by a Belgian corporation or other entity, shall not exceed 15 percent under the provisions of Article VIIIA of the convention if such alien, corporation, or other entity at no time during the taxable year in which such interest is derived has a permanent establishment in the United States. As to what constitutes a permanent establishment, see Article II(1)(f) of the convention.

(b) *Application of reduced rate at source.*—To secure the reduced rate of United States tax at source in the case of coupon bond interest, the nonresident alien who is a resident of Belgium, or the Belgian corporation or other entity, shall for each issue of bonds file Form 1001-B in duplicate when presenting the interest coupons for payment. This form shall be signed by the owner of the interest, trustee, or agent and shall show the name and address of the obligor, the name and address of the owner of the interest, and the amount of the interest. It shall contain a statement that the owner (1) is a resident of Belgium, or is a Belgian corporation or other entity, and (2) has no permanent establishment in the United States.

The reduction in the rate of United States tax contemplated by Article VIIIA of the convention, insofar as it concerns coupon bond interest, is applicable only to the owner of the interest. The person presenting the coupon or on whose behalf it is presented shall, for the purpose of the reduction in tax, be deemed to be the owner of the interest only if he is, at the time the coupon is presented for payment, the owner of the bond from which the coupon has been detached. If the person presenting the coupon or on whose behalf it is presented is not the owner of the bond, Form 1001, and not Form 1001-B, shall be executed.

The original and duplicate of Form 1001-B shall be forwarded by the withholding agent to the District Director of Internal Revenue, Audit Division, Alien Returns Section, Baltimore 2, Maryland, with the quarterly return on Form 1012. See section 39.143-7 of this chapter [Regulations 118]. Form 1001-B shall be listed on Form 1012.

For general provisions pertaining to the use, without reference to the provisions of the convention, of ownership certificate, Form 1001, by nonresident aliens and nonresident foreign corporations, see section 39.143-4 and section 39.143-6 of this chapter.

To secure the reduced rate of United States tax at source in the case of interest, other than coupon bond interest, the nonresident alien who is a resident of Belgium, or the Belgian corporation or other entity, shall file Form 1001A-B in duplicate with the withholding agent in the United States. This form shall be signed by the owner of the interest, trustee, or agent and shall show the name and address of the obligor and the name and address of the owner of the interest. It shall contain a statement that the owner (1) is a resident of Belgium, or is a Belgian corporation or other entity, and (2) has no permanent establishment in the United States.

Form 1001A-B shall be filed with the withholding agent for each successive 3-calendar-year period during which such interest is paid. For this purpose, the first such period shall commence with the beginning of the calendar year in which such income is first paid on or after January 1, 1953. Each such form filed with any withholding agent shall be filed not later than 20 days preceding the date of the first payment within each successive period, or, if that is not possible because of special circumstances, as soon as possible after such first payment. Once such a form has been filed in respect of any 3-calendar-year period, no additional Form 1001A-B need be filed in respect thereto unless the Commissioner of Internal Revenue notifies the withholding agent that another such form shall be filed by the taxpayer.

If, after filing such form, the taxpayer ceases to be eligible for the reduced rate of United States tax granted by Article VIIIA of the convention in respect to such interest, he shall promptly notify the withholding agent by letter in duplicate. When any change occurs in the ownership of the interest as recorded on the books of the payer, the reduction in rate of withholding of United States tax shall no longer apply unless the new owner of record is entitled to and does properly file a Form 1001A–B with the withholding agent.

The duplicate of each Form 1001A–B (and letter) shall be immediately forwarded by the withholding agent to the District Director of Internal Revenue, Audit Division, Alien Returns Section, Baltimore 2, Maryland.

SEC. 7.1103. NATURAL RESOURCE ROYALTIES AND REAL PROPERTY RENTALS.—The convention does not change the rate of United States tax imposed pursuant to sections 211 and 231 of the Internal Revenue Code upon natural resource royalties and real property rentals. The withholding of United States tax with respect to such items derived from sources within the United States by nonresident aliens who are residents of Belgium, or by Belgian corporations or other entities, is not changed by the convention. See sections 143(b) and 144 of the Internal Revenue Code and Articles VI and IX(1) of the Convention.

SEC. 7.1104. PATENT AND COPYRIGHT ROYALTIES AND FILM RENTALS.—(*a*) *General.*—Royalties derived from sources within the United States in taxable years beginning on or after January 1, 1953, by a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of Belgium, or by a Belgian corporation or other entity, as consideration for the right to use copyrights, patents, secret processes and formulae, trade-marks, and other analogous rights are exempt from United States tax under the provisions of Article IX(2) of the convention if such alien, corporation, or other entity at no time during the taxable year in which such royalties are derived has a permanent establishment within the United States. Such royalties are, therefore, not subject to the withholding of United States tax at source. As to what constitutes a permanent establishment, see Article II(1)(f) of the convention.

The term "royalties" as used in this section shall be deemed to include rentals in respect of motion picture films.

(*b*) *Application of exemption from withholding.*—To avoid withholding of United States tax at source in the case of the royalties to which paragraph (*a*) is applicable, the nonresident alien who is a resident of Belgium, or the Belgian corporation or other entity, shall file Form 1001A–B in duplicate with the withholding agent in the United States. The provisions of section 7.1102(*b*) relating to the execution, filing, and effective period of such form with respect to interest are equally applicable with respect to the income falling within the scope of this section.

The duplicate of each Form 1001A–B (and letter) shall be immediately forwarded by the withholding agent to the District Director of Internal Revenue, Audit Division, Alien Returns Section, Baltimore 2, Maryland.

SEC. 7.1105. PRIVATE PENSIONS AND ANNUITIES.—(*a*) *General.*—Private pensions and annuities, as defined in Article X (3) and (4) of the convention, derived from sources within the United States in taxable years beginning on or after January 1, 1953, and paid to a nonresident alien individual who is a resident of Belgium are exempt from United States tax under the provisions of Article X(2) of the convention. Such items of income are, therefore, not subject to the withholding of United States tax at source.

(*b*) *Application of exemption from withholding.*—To avoid withholding of United States tax at source in the case of the items of income to which paragraph (*a*) is applicable, the nonresident alien individual who is a resident of Belgium shall notify the withholding agent by letter in duplicate that such income is exempt from United States tax under the provisions of Article X of the convention. The letter of notification shall be signed by the owner of the income, shall show the name and address of both the payer and the owner of the income, and shall contain a statement that the owner, an individual, is neither a citizen nor a resident of the United States but is a resident of Belgium. If such letter is also to be used as authorization for the release, pursuant to section 7.1106, of excess tax withheld from such items of income, it shall also contain a statement that the owner was, at the time when the income was derived from which the excess tax was withheld, neither a citizen nor a resident of the United States but was a resident of Belgium.

This letter shall constitute authorization for the payment of such items of income without withholding of United States tax at source unless the Commissioner of Internal Revenue subsequently notifies the withholding agent that the tax shall be withheld with respect to payments of such items of income made after receipt of such notice. If, after filing a letter of notification, the owner of the income ceases to be eligible for the exemption from United States tax granted by the convention in respect to such income, he shall promptly notify the withholding agent by letter in duplicate. When any change occurs in the ownership of such income as recorded on the books of the payer, the exemption from withholding of United States tax shall no longer apply unless the new owner of record is entitled to and does properly file a letter of notification with the withholding agent.

Each letter of notification, or the duplicate thereof, shall be immediately forwarded by the withholding agent to the District Director of Internal Revenue, Audit Division, Alien Returns Section, Baltimore 2, Maryland.

(*c*) *Definition of pensions and annuities.*—Under Article X(3) of the convention, the term "pensions," as used in Article X, means periodic payments made in consideration for services rendered or by way of compensation for injuries received.

Under Article X(4) of the convention, the term "annuities," as used in Article X, means a stated sum payable periodically at stated times under an obligation to make the payments in consideration of money paid.

SEC. 7.1106. RELEASE OF EXCESS TAX WITHHELD AT SOURCE.—In order to give the convention effective application at the earliest practicable date, the exemptions from, and reductions in the rate of, withholding of United States tax at source granted by this Treasury Decision are hereby made effective beginning January 1, 1953, contingent upon compliance with the applicable provisions of section 7.1101 through section 7.1105.

In the case of dividends derived from sources within the United States and paid to a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) or to a foreign corporation, whose address at the time of payment was in Belgium, if United States tax at the statutory rate (30 percent as of the date of approval of this Treasury Decision) has been withheld from such dividends on or after January 1, 1953, there shall be released by the withholding agent and paid over to the person from whom it was withheld an amount which is equal to the amount obtained by subtracting 15 percent of such dividends from the tax so withheld.

In the case of every taxpayer whose address at the time of payment was in Belgium and who furnishes to the withholding agent Form 1001A-B in accordance with section 7.1102(*b*) and section 7.1104(*b*), if United States tax at the statutory rate (30 percent as of the date of approval of this Treasury Decision) has been withheld on or after January 1, 1953, from the items of income in respect of which such form is prescribed in such sections, there shall be released by the withholding agent and paid over to the person from whom it was withheld—

(1) in the case of interest (other than coupon bond interest), an amount which is equal to the amount obtained by subtracting 15 percent of such interest from the tax so withheld from such interest; and

(2) in the case of patent royalties, copyright royalties, film rentals, and the like, an amount equal to the tax so withheld from such items.

In the case of every taxpayer whose address at the time of payment was in Belgium and who furnishes to the withholding agent Form 1001-B clearly marked "SUBSTITUTE" and executed in accordance with section 7.1102(*b*), if United States tax at the statutory rate (28 percent or 30 percent, as the case may be, as of the date of approval of this Treasury Decision) has been withheld from coupon bond interest on or after January 1, 1953, there shall be released by the withholding agent and paid over to the person from whom it was withheld an amount which is equal to the difference between the amount of such interest multiplied by the higher of such statutory rates (30 percent as of the date of approval of this Treasury Decision) and 15 percent of such interest. One such substitute form shall be filed in duplicate with respect to each issue of bonds and will serve with respect to that issue to replace all Forms 1001 previously filed by the taxpayer in the calendar year in which the excess tax was withheld and with respect to which such excess is released.

The original and duplicate of such substitute Form 1001-B shall be forwarded by the withholding agent to the District Director of Internal Revenue, Audit Division, Alien Returns Section, Baltimore 2, Maryland, with the quarterly return on Form 1012. See section 39.143-7 of this chapter. Such substitute Form 1001-B shall be listed on Form 1012.

In the case of every taxpayer whose address at the time of payment was in Belgium and who furnishes to the withholding agent the letter of notification prescribed in section 7.1105(*b*) as authorization for the release of excess tax withheld, if United States tax at the statutory rate (30 percent as of the date of approval of this Treasury Decision) has been withheld on or after January 1, 1953, from private pensions and annuities as defined in Article X, there shall be released by the withholding agent and paid over to the person from whom it was withheld an amount equal to the tax so withheld from such items.

The provisions of this section shall have no application to excess tax withheld at source which has been paid by the withholding agent to the district director of internal revenue pursuant to section 39.143-7 of this chapter.

SEC. 7.1107. ADDRESSEE NOT ACTUAL OWNER.—(*a*) *General.*—If the recipient in Belgium of any dividend from sources within the United States, with respect to which United States tax at the reduced rate of 15 percent has been withheld at source pursuant to section 7.1101(*c*), is a nominee or representative through whom such dividend flows to a person other than one described in section 7.1101(*a*) as being entitled to such reduced rate, such recipient in Belgium shall withhold an additional amount of United States tax equivalent to the United States tax which would have been withheld if the convention had not been in effect (30 percent of such dividend as of the date of approval of this Treasury Decision) minus the 15 percent which has been withheld at the source.

In any case in which a fiduciary or partnership with an address in Belgium receives, otherwise than as a nominee or representative, a dividend from sources within the United States with respect to which United States tax at the reduced rate of 15 percent has been withheld at source pursuant to section 7.1101(*c*), if a beneficiary of such fiduciary or a partner in such partnership is not entitled to the reduced rate of United States tax granted by Article VIII(1) of the convention, the fiduciary or partnership shall withhold an additional amount of United States tax with respect to the portion of such dividend included in such beneficiary's share of the distributed or distributable income, or in such partner's distributive share of the income, of such fiduciary or partnership, as the case may be. The amount of the additional tax is to be calculated in the same manner as under the immediately preceding paragraph of this section.

If any amount of United States tax is released pursuant to section 7.1106 by the withholding agent in the United States with respect to a dividend paid to such a person (nominee, representative, fiduciary, or partnership) with an address in Belgium, the latter shall also withhold from such released amount any additional amount of United States tax, otherwise required to be withheld by the preceding provisions of this section in respect of such dividend, in the same manner as if at the time of payment of such dividend United States tax at the rate of only 15 percent had been withheld at source therefrom.

(*b*) *Returns filed by Belgian withholding agents.*—The amounts withheld pursuant to paragraph (*a*) by any withholding agent in Belgium shall be deposited, without converting such amounts into United States dollars, with the Belgium Directeur General de l'Administration des Contributions Directes on or before the 15th day after the close of the quarter of the calendar year in which such withholding in Belgium occurs. The withholding agent making such deposit shall render therewith such appropriate Belgian form as may be prescribed by the Directeur General de l'Administration des Contributions Directes. The amounts so deposited should be remitted by the Directeur General by draft in United States dollars to the District Director of Internal Revenue, Baltimore 2, Maryland, U. S. A., on or before the end of the calendar month in which the deposit is made, and should be accompanied by such Belgian form as may be required to be rendered by the withholding agent in Belgium in connection with such deposit.

SEC. 7.1108. INFORMATION TO BE FURNISHED IN ORDINARY COURSE.—(*a*) *General.*—In compliance with the provisions of Article XV of the convention the Commissioner of Internal Revenue will transmit to the Belgian Directeur General de l'Administration des Contributions Directes, as soon as practicable after the close of the calendar year 1953 and of each subsequent calendar year during which the convention is in effect, the following information relating to such preceding calendar year:

(1) The duplicate copy of each available Form 1042 Supplement filed pursuant to paragraph (*b*) of this section; and

(2) The duplicate copy of each available ownership certificate, Form 1001-B, filed pursuant to section 7.1102(*b*), and substitute Form 1001-B, filed pursuant to section 7.1106, in connection with coupon bond interest.

(*b*) *Information return.*—To facilitate compliance with Article XV of the convention, every United States withholding agent shall make and file in duplicate with the district director of internal revenue for the district in which the withholding agent is located an information return on Form 1042 Supplement, with respect to Belgian addressees, which shall be filed for the calendar year 1953 and subsequent calendar years. This return shall be filed simultaneously with the Form 1042 required by section 39.143-7 of this chapter.

There shall be reported on such Form 1042 Supplement all items of fixed or determinable annual or periodical income derived from sources within the United States and paid to nonresident aliens (including nonresident alien individuals, fiduciaries, and partnerships) and to nonresident foreign corporations, whose addresses at the time of payment were in Belgium, including such items of income upon which, in accordance with this Treasury Decision, no withholding of United States tax is required; except that any of such items which constitute interest in respect of which Form 1001-B or substitute Form 1001-B has been filed in duplicate with the withholding agent are not required to be reported on such Form 1042 Supplement.

SEC. 7.1109. BENEFICIARIES OF A DOMESTIC ESTATE OR TRUST.—A nonresident alien who is a resident of Belgium and who is a beneficiary of a domestic estate or trust shall be entitled to the exemption from, or reduction in the rate of, United States tax granted by Articles VIII, VIIIA, and IX(2) of the convention with respect to dividends, interest, and copyright royalties and the like, to the extent such item or items are included in his share of the distributed or distributable income of such estate or trust, provided that he otherwise satisfies the requirements of these respective articles. In order to be entitled in such instance to the exemption from, or reduction in the rate of, withholding of United States tax such beneficiary must otherwise satisfy such requirements and shall, where applicable execute and submit to the fiduciary of such estate or trust in the United States the Form 1001A-B prescribed in section 7.1102(*b*) and section 7.1104(*b*).

Because it is necessary to bring into effect at the earliest practicable date the rules of this Treasury Decision respecting release of excess tax witheld, and exemption from, or reduction in the rate of, withholding of tax, it is hereby found that it is impracticable to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that act.

(This Treasury Decision is issued under the authority contained in secs. 62 and 3791 (53 Stat. 32, 467; 26 U. S. C. 62, 3791) of the Internal Revenue Code and in Article XXI of the convention.)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved December 4, 1953.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 9, 1953, 8:50 a. m.)

REGULATIONS 118, SECTION 39.143-2: Fixed or determinable annual or periodical income.

Alimony payments to an individual, alien as to the United States, residing in Sweden. (See Rev. Rul. 54-53, p. 156.)

REGULATIONS 118, SECTION 39.143-7: Return and payment of tax withheld. Rev. Rul. 54-242

Countries with respect to which information returns on Form 1042 Supplement, relating to fixed or determinable annual or periodical income derived from sources within the United States, must be filed by withholding agents.

Advice is requested as to the countries with respect to which information returns on Form 1042 Supplement are required to be filed by withholding agents pursuant to section 7.1(a) of Treasury Decision 6055, C. B. 1953-2, 77.

Section 7.1(a) of Treasury Decision 6055, *supra*, provides that for the calendar year 1953 and subsequent calendar years, every United States withholding agent shall make and file an information return on Form 1042 Supplement, relating to fixed or determinable annual or periodical income derived from sources within the United States and paid to nonresident aliens whose addresses at the time of payment are within a foreign country which has entered into an income tax convention with the United States, if such convention provides for the mutual exchange of information and if the Commissioner of Internal Revenue determines that such return is required in the case of such country. A separate return is required for each country with respect to which such a determination is made.

Income tax conventions with the following countries are now in effect: Australia, Belgium, Canada, Denmark, Finland, France, Greece, Ireland, the Netherlands, New Zealand, Norway, Sweden, Switzerland, and the United Kingdom. Information returns on Form 1042 Supplement are required to be made and filed by withholding agents with respect to these countries for the calendar year 1954 and subsequent years.

The filing of information returns on Form 1042 Supplement will be required in the case of any country with which the United States in the future enters into an income tax convention providing for the mutual exchange of information. If the proclamation of the President of the United States, relative to the ratification of such a convention, is issued during the first 6 months of a calendar year, information returns on Form 1042 Supplement with respect to that country will be required for the calendar year in which the proclamation is issued, and for each subsequent calendar year. However, if such proclamation is issued during the last 6 months of a calendar year, information returns on Form 1042 Supplement with respect to that country will not be required for the calendar year in which the proclamation is issued, but will be required for each subsequent calendar year.

The above provisions do not apply to any calendar year in which amounts paid by withholding agents are not subject to the provisions of a convention between the United States and a particular foreign country. Thus, if the President's proclamation relative to a future income tax convention with a foreign country is issued during the first 6 months of 1955 and the convention applies only to amounts paid on or after January 1, 1956, information returns on Form 1042 Supplement with respect to that country are not required for 1955, but are required for the calendar year 1956 and subsequent years. Similarly, if a convention with a foreign country is terminated, no returns on Form 1042 Supplement are required with respect to that country for any calendar year subsequent to the last calendar year during which the provisions of the convention apply.

REGULATIONS 118, SECTION 39.143-7: Return and payment of tax withheld.

Regulations 118 amended. (See T. D. 6059, p. 80.)

SECTION 144.—PAYMENT OF CORPORATION INCOME TAX AT SOURCE

REGULATIONS 118, SECTION 39.144-1: Withholding in the case of nonresident foreign corporations.

Release of excess tax withheld, and exemption from, or reduction in rate of, withholding in the case of Belgian corporations, as affected by the income tax convention between the United States and Belgium. (See T. D. 6056, p. 132.)

SECTION 145.—PENALTIES

REGULATIONS 118, SECTION 39.145-1: Penalties. Ct. D. 1766

CRIMINAL LIABILITY—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. CONTACT WITH JUROR—PRESUMPTION OF PREJUDICE—HEARING GRANTED.

In a criminal case, any private communication, contact, or tampering, directly or indirectly, with a juror during a trial about the matter pending before the jury is, for obvious reasons, deemed presumptively prejudicial, if not made in pursuance of known rules of the court and the instructions and directions of the court made during the trial, with full knowledge of the parties. The presumption is not conclusive, but the burden rests heavily upon the Government to establish, after notice to and hearing of the defendant, that such contact with the juror was harmless to the defendant.

2. JUDGMENT VACATED.

Judgment of the United States Court of Appeals for the Ninth Circuit (205 F. (2d) 277 (1952)) vacated and case remanded to district court for hearing to determine whether alleged jury tampering was harmful to defendant.

SUPREME COURT OF THE UNITED STATES

Elmer F. Remmer, petitioner, v. *United States of America*

On writ of certiorari to the United States Court of Appeals for the Ninth Circuit

[March 8, 1954]

OPINION

Mr. Justice MINTON delivered the opinion of the Court.

The petitioner was convicted by a jury on several counts charging willful evasion of the payment of Federal income taxes. A matter admitted by the Government to have been handled by the trial court in a manner that may have been prejudicial to the petitioner, and therefore confessed as error, is presented at the threshold and must be disposed of first.

After the jury had returned its verdict, the petitioner learned for the first time that during the trial a person unnamed had communicated with a certain juror, who afterwards became the jury foreman, and remarked to him that he could profit by bringing in a verdict favorable to the petitioner. The juror reported the incident to the judge, who informed the prosecuting attorneys and advised with them. As a result, the Federal Bureau of Investigation was requested to make an investigation and report, which was accordingly done. The F. B. I. report was considered by the judge and prosecutors alone, and they apparently concluded that the statement to the juror was made in jest, and nothing further was done or said about the matter. Neither the judge nor the prosecutors informed the petitioner of the incident, and he and his counsel first learned of the matter by reading of it in the newspapers after the verdict.

The above-stated facts were alleged in a motion for a new trial, together with an allegation that the petitioner was substantially prejudiced, thereby depriving him of a fair trial, and a request for a hearing to determine the circumstances surrounding the incident and its effect on the jury.* A supporting affidavit of the petitioner's attorneys recited the alleged occurrences and stated that if they had known of the incident they would have moved for a mistrial and requested that the juror in question be replaced by an alternate juror. Two newspaper articles reporting the incident were attached to the affidavit. The Government did not file answering affidavits. The district court, without holding the requested hearing, denied the motion for a new trial. The court of appeals held that the

*The motion for a new trial was also grounded on many other contentions, several of which have also been presented to this Court Because of our disposition of the case on the issue treated herein, we do not pass upon these additional questions.

district court had not abused its discretion, since the petitioner had shown no prejudice to him. 205 F. 2d 277, 291. The case is here on writ of certiorari. 346 U. S. 884.

In a criminal case, any private communication, contact, or tampering, directly or indirectly, with a juror during a trial about the matter pending before the jury is, for obvious reasons, deemed presumptively prejudicial, if not made in pursuance of known rules of the court and the instructions and directions of the court made during the trial, with full knowledge of the parties. The presumption is not conclusive, but the burden rests heavily upon the Government to establish, after notice to and hearing of the defendant, that such contact with the juror was harmless to the defendant. *Mattox* v. *United States*, 146 U. S. 140, 148–150; *Wheaton* v. *United States*, 133 F. 2d 522, 527.

We do not know from this record, nor does the petitioner know, what actually transpired, or whether the incidents that may have occurred were harmful or harmless. The sending of an F. B. I. agent in the midst of a trial to investigate a juror as to his conduct is bound to impress the juror and is very apt to do so unduly. A juror must feel free to exercise his functions without the F. B. I. or anyone else looking over his shoulder. The integrity of jury proceedings must not be jeopardized by unauthorized invasions. The trial court should not decide and take final action *ex parte* on information such as was received in this case, but should determine the circumstances, the impact thereof upon the juror, and whether or not it was prejudicial, in a hearing with all interested parties permitted to participate.

We therefore vacate the judgment of the court of appeals and remand the case to the district court with directions to hold a hearing to determine whether the incident complained of was harmful to the petitioner, and if after hearing it is found to have been harmful, to grant a new trial.

Judgment vacated.

The Chief Justice took no part in the consideration or decision of this case.

SUPPLEMENT E.—ESTATES AND TRUSTS

SECTION 162.—NET INCOME

Regulations 118, Section 39.162-1: Income of estates and trusts. Rev. Rul. 54-207

A capital loss carryover provided by section 117(e) of the Internal Revenue Code resulting from a capital loss incurred by a decedent is not deductible by his estate. A capital loss sustained by a decedent during his lifetime is deductible only in the return filed on his behalf. There can be no capital loss carryover from the decedent to his estate for the reason that the decedent and the estate are separate tax entities. See *New Colonial Ice Company* v. *Helvering*, 292 U. S. 435, Ct. D. 841, C. B. XIII-1, 194; *Estate of R. R. Russell et al.* v. *Commissioner*, 34 BTA 715; I. T. 1562, C. B. II-1, 33 (1923).

SECTION 165.—EMPLOYEES' TRUSTS

Regulations 118, Section 39.165-1: Employees' trusts. Rev. Rul. 54-51

An investment by a profit-sharing trust in an ordinary life insurance contract for each insurable participant under the trust, will be considered incidental and subordinate to the primary purpose of a qualified profit-sharing plan where (1) the aggregate premiums for life insurance in the case of each participant is less than one-half of the aggregate of the contributions allocated to him at any particular time; and (2) the plan shall require the trustee to convert the entire value of the life insurance contract at or before retirement to provide periodic income so that no portion of such value may be used to continue life insurance protection beyond retirement. Such an investment will not disqualify the plan under section 165(a) of the Internal Revenue Code.

Advice is requested whether, on the basis of the following facts, an investment in ordinary life insurance by a profit-sharing trust for each of its insurable participants will disqualify the profit-sharing plan under section 165(a) of the Internal Revenue Code.

The employer has established a profit-sharing plan having acceptable contribution and allocation formulae. Under the plan less than one-half of each amount annually allocated to each respective insurable participant's account is "invested" in an ordinary life insurance contract on his life. The insurer has agreed with the trustee that, if so requested at a later date, the contract will be converted to an insurance income contract which will provide the employee with an annuity benefit for life following his retirement. The ordinary life insurance contracts purchased under the plan are owned by the trustee, but the participant has the right to name a beneficiary to receive the "death proceeds" of such contract upon his death. Under the plan the trustee is required, 1 year prior to the participant's normal retirement date, to apply the funds credited to the participant in the pooled investment account to convert the ordinary life insurance contract on his life to an insurance income contract in the maximum amount permitted under the agreement with the insurer. When an employee has attained normal retirement age, the trustee shall make available to the retiring employee the retirement income as provided by the insurance income contract then in force and, to the extent that any other funds remain in the trust, they shall be applied to purchase a single premium annuity contract, or the trustee may pay such funds to him in equal monthly installments over a fixed period of time.

Section 39.165-1(a)(2) of Regulations 118 defines the term "profit-sharing plan" as follows:

A profit-sharing plan * * * is a plan established and maintained by an employer to provide for the participation in his profits, by his employees or their beneficiaries, based on a definite predetermined formula for determining the profits to be shared and a definite predetermined formula for distributing the funds accumulated under the plan *after a fixed number of years*, the attainment of a stated age, or upon the prior occurrence of some event such as illness, disability, retirement, death or severance of employment. [Italics supplied.]

Section 39.23(p)-1 of Regulations 118, pertaining to the deduction of contributions for incidental benefits, states that section 23(p) is applicable to all contributions (including contributions to provide incidental benefits such as life insurance protection) under a stock bonus, pension, profit-sharing, or annuity plan.

For the purpose of this ruling, life insurance may be considered "incidental" where (1) the aggregate premiums for life insurance in the case of each participant is less than one-half of the aggregate of the contributions allocated to him at any particular time; and (2) the plan shall require the trustee to convert the entire value of the life insurance contract at or before retirement to provide periodic income so that no portion of such value may be used to continue life insurance protection beyond retirement.

In view of the foregoing, it is held that an investment by a profit-sharing trust in ordinary life insurance contracts under the above-stated conditions will not disqualify a profit-sharing plan under section 165(a) of the Internal Revenue Code.

REGULATIONS 118, SECTION 39.165-1: Employees' trusts. Rev. Rul. 54-67

A plan established by an employer which provides his employees only such benefits as are afforded through the purchase of ordinary life insurance contracts, which contracts are converted to life annuities at the normal retirement date, does not constitute a "pension" plan within the meaning of section 165(a) of the Internal Revenue Code.

Advice is requested whether a plan established by an employer which provides his employees only such benefits as are afforded through the purchase of ordinary life insurance contracts, which contracts are converted to life annuities at the normal retirement date, constitutes a "pension" plan within the meaning of section 165(a) of the Internal Revenue Code.

Section 165(a) of the Code provides in part as follows:

(a) EXEMPTION FROM TAX.—A trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall not be taxable under this supplement [Supplement E, Subchapter C of Chapter 1 of the Code.] * * *.

The primary purpose of an ordinary life insurance contract is the providing of life insurance protection, and the reserve accumulated thereon is a result of premium payments being made on a level basis. Such a reserve will provide a relatively small retirement annuity in comparison with the annuity that a retirement income contract of the same face amount will provide. Therefore, it may not be said that a plan providing only for the purchase of ordinary life insurance contracts is primarily for the payment of definitely determinable benefits to employees over a period of years after retirement. (See Regulations 118, section 39.165-1(a)(2).)

Accordingly, it is held that such a plan does not qualify as a "pension" plan within the meaning of section 165(a) of the Code. Such a plan is to be distinguished from a plan which also provides incidental life insurance protection. (See Regulations 118, section 39.23(p)(1)(a).)

REGULATIONS 118, SECTION 39.165-1: Employees' trusts. Rev. Rul. 54-152
(Also Sections 23(p), Section 39.23(p)-1.)

An employees' pension trust under which the employer does not contribute to the trust fund (the trust fund consisting only of stated contributions of employees and the income thereon), but does obligate itself to pay the full amount of the stipulated retirement benefits to each retired employee participant after the funds in the trust to the employee's credit have been exhausted, will not fail to qualify for exemption from Federal income tax under section 165 of the Internal Revenue Code by reason of such limitations upon contributions. Retirement benefits paid by the employer to retired employees pursuant to its obligation under such a plan may be deducted from gross income in accordance with section 23(p)(1)(D) of the Code. See section 39.23(p)-11, Regulations 118.

REGULATIONS 118, SECTION 39.165-1: Employees' trusts. Rev. Rul. 54-231

Section 39.165-1 of Regulations 118 provides that the term "profit-sharing plan," as used in section 165(a) of the Internal Revenue Code, is a plan established and maintained by an employer to provide for the participation in his profits, by his employees or their beneficiaries, based on definite predetermined formulas, for determining the profits to be shared and for distributing the funds accumulated under the plan after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event such as illness, disability, retirement, death, or severance of employment. The term "fixed number of years" is considered to mean at least 2 years. Accordingly, a plan which permits any employee to withdraw any portion of his share of the employer's contribution 18 months after it has been made and within a period of less than 2 years without regard to the attainment of a stated age or the occurrence of some event such as illness, disability, retirement, death, or severance of employment is not a profit-sharing plan within the purview of section 165(a) of the Code. Where the period of time is more than 2 years the Service will examine all the circumstances of the plan to determine its purpose and effect.

REGULATIONS 118, SECTION 39.165-6: Taxability of beneficiary under a trust which meets the requirements of section 165(a). Rev. Rul. 54-52

Funds used by the trustee of an employees' trust qualified under section 165(a) of the Internal Revenue Code, to pay premiums on a group life insurance contract which affords term insurance protection only, are currently includible in gross income of the employee-participant of the trust under the provisions of section 165(b) of the Code.

Advice is requested whether the last sentence of section 39.22(a)-3 of Regulations 118, is applicable to premiums paid by a qualified employees' trust under a group life insurance contract which affords term insurance protection only.

The last sentence of section 39.22(a)-3, *supra*, states that "Premiums paid by an employer on policies of group life insurance covering the lives of his employees, the beneficiaries of which are designated by the employees, are not income to the employees." However, the application of this statement of the regulations, as it appeared in section 29.22(a)-3 of the prior Regulations 111, was qualified and explained by Mimeograph 6477, C. B. 1950-1, 16. Paragraph 8 of this mimeograph, relating to employees' trusts, provides in part that "So much of a premium so paid as is used for current life insurance protection for an employee and is paid from contributions of the employer or earnings thereon constitutes income to the employee for the year when paid * * *." This statement is in conformity with the provisions of section 39.165-6 of Regulations 118, promulgated under section 165(b) of the Internal Revenue Code, which governs the taxibility of beneficiaries with respect to distributions received from a qualified employees' trust under section 165(a) of the Code. It will be noted that section 39.22(a)-3, *supra*, relates to premiums paid by employers, whereas, section 39.165-6, *supra*, governs the tax consequences of insurance protection purchased by an employees' trust for its participants.

Funds contributed by an employer to an employees' pension, profit-sharing or stock bonus trust are deemed to be compensation for services rendered as indicated in section 23(p) of the Internal Revenue Code. Amounts distributed or made available are includible in the distributees' gross income for the year so distributed or made available to the extent and in the manner prescribed under section 165(b) of the Code. Payments made by an employees' trust as a premium for life insurance protection of a participant of the trust constitute a distribution by the trust. See *Raymond J. Moore et al.* v. *Commissioner*, 45 B. T. A. 1073.

It is held that funds used to provide term life insurance protection for the trust participants under a group life insurance contract are currently includible in the gross income of the employee-participants under the provisions of section 165(b) of the Code.

SUPPLEMENT F.—PARTNERSHIPS

SECTION 182.—TAX OF PARTNERS

REGULATIONS 118, SECTION 39.182-1: Distributive shares of partners. Rev. Rul. 54-68
(Also Section 3797, Section 39.3797-4.)

An arrangement wherein the members of the medical staff of a hospital agree to pool certain fees constitutes a partnership for Federal tax purposes, and each member is taxable upon his distributive share of the net earnings thereof, whether or not distributed.

Advice is requested regarding the Federal income tax consequences of an agreement entered into by all member physicians of the medical staff of a hospital to pool certain fees.

Under the terms of the agreement entered into by all members of the hospital staff, the fees received by each individual physician on account of services rendered ward patients are turned over to a medical service fund. It appears that some ward patients are able to pay for their medical care but others are not. The purpose of the arrangement is to make sure that each member of the staff receives an equitable share of the fees paid by ward patients. Distributions are made out of the fund to the member physicians in proportion to the duration of their membership on the staff during the period of accumulation. By the end of each calendar year substantially all the fees received during such year are distributed, but certain small amounts are retained as reserves for administration expenses of the fund.

Section 3797(a)(2) of the Internal Revenue Code states that "The term 'partnership' includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which it not, within the meaning of this title, a trust or estate or a corporation." The term "partner" is defined as a member of such syndicate, group, pool, joint venture, or other unincorporated organization.

It is held that the instant arrangement constitutes a partnership within the meaning of section 3797(a)(2) of the Internal Revenue Code, and that the members of the hospital staff are the partners thereof. The organization must file a partnership return, Form 1065, for each taxable year reporting therein, among other things, the total amount of fees received for such taxable year, the names of the individuals who would be entitled to share in its net income if distributed and the amount of the distributive share of each individual. It is further held that each member must report as taxable income his distributive share of the net income of the organization for the taxable year ending with or within his taxable year, whether or not distributed, even though it may reflect certain amounts retained by the organization as a reserve for expenses.

REGULATIONS 118, SECTION 39.182-1: Distributive shares of partners. Rev. Rul. 54-167
(Also Section 23(e), Section 39.23(e)-1.)

A partnership cannot exist for the purpose of serving as an elected public official, and the compensation and any expense allowance received by a partner for his services in such an elective office do not constitute partnership income, even when pooled with the earnings of a partnership of which he is a member as required by the partnership agreement. Such partner must include his salary from the elective office, with the exception of any tax-exempt allowance, in the gross income in his individual Federal income tax return. To the extent that his share of the pooled income, consisting of his compensation, allowances, and partnership earnings, exceeds the amount paid by him to the pool, it will constitute his distributive share of the partnership income. In the event the amount paid by him to the pool is in excess of his share of the pooled income, such excess is a deductible loss to him under section 23(e) of the Internal Revenue Code, and is taxable income to his copartners. See I. T. 3824, C. B. 1946-2, 37.

SECTION 183.—COMPUTATION OF PARTNERSHIP INCOME

REGULATIONS 118, SECTION 39.183-1: Computation of partnership income.

Election to deduct intangible drilling and development costs as an expense. (See Rev. Rul. 54-42, p. 64.)

SECTION 187.—PARTNERSHIP RETURNS

REGULATIONS 118, SECTION 39.187-1: Partnership returns. Rev. Rul. 54-26
(Also Section 113(a), Sections 39.113(a)(5)-1 and 39.113(a)(13)-1.)

Application of Rev. Rul. 144, C. B. 1953-2, 212, relating to the effect on a partnership, for Federal income tax purposes, of the death, withdrawal, substitution, or addition of a partner.

Rev. Rul. 144, C. B. 1953-2, 212, revoked O. D. 228, C. B. 1, 190 (1919) and holds that a change in the membership of a partnership resulting from the death, withdrawal, substitution, or addition of a parner, or a shift of interest among existing partners does not, in itself, effect a termination of a partnership for Federal income tax purposes. Rev. Rul. 144 also holds that a partnership's basis in its assets is distinct from the partners' bases in their partnership interest, and is not affected by changes in such partnership interests. However, the bases of the interests of the partners may be affected by any change in membership.

In view of the fact that Revenue Ruling 144 was not published until August 3, 1953, the Internal Revenue Service, under the authority of section 3791(b) of the Internal Revenue Code, will not require the provisions of that Revenue Ruling to be applied with respect to those changes in partnership interests which occurred prior to January 1, 1954.

REGULATIONS 118, SECTION 39.187-1: Partnership returns. Rev. Rul. 54-55

Effect of the death of a partner in the case of a partnership consisting of only two partners.

Advice is requested whether Rev. Rul. 144, C. B. 1953-2, 212, holding that a change in the membership of a partnership resulting from the death, withdrawal, substitution, or addition of a partner or a shift of interests among existing partners does not, in itself, effect a termination of a partnership for Federal income tax purposes, applies to a case where one of two partners dies.

In some cases the surviving partner and the estate of the deceased partner continue the business as a partnership within the meaning of section 3797(a)(2) of the Internal Revenue Code. In this situation the rule of Rev. Rul. 144 is applicable.

In other cases the partnership business is wound up over a period of time and the deceased partner's estate continues decedent's interest in the profits and losses of the business during the winding-up period. In this situation the partnership continues throughout such period. See *Heiner* v. *Paul Mellon at al.*, 304 U. S. 271, Ct. D. 1345, C. B. 1938-1, 349.

In other cases the surviving partner, pursuant to an obligation undertaken in the partnership agreement, purchases the decedent's interest in the partnership from the decedent's estate for an amount fixed or determinable as of the date of decedent's death. In this situation the partnership terminates for Federal income tax purposes on the date of decedent's death.

Since this Revenue Ruling applies the principles stated in Rev. Rul. 144 to the facts herein, it will be given nonretroactive application to the same extent as Rev. Rul. 144, and accordingly, pursuant to the authority contained in section 3791(b) of the Code, the Internal Revenue Service will not require this Revenue Ruling to be applied with respect to those changes in partnership interests which occurred prior to January 1, 1954. See Rev. Rul. 54-26, page 153, this Bulletin.

SUPPLEMENT G.—INSURANCE COMPANIES

SECTION 201.—LIFE INSURANCE COMPANIES

REGULATIONS 118, SECTION 39.201-7: Net income and deductions. Rev. Rul. 54-232
(Also Section 201, Section 39.201-4.)

Federal income tax consequences of the exchange by an insurance company of more than 50 percent of the capital stock acquired by it in another insurance company for a substantial portion of such company's assets and business.

Advice is requested on the Federal income tax consequences of the exchange by an insurance company of more than 50 percent of the capital stock acquired by it in another insurance company for a substantial portion of such company's assets and business.

The A insurance company (herein called A) is and has for many years been a "life insurance company" within the meaning of section 201 of the Internal Revenue Code. It is engaged in the industrial, credit, and ordinary life insurance business and the health and accident insurance business. The B insurance company (herein called B) was organized for the purpose of engaging in the life insurance business. It is proposed that B will acquire by purchase from certain of A's stockholders more than 50 percent of the capital stock of A (all of the stock owned by such stockholders). Pursuant to a reinsurance agreement between A and B, B will surrender such stock to A and A will convey to B substantially all of its assets excepting about $3,000,000 in cash, stocks, and securities; A will transfer to B and B will reinsure most of A's insurance business, except that A will retain its credit life, credit accident, and credit accident and health insurance business, and a portion of its other life insurance business consisting of paid-up insurance. Upon completion of these transactions, which are subject to approval by the requisite authorities, the capital stock of A surrendered by B will be canceled.

Section 201(b) of the Internal Revenue Code provides in part as follows:

DEFINITION OF LIFE INSURANCE COMPANY.—When used in this chapter, the term "life insurance company" means an insurance company which is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with health and accident insurance), or noncancellable contracts of health and accident insurance, and the life insurance reserves (as defined in subsection (c)(2)) plus unearned premiums and unpaid losses on noncancellable life, health, or accident policies not included in life insurance reserves, of which comprise more than 50 per centum of its total reserves. For the purpose of this subsection, total reserves means life insurance reserves, unearned premiums and unpaid losses not included in life insurance reserves, and all other insurance reserves required by law. * * *

Section 201(c) of the Code, provides, in part, that in the case of a life insurance company, "The term 'gross income' means the gross amount of income received during the taxable year from interest, dividends, and rents."

It is held that if company A qualifies as a life insurance company within the meaning of section 201 of the Internal Revenue Code for the taxable year in which the transactions are consummated, such transactions will not result in the receipt of taxable income by A or its remaining stockholders, except insofar as rents or interest have been earned and not previously included in income on the assets transferred. (Cf. Rev. Rul. 255, C. B. 1953-2, 10.) If company A is a life insurance company within the meaning of section 201(b) of the Code prior to the consummation of the proposed transactions, and if after the proposed transactions and until the end of the taxable year during which the proposed transactions are consummated A is an "insurance company" and its life insurance reserves meet the 50-percent requirement of section 201(b) of the Code, it will continue to be a "life insurance company" within the meaning of section 201(b) of the Code for such taxable year. In this connection it is held that insurance reserves on paid-up life insurance policies, which reserves are required by law and are computed on the basis of recognized mortality tables and assumed rates of interest, constitute "life insurance reserves" within the meaning of sections 201(c)(2) and 201(b).

SUPPLEMENT H.—NONRESIDENT ALIEN INDIVIDUALS

SECTION 211.—TAX ON NONRESIDENT ALIEN INDIVIDUALS

REGULATIONS 118, SECTION 39.211-2: Definition. (Also Section 11, Section 39.11-2; Section 12, Section 39.12-1.) Rev. Rul. 54-87

A foreign student studying in the United States for a degree which requires temporary residence in the United States for a minimum of 2 years will be classified, for Federal income tax purposes, as a resident alien.

Advice is requested relative to the status for Federal income tax purposes of foreign students studying in this country.

In many instances foreign students, both graduate and undergraduate, combine a part-time job with their study program. Some of them bring their families with them to the United States.

Section 39.211-2 of Regulations 118 provides in part that an alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient is determined by his intentions with regard to the length and nature of his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned.

Accordingly, it is held that a foreign student studying in the United States for a degree which requires temporary residence in the United States for a minimum of 2 years will be classified, for Federal income tax purposes, as a resident alien during the period of such residence.

REGULATIONS 118, SECTION 39.211-7: Taxation of nonresident alien individuals. Rev. Rul. 54-53
(Also Section 143, Section 39.143-2.)

An individual who is not a United States citizen and who resides in Sweden receives periodic alimony payments from an intervivos trust established in the United States by her former husband for the purpose of making the payments. Such payments are taxable by the Swedish authorities under the revenue laws of that country. Such payments also constitute fixed or determinable annual or periodical income subject to the United States income tax. See *Girard Trust Corn Exchange Bank, as trustee of a trust under deed of Albert R. Gallatin Welsh dated March 19, 1935* v. *Commissioner*, 194 Fed. (2d) 708, certiorari denied 344 U. S. 821. *Held*, periodic alimony payments are not exempt from United States income tax under any of the provisions of the tax convention and protocol between the United States and Sweden, proclaimed by the President of the United States December 12, 1939, effective January 1, 1940. See T. D. 4975, C. B. 1940-2, 43. Accordingly, the alimony payments are subject to United States income tax and to the withholding of such tax at source at the rate of 30 percent. See sections 211(a)(1)(A) and 143(b) of the Internal Revenue Code. Further, Article XX of the convention, provides in part that where action of the competent authorities of the United States and Sweden has resulted or may result in double taxation in respect of any taxes to which the convention relates, such authorities may agree to an equitable avoidance of double taxation. However, such article does not refer to a case where the reason for the double taxation of income is due to the differences in the systems of taxation in the two countries.

SUPPLEMENT I.—FOREIGN CORPORATIONS

SECTION 231.—TAX ON FOREIGN CORPORATIONS

REGULATIONS 118, SECTION 39.231-1: Taxation of foreign corporations. Rev. Rul. 54-119

Income of a Canadian corporation derived from sources within the United States and attributable to the personal appearances in the

United States of an entertainer does not constitute compensation for personal services as contemplated by section 7.22(d) of the regulations prescribed under the United States-Canadian tax convention. See T. D. 5206, C. B. 1943, 526. Such income constitutes industrial and commercial profits which are exempt from tax under Article 1 of the convention, provided the corporation has no permanent establishment in the United States.

SUPPLEMENT J.—POSSESSIONS OF THE UNITED STATES

SECTION 251(a).—INCOME FROM SOURCES WITHIN POSSESSIONS OF UNITED STATES: GENERAL RULE

REGULATIONS 118, SECTION 39.251(a)-1: Citizens of the United States and domestic corporations deriving income from sources within a possession of the United States. — Rev. Rul. 54-16
(Also Section 51, Section 39.51-1.)

Where the income received by a husband during a portion of a taxable year for services rendered in a possession of the United States, is equally divided with his wife in accordance with community property laws of the State in which they are domiciled, either the husband or his wife, or both of them, may exclude such income from gross income for Federal income tax purposes provided they individually meet the statutory percentage requirements of section 251 of the Internal Revenue Code.

I. T. 3665, C. B. 1944, 161, modified.

Reconsideration has been given to the issue involved in I. T. 3665, C. B. 1944, 161, in the light of the decisions in *Francis C. Mullen et ux.* v. *Commissioner*, 14 T. C. 1179 and by the District Court of the United States in and for the Southern District of California, Central Division, in the case of *Maziebelle G. Markham* v. *United States*, June 23, 1953.

In I. T. 3665, *supra*, it was held that where a husband rendered service on Midway Island, a possession of the United States, for nearly 8 months during 1941 and received therefor compensation which constituted community income under the laws of the State of California where he and his wife were domiciled, that if the requirements of section 251 of the Internal Revenue Code were met by the husband, the wife's share of the community income was excluded from gross income for Federal income tax purposes. This conclusion was based on the principle that if compensation is received by the husband domiciled in a community property State and is exempt from taxation under the Internal Revenue Code, such income is excluded from gross income prior to its receipt by the wife, and that what she receives is exempt income. In other words, the income being exempt when earned by the husband, it is also exempt when received by the wife, regardless of whether the husband and the wife file separate returns or a joint return.

Since the publication of I. T. 3665, *supra*, the Tax Court has considered the case of *Francis C. Mullen et ux.* v. *Commissioner*, *supra*, which concerned a husband and wife who were residents of Texas, a community property State. During the taxable years 1945 to 1947, inclusive, the husband was employed in Puerto Rico and the wife in Texas. The taxpayers contended that the husband's income was exempt from Federal income tax under section 251 of the Code. It was held that inasmuch as the income of the husband was composed of one-half of his earnings and one-half of his wife's earnings, less than 80 percent of their respective income was derived from sources within a possession of the United States and that, therefore, neither the husband nor the wife qualified for exemption from tax under section 251(a)(1) of the Code. The Tax Court during the course of its opinion stated, in part, as follows:

The petitioners refer us to I. T. 3665, 1944 C. B. 161, which contains the following language from *E. R. Kaufman*, 9 B. T. A. 1180:

> "The earnings of the husband from personal services become immediately a part of the community. Any exemption from taxation in relation to those earnings immediately attaches to the total amount, and whatever right the wife may have to report one-half thereof can not affect its taxable status and convert into taxable income that which was exempt when it came into the community."

In that case, however, the earnings of the husband, as an employee of a state, were exempt from Federal income tax under the Revenue Act of 1921 and that exemption applied regardless of the later inclusion of the earnings in the community. There was no other test which the earnings had to meet in order to be exempt. The earnings of the husband in the present case were not exempt when they came into the community, because, in order to be exempt, the requirements of section 251 have to be complied with first. There is no choice as to when section 251 must apply, that is, before or after the amount earned by each spouse is brought into the community. The rights of each spouse in income being equivalent when it is earned, the question of whether or not any part of that income is exempt under section 251 must follow *after* a hypothetical distribution of the income between the spouses, for it is not until then that their respective rights in the earnings of each are known. In their application to the earnings of the spouses, the principles of community property law do not await the determination of the source of those earnings—they apply at once.

In the Markham case, *supra*, the taxpayer's husband was a member of a partnership which in 1940 entered into a joint agreement with a third party for the purpose of carrying out certain construction contracts in the Panama Canal Zone, a possession of the United States. The joint venture began operations in the Canal Zone on or about May 1, 1940, and continued to operate therein until December 31, 1941. All of the income of the taxpayer and her husband derived from the active conduct of the partnership business in the Panama Canal Zone was community income under the laws of California. Although the taxpayer had income other than from the partnership, her share of the income from the joint venture for the periods May 1, 1940, to December 31, 1941, amounted to at least 80 percent of her entire gross income for such period. The husband could not satisfy the percentage requirements of section 251 of the Code with respect to his income. The Government contended that inasmuch as the taxpayer's husband had earned the income and could not qualify for the exclusion under section 251 of the Code the taxpayer could not qualify even though she, in her individual capacity, met the requirements of section 251, that is, at least 80 percent of her income was derived from sources within a possession of the United States and at least 50 percent was derived from the active conduct of a trade or business within a possession of the United States. However, the court held that the taxpayer was entitled to the benefits of section 251 of the Code even though her husband could not qualify for such benefits.

The position taken in I. T. 3665, *supra*, was based in part on the case of *E. R. Kaufman* v. *Commissioner*, 9 B. T. A. 1180, acquiescences C. B. VII-2, 21, which held that where the income of the husband is exempt from taxation because it was derived from services performed for a State government, such income retains its exempt status in the hands of the wife, who under the community property laws of that State, is entitled to one-half of his income.

While the result reached in I. T. 3665, *supra*, is correct, assuming the wife in that case had no income other than her community share of the compensation earned and received by her husband on Midway Island, the Kaufman case is not applicable to, or controlling of, the exclusion granted in section 251, *supra*. The exclusion and exemption in both situations is with respect to a specified class of income. However, section 251 of the Code requires more than the determination of a class of income. It also requires that the class represent a specific portion of the taxpayer's gross income. Under section 116(a) of the Code income earned by either spouse while a bona fide resident of a foreign country for an uninterrupted period of an entire year or his or her presence in a foreign country for 17 months is exempt as to both spouses irrespective of how much or what kind of other income either or both may have. Under the situation in the Kaufman case, and the law as then existing, if services were performed for a State government by either spouse the income received therefor was exempt as to both spouses irrespective of any other income they may have had. However, under section 251 of the Code the mere fact that the income is in a specified class, that is, the income was derived from the active conduct of a trade or business within a possession of the United States or from sources within the possession, does not qualify such income for exclusion or exemption. In addition, in order for such income to be exempt it must be determined in the case of each individual taxpayer whether the percentage requirements of section 251, *supra*, are met.

In view of the foregoing, it is held that where the income received by a husband during a portion of a taxable year for services rendered in a possession of the United States, is equally divided with his wife in accordance with community property laws of the State in which they are domiciled, either the husband or his wife, or both of them may exclude such income from gross income for Federal income tax purposes provided they individually meet the statutory percentage requirements of section 251 of the Internal Revenue Code.

I. T. 3665, *supra*, is modified to accord herewith.

SUPPLEMENT O.—OVERPAYMENTS

SECTION 322.—REFUNDS AND CREDITS

REGULATIONS 118, SECTION 39.322-1: Authority for abatement, credit, and refund of tax. Rev. Rul. 54-149

Payments of estimated tax for a particular taxable year may not be refunded prior to the close of such taxable year, even though an amended declaration filed by the taxpayer after such payments were made may show an estimated tax liability of zero. Such payments may be refunded only after the close of the taxable year for which they are made, when the actual amount of taxes due and the amount of the overpayment may be correctly determined. See section 322(e) of the Internal Revenue Code.

REGULATIONS 118, SECTION 39.322-3: Claims for refunds by taxpayers. Rev. Rul. 54-17

The taxpayer, as the term is employed in section 322 of the Internal Revenue Code, means the one against whom the taxes were assessed. Thus where a corporation, since liquidated by merger with a successor corporation, overpaid its Federal income taxes, a claim for refund or credit should be executed by the successor corporation in the name of, and on behalf of, the corporation which paid such taxes, followed by the name of the successor corporation. There must be filed with each claim proper evidence establishing the liquidation and succession. If the succession is a matter of public record, certificates of the secretaries of state or other public officials having custody of these records must be attached. If the succession is not a matter of public record (and only in such event) then all pertinent documents pertaining to such succession, properly certified by a notary public or other qualified officers of the corporation, must be attached to the claim.

SUPPLEMENT R.—EXCHANGES AND DISTRIBUTIONS IN OBEDIENCE TO ORDERS OF SECURITIES AND EXCHANGE COMMISSION

SECTION 371.—NONRECOGNITION OF GAIN OR LOSS

REGULATIONS 118, SECTION 39.371-2: Purpose and scope of exception.

Transactions made to integrate and simplify a holding company system pursuant to an order of the Securities and Exchange Commission. (See Rev. Rul. 54-192, p. 99.)

SUPPLEMENT U.—TAXATION OF BUSINESS INCOME OF CERTAIN SECTION 101 ORGANIZATIONS

SECTION 421.—IMPOSITION OF TAX

REGULATIONS 118, SECTION 39.421-1: Imposition of tax.

Income received by a tax-exempt organization from research activities. (See Rev. Rul. 54-73, below.)

SECTION 422.—UNRELATED BUSINESS NET INCOME

REGULATIONS 118, SECTION 39.422-1: Definition of unrelated business net income. Rev. Rul. 54-73
(Also Section 421, Section 39.421-1; Section 101(6), Section 39.101(6)-1.)

Income derived from research by a tax-exempt college, university, or hospital, or by a tax-exempt organization operated primarily for the purpose of carrying on fundamental research, does not constitute income from an unrelated trade or business. Income derived by any organization to which supplement U is applicable from research for the United States or any of its agencies or for a State or political subdivision thereof is not income from an unrelated trade or business.

Advice is requested as to the taxability of income derived by colleges, universities, hospitals and other nonprofit organizations from research activities and of income derived from research for the United States or any of its agencies or instrumentalities, or for a State or political subdivision thereof.

Section 421 of the Internal Revenue Code provides in part as follows:

(a) IN GENERAL.—There shall be levied, collected, and paid for each taxable year beginning after December 31, 1950—

(1) upon the supplement U net income * * * of every organization described in subsection (b)(1), a normal tax of * * *

* * * * * * *

(b) ORGANIZATIONS SUBJECT TO TAX.—

(1) ORGANIZATIONS TAXABLE AS CORPORATIONS.—

(A) Organizations Exempt Under Section 101(1), (6), (7) and (14). * * *

(B) State Colleges and Universities.—The taxes imposed by subsection (a)(1) shall apply in the case of any college or university which is an agency or instrumentality of any government * * *. Such taxes shall also apply in the case of any corporation wholly owned by one or more such colleges or universities. * * *

(c) DEFINITION OF SUPPLEMENT U NET INCOME.—The term "supplement U net income" of an organization means the amount by which its unrelated business net income (as defined in section 422) exceeds $1,000.

Section 422 of the Code provides in part as follows:

(a) DEFINITION.—The term "unrelated business net income" means the gross income derived by any organization from any unrelated trade or business * * * subject to the following exceptions, additions, and limitations:

* * * * * * *

(7) There shall be excluded all income derived from research for (A) the United States, or any of its agencies or instrumentalities, or (B) any State or political subdivision thereof; and there shall be excluded all deductions directly connected with such income.

(8)(A) In the case of a college, university, or hospital, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income.

(B) In the case of an organization operated primarily for the purposes of carrying on fundamental research the results of which are freely available to the general public, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income.

Section 39.422-1(b)(6) of Regulations 118 provides that in computing unrelated business net income there shall be excluded income derived from research for the United States or any of its agencies or instrumentalities or a State or political subdivision thereof, and all deductions directly connected with such income; all income derived from research by a college, university or hospital performed for any person and all deductions connected with such income; and all income derived from research by an organization operated primarily for the purpose of carrying on fundamental research (as distinguished from applied research) the results of which are freely available to the general public performed for any person and all deductions connected with such income. The term "research" does not include activities of a type ordinarily carried on as an incident to commercial or industrial operations, for example, the ordinary testing or inspection of materials or products or the designing or construction of equipment and buildings. The term "fundamental research" does not include research carried on for the primary purpose of commercial or industrial application.

In the case of tax-exempt colleges; universities, and hospitals, as well as tax-exempt organizations operated primarily for the purpose of carrying on fundamental research (as distinguished from applied research) the results of which are freely available to the general public, income derived from any research, whether fundamental or applied, will not constitute income from an unrelated trade or business. Furthermore, in the case of any organization to which the tax imposed by section 421 of the Code is applicable, income derived from any research for the United States or any State, territory, or political subdivision thereof is excluded from unrelated business income and is not subject to supplement U tax. On the other hand, a tax-exempt organization which is not primarily engaged in fundamental research and which is not a college, university, or hospital will be subject to tax on its supplement U net income (except from sources mentioned in the preceding sentence) with respect to any research if regularly carried on and if not substantially related to its tax-exempt purposes.

Activities of a type ordinarily carried on as an incident to commercial or industrial operations such as those mentioned in the examples given in the regulations referred to above do not constitute research and are not excluded by the foregoing provisions in computing unrelated business net income of any organization subject to the supplement U tax whether or not the organization is of the class specified in section 422(a)(8) (A) and (B) above and whether or not the income from such activities is derived from a source specified in section 422(a)(7) above.

Whether the research or other activities not excluded from unrelated trade or business by the foregoing specific provisions constitute a trade or business unrelated to the organization's tax-exempt purposes is dependent on the facts of each case.

SUBCHAPTER D.—EXCESS-PROFITS TAX

PART I.—RATE AND COMPUTATION OF TAX

SECTION 433.—EXCESS-PROFITS NET INCOME

REGULATIONS 130, SECTION 40.433(a)-2: Computation of excess-profits net income for the taxable year. Rev. Rul. 54-74

Treatment for excess-profits tax purposes of bad debt recoveries by banks on the reserve method of accounting for bad debts.

Advice is requested with respect to the proper treatment, for excess-profits tax purposes, to be accorded recoveries of bad debts in the case of banks using the reserve method of accounting for bad debts.

Section 433(a)(1)(G) of the Internal Revenue Code provides for the exclusion from excess-profits net income of any income attributable to the recovery of a bad debt if the deduction for such debt was allowable from gross income for any taxable year for which an excess-profits tax was not imposed (that is, a taxable year beginning before January 1, 1940, or a taxable year beginning after December 31, 1945, and ending before July 1, 1950), or if such debt was properly charged to a bad debt reserve during any such taxable year. Under section 433(a)(1)(L) of the Code, banks which have elected the reserve method of accounting for bad debts for income tax purposes should substitute for excess-profits tax purposes a deduction for bad debts which actually become worthless in the taxable year.

Line 19, page 1 of Schedule EP (Form 1120), for the taxable years 1952 and 1953 should reflect the excess, if any, of the actual bad debts for the taxable year over the total recoveries of bad debts during such taxable year. If such recoveries exceed such actual bad debts, line 19 should show such excess as an addition, preferably in red ink. Line 16 of the returns should reflect only those recoveries which should be excluded under section 433(a)(1)(G) of the Code. Since, for excess-profits tax purposes, banks are on the specific chargeoff method for treating bad debts, no adjustment on line 5 of Schedule EP (Form 1120) will be necessary where the ceiling is reached and no addition to the reserve is permissible for income tax purposes under the provisions of Mimeograph 6209, C. B. 1947-2, 26.

SECTION 433(b).—EXCESS-PROFITS NET INCOME: TAXABLE YEARS IN BASE PERIOD

REGULATIONS 130, SECTION 40.433(b)-3: Abnormal deductions in base period.

Meaning of the word "deductions" in the term "abnormal deductions" for excess-profits tax purpose. (See Rev. Rul. 54-88, p. 177.)

SECTION 437.—INVESTED CAPITAL CREDIT

REGULATIONS 130, SECTION 40.437-5: Definition of equity capital.
(Also Section 458, Section 40.458-4.)

T. D. 6065

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS-PROFITS TAX; TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Regulations 130 amended to clarify treatment of taxpayer's liability for Federal income and excess-profits tax for the purpose of determining both equity capital under section 437(c) and equity invested capital under section 458(d) of the Internal Revenue Code.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

On December 13, 1952, notice of proposed rulemaking to amend Regulations 130 [26 CFR, pt. 40] with respect to the accrual of income and excess-profits tax liability for the purpose of determining equity capital under section 437(c) of the Internal Revenue Code and equity invested capital under section 458(d) of the Internal Revenue Code was published in the Federal Register (17 F. R. 11350). After consideration of all relevant matter presented by interested persons regarding the rules proposed, the amendments to Regulations 130 set forth below are hereby adopted.

PARAGRAPH 1. Section 40.437-5, as amended by Treasury Decision 5952 [C. B. 1952-2, 202], approved December 2, 1952, is further amended by redesignating "(c)" of such section as "(c)(1)", and by adding at the end thereof the following:

(2) In computing liabilities as of the beginning of the taxable year, a taxpayer keeping its books and making its income tax returns on the accrual basis shall, in accordance with the principles applicable in the determination of earnings and profits, treat as a liability the Federal income and excess-profits taxes imposed for the preceding taxable year. This rule is applicable whether or not such taxes were definite and ascertainable in amount at the close of the preceding year and whether or not such taxes were contested by the taxpayer. The provisions of the Excess Profits Tax Act of 1950 shall be taken into account for this purpose in determining the income and excess-profits tax for taxable years ending after June 30, 1950. In general, changes in the Federal income and excess-profits tax laws applicable to a taxable year, enacted after the close of such year, will be taken into account in determining liabilities if the last date prescribed for filing the return for such year is subsequent to the date of enactment of such changes.

PAR. 2. Section 40.458-4 is amended by striking the fourth sentence of (a)(1) and by inserting in lieu thereof the following:

In computing accumulated earnings and profits as of the beginning of the taxable year, a taxpayer keeping its books and making its income tax returns on the accrual basis shall, in accordance with the principles applicable in the determination of earnings and profits, subtract the Federal income and excess-profits taxes imposed for the preceding taxable year. This rule is applicable whether or not such taxes were definite and ascertainable in amount at the close of the preceding year and whether or not such taxes were contested by the taxpayer. The provisions of the Excess Profits Tax Act of 1950 shall be taken into account for this purpose in determining the income and excess-profits tax for taxable years ending after June 30, 1950. In general, changes in the Federal income and excess-profits tax laws applicable to a taxable year, enacted after the close of such year, will be taken into account in determining earnings and profits if the last date prescribed for filing the return for such year is subsequent to the date of enactment of such changes.

(This Treasury Decision is issued under the authority contained in secs. 62 and 3791 of the Internal Revenue Code (53 Stat. 32, 467; 26 U. S. C. 62, 3791).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved March 19, 1954.
M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 24, 1954, 8:49 a. m.)

SECTION 449.—PERSONAL SERVICE CORPORATIONS

REGULATIONS 130, SECTION 40.449-1: Taxation of personal service corporations. Rev. Rul. 54-18
(Also Section 52, Section 39.52-1, Regulations 118.)

Taxpayers desiring to use Schedule PS (Form 1120), Computation of United States Personal Service Corporation Income, in filing returns for the calendar year 1953 or for a fiscal year ending in 1954 should utilize Schedule PS (Form 1120) for 1951 and should make the appropriate changes in the dates printed thereon.

SECTION 452.—ADJUSTMENT IN CASE OF POSITION INCONSISTENT WITH PRIOR INCOME TAX LIABILITY

REGULATIONS 130, SECTION 40.452-4: Ascertainment of amount of adjustment. T. D. 6061
(Also Section 40.452-5.)

TITLE 26—INTERNAL REVENUE—CHAPTER I, SUBCHAPTER A, PART 40.—EXCESS PROFITS TAX: TAXABLE YEARS ENDING AFTER JUNE 30, 1950

Regulations 130 amended to correct the example in section 40.452-4(f), relating to adjustment in case of position inconsistent with prior income tax liability.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

Regulations 130 (26 CFR, pt. 40) are hereby amended as follows:

PARAGRAPH 1. Section 40.452-4(f), which contains an example illustrating the computation of an adjustment in the case of a position inconsistent with prior income tax liability, is amended as follows:

(A) By striking out the computation following the colon in the third paragraph of the section and inserting in lieu thereof the following:

Tax previously determined for 1946	$28,500
Normal-tax net income ($75,000) and surtax net income ($75,000) on which tax previously determined was based	75,000
Plus: Ordinary loss previously allowed under section 117(j) (excess of $25,000 loss on exchange with Y Corporation over $10,000 gain on sale of other depreciable business property)	15,000
Ordinary normal-tax net income	90,000
Ordinary surtax net income	90,000
Tax as recomputed (38 percent of $90,000 plus 25 percent of $10,000 gain from sale of depreciable business property)	36,700
Tax previously determined	28,500
Increase in tax	8,200
Interest on increase in tax	1,968
Total increase for 1946	10,168

(B) By striking out the computation following the colon in the last paragraph of the section and inserting in lieu thereof the following:

Increase for 1946 (X Corporation)	$10,168
Less: Decrease for 1946 (Y Corporation)	589
Net increase (amount of adjustment authorized)	9,579

PAR. 2. Section 40.452–5(b), relating to the deductibility of the portion of the adjustment under section 452 which represents interest, is amended by substituting "$1,854" for "$942" and "$1,968" for "$1,056".

Because this Treasury Decision merely corrects an erroneous computation in the regulations, it is found to be unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that act.

(This Treasury Decision is issued under the authority contained in secs. 62 and 3791 of the Internal Revenue Code (53 Stat. 32, 467; 26 U. S. C. 62, 3791).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved January 19, 1954.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 22, 1954, 8:51 a. m.)

SECTION 458.—HISTORICAL INVESTED CAPITAL

REGULATIONS 130, SECTION 40.458–4: Determination of equity invested capital—Accumulated earnings and profits.

Regulations 130 amended. (See T. D. 6065, p. 163.)

PART II.—EXCESS-PROFITS CREDIT BASED ON INCOME IN CONNECTION WITH CERTAIN EXCHANGES

SECTION 461.—DEFINITIONS

REGULATIONS 130, SECTION 40.461–2: Acquiring corporations. Rev. Rul. 54–107

Where a corporation has disposed of a portion of its assets, distributed the proceeds to its shareholders, and exchanged its remaining assets for all of the issued and outstanding capital stock of a newly formed corporation, the formation of the new corporation will be deemed, for purposes of subchapter D of chapter 1 of the Internal Revenue Code, a transaction within the meaning of section 461(a)(1)(E) of the Code and, therefore, the new or "acquiring corporation" is entitled to compute its excess-profits credit under part II of subchapter D of chapter 1 of the Code.

Advice is requested whether the formation of a new corporation, and the transfer of certain assets under the following circumstances, will qualify as a part II transaction within the meaning of section 461(a)(1)(E) of the Internal Revenue Code, and whether the new corporation is entitled to compute its excess-profits credit under part II of subchapter D of chapter 1 of the Code.

The M Corporation, hereinafter referred to as the taxpayer, was incorporated in 1922. Its authorized capital stock consists of 10,000 shares of preferred stock and 5,000 shares of common stock. Due to certain circumstances involved, its stockholders authorized the board of directors to liquidate and dissolve the corporation and to distribute the proceeds in accordance with the provisions of the stockholders liquidation agreement.

The taxpayer's assets included, among other things, the capital stock of several subsidiary corporations, all but one of which were liquidated under the provisions of section 112(b)(6) of the Code. The capital stock of the remaining subsidiary corporation was sold. Certain fixed assets were also sold. The proceeds of these transactions were distributed to the stockholders in accordance with the provisions of the liquidation agreement. The remaining assets of the taxpayer consisted of a manufacturing plant which it had been unable to dispose of, and certain other assets. In order to avoid unnecessary waste and to maintain the property in good condition for a potential purchaser, these assets, which constituted substantially less than all of the properties of the taxpayer, were transferred, subject to certain liabilities, to a newly organized corporation in exchange for all of its issued and outstanding capital stock. The taxpayer will retain the stock until a sale of it is effected, or until the assets of the new corporation are sold and the corporation is liquidated. The proceeds will then be distributed to the taxpayer's stockholders pursuant to the liquidation agreement.

Section 40.461-2 of Regulations 130 states in part:

SEC. 40.461-2. ACQUIRING CORPORATIONS.—(a) The types of transactions whereby a corporation becomes an acquiring corporation are specified in section 461(a). In addition to statutory mergers and consolidations and the acquisition of property in a complete liquidation in which gain or loss is not recognized because of the provisions of section 112(b)(6), only the following types of transactions are included.

* * * * * * *

(5) Under section 461(a)(1)(E), the acquisition of a part, as distinguished from all or substantially all, of the properties of a corporation * * *. A transaction which qualifies as a Part II transaction without regard to section 461(a)(1)(E), is not a transaction described in section 461(a)(1)(E) for the purpose of any special rule under Part II pertaining to transactions described in section 461(a)(1)(E).

In view of the foregoing, it is held that the transfer of the remaining properties of the taxpayer to the new corporation was part of a single transaction which embraced the prior distributions by the taxpayer as well as the instant acquisition by the new corporation. Since, when viewed in this manner, less than "substantially all the properties" of the taxpayer were transferred to the newly formed corporation in exchange for all of its issued and outstanding capital stock, it is further held that the creation of the new corporation and the transfer of the remaining assets to it is, for purposes of subchapter D of chapter

1 of the Internal Revenue Code, a transaction within the meaning of section 461(a)(1)(E) of the Code, and that the new or "acquiring corporation" is entitled to compute its excess-profits credit under part II of subchapter D of chapter 1 of the Code.

REGULATIONS 130, SECTION 40.461-2: Acquiring corporations. Rev. Rul. 54-120
(Also Section 474, Section 40.474-1.)

Taxpayer is not an acquiring corporation within the meaning of section 461(a)(1)(D) of the Internal Revenue Code, since it did not acquire substantially all the properties of the sole proprietorship in exchange for all of its capital stock. It is, however, a purchasing corporation within the purview of section 474(a)(1)(A) of the Code, since the properties acquired constituted substantially all the properties (other than cash) owned by the proprietorship.

Advice is requested whether, under the facts hereinafter stated, the taxpayer is an acquiring corporation within the meaning of section 461(a)(1)(D) of the Internal Revenue Code, or a purchasing corporation within the purview of section 474(a)(1)(A) of the Code.

The taxpayer was organized in 1949 for the purpose of carrying on a supply business formerly operated as a sole proprietorship under the name of M Company. During the same year the merchandise inventory, furniture and equipment, and goodwill of the proprietorship, with an aggregate balance sheet value of \$13.4*x*, were transferred to the taxpayer in exchange for all of its capital stock, a nontaxable exchange under section 112(b)(5) of the Internal Revenue Code. On the same date, the real estate of the proprietorship, with an aggregate balance sheet value of \$.5*x*, was transferred to the N Corporation, another corporation formed simultaneously with the taxpayer corporation. That part of such real estate necessary for the taxpayer's operations was leased from the N Corporation. The remaining assets, consisting of cash in the amount of \$3.7*x*, trade accounts receivable in the amount of \$3.9*x*, and other receivables and sundry assets in the amount of \$.3*x*, were retained by the proprietorship which also remained obligated for the liabilities, with an aggregate balance sheet value of \$4*x*, none being assumed by either corporation. No active business was carried on by the proprietorship after the date of the foregoing transactions.

Under section 461(a)(1)(D) of the Internal Revenue Code, an acquiring corporation is defined as a corporation which has acquired "substantially all the properties of a partnership in an exchange to which section 112(b)(5), or so much of section 112 (c) or (e) as refers to section 112(b)(5), is applicable." The word partnership as used in section 461(a)(1)(D), *supra*, is defined in section 461(f) of the Code to include a business owned by a sole proprietorship. On the basis of the facts submitted, it is held that the properties acquired by the taxpayer did not constitute substantially all the properties of the proprietorship within the meaning of section 461(a)(1)(D) of the Code.

Section 474 of the Code, entitled "Excess Profits Credit Based on Income—Certain Taxable Acquisitions," defines a purchasing corporation, in subsection (a)(1)(A) thereof, as a corporation which, before

December 1, 1950, acquired "in a transaction other than a transaction described in section 461(a), substantially all of the properties (other than cash) of another corporation, of a partnership, or of a business owned by a sole proprietorship." Although the title to section 474 would, if construed literally, limit that section only to certain taxable acquisitions, it is the position of the Internal Revenue Service that a corporation which acquires properties from a sole proprietorship in a nontaxable transaction, as in the instant case, may qualify as a purchasing corporation under such section, provided the transaction is not one described in section 461(a) of the Code. This view is recognized in sections 40.474-5(a)(3) and 40.474-6(a)(3) of Regulations 130, as added by T. D. 5998, C. B. 1953-1, 372.

Accordingly, it is held that the taxpayer is not an acquiring corporation within the meaning of section 461(a)(1)(D) of the Internal Revenue Code, since it did not acquire substantially all of the properties of the sole proprietorship in exchange for all of its capital stock. It is further held that the taxpayer is a purchasing corporation within the purview of section 474(a)(1)(A) of the Code, since the properties acquired did constitute substantially all the properties (other than cash) owned by the proprietorship. The qualification of the purchase as one of substantially all the properties under section 474(a)(1)(A) is attributable to the exclusion of cash from consideration pursuant to the specific language of that section.

PART IV.—EXCESS-PROFITS CREDIT BASED ON INCOME IN CONNECTION WITH CERTAIN TAXABLE ACQUISITIONS OCCURRING PRIOR TO DECEMBER 1, 1950

SECTION 474.—EXCESS-PROFITS CREDIT BASED ON INCOME—CERTAIN TAXABLE ACQUISITIONS

REGULATIONS 130, SECTION 40.474-1: Purpose and scope of part IV.

Acquisition by a corporation of substantially all the properties (other than cash) of a business owned by a sole proprietorship. (See Rev. Rul. 54-120, p. 168.)

SUBCHAPTER E.—TAX ON SELF-EMPLOYMENT INCOME

SECTION 481.—DEFINITIONS

REGULATIONS 118, SECTION 39.481-1: Net earnings from self-employment.
(Also Section 3797, Sections 39.3797-1, 39.3797-4.)

Rev. Rul. 54-75

The term "net earnings from self-employment" as defined in section 481(a) of the Internal Revenue Code may include the income derived by a wife from a trade or business carried on by a husband and wife partnership, even though such a partnership is not recognized as valid under the law of the State in which organized and operated.

Advice is requested whether the term "net earnings from self-employment" as defined in section 481(a) of the Internal Revenue Code may include partnership income of wives who are members of a husband and wife partnership where such a partnership is not recognized as valid under the law of the State in which it operates, but is recognized for Federal income tax purposes. In the instant case the partnerships under consideration operate in Louisiana and Texas.

In Louisiana and in Texas in some circumstances husband and wife partnerships are not recognized for many purposes. See for example, *Fairbanks, Morse & Co.* v. *Bordelon et al.*, 198 So. 391; *Monroe Grocery Co., Ltd.* v. *T. L. & M. Davis et al.*, 116 So. 546; 13 Tex. Civ. Stat. Art. 4626; *Dillard et al.* v. *Smith, Chief Justice et al.*, 205 S. W. (2d) 366. The question presented is whether State law is controlling in determining the existence of a partnership for self-employment tax purposes.

Under section 481(a) of the Internal Revenue Code the term "net earnings from self-employment" includes an individual's distributive share of the ordinary net income or loss "as computed under section 183," from any trade or business carried on by a partnership of which he is a member, with certain exceptions not here material. Thus, for purposes of determining net earnings from self-employment a partnership is one which is recognized as such for income tax purposes. See section 39.481-1 of Regulations 118.

Section 3797(a)(2) of the Internal Revenue Code provides a definition of the words "partnership" and "partner" for purposes of the Internal Revenue Code. Section 39.3797-1 of Regulations 118 provides that the term "partnership" within the meaning of the Code is not limited to the common law meaning of partnership, but is broader in its scope and includes groups not commonly called partnerships. It follows that the term "partner" is not restricted to one who has the capacity to become a member of a partnership under local law. The Code prescribes its own standards of classification of business organizations and local law is not controlling.

Where a wife who is a member of the same partnership as her husband is regarded as a partner within the meaning of the Code, her distributive share of the "ordinary net income * * * from any trade or business carried on" by the partnership may constitute "net earnings from self-employment" as defined in section 481(a) of the Code for purposes of the tax on self-employment income even though such partnership is not recognized for some purposes under the law of the State in which it operates.

REGULATIONS 118, SECTION 39.481-1: Net earnings from self-employment. Rev. Rul. 54-112

Amounts paid to a seamstress for services performed for an established customer clientele constitute earnings from self-employment within the meaning of section 481(a) of the Internal Revenue Code, where the services are performed in the private homes of the customers, the seamstress furnishes the equipment required to do the work, and she determines the fee to be charged.

Advice is requested whether amounts paid to a seamstress for the performance of services in the private homes of her customer clientele constitute earnings from self-employment for purposes of the Self-Employment Contributions Act.

In the instant case, the seamstress is engaged in making dresses, housecoats, children's clothes, slipcovers, and draperies and in altering garments. She has been engaged in this work for several years and has developed an established customer clientele who call on her for such services. She works in the private homes of her customers, furnishing her own equipment, such as scissors, needles, patterns, and a portable sewing machine. Charges for the work performed are determined by her according to the amount of time required for the completion of the work involved. While most of her work comes from her regular customers, she occasionally accepts work from others. Her work is seasonal.

Section 481 of the Internal Revenue Code provides in part as follows:

> (a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this chapter [chapter 1] which are attributable to such trade or business * * *
>
> * * * * * * *
>
> (c) TRADE OR BUSINESS.—The term "trade or business", when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 23, except that such term shall not include—
>
> * * * * * * *
>
> (2) The performance of service by an individual as an employee * * *

While each case must be determined upon the basis of its particular facts, in the instant case the seamstress is not performing services as an employee, but is engaged in carrying on a trade or business. Accordingly, the amounts paid to her for the services performed for her customers constitute earnings from self-employment within the meaning of section 481(a) of the Internal Revenue Code.

REGULATIONS 118, SECTION 39.481-1: Net earnings from self-employment. Rev. Rul. 54-194

> The income derived by an individual from the sale of Christmas trees which are grown, without planting or cultivating the soil, on mountainous cut-over timberland owned by him constitutes earnings from self-employment for Federal self-employment tax purposes.

Advice is requested whether the income derived by an individual from the sale of Christmas trees grown on uncultivated timberland is subject to the tax on self-employment income.

An individual who is regularly employed at a yearly salary as a "ditch rider" on an irrigation project owns several parcels of timberland from which he cuts trees to be sold as Christmas trees in carload lots direct to dealers. The land on which the trees are grown is mountainous and has previously been logged off, the logs having been sold to sawmills. The stumps have not been removed to afford cultivation and the land cannot be plowed or seeded even for grazing purposes. The individual purchased the land primarily for the purpose of selling the trees and he has no intention of cultivating the soil for use as a farm or for the raising of livestock. The trees are not planted and the soil is not cultivated to promote their growth. The individual prunes the trees and cuts down larger trees to afford more light and sunshine for the smaller ones. He devotes approximately 160 hours per year to pruning, cutting, and selling the Christmas trees and he does not engage any persons to assist him.

Section 481(a) of the Internal Revenue Code provides in part:

(a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed * * * except that in computing such gross income and deductions * * *—

* * * * * * *

(2) There shall be excluded income derived from any trade or business in which, if the trade or business were carried on exclusively by employees, the major portion of the services would constitute agricultural labor as defined in section 1426(h) * * *

Section 1426(h) of the Code defines the term "agricultural labor" as including all services performed:

(1) On a farm, in the employ of any person, in connection with cultivating the soil, or in connection with raising or harvesting any agricultural or horticultural commodity, * * *

* * * * * * *

As used in this section, the term "farm" includes stock, dairy, poultry, fruit, fur-bearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards.

It is held that services performed in the employ of any person in connection with the planting, raising, cultivating, and harvesting of Christmas trees constitute "agricultural labor" as that term is defined in section 1426(h) of the Code, only when such services are performed on a "farm." Services performed in connection with the cutting and transporting of trees from uncultivated land or forests do not constitute "agricultural labor" within the meaning of such section.

Since the operations of the individual involved in the instant case were not conducted on a "farm," the services performed in connection with such operations are not to be treated as "agricultural labor" as defined in section 1426(h) of the Code.

Accordingly, it is held that the income derived by an individual from the sale of Christmas trees which are grown without planting or cultivating the soil on mountainous cut-over timberland owned by him constitutes earnings from self-employment for Federal self-employment tax purposes.

REGULATIONS 118, SECTION 39.481-1: Net earnings from self-employment.

Income derived by coowner and manager of a farm excluded from "net earnings from self-employment" by reason of the provisions of section 481(a)(2) of the Self-Employment Contributions Act. (See Rev. Rul. 54-170, p. 213.)

REGULATIONS 118, SECTION 39.481-3: Trade or business. Rev. Rul. 54-208

Services performed by an individual as a normal extension of his profession of funeral director are considered as incidental to the practice of such profession and net earnings therefrom will be exempt from the tax on self-employment; however, where a funeral director engages in an enterprise which is not incidental to the practice of his profession of funeral director, such as the operation of an ambulance service, a furniture store, or a florist shop, the net earnings therefrom will not be exempt from the tax on self-employment income.

Advice is requested as to the scope of the term "funeral director" as it is used in the Self-Employment Contributions Act, section 481(c)(5) of the Internal Revenue Code. For taxable years beginning after December 31, 1950, section 480 of the Code imposes a tax upon the self-employment income of every individual. Self-employment income, in general, consists of the net earnings derived by an individual (other than a nonresident alien) from a "trade or business" carried on by him as sole proprietor or by a partnership of which he is a member, subject to certain exclusions, exceptions, and limitations.

For purposes of such tax, section 481(c)(5) of the Code excludes from the term "trade or business" the performance of services by an individual in the exercise of his profession as a funeral director. However, the performance of these services by an individual cannot constitute the exercise of such excluded profession unless the individual meets the legal requirements, if any, for the practice thereof in the place where the services are performed. Furthermore, the statutory designation of the term "funeral director" is to be given its commonly accepted meaning. See Regulations 118, section 39.481-3; Rev. Rul. 276, C. B. 1953-2, 88.

Generally this term is understood to refer to one who is responsible for making and carrying out all of the necessary arrangements for funerals. In connection with the practice of his profession, a funeral director may perform services not in themselves so excluded such as the reporting of deaths, the procurement of permits required by law, the procurement of certified copies of death certificates, the removal and transportation of bodies for embalming processes, the embalming of bodies, and the sale of caskets, vaults, and shrouds. But since each of these activities is a normal extension of the exercise of the profession of funeral director, and can reasonably be embraced therein, all of them will be regarded as an incidence of the practice of such profession and, hence, the net earnings therefrom will be exempt from the tax on self-employment income.

On the other hand, if one who practices the profession of funeral director also engages in an enterprise which is not incidental thereto, such as the operation of an ambulance service, a furniture store, or a florist shop, the net earnings from each must be segregated and only those attributable to such profession can be exempt from the tax on self-employment income. See Rev. Rul. 275, C. B. 1953-2, 86.

REGULATIONS 118, SECTION 39.481-3: Trade or business. Rev. Rul. 54-223

Remuneration for services performed by a member of a partnership as an employee of another organization constitutes wages paid to him, no part of which may be considered as gross income derived from a trade or business carried on by the partnership for purposes of computing net earnings from self-employment, even though the wages have been assigned to the partnership in accordance with a partnership agreement providing for pooling all of the income earned by all of the partners.

Advice is requested relative to the treatment for self-employment tax purposes of certain wages earned by an individual and assigned to a partnership of which he is a member.

In the instant case, the individual receives remuneration for personal services performed by him as driver of a school bus. He is also a member of a partnership engaged in the gas, oil and garage business. Since the partners have agreed to pool all income earned by them, he turns the amount received for services as a bus driver over to the partnership and it is included in the gross income of the partnership in computing the amount of net income distributable to the partners.

Section 481 (a) of the Internal Revenue Code defines the term "net earnings from self-employment" as the "gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this chapter [Ch. I] which are attributable to such trade or business, plus his distributive share (whether or not distributed) of the ordinary net income or loss, as computed under section 183, from any trade or business carried on by a partnership of which he is a member; * * *"

Section 481(b) of the Code provides generally that the term "self-employment income" means the net earnings from self-employment derived by an individual but does not include—

> (1) That part of the net earnings from self-employment which is in excess of: (A) $3,600, minus (B) the amount of the wages paid to such individual during the taxable years; * * *

Section 481(c) of the Code provides that the term "trade or business" as used in section 481(a) of the Code shall not include the performance of service by an individual as an employee.

Where a partner as an employee of another organization earns compensation constituting "wages" for Federal employment tax purposes, those wages are subject to such taxes irrespective of whether they have been assigned to his partnership. Accordingly, in line with the purpose of section 481(b) of the Code, the employee-partner in the instant case should treat such wages as "wages paid" to him in computing his self-employment income in accordance with section 481(b)(1) of the Code. No part of such wages paid over to the other partners in accordance with the partnership agreement may be considered as "gross income derived * * * from any trade or business" carried on by such other partners, within the meaning of section 481(a) of the Code, for purposes of computing their "net earnings from self-employment."

The conclusions stated herein are limited to the application of the self-employment tax to assignments of wages by an employee-partner to his partnership.

CHAPTER 2.—ADDITIONAL INCOME TAXES

SUBCHAPTER A.—PERSONAL HOLDING COMPANIES

SECTION 502.—PERSONAL HOLDING COMPANY INCOME

REGULATIONS 118, SECTION 39.502-1: Personal holding company income. Rev. Rul. 54-34

The M Corporation, a corporation engaged in the business of selling fire insurance, is the assignee of certain insurance agency agreements to which A and his son are parties. A owns more than 25 percent in value of the outstanding stock of M Corporation. The insurance agency agreements were entered into during a period in which A and his son were engaged in the business of selling fire insurance under a partnership agreement, and provide in part that A or his son are named as agent for a fire insurance company, with "full power and authority to receive and accept proposals for insurance covering such classes of risks as the company may, from time to time, authorize to be insured; to collect, receive, and receipt for premiums on insurance tendered by the agent to and accepted by the company * * *." The fire insurance company has not relinquished its right to name the individual who may accept insurance risks on its behalf under the contract. *Held*, under the provisions of section 502(e) of the Internal Revenue Code, commissions received by M Corporation pursuant to the contract constitute personal holding company income. *Cf. General Management Corporation* v. *Commissioner*, 135 Fed. (2d) 882, certiorari denied, 320 U. S. 757.

SECTION 504.—UNDISTRIBUTED SUBCHAPTER A NET INCOME

REGULATIONS 118, SECTION 39.504-1: Undistributed subchapter A net income. T. D. 6058
(Also Section 29.504-1, Regulations 111.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29 AND PART 39

Regulations 111 and 118 amended to conform to section 349 of the Revenue Act of 1951, relating to the exclusion of certain nondistributable subchapter A net income of personal holding companies.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

On September 5, 1953, there was published in the Federal Register (18 F. R. 5388) a notice of proposed rulemaking with respect to amendments to conform Regulations 103 and 111 [26 CFR, pts. 19, 29] to section 349 of the Revenue Act of 1951, approved October 20, 1951, relating to the exclusion of certain nondistributable income in determining the undistributed subchapter A net income of personal holding companies. No comments regarding the rules proposed having been received during the 30-day period prescribed in such notice, the amendments to such regulations and to Regulations 118 [26 CFR, pt. 39] set forth below are hereby adopted:

REGULATIONS 111 [26 CFR, PT. 29]

PARAGRAPH 1. There is inserted immediately preceding section 29.504–1 following:

SEC. 349. NONDISTRIBUTABLE INCOME OF PERSONAL HOLDING COMPANIES [REVENUE ACT OF 1951, APPROVED OCTOBER 20, 1951].

Effective for taxable years beginning after December 31, 1939, section 504 is hereby amended by adding at the end thereof the following new subsection:

"(e) The amount by which the undistributed subchapter A net income determined without reference to this subsection exceeds the amount which could be distributed on the last day of the taxable year as a dividend (1) without violating any action, regulation, rule, order, or proclamation taken, promulgated, made, or issued by, or pursuant to the direction of, the President or any agency that he may designate, under the Trading With the Enemy Act of October 16, 1917, as amended, or the First War Powers Act of 1941, and (2) not subject to a lien in favor of the United States."

PAR. 2. Section 29.504–1 is amended as follows:

(A) By deleting in the first sentence thereof the word "and" which immediately precedes "(D)".

(B) By striking the period at the end of the first sentence and by inserting in lieu thereof a comma and the following:

and (E) the amount by which the undistributed subchapter A net income (determined without reference to this provision) exceeds the amount which could be distributed on the last day of the taxable year as a dividend (1) without violating any action, regulation, rule, order, or proclamation taken, promulgated, made, or issued by, or pursuant to the direction of, the President or any agency that he may designate, under the Trading With the Enemy Act, 40 Stat. 411, as amended (50 U. S. C. App. 1 et seq.), or the First War Powers Act, 1941, 55 Stat. 838 (50 U. S. C. App. 601 et seq.), and (2) not subject to a lien in favor of the United States.

PAR. 3. The amendments to Regulations 111 (covering taxable years beginning after December 31, 1941, and before January 1, 1952) made by paragraphs 1 and 2 of this Treasury Decision are hereby made applicable to taxable years beginning after December 31, 1939, and before January 1, 1942 (such years being covered by Regulations 103).

REGULATIONS 118 [26 CFR, PT. 39]

PAR. 4. Section 39.504–1 is amended as follows:

(A) By deleting in the first sentence thereof the word "and" which immediately precedes "(c)".

(B) By striking the period at the end of the first sentence and by inserting in lieu thereof a comma and the following:

and (d) the amount by which the undistributed subchapter A net income (determined without reference to this provision) exceeds the amount which could be distributed on the last day of the taxable year as a dividend (1) without violating any action, regulation, rule, order, or proclamation taken, promulgated, made, or issued by, or pursuant to the direction of, the President or any agency that he may designate, under the Trading with the Enemy Act, 46 Stat. 411, as amended (50 U. S. C. App. 1 et seq.), or the First War Powers Act, 1941, 55 Stat. 838 (50 U. S. C. App. 601 et seq.), and (2) not subject to a lien in favor of the United States.

(This Treasury Decision is issued under the authority contained in secs. 62 and 3791 of the Internal Revenue Code (53 Stat. 32, 467; 26 U. S. C. 62, 3791).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved December 4, 1953.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 9, 1953, 8:50 a. m.)

SUBCHAPTER E.—EXCESS-PROFITS TAX

PART I

SECTION 711(b).—EXCESS-PROFITS NET INCOME: TAXABLE YEARS IN BASE PERIOD

REGULATIONS 112, SECTION 35.711(b)-2: Abnormal deduction in base period. Rev. Rul. 54-88
(Also Section 433(b), Section 40.433(b)-3 Regulations 130.)

For excess-profits tax purposes, the word "deductions" in the term "abnormal deductions" means deductions allowable by section 23 of the Internal Revenue Code. Subtractions or losses reflected in net sales, cost of goods sold and gross income, do not constitute "deduction" within the meaning of sections 711(b)(1) and 433(b) (9) and (10) of the Internal Revenue Code.

The purpose of this Revenue Ruling is to state the position of the Internal Revenue Service with respect to the meaning of the term "deductions" as used in section 711(b)(1) and section 433(b) (9) and (10) of the Internal Revenue Code.

The term "deductions" means "expenses" or "statutory deductions" allowable by section 23 of the Internal Revenue Code. It does not mean subtractions which are properly includible in the computation of gross income.

Subtractions, which are properly includible in computations of gross income regardless of the methods of accounting or computation used in the taxpayer's books or returns, include inventory adjustments for shortages (*Fremont Cake and Meal Company* v. *Commissioner*, Tax Court Memorandum Opinion dated November 20, 1950), abandoned or unsalable merchandise (*Mrs. C. J. Barnard* v. *Commissioner*, 18 B. T. A. 1022), and price fluctuations and changes in methods of valuation (*Colorado Milling and Elevator Company* v. *Commissioner*, 17 T. C. 1280 appealed on another issue).

No part of cost of goods sold as such may be treated other than as a subtraction in computing gross income. However, whether a particular expenditure is properly includible in cost of goods sold, depends upon the nature of the expenditure. In a manufacturing business, cost of goods sold includes the cost of raw materials and supplies entering into or consumed in the production of the articles sold, expenditures for direct labor, and indirect expenses incident to and necessary for the production of the articles. *Cf.* section 39.22(c)-3, Regulations 118. However, for the purposes of section 711(b)(1) and section 433(b) (9) and (10) of the Code, it does not include allowances for depreciation, rentals, taxes, insurance, other recurring charges, or losses incurred or accrued with respect to land, buildings, machinery, and equipment or other facilities used in production of articles irrespective of whether these items may be included as part of cost of goods sold under an acceptable accounting practice.

Though expenditures allowable as deductions by section 23 of the Code have been claimed and allowed as a part of cost of goods sold pursuant to an acceptable accounting practice, that fact does not change the nature of the expenditures or require that they shall be considered as subtractions in computing gross income in applying section 711(b)(1) and section 433(b) (9) and (10) of the Code. Thus, State real estate, personal property, income, or franchise taxes, Federal and State social security or unemployment compensation taxes are not subtractions in computing gross income, though they have been claimed and allowed as a part of the cost of goods sold (*The Montreal Mining Company* v. *Commissioner*, 2 T. C. 688). The fact however that a taxpayer has included an item in cost of goods sold, though not decisive, is of evidentiary value, as showing that the taxpayer considered the item to be normal rather than abnormal (*Tovrea Land and Cattle Company* v. *Commissioner*, 10 T. C. 90).

In the case of articles of inventory which are the subject of one or more losses within the meaning of the term "deductions under section 23(f) for losses," as used in section 711(b)(1)(E) and section 433(b)(9)(C) of the Code, the cost of the articles shall be computed pursuant to the provisions of this Revenue Ruling respecting the computation of cost of goods sold. If the adopted basis of valuing inventories is "cost or market, whichever is lower," the basis for computing the casualty loss shall not exceed the lower value at the time of the casualty. If for the taxable years beginning after December 31, 1940, and prior to January 1, 1948, the provisions of section 22(d)(6)(A) of the Code are applicable, the basis for computing the casualty loss shall be adjusted to reflect the increase or decrease of net income, under clauses (i) and (ii) thereof, attributable to the casualty loss. In view of the provisions of section 433(b)(10)(D) of the Code, if the provisions of section 22(d)(6)(F) of the Code are applicable, the basis for computing the casualty loss for any taxable year ending after June 30, 1950, and prior to January 1, 1954, shall also be adjusted to reflect the attributable increase or decrease of net income under clause (i) thereof. However, for the purposes of section 711(b)(1)(E) and section 433(b)(9)(C) of the Code, the loss attributable to the casualty shall not include any part due to circumstances other than the casualty, as, for example, price fluctuations occurring prior to the casualty.

Expenditures allowable as ordinary and necessary business expenses, including expenditures occasioned by the casualty, cannot be treated as "deductions under section 23(f) for losses" within the meaning of section 711(b)(1)(E) and section 433(b)(9)(C) of the Code. There is no authority to change an expense under section 23(a)(1)(A) of the Code into a loss under section 23(f), in order to consider and disallow it under the provisions of section 711(b)(1)(E) or section 433(b)(9)(C) of the Code (*Consolidated Motor Lines, Inc.* v. *Commissioner*, 6 T. C. 1066). This rule is applicable regardless of whether the expenditures have been claimed and allowed as deductions under section 23(a)(1)(A) of the Code or, pursuant to an acceptable accounting practice, have been included in cost of goods sold and claimed and allowed as subtractions in computing gross income (*Veeder-Root, Inc.* v. *Commissioner*, 11 T. C. 602).

CHAPTER 3.—ESTATE TAX

SUBCHAPTER A.—BASIC ESTATE TAX

PART II.—ESTATES OF CITIZENS OR RESIDENTS OF THE UNITED STATES

SUBPART I.—COMPUTATION OF TAX

SECTION 811.—GROSS ESTATE

REGULATIONS 105, SECTION 81.3: Gross estate. Rev. Rul. 54–246

The consent executed by a husband, under the provisions of section 1000(f) of the Internal Revenue Code, to treat a gift of property owned by his wife to a third party donee as having been made one-half by each, is not deemed to have created in the husband an interest in the property transferred which, upon his death, would render any part of such property includible in his gross estate for Federal estate tax purposes under the provisions of any of the subsections of section 811 of the Code.

SECTION 811(a).—GROSS ESTATE: DECEDENT'S INTEREST

REGULATIONS 105, SECTION 81.13: Property of decedent at time of death. Rev. Rul. 54–19
(Also Section 22(a), Section 39.22(a)-1, Regulations 118.)

Amounts receivable in settlement of claims under the New Jersey "Death by Wrongful Act" statute, N. J. S. A. 2A: 31–1—31–6, are not includible in the decedent's gross estate for Federal estate tax purposes under section 811(a) of the Internal Revenue Code nor taxable as income to the decedent's estate or to the dependents who will receive the proceeds of the recovery.

Advice is requested whether the proceeds in settlement of a claim under the New Jersey "Death by Wrongful Act" statute are includible in the decedent's gross estate under section 811(a) of the Internal Revenue Code or constitute taxable income of the estate or of the dependents who will receive the proceeds of the recovery.

The decedent met his death as the result of an airplane crash. The executrix of the estate of the decedent commenced court action against the carrier under the New Jersey "Death by Wrongful Act" statute, N. J. S. A. 2A: 31-1—31-6. The carrier has offered to settle the claims asserted by the petitioner.

The New Jersey "Death by Wrongful Act" statute provides that an action will lie, notwithstanding the death of the person injured, against the person who would be liable for damages for the wrongful act, negligense or default had the deceased merely been injured. The action shall be brought by the executor or administrator, w. w. a., or by an administrator ad prosequendum, if there be neither of the latter appointed. However, the action shall be maintained by either of the above parties not for his benefit as such administrator ad prosequendum, etc., but rather for persons who would take the decedent's property had he died intestate under the laws of New Jersey. Specifically, chapter 31-4, "Persons entitled to amount recovered" reads as follows:

> The amount recovered in proceedings under this chapter shall be for the exclusive benefit of the persons entitled to take any intestate personal property of the decedent, and in the proportions in which they are entitled to take the same. If any of the persons so entitled were not dependent on the decedent at his death, the remainder of the persons so entitled shall take the same as though they were the sole persons so entitled. If all or none of the persons so entitled were then dependent on him, they shall all take as aforesaid.

Section 811(a) of the Internal Revenue Code provides:

> The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—
>
> (a) DECEDENT'S INTEREST.—To the extent of the interest therein of the decedent at the time of his death; * * *

The decisive question in this case is whether the decedent had an interest in the amount recoverable under the New Jersey "Death by Wrongful Act" statute or in the right of action at the time of his death. The action against the carrier was brought under the statute, and the statute governs in determining the distribution of the proceeds of the recovery. The decedent in his lifetime never had an interest in the right of action or in the proceeds. He did not create the right, it was created by statute and vested in the persons designated in the statute. Inasmuch as the decedent had no right of action or interest in the proceeds at the time of his death, nothing "passed" from the decedent to the beneficiaries. Accordingly, the amounts recovered by the beneficiaries would not be includible in the decedent's gross estate for Federal estate tax purposes.

Section 22(a) of the Internal Revenue Code provides that all gains, profits, and income derived from any source whatever are income subject to taxation. Proceeds of this nature, that is, compensation for loss of life, are not embraced in the general concept of the term "income". See I. T. 2420, C. B. VII-2, 123.

In view of the foregoing, amounts receivable in settlement of claims under the New Jersey "Death by Wrongful Act" statute, N. J. S. A. 2A: 31-1—31-6, are not includible in the decedent's gross estate for Federal estate tax purposes under section 811(a) of the Internal Revenue Code nor taxable as income to the decedent's estate or to the dependents who will receive the proceeds of the recovery.

REGULATIONS 105, SECTION 81.13: Property of decedent at time of death. Rev. Rul. 54–89

Where a married man domiciled in Texas purchases in his own name with community funds acquired in Texas real property located in New Mexico and Kansas and predeceases his wife, only one-half of the value of such property is includible in his gross estate for Federal estate tax purposes. The respective rights of the husband and wife in such real property are governed by the law of the place where the property is situated.

Advice is requested relative to the extent real property acquired in the manner set forth below is to be included in the decedent's gross estate for Federal estate tax purposes.

A married man, a resident of Texas, a community property State, purchased with the community funds of himself and his wife real property situated in New Mexico and Kansas. The husband took title to the purchased property in his own name. He died survived by his wife.

The respective rights of the husband and wife in real property are governed by the law of the place where such property is situated rather than by the law of the domicile of the parties.

The law of descent and distribution contained in chapter 31 of the New Mexico Statutes, annotated, 1941, provides that upon the death of the husband one-half of the community estate goes to the wife and the other half is subject to the testamentary disposition of the husband. (Sec. 31–109.) Accordingly, it is held that the value of only one-half of the New Mexico real estate is includible in the deceased husband's gross estate.

The general rule in a community property State is that where a husband, as manager and business agent of the community, purchases real property in a common law State with community funds and takes title thereto in his own name, he holds a one-half interest in the property as trustee for his wife.

Section 67–406 of General Statutes of Kansas, Annotated, reads as follows:

Conveyance to one person when consideration paid by another. When a conveyance for a valuable consideration is made to one person and the consideration therefor is paid by another, no use or trust shall result in favor of the latter; but the title shall vest in the former, subject to the provisions of the next two sections.

Section 67–407 provides that every such conveyance shall be presumed fraudulent as against the creditors of the person paying the consideration.

Section 67–408 provides as follows:

The provisions of the section next before the last shall not extend to cases where the alienee shall have taken any absolute conveyance in his own name without the consent of the person with whose money the consideration was paid; or where such alienee in violation of some trust shall have purchased the land with moneys not his own; or where it shall be made to appear that by agreement and without any fraudulent intent the party to whom the conveyance was made, or in whom the title shall vest, was to hold the land or some interest therein in trust for the party paying the purchase money or some part thereof.

In construing the provisions of sections 67–406 and 408 of the General Statutes of Kansas, the Supreme Court of Kansas has consistently held that where the husband purchases land in Kansas in part or in whole with his wife's money, a trust is impressed on the land in favor of the wife to the extent the purchase price was paid with her funds, unless the wife intended to make a gift to her husband. See *Commissioner* v. *Carrie E. Molter*, 60 Fed. (2d) 498. Accordingly, it is held that the value of only one-half of the Kansas real property is includible in the deceased husband's gross estate.

REGULATIONS 105, SECTION 81.13: Property of decedent at time of death. Rev. Rul. 54–168

The value of the restricted allotted lands of an Indian of the Quapaw Tribe is includible in the deceased Indian's gross estate for Federal estate tax purposes under the provisions of section 811 (a) of the Internal Revenue Code.

Advice is requested whether the value of a 160 acre homestead owned by the decedent, a restricted Indian of the Quapaw Tribe, is includible in his gross estate for Federal estate tax purposes.

Under the principles laid down by the Supreme Court of the United States in *Oklahoma Tax Commission* v. *United States*, 319 U. S. 598, and in *West* v. *Oklahoma Tax Commission*, 334 U. S. 717, restricted allotted Indian lands are exempt from Federal estate taxes if such lands are expressly exempted from taxation in treaties with the specific tribes of Indians concerned or in Federal statutes dealing with such Indians, but exemption from such taxes is not to be implied or inferred. This is clear from the following extract from the decision of the Court in Oklahoma Tax Commission v. United States, *supra*, in which the Court considered the question whether allotted lands and other property of restricted Indians of the Five Civilized Tribes were subject to Oklahoma estate taxation:

This Court has repeatedly said that tax exemptions are not granted by implication. United States Trust Co. v. Helvering, 307 U. S. 57, 60. It has applied that rule to taxing acts affecting Indians as to all others. As was said of an excise tax on tobacco produced by the Cherokee Indians in 1870, "If the exemption had been intended, it would doubtless have been expressed." Cherokee Tobacco, 11 Wall. 616, 620. In holding the income tax applicable to Indians, the Court said, "The terms of the 1928 Revenue Act are very broad, and nothing there indicates that Indians are to be excepted. * * * If exemption exists it must derive plainly from agreements with the Creeks or some Act of Congress dealing with their affairs". Superintendent v. Commissioner, *supra*, 420. If Congress intends to prevent the State of Oklahoma from levying a general nondiscriminatory estate tax applying alike to all its citizens, it should say so in plain words. Such a conclusion cannot rest on dubious inferences. "Nontaxability and restriction upon alienation are distinct things", Superintendent v. Commissioner, *supra*, 421, and when Congress wants to require both nonalienability and nontaxability it can, as it has so often done, say so explicitly.

The concept that restricted properties of Indians were Federal instrumentalities and therefore constitutionally exempt from estate tax consequences was expressly renounced in Oklahoma Tax Commission v. U. S. and West v. Oklahoma Tax Commission, *supra*.

An examination of the treaties between the United States and the Quapaw Tribe of Indians discloses no provision under which restricted allotted lands of such Indians are exempted from taxation. Furthermore no provision has been found in any of the Federal statutes dealing with the Quapaw Indians which can be held to grant exemption from Federal taxation to allotted lands of these Indians. The Act of

April 17, 1937, 50 Stat. 68, amending the Act of March 3, 1921, 41 Stat. 1225, which is referred to by the United States Court of Claims in its decision in *Roberts* v. *United States*, 96 Fed. Supp. 775, authorized the State of Oklahoma to levy a gross production tax upon minerals produced from restricted allotted lands of the Quapaw Indians, which was to be "in lieu of all other State taxes of whatsoever nature on said restricted lands or the income therefrom". However, this act granted no exemption from Federal taxation.

In the light of the position taken by the Supreme Court of the United States in the Oklahoma Tax Commission cases that exemptions from estate taxation of allotted lands of restricted Indians may not be implied or inferred, it is held, in the absence of any statutory exemption from Federal taxation of restricted allotted Quapaw lands, that the value of such lands is includible in such Indians' gross estate for Federal estate tax purposes. The position so taken is in accord with the position taken in Roberts v. United States, *supra*, which held that the Act of April 17, 1937, *supra*, did not exempt the estate of a deceased restricted Indian of the Quapaw Tribe from Federal estate taxes.

REGULATIONS 105, SECTION 81.13: Property of decedent at time of death.

Value of stock originally acquired by decedent subject to an option to purchase reserved by the issuing corporation. (See Rev. Rul. 54-76, p. 194.)

SECTION 811(c).—GROSS ESTATE: TRANSFERS IN CONTEMPLATION OF, OR TAKING EFFECT AT, DEATH

REGULATIONS 105, SECTION 81.17: Transfers intended to take effect at or after the decedent's death.

Value of an annuity provided by an election of a member of the uniformed services under the Uniformed Services Contingency Option Act of 1953. (See Rev. Rul. 54-155, p. 15.)

SECTION 811(f).—GROSS ESTATE: POWERS OF APPOINTMENT

REGULATIONS 105, SECTION 81.24: Property subject to power of appointment by decedent. Rev. Rul. 54-59

Where the inclusion in the gross estate of a deceased donee of a general power of appointment of the property subject to the power, is dependent upon an exercise of the power by the donee, and the donee partially exercises the power by appropriating a part of the property to her own use, the property unaffected by the exercise is not includible in the donee's gross estate for Federal estate tax purposes under section 811(f)(1) of the Internal Revenue Code.

Advice is requested whether the value of property over which the decedent died possessed of a general power of appointment under the will of her deceased husband, is includible in her gross estate for Federal estate tax purposes under the provisions of section 811(f) of the Internal Revenue Code where inclusion of such power is dependent upon the exercise thereof.

The decedent's husband died in April 1949. By his will, which was executed in 1939 and not republished by a codicil executed after October 21, 1942, he bequeathed and devised the residue of his estate in trust, to pay the income to his wife during her life and upon her death to distribute the principal to named beneficiaries. The will authorized the trustee to pay over, transfer and deliver any part or all of the principal of the trust estate to the wife at any time or times she may in her absolute and uncontrolled discretion request the same. This discretionary power conferred upon the wife gave her a general power of appointment over the principal within the meaning of section 811(f) of the Internal Revenue Code. The wife exercised the power during her life by withdrawing to her own use a part of the principal of the trust estate.

Section 811(f)(1) of the Code as amended by the Powers of Appointment Act of 1951, Public Law 58, 82nd Congress, 65 Stat. 91, C. B. 1951-2, 343, provides in part that the value of the gross estate of a decedent shall be determined by including the value at the time of his death of:

> (1) PROPERTY WITH RESPECT TO WHICH DECEDENT EXERCISES A GENERAL POWER OF APPOINTMENT CREATED ON OR BEFORE OCTOBER 21, 1942.—To the extent of any property with respect to which a general power of appointment created on or before October 21, 1942, is exercised by the decedent (1) by will or (2) by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under subsection (c) or (d); but the failure to exercise such a power or the complete release of such a power shall not be deemed an exercise thereof.

Section 2(b) of the Powers of Appointment Act of 1951 provides:

> (b) DATE OF CREATION OF POWER.—For the purpose of this section a power of appointment created by a will executed on or before October 21, 1942, shall be considered a power created on or before such date if the person executing such will dies before July 1, 1949, without having republished such will, by codicil or otherwise, after October 21, 1942.

The will of the husband which created the power of appointment was executed prior to October 21, 1942, and he died before July 1, 1949, without having republished such will, by a codicil or otherwise, after October 21, 1942. Accordingly the property subject to the power is not includible in the instant decedent's gross estate (the donee of the power) unless the decedent exercised the power by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in her gross estate under section 811 (c) or (d) of the Internal Revenue Code.

Where the inclusion of property subject to a power to appoint is dependent upon an exercise of the power by the decedent, a partial exercise may, or may not, depending upon the nature of the exercise, require the inclusion of the entire property in the donee's estate. Where the exercise affects the entire property, for example, the appointment of a life estate in the whole, the entire property is subject to the tax. However, where the exercise affects only a part of the property, the portion unaffected by the exercise is not subject to estate tax. *Cf. Estate of Mabel Wooster* v. *Commissioner*, 9 T. C. 742. In the instant case the decedent's exercise of the power of appointment by withdrawing a part of the principal of the trust estate in nowise affected her husband's testamentary disposition of the remaining principal. It is, accordingly, held that, where the inclusion in the gross estate of a deceased donee of a general power of appointment of the property subject to the power is dependent upon an exercise of the power by the donee, and the donee partially exercises the power by appropriating a part of the property to her own use, the property unaffected by the exercise is not includible in the donee's gross estate for Federal estate tax purposes under section 811(f)(1) of the Internal Revenue Code.

REGULATIONS 105, SECTION 81.24: Property subject to power of appointment by decedent. Rev. Rul. 54–153

Where a trustee, who is also a beneficiary of a trust, is prevented by a State statute from participating in a decision to distribute corpus to himself, his estate, his creditors, or the creditors of his estate, no part of the trust property is includible in his gross estate under section 811(f)(2) of the Internal Revenue Code by reason of the fact that the trust instrument provides that the trustees may distribute corpus to the beneficiary.

Advice is requested whether the decedent as trustee and sole beneficiary of a trust possessed at her death a power of appointment within the meaning of section 811(f)(2) of the Internal Revenue Code.

The decedent, domiciled in the State of New York, was a cotrustee and lifetime income beneficiary of a trust created under the will of her husband who died in 1953. The will provided that should the beneficiary be in need of additional funds for her maintenance, comfort, or support, or for any other purpose or purposes whatsoever, the trustees had the authority to pay her such amounts of principal held in trust as in the exercise of their sole and absolute discretion they deem advisable for such purposes.

Section 141 of the New York Real Property Law, which applies also to personalty, provides in part as follows:

A power, vested in a person in his capacity as trustee of an express trust, to distribute principal to himself cannot be exercised by him; if the power is vested in two or more trustees, it may be executed by the trustee or trustees who are not so disqualified; if there is no trustee qualified to execute the power, its execution devolves on the supreme court * * *.

The New York courts have held that a trustee who is also a beneficiary of a trust is prevented by section 141 of the New York Real Property Law from participating in a decision to distribute corpus to himself. *In re: Bender's Will*, 105 N. Y. S. (2d) 15; *In re: Atkins Estate*, 98 N. Y. S. (2d) 690. In the absence of an indication that the New York courts would construe the statute otherwise, the Internal Revenue Service will accept the view that such trustee is also prevented by the statute from exercising the power to distribute principal to his estate, his creditors, or the creditors of his estate.

It is held that where a trustee, who is also a beneficiary of a trust, is prevented by a State statute from participating in a decision to distribute corpus to himself, his estate, his creditors, or the creditors of his estate, no part of the trust property is includible in his gross estate under section 811 (f) (2) of the Internal Revenue Code by reason of the fact that the trust instrument provides that the trustees may distribute corpus to the beneficiary.

SECTION 811(g).—GROSS ESTATE: PROCEEDS OF LIFE INSURANCE

REGULATIONS 105, SECTION 81.27: Insurance receivable by other beneficiaries. Rev. Rul. 54-29

Proceeds of insurance policies on decedent's life payable to his former wife under an agreement which was by its express terms to become effective only upon approval by the court in pending divorce proceedings, are not includible in decedent's gross estate where the agreement was ratified and approved by the court and made a part of the divorce decree by reference.

Advice is requested whether the interest of the decedent's former wife in the proceeds of insurance policies on the decedent's life is includible in his gross estate for Federal estate tax purposes.

The decedent and his wife, residents of Alabama, entered into a property settlement agreement in contemplation of a divorce. The agreement provided that the decedent should pay his wife a certain sum monthly for her maintenance and support until her death or remarriage or the decedent's death, whichever event should first occur. The agreement further provided that the decedent should maintain and keep in full force and effect certain life insurance policies on his life payable to his wife in the form of an annuity. The agreement expressly provided that it should not become effective unless approved by the court in the divorce proceedings and, if so approved, it should be incorporated in and made a part of the decree of divorce. In the decree of absolute divorce, the agreement was ratified and confirmed and made a part of the decree by reference.

Section 811(g) (2) of the Internal Revenue Code, relating to the includibility of the proceeds of life insurance in the insured's gross estate, provides in part as follows:

(2) RECEIVABLE BY OTHER BENEFICIARIES.—To the extent of the amount receivable by all other beneficiaries as insurance under policies upon the life of the decedent (A) purchased with premiums, or other consideration, paid directly or indirectly by the decedent, in proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance, or (B) with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. * * *

Section 811(g) (3) of the Internal Revenue Code provides as follows:

(3) TRANSFER NOT A GIFT.—The amount receivable under a policy of insurance transferred, by assignment or otherwise, by the decedent shall not be includible under paragraph (2) (A) if the transfer did not constitute a gift, in whole or in part, under Chapter 4, or, in case the transfer was made at a time when Chapter 4 was not in effect, would not have constituted a gift, in whole or in part, under such chapter had it been in effect at such time.

In *Cornelia Harris* v. *Commissioner*, 340 U. S. 106, Ct. D. 1937, C. B. 1950–2, 77, it was held that where a property settlement agreement entered into in contemplation of divorce was to become effective only upon its approval by the divorce court and such agreement was ratified and approved by the court, the divorced wife acquired her property interest by the court decree and not by way of a transfer from her husband.

The agreement in this case, as in the Harris case, *supra*, was not to become binding upon either party unless approved by the court in the decree of divorce. In this case, under Alabama law, the wife acquired at the time of the divorce an absolute interest in the annuity payments provided in the insurance policies and the court had under Alabama law authority to decree such payments. Accordingly, to the extent receivable by the decedent's divorced wife, the insurance proceeds are not includible in the decedent's gross estate under section 811(g)(2)(A) of the Internal Revenue Code (premium payment test) as she did not acquire her interest in the proceeds by way of transfer which would constitute a gift under chapter 4 of the Internal Revenue Code; nor, to the extent receivable by the divorced wife, are the proceeds includible under section 811(g)(2)(B) (incidents of ownership test) as the decedent did not possess any incidents of ownership in the policies at the time of his death.

In view of the foregoing it is held that proceeds of insurance policies on decedent's life payable to his former wife under an agreement which was by its express terms to become effective only upon approval by the court in pending divorce proceedings, are not includible in decedent's gross estate where the agreement was ratified and approved by the court and made a part of the divorce decree by reference.

SECTION 811(k).—GROSS ESTATE: VALUATION OF UNLISTED STOCK AND SECURITIES

Regulations 105, Section 81.10: Valuation of property. Rev. Rul. 54–77
(Also Section 1005, Regulations 108, Section 86.19.)

Valuation of stock of closely held corporations in estate tax and gift tax returns.

Section 1. Purpose.

The purpose of this revenue ruling is to outline and review in general the approach, methods and factors to be considered in valuing shares of the capital stock of closely held corporations for estate tax and gift tax purposes. The methods discussed herein will apply likewise to the valuation of corporate stocks on which market quotations are either unavailable or are of such scarcity that they do not reflect the fair market value.

Sec. 2. Background and Definitions.

.01 All valuations must be made in accordance with the applicable provisions of the Internal Revenue Code and the Federal estate tax and gift tax regulations. Sections 811 and 1005 of the Code require that the property to be included in the gross estate, or made the subject of gift, shall be taxed on the basis of the value of the property at the time of the death of the decedent, the optional date if so elected, or the date of gift.

.02 Section 81.10 of Estate Tax Regulations 105 and section 86.19 of Gift Tax Regulations 108 define fair market value, in effect, as the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell. Court decisions frequently state in addition that the hypothetical buyer and seller are assumed to be able, as well as willing, to trade and to be well informed about the property and concerning the market for such property.

.03 Closely held corporations are those corporations the shares of which are owned by a relatively limited number of stockholders. Often the entire stock issue is held by one family. The result of this situation is that little, if any, trading in the shares takes place. There is, therefore, no established market for the stock and such sales as occur at irregular intervals seldom reflect all of the elements of a representative transaction as defined by the term "fair market value."

SEC. 3. APPROACH TO VALUATION.

.01 Determination of fair market value, being a question of fact, will depend upon the circumstances in each case. No formula can be devised that will be generally applicable to the multitude of different valuation issues arising in estate and gift tax cases. Often an appraiser will find wide differences of opinion as to the fair market value of a particular stock. In resolving such differences he should maintain a reasonable attitude in recognition of the fact that valuation is not an exact science. A sound valuation will be based upon all the relevant facts, but the elements of common sense, informed judgment and reasonableness must enter into the process of weighing those facts and determining their aggregate significance.

.02 The fair market value of a specific property will vary as general economic conditions change from "normal" to "boom" or "depression"; that is, according to the degree of optimism or pessimism with which the investing public regards the future at the required date of appraisal. Uncertainty as to the stability or continuity of the future income from a property decreases its value by increasing the risk of loss of earnings and value in the future. The value of a property with very uncertain future prospects is highly speculative. The appraiser must exercise his judgment as to the degree of risk attaching to a specific property, but that judgment must be related to all of the other factors affecting value.

SEC. 4. FACTORS TO CONSIDER.

.01 It is advisable to emphasize that in the valuation of the stock of closely held corporations or the stock of corporations where market quotations are either lacking or too scarce to be recognized, all available financial data, as well as all relevant factors affecting the fair market value, should be considered. The following factors, although not all-inclusive, are fundamental and require careful analysis in each case:

(a) The nature of the business and the history of the enterprise, including the date of incorporation.

(b) The economic outlook in general and the condition and outcome of the specific industry in particular.

(c) The book value of the stock and the financial condition of the business.

(d) The earning capacity of the company.

(e) The dividend-paying capacity.

(f) Goodwill.

(g) Sales of the stock and the size of the block of stock to be valued.

(h) The market price of stocks of corporations engaged in the same or a similar line of business which are listed on an exchange.

.02 A brief discussion of each of the foregoing factors follows:

(a) The history of a corporate enterprise will show its past stability or instability, its growth or lack of growth, the diversity or lack of diversity of its operations, and other facts needed to form an opinion of the degree of risk involved in the business. For recently incorporated companies the history of predecessor businesses should be considered. The detail to be considered should increase with approach to the required date of appraisal, since recent events are of greatest help in predicting the future; but a study of gross and net income, and of dividends covering a long prior period, is highly desirable. The history to be studied should include, but need not be limited to, the nature of the business, its products or services, its operating and investment assets, capital structure, plant facilities and management, all of which should be considered as of the date of the appraisal, with due regard for recent significant changes. Events of the past that are unlikely to recur in the future should be discounted, since value has a close relation to future expectancy.

(b) A sound appraisal of a closely held stock must consider current and prospective economic conditions as of the date of appraisal, both in the national economy and in the industry or industries with which the corporation is allied. It is important to know that the company is more, or less, successful than its competitors in the same industry, or that it is maintaining a stable position with respect to competitors. Equal or even greater significance may attach to the ability of the industry with which the company is allied to compete with other industries. Prospective competition which has not been a factor in prior years should be given careful attention. The public's appraisal of the future prospects of competitive industries or of competitors within an industry may be indicated by price trends in the markets for commodities and for securities. The death of the manager of a so-called "one-man" business may have a depressing effect upon the value of the stock of such business, particularly if there is a lack of trained personnel capable of succeeding to the management of the enterprise. In valuing the stock of this type of business, therefore, the effect of the loss of the manager on the future expectancy of the business, and the absence of management-succession potentialities are pertinent factors to be taken into consideration. On the other hand, there may be factors which offset, in whole or in part, the loss of the manager's services. For

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instance, the nature of the business and of its assets may be such that they will not be impaired by the death of the manager. Furthermore, the loss may be adequately covered by life insurance, or competent management might be employed on the basis of the consideration paid for the former manager's services. These, or other offsetting factors, if found to exist, should be carefully weighed against the loss of the manager's services in valuing the stock of the enterprise.

(c) Balance sheets should be obtained, preferably in the form of comparative annual statements for two or more years immediately preceding the date of appraisal, together with a balance sheet at the end of the month preceding that date, if corporate accouning will permit. Any balance sheet descriptions that are not self-explanatory, and balance sheet items comprehending diverse assets or liabilities, should be clarified in essential detail by obtaining supplemental schedules. These statements usually will disclose to the appraiser, (1) liquid position (ratio of current assets to liabilities); (2) amount of net fixed assets; (3) working capital; (4) long-term indebtedness; (5) capital structure; and (6) net worth. Consideration also should be given to any assets not essential to the operation of the business, such as investments in securities, real estate, etc. In general, such nonoperating assets will command a lower rate of return than do the operating assets, although in exceptional cases the reverse may be true. In computing the book value per share of stock, assets of the investment type should be revalued on the basis of their market price and the book value adjusted accordingly. Comparison of the company's balance sheets over several years may reveal, among other facts, such developments as the acquisition of additional production facilities or subsidiary companies, improvement in financial position, and details as to recapitalizations and other changes in the captal structure of the corporation. If the corporation has more than one class of stock outstanding, the charter or certificate of incorporation should be examined to ascertain the explicit rights and privileges of the various stock issues including: (1) voting power, (2) preference as to dividends, and (3) preference as to assets in the event of liquidation.

(d) Detailed profit-and-loss statements should be obtained and considered for a representative period immediately prior to the required date of appraisal, preferably five or more years. Such statements should show (1) gross income by principal items; (2) principal deductions from gross income including major items of operating expense, interest and other expense on each item of long-term debt, depreciation and depletion if such deductions are made, officers' salaries in total if they appear to be reasonable or in detail if they seem to be excessive, contributions (whether or not deductible for tax purposes) that the nature of its business and its community position require the corporation to make, and taxes by principal items, including income and excess-profits taxes; (3) net income available for dividends; (4) rates and amounts of dividends paid on each class of stock; (5) remaining amount carried to surplus; and (6) adjustments to, and reconciliation with, surplus as stated on the balance sheet. With profit and loss statements of this character available, the appraiser should be able to separate recurrent from nonrecurrent items of income and expense, to distinguish between operating income and investment income, and to ascertain whether or not any line of business in which the company is engaged is operated consistently at a loss and might be abandoned with benefit to the company. The percentage of earnings retained for business expansion should be noted when dividend-paying capacity is considered. Potential future income is a major factor in many valuations of closely held stocks, and all information concerning past income which will be helpful in predicting the future should be secured. Prior earnings records usually are the most reliable guide as to the future expectancy, but resort to arbitrary five-or-ten-year averages without regard to current trends or future pospects will not produce a realistic valuation. If, for instance, a record of progressively increasing or decreasing net income is found, then greater weight may be accorded the most recent years' profits in estimating earning power. It will be helpful, in judging risk and the extent to which a business is a marginal operator, to consider deductions from income and net income in terms of percentage of sales. Major categories of cost and expense to be so analyzed include the consumption of raw materials and supplies in the case of manufacturers, processors and fabricators; the cost of purchased merchandise in the case of merchants; utility services; insurance; taxes; depletion or depreciation; and interest.

(e) Primary consideration should be given to the dividend-paying capacity of the company rather than to dividends actually paid in the past. Dividend-paying capacity is a factor that must be considered in an appraisal, but dividends actually paid in the past may not have any relation to dividend-paying capacity. Specifically, the dividends paid by a closely held family company may be measured by the income needs of the stockholders or by their desire to avoid taxes on dividend receipts, instead of by ability of the company to pay dividends. Where an actual or effective controlling interest in a corporation is to be valued, the dividend factor is not a material element, since the payment of such dividends is discretionary with the controlling stockholders. The individual or group in control can substitute salaries and bonuses for dividends, thus reducing net income and understating the dividend-paying capacity of the company. It follows, therefore, that dividends are less reliable criteria of fair market value than other applicable factors.

(f) In the final analysis, goodwill is based upon earning capacity. The presence of goodwill and its value, therefore, rests upon the excess of net earnings over and above a fair return on the net tangible assets. Such excess earnings capitalized at an appropriate rate will furnish one basis on which to value the goodwill applicable to the stock, but not necessarily the controlling basis. While the element of goodwill may be based primarily on earnings, such factors as the prestige and renown of the business, the ownership of a trade or brand name, and a record of successful operation over a prolonged period in a particular locality, also may furnish support for the inclusion of intangible value.

(g) Sales of stock of a closely held corporation should be carefully investigated to determine whether they represent transactions at arm's length. Forced or distress sales do not ordinarily reflect fair market value, nor do isolated sales in small amounts necessarily control as the measure of value. This is especially true in the valuation of a controlling interest in a corporation. Since, in the case of closely held stocks, no prevailing market prices are available, there is no basis for making an adjustment for blockage. It follows, therefore, that such stocks should be valued upon a consideration of all the evidence affecting the fair market value. The size of the block of stock itself is a relevant factor to be considered. Although it is true that a minority interest in an unlisted corporation's stock is more difficult to sell than a similar block of listed stock, it is equally true that control of a corporation, either actual or effective, representing as it does an added element of value, may justify a higher value for a specific block of stock.

(h) The Revenue Act of 1943 amended the Internal Revenue Code by adding subsection (k) of section 811, which states, in effect, that in valuing unlisted securities the value of listed stocks or securities of corporations engaged in the same or similar line of business should be taken into consideration. In selecting corporations for comparative purposes, care should be taken to use only truly comparable companies. For illustration, a corporation having one or more issues of preferred stock, bonds or debentures in addition to its common stock should not be considered comparable to one having only common stock outstanding. In like manner, a company with declining business and contracting markets is not comparable to one with a record of current progress and market expansion. The test should be for similarity not only of the type of business but of the trend of earnings, capital structure, volume of sales, and size in terms of total assets, as well, in order that the most valid comparison possible will be obtained.

SEC. 5. WEIGHT TO BE ACCORDED VARIOUS FACTORS.

The valuation of closely held corporate stock entails the consideration of all relevant factors as stated in section 4. Depending upon the circumstances in each case, certain factors may carry more weight than others because of the nature of the company's business. To illustrate:

(a) Earnings may be the most important criterion of value in some cases whereas asset value will receive primary consideration in others. In general the appraiser will accord primary consideration to earnings when valuing stocks of companies which sell products or services to the public; conversely, in the investment or holding type of company, the appraiser may accord the greatest weight to the assets underlying the security to be valued.

(b) The value of the stock of a personal or family holding company is closely related to the value of the assets underlying the stock. For companies of this type the appraiser should determine the fair market values of the assets of the company. Operating expenses of the holding company and cost of liquidating it, if any, merit consideration when appraising the relative values of the stock and of the underlying assets. The market values of the underlying assets give due weight to potential earnings and dividends of the particular items of property underlying the stock, capitalized at rates deemed proper by the investing public at the date of appraisal. A current appraisal by the investing public should be superior to the retrospective opinion of an individual. For these reasons adjusted net worth should be accorded greater weight in valuing the stock of a closely held family or personal holding company than any of the other customary yardsticks of appraisal, such as earnings and dividend paying capacity.

SEC. 6. CAPITALIZATION RATES.

In the application of certain fundamental valuation factors, such as earnings and dividends, it is necessary to capitalize the average or current results at some appropriate rate. Determination of the proper capitalization rate presents one of the most difficult problems in valuation. That there is no ready or simple solution will be made apparent by a cursory check of the rates of return and dividend yields in terms of the selling prices of corporate shares listed on the major exchanges of the country. Wide variations will be found even for companies in the same industry. Moreover the ratio will fluctuate from year to year depending upon economic conditions. Thus, no standard tables of capitalization rates applicable to closely held corporations can be formulated. Among the more important factors to take into consideration in deciding upon a capitalization rate in a particular case are: (1) the nature of the business; (2) the risk involved; and (3) the stability or irregularity of earnings.

SEC. 7. AVERAGE OF FACTORS.

Because valuations cannot be made on the basis of a prescribed formula, there is no means whereby the various applicable factors in a particular case can be assigned mathematical weights in deriving the fair market value. For this reason no useful purpose is served by taking an average of several factors (for example: book value, capitalized earnings and capitalized dividends) and basing the valuation on the result. Such a process excludes active consideration of other pertinent factors, and the end result is incapable of being supported by a realistic application of the significant facts in the case except by mere chance.

SEC. 8. RESTRICTIVE AGREEMENTS.

Frequently, in the valuation of closely held stock for estate and gift tax purposes, it will be found that the stock is subject to an agreement restricting its sale or transfer. Where shares of stock were acquired by a decedent subject to an option reserved by the issuing corporation to repurchase at a certain price, the option price is usually accepted as the fair market value for estate tax purposes. See Rev. Rul. 54-76 below. However, in such case the option price is not determinative of fair market value for gift tax purposes. Where the option, or buy and sell agreement, is the result of voluntary action by the stockholders and is binding during the life as well as at the death of the stockholders, such agreement may or may not, depending upon the circumstances of each case, fix the value for estate tax purposes. However, such agreement is a factor to be considered, with other relevant factors, in determining fair market value. Where the stockholder is free to dispose of his shares during life and the option is to become effective only upon his death, the fair market value is not limited to the option price. It is always necessary to consider the relationship of the parties, the relative number of shares held by the decedent, and other material facts, to determine whether the agreement represents a bona fide business arrangement or is a device to pass the decedent's shares to the natural objects of his bounty for less than an adequate and full consideration in money or money's worth. In this connection see Rev. Rul. 157, C. B. 1953-2, 155 and Rev. Rul. 189, C. B. 1953-2, 294.

REGULATIONS 105, SECTION 81.10(c): Valuations of property: Stocks and bonds. Rev. Rul. 54-76
(Also Section 811(a), Section 81.13.)

A decedent bequeathed shares of stock of a corporation, which reserved under its articles of organization an option to repurchase its stock at a specific price before any transfer could be made to others. The executors filed a petition in the local probate court asking whether the restriction on the transfer applied to a transfer by an executor to a specific legatee. The supreme court of the State, in affirming the decision of the lower court, concluded that the restrictions were binding on the decedent and the executors not only because they were included in the articles of incorporation and were, therefore, in effect a part of the charter of the corporation, but also by reason of the contract made with the corporation when the decedent accepted the certificates of stock containing the printed restrictions. *Held* although valid and enforceable restrictions affecting the transfer of stock do not necessarily control value for Federal estate tax purposes (see Rev. Rul. 157, C. B. 1953-2, 155), where a stockholder acquires stock from the corporation subject to an option reserved to the corporation in the articles of organization to repurchase the stock at a specific price before any sale or transfer, including any transfer at the death of the stockholder, can be validly made to others, the option price, in the absence of other material circumstances, will be accepted as the fair market value at the date of death, especially where the option is exercised by the corporation. See *Estate of Albert L. Salt, et al.* v. *Commissioner*, 17 T. C. 92, acquiescence, C. B. 1952-1, 4.

SECTION 812(d).—NET ESTATE: TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES

REGULATIONS 105, SECTION 81.44: Transfers for public, charitable, religious, etc., uses. Rev. Rul. 54-90

A decedent possessed at her death a power of appointment over property which was not includible in her gross estate under section 811(f) of the Internal Revenue Code as amended by the Powers of Appointment Act of 1951 but which was expressly made available under her will for the payment of all legacies, as were her probate assets. *Held*, for the purpose of computing the amount allowable as a charitable deduction under section 812(d) of the Internal Revenue Code, all bequests, charitable and noncharitable (except for bequests of specific assets) are considered payable pro rata out of the probate assets and the appointed property. Therefore, only the amount which is determined to be paid to charities pro rata out of the probate assets is deductible under section 812(d) of the Code.

REGULATIONS 105, SECTION 81.44: Transfers for public, charitable, religious, etc., uses.

Bequests, legacies, devises, or transfers to the Pacific War Memorial Commission an agency of the Territory of Hawaii. (See Rev. Rul. 54-220, p. 65.)

SECTION 812(e).—NET ESTATE: BEQUESTS, ETC., TO SURVIVING SPOUSE

REGULATIONS 105, SECTION 81.47a: Bequests, etc., to surviving spouse. Rev. Rul. 54-20

> The power given by decedent to his widow to appoint a portion of the property passing from the decedent in trust for the benefit of the widow does not in itself create a separate trust in respect of the portion of the trust corpus over which the widow has a power of appointment so as to qualify the value of the entire trust passing from the decedent, or any portion thereof, for the marital deduction under section 812(e)(1)(F) of the Internal Revenue Code.

Advice is requested whether the power given by decedent to his widow to appoint a portion of the property passing from the decedent in trust for the benefit of the widow in itself creates a separate trust in respect of that portion of the trust corpus over which the widow has a power of appointment so as to qualify the value of the entire trust passing from the decedent, or any portion thereof, for the marital deduction under section 812(e)(1)(F) of the Internal Revenue Code.

In the instant case the decedent bequeathed the entire residue of his estate to an inter vivos trust created by him during life, the terms of which called for the payment of the net income from the trust estate to his surviving spouse so long as she should live, with the power in the spouse, exercisable during life or by will, to appoint in her favor, in favor of her estate, or otherwise as she may please, a portion of the trust corpus equal in value to 50 percent of the value of the decedent's adjusted gross estate, reduced by the value of property included therein which passed to the spouse other than under the terms of the trust.

In the case of an interest in property which passes from a decedent to a trust which comes within the purview of subparagraph (F) of section 812(e)(1), the marital deduction is to be allowed only if the terms of the trust satisfy all the requirements of this subparagraph. One of such requirements is that under the terms of the trust the surviving spouse must have the power, exercisable in favor of such spouse, or in favor of his or her estate, *to appoint the entire corpus free of trust*. That portion of section 81.47a of Regulations 105, which deals with this point, provides as follows:

> If the surviving spouse is entitled to only a portion of the trust income, or has power to appoint only a portion of the corpus, the trust fails to satisfy conditions (1) and (3), respectively. * * *

Condition (3) is to the effect that the power exercisable in favor of the spouse, or of her estate must extend to the entire corpus of the trust. However, it is further provided in the regulations that this condition may be satisfied by one or more of several separate trusts created by the decedent; that an undivided interest in property may constitute the corpus of a trust, and that the will or a single trust instrument may create more than one trust.

Under the terms of the trust in the instant case the decedent's widow is entitled to the entire net income from the trust estate during her lifetime. However, there was no segregation of the interest in the residue of the decedent's estate which passed in trust subject to the power of appointment in his widow such as would constitute a separate trust of an undivided interest in the property so passing. A trust instrument merely giving the widow the power to appoint a portion of the corpus of the trust estate transferred to the trust does not thereby create a separate trust in respect of any portion of, or interest in, the property forming the entire trust corpus. The interest in the trust property which passed to the widow was in effect a life estate in the entire property, together with a power of appointment over only a portion of the property, which is less than the virtual ownership contemplated by section 812(e)(1)(F) of the Code and section 81.47a of Regulations 105.

In view of the foregoing it is held that the power given by decedent to his widow to appoint a portion of the property passing from the decedent in trust for the benefit of the widow does not in itself create a separate trust in respect of the portion of the trust corpus over which the widow has a power of appointment so as to qualify the value of the entire trust passing from the decedent, or any portion thereof, for the marital deduction under section 812(e)(1)(F) of the Internal Revenue Code.

REGULATIONS 105, SECTION 81.47(b): Nondeductible interests. — Rev. Rul. 54–121

Where payment of insurance proceeds is to be made to decedent's surviving spouse only if living upon receipt by insurer of due proof of insured's death otherwise to named secondary or contingent beneficiaries, the provisions of section 812(e)(1)(D) of the Internal Revenue Code are not applicable and the marital deduction is disallowed by reason of the terminable interest rule of section 812(e)(1)(B) of the Code.

Advice is requested concerning the estate tax marital deduction provisions of section 812(e) of the Internal Revenue Code as applied to the proceeds of life insurance under the circumstances set forth below.

In the instant case a policy of insurance provides in effect that the interests of the primary beneficiary (spouse of the insured) in the proceeds of life insurance will fail in case such beneficiary is not living on the date the insurance company receives due proof of the death of the insured. Secondary or contingent beneficiaries are named to take the insurance under such circumstances. The specific question is whether the provisions of section 812(e)(1)(D) of the Code apply in such a case since the condition which will cause a termination of the interest of the surviving spouse is one which may occur either within or after the 6-month period provided in this section.

Section 812(e)(1)(B) of the Code, relating to life estates or other terminable interests, provides that no marital deduction shall be allowed with respect to property interests which pass from a decedent to his surviving spouse if (1) an interest in the same property passed at any time for less than an adequate and full consideration in money or money's worth from the decedent to any person other than such spouse, or the estate of such spouse, and (2) by reason thereof, such person, or his heirs or assigns, may possess or enjoy any part of such property after the termination or failure of the interest therein which passed to the surviving spouse.

Section 812(e)(1)(D) of the Internal Revenue Code provides:

> (D) Interest of Spouse Conditional on Survival for Limited Period.—For the purposes of subparagraph (B) an interest passing to the surviving spouse shall not be considered as an interest which will terminate or fail upon the death of such spouse if—
>
> (i) such death will cause a termination or failure of such interest only if it occurs within a period not exceeding six months after the decedent's death, or only if it occurs as a result of a common disaster resulting in the death of the decedent and the surviving spouse, or only if it occurs in the case of either such event; and
>
> (ii) such termination or failure does not in fact occur.

Section 81.47b(d) of Regulations 105 provides that where the condition (unless it relates to the death of the spouse as a result of a common disaster) is one which may occur either within the 6-month period or thereafter, the exception provided under section 812(e)-(1)(D) of the Code will not apply.

Under the terms of the instant policy, the payment of the insurance proceeds to the surviving spouse is conditioned upon her being alive upon receipt by the insurer of due proof of the insured's death. Since submission of due proof of the insured's death may occur either within the 6-month period following the decedent's death or thereafter, it follows that a termination or failure of the surviving spouse's interest in the proceeds may also occur by reason of her death either within such period or thereafter. It is accordingly held that the terms of this contract do not come within the provisions of section 812(e)-(1)(D) of the Internal Revenue Code and that the marital deduction is therefore disallowed by reason of the so-called terminable interest rule of section 812(e)(1)(B) of the Code. Whether the interest passing to the surviving spouse is in the form of life insurance proceeds or otherwise, or, whether the spouse does in fact survive the condition stated and take the property, is immaterial.

However, see *Estate of Floy B. Kellar, et al.*, v. *Kasper*, decided by the District Court of the United States for the District of South Dakota, Western Division, on July 29, 1953, which involved a bequest of the residue of the decedent's estate to his surviving spouse provided she should be living at the time of distribution of the estate. This case was decided in favor of the taxpayer but an appeal from the decision was filed by the Government with the United States Court of Appeals for the Eighth Circuit on September 2, 1953.

SECTION 813(c).—CREDITS AGAINST TAX: PAID TO FOREIGN COUNTRIES

REGULATIONS 105, SECTION 81.9: Credit for death taxes. Rev. Rul. 54-169*

(Also Section 936(c), Section 81.9, Regulations 105.)

Form 706CE, Certification of Payment of Foreign Death Duty, has been issued for use in evidencing the payment of foreign death taxes in all cases where credit therefor, whether pursuant to the Internal Revenue Code or any death duty convention, is claimed against the Federal estate tax.

Mims. 5872, C. B. 1945, 396 and 6117, C. B. 1947-1, 150, modified.

SECTION 1. PURPOSE.

Credits against the Federal estate tax for estate, inheritance, legacy or succession taxes actually paid to a foreign country are, under certain circumstances, authorized by the Internal Revenue Code and the death duty conventions in effect between the United States and several foreign countries. The purpose of this Revenue Ruling is to authorize the use of a single form which, when properly certified by the appropriate foreign tax official, may be accepted as evidence of the payment of these taxes.

SEC. 2. Form 706CE.

.01 Form 706CE, Certification of Payment of Foreign Death Duty, has been issued for use in evidencing the payment of foreign death taxes. It supersedes Form 706d, Certification of Dominion Succession Duties, Form 706f, Certification of United Kingdom Estate Duty, and Form 706i, Certification of French Inheritance Tax. Except as otherwise provided in subsection .02 below, Form 706CE is to be used to evidence payment of estate, inheritance, legacy, or succession taxes to a foreign country in every case where credit therefor, whether pursuant to the Internal Revenue Code or any death duty convention, is claimed against the Federal estate tax.

.02 Until the present supplies thereof are exhausted, Forms 706d, 706f, and 706i may be used to evidence payment of the foreign death taxes for which credits are authorized by the conventions with Canada, the United Kingdom, and France. Form 706CE will be available in all District Directors' offices.

SEC. 3. EFFECT ON OTHER DOCUMENTS.

This Revenue Ruling amends Mim. 5872, C. B. 1945, 396, and Mim. 6117, C. B. 1947-1, 150.

SUBPART II.—RETURNS AND PAYMENT OF TAX

SECTION 821.—RETURNS

REGULATIONS 105, SECTION 81.65: Preparation of return. Rev. Rul. 54-35

Section 81.65 of Estate Tax Regulations 105, relating to the preparation of the Federal estate tax return, Form 706, provides that "Dupli-

*Originally issued as IR-Mimeograph No. 54-54, dated April 5, 1954.

cate copies of the will, if the decedent died testate, one of which should be certified, must be submitted with the return, together with copies of such other documents as are required in Form 706 and in the applicable section of these regulations." The term "certified copy" refers to a certification made by a public officer having official custody of the original document. Accordingly, since a will is a document in the custody of the register of wills, an official serving in such capacity or his duly authorized representative is the person who must certify one of the copies of the will submitted with the Federal estate tax return.

REGULATIONS 105, SECTION 81.65: Preparation of return. Rev. Rul. 54-36

An attorney or agent who has prepared a Federal estate tax return, Form 706, and signed the "Declaration of Attorney or Agent Preparing Return" is not prevented from later assisting the taxpayer in establishing as a matter of fact a different value for an item of property shown on the return, either through a claim for refund or as an offset against a deficiency resulting from other adjustments proposed by an investigating officer. The attorney or agent who signed such declaration stated only that "this return, including the additional sheets inserted, if any, is a true, correct, and complete statement of all the information respecting the estate tax liability of this estate *of which I have any knowledge*." [Italics supplied.]

REGULATIONS 105, SECTION 81.65: Preparation of returns. Rev. Rul. 54-209*

The Estate Tax Return, Form 706 (Revised December 1953), reflects late statutory changes. Some of the subject matter has been rearranged in a more logical sequence, the instructions have been amplified, obsolete material has been deleted, and there has been added a new Schedule S, "Credit for Foreign Death Duties," which must accompany each claim for refund of tax based in whole or in part on the allowance of credit for foreign death taxes.

Mim. No. 5872, C. B. 1945, 396, and Mim. No. 6117, C. B. 1947-1, 150, superseded, Rev. Rul. 54-169, page 198, this Bulletin, remains in full force and effect.

SECTION 1. PURPOSE.

In the December 1953 revision of the estate tax return, Form 706, several changes were made. The purpose of this Revenue Ruling is to explain the more significant of those changes. In addition to the changes noted in sections 2 to 10, inclusive, of this Revenue Ruling, minor changes in the instructions have been made, either for the purpose of clarifying statements which have been misunderstood by taxpayers or for the purpose of reflecting changes in the law.

SEC. 2. REARRANGEMENT OF SUBJECT MATTER.

.01 Some rearrangement has been made in the subject matter. For the most part the rearrangement has been confined to the placing on

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*Originally issued as IR-Mimeograph No. 54-78, dated April 30, 1954.

the front and back of sheet I of several items which formerly were scattered throughout the form. Except for the introduction of Schedule S, and the instructions therefor, all of the other items and schedules, beginning with "General Instructions" and ending with "Additional Instructions for Estates of Nonresidents not Citizens of the United States," appear in the same sequence as formerly.

.02 For the convenience of the District Directors' offices, several items relating to the assessment of the tax have been placed on the front of sheet I. They include the name of the decedent, the computation of the tax, and the space used for the recording of assessments. On the lower portion of sheet I, under the heading "Determination by Internal Revenue Service," a blank space has been provided for the recording of data through the use of assessment and overassessment stamps. The "Table for Computation of Estate Tax" now appears on the back of sheet I.

SEC. 3. SITUS RULES APPLICABLE IN THE CASE OF NONRESIDENT ALIENS.

As a consequence of statutory changes and the entering into effect of many new death duty conventions with foreign countries, the situs rules found in the instructions for several of the schedules and in "Additional Instructions for Estates of Nonresidents not Citizens of the United States" have been revised and enlarged. Subsequent to the time the December 1953 revision of Form 706 was made, new death duty conventions with Greece and Australia became effective. The situs rules under these two conventions are not set forth on the form. The Greek convention is effective with respect to the estates of decedents dying on or after December 30, 1953, and the convention with Australia is effective with respect to the estates of decedents dying on or after January 7, 1954.

SEC. 4. SCHEDULE G.

The third and fifth questions on Schedule G have been reworded in order that their meaning may be clear and that the information required by the regulations will be furnished. Instructions for the schedule have been revised to reflect these changes and changes made by the Technical Changes Act of 1953.

SEC. 5. SCHEDULE H.

The instructions for Schedule H have been completely revised to reflect the changes made by the Powers of Appointment Act of 1951.

SEC. 6. SCHEDULE L.

Schedule L has been revised to eliminate therefrom any reference to the deduction which at one time was allowed for the support of dependents. The instructions for the schedule now carry a brief statement to the effect that no deduction for the support of dependents is allowed in the case of a decedent who died after September 23, 1950.

SEC. 7. SCHEDULE O.

There has been eliminated from Schedule O the line formerly used for entering the total of the amounts allowed as deductions for the support of dependents.

SEC. 8. SCHEDULE R.

Schedule R has been revised to provide for the computation thereon of the prorated specific exemption provided for in several death duty conventions. It is designed for use by the estate of every nonresident alien except one who at the time of his death was a resident of France or a citizen or resident of Greece. An amendment of the regulations under the Canadian convention relative to the use of certain forms will be issued in the near future. After that amendment is issued, supplemental Form 706b will no longer be used for computing the net estates of nonresident aliens who were residents of Canada. The computation of the net estate of a nonresident alien who at the time of his death was a resident of France or a citizen or resident of Greece should be set forth on supplemental Form 706g (Schedule R(2)) and not on Schedule R. In using Form 706g in the case of a Greek estate, care should be exercised to follow the situs rules contained in the Greek convention (and not those contained in the French convention), and no deduction should be taken for bequests to the surviving spouse since the Greek convention provides that no marital deduction is allowable.

SEC. 9. SCHEDULE S.

Schedule S is a new schedule. It is to be used by the estates of citizens or residents of the United States in computing the amounts which the Internal Revenue Code and the death duty conventions with foreign countries authorize as credits against the Federal estate tax for estate, inheritance, legacy, or succession taxes paid to a foreign country. Supplemental Form 706h formerly used for computing the amount of the credit authorized by the French convention will no longer be used for that purpose. Amendments of the regulations under the conventions with Canada and the United Kingdom relative to the use of certain forms will be issued in the near future. After those amendments are issued, supplemental Forms 706c and 706e formerly used for computing the amount of the credits authorized by the conventions with Canada and the United Kingdom will no longer be used for those purposes. In every case where a claim for refund of tax is filed and the claim is based in whole or in part on the allowance of credit for foreign death taxes, a computation of the credit on a copy of Schedule S must accompany the claim.

SEC. 10. COMPUTATION OF TAX.

The "Computation of Tax" has been simplified. Formerly executors were confronted with the possible necessity of making entries in the computation at 11 places. Most executors will now find it necessary to make entries at only 4 places. The instructions for the computation have been rearranged to reduce considerably the amount of instruction material which the executor in the average case must read.

SEC. 11. DISPOSITION OF COPIES OF PRIOR REVISIONS OF FORM 706.

In order to prevent the distribution to taxpayers of obsolete copies of Form 706, effective upon the receipt in a District Director's office of a supply of the December 1953 revision of Form 706, the supply of prior revisions of that form held for distribution to the public shall be disposed of in the manner prescribed for the disposition of waste paper.

SEC. 12. EFFECT ON OTHER DOCUMENTS.

Mim. No. 6872, C. B. 1945, 396, and Mim. No. 6117, C. B. 1947–1, 150, as well as any other instructions inconsistent with this Revenue Ruling, are hereby superseded. Rev. Rul. 54–169, page 198, this Bulletin, remains in full force and effect.

SEC. 13. EFFECTIVE DATE.

This Revenue Ruling is effective April 30, 1954.

REGULATIONS 105, SECTION 81.65: Preparation of return.

Reproduction, for filing purposes, of Federal tax return forms and schedules. (See Rev. Rul. 54–64, p. 82.)

SECTION 822.—PAYMENT OF TAX

REGULATIONS 105, SECTION 81.78: Payment with bonds or notes of the United States. Rev. Rul. 54–113

Rev. Rul. 156, C. B. 1953–2, 253, sets forth the procedure for effecting the application of certain Treasury bonds in payment of Federal estate taxes.

The date which the representative of the estate designates on Form PD1782, Application of Redemption, as the date the Treasury bonds are to be redeemed in payment of the tax shown to be due on the estate tax return or in payment of an estate tax deficiency, shall be considered the date of payment of the tax due (to the extent of the proceeds of the bonds so applied), provided the bonds are received by the Federal Reserve bank, or by the Treasury Department in cases where bonds are submitted direct on or before the date on which the returned tax or deficiency tax is due. If the bonds are received after the due date of the returned tax or the date prescribed for payment of a deficiency tax, then the date the bonds are received by the Federal Reserve bank, or by the Treasury Department where the bonds are submitted direct, shall be considered the date of payment.

Federal Reserve banks have recently been instructed to indicate on the Forms PD1782 the actual dates such bonds are received by them. Accordingly, where Treasury bonds are deposited with a Federal Reserve bank to be redeemed in payment of estate taxes, the actual date of such deposit will be reflected on Form 15, Certificate of Deposit. Where the bonds are deposited directly with the Treasury Department, the actual date of such deposit will be shown on the certificate of deposit.

PART III.—ESTATES OF NONRESIDENTS NOT CITIZENS OF THE UNITED STATES

SECTION 861.—NET ESTATE

REGULATIONS 105, SECTION 81.13: Property of decedent at time of death. Rev. Rul. 54-21
(Also Section 862, Section 81.50.)

Bonds of a domestic corporation which are among the assets in the estate of a decedent who was a citizen and resident of Canada will not be included in the net estate for Federal estate tax purposes unless physically situated in the United States at the time of his death.

Advice is requested whether bonds of a domestic corporation, which are among the assets of the estate of a decedent who was a resident and citizen of Canada, are includible in the net estate for Federal estate tax purposes.

Section 861(a) of the Internal Revenue Code and section 81.13 of Regulations 105, promulgated pursuant to section 811(a) of the Code, provide, in part, that in the case of a decedent who was a nonresident not a citizen of the United States at the time of death, only the property situated in the United States is includible in the net estate.

The question is presented because of an apparent conflict between the provisions of the supplemental death duty convention between the United States and Canada and the provisions of Estate Tax Regulations 105, relating to the situs of property. Under section 81.50 of the regulations, bonds in the estate of a nonresident not a citizen are deemed not within the United States unless physically situated therein. See *Herman A. Holsten, executor, for the estate of Luisa Terry Ponvert* v. *Commissioner*, 35 B. T. A. 568, affirmed per curiam, 93 Fed. (2d) 1002. Under subparagraph (f) of Article II of the convention bonds of a company are deemed to be situated at the place where the company is incorporated. However, the proviso at the end of Article II prescribes that such Article shall not be construed as increasing the liability of the estate of any person under the estate tax laws of the United States.

By virtue of the above-mentioned proviso, the situs rules of Article II do not subject any property to the estate tax that would not otherwise be so subjected. Accordingly, unless the bonds were physically situated within the United States at the time of the decedent's death, they are not includible in the net estate.

SECTION 862.—PROPERTY WITHIN THE UNITED STATES

REGULATIONS 105, SECTION 81.50: Situs of property.

Bonds of a domestic corporation held by a nonresident not a citizen deemed property within the United States if physically situated therein. (See Rev. Rul. 54–21, p. 203.)

SECTION 863.—PROPERTY WITHOUT THE UNITED STATES

REGULATIONS 105, SECTION 81.50: Situs of property. Rev. Rul. 54–114

Moneys held for a nonresident alien decedent, who was not engaged in business in the United States at the time of his death, by an express company whose certificate of incorporation authorizes it to do banking business and which does in fact do banking business, are not deemed property within the United States for Federal estate tax purposes under the provisions of section 863(b) of the Internal Revenue Code. Moneys held for such nonresident alien decedent by an express company not engaged in the banking business, as, for example, amounts represented by travelers checks of such express company issued to and held by such decedent at the time of his death, are not excludable from the gross estate under section 863(b) of the Code since the relationship of banker and depositor does not exist in such a case.

PART IV.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT F.—EXTENSION OF PAYMENT IN CASE OF FUTURE INTERESTS

SECTION 925.—PERIOD OF EXTENSION

REGULATIONS 105, SECTION 81.79(b): Extension of time for payment of tax attributable to a reversionary or remainder interest.

Credit for foreign death duties and refund of tax attributable to a reversionary or remainder interest. (See Rev. Rul. 54–78, p. 390.)

SUBCHAPTER B.—ADDITIONAL ESTATE TAX

SECTION 936(c).—CREDITS AGAINST TAX: ESTATE, ETC., TAXES PAID TO FOREIGN COUNTRIES

REGULATIONS 105, SECTION 81.9: Credit for death taxes.

Form 706CE, Certification of Payment of Foreign Death Duty, for use in evidencing the payment of foreign death taxes. (See Rev. Rul. 54–169, p. 198.)

CHAPTER 4.—GIFT TAX

SECTION 1000.—IMPOSITION OF TAX

REGULATIONS 108, SECTION 86.2: Transfers reached.

Rental payment by grantor to a trustee for property which he conveyed to the trust. (See Rev. Rul. 54–9, p. 20.)

REGULATIONS 108, SECTION 86.3: Cessation of donor's dominion and control.
(Also Section 1005, Section 86.19.)

Rev. Rul. 54–135

Where a donor endorses a certificate of stock and delivers it to his bank or broker with direction to have it transferred to a donee, the gift is completed for gift tax purposes on the date the stock is transferred to the donee on the books of the corporation. Accordingly, the value of such stock for gift tax purposes is the fair market value thereof as of such date, determined under the provisions of section 86.19(*c*) of Regulations 108, rather than the fair market value thereof on the date on which the donor requested his bank or broker to have the transfer made and endorsed the certificate for that purpose.

REGULATIONS 108, SECTION 86.3a: Gift of husband or wife to third party after April 2, 1948.
(Also Section 1006, Section 86.20.)

Rev. Rul. 54–6

A husband and wife are entitled to the gift-splitting benefits under the provisions of section 1000(f) of the Internal Revenue Code where one spouse files a Federal gift tax return for himself and, in addition to signifying his own consent, executes thereon as agent for his absent spouse a consent to treat the gift as having been made one-half by each spouse, and files a gift tax return for the absent spouse as her agent, provided the return filed and the consent executed by the one spouse as agent for the other are ratified within a reasonable time after the absent spouse is able to do so.

Advice is requested whether a husband and wife are entitled to the gift-splitting benefits under the provisions of section 1000(f) of the Internal Revenue Code in a situation where one spouse files a Federal gift tax return for himself and as agent for his absent spouse executes thereon a consent to treat the gift as having been made one-half by each spouse, and in addition files a gift tax return for the absent spouse as her agent, and the return filed and the consent executed by the one spouse as agent for the other are ratified within a reasonable time after the absent spouse is able to do so.

In the instant case the wife was the actual donor of the gift. In the absence of her husband, who was on active military duty outside the United States, she filed a timely gift tax return for herself and executed thereon, as agent for her husband, a consent to treat the gift as having been made one-half by each spouse. At the same time a gift tax return was filed for the husband, as donor, and signed by the wife as agent. The return and consent executed by the wife as agent were ratified by the husband subsequent to March 15 following the close of the year in which the gift was made but within a reasonable time after he was able to do so.

Section 1000(f) of the Internal Revenue Code, relating to gifts by a husband or wife to a third party, provides in pertinent part that a gift made after the date of the enactment of the Revenue Act of 1948 by one spouse to a person other than his spouse shall, for the purpose of the Federal gift tax, be treated as having been made one-half by each spouse. This provision of the gift tax law is applicable only if both parties consent (in accordance with the regulations) to treat all such gifts made during the year by either while married to the other as having been made one-half by each spouse. It is further provided that such a consent may not be signified after the 15th day of March following the close of the calendar year in which the gifts were made, unless before such 15th day no return has been filed for such year by either spouse. Section 1006(b) of the Code provides that Federal gift tax returns must be filed on or before March 15 following the close of the calendar year in which the gifts were made.

Section 86.3a of Regulations 108, relative to the signifying of a consent as required by section 1000(f) of the Code, makes no provision for the execution of a consent by an agent. However, section 86.20(a) of the regulations, promulgated pursuant to section 1006 of the Code, relative to the filing of gift tax returns, contemplates execution of a return by an agent and provides, so far as here material:

> The return shall not be made by an agent unless by reason of illness, absence, or nonresidence, the person liable for the return is unable to make it within the time prescribed. * * * If by reason of illness, absence, or nonresidence, a return is made by an agent, such return must be ratified by the donor or other person liable for its filing within a reasonable time after such person becomes able to do so; otherwise the return filed by the agent will not be considered the return required by the statute. * * *

Section 86.20(b) of the regulations further provides that the provisions of section 86.20(a), *supra*, are applicable with respect to the filing of Federal gift tax returns in the case of a husband or wife who consent to the application of section 1000(f) of the Code.

It is accordingly held that a husband and wife are entitled to gift-splitting benefits under the provisions of section 1000(f) of the Internal Revenue Code in a situation where one spouse files a Federal gift tax return for himself and, in addition to signifying his own consent, executes thereon as agent for his absent spouse a consent to treat the gift as having been made one-half by each spouse, and as such agent also files a gift tax return for the absent spouse, provided the return and consent executed by the one spouse as agent for the other are ratified within a reasonable time after the absent spouse is able to do so.

REGULATIONS 108, SECTION 86.3a: Gift of husband or wife to third party after April 2, 1948.

Allocation of lifetime specific exemption in gifts of husband or wife to third party. (See Rev. Rul. 54–30, below.)

SECTION 1003(b).—NET GIFTS: EXCLUSIONS FROM GIFTS

REGULATIONS 108, SECTION 86.10: Total amount of gifts. Rev. Rul. 54–91

Gifts were made in trust, the terms of which provide that the trustee in his uncontrolled discretion is to use the net income and principal for the support, education, or benefit of the donor's minor children in such amounts and at such times as shall be in accordance with the needs and best interests of the beneficiaries as though he were holding the property as guardian of the beneficiaries. No person was ever appointed as legal guardian. *Held*, since there was no legally appointed guardian to demand immediate distribution, and the manner, method, and time in which the trustee shall use the income and principal of the trust for the support, education, or benefit of the beneficiaries is discretionary with the trustee, the transfers in trust constituted gifts of future interests in property against which no exclusions are allowable under section 1003 of the Internal Revenue Code. See *Arthur C. Stifel* v. *Commissioner*, 197 Fed. (2d) 107.

REGULATIONS 108, SECTION 86.10: Total amount of gifts. Rev. Rul. 54–92

Where a gift is made in trust the terms of which provide that the trustee is to pay the income to a designated beneficiary and that the trustee may distribute such parts of the trust principal to the beneficiary as in his uncontrolled discretion he may deem necessary and proper, it is held that the income which will be distributed to the beneficiary, which is the beneficiary's present interest, is not susceptible of determination and that under such circumstances no exclusion is allowable under section 1003(b)(3) of the Internal Revenue Code with respect to the gift made of the right to receive income from the property transferred. See *Sylvia H. Evans* v. *Commissioner*, 198 Fed. (2d) 435.

SECTION 1004.—DEDUCTIONS

REGULATIONS 108, SECTION 86.12: Specific exemption. Rev. Rul. 54–30
(Also Section 1000, Section 86.3a.)

No part of the lifetime specific exemption allowable under the provisions of section 1004(a)(1) of the Internal Revenue Code to one spouse may be deducted from the value of a gift attributable to the other spouse. The "gift-splitting" provisions of section 1000(f) of the Code do not authorize the filing of a joint gift tax return nor permit the allocation of any portion of the lifetime specific exemption of either spouse to the use of the other. For example, if a husband has no specific exemption remaining available, but his wife does, and the husband makes a gift to which his wife consents pursuant to section 1000(f) of the Code, the specific exemption remaining available may be claimed only on the return of the wife with respect to one-half of the gift. The husband may not claim a specific exemption since he has none available.

REGULATIONS 108, SECTION 86.13: Charitable, etc., gifts.

Gifts of property to the Pacific War Memorial Commission an agency of the Territory of Hawaii. (See Rev. Rul. 54–220, p. 65.)

SECTION 1005.—GIFTS MADE IN PROPERTY

REGULATIONS 108, SECTION 86.19: Valuation of property.

Valuation of stock of closely held corporations in Federal gift tax returns. (See Rev. Rul. 54–77, p. 187.)

REGULATIONS 108, SECTION 86.19: Valuation of property.

Value of stock transferred from donor to donee. (See Rev. Rul. 54–135, p. 205.)

SECTION 1006.—RETURNS

REGULATIONS 108, SECTION 86.20: Persons required to file return.

Gift tax return filed by one spouse as agent for absent spouse. (See Rev. Rul. 54–6, p. 205.)

REGULATIONS 108, SECTION 86.23: Form of return.

Reproduction, for filing purposes, of Federal tax return forms and schedules. (See Rev. Rul. 54–64, p. 82.)

CHAPTER 9.—EMPLOYMENT TAXES

SUBCHAPTER A.—EMPLOYMENT BY OTHERS THAN CARRIERS

PART I.—TAX ON EMPLOYEES

SECTION 1401(d)(3).—DEDUCTION OF TAX FROM WAGES: SPECIAL REFUNDS

REGULATIONS 128, SECTION 408.802: Special refunds of employee tax on wages over $3,600.

Employee tax withheld with respect to more than $3,600 of an employee's wages by reason of the employee having received wages from two or more employers during a calendar year. (See Rev. Rul. 54-221, p. 73.)

PART III.—GENERAL PROVISIONS

SECTION 1420.—COLLECTION AND PAYMENT OF TAXES

Cost-of-living allowances paid to civilian employees of the United States Government stationed outside of the United States. (See Rev. Rul. 54-40, p. 222.)

REGULATIONS 128, SECTION 408.607: Payment of tax. Rev. Rul. 54-210

A limited partner who, upon dissolution of a limited partnership created under the Uniform Limited Partnership Act of California, received the return of "property" contributed to the capital of the partnership is liable for Federal employment taxes incurred by the partnership prior to its dissolution.

Advice is requested whether, upon the dissolution of a limited partnership organized under the Uniform Limited Partnership Act of the State of California, a limited partner, who performed no services in connection with the operation of the business and did not participate in its management, is liable for Federal employment taxes incurred by the partnership prior to its dissolution.

A limited partnership was formed under the Uniform Limited Partnership Act of the State of California for the purpose of operating a restaurant and bar business and a Certificate and Articles of Limited Partnership were duly executed and recorded as required by the State law. Two partners were designated as general partners and one as a limited partner. Simultaneously, the three partners entered into a Conditional Sale Agreement whereby the general partners agreed to purchase the restaurant and bar owned by the limited partner. Under the partnership agreement, the limited partner transferred a liquor license at an agreed value of *x* dollars to the partnership as his contribution and the general partners transferred to the partnership all property, as well as the beneficial interest and rights, acquired by them under the Conditional Sale Agreement. It was agreed that all partnership profits were to be paid to the general partners and credited to them. The limited partner was given a specific lien on all the partnership profits, merchandise, etc., as security for the payments to be made by the general partners under the Sale Agreement. The general partners were responsible for the conduct of the business. The limited partner performed no services in connection with the operation of the business and did not participate in its management. The agreement provided for the dissolution of the partnership upon payment of the full purchase price of the business or upon cancelation of the Conditional Sale Agreement by reason of the buyers' failure to perform the terms and conditions of such agreement. If the partnership was dissolved because of the buyers' default, the liquor license was to be transferred to the limited partner. The partnership was dissolved due to the buyers' default in payments, and the liquor license was transferred to the limited partner. The general partners filed the required employment tax returns but failed to pay the taxes due. The question has arisen whether the limited partner is liable for the taxes incurred by the partnership prior to its dissolution.

The applicable portions of the following sections of the Uniform Limited Partnership Act of California as set forth in title 2, chapter 2, of the California Corporations Code Annotated, adopted July 1, 1947, and in effect during the period involved, provide:

> Section 15501. The limited partners as such shall not be bound by obligations of the partnership.
>
> Section 15504. The contribution of a limited partner may be cash or other property, but not services.
>
> Section 15507. A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business.
>
> Section 15517. Liability of a limited partner to the partnership. When a contributor has rightfully received the return in whole or in part of the capital of his contribution, he is nevertheless liable to the partnership for any sum, not in excess of such return with interest, necessary to discharge its liabilities to all creditors who extended credit or whose claims arose before such return.

In the instant case, the Certificate and Articles of Limited Partnership, executed under the provisions of the Uniform Limited Partnership Act of California and recorded in accordance with the State law, evidence the existence of a bona fide partnership composed of two general partners and one limited partner. For Federal employment tax purposes, the members of a partnership are both jointly and severally the "employer" of the individuals employed by the firm. See S. S. T. 317, C. B. 1938-2, 277. The fact that the limited partner did not participate in the management of the business is not material since that right is vested in the general partners.

The liquor license of the agreed value of x dollars, held in the names of the three partners, is regarded as a contribution by the limited partner of "other property" within the contemplation of section 15504 of the Uniform Limited Partnership Act of California.

Under section 15517, *supra*, a contributor who has received the return in whole or in part of his contribution is liable to the partnership for any sum, not in excess of such return with interest, necessary to discharge its liabilities to all creditors who extended credit or whose claims arose before such return. It is accordingly concluded that since his capital contribution was returned to him, the limited partner is liable to the extent of his returned contribution with interest for the payment of the Federal employment taxes incurred by the partnership prior to its dissolution.

SECTION 1421.—OVERPAYMENTS AND UNDERPAYMENTS

REGULATIONS 182, SECTION 408.801: Refund or credit of overpayments which are not adjustable.

Employee tax erroneously withheld with respect to more than $3,600 of wages paid by a single employer during a calendar year. (See Rev. Rul. 54–221, p. 73.)

SECTION 1426.—DEFINITIONS

Cost-of-living allowances paid to civilian employees of the United States Government stationed outside of the United States. (See Rev. Rul. 54–40, p. 222.)

REGULATIONS 128, SECTION 408.204: Who are employees.

Rev. Rul. 54–99

A manicurist and a barbershop operator entered into an agreement whereby the manicurist committed herself to furnish a manicuring service to the patrons of the barbershop during the hours that the shop is open for business; however, it was stipulated that no such service would be furnished on Wednesdays. The service agreed upon consisted of the availability of a skilled and competent manicurist, either the party to the agreement or some other qualified person acceptable to the barbershop operator. The manicurist is free to refuse manicuring service to any patron of the barbershop, regulates her own working hours, furnishes her own equipment, tools, instruments and supplies required in the conduct of her business, collects and retains the proceeds for herself without using the operator's cash register, and may terminate the arrangement whenever it is no longer satisfactory. *Held*, the manicurist is not an employee of the operator of the barbershop for Federal employment tax purposes.

Advice is requested whether an individual who, under an agreement with an operator of a barbershop, furnishes a manicuring service to the patrons of the shop is an employee of the operator of the shop for Federal employment tax purposes.

In the instant case, a manicurist and the operator of a barbershop entered into an agreement whereby she committed herself to furnish a manicuring service to the patrons of the barbershop during the hours that the shop is open for business; however, it was stipulated that no such service would be furnished on Wednesdays. The service agreed upon consisted of the availability of a skilled and competent manicurist, either the party to the agreement or some other qualified person acceptable to the barbershop operator. The manicurist is free to refuse manicuring service to any patron of the barbershop if she so chooses. She regulates her own working hours, furnishes her own equipment, tools, instruments, and supplies required in the conduct of her business, and collects and retains the proceeds from her work without using the operator's cash register or otherwise furnishing the operator of the barbershop information concerning her income. She is not required to and does not secure the operator's approval when she takes a vacation; however, in the interest of good business relationship, she does, as a matter of practice, tell him when she plans to be away for an extended period of time. Whenever the arrangement is no longer satisfactory, either party may terminate it.

Section 408.204(c) of Regulations 128 provides that generally the legal relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. It is not necessary that the employer actually direct or control the manner in which the services are performed, it is sufficient if he has the right to do so. An individual who is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and method for accomplishing the result, is an independent contractor. An individual performing services as an independent contractor is not as to such services an employee under the usual common law rules.

Whether a person is an independent contractor or an employee is largely a question of fact to be determined upon the particular facts of each case. In the instant case the manicurist obligated herself to furnish a service to the operator of the barbershop. She did not agree that she personally would perform the services required but retained the right to employ someone else for this purpose. The agreement between them does not give the operator the right to direct the manner in which these services are to be performed; in fact, the only right the operator has in the event of unsatisfactory service is to bring about the termination of the arrangement. That, in itself, is not sufficient to establish the relationship of employer and employee between him and the manicurist. Accordingly, it is held that the manicurist in the instant case is not an employee of the operator of the barbershop for Federal employment tax purposes.

REGULATIONS 128, SECTION 408.205: Who are employers. **Rev. Rul. 54–31**

(Also Section 1607, Section 403.205, Regulations 107.)

A change in the membership of a partnership resulting from the death, withdrawal, substitution, or addition of a partner, or a shift of interests among existing partners does not, in itself, effect a termination of a partnership for the purposes of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

S. S. T. 199, C. B. 1937–2, 405, and S. S. T. 354, C. B. 1939–1 (Part 1), 294, modified.

Further consideration has been given to the consequence of a change in the membership of a partnership resulting from the death, withdrawal, substitution, or addition of a partner, for the purposes of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

S. S. T. 199, C. B. 1937-2, 405, held in part that a new employment begins, for the purposes of Titles VIII and IX of the Social Security Act where a partnership business is continued after the death or retirement of a partner. (Titles VIII and IX of the Social Security Act have been incorporated in ch. 9 of the Internal Revenue Code, and are cited as the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.) S. S. T. 354, C. B. 1939-1 (Part 1), 294 held that S. S. T. 199 applied only where the business of the partnership is continued, that services performed in winding up a partnership's affairs were not to be regarded as being performed in a new employment. Services performed in carrying on the business of a new partnership, or in carrying on the business on behalf of a remaining partner, however, were to be regarded as services performed in a new employment.

In Rev. Rul. 144, C. B. 1953-2, 212, it is stated that, as defined in section 3797(a)(2) of the Internal Revenue Code, the term "partnership" for tax purposes is broader than the term under common law, the Uniform Partnership Act, or individual State laws. Accordingly, the Federal tax consequences of transactions involving partnerships and interest in partnerships will be determined upon the basis of their substance and in accordance with the Federal tax laws without regard to the technical refinements of State laws. Rev. Rul. 144 held that a change in the membership of a partnership resulting from the death, withdrawal, substitution or addition of a partner, or a shift of interests among existing partners does not, in itself, effect a termination of a partnership for Federal income tax purposes.

In view of the foregoing, it is held that a change in the membership of a partnership resulting from the death, withdrawal, substitution, or addition of a partner, or a shift of interests among existing partners does not, in itself, effect a termination of a partnership for the purposes of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act. Ordinarily the partnership will be treated as continuing where the business of the partnership, or a substantial portion thereof, is continued.

S. S. T. 199 and S. S. T. 354, *supra*, are modified to the extent that they are inconsistent with the foregoing.

Under the authority contained in section 3791(b) of the Internal Revenue Code, the Internal Revenue Service will not require the provisions of this Revenue Ruling to be applied with respect to those changes in partnership interests which occurred prior to January 1, 1954.

REGULATIONS 128, SECTION 408.208: Agricultural labor. Rev. Rul. 54-170
(Also Section 481, Section 39.481-1, Regulations 118.)

An income-producing farm descended to the heirs of a decedent as coowners, and one of the heirs operated the farm for the joint

profit of all, receiving a stated sum each year and his pro rata share of the profits. This arrangement constituted a partnership within the meaning of section 3797(a)(2) of the Internal Revenue Code, and none of the income derived by the operator from this arrangement constituted wages for Federal employment tax purposes or net earnings from self-employment for self-employment tax purposes.

Advice is requested regarding the nature for Federal employment and self-employment tax purposes of income derived by an individual from the operation of a farm under the circumstances described below.

The farm in question descended by will to an individual and six other heirs as cotenants. By agreement among the cotenants such individual (hereafter called the operator) operates the farm for the joint profit of all the cotenants and devotes his full time and attention thereto. For his services in this connection the operator receives a stated sum per year in addition to his pro rata share of the profits from the farming operation. At the end of each year he accounts to each of the cotenants with respect to income, expenses, and profits for such year. The operation of the farm consists principally of the cultivation of the soil, the raising and harvesting of fruit and field crops, the care and maintenance of a dairy herd, and the care and maintenance of farm buildings and equipment. All the crops produced on the farm are sold. No milk produced by others is received or processed on the farm.

Under the facts of the instant case the cotenants are partners within the meaning of section 3797(a)(2) of the Internal Revenue Code. It follows that the amounts received by the operator for his work relating to the operation of the farm cannot be regarded as wages for Federal employment tax purposes. Being a partner, he is not an employee of the partnership for Federal employment tax purposes. See S. S. T. 23, C. B. XV-2, 405 (1936).

Amounts received by the operator do not constitute "net earnings from self-employment" for self-employment tax purposes. As defined in section 481(a) of the Code, the term "net earnings from self-employment" means "the gross income derived by an individual from any trade or business carried on by such individual, less the deductions * * * attributable to such trade or business, plus his distributive share (whether or not distributed) of the ordinary net income or loss, * * * from any trade or business carried on by a partnership of which he is a member." But that section further provides that in computing such gross income and deductions and such distributive share of the partnership's ordinary net income or loss there shall be excluded, among other things, "income derived from any trade or business in which, if the trade or business were carried on exclusively by employees, the major portion of the services would constitute agricultural labor as defined in section 1426(h)."

It appears that the major portion of the services rendered in connection with the operation of the instant farm would, if performed exclusively by employees, constitute "agricultural labor" as defined in section 1426(h) of the Code. See Regulations 128, section 408.208. Accordingly, the income derived by the operator from the operation of the farm does not constitute net earnings from self-employment for purposes of the tax on self-employment income.

REGULATIONS 128, SECTION 408.214: States and their political subdivisions and instrumentalities.

Rev. Rul. 54–224

The N County Agricultural Extension Association of Pennsylvania, organized pursuant to the Pennsylvania statutes for the purpose of cooperating with the United States Department of Agriculture and the Pennsylvania State College in carrying out functions required by the Smith-Lever Act, providing for cooperative agricultural extension work, financed by county funds, no membership dues being paid by anyone in the Association, and expressly declared by statute to be a political subdivision of the State, is a wholly owned instrumentality within the meaning of section 1426(b)(8) of the Federal Insurance Contributions Act, as amended.

Advice is requested relative to the status, for Federal employment tax purposes, of the N County Agricultural Extension Association of Pennsylvania.

The N County Agricultural Extension Association was organized pursuant to the Pennsylvania statutes for the purpose of cooperating with the United States Department of Agriculture and the Pennsylvania State College in carrying out functions required by the Smith-Lever Act, 38 Stat. 372, providing for cooperative extension work. The Pennsylvania statutes authorize the county commissioners of each county to appropriate funds for the operation of the office of the agricultural extension association organized within the county. Such funds are direct appropriations to the associations for local expenses, such as, secretarial help, office, office supplies, transportation within the county, etc. The secretary of the association is employed by the executive committee of the association and not by the county in which the association is organized. The membership of the Association is composed of persons living in the county and interested in agriculture and home economics work and no membership dues are paid by anyone in the Association. The executive committee of the Association is elected by the members at its annual meeting and the committee members serve without compensation or expenses.

Section 1426(b) of the Federal Insurance Contributions Act, as amended, contains the following exception from the term "employment", as that term is defined in the Act:

(8) Service * * * performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned by one or more States or political subdivisions; * * *

The determination of whether a county farm bureau is a State instrumentality is based largely upon the structure of the organization.

In the instant case, the N County Agricultural Extension Association is an organization used by the State in carrying into effect a part of its governmental functions. All its funds are received as appropriations from the County Board of Commissioners and no membership dues are paid by anyone in the Association. The County Board of Commissioners supplies the office, furniture, equipment and other expenses, and any such property would revert to the County upon dissolution of the Association. The Association is not incorporated and has been held by the State counsel to be a political subdivision of the

State within the meaning of section 2(c) of Act No. 491 of the Pennsylvania statutes. Accordingly, it is concluded that the N County Agricultural Extension Association is a wholly owned instrumentality within the meaning of section 1426(b)(8) of the Federal Insurance Contributions Act, as amended.

In Em. T. 434, C. B. 1942–2, 216, it is held that the M County Farm Bureau which was organized in the State of Missouri and is operated to cooperate with the College of Agriculture of the University of Missouri in carrying out the functions of the Smith-Lever Act, *supra*, is not an instrumentality of the State. However, the following facts readily distinguish that ruling from the present case. The M County Farm Bureau is a corporate body engaged in cooperative purchasing for the profit of its members. It also is engaged in legislative promotion work when measures of interest to the farmers are proposed and in addition cooperates with the University of Missouri College of Agriculture and the United States Department of Agriculture in bringing the extension program in agriculture and home economics to the farmers of the county. The sources of income are membership fees and an annual appropriation from the county court, the latter made solely for the support of the extension program. It was concluded that the structure of the M County Farm Bureau is inconsistent with ownership by the State or county and that the mere cooperation with the agricultural extension work carried on by the University of Missouri College of Agriculture does not transform it into a State instrumentality.

REGULATIONS 128, SECTION 408.226: Wages. (Also Section 1621, Section 406.207, Regulations 120.) Rev. Rul. 54–225

Payments made by a producer of musical jingles, spot announcements, radio transcriptions, and film sound tracks to a radio or television artist, who is an employee of the producer with respect to services performed in making recordings, for the reuse of such recordings constitute "wages" for purposes of the Federal employment taxes including the withholding of income tax on wages.

Advice is requested whether payments made to a commercial recording artist for the reuse of recordings and transcriptions made in connection with radio and television broadcasting programs constitute "wages" for purposes of the Federal employment taxes including the withholding of income tax on wages.

In the radio and television broadcasting industry, it is customary for producers of recordings of musical jingles, spot announcements, radio transcriptions, and film sound tracks to engage artists to make recordings and transcriptions for specific sponsors. On occasions they may make recordings to be sold through an advertising agency to individual sponsors. The artist is paid a stated amount for each recording and transcription so made and an hourly rate for the time spent in rehearsals in connection therewith. In the performance of such services, the artist is an employee of the producer. In addition to the payments received for such engagements, the artist receives additional payments as the recordings are subsequently reused. Since the additional amounts are paid without the performance of additional services by the artist, the question arises whether such payments constitute "wages" for purposes of the Federal employment taxes including the withholding of income tax on wages.

The applicable provisions of the Internal Revenue Code (secs. 1426(a), 1607(b), and 1621(a)) provide that the term "wages" means all remuneration for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash, with certain exceptions and limitations not here pertinent. The regulations promulgated pursuant to the abovementioned sections of the Code provide that remuneration for employment, unless specifically excepted by the statute, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them. (Secs. 408.226, 403.227, and 406.207 of Regulations 128, 107, and 120, respectively.)

The producer and the theatrical union in which the artist is a member agree to accept and conform to a Code of Fair Practice governing the minimum terms and conditions established by the union for radio recording artists. The Code of Fair Practice provides that the artists will be given notice thereof and will contract subject thereto. The Code of Fair Practice contemplates a normal period for the use of recordings and transcriptions for which a stated fee is paid the artists as remuneration. The Code of Fair Practice also contemplates that the recordings and transcriptions may be reused subsequent to the expiration of the normal period, for which use the artist is entitled to receive an additional fee. It appears that the additional fee received by the artist for reuse of a recording is paid pursuant to the terms of the Code of Fair Practice in connection with and as a result of the employment relationship which existed between the producer and the artists at the time the recordings or transcriptions were made.

Accordingly, it is held that the additional amounts paid to a radio or television artist for the reuse of recordings and transcriptions made as a result of services performed by the artist constitute "wages" for Federal employment tax purposes and the withholding of income tax on wages under section 1622 of the Internal Revenue Code, regardless of whether or not the artist is still in the employ of the producer at the time the wages are paid.

SUBCHAPTER B.—EMPLOYMENT BY CARRIERS

PART IV.—GENERAL PROVISIONS

SECTION 1532.—DEFINITIONS

REGULATIONS 114, SECTION 411.203: Who are employees. Ct. D. 1767

EMPLOYMENT TAXES—INTERNAL REVENUE CODE—DECISION OF COURT

1. EMPLOYMENT TAXES—LIABILITY FOR—WHO ARE EMPLOYERS—WHO ARE EMPLOYEES.

Where individuals, who render personal service on property used in the taxpayer—railroad's operations, are hired, fired, supervised, and compensated by an independent contractor who has contracted to perform the work for the railroad, such individuals are not "in the service of the railroad" within the meaning of section 1532(d) of the Code, and, hence, are not employees of the taxpayer for purposes of the Railroad Retirement Tax Act.

2. JUDGMENT AFFIRMED.

Judgment of the United States District Court for the District of Minnesota (104 F. Supp. 745 (1952)) affirmed.

UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Elmer F. Kelm, Collector of Internal Revenue, appellant, v. *Chicago, St. Paul, Minneapolis & Omaha Railway Company, appellee*

Appeal from the United States District Court for the District of Minnesota

Before GARDNER, Chief Judge, and SANBORN and JOHNSEN, Circuit Judges

[August 10, 1953]

OPINION

SANBORN, Circuit Judge: This action was brought by the Chicago, St. Paul, Minneapolis & Omaha Railway Company (hereinafter referred to as the Omaha) against the Collector of Internal Revenue (whom we shall refer to as the Government) to recover Federal employment taxes assessed and paid for the year 1947 under the Railroad Retirement Tax Act, subchapter B of chapter 9 of the Internal Revenue Code, 26 U. S. C. A. Int. Rev. Code, section 1500 *et seq.*[1]

The taxes assessed against the Omaha and paid by it were upon the earnings of persons who worked on the Omaha's property but who were hired, directed, supervised, paid, and fired by the Shipley Company, a partnership which, under a contract with the Omaha, performed services for it in connection with the operation of the railroad.

The Omaha asserted that it was not liable for the taxes in suit. This was denied by the Government. The case was tried to the court, which determined that the Omaha was not liable under the Railroad Retirement Tax Act for taxes with respect to the earnings of the employees of the Shipley Company. (104 F. Supp. 745.) From the ensuing judgment, the Government has appealed.

There is no dispute about the facts. For more than forty-five years the Omaha has contracted for services such as the Shipley Company performed for it under contract in 1947 and had continuously since 1923 performed for it under contracts. Generally stated, these services had to do with the placing of coal in bins or chutes along the railroad tracks for use in locomotives, coaling of locomotives, storing ice, icing refrigerator cars, servicing heaters in such cars, cleaning freight cars, transferring shipments from bad order cars, and unloading livestock for feed, water and rest, and reloading it. Similar contract services rendered by the Shipley Company were involved in the case of *Reynolds* v. *Chicago, St. Paul, Minneapolis & Omaha Ry. Co.*, 8 Cir., 168 F. 2d 943, which case, together with *Reynolds* v. *Northern Pacific Ry. Co.*, 8 Cir., 168 F. 2d 934, certiorari denied 335 U. S. 828, and *Reynolds* v. *Great Northern Ry. Co.*, 8 Cir., 168 F. 2d 944, was decided by this court in 1948.

In the *Northern Pacific*, *Great Northern* and *Omaha* cases just referred to, this court ruled that the railroads were not liable under the Carriers Taxing Act of 1937 for employment taxes for years prior to 1947 with respect to employees of independent contractors performing services comparable to those performed by the Shipley Company for the Omaha in the year 1947.

The contention of the Government is that after January 1, 1947, the Railroad Retirement Tax Act, which amended the Carriers Taxing Act of 1937, brought within the coverage of the act the employees of the Shipley Company and of other railroad contractors performing similar services on railroad property, and made the railroads liable for taxes upon the earnings of such employees. The amendment upon which the Government relies is found in section 1532(d) of

[1] Prior to its amendment on July 31, 1946, 60 Stat 722, the act was known as the Carriers Taxing Act of 1937, 50 Stat. 435, 45 U. S. C. A., sec. 261 *et seq.*; title 26 (Int. Rev. Code) U. S. C. 1940 Ed., sec 1500 *et seq.*

title 26 U. S. C. A. Int. Rev. Code. Prior to July 31, 1946, that section, which defined "service," read as follows (title 26 U. S. C., 1940 Ed., section 1532 (d)):

> "An individual is in the service of an employer whether his service is rendered within or without the United States if he is subject to the continuing authority of the employer to supervise and direct the manner of rendition of his service, which service he renders for compensation."

After the amendment of July 31, 1946, section 1532(d) read:

> "An individual is in the service of an employer whether his service is rendered within or without the United States if (i) he is subject to the continuing authority of the employer to supervise and direct the manner of rendition of his service, *or he is rendering professional or technical services and is integrated into the staff of the employer or he is rendering, on the property used in the employer's operations, other personal services the rendition of which is integrated into the employer's operations*, and (ii) he renders such service for compensation * * * ."

It was the insertion of the language "or he is rendering, on the property used in the employer's operations, other personal services the rendition of which is integrated into the employer's operations" upon which the Government bases its contention that after January 1, 1947, the Omaha became liable for employment taxes on employees of the Shipley Company performing railroad services on the Omaha's property.

Under the definition of "employer" in section 1532(a), title 26 U. S. C. A. Int. Rev. Code, the Omaha is unquestionably an "employer." An "employee," under section 1532(b), "means any individual in the service of one or more employers for compensation," and, under section 1532(d), an individual is purportedly in the service of an "employer" if he is rendering personal services, on the employer's property, "the rendition of which is integrated into the employer's operations." Therefore, it is argued that any individual who, on the property of the Omaha, renders a personal service in the furtherance of its operations, such as icing refrigerator cars, coaling locomotives, or unloading bad order cars, is one of its employees for the purposes of the taxing act in suit, regardless of who hired him, who pays him, or who supervises or directs the manner in which he performs his services. The Government asserts that all of the employees of the Shipley Company doing railroad work for the Omaha upon its property are clearly covered by the act, and that the Omaha is liable for employment taxes with respect to them.

In the case of *Reynolds* v. *Northern Pacific Ry. Co.*, *supra*, 168 F. 2d 934, 939, 942–943, we referred to the July 31, 1946, amendment to section 1532(d) respecting the definition of "service" as indicating that Congress had not intended that the employees of independent contractors doing railroad work should be covered by the Carriers Taxing Act of 1937 for years prior to 1947. The amended act had only an incidental significance in the *Northern Pacific* case and its companion cases. However, upon the assumption that the amendment of July 31, 1946, meant all that its language was susceptible of meaning we expressed the view that the coverage of the act had apparently been extended to include, after January 1, 1947, the employees of independent contractors performing railroad services on railroad property. What we said was, of course, not intended as a ruling upon the question of the scope or effect of the amendment. This we made clear in a subsequent per curiam opinion. 168 F. 2d 944. We had had no occasion to consider the legislative history of the amendment.

It is interesting to note that the Court of Claims in the case of *Pennsylvania R. Co.* v. *United States* (decided in 1947), 70 F. Supp. 595, 604, in which the question of the liability of the railroad for employment taxes under the Carriers Taxing Act of 1937 with respect to employees of an independent contractor was involved, intimated that no significant change in the taxing act had been made by the amendment of July 31, 1946, "when considered as a whole and in the light of legislative history."

The district court in deciding the instant case followed the decision of the Court of Appeals for the Tenth Circuit in *Nicholas* v. *Denver & Rio Grande Western R. Co.*, 195 F. 2d 428, which involved the same question. The Tenth Circuit held that the employees of an independent contractor performing services for the Denver & Rio Grande Western R. Co., on its property, were not within the coverage of the Railroad Retirement Tax Act. That court said of the amendment upon which the Government relied in that case and relies in this case (pages 432–433 of 195 F. 2d):

"When the new language contained in the act is read in the light of its context, in the light of other related provisions of law, and in the light of the entire legislative history of the amendatory act, there is no sustainable basis for the contention that the added language was intended or designed to bring within the scope of the act an independent contractor such as Lamberg and his employees. While the bill as originally introduced was intended among other things to bring independent contractors of that kind and their employees within the purview of the legislation, and whatever the purpose of Congress may have been in other respects, the legislative history indicates clearly that the final action of Congress represented a deliberate intent and purpose to leave such contractors and their employees outside the scope of the act insofar as employment taxes were concerned. And that ultimate Congressional intent and purpose being clear, courts are not free to construe the act otherwise."

The legislative history of the act in suit is adequately and accurately stated in Judge Bratton's opinion in the *Denver & Rio Grande Western R. Co.* case, and need not be repeated. See pages 431–432 of 195 F. 2d. It is sufficient to say that the proponents of the bill introduced in Congress to amend the Carriers Taxing Act of 1937 sought to enlarge its coverage and to make it applicable to independent contractors such as the Shipley Company and their employees doing railroad work, by expanding the definition of "employer" to expressly cover such contractors. No one reading the legislative proceedings resulting in the rejection of that proposed change can have any doubt that Congress intended to deny the extensions of coverage proposed.

The Government, however, contends that recourse may not be had to the legislative history of the amended act because the language of the amendment relied upon is plain and unambiguous. That contention presents the doubtful question in this case. If the language of the amendment is taken at its full face value, it means what the Government says it means and what we thought it meant when in 1948 we decided the *Northern Pacific* and companion cases. It is not our understanding that legislative history may be resorted to for the purpose of creating an ambiguity in the language of a statute which otherwise would not be ambiguous. Congress enacts laws; not the legislative proceedings underlying them. If one may not rely upon plain statutory language as expressing the meaning of an act and must search legislative history in order to determine whether or not Congress meant what it said, then the history of legislation should, at least, be made as accessible as the law to which it relates, so that one may be advised when and why a statute and its history part company.

We know, from the proceedings which resulted in the passage of the Railroad Retirement Tax Act, that, after the bill for the act passed the House, the Senate undertook to strike from the bill all of the language which it was thought would bring contractors such as the Shipley Company and its employees within the coverage of the act. Whether the Senate succeeded in its attempt is, to say the least, doubtful.

The language of the amendment which was not eliminated from the bill, and upon which the Government now relies, is, we think, no more ambiguous than was that of the statute considered by this court in the case of *Warner* v. *Dworsky*, 194 F. 2d 277, 279–280, or that involved in *Missouri Pac. R. Co. 5¼% Secured S.B.C.* v. *Thompson*, 8 Cir., 194 F. 2d 799, 803–804. One reasonably may believe that Congress should be held strictly accountable for the language which it uses in a statute, and if any corrections are needed they should be made by that body and not by the courts. See *Crooks* v. *Harrelson*, 282 U. S. 55, 60.

This court, however, has recognized that in determining the purpose and coverage of a taxing statute, legislative history may not safely be ignored and must be considered, and that the language of such an act cannot always be accorded its ordinary meaning. In *Helvering* v. *Rebsamen Motors, Inc.*, 8 Cir., 128 F. 2d 584, 587, this court, in referring to a decision (reversed by the Supreme Court) construing a taxing act, said:

"We followed the rule that the use by a legislative body of words having definite meanings creates no ambiguity and that such words are to be taken and understood in their plain, ordinary, and popular sense. We have come to realize that that rule is not always a safe guide to follow in construing the language of a taxing statute. *United States* v. *Armature Rewinding Co.*, 8 Cir., 124 F. 2d 589, 591. It is our understanding, however, that the rule is still to be applied unless it can clearly be seen that Congress used the

> words in question in a broader or different sense than that which would ordinarily be attributed to them. See *Foley Securities Corp.* v. *Commissioner*, 8 Cir., 106 F. 2d 731, 734, 735."

We have also recognized the desirability of uniformity of decision among the Circuits, particularly with respect to the coverage of taxing statutes. *United States* v. *Armature Rewinding Co.*, 8 Cir., 124 F. 2d 589, 591, and cases cited. We have with some misgivings concluded that in the instant case resort properly may be had to the legislative history of the Railroad Retirement Tax Act for determining the purpose and scope of the language of the amendment here in controversy.

It is safe to say that neither the proponents nor the opponents of the bill which as amended became the Railroad Retirement Tax Act regarded the amendment, upon which the Government now relies, as having any substantial bearing upon the coverage of the act, and that if there had been any intimation that the amendment was intended to have an effect such as is now claimed for it, it would have been stricken from the bill.

The Chairman of the Railroad Retirement Board, in explaining to the House Committee the proposed amendments, made the following statement about the changes in the section with which we are concerned:

> "*Clarification of definition of 'Employee.'*—The several acts proposed to be amended by H.R. 1362 define an employee, in part, in terms of persons 'in the service of' an employer. And a person is 'in the service of' an employer if he is 'subject to the continuing authority of the employer to supervise and direct the manner of rendition of his service, which service he renders for compensation.' The Board has found that professional and technical persons, many of whom are commonly regarded as employees, typically decide for themselves the manner in which they will render service; a railroad vice president, for example, having jurisdiction over the railroad's medical department would not think of telling a doctor how to perform a surgical operation. And the doctor would probably resent direction in such a matter as unwarranted lay interference with his professional conduct. But the doctor may obviously be an employee of the railroad; and the Board has so held in many cases. But there are cases in which such a holding would seem to be appropriate, but in which the facts cannot be fit into the statutory definition; and others in which an appropriate ruling becomes unduly difficult. The provision of H. R. 1362 that a person rendering professional or technical services is in the service of an employer if he 'is integrated into the staff of the employer' will be beneficial to the administration of the act.
>
> "The Board has held, in numerous cases, that individuals rendering services under a contract with a railroad are in fact employees of the railroad by virtue of a finding that such individuals are 'subject to the continuing authority of "the railroad" to supervise and direct the manner of rendition' of their service. As part of the clarification process set out in H. R. 1362, such contractors are made employers. This may be reasonable where a large number of persons are working for the contractor, but it might result in the removal from coverage of some individual contractors who themselves perform all the services under the contract. This result, as is desirable, is avoided in H. R. 1362 by appropriate modification of the subsection dealing with 'in the service of an employer.' "

Apparently the proponents of the amendment, in order to avoid the anomalous situation of making an "employer" out of an individual contractor who had no employees and who himself did all the work contracted for, proposed to make him an "employee," instead of an "employer," under the act. Therefore it appears that the amendment in suit was not intended to relate to independent contractors such as the Shipley Company and its employees, but only to a self-employed individual who was rendering service to a railroad under contract.

A ruling that the Railroad Retirement Tax Act required the Omaha, after January 1, 1947, to pay employment taxes with respect to the earnings of the employees of the Shipley Company would be contrary to the clearly indicated intent of Congress not to extend the coverage of the act to such contractors and their employees.

The judgment appealed from is affirmed.

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SUBCHAPTER C.—TAX ON EMPLOYERS OF EIGHT OR MORE

SECTION 1607.—DEFINITIONS

REGULATIONS 107, SECTION 403.205: Who are employers.

Effect of a change in the membership of a partnership where a substantial portion of the business is continued. (See Rev. Rul. 54–31, p. 212.)

SUBCHAPTER D.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 1621.—DEFINITIONS

REGULATIONS 120, SECTION 406.207: Wages. (Also Section 1426, Section 406.226, Regulations 128, Section 1420.) Rev. Rul. 54–40

Cost-of-living allowances, paid to certain civilian employees of the Government of the United States stationed outside the United States, are not "wages" subject to the withholding of income tax at the source under section 1622 of the Internal Revenue Code. Whether such allowances are "wages" subject to Federal employment taxes is to be determined, under section 1420(e) of the Code, by the head of the Government agency involved.

Advice is requested whether cost-of-living allowances, paid to certain civilian employees of the Government of the United States stationed outside of the continental United States, are subject to the Federal Insurance Contributions Act taxes or to the withholding of income tax under section 1622 of the Internal Revenue Code.

Section 204 of the Independent Offices Appropriation Act of 1949, approved April 20, 1948, 62 Stat. 194, as extended, provides for the payment, in accordance with regulations prescribed by the President, of cost-of-living allowances to civilian officers and employees of the Government of the United States stationed in foreign countries.

Section 207 of the Independent Offices Appropriation Act, *supra*, as amended by section 104 of the Supplemental Independent Offices Appropriation Act of 1949, approved June 30, 1948, 62 Stat. 1205, authorizes payment of similar allowances, in accordance with regulations prescribed by the President, to certain civilian employees of the Government of the United States stationed in Territories and possessions of the United States.

In view of the purposes for which the aforementioned cost-of-living allowances are provided the employees in question, it is believed that such payments do not constitute "wages" within the meaning of the Federal Insurance Contributions Act or of section 1621(a) of the Internal Revenue Code, relating to the withholding of income tax at the source.

Accordingly, it is held that an amount, which is specifically identified as a "cost-of-living allowance," paid to a civilian employee of the

Government of the United States stationed outside the continental United States or in Alaska, pursuant to sections 204 or 207 of the Independent Offices Appropriation Act of 1949, *supra*, as amended and extended, and in accordance with applicable regulations thereunder prescribed by the President, is not subject to the withholding of income tax under section 1622 of the Internal Revenue Code. However, a payment which is compensatory in nature, such as a "post differential" paid to an employee for service at a post where conditions of environment have been deemed to warrant the payment of additional compensation as a recruitment incentive, is subject to the withholding of income tax under section 1622 of the Code.

It is the opinion of the Internal Revenue Service that the status of the "cost-of-living allowance" and of the "post differential" for purposes of the Federal Insurance Contributions Act would be the same as for purposes of income tax withholding. However, attention is directed to section 1420(e) of the Internal Revenue Code, which provides in substance that in the case of taxes imposed by the Federal Insurance Contributions Act with respect to service performed in the employ of the United States or of a wholly owned instrumentality thereof, the determination whether an individual has performed service which constitutes employment, the determination of the amount of remuneration for such service which constitutes wages, and the return and payment of the taxes imposed thereon, shall be made by the head of the Federal agency or instrumentality having the control of such service, or by such agents as such head may designate.

REGULATIONS 120, SECTION 406.207: Wages.

Payments made by a producer to a radio or television artist for reuse of recordings. (See Rev. Rul. 54–225, p. 216.)

REGULATIONS 120, SECTION 406.208: Exclusions from wages. Rev. Rul. 54–122

A pension paid to a retired employee whose remuneration for services performed prior to his retirement was specifically excluded from the term "wages" under section 1621(a) of the Internal Revenue Code is not subject to income tax withholding under section 1622 of the Code.

Advice is requested whether a pension paid to a retired employee is subject to income tax withholding where the remuneration paid for the services performed by him prior to his retirement was specifically excluded from the term "wages" under section 1621(a) of the Internal Revenue Code.

In the instant case the pension is paid to an individual who, prior to his retirement, was engaged in the performance of services which constitute "agricultural labor" within the meaning of section 1621(a)(2) of the Code.

Section 406.207(b) of Regulations 120 provides that in general pensions and retired pay are wages subject to withholding. However, section 1621 of the Code provides, in part, that the term "wages" for income tax withholding purposes means all remuneration for services performed by an employee for his employer with certain exceptions among which is remuneration paid for agricultural labor as defined in section 1426(h) of the Code.

Inasmuch as the pension paid to the retired employee is deferred compensation for past services rendered, remuneration for which is specifically excepted from the term "wages" under section 1621(a) of the Code, such pension is not subject to income tax withholding under section 1622 of the Code.

SECTION 1623.—LIABILITY FOR TAX

REGULATIONS 120, SECTION 406.401: Liability for tax.

Liability of a limited partner for Federal income tax withheld at the source and due from a limited partnership in which he is a member. (See Rev. Rul. 54–213, p. 285.)

SUBCHAPTER E.—GENERAL PROVISIONS

SECTION 1631.—FAILURE OF EMPLOYER TO FILE RETURN

REGULATIONS 120, SECTION 406.605: Place and time for filing returns. Rev. Rul. 54–45

Procedure relating to the assertion of penalty with respect to income tax withholding returns.

1. The purpose of this Revenue Ruling is to prescribe the policy of the Internal Revenue Service in asserting penalty in connection with the return and payment of income withholding tax when the return is filed on or before the 10th day of the second month following the period for which it is made, accompanied by depositary receipts and a check in full payment of the tax due.

2. Section 406.605 of Regulations 120, which specifies the due date for the return and payment of income tax withheld on wages, provides that if, and only if, the return is accompanied by depositary receipts, Form 450, showing timely deposits, in full payment of the taxes due for the entire calendar quarter, the return may be filed on or before the 10th day of the second month following the period for which it is made. Otherwise the due date for filing the return is the last day of the month following the close of the calendar quarter for which the return is made.

3. It has been brought to the attention of the Service that last minute changes sometimes occasion minor adjustments in the tax due from the time the deposit of the full amount of the tax as determined is made on or before the 30th day of the month following the end of a calendar quarter and the time the return may be timely filed on or before the 10th day of the second month following the period for which it is made.

4. Therefore, if an employer, after the 30th day of the month following the calendar quarter for which his return of income withhold-

ing tax is made, ascertains a slight error in his computation of the amount of tax due and when filing his return on or before the 10th day of the second month following such quarter accompanies the return and depositary receipts with a check covering the minor adjustment, no penalty for delinquent filing will be asserted.

SECTION 1633.—RECEIPTS FOR EMPLOYEES

REGULATIONS 116, SECTION 405.501: Receipts for tax withheld at source on wages. Rev. Rul. 54-32

Form W-2, Withholding Tax Statement for 1954—Rules for the manufacture of substitutes.

1. Reproductions of the official Form W-2 may be made by employers and printers who so desire. If any employer does not desire to use reproductions of these forms, however, substitutes may be privately printed with slight variations of format, and used without specific approval of the Internal Revenue Service if the following conditions are met:

(*a*) *Arrangement of assembly:* Except as provided in section (e), the parts in the assembly shall be arranged as follows: Copy A, "For District Director"; Copy B, "For Employee's Tax Return"; Copy C, "For Employee's Records"; Copy D, "For Employer." All references to the various parts shall be to "Copy A," "Copy B," "Copy C," and "Copy D."

(*b*) *Color and quality of ink and paper:* Brown ink on white paper, both of quality as good as that used by the Government; the paper to be of substantially the same weight and texture as that used in the official form, which is printed on substance 32 paper.

(*c*) *Typography:* Type to be not smaller than the corresponding type on the official form and, as nearly as possible, of the same font.

(*d*) *Format and data:* The substitute forms to provide the same spaces as the official form for reporting wages paid and taxes withheld. Payroll deductions other than those required to be reported on the form may not be shown on Copies A and B. No deviation from the instructions on either the front or back of Copies A, B, or C will be permitted.

(*e*) *Additional copies:* Additional copies may be prepared for the use of employers in connection with taxes or deductions other than Federal income tax and Federal Insurance Contributions Act taxes. Such additional copies shall not be placed ahead of Copy C in the assembly except that if a copy for a State or local taxing authority is prepared, it may be placed in the third position in the assembly for better legibility.

(*f*) *Dimensions:* The official form is 8 inches wide by 3½ inches deep, exclusive of a ½ inch snap stub on the left side of the form. The substitute forms may vary in width from 7 inches to 8 inches, and in depth from 3⅙ inches to 3½ inches. The snap feature is not required on substitutes.

(*g*) *Carbonized forms or "spot carbons":* Not permissible. Interleaved carbon, if used, to be of good quality to preclude smudging and, preferably, black.

(*h*) *The Government Printing Office symbol:* To be omitted.

(*i*) *Special identification:* Copy B must show the full-face dots, arranged vertically on the upper right side.

2. The official form is designed for mailing in a standard window envelope. This feature will be found desirable in most of the privately printed substitutes. In any rearrangement of the spaces for wage information, the block headed "SOCIAL SECURITY INFORMATION" must be to the left or above the block headed "INCOME TAX INFORMATION."

3. It is important that a space at least ¼-inch deep be provided at the top of the blocks containing the notices to the employer and the employee.

4. Copy D is included in the official assembly for the convenience of the employer. Although there is no requirement that privately printed substitute forms include Copy D, employers may find it desirable to make and retain such copy.

5. Approval of proposed substitute forms which do not meet the conditions stated above should be requested by letter, addressed to the Commissioner of Internal Revenue, Attention: O:C:CA, Washington 25, D. C., accompanied by a sample or rough draft copy of the proposed substitute.

REGULATIONS 120, SECTION 406.501: Receipts for tax withheld at source on wages. Rev. Rul. 54–226

Use and reproduction by State and local Governments of Form W–2, Withholding Statements.

Circular 2299, C. B. 1951–2, 194, and Revenue Ruling 54–32, page 225, this Bulletin amended.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to prescribe certain requirements governing the private printing of substitutes for Form W–2 for 1954 for the use of State and local Governments, and the use of official Forms W–2 for 1954.

SEC. 2. BACKGROUND.

If the official Form W–2 for 1954, or a substitute therefor which meets the requirements and specifications set forth in Revenue Ruling 54–43, page 225, this Bulletin, is used by an employer to show Federal income tax withholding information in the case of an employee with wages and employee contributions under a State-Federal agreement pursuant to section 218 of the Social Security Act, added by section 106 of the Social Security Act Amendments of 1950, no objection will be interposed by the Internal Revenue Service to the employer entering the amounts of such wages and contributions in the spaces provided for Federal Insurance Contributions Act wages and Federal Insurance Contributions Act employee tax. Before making these entries, however, the employer should determine whether or not such action will be satisfactory to the particular State involved. Objection thereto may be raised in those States which permit an employee to deduct Federal Insurance Contributions Act employee tax in computing his State income tax, but which do not permit a similar deduction for Old-Age and Survivors' Insurance contributions made pursuant to section 218.

SEC. 3. USE OF SUBSTITUTE FORMS.

.01 Employers, with employees covered for Old-Age and Survivors' Insurance purposes by agreement under section 218, who desire to report on Form W-2 not only the required Federal income tax information, but also information concerning employee contributions withheld and wages paid within the meaning of a State-Federal agreement under section 218, may use substitutes for Form W-2 for 1954 without obtaining specific approval of the Internal Revenue Service provided such substitutes meet the requirements stated in Revenue Ruling 54-32, *supra*, and provided further that the following changes are made:

(1) Substitute "OLD-AGE AND SURVIVORS' INSURANCE UNDER STATE-FEDERAL AGREEMENTS" for the heading, "SOCIAL SECURITY INFORMATION (Federal Insurance Contributions Act)".

(2) Substitute "Total O. A. S. I. Wages (before payroll deductions) paid in 1954" and "O. A. S. I. employee contributions withheld, if any" for the captions, "Total F. I. C. A. Wages (before payroll deductions) paid in 1954" and "F. I. C. A. employee tax withheld, if any".

(3) Change the first sentence of the Notice to Employee, on Copy B, to read, "(1) Social Security Wages—If your wages were subject to O. A. S. I. contributions, but are not shown, your O. A. S. I. wages are the same as wages shown under 'INCOME TAX INFORMATION', but not more than $3,600."

(4) Change the first and second sentences of the Notice to Employee, on Copy C, to read, "If your wages were subject to O. A. S. I. contributions, but are not shown, your O. A. S. I. wages are the same as wages shown under 'INCOME TAX INFORMATION', but not more than $3,600. Your O. A. S. I. account is credited with wages subject to O. A. S. I. contributions."

(5) The instructions appearing on the back of Copy A may be omitted. If not omitted, the phrase "Old-Age and Survivors' Insurance" shall be substituted for "the Federal Insurance Contributions Act"; "O. A. S. I." shall be substituted for "F. I. C. A."; and "employee contribution" shall be substituted for "employee tax" wherever they appear in the instructions.

.02 In cases where State and local Government employees are not covered under the social security program and the taxes under the Federal Insurance Contributions Act do not apply to their wages, the employer may use substitutes for Form W-2 for 1954 without obtaining specific approval of the Internal Revenue Service, provided such substitutes meet the requirements stated in Revenue Ruling 54-32, *supra*, and provided further that the following changes are made:

(1) The entire block headed "SOCIAL SECURITY INFORMATION (Federal Insurance Contributions Act)" should be deleted.

(2) The first sentence of the Notice to Employee on Copy B, and the first two sentences of such notice on Copy C, should be deleted.

(3) The instructions appearing on the back of Copy A may be omitted. If not omitted, subparagraphs (b) and (c) of para-

graph 2 shall be deleted, and subparagraphs (d), (e), and (f) shall be redesignated as (b), (c), and (d).

SEC. 4. EFFECT ON OTHER DOCUMENTS.

This ruling amends Circular 2299, C. B. 1951-2, 194, and Revenue Ruling 54-32, page 225, this Bulletin.

CHAPTER 9A.—WAR TAX AND WAR TAX RATES

SECTION 1657.—FLOOR STOCKS REFUNDS ON ELECTRIC LIGHT BULBS

REGULATIONS 46, SECTION 316.204a: Credits or refunds of tax on floor stocks of electric light bulbs, refrigerators, and appliances. T. D. 6072
(Also Section 3416.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 316.—EXCISE TAXES ON SALES BY THE MANUFACTURER

Credits or refunds of tax on floor stocks of electric light bulbs and tubes, refrigerators, quick-freeze units, refrigerating and freezing apparatus, and electric, gas, and oil appliances.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

In order to conform Regulations 46, 1940 Edition (26 CFR, pt. 316), relating to excise taxes on sales by the manufacturer under subchapter A of chapter 29 of the Internal Revenue Code, to section 1657 of the Internal Revenue Code, as amended by section 504(c) of the Excise Tax Reduction Act of 1954 (Public Law 324, 83d Cong., approved March 31, 1954), and to section 3416 of the Internal Revenue Code, as added by section 305(b) of the Excise Tax Reduction Act of 1954, such regulations are amended as follows:

PARAGRAPH 1. There is inserted immediately following section 316.204 the following:

SEC. 504. TECHNICAL AMENDMENTS (EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954).

* * * * * * *

(b) RATE REDUCTION DATE.—Section 1659 (relating to definition of "rate reduction date") is hereby amended to read as follows:

"SEC. 1659. DEFINITION OF 'RATE REDUCTION DATE'.

"For the purposes of this chapter [secs. 1650–1659, incl.] the term 'rate reduction date' means April 1, 1954."

* * * * * * *

SEC. 1657. FLOOR STOCKS REFUNDS ON ELECTRIC LIGHT BULBS (AS AMENDED BY SECTION 504(c), EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954).

(a) IN GENERAL.—With respect to any article upon which tax is imposed under section 3406(a)(10), upon which internal revenue tax at the rate prescribed in section 1650 has been paid, and which, on the rate reduction date is held by any person and intended for sale, or for use in the manufacture or production of any article intended for sale, there shall be credited or refunded to the manufacturer or producer of such article (without interest), subject to such regulations as may be prescribed by the Commissioner with the approval of the Secretary, an amount equal to so much of the difference between the tax so paid and the tax that would have been paid if the applicable rate had been 10 per centum, as has been paid by such manufacturer or producer to such person as reimbursement for the tax reduction on such articles, if claim for such credit or refund is filed with the Commissioner prior to August 1, 1954, based upon a request for reimbursement submitted by such person to the manufacturer or producer of such article prior to July 1, 1954.

(b) LIMITATIONS ON ELIGIBILITY FOR CREDIT OR REFUND.—No person shall be entitled to credit or refund under subsection (a) unless he has in his possession such evidence of the inventories with respect to which he has made the reimbursements described in subsection (a) as the regulations under subsection (a) prescribe.

(c) All provisions of law, including penalties, applicable in respect of the tax imposed under section 3406(a)(10) shall, insofar as applicable and not inconsistent with this section, be applicable in respect of the credits and refunds provided for in this section to the same extent as if such credits or refunds constituted credits or refunds of such taxes.

SEC. 305. REDUCTION OF TAX ON REFRIGERATORS AND QUICK-FREEZE UNITS AND ON ELECTRIC, GAS, AND OIL HOUSEHOLD APPLIANCES (EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954).

* * * * * * *

(b) FLOOR STOCKS REFUND.—Subchapter A of chapter 29 (relating to manufacturers' excise taxes) is hereby amended by adding at the end thereof a new section as follows:

"SEC. 3416. FLOOR STOCKS REFUND ON REFRIGERATORS, QUICK-FREEZE UNITS, AND ELECTRIC, GAS, AND OIL HOUSEHOLD APPLIANCES.

"(a) IN GENERAL.—Where before April 1, 1954, any article subject to the tax imposed by section 3405(a), section 3405(b), or section 3406(a)(3) has been sold by the manufacturer, producer, or importer, and on such date is held by a dealer and has not been used and is intended for sale, there shall be credited or refunded (without interest) to the manufacturer, producer, or importer an amount equal to the difference between the tax paid by such manufacturer, producer, or importer, on his sale of the article and the tax made applicable to such article on and after April 1, 1954, if such manufacturer, producer, or importer—

"(1) has paid such amount as reimbursement to the dealer who held such article on April 1, 1954; and

"(2) files claim for such credit or refund before August 1, 1954.

"(b) DEFINITION OF DEALER.—As used in this section, the term 'dealer' includes a wholesaler, jobber, distributor, or retailer. For the purposes of this section, an article shall be considered as 'held by a dealer' if title thereto has passed to such dealer (whether or not delivery to him has been made), and if for purposes of consumption title to such article or possession thereof has not at any time been transferred to any person other than a dealer.

"(c) LIMITATION ON ELIGIBILITY.—No person shall be entitled to credit or refund under this section unless he has in his possession such evidence of the inventories with respect to which he has made the reimbursements described in subsection (a) as may be required by regulations prescribed under this section.

"(d) PENALTIES AND ADMINISTRATIVE PROCEDURES.—All provisions of law, including penalties, applicable in respect of the taxes imposed under sections 3405(a), 3405(b), and 3406(a)(3) shall, insofar as applicable and not inconsistent with this section, be applicable in respect of the credits and refunds provided for in this section to the same extent as if such credits or refunds constituted credits or refunds of such taxes."

SEC. 316.204a. CREDITS OR REFUNDS OF TAX ON FLOOR STOCKS OF ELECTRIC LIGHT BULBS, REFRIGERATORS, AND APPLIANCES.—(a) *In general.*—This section prescribes the regulations applicable with respect to claims for refund or credit of tax on floor stocks by—

(1) manufacturers or producers of electric light bulbs or tubes (taxable under section 3406(a)(10) of the Internal Revenue Code), provided for under section 1657 of the Code, as amended by section 504(c) of the Excise Tax Reduction Act of 1954, and

(2) manufacturers, producers, or importers of refrigerators, quick-freeze units, or refrigerating and freezing apparatus (taxable under section 3405 (a) and (9) of the Code, or electric, gas, or oil appliances (taxable under section 3406(a)(3) of the Code), provided for under section 3416 of the Code, as added by section 305(b) of the Excise Tax Reduction Act of 1954.

(b) *Definitions.*—As used hereinafter in this section—

(1) The term "electric light bulb" means any electric light bulb or tube described in and taxable under section 3406(a)(10) of the Code (including in each case parts or accessories of such article sold on or in connection therewith, or with the sale thereof). (See section 316.180 of the regulations in this part.)

(2) The term "refrigerator" means any household type refrigerator, household type unit for the quick freezing or frozen storage of foods, or combination of such household type refrigerator and unit, described in and taxable under section 3405(a) of the Code, and any "refrigerator component" described in and taxable under section 3405(b) of the Code (including in each case parts or accessories therefor sold on or in connection with the sale thereof). (See sections 316.70(c) and 316.71(c) of the regulations in this part.)

(3) The term "appliance" means any electric, gas, or oil appliance described in and taxable under section 3406(a)(3) of the Code (including in each case parts or accessories of such article sold on or in connection therewith, or with the sale thereof). (See section 316.110(b) of the regulations in this part.)

(4) The term "floor stocks" means—

(i) in the case of refrigerators and appliances, any such article which on April 1, 1954, is held by a dealer and which on such date has not been used (that is, title to such article or possession thereof has not at any time been transferred for purposes of consumption to any person other than a dealer) and is intended for sale; and

(ii) in the case of electric light bulbs, any such article which on April 1, 1954, is held by any person and intended for sale, or for use in the manufacture or production of any article intended for sale.

(5) The term "holder" or "dealer" means any wholesaler, jobber, distributor, or retailer holding floor stocks intended for sale, as well as any person holding floor stocks of electric light bulbs for use in the manufacture of another article intended for sale.

(6) The term "old rate" means the tax rate in effect prior to April 1, 1954.

(7) The term "new rate" means the tax rate in effect on and after April 1, 1954.

(c) *Refund or credit.*—Any manufacturer or producer of electric light bulbs and any manufacturer, producer, or importer of refrigerators or appliances may claim a refund or credit in an amount equal to the difference between the tax paid by him at the rate applicable at the time he sold such articles (in the case of electric light bulbs 20 percent and in the case of refrigerators and appliances 10 percent) and the tax at the rate which would have been applicable had he sold such articles on or after April 1, 1954 (in the case of electric light bulbs 10 percent and in the case of refrigerators and appliances 5 percent), subject to the terms and conditions set forth in this section. An importer of electric light bulbs is not eligible for a refund or credit under this section.

(d) *Basis for refund or credit.*—The claim for refund or credit shall apply only with respect to floor stocks held on April 1, 1954, by a holder. Electric light bulbs, refrigerators, or appliances in transit at the first moment of April 1, 1954, shall be regarded as being held by the person to whom shipped; except where title to such articles does not pass until delivered to the consignee, in which case they shall be deemed to be held by the shipper.

(e) *Limitation on amount of refund or credit.*—The amount to be refunded or credited under this section shall in no case exceed the amount which the manufacturer, producer, or importer has paid to the holders as reimbursement for the tax reduction on the articles sold by him to such holders.

(f) *Time and place for filing claim for refund or credit.*—(1) *Refund.*—A claim for refund shall be filed on Form 843 before August 1, 1954, with the District Director of Internal Revenue for the district in which is located the claimant's principal place of business. The claim shall contain a statement that the amount claimed has not and will not be taken as a credit against tax. Since the offices of the District Directors are closed on Staturday, July 31, 1954, a claim for refund, to be considered as timely filed, must be received in the office of the District Director not later than Friday, July 30, 1954.

(2) *Credit.*—A claim for credit against tax due shall be taken on the appropriate tax return filed with the district director of internal revenue before August 1, 1954. Since the offices of the District Directors are closed on Saturday, July 31, 1954, a claim for credit, to be considered as timely filed, must be claimed on a return received in the office of the proper District Director not later than Friday, July 30, 1954. A credit against tax due may be taken on the tax return, Form 720, filed on or before July 30, 1954, by the claimant for the quarter covering the months of April, May, and June 1954. If a monthly return is filed, the credit may be taken on the return for a month not later than June 1954, if such return is filed on or before July 30, 1954. However, reimbursements actually made to holders during April 1954 may be taken as a credit on the return covering January, February, and March 1954, or on the return for the month of March 1954, if the return is filed monthly, provided the credit is timely claimed. The return on which the credit is taken must have attached a statement that a refund claim has not and will not be filed covering the amount taken as a credit. Any amount claimed under this section may be taken as a credit on the required tax return even though the amount of the credit is in excess of the total tax liability shown on such return. In such case, the entire amount of the credit not previously claimed must be shown on the return, but the amount in excess of the total tax liability shown on such return will be processed as if it were a claim for refund filed on Form 843 (as provided in subparagraph (1) of this paragraph). For example, if the tax return for the second quarter (covering the months of April, May, and June, 1954, and filed on or before July 30, 1954) shows a total tax liability of $40,000 and a claimant has reimbursed holders to the extent of $100,000 during that quarter, the claimant may claim a credit on that return in the full amount of $100,000 but the amount in excess of the total tax liability shown on such return ($60,000) will be processed as if such excess had been claimed as a refund on Form 843. A claimant who is required to make monthly deposits with a Federal Reserve Bank may reduce his monthly liability by the total reimbursements made by him to holders during that month. However, it should be noted that the mere reduction of the monthly liability in such case is not a filing of a claim for credit within the meaning of this section. Where reimbursements are made to holders during the month of July 1954, the liability for such month should not be reduced by the total of such reimbursements. The amount of such July 1954 reimbursements may be claimed as a credit on the return covering April, May, and June 1954, or on the return for the month of June 1954, if the return is filed monthly, or as a refund on Form 843, if such return or claim is filed on or before July 30, 1954.

(g) *Statement to be attached to claim for refund or credit.*—Every person filing a claim for refund on Form 843 or a claim for credit on Form 720 must attach to such form a statement to the effect that (1) he has paid tax on the articles covered by his claim at the rate in effect at the time such articles were sold by him, (2) he has in his possession and available for inspection by internal revenue officers at his principal place of business the evidence with respect to the inventories required by paragraph (h) of this section, (3) he has actually reimbursed all holders of such inventories prior to the date of the filing of his claim, (4) the amount of his claim does not exceed the amount that he has paid to the holders as reimbursement, and (5) in the case of claims covering electric light bulbs and tubes, he has made reimbursement to holders only on the basis of requests for such reimbursement received by him prior to July 1, 1954.

(h) *Evidence required to support a claim for refund or credit.*—(1) *In general.*—Every person filing a claim for refund or credit under the provisions of this section must support such claim by having in his possession and available for inspection by internal revenue officers at his principal place of business for at least a period of 4 years from the date of filing of such claim evidence showing the following:

(i) *Inventories*—(*a*) *Electric light bulbs.*—The total inventory of all electric light bulbs, by types and sizes, sold tax-paid and held as floor stocks by the holders thereof as of 12: 01 a. m. April 1, 1954, and intended for sale, or for use in the manufacture of another article intended for sale.

(*b*) *Refrigerators and appliances.*—The total inventory of all refrigerators and appliances sold tax-paid and held as floor stocks on 12: 01 a. m. April 1, 1954, and intended for sale. The inventory shall show the model number of each article and the quantity of each model.

(*c*) *Items includible in inventories.*—There may be included in such inventories all refrigerators, appliances, or electric light bulbs held as floor stocks on 12: 01 a. m. April 1, 1954, and intended for sale, and in the case of electric light bulbs also those electric light bulbs intended for use in the further manufacture of another article. The following are some items which shall not be included in such inventories:

(*1*) refrigerators, appliances, or electric light bulbs purchased by the holder as a component part of, or on, or in connection with, another article;

(*2*) refrigerators, appliances, or electric light bulbs purchased tax-free by the holder;

(*3*) refrigerators, appliances, or electric light bulbs previously sold by a holder to a purchaser for use and thereafter repossessed; and

(*4*) electric light bulb on which tax was paid by an importer on his sales thereof.

The effect of this subdivision may be illustrated by the following examples:

Example (*1*). A holder of refrigerators on April 1, 1954, has mortgaged a portion of his stock as security for a loan. Since in this instance the holder retains possession but may have transferred title to the lender for a purpose other than consumption, the refrigerators may be included in the holder's inventory.

Example (*2*). A holder purchased a lighting fixture in which a fluorescent tube was attached as a component part and also purchased a tube and a lighting fixture as a unit but the tube and the fixture were not attached to each other. In both instances the tube is not to be included in the inventory.

Example (*3*). A building contractor on April 1, 1954, has title and possession of refrigerators and garbage disposal units which he intends to install in apartments he is in the process of constructing or which he may construct in the future. These articles are not includible in the inventory since the contractor is not holding such articles for sale on April 1, 1954.

Example (*4*). A trailer manufacturer on April 1, 1954, has title to, and possession of, refrigerators which he intends to install in trailers he is manufacturing or which he intends to manufacture. These refrigerators are not includible in the inventory since the trailer manufacturer is not holding them for sale on April 1, 1954.

Example (*5*). A holder has on hand on April 1, 1954, several refrigerating components purchased tax-paid which he intends to use in the manufacture of another article. These components are not includible in the inventory since they are not held and intended for sale as such.

(ii) *Other evidence required.*—In addition to the evidence required under subdivision (i) of this subparagraph, the evidence available for inspection should also show (*a*) the name and address of each holder of such inventories, (*b*) the quantities of articles held by each such holder, (*c*) the total tax paid by the claimant on such inventories, and (*d*) the total tax which the claimant would have paid on such inventories had he computed his tax at the new rate. The total tax paid on the inventory should reflect the actual tax paid on each article included in such inventory, determined in accordance with section 316.8 and by making adjustments for any retroactive price changes granted to holders prior to any reimbursement made to such holders in accordance with this section. Where it is impracticable to ascertain the actual tax paid on each article, the claimant may determine the total tax paid on the basis of any other method acceptable to the Internal Revenue Service, provided that the use of such method does not result in an amount in excess of the aggregate tax actually paid on the articles included in the inventory. All requests for approval of a method of determining the total tax paid shall be submitted to the office of the District Director of Internal Revenue with whom the claimant will file his claim for refund or credit in sufficient time to permit such method to be approved or disapproved prior to the filing of the claim. The same basis for determining the total tax paid should be used in determining the tax which would have been paid under the new rate. Where the total tax paid is determined on a basis other than the actual tax paid on each article, the basis on which tax is computed on each article must be determined in accordance with the provisions of section 316.8.

(iii) *Proof of reimbursement to holders.*—(*a*) *In general.*—Each claimant must have in his possession satisfactory evidence showing that each holder of articles on which a refund or credit is claimed under this section has with respect to such articles held by him on April 1, 1954, been properly reimbursed and that such reimbursement was actually made prior to the time the claim for refund or credit is filed. The reimbursement may be made directly to the holder by the manufacturer or by the manufacturer's authorized agent or representative. Reimbursement may also be made to the holder's agent or representative authorized by him to receive such reimbursement. Where a manufacturer through his agent or representative reimburses a holder the evidence must show that the holder actually received such reimbursement. Where a holder authorizes the manufacturer to reimburse him through the holder's agent, evidence showing reimbursement to such agent by the manufacturer will be accepted as proof of actual reimbursement to the holder. Reimbursement shall be made, at the holder's option, in cash, other merchandise, or by credit to the holder's account. In the case of credit the amount of the reimbursement may not be in excess of the amount shown as the debit balance of the holder's account payable at the time the reimbursement is made. For example, if Company A reimburses Holder B through Distributor C in an amount of $50 on June 1, 1954, and Holder B owes Distributor C $25 on that date, Holder B may be credited in his account payable only in the amount of $25, and the balance of $25 must be paid to Holder B in cash or merchandise.

(*b*) *Special limitation on reimbursement to holders of electric light bulbs.*—A manufacturer or producer claiming refund or credit with respect to the tax on floor stocks of electric light bulbs must have satisfactory evidence showing that each holder of such bulbs requested reimbursement prior to July 1, 1954. Requests for reimbursements received on or after July 1, 1954, will result in the disallowance of that portion of the claim for refund or credit attributable to such requests.

(i) *Interest.*—No interest shall be allowed with respect to any amount of tax refunded or credited under the provisions of this section.

(j) *Effect on claims filed under section 316.204.*—Claims for refund or credit with respect to returned sales, sales for export, sales to States, etc., and sales for exempt uses, authorized under section 3443(a) of the Internal Revenue Code and provided for under section 316.204, filed with respect to articles sold by a claimant prior to April 1, 1954, shall be based on the rate of tax in effect on and after April 1, 1954; except where the claimant submits proper evidence showing that such articles were not covered by a claim for refund or credit of tax on floor stocks provided for under this section, and in such case the claim for refund or credit filed pursuant to the provisions of section 316.204 shall be based on the rate of tax in effect prior to April 1, 1954.

PAR. 2. This Treasury Decision shall be effective on April 1, 1954. Because this Treasury Decision applies to electric light bulbs, refrigerators, and appliances held on April 1, 1954, and prescribes the procedures respecting the filing of claims before August 1, 1954, for refund or credit of tax on floor stocks of such articles, it is hereby found that it is impracticable to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said act.

(This Treasury Decision is issued pursuant to the authority contained in secs. 1657 (59 Stat. 575; 68 Stat. 42), 3416 (68 Stat. 40), 3450 (53 Stat. 419), 3791 (53 Stat. 467) of the Internal Revenue Code (26 U. S. C. 1657, 3416, 3450, and 3791).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved June 3, 1954.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register June 4, 1954, 8: 53 a. m.)

REGULATIONS 46, SECTION 316.204a: Credits or refunds of tax on floor stocks of electric light bulbs, refrigerators, and appliances. (Also section 3416.) Rev. Rul. 54–239

In applying the floor stocks tax refund or credit provisions of the Excise Tax Reduction Act of 1954 (Public Law 324, 83d Cong., approved March 31, 1954), page 343, this Bulletin, with respect to floor stocks of electric light bulbs and tubes, refrigerators, and appliances held on April 1, 1954, the 4-year statute of limitations contained in section 3313 of the Internal Revenue Code is not applicable.

CHAPTER 10.—ADMISSIONS AND DUES

SUBCHAPTER A.—ADMISSIONS

SECTION 1700.—TAX

REGULATIONS 43, SECTION 101.2: Meaning of "admissions." Rev. Rul. 54–7

Persons are admitted to certain areas of a dam without payment of any charge. However, persons who take a guided tour for which a fee is charged are admitted to areas of the dam and to a powerhouse to which persons who do not take the tour are not admitted. The proceeds from the tour are used to compensate guides and to maintain tourist facilities. *Held*, an amount paid for a guided tour which includes admission to areas to which persons who do not take the tour are not admitted constitutes an amount paid for admission and is subject to the tax imposed under section 1700(a) of the Internal Revenue Code. The tax applies even though the proceeds from the tour are used to compensate guides and to maintain tourist facilities. However, an amount paid for a tour of areas to which anyone may be admitted free of charge is not considered an amount paid for admission and is not subject to tax.

REGULATIONS 43, SECTION 101.2: Meaning of "admission." Rev. Rul. 54–22

Tax on admissions imposed by section 1700(a) of the Internal Revenue Code applies to an amount paid for an exchange ticket when sold for an amount equal to the minimum admission charge, exclusive of tax, even though such ticket may be exchanged for higher priced accommodations for which an additional payment is necessary. If an exchange ticket is sold for a lesser amount than the minimum admission charge, exclusive of the tax, and admission cannot be gained except by payment of an additional charge, the amount paid for the exchange ticket is not subject to tax until or unless such ticket is exchanged for a ticket of admission, at which time the tax attaches to the total amount paid for the exchange ticket and the additional charge.

Advice is requested concerning the application of tax on admissions imposed by section 1700(a) of the Internal Revenue Code to amounts paid for exchange tickets.

In the instant case M Corporation, which produces and manages a traveling show, engages organizations in communities where performances are scheduled to conduct advance sales of exchange tickets. The exchange tickets are sold for $1 each of which amount 50 cents is retained by the organization selling the ticket and the remaining 50 cents is turned over to the M Corporation. The exchange tickets are redeemable at the box office for general admission tickets for the show or may be applied toward the purchase of reserve seats.

Section 1700(a) of the Code imposes a tax on the amount paid for admission to any place and applies to the amount which must be paid in order to gain admission to a place and not to the admission itself.

It is held that where an exchange ticket is sold for an amount equal to the minimum admission charge, excluding the tax, the amount paid for such exchange ticket constitutes a payment for admission and the tax attaches at the time such payment is made, even though the ticket may be exchanged at the box office for higher priced accommodations for which an additional payment is necessary. On the other hand, if an exchange ticket is sold for a lesser amount than the minimum admission charge, excluding the tax, so that admission cannot be gained except by payment of an additional amount, the amount paid for the exchange ticket does not constitute an amount paid for admission and the tax does not apply thereto unless and until such ticket, together with the amount of the additional charge, is presented at the box office, at which time the tax attaches to the total amount paid for the exchange ticket and the additional charge.

Accordingly, since the tickets sold by the organizations engaged by the M Corporation may be exchanged for general admission tickets to the show without payment of an additional charge, the tax attaches at the time the payment of one dollar is made to the organizations by the purchasers of the exchange tickets. In the event such tickets are exchanged for higher priced accommodations the tax attaches to the additional amount paid at the time of payment at the box office.

Where an exchange ticket is sold under circumstances that a tax is due at the time of sale, the tax should be collected by the organization and remitted to the corporation who is actually liable for the collection and return of the tax to the Government.

The exemption from the collection of tax on admissions provided by section 1701 of the Code with respect to certain classes of organizations described therein, does not apply where, as in this case, all the proceeds do not inure exclusively to the benefit of such organizations.

REGULATIONS 43, SECTION 101.14: Scope of tax. Rev. Rul. 54–211

The operation of a television set in a restaurant, bar or similar establishment does not, in itself result in liability for the cabaret tax imposed by section 1700(e) of the Internal Revenue Code. Accordingly, amounts paid for food, beverages, or merchandise in an establishment which does not otherwise qualify as a cabaret will not be subjected to such tax by reason of the operation of a television set therein.

SECTION 1701.—EXEMPTIONS FROM TAX

REGULATIONS 43, SECTION 101.15: Exemptions from tax. Rev. Rul. 54–23

Where a rodeo is conducted by an educational institution which qualifies for exemption from admissions tax, riders competing in the rodeo for prize money under an arrangement with the educational institution whereby the prize money is derived from the entry fees paid by the riders are professional performers within the meaning of section 1701 (a) (2) (C) of the Internal Revenue Code, and the prize money paid to the performers is compensation within the meaning of that section. Since the exemption from tax on admissions provided by section 1701 of the Code does not apply to admissions where rodeo performers participate for compensation, the charge for admission to the rodeo, even though conducted by an exempt educational institution, is subject to the tax on admissions. For this purpose, "participating for compensation" means performing for payment whether such payment is received from the admission proceeds or from some other source.

REGULATIONS 43, SECTION 101.15: Exemptions from tax. Rev. Rul. 54–24

> The activities of a language group are considered to be a part of the services offered by an educational institution which qualifies for exemption from the tax on admissions under section 1701(a)(1)(A)(ii) of the Internal Revenue Code. Proceeds from admissions to an affair conducted by the educational institution which inure to the benefit of the language group inure in effect to the educational institution and are not subject to the tax on admissions imposed by section 1700(a) of the Code.

Advice is requested whether the exemption provided by section 1701(a)(1)(A)(ii) of the Internal Revenue Code from the tax on admissions applies to the proceeds from an affair conducted by an educational institution which inure to a language group.

In the instant case, a language group maintains a house on the campus of an educational institution which qualifies for exemption under section 1701(a)(1)(A)(ii) of the Internal Revenue Code. The house is open to the student body of the institution. The language group is a nonprofit organization. Its purpose is to furnish to the student body an opportunity to acquire a practical knowledge of a foreign language and to acquaint the students with the life and customs of the country in which the language is spoken. Residence or meals in the house, in which only the foreign language is spoken, may replace credits in courses of conversation and a part of the prescribed training necessary for a teacher's certificate. While the language group is not embraced strictly within the curriculum of the educational institution, it is maintained by the department of foreign languages of the institution and teachers are assigned and paid by the institution to aid in directing conversation in the house.

Section 1701 of the Code provides in part as follows:

> No tax shall be levied * * * in respect of—
>
> (a) CERTAIN RELIGIOUS, EDUCATIONAL, OR CHARITABLE ENTERTAINMENTS, ETC.—
>
> (1) IN GENERAL.— * * * any admissions all the proceeds of which inure—
>
> (A) exclusively to the benefit of—
>
> * * * * * * *
>
> (ii) an educational institution which is exempt under section 101(6) or which is an educational institution of a government or political subdivision thereof, if such organization normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on;
>
> * * * * * * *
>
> if no part of the net earnings thereof inures to the benefit of any private stockholder or individual;
>
> * * * * * * *
>
> (2) NONEXEMPT ADMISSIONS.—The exemption provided under paragraph (1) shall not apply in the case of admissions to (A) any athletic game or exhibition unless the proceeds inure exclusively to the benefit of an elementary or secondary school or unless in the case of an athletic game between two elementary or secondary schools, the entire gross proceeds from such game inure to the benefit of a hospital for crippled children, (B) wrestling matches or exhibitions, (C) carnivals, rodeos, or circuses in which any professional performer or operator participates for compensation, or (D) any motion picture exhibition.

The exemption from the tax on admissions provided by section 1701(a)(1)(A)(ii) of the Code, relating to educational institutions, extends to any organization sponsored and administered by an educational institution as part of its educational program, and in which membership is open to any of the members thereof. Examples of such organizations are student governing bodies, athletic associations, dramatic clubs, language clubs, science clubs, and similar groups. See section 101.15, Regulations 43, as amended by T. D. 6007, C. B. 1953-1, 412. Conversely, the exemption does not extend to or apply to fraternities, sororities, purely social clubs, or other such organizations.

Since the activities of the language group are a part of the services offered by the institution, it is held that the proceeds from an affair conducted by the educational institution which inure to the language group inure, in effect, to the educational institution, and are exempt from the tax on admissions imposed by section 1700 of the Code, except as otherwise provided by section 1701(a)(2) of the Code.

REGULATIONS 43, SECTION 101.15: Exemptions from tax. Rev. Rul. 54–46

The exemption from tax on admissions provided by section 1701(a)(1) of the Internal Revenue Code does not apply to charges for admission to affairs, all the proceeds of which inure to a scholarship fund controlled and administered by a nonexempt association.

Advice is requested whether the exemption from tax on admissions provided by section 1701(a)(1) of the Internal Revenue Code is applicable to charges for admission to affairs where the proceeds inure to a scholarship fund controlled and administered by a nonexempt association.

In the instant case, an association presents plays, all the proceeds of which inure to a scholarship fund. The fund is not a separate entity but is controlled and administered by the association as one of its activities and is used to provide a scholarship to an outstanding student of a university which qualifies for exemption under section 1701(a)(1)(A)(ii) of the Code. Neither the association nor the fund qualifies for exemption from income tax under section 101(6) of the Code as an educational or charitable organization.

Section 1701 of the Code provides in part as follows:

SEC. 1701. EXEMPTIONS FROM TAX.

No tax shall be levied * * * in respect of—

(a) CERTAIN RELIGIOUS, EDUCATIONAL, OR CHARITABLE ENTERTAINMENTS, ETC.—

(1) IN GENERAL.— * * * any admissions all the proceeds of which inure—

(A) exclusively to the benefit of—

* * * * * * *

(ii) an educational institution which is exempt under section 101(6) or which is an educational institution of a government or political subdivision thereof, if such organization normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on;

(iii) a corporation or any community chest, fund, or foundation organized and operated exclusively for charitable purposes, exempt under section 101(6), if such corporation or organization is supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or is primarily supported by contributions from the general public;

* * * * * * *

if no part of the net earnings thereof inures to the benefit of any private stockholder or individual;

Where an educational institution which qualifies for exemption under section 1701(a)(1)(A)(ii) of the Code controls and administers a scholarship fund as part of its institutional activities, the exemption provided by that section applies to charges for admission to affairs presented by any organization all the proceeds of which inure to such fund. See Rev. Rul. 163, C. B. 1953–2, 335. However, the exemption provided by that section does not apply to charges for admission to affairs where the proceeds of which inure to a scholarship fund which is controlled and administered by a nonexempt organization.

The exemption from tax on admissions provided by section 1701(a)(1)(A)(iii) of the Code, with respect to organizations operated exclusively for charitable purposes, applies to charges for admission to affairs, the proceeds of which inure to a scholarship fund where the fund is identifiable as a separate entity organized for charitable purposes, exempt under section 101(6) of the Code, and is primarily supported by contributions from the general public.

It is held that since, in the instant case, the scholarship fund is controlled and administered by an association which does not qualify as an educational institution under section 1701(a) (1) (A) (ii) of the Code, the exemption provided by that section does not apply. It is further held that, since the scholarship fund controlled and administered by the association is not identifiable as a separate entity meeting the specific requirements set forth in section 1701(a) (1) (A) (iii) of the Code, the exemption provided by that section with respect to charitable organizations does not apply. Accordingly, the charges for admission to plays presented by the association, the proceeds of which inure to its scholarship fund are subject to the admissions tax imposed by section 1700 of the Code.

REGULATIONS 43, SECTION 101.15: Exemptions from tax. Rev. Rul. 54–115

A development fund was created and controlled by an educational institution, exempt under section 1701(a) (1) (A) (ii) of the Internal Revenue Code, as the official agency for soliciting and receiving funds for the purpose of increasing the facilities of the institution for broader educational opportunities. Charges for admissions to an affair conducted by an alumni association the proceeds of which inure to the development fund inure, in effect, to the institution and are not subject to the tax on admissions imposed by section 1700(a) of the Code.

Advice is requested whether the exemption provided by section 1701(a) (1) (A) (ii) of the Internal Revenue Code applies to charges for admissions to affairs conducted by an alumni association, the proceeds of which inure to a development fund created by an exempt educational institution for the purpose indicated.

The development fund is a nonprofit organization created and controlled by the board of trustees of an exempt university as the official agency for soliciting funds for the university. Its purpose is to assist in developing and increasing the facilities of the university for broader educational opportunities and services to its students, alumni, and citizens of the State by encouraging gifts of money, property, works of art, and the like, and to receive, hold, and administer such gifts. Gifts may be solicited only for purposes previously approved by the board of trustees of the university. The development fund is exempt from payment of income tax under section 101(6) as an organization operated exclusively for educational purposes.

Section 1701 of the Code provides in part as follows:

No tax shall be levied * * * in respect of—

(a) CERTAIN RELIGIOUS, EDUCATIONAL, OR CHARITABLE ENTERTAINMENTS, ETC.—

(1) IN GENERAL.—* * * any admissions all the proceeds of which inure—

(A) exclusively to the benefit of—

* * * * * * *

(ii) an educational institution which is exempt under section 101(6) or which is an educational institution of a government or political subdivision thereof, if such organization normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on;

* * * * * * *

if no part of the net earnings thereof inures to the benefit of any private stockholder or individual;

* * * * * * *

(2) NONEXEMPT ADMISSIONS.—The exemption provided under paragraph (1) shall not apply in the case of admissions to (A) any athletic game or exhibition unless the proceeds inure exclusively to the benefit of an elementary or secondary school or unless in the case of an athletic game between two elementary or secondary schools, the entire gross proceeds from such game inure to the benefit of a hospital for crippled children, (B) wrestling matches, prize fights, or boxing, sparring or other pugilistic matches or exhibitions, (C) carnivals, rodeos, or circuses in which any professional performer or operator participates for compensation, or (D) any motion picture exhibition.

It is held that the charges for admission to an affair conducted by an alumni association the proceeds of which are paid into the development fund established under the above circumstances inure, in effect, to the educational institution and are exempt from the tax on admissions imposed by section 1700(a) of the Code, except as otherwise provided by section 1701(a)(2) of the Code.

SUBCHAPTER B.—DUES

SECTION 1710.—TAX

REGULATIONS 43, SECTION 101.28: Initiation fees. Rev. Rul. 54–37

Application of the tax on initiation fees imposed by section 1710(a)(2) of the Internal Revenue Code to fees paid to a club by withdrawing and incoming members with respect to the transfer of stock.

Advice is requested regarding the application of the tax on initiation fees imposed by section 1710(a)(2) of the Internal Revenue Code to fees paid to a club by withdrawing and incoming members with respect to the transfer of stock.

Under the Internal Revenue Code, the term "initiation fees" includes any payment, contribution, or loan, required as a condition precedent to membership, whether or not such payment, contribution, or loan is evidenced by a certificate of interest or indebtedness, or share of stock, and irrespective of the person or organization to whom paid, contributed, or loaned.

Rev. Rul. 137, C. B. 1953–2, 343, holds that a transfer fee required by a club to be paid by a withdrawing member with respect to his sale of stock is not paid as a condition precedent to membership in the club and the amount of such transfer fee is not subject to tax on initiation fees imposed by section 1710(a)(2) of the Code.

Section 101.28 of Regulations 43 provides in part that in the case of a transfer of stock from a retiring member, the club should collect the tax on the amount paid by the new member for the stock as well as tax on any transfer fee required from the new member. In such a case, the transfer fee required by the club to be paid by the new member as well as the amount paid by him for the stock are paid as a condition precedent to membership in the club.

The holding in Rev. Rul. 137 applies only in cases where a club requires the withdrawing or retiring member to pay the transfer fee. Where a club requires the new member to pay the transfer fee, the amount paid is subject to tax on initiation fees under section 1710(a)(2) of the Code.

SUBCHAPTER C.—PROVISIONS COMMON TO ADMISSIONS AND DUES

SECTION 1715.—PAYMENT OF TAX

REGULATIONS 43, SECTION 101.37: Duty to collect, return, and pay tax.—Dues and initiation fees.

Regulations 43 amended. (See T. D. 6057, p. 272.)

CHAPTER 11.—DOCUMENTS, OTHER INSTRUMENTS, AND PLAYING CARDS [INCLUDING STAMP TAXES]

SUBCHAPTER A.—RATE AND PAYMENT OF TAX

SECTION 1801.—CORPORATE SECURITIES

REGULATIONS 71, SECTION 113.55: Issues subject to tax. Rev. Rul. 54-60

A change in the interest rate of outstanding bonds, as effected by a consolidation agreement, constitutes such a material change in the obligations as to create a new issue, subject to original issue tax under sections 1800 and 1801 of the Internal Revenue Code.

Advice is requested concerning the application of the tax on issue of corporate securities imposed by sections 1800 and 1801 of the Internal Revenue Code where, under the provisions of a consolidation agreement, the interest rate of outstanding bonds is increased.

In the instant case, M Corporation and N Bank executed an agreement pursuant to which three mortgages and the bonds secured thereby were consolidated to constitute one outstanding mortgage and bond. The agreement also effected an increase in the interest rate of the obligation from 3 percent to $3\frac{1}{2}$ percent.

Sections 1800 and 1801 of the Code impose a tax on all bonds issued by any corporation. The rate of tax is 11 cents on each $100 or fraction thereof of the face value of each bond.

It is held that the change in the interest rate of the outstanding bonds, as effected by the consolidation agreement, constitutes such a material change in the obligations as to create a new issue subject to original issue tax under sections 1800 and 1801 of the Code. The tax is due and payable on the unpaid balance of the bonds as consolidated and the necessary stamps should be affixed to the consolidation agreement and properly canceled.

REGULATIONS 71, SECTION 113.56: Issues not subject to tax. Rev. Rul. 54–212

An agreement which merely reduces in amount the quarter-annual installments due on a consolidated bond, but which does not affect the principal amount of the obligation, does not effect such a material change in the obligation as to create a new issue subject to original issue tax under sections 1800 and 1801 of the Internal Revenue Code. Cf. Rev. Rul. 54–60, page 241, this Bulletin.

SECTION 1802.—CAPITAL STOCK (AND SIMILAR INTERESTS)

REGULATIONS 71, SECTION 113.20: Scope of tax. Rev. Rul. 54–38

There is no provision in law whereby the issuance or transfer of stock of a corporation organized for religious, charitable, scientific, literary, or educational purposes is by reason of such character exempt from the stamp tax imposed by section 1802 of the Internal Revenue Code. Accordingly, the issuance of stock by a corporation organized for any such purposes or the subsequent transfer of the stock are not exempt from the tax under that section of the Code by reason of such character.

SUBCHAPTER C.—PENALTIES AND FORFEITURES

SECTION 1823.—FRAUDS RELATING TO STAMPS

REGULATIONS 88, SECTION 319.132: Reuse of stamps prohibited. Rev. Rul. 54–157

A "Firearms Act" stamp is considered by the Internal Revenue Service to have been "used" after it has once been affixed to an instrument, whether or not such instrument is proper or acceptable.

Section 2734 of the Internal Revenue Code provides a tax on the making of firearms at the rate of $200 for each firearm except in the case of certain weapons defined therein for which the rate of tax is $1 for each such weapon. Section 2720 of the Internal Revenue Code provides that each transfer of a firearm in the United States is subject to tax at the rate of $200 for each firearm except in the case of certain weapons defined therein upon which the transfer tax is at the rate of $1 for each such weapon.

Section 319.131 of Regulations 88 provides that $1 and $200 adhesive stamps bearing the words "Firearms Act" are used for the payment of the tax on the making of firearms by other than a qualified manufacturer who has registered and paid special (occupational) tax, and the transfer tax. Section 319.71 of Regulations 88 provides that such adhesive stamps issued by District Directors of Internal Revenue are canceled by writing or stamping thereon, in ink, the initials of the person canceling the stamp and the day, month, and year, or by cutting with a machine or punch the initials and date. The stamps are affixed to the original copies of the appropriate Forms 1A (Firearms) in the case of the tax on the making of firearms, or Forms 4 (Firearms) in the case of the transfer of a firearm.

Section 1823 of the Internal Revenue Code provides, in part, that whoever willfully removes, or alters the cancellation or defacing marks of, or otherwise prepares, any adhesive stamp with intent to use, or causes the same to be used, after it has already been used, shall, upon conviction, be punished by a fine of not more than $1,000, or by imprisonment for not more than 5 years, or both, and any such reused, canceled, or counterfeit stamp and the vellum, parchment, document, paper, package, or article upon which it is placed or impressed shall be forfeited to the United States.

A "Firearms Act" stamp is considered to have been "used" after it has once been affixed to an instrument, whether or not such instrument is proper or acceptable. The removal of any adhesive stamp from a document to which once affixed with intent to reuse such stamp is specifically prohibited by law.

Except where specifically prohibited, minor corrections may be effected on all copies of an original form to which a stamp has been affixed and such form will be accepted for filing. However, if the desired changes require extensive correction, or are of a substantive nature, a new form must be executed. In such event a new "Firearms Act" stamp must be purchased and affixed to the form prior to submission to the Commissioner of Internal Revenue.

Where a "Firearms Act" stamp has been affixed to a Form 1A (Firearms) or Form 4 (Firearms) which is improperly executed or unacceptable for any reason, the stamp should not be removed but the form, with the stamp affixed thereto, should be submitted to the appropriate District Director of Internal Revenue with a claim for redemption filed on Form 843.

CHAPTER 15.—TOBACCO, SNUFF, CIGARS, AND CIGARETTES

SUBCHAPTER D.—IMPORTATION AND EXPORTATION

PART II.—EXPORTATION

SECTION 2135.—EXEMPTION FROM TAX

REGULATIONS 76, ARTICLE 3: Bond. T. D. 6066
(Also Article 12.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 141.—SHIPMENT OR DELIVERY OF MANUFACTURED TOBACCO, SNUFF, CIGARS, CIGARETTES, AND CIGARETTE PAPERS AND TUBES FOR USE AS SEA STORES WITHOUT PAYMENT OF TAX.

Tobacco sea stores bonds

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

In order to establish maximum penal sums for tobacco sea stores bonds, required of manufacturers of tobacco products and cigarette papers and tubes, and proprietors of tobacco sea stores warehouses, Regulations 76 [26 CFR, pt. 141], but only as prescribed and made applicable to the Internal Revenue Code by Treasury Decision 4885 [C. B. 1939-1 (Part 1), 396], approved February 11, 1939, are hereby amended as follows:

PARAGRAPH 1. Section 1, act of August 4, 1886, set forth immediately preceding article 3 (26 CFR 141.3) is stricken out, and there is inserted in lieu thereof:

SEC. 2135. INTERNAL REVENUE CODE, EXEMPTION FROM TAX.

(a) SHIPMENTS TO FOREIGN COUNTRIES AND POSSESSIONS OF THE UNITED STATES.—

(1) MANUFACTURERS.—Manufactured tobacco, snuff, cigars or cigarettes may be removed for export to a foreign country or for shipment to a possession of the United States without payment of tax under such rules and regulations and the making of such entries, and the filing of such bonds and bills of lading as the Commissioner, with the approval of the Secretary, shall prescribe.

* * * * * * *

(3) CIGARETTE PAPERS AND TUBES.—Under such rules and regulations as the Commissioner with the approval of the Secretary may prescribe, the taxes imposed by subsection (d) of section 2000 shall not apply in respect of cigarette papers or tubes sold for export or for shipment to a possession of the United States and in due course so exported or shipped.

PAR. 2. The second and third sentences of article 3(a) (26 CFR 141.3(a)), as amended by Treasury Decision 5205 (8 F. R. 74) [C. B. 1943, 1182], are amended to read as follows:

A separate bond must be filed for each such factory from which withdrawals without payment of tax under this part are to be made. The penal sum of the bond must be sufficient to cover the estimated amount of tax which may at any time constitute a charge against the bond: *Provided*, That the penal sum of the bond furnished under this section shall not exceed $100,000 nor be less than $500, in the case of a bond covering withdrawals of cigars and cigarettes, and shall not exceed $25,000 nor be less than $500, in the case of a bond covering withdrawals of tobacco and snuff, or cigarette papers and tubes.

PAR. 3. The fifth and sixth sentences of article 3(a) (26 CFR 141.3(a)), as amended by Treasury Decision 5205 (8 F. R. 74), are stricken out and in lieu thereof is added a new sentence reading as follows:

When the limit of liability under a bond given in less than the maximum penal sum has been reached, no further shipments shall be made until the liability has been decreased, as provided in this part, or an additional or strengthening bond, with the same surety as that on the original bond, or a new or superseding bond, is furnished.

PAR. 4. The first sentence of article 12 (26 CFR 141.12), as amended by Treasury Decision 5205 (8 F. R. 74), is amended by striking out the words "and in no case less than $1,000", and inserting in lieu thereof ": *Provided*, That the penal sum of any such bond shall not exceed $200,000 nor be less than $1,000".

PAR. 5. The fourth sentence of article 12 (26 CFR 141.12), as amended by Treasury Decision 5205 (8 F. R. 74), is amended to read as follows:

When the limit of liability under a bond given in less than the maximum penal sum has been reached, no additional shipments shall be received into the warehouse until an additional or strengthening bond, with the same surety as that on the original bond, or a new or superseding bond, is furnished.

Because the amendments made by this Treasury Decision are of a liberalizing character, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitations of section 4(c) of said act.

This Treasury Decision shall be effective on the date of its publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in sec. 3791 of the Internal Revenue Code (53 Stat. 467; 26 U. S. C. 3791).)

T. Coleman Andrews,
Commissioner of Internal Revenue.

Approved March 25, 1954.

M. B. Folsom,
Acting Secretary of the Treasury.

(Published in the Federal Register March 31, 1954)

CHAPTER 19.—RETAILERS' EXCISE TAXES

SECTION 2400.—TAX ON JEWELRY, ETC.

Regulations 51, Section 320.34: Watches and clocks. Rev. Rul. 54–116
(Also Section 320.33.)

Stop watches and pedometers that are not equipped with hands and dials or any other device which indicates the time of day are not considered watches within the meaning of section 2400 of the Internal Revenue Code and are not taxable as such under that section. However, the tax imposed by section 2400 of the Code on the sale of articles made of, or ornamented, mounted or fitted with, precious metals or imitations thereof applies to the sale of stop watches and pedometers, otherwise not taxable, where the cases for such articles are so made, ornamented, mounted, or fitted.

SECTION 2401.—TAX ON FURS

Regulations 51, Section 320.40: Scope of tax. Rev. Rul. 54–100

Articles made of fur on the hide or pelt which can be worn separately or interchangeably with coats, suits, or other garments are articles of fur within the meaning of section 2401 of the Internal Revenue Code and subject to tax when sold at retail.

A reversible coat made of fur on one side and cloth on the other is an article of which fur is a component material and is subject to tax if the value of the fur component is more than three times the value of the next most valuable component material.

Advice is requested concerning the application of the retailers' excise tax imposed by section 2401 of the Internal Revenue Code to a fur article sold in combination with a cloth coat or fur-trimmed cloth coat when the fur article is attached to the coat in such a manner that it can be readily removed therefrom by the consumer and worn separately. Advice is also requested as to the application of the tax to the sale of a reversible coat made of fur on one side and cloth on the other.

The tax imposed by section 2401 of the Internal Revenue Code applies to the sale at retail of articles made of fur on the hide or pelt, and articles of which such fur is the component material of chief value, but only if such value is more than three times the value of the next most valuable component material.

Articles made of fur on the hide or pelt, such as collars, stoles, capes, ascots, and scarves which can be worn separately or interchangeably with coats, suits, or other garments are articles of fur within the meaning of section 2401 of the Code and are subject to the tax imposed by that section when sold at retail.

If any one of the above-described articles of fur which can be worn separately is attached to a cloth coat or suit and these articles are sold as an ensemble, there is a combination sale of a completely finished fur article and a cloth coat or suit rather than a sale of a fur-trimmed article, and the tax is due on that portion of the retail sales price of the ensemble or unit which is attributable to the fur article. Such portion may be determined by applying to the retail sales price of the ensemble or unit, the ratio which the separate retail sales price of the fur article bears to the sum of the sales prices of both the fur article and the cloth coat. If such articles are not sold separately at retail and do not have established retail sales prices, the comparison may be made on the basis of the costs of the articles.

Where an article which is not in itself a complete fur article and which cannot be worn separately or interchangeably with other garments is sewed by any means to a cloth coat or suit, the sale of such fur-trimmed cloth coat or suit at retail is subject to tax provided the value of the fur component is more than three times the value of the next most valuable component material.

Where an article of fur which can be worn separately or interchangeably with other garments, as described above, is sold in combination with a fur-trimmed cloth coat or suit, for example, a garment having fur cuffs or fur borders, the entire ensemble is subject to tax, if the value of the fur trimming (exclusive of the fur article) is more than three times the value of the next most valuable component. If, in such case, the fur-trimmed garment is nontaxable because the value of the fur trimming is not in excess of three times the value of the next most valuable component, the tax will apply only to the portion of the sale price of the entire ensemble which is allocable to the fur article included in the combination.

The taxability of the hereinbefore-mentioned articles is not affected by the color of the material used as linings for the articles.

A reversible coat made of fur on one side and cloth on the other, the cloth material being of the kind normally used as the outside material of cloth coats, as distinguished from the kind of material ordinarily used in making linings for fur or cloth coats, is considered to be an article of which fur is a component material regardless of whether the fur component is permanently attached to the cloth coat or is detachable. The sale of such a garment is subject to tax if the value of the fur component is more than three times the value of the cloth shell at the time the components are assembled into a finished garment.

SECTION 2402.—TAX ON TOILET PREPARATIONS

REGULATIONS 51, SECTION 320.50: Scope of tax. Rev. Rul. 54–101

Articles which constitute toilet preparations within the meaning of section 2402 of the Internal Revenue Code are subject to the tax imposed by that section even though sold for use as theatrical makeup. Articles taxable as toilet preparations include face creams, toilet powders, lipsticks, rouges, eyebrow and eyelash mascara, eye shadow creams, and other preparations which are commonly and commercially known and sold in the trade for toilet purposes. However, such items as grease paints, clown white, nose putty, black wax, blackface for minstrel makeup, and spirit gum are not considered to be toilet preparations within the meaning of section 2402 of the Code and are not subject to the tax imposed by that section.

CHAPTER 25.—FIREARMS

SUBCHAPTER A.—PISTOLS AND REVOLVERS

SECTION 2707(a).—PENALTIES

Rev. Rul. 54–158

The 100 percent penalty provided in section 2707(a) of the Internal Revenue Code should be assessed in a case where money withheld from employees as taxes, in lieu of being paid over to the Government, was knowingly and intentionally used to pay the operating expenses of a business, or for other purposes.

Advice is requested whether the 100 percent penalty provided in section 2707(a) of the Internal Revenue Code should be assessed in a case where money withheld from employees as taxes, in lieu of being paid over to the Government, was knowingly and intentionally used to pay the operating expenses of a business, or for other purposes.

Section 2707 of the Code is applicable to withholding of income tax at the source, taxes under the Federal Unemployment Tax Act, and taxes under the Federal Insurance Contributions Act, and provides in part as follows:

(a) Any person who willfully fails to pay, collect, or truthfully account for and pay over the tax imposed by section 2707(a), or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty of the amount of the tax evaded, or not paid, collected, or accounted for and paid over, to be assessed and collected in the same manner as taxes are assessed and collected. * * *.

* * * * * * *

(d) The term "person" as used in this section includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

The question as to what constitutes willful, or "willfully" as used in section 2707(a) of the Code was considered in *Matter of Alex D. Haynes* (a bankrupt), 88 Fed Supp. 379; *Paddock et al.* v. *Siemoneit et al.*, 218 S. W. (2d) 428; and *Kellems et al.* v. *United States*, 97 Fed. Supp. 681. The bankrupt in the *Haynes* case, *supra*, was one of the organizers, also a stockholder, director, president, and manager of a corporation which was kept going by virtue of certain loans from outside sources, but at no time did it have sufficient funds to meet its current obligations. The corporation was insolvent and certain withholding taxes, taxes under the Federal Insurance Contributions Act, and taxes under the Federal Unemployment Tax Act were not paid. The bankrupt, also, was one of the officers of the corporation whose duty it was to collect, where collection was necessary, and pay the taxes to the United States. With reference to the application of section 2700(a) of the Code to the facts in that case, the court said:

> * * * We are well aware of the many meanings that the courts have placed on the word "willful". Spies v. United States, 317 U. S. 492, 63 S. Ct. 364, 367, 87 L. Ed. 418 [Ct. D. 1571, C. B. 1943, 1038]. In this case the court said it "is a word of many meanings, its construction often being influenced by its contents". It is our judgment that as the word is used in this statute [section 2707(a)] it does not mean wicked design but rather that the person acts knowingly and intentionally. It would seem therefore that if the officer of the corporation had in his hands or under his control the funds that had been set apart for the purpose of paying the tax and appropriated such funds for some other purpose that he acts "willfully".

The liability of an officer of an insolvent corporation for the civil penalty provided in section 2707(a) of the Code for failure to pay over taxes withheld from wages of employees of the corporation was involved in *Paddock et al.* v. *Siemoneit et al.*, *supra*. In that case the court determined as a fact that Siemoneit was the disbursing officer of the corporation and that it was his decision that the taxes would not be paid when due. The court found that Siemoneit in failing to cause the corporation to pay over the taxes had no fraudulent motive or intent or purpose to defraud the Government of its revenue, but that he deliberately and intentionally failed to cause payment of the taxes when they were due. The court, citing *Murray R. Spies* v. *United States*, 317 U. S. 492, Ct. D. 1571, C. B. 1943, 1038, and *United States* v. *Harry Murdock*, 290 U. S. 389, Ct. D. 771, C. B. XIII-1, 144 (1934), stated in part as follows:

> Section 2707(a) provides that the penalty imposed therein shall be "assessed and collected in the same manner as taxes are assessed and collected". Thus it is clear that the statute intended a civil, not a criminal, sanction. The imposition of civil as well as criminal sanctions for the same act or omission is permissible; and one sanction which has long been recognized as civil, rather than criminal, in spite of its possible severity, is the payment of fixed or variable sums of money. * * *.
>
> In *United States* v. *Illinois Central Railroad Company*, 303 U. S. 239, 58 S. Ct. 533, 82 L. Ed. 773, suit was brought to recover a civil penalty for violation of a Federal statute requiring the periodical unloading of livestock in transit. The Supreme Court there rejected the argument that "willful" included an evil motive or bad purpose and approved its definition as the attitude of a person "who, having a free will or choice, either intentionally disregards the statute or is plainly indifferent to its requirements." * * *.
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> * * * * * * *
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> In the light of the decisions of the Supreme Court of the United States, and even though we agree that penalty statutes should generally be construed in

favor of the taxpayer, we have concluded that the district court's finding that the respondent intentionally and deliberately failed to pay the taxes when due was sufficient to make him liable for the civil penalty under section 2707(a). Respondent admittedly knew that the taxes were due. There was no contention that the statute was inapplicable to the taxpayer * * * Nor does the proof show that the corporation could not have paid the taxes when they were due. The proof merely shows that it was inconvenient for the corporation to pay the taxes at that time, and that it was thought that the corporation would have a better chance to operate profitably if it postponed the payment of its tax obligation and used the funds for its own purposes instead of paying them over to the Government as the law requires. The choice was knowing, deliberate and intentional, and with full realization that the law was being violated. In our opinion this is the kind of case which section 2707(a) was intended to cover.

In the Kellems case, *supra*, which involved a failure to comply with the withholding provisions of the income tax laws, the court found that the taxpayer had acted without reasonable cause and stated in part:

The "government" * * * has taken the position throughout, and still adheres to the position, that an intentional and deliberate non-compliance, which concededly existed here, was enough to bring the penalty statute into play. I overruled this contention * * * and still hold, that the word *willful* in the penalty statute means "without reasonable cause," that is to say, "capricious" * * *.

The difference between the meaning of the word "willful" as used in a statute imposing *civil* penalties (such as subsection (a) of section 2707 of the Code, *supra*) and as used in statutes imposing *criminal* penalties of fine or imprisonment, or both, (such as subsections (b) and (c) of section 2707) can be seen from the decision of the Supreme Court of the United States in the case of United States v. Murdock, *supra*. In that case the Supreme Court in considering *inter-alia*, section 256 of the Revenue Act of 1926 and section 148 of the Revenue Act of 1928, requiring the making of returns showing payments to others, and section 1114(a) of the Revenue Act of 1926 (now section 2707(b) of the Internal Revenue Code), which imposes criminal penalties for willful failure to make such returns, stated in part as follows:

The word [willfully] often denotes an act which is intentional, or knowing, or voluntary, as distinguished from accidental. But when used in a criminal statute it generally means an act done with a bad purpose (*Felton* v. *United States*, 96 U. S. 699; *Potter* v. *United States*, 155 U. S. 438; *Spurr* v. *United States*, 174 U. S. 728); without justifiable excuse (*Felton* v. *United States*, supra; *Williams* v. *People*, 26 Colo. 272; *People* v. *Jewell*, 138 Mich. 620; *St. Louis, Iron Mountain & S. Ry. Co.* v. *Batesville & W. Tel. Co.*, 80 Ark. 499; *Clay* v. *State*, 52 Tex. Cr. R., 555); stubbornly, obstinately, perversely, (*Wales* v. *Miner*, 89 Ind. 118, 127; *Lynch* v. *Commonwealth*, 131 Va. 762; *Claus* v. *Chicago Gt. W. Ry. Co.*, 136 Iowa 7; *State* v. *Harwell*, 129 N. C. 550). * * *

This court has held that where directions as to the method of conducting a business are embodied in a Revenue Act to prevent loss of taxes, and the Act declares a willful failure to observe the directions a penal offense, an evil motive is a constituent element of the crime. * * * *Felton* v. *United States*, supra, * * *.

In view of the foregoing, it is held that the 100 percent penalty provided in section 2707(a) of the Code should be assessed in a case where money withheld from employees as taxes, in lieu of being paid over to the Government, was knowingly and intentionally used to pay the operating expenses of a business, or for other purposes.

SUBCHAPTER B.—MACHINE GUNS AND SHORT-BARRELLED FIREARMS

SECTION 2720.—TAX

REGULATIONS 88, SECTION 319.80: Scope of tax. Rev. Rul. 54–180
(Also Section 3260; Section 319.36.)

Partially deactivated submachine guns may be rented to various television networks without payment of the transfer tax of $200 covering each such transfer provided the television networks and the person from whom the machine guns are rented qualify as firearms dealers and pay a special occupational tax of $200 per year.

Advice is requested as to the procedure to be followed with respect to the rental of partially deactivated submachine guns by a firearms company to various television networks.

A firearms dealer holding a $1 Federal firearms license was requested by various television networks to supply submachine guns to their studios. Since the demand for the use of such weapons by the television networks may be frequent, the dealer desires to render this service without the necessity of paying the $200 transfer tax on each occasion a weapon is rented. The submachine guns will be partially deactivated in order that blank cartridges may be used but the submachine guns will not discharge a projectile.

Section 2720 of the Internal Revenue Code provides that there shall be paid upon firearms transferred in the United States a tax at the rate of $200 for each firearm except that on certain firearms, as described therein, the transfer tax shall be at the rate of $1. Section 2721(a) of the Internal Revenue Code provides certain exemptions from the transfer tax, one of which is the transfer of any firearm which is unserviceable and which is transferred as a curiosity or ornament. In order for a machine gun to be classed as unserviceable it must be incapable of discharging a shot by means of an explosive and also incapable of being repaired and restored to a firing condition. The submachine guns in question could be restored to a firing condition and, therefore, could not be exempt from the transfer tax.

Section 3260(a)(2) of the Internal Revenue Code requires the payment of a special occupational tax of $200 per year by dealers in firearms except that dealers who handle certain types of guns specified therein shall pay a tax of $1 per year.

Partially deactivated submachine guns may be rented to various television networks without payment of the transfer tax of $200 covering each such transfer provided the television networks and the person from whom the machine guns are rented qualify as firearms dealers and pay the special occupational tax of $200 per year. Before the firearms may be so transferred, the television networks and the firearms company must each file a return on Form 11A (Firearms) with, and pay the tax to, the appropriate District Director of Internal Revenue, in accordance with section 319.37 of Regulations 88. Forms 3 (Firearms) and Forms 2 (Firearms) covering the transfers may be filed by the transferor and the transferee, respectively, every 6 months, as of July 1 and January 1, in lieu of such forms being prepared to cover each day's transactions.

SECTION 2733.—DEFINITIONS

REGULATIONS 88, SECTION 319.12: Firearm. Rev. Rul. 54–159

The alteration of .38 and .45 caliber revolvers by removing the rifling from the barrel of the guns and using standard revolver cartridge casings, hand loaded with shot, in lieu of the customary lead projectiles, does not bring such weapons within the meaning of a "firearm" as defined in section 2733(a) of the Internal Revenue Code.

Advice is requested whether the alteration of .38 and .45 caliber revolvers to fire standard revolver cartridges hand loaded with shot would cause them to be reclassified as firearms.

A gunsmith proposes to alter .38 and .45 caliber revolvers to fire shot cartridges. The alteration is accomplished by removing the rifling from the barrel of the gun, installation of a restrictor ring or choke, and using standard revolver cartridge casings, hand loaded with shot, instead of the customary lead projectiles.

Section 2733(a) of the Internal Revenue Code defines a firearm as "a shotgun or rifle having a barrel of less than 18 inches in length, or any other weapon, except a pistol or revolver, from which a shot is discharged by an explosive if such weapon is capable of being concealed on the person, * * *."

The alteration of .38 and .45 caliber revolvers by the removal of the rifling from the barrel and the use of standard revolver cartridge casings, hand loaded with shot, instead of the customary lead projectiles, does not remove such weapons from the classification as revolvers. They are not firearms within the meaning of section 2733(a) of the Internal Revenue Code.

REGULATIONS 88, SECTION 319.12: Firearm. Rev. Rul. 54–181

Classification of certain weapons for determination of whether they are "firearms" within the meaning of that term as used in section 2733 of the Internal Revenue Code.

Advice is requested whether the weapons listed below are firearms under section 2733 of the Internal Revenue Code.

Section 2733(a) of the Code defines a firearm as "a shotgun or rifle having a barrel of less than eighteen inches in length, or any other weapon, except a pistol or revolver, from which a shot is discharged by an explosive if such weapon is capable of being concealed on the person, or a machine gun, and includes a muffler or silencer for any firearm whether or not such firearm is included within the foregoing definition, but does not include any rifle which is within the foregoing provisions solely by reason of the length of its barrel if the caliber of such rifle is .22 or smaller and if its barrel is sixteen inches or more in length."

The following weapons, capable of being concealed on the person, are firearms, being classified as "any other weapon":

A U. S. Carbine, M–1, .30 caliber semiautomatic, having an 18-inch barrel with the stock sawed off leaving a pistol grip of 4 inches in length.

A jackknife pistol.

A palm-squeeze revolver.

A single 18½-inch barrel gun, chambered to fire 16 gauge shotgun shells, with sawed-off stock, altered in such a manner as to change the characteristics of the original weapon so that it cannot be classified either as a shotgun or pistol in the commonly accepted definition of those words.

A dipper percussion gun, which is made of bronze and which fires about a .32 caliber projectile by means of a percussion cap, and is 13½ inches overall in length, with a cup attached to one end.

A gun made by using a 32–20 rifle barrel mounted on the receiver or frame of a .410 gauge shotgun, with a pistol type grip at an angle to the bore for holding in one hand and designed to discharge a shot by the action of an explosive.

The following weapons are not firearms within the meaning of section 2733(a) of the Internal Revenue Code:

A pistol grip type German Flare gun with two barrels 6½ inches in length which is not capable of firing shotgun shells.

A twelve gauge, 30 inch double-barrel shotgun, one barrel of which has been sawed off to 14¼ inches. Since the remaining barrel is 30 inches in length, the weapon is not considered as capable of being concealed on the person.

Section 2733(b) of the Internal Revenue Code defines a machine gun as "any other weapon which shoots, or is designed to shoot, automatically or semiautomatically, more than one shot, without manual reloading, by a single function of the trigger."

An 8 millimeter caliber German Light Maxim Field Machine Gun was altered by removing the original breech mechanism so that the action and barrel assembly of a .22 caliber short rim-fire autoloading semiautomatic rifle, less wooden stock, forearm and sights, could be cradled on the inside of the breech of the gun by use of brackets. Such gun then was capable of firing .22 caliber rim-fire ammunition and is operated by means of a 110 volt switch-controlled electric motor with a set of beveled gears to transmit motion of the motor to the trigger mechanism of the rifle, so that when the trigger of the gun is pulled, motion of the electric motor is transmitted to the mechanism of the rifle, thus firing the gun as long as the trigger is held back or until the 15-shot tubular magazine is emptied. This weapon is classified as a "machine gun" within the meaning of section 2733(b) of the Code.

REGULATIONS 88, SECTION 319.12: Firearm. Rev. Rul. 54–233

A revolver refitted with a 10-inch barrel is a firearm as defined in section 2733(a) of the Internal Revenue Code.

Advice is requested whether the conversion of a .455 caliber revolver for the purpose of accommodating shot cartridges would cause it to be classified as a firearm.

A gunsmith proposes to convert a .455 caliber revolver for the purpose of accommodating shot cartridges. The conversion of the revolver is accomplished by removing the regular revolver barrel and refitting a 10-inch barrel to the frame of the revolver.

It is held that the refitting of revolvers with barrels, other than revolver barrels, constitutes a conversion of such weapons and since a

10-inch barrel is not designed for use therewith but is an adoption of a barrel designed for use with other weapons such a conversion would place the firearm within the classification of "any other weapon" as defined in section 2733(a) of the Internal Revenue Code.

SECTION 2733(a).—DEFINITIONS: FIREARM

REGULATIONS 88, SECTION 319.12: Firearm. Rev. Rul. 54-245
(Also Federal Firearms Act, Section 1;
Regulations 131, Section 315.2.)

Section 1(3) of the Federal Firearms Act and section 315.2 of Regulations 131 define a firearm as "any weapon, by whatever name known, which is designed to expel a projectile or projectiles by action of an explosive and a firearm muffler or firearm silencer, or any part or parts of such weapon."

A telescopic sight or riflescope for a firearm is considered in the category of an accessory and not a part of a firearm within the above definition. Therefore, a person may import and sell telescopic sights, or riflescopes, for firearms without obtaining a license to deal in firearms under the Federal Firearms Act. There is no provision of law that imposes an excise tax on the manufacturer, producer, or importer of such product.

Section 2733(a) of the Internal Revenue Code defines a firearm as "a shotgun or rifle having a barrel of less than eighteen inches in length, or any other weapon, except a pistol or revolver, from which a shot is discharged by an explosive if such weapon is capable of being concealed on the person, or a machine gun, and includes a muffler or silencer for any firearm whether or not such firearm is included within the foregoing definition, but does not include any rifle which is within the foregoing provisions solely by reason of the length of its barrel if the caliber of such rifle is .22 or smaller and if its barrel is sixteen inches or more in length."

The X Corporation manufactures a tool powered by blank .22 and .38 cartridges which is used for setting studs or driving anchors into masonry or metal. The tool is manufactured in two sizes, one for light duty and one for heavy duty. It is held that such tool is not a firearm within the definition of the Federal Firearms Act or section 2733(a) of the Internal Revenue Code. Accordingly, a dealer is not required to obtain a license to sell such tool nor is he liable for the special tax imposed by section 3260 of the Internal Revenue Code.

REGULATIONS 88, SECTION 319.12: Firearm. Rev. Rul. 54-247
(Also Federal Firearms Act, Section 1;
Regulations 131, Section 315.2.)

A device for trapping animals which fires a special plastic cartridge but is not capable of firing projectiles is not a "firearm" within the meaning of section 2733(a) of the Internal Revenue Code or section 1(3) of the Federal Firearms Act. Since the plastic cartridges are not designed to fire projectiles, they cannot be considered ammunition according to the commonly accepted definition of the term.

CHAPTER 27.—OCCUPATIONAL TAXES

SUBCHAPTER A.—SPECIAL PROVISIONS

PART VIII.—FIREARMS

SECTION 3260.—TAX

REGULATIONS 88, SECTION 319.36: Rates of tax.

Tax liability incurred through the rental of partially deactivated submachine guns. (See Rev. Rul. 54–180, p. 250.)

CHAPTER 27A.—WAGERING TAXES

SUBCHAPTER A.—TAX ON WAGERS

SECTION 3285.—TAX

REGULATIONS 132, SECTION 325.22: Excluded wagers. Rev. Rul. 54–240
(Also Section 325.21.)

Punch boards and tip games come within the meaning of a "drawing" as that term is used in section 3285(b)(2) of the Internal Revenue Code, and the operation thereof by an organization exempt from income tax under section 101 of the Code is likewise exempt from wagering taxes, provided no part of the net proceeds derived from such operation inures to the benefit of any private shareholder or individual. However, no exemption from wagering taxes is provided by law in connection with the operation of wagering pools conducted for profit and all operators thereof, including organizations exempt from income tax under section 101 of the Code are liable for the wagering taxes imposed by sections 3285 and 3290 of the Code.

Advice is requested concerning the application of the wagering taxes imposed by sections 3285 and 3290 of the Internal Revenue Code to the operation of punch boards, tip games, and wagering pools by an organization exempt from income tax under section 101 of the Code.

Section 3285 of the Code imposes on wagers an excise tax equal to 10 percent of the amount thereof. Section 3290 of the Code provides that an occupational tax of $50 per year shall be paid by each person liable for the excise tax and by every person who is engaged in receiving wagers for or on behalf of any person liable for the excise tax,

The term "wager" is defined in section 3285(b)(1) of the Code as including (A) any wager with respect to a sports event or a contest placed with a person engaged in the business of accepting such wagers, (B) any wager placed in a wagering pool with respect to a sports event or a contest, if such pool is conducted for profit, and (C) any wager placed in a lottery conducted for profit.

The term "lottery" as used in section 3285(b)(1) of the Code includes the numbers game, policy, and similar types of wagering, but, under the provisions of section 3285(b)(2) of the Code, it does not include any drawing conducted by an organization exempt from income tax under section 101 of the Code if no part of the net proceeds derived from such drawing inures to the benefit of any private shareholder or individual. (See report of Senate Committee on Finance, Senate Report No. 781, Eighty-second Congress, First session, C. B. 1951-2, 458, at 541.) The term "drawing" refers to the physical drawing of a ticket, or the equivalent thereof, such as the use of a wheel or a similar device, whereby the winner is conclusively determined by a number, letter, legend, or symbol, without reference to any other event the happening of which is beyond the control of the operator. See M. T. 44, C. B. 1952-2, 251.

It is held that punch boards and tip games come within the meaning of a "drawing," as that term is used in section 3285(b)(2) of the Code, and the operation thereof by any organization exempt from income tax under section 101 of the Code is also exempt from wagering taxes, provided no part of the net proceeds derived from such operation inures to the benefit of any private shareholder or individual.

Section 325.21(c) of Regulations 132, provides that a wagering pool conducted for profit includes any scheme or method for the distribution of prizes to one or more winning bettors based upon the outcome of a sports event or a contest or a combination or series of such events or contests, provided such wagering pool is managed and conducted for the purpose of making a profit.

No exemption from wagering taxes is provided by law in connection with the operation of wagering pools conducted for profit. Accordingly, all operators of such pools, including organizations which are exempt from income tax under section 101 of the Code, are liable for the 10-percent excise tax and the occupational tax of $50 per year imposed by sections 3285 and 3290 of the Code. Likewise, each person engaged in receiving wagers for or on behalf of the operator of such a pool is also liable for the occupational tax.

CHAPTER 28.—PROVISIONS COMMON TO MISCELLANEOUS TAXES

SUBCHAPTER A.—GENERAL PROVISIONS

PART II.—ASSESSMENT, COLLECTION, AND REFUND

SECTION 3310.—RETURNS AND PAYMENT OF TAX

Rev. Rul. 54-234*

Form 720, Quarterly Federal Excise Tax Return-Statement, will continue to be furnished by taxpayers whose records do not supply a portion of the information called for on the return.

Section 4 of Rev. Rul 254, C. B. 1953-2, 451, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to continue the policy stated in Revenue Ruling 254, C. B. 1953-2, 451.

*Originally issued as IR-Mimeograph No. 54-103, dated June 10, 1954.

SEC. 2. BACKGROUND.

Section 3 of Revenue Ruling 254, *supra*, provides in part as follows:

.02 The Internal Revenue Service will accept returns on Form 720 in which the taxpayer completes the information called for in items 1 through 5 and shows the amount of tax in column 6 of the appropriate schedule on the form. Taxpayers should, however, complete such other portions of the form as may be feasible, and should be encouraged to supply such additional data as they can based upon existing records of purchases, sales, production, and inventories.

.03 Taxpayers who do not supply the data called for on Form 720 should attach to the form as filed * * * a brief statement explaining the failure to supply the necessary data and describing the system employed by the taxpayer to assure the proper determination of excise tax liability. Where the taxpayer is a member of an organization which submits to the Internal Revenue Service a statement of the accounting procedures used by members, the taxpayer may attach a copy of such statement or refer to such statement, in lieu of submitting a separate statement, if the taxpayer's procedures are in accordance with that described by the organization.

.04 The taxpayer need furnish the foregoing statement only once, unless a further explanation is requested or unless a change in his record-keeping procedures affects his ability to fill in the return or determine the tax.

SEC. 3. PERIOD TO WHICH THIS POLICY IS APPLICABLE.

The foregoing policy will be continued until further notice. No change in the policy is contemplated for any quarter in 1954.

SEC. 4. EFFECT ON OTHER DOCUMENTS.

This Revenue Ruling supersedes section 4 of Rev. Rul. 254, C. B. 1953-2, 451.

SEC. 5. INQUIRIES.

Taxpayers are invited to consult with District Directors of Internal Revenue about any problem relating to the requirements for filling in Form 720.

SECTION 3312.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION

REGULATIONS 71, SECTION 113.150: Records and returns. Rev. Rul. 54–196

Canceled documentary stamps may not be removed from the instruments to which they are attached during the 4-year period from the date the tax accrued and, as a matter of protection to the taxpayer, should not be removed before the expiration of the 5-year period during which suit may be instituted to recover any taxes alleged to be due.

Advice is requested whether documentary stamps may be removed from instruments for the purpose of sale or exchange by or with stamp collectors.

Under section 3312 of the Internal Revenue Code assessment of documentary stamp taxes due may be made at any time within 4 years after the taxes accrued. After 4 years, but not more than 5 years, suit may be instituted without assessment to recover any taxes alleged to be due but which remain unpaid.

Pursuant to the provisions of section 113.150 of Regulations 71, all instruments, memoranda, books, or documents to which documentary stamps have been affixed and canceled shall be maintained and preserved for at least 4 years from the time of the related transaction.

In view of the foregoing canceled documentary stamps may not be removed from the instruments to which they are attached during the 4-year period from the date the tax accrued and, as a matter of protection to the taxpayer, should not be removed before the expiration of the 5-year period during which suit may be instituted.

Although the Internal Revenue Service recognizes that there is no prohibition in the law or regulations against the removal of such stamps after the 4-year period, attention is directed to the penalties provided under section 1823 of the Internal Revenue Code for the fraudulent use or reuse of such stamps.

PART IV.—MISCELLANEOUS PROVISIONS

SECTION 3331.—EXEMPTION FROM TAX OF DOMESTIC GOODS PURCHASED FOR THE UNITED STATES

REGULATIONS 8, SECTION 140.212: Tax-free shipment of tobacco, snuff, cigars, cigarettes, and cigarette papers and tubes, for use of the United States: Shipments restricted.

Rev. Rul. 54–69

Cigarettes may not be withdrawn free of tax for delivery to military and naval bases and establishments in this country for distribution to officers and enlisted personnel at special and holiday dinners or recreational activities, where the funds used for the purchase of the cigarettes are derived from donations by officers and enlisted personnel to club or camp funds and profits from post or base exchanges.

Permission has been requested for the withdrawal of nontaxpaid cigarettes for delivery to military and naval bases and establishments in the United States for distribution to officers and enlisted personnel at special and holiday dinners and at recreational activities.

While such goods are intended for gratuitous distribution, the funds with which the cigarettes would be purchased are derived from donations by officers and enlisted personnel to club or camp funds, and profits from post or base exchanges.

Section 3331 of the Internal Revenue Code provides as follows:

The privilege existing by provision of law on December 1, 1873 or thereafter of purchasing supplies of goods imported from foreign countries for the use of the United States, duty free, shall be extended, under such regulations as the Secretary may prescribe, to all articles of domestic production which are subject to tax by the provisions of this subtitle.

Section 140.212 of Regulations 8, as added by Treasury Decision 6052, C. B. 1953–2, 346, issued under the authority of section 3331 of the Internal Revenue Code, provides as follows:

Manufacturers of tobacco, snuff, cigars, cigarettes, and cigarette papers and tubes, may ship such articles tax-free from their factories, in accordance with this subpart, to Federal agencies and institutions for gratuitous distribution. Shipments of such articles for sale by Federal agencies or institutions are not within the meaning of the law authorizing the purchase of articles tax-free for use of the United States. Institutions owned or controlled by the Governments of the several States, Territories, or the District of Columbia, are not entitled to receive such articles tax-free.

The purpose of the statute is to avoid the procedures of requiring the Government to pay into the Treasury as taxes funds appropriated out of the Treasury for its support.

Since the cigarettes will be paid for from funds of the respective organizations, and not from congressionally appropriated funds, the withdrawal of cigarettes for delivery to military and naval bases and establishments in this country for distribution to officers and enlisted personnel at special and holiday dinners and at recreational activities would not be withdrawals "for use of the United States" within the meaning of section 3331 of the Internal Revenue Code. Cigarettes may not be withdrawn from factories tax-free for such purposes.

CHAPTER 29.—MANUFACTURERS' EXCISE AND IMPORT TAXES

SUBCHAPTER A.—MANUFACTURERS' EXCISE TAXES

The Revenue Service has concluded that the portion of Revenue Ruling 54-25, published in Internal Revenue Bulletin 1954-2, 29, under date of January 11, 1954, dealing with the computation of tax base is ambiguous and subject to varying interpretations. Accordingly, in the interest of clarity of understanding and application, that Revenue Ruling is superseded to read as follows:

SECTION 3403.—TAX ON AUTOMOBILES, ETC.

REGULATIONS 46, SECTION 316.50: Scope of tax. Rev. Rul. 54-25
(Also Section 3441, Section 316.15.)

Method of computing tax imposed by section 3403 of the Code with respect to sales of automobiles by an importer who sells only a' retail.

Rev. Rul. 54-25, I. R. B. 1954-2, 29, superseded.

Advice is requested concerning the method of computing the tax imposed by section 3403 of the Internal Revenue Code with respect to sales of automobiles by an importer who sells only at retail.

Under the authority of section 3441(b)(1) of the Code, the tax on sales of automobiles by an importer who sells only at retail is to be computed on the price for which such articles are sold by manufacturers or producers in the ordinary course of trade as determined by the Commissioner. Such determination has been made with respect to automobiles and has been found to represent an amount equal to 75 percent of the established retail list price subject to the adjustments provided by section 3441(a) of the Code. Such adjustments are to be made as follows: To 75 percent of the list price should be (A) added any separate charge made by the importer for transportation or delivery of the car to the purchaser and (B) deducted the amounts of (1) the transportation or delivery expense actually incurred by the importer in effecting delivery to the purchaser, and (2) any expense for insuring the shipment to the purchaser (but not including insurance on the shipment to the importer). This computation reflects the fair market price in the case where the amount of the tax is to be passed on as a separate item on the invoice to the purchaser. In such case the tax will be computed at the statutory rate of 10 percent of such fair market price. However, where the amount of the tax is not passed on as a separate item but is included in the invoice price, the foregoing computation reflects not only the fair market price but the tax thereon as well. In that case, and in compliance with the rule set forth in section 316.11 of Regulations 46, the tax may be determined by taking one-eleventh (10/110) of such amount, so as to eliminate the tax from the tax base as required by the law.

In the event the tax base determined in the above-described manner results in a price which is less than the importer's cost of the automobiles including duty, insurance, and other charges incident to placing the automobiles in condition ready for delivery to his customers, the tax shall be computed at 10 percent of such cost.

REGULATIONS 46, SECTION 316.50: Scope of tax. Rev. Rul. 54-61

Sales by a manufacturer of new truck or truck trailer bodies produced from new or salvaged materials to replace bodies which have been wrecked are taxable under section 3403(a) of the Internal Revenue Code.

Advice is requested concerning the application of the tax under section 3403(a) of the Internal Revenue Code to the sale by a manufacturer of new truck or truck trailer bodies produced from new or salvaged materials furnished by the manufacturer to replace bodies which have been wrecked.

Under section 3403(a) of the Code, tax at the rate of 8 percent is imposed on the sale by the manufacturer of automobile truck chassis, automobile truck bodies, truck and bus trailer and semitrailer chassis, and truck and bus trailer and semitrailer bodies.

It is held that where a manufacturer furnishes either new or salvaged materials and produces new truck or truck trailer bodies to replace bodies which have been wrecked, the sale of the bodies by the manufacturer is subject to tax under section 3403(a) of the Code. However, under the provisions of section 3443(a) of the Code, a credit may be allowed to a manufacturer in the amount of excise tax which has been paid on any new parts purchased and used by him in the manufacture of bodies with respect to which tax has been reported or paid. (See section 316.204, Regulations 46.)

Sales by a manufacturer of truck or truck trailer bodies to dealers or others for resale are considered sales at wholesale. Where the manufacturer's vendee purchases such a body for use and not for resale, the transaction is considered a sale at retail.

The following sets forth the method of computing the tax with respect to sales by manufacturers of truck or truck trailer bodies at wholesale, wholesale and retail, and retail only.

With respect to sale of bodies at wholesale, the tax imposed by section 3403(a) of the Code should be based on the wholesale price subject to the following adjustments provided by section 3441(a) of the Code. To the wholesale price there should be added any charge for the transportation or delivery of the bodies; and there should be excluded any expenses actually incurred by the manufacturer (1) in effecting delivery of the bodies to the purchasers, (2) for installation of the completed bodies on chassis, (3) for insuring shipments to the purchasers, and the amount of tax if not entered on the invoice as a separate charge.

Under the authority of section 3441(b)(1) of the Code, the tax on retail sales of bodies by a manufacturer who also sells such articles at wholesale, is to be based upon his highest established wholesale price to independent dealers, subject to the same adjustments hereinbefore stated in connection with sales at wholesale.

The tax on sales of bodies by a manufacturer who sells only at retail is to be computed, under the authority of section 3441(b)(1) of the Code, on the price for which such articles are sold by manufacturers or producers in the ordinary course of trade as determined by the Commissioner. Such determination has been made with respect to truck or truck trailer bodies and it has been found to represent 75 percent of the established retail price, subject to adjustment with respect to the above-mentioned additions and exclusions provided by section 3441(a) of the Code. This results in the adjusted price on which the tax is to be based. If the tax is not included in the retail price, it is to be computed at 8 percent of the adjusted price. Where the tax is included in the retail price, it may be computed at two twenty-sevenths ($^{8}/_{108}$) of the adjusted price in order to provide for the exclusion of the tax from the price on which it is based. In any case where the tax base determined in this manner with respect to sales by a manufacturer who sells only at retail results in a price which is less than the manufacturer's cost of the body when in condition ready for delivery to the purchaser, the tax should be computed at 8 percent of such cost.

It is further held that where a manufacturer merely replaces certain parts of a used truck or truck trailer body belonging to a customer, such operation is considered to constitute a repair operation and the tax imposed under section 3403(a) of the Code does not apply to the amount charged for such repairs. However, the manufacturer is liable for tax under section 3403(c) of the Code with respect to any taxable parts or accessories of his manufacture or which were purchased by him tax-free for further manufacture, which are sold to the customer in connection with the repair operation.

REGULATIONS 46, SECTION 316.50: Scope of tax. Rev. Rul. 54–117

A low-bed trailer or semitrailer which is designed and constructed for transporting heavy equipment and which by special permission may operate on highways is considered to be an automobile truck trailer or semitrailer within the meaning of section 3403(a) of the Internal Revenue Code. Sales of such trailers by the manufacturer are subject to tax under that section even though they may exceed the maximum width and weight limitations prescribed by the laws of the various States.

SECTION 3406.—EXCISE TAXES IMPOSED BY THE REVENUE ACT OF 1941

REGULATIONS 46, SECTION 316.110: Scope of tax. Rev. Rul. 54-228

Electric air heaters which, because of their design and construction and the purpose to be served, are usually built in or permanently attached to a wall, fixture or similar construction element, do not come within the classification of appliances of the household type contemplated by section 3406(a)(3) of the Internal Revenue Code and sales thereof by the manufacturer are not subject to the tax imposed by that section. On the other hand, portable electric air heaters are considered to be included in the classification of appliances of the household type and sales thereof by the manufacturer are subject to tax. S. T. 945, C. B. 1952-2, 256, modified.

Advice is requested concerning the application of the tax on electric appliances imposed by section 3406(a)(3) of the Internal Revenue Code to electric air heaters of the type designed for permanent installation as distinguished from those of the portable type.

Section 3406(a)(3) of the Code, effective October 1, 1941, imposed a tax at the rate of 10 percent on the sale by the manufacturer, producer, or importer of electric air heaters (not including furnaces). By virtue of the amendment of that section of the Code by section 485 of the Revenue Act of 1951, effective November 1, 1951, the tax on such heaters was limited in application to those of the household type. Under the law as amended by section 305 of the Excise Tax Reduction Act of 1954, effective April 1, 1954, the rate of tax on household type electric air heaters was reduced from 10 to 5 percent.

S. T. 945, C. B. 1952-2, 256, holds that the tax imposed by section 3406(a)(3) of the Code is applicable to sales of electric air heaters which are not in fact furnaces, even though they take the place of furnaces and are permanently installed in the walls, ceilings, or floors of buildings.

In addition to electric air heaters, the statute imposes a tax on a wide variety of electric, gas, and oil appliances of the household type. In this range of taxable appliances the articles vary in size from large to small. Likewise, a number of articles are portable, while others because of their design and construction and the purpose intended to be served are usually built in or permanently attached to a wall, fixture, or similar construction element. In the administration of section 3406(a)(3) of the Code it is not possible to lay down a general rule or yardstick such as size, capacity, or portability which is susceptible of equal application to each of the articles taxed thereunder. In other words the scope of this section of the law is dependent upon the nature of the particular article involved, and considerations which would be determinative in the case of an electric air heater would not necessarily be appropriate in the case of other articles named in the law.

With respect to electric air heaters, the distinction between those which are portable and those which are built in or permanently installed is considered to be a significant factor in determining whether they are appliances of the household type within the contemplation of section 3406(a)(3) of the Code. It is held that electric air heaters which, because of their design and construction and the purpose to be served, are usually built in or permanently attached to a wall, fixture or similar construction element, do not come within the classification of appliances of the household type contemplated by section 3406(a)(3) of the Code. Accordingly, sales of such heaters by the manufacturer are not subject to the tax imposed by that section. On the other hand, portable electric air heaters are considered to be included in the classification of appliances of the household type and sales thereof by a manufacturer are subject to tax.

S. T. 945, *supra*, is modified to the extent that it is inconsistent with the ruling herein expressed.

REGULATIONS 46, SECTION 316.120: Scope of tax. Rev. Rul. 54–136

Lenses (except still camera lenses having a focal length of one hundred and twenty millimeters or less and motion picture camera lenses having a focal length of thirty millimeters or less), photographic apparatus and equipment, and any apparatus or equipment designed especially for use in the taking of photographs or motion pictures or in developing, printing, or enlarging photographs or motion pictures, are not included in section 3406(a)(4) of the Code, as amended, and sales thereof by the manufacturer are not subject to tax. Articles which prior to the amendment of that section were held to be taxable under these classifications are not now classifiable as parts or accessories, and sales thereof are not subject to tax on or after November 1, 1951, even though sold by the manufacturer on or in connection with a taxable camera or lens.

Advice is requested whether photographic apparatus and equipment and certain lenses, taxable under section 3406(a)(4) of the Internal Revenue Code prior to its amendment by the Revenue Act of 1951 are now taxable under that section, as amended, as parts or accessories when sold by the manufacturer on or in connection with a taxable camera or lens.

Section 3406(a)(4) of the Code, prior to the amendment thereof by section 486(a) of the Revenue Act of 1951, provided as follows:

SEC. 3406. EXCISE TAXES IMPOSED BY THE REVENUE ACT OF 1941.

(a) IMPOSITION.—There shall be imposed on the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to the rate, on the price for which sold, set forth in the following paragraphs (including in each case parts or accessories of such articles sold on or in connection therewith, or with the sale thereof):

* * * * * * *

(4) PHOTOGRAPHIC APPARATUS.—Cameras (except cameras weighing more than four pounds exclusive of lens and accessories) and lenses, photographic apparatus and equipment, and any apparatus or equipment designed especially for use in the taking of photographs or motion pictures or in developing, printing, or enlarging photographs or motion pictures, 25 per centum; unexposed photographic films (including motion picture films but not including X-ray film), photographic plates and sensitized paper, 15 per centum.

Section 316.120(a) of Regulations 46, applicable for the period October 1, 1941, to October 31, 1951, inclusive, defines the term "photographic apparatus and equipment" as including any article used on or in connection with a camera or lens in the taking of a still or motion picture. The following items are listed as descriptive but not all inclusive of such articles: range finders, view finders, lens extension tubes, filters, diffusers, tripods, focusing finders, etc. That section defines the phrase "any apparatus or equipment designed especially for use in the taking of photographs or motion pictures or in the developing, printing, or enlarging of photographs or motion picture films" as including the following articles which likewise are stated to be descriptive and not all inclusive: exposure meters, enlargers, lenses and other attachments for enlargers, tanks, or pans designed for developing films, printing frames, photoflood lamps and reflectors, flash bulbs, etc.

Section 3406(a)(4) of the Code, as amended by the Revenue Act of 1951, effective November 1, 1951, provides as follows:

SEC. 3406. EXCISE TAXES IMPOSED BY THE REVENUE ACT OF 1941.

(a) IMPOSITION.—There shall be imposed on the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to the rate, on the price for which sold, set forth in the following paragraphs (including in each case parts or accessories of such articles sold on or in connection therewith, or with the sale thereof):

* * * * * * *

(4) PHOTOGRAPHIC APPARATUS.—Cameras and camera lenses, and unexposed photographic film in rolls (including motion picture film), 20 per centum. The tax imposed under this paragraph shall not apply to X-ray cameras, to cameras weighing more than four pounds exclusive of lens and accessories, to still camera lenses having a focal length of more than one hundred and twenty millimeters, to motion picture camera lenses having a focal length of more than thirty millimeters, to X-ray film, to unperforated microfilm, to film more than one hundred and fifty feet in length, or to film more than twenty-five feet in length and more than thirty millimeters in width. Any person who acquires unexposed photographic film not subject to tax under this paragraph and sells such unexposed film in form and dimensions subject to tax hereunder (or in connection with a sale cuts such film to form and dimensions subject to tax hereunder) shall for the purposes of this subsection be considered the manufacturer of the film so sold by him.

Lenses (except still camera lenses having a focal length of one hundred and twenty millimeters or less and motion picture camera lenses having a focal length of thirty millimeters or less), photographic apparatus and equipment, and any apparatus or equipment designed especially for use in the taking of photographs or motion pictures or in developing, printing, or enlarging photographs or motion pictures are not included in section 3406(a)(4) of the Code, as amended, and sales thereof by the manufacturer are not subject to tax. Articles which prior to the amendment of that section were held to be taxable under these classifications are not now classifiable as parts or accessories and sales thereof are not subject to tax on or after November 1, 1951, even though sold by the manufacturer on or in connection with a taxable camera or lens.

The following are descriptive of articles included in such classifications and not subject to tax, provided they are not incorporated in a taxable camera or taxable lens so as to become an integral part thereof: Telephoto copying, portrait and wide angle supplementary lens attachments which have an infinite focal length and cannot be used for the taking of photographic pictures unless combined with camera lenses; range finders including those attachable to cameras but operating independently thereof but not including those which, although detachable from a camera, cannot operate independently thereof; view finders; focusing finders; lens extension tubes; lighting equipment including flashholders, flash guns and holders for flood lamps; filters in slip-on cells; diffusers; exposure meters; cable releases; self-timers; supplementary backs; and tripods.

Articles that are incorporated in a taxable camera or a taxable lens so as to become an integral part thereof, and range finders which, although detachable from a taxable camera, cannot operate independently thereof, are subject to tax as parts and accessories when sold by manufacturers on or in connection with taxable cameras or lenses.

SECTION 3407.—TAX ON FIREARMS, SHELLS, AND CARTRIDGES

Regulations 46 (1940), Section 316.80: Scope of tax. Rev. Rul. 54–98

> The tax imposed by section 3407 of the Internal Revenue Code attaches to the sale of complete firearms, or firearms in a knockdown condition but complete as to all component parts. The tax does not apply to the sale of parts or accessories for firearms when sold separately or when sold with a complete firearm for use as spare parts or accessories.

Advice is requested whether the tax on firearms imposed under section 3407 of the Internal Revenue Code is applicable to sales by a manufacturer of telescopic mounts, rubber recoil pads, rifle sights, and repair parts for rifles and shotguns.

Section 3407 of the Code imposes a tax of 11 percent on the sale by the manufacturer, producer, or importer of firearms, shells, and cartridges. The tax attaches only to sales of complete firearms, or to firearms which, although in a knockdown condition, are complete as to all component parts. (Sec. 316.4 of Regulations 46.) Parts or accessories of firearms are not taxable when sold separately, or when sold with a complete firearm for use as spare parts or accessories.

Accordingly, telescopic mounts, rubber recoil pads, rifle sights, and similar parts for rifles and shotguns are not taxable when sold separately, or when sold with complete firearms for use as spare parts or accessories. As to component parts of shells and cartridges see S. T. 561, C. B. XI-2, 483.

SECTION 3416.—FLOOR STOCKS REFUND ON REFRIGERATORS, QUICK-FREEZE UNITS, AND ELECTRIC, GAS, AND OIL HOUSEHOLD APPLIANCES

Regulations 46, Section 316.204a: Credits or refunds of tax on floor stocks of electric light bulbs, refrigerators, and appliances.

Application of statute of limitations contained in section 3313 of the Internal Revenue Code to claims for refund or credit of the manufacturers' excise taxes provided in the Excise Tax Reduction Act of 1954, with respect to floor stocks of refrigerators and appliances.

(See Rev. Rul. 54–239, p. 234.)

SUBCHAPTER C.—GENERAL ADMINISTRATIVE PROVISIONS

SECTION 3441.—SALE PRICE

REGULATIONS 46, SECTION 316.15: Fair market price in case of retail sales, consignments, etc., generally.

Computation of tax on retail sales of automobiles by importer. (See Rev. Rul. 54-25, p. 258.)

SECTION 3443.—CREDITS AND REFUNDS

REGULATIONS 46, SECTION 316.204: Credits and refunds. Rev. Rul. 54-118

In the case of (1) an overpayment of manufacturers' excise tax with respect to certain sales (or uses) of a particular class of articles, and (2) the circumstances under which the overpayment arose are such that the taxpayer could not obtain a refund thereof without first complying with the provisions of section 3443(d) of the Internal Revenue Code, the allowance of such overpayment as an offset against the tax due on other sales of the same or of a different class of articles would constitute a crediting of the overpayment within the purview of section 3443(d), whether the allowance is made as a credit on a return or as an offset in computing the net amount of an additional tax liability. Accordingly, in such case the provisions of section 3443(d) must first be complied with, before the taxpayer is entitled to any adjustment of the overpayment. Under the provisions of that section, a credit for the overpayment is not allowable unless the person who paid the tax establishes (1) that he has not included the tax in the price of the article with respect to which it was imposed, or collected the amount of tax from the vendee, or (2) that he has repaid the amount of the tax to the ultimate purchaser of the article or has secured the written consent of such ultimate purchaser to the allowance of the credit. Section 316.204 of Regulations 46 defines an "ultimate purchaser" as a person who purchases an article for consumption, or for use in the manufacture of other articles and not for resale in the form in which purchased.

CHAPTER 30.—TRANSPORTATION AND COMMUNICATION

SUBCHAPTER C.—TRANSPORTATION OF PERSONS

SECTION 3469.—TAX ON TRANSPORTATION OF PERSONS, ETC.

REGULATIONS 42, SECTION 130.52: Rate and application of tax. Rev. Rul. 54-62

The tax on the transportation of persons imposed by section 3469 of the Internal Revenue Code is to be collected by a carrier at the

prescribed rate of 15 percent with respect to each payment for transportation. In computing the amount of tax to be collected a fractional part of a cent must be disregarded unless it amounts to one-half cent or more, in which case it must be increased to one cent. The Internal Revenue Service cannot authorize the collection of tax in an amount greater than that legally due.

Advice is requested whether a carrier in collecting the tax on the transportation of persons imposed by section 3469 of the Internal Revenue Code may collect an amount in excess of 15 percent of its established passenger fare.

In the instant case the carrier's established passenger fare is 43 cents with respect to which a tax of 6.45 cents is applicable computed at the prescribed rate of 15 percent. The carrier in order to avoid the use of pennies desires to collect 7 cents as tax with respect to each fare or a total of 50 cents.

Sections 3469(a) and 1650 of the Internal Revenue Code impose a tax of 15 percent upon the amount paid for the transportation of persons by rail, motor vehicle, water, or air. Section 3469(d) of the Code provides that the tax shall be paid by the person making the payment subject to the tax.

Section 3658 of the Code provides that in the payment of any tax not payable by stamp a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it must be increased to one cent.

It is held that a carrier must collect the tax at the prescribed rate of 15 percent of each payment made to it for the transportation of persons and that in computing the tax on each such payment a fractional part of a cent must be disregarded unless it amounts to one-half cent or more, in which case it must be increased to one cent. Accordingly, the tax required to be collected on an established passenger fare of 43 cents is 6 cents and the Internal Revenue Service cannot authorize the collection of tax in an amount greater than that legally due.

REGULATIONS 42, SECTION 130.52: Rate and application of tax. Rev. Rul. 54–182

Separate amounts paid, in connection with a one-way trip, for local transportation in one city and for transfer and through transportation to a neighboring city, constitute amounts paid for continuous transportation, and where the total of the separate amounts paid for such transportation, including the cost of the transfer, exceeds 35 cents, such total amount is subject to the tax on transportation of persons imposed by section 3469 of the Internal Revenue Code.

Advice is requested whether the tax on transportation of persons imposed by section 3469 of the Internal Revenue Code attaches to charges for a one-way trip under the following circumstances.

A carrier operates buses on local lines within city M and on an interurban line between a terminal in city M and a terminal in neighboring city N. A charge of 16 cents is made for any local fare on lines within city M. A fare of 35 cents is charged for transportation from any point on the interurban line in city M to city N. A passenger who uses a local line in city M may, upon purchase of a 1-cent transfer, which constitutes a receipt for the payment of the local fare of 16 cents, and an additional payment of 20 cents, or a total of 37 cents, obtain transportation from any point on a local line in city M to the established terminal or a discharge point on the interurban line in city N.

Section 3469(a) of the Code imposes upon the amounts paid for the transportation of persons by rail, motor vehicle, water or air, with certain exceptions not here applicable, a tax equivalent to 10 percent of the amount so paid. Under the provisions of section 3469(b) of the Code the tax does not apply to amounts paid for transportation which do not exceed 35 cents.

In accordance with the provisions of section 130.52 of Regulations 42, the tax on the transportation of persons is to be measured by the total amount paid, whether paid at one time or collected at intervals during the course of a continuous transportation, as in the case of a carrier operating under the zone system.

It is held that the separate amounts paid under the circumstances described constitute payments for continuous transportation as contemplated by the regulations. Accordingly, where the total of the separate amounts paid, including the charge for the transfer, exceeds 35 cents, such total amount is subject to the tax on transportation of persons.

REGULATIONS 42, SECTION 130.54: Payments not subject to tax. — Rev. Rul. 54-39

Section 130.54(b) of Regulations 42 sets forth the requirements for establishing the nonapplication of the tax on transportation of persons imposed by section 3469 of the Internal Revenue Code, to a payment made outside the United States for transportation between two or more points within the United States, which is part of transportation from or to a point outside the United States. The Internal Revenue Service has not approved the use of any form or exemption certificate to establish the nontaxable character of such a payment.

REGULATIONS 42, SECTION 130.54: Payments outside the United States. — Rev. Rul. 54-141

The tax on the transportation of persons imposed by section 3469 (a) and (c) of the Internal Revenue Code applies to an amount paid in Canada or Mexico by a resident of the United States who intends to travel between two points in the United States and who would normally make payment for such transportation in the United States but instead goes to Canada or Mexico to purchase his transportation for the ostensible purpose of having an "outside leg" as evidence of a journey from or to a point outside the United States.

Advice is requested concerning the application of the tax on the transportation of persons imposed by section 3469 (a) and (c) of the Internal Revenue Code in a situation where a resident of the United States intends to travel between two points in the United States and would normally make payment for such transportation in the United States but instead goes to Canada or Mexico to purchase this transportation and at the same time to purchase a separate ticket for transportation between a point in Canada or Mexico and a point in the United States for the ostensible purpose of having such "outside leg" as evidence of a journey from or to a point outside the United States. Advice is also requested as to the tax consequences where such resident purchases a through ticket instead of separate tickets.

In accordance with the provisions of section 3469 (a) and (c) of the Internal Revenue Code the tax is imposed upon amounts paid without the United States on or after November 1, 1950, for the transportation of persons on or after such date, by rail, motor vehicle, water, or air which begins and ends in the United States and for seating or sleeping accommodations furnished in connection therewith.

Section 130.54(b) of Regulations 42 provides, in part, that the tax does not apply to a payment made outside the United States for transportation which begins or ends outside the United States. For purposes of the preceding sentence, a payment made outside the United States for transportation between two or more points within the United States (such transportation being referred to in such section as "the United States portion"), which is part of transportation from or to a point outside the United States is a payment for transportation which begins or ends outside the United States, where it is definitely established at the time of making payment for the United States portion that such portion is purchased for use in making the journey from or to a point outside the United States. The nontaxable character of the payment made outside the United States for the United States portion is to be established under the rules set forth in subparagraphs (2) through (5) of section 130.54(b), *supra*. In these rules the transportation to or from a point outside the United States is referred as "connecting transportation."

It is held that a resident of the United States purchasing transportation under the circumstances described in the first paragraph has not, within the purview of section 130.54 of Regulations 42, purchased transportation which constitutes "connecting transportation" from or to a point outside the United States regardless of whether the separate ticket or the portion of the through ticket which represents the "outside leg" is used. Accordingly, the alleged connecting transportation between the point in Canada or Mexico and the point in the United States shall be disregarded in determining liability for the tax, and the payment made in Canada or Mexico for the transportation which begins and ends in the United States is subject to the tax on the transportation of persons.

The following examples will serve to illustrate the application of the foregoing:

1. A resident of Buffalo intends to travel by rail from Buffalo to New Orleans. He goes to Fort Erie, Ontario, Canada, and purchases his ticket for the trip from Buffalo to New Orleans. He also purchases in Fort Erie a bus ticket for transportation from Fort Erie to Buffalo in order to have an "outside leg" as evidence that his journey began at a point outside the United States. He uses the bus ticket for his return to Buffalo. The transportation by bus from Fort Erie to Buffalo does not constitute "connecting transportation." Therefore, the amount paid in Fort Erie for the rail transportation from Buffalo to New Orleans is a payment for transportation which begins and ends in the United States and is subject to the tax.

2. A resident of Detroit intends to travel to Miami. He goes to Windsor, Ontario, Canada, by private automobile and purchases his ticket for transportation by air from Detroit to Miami. As evidence of an "outside leg" he also purchases in Windsor a rail ticket for transportation for Windsor to Detroit, but this ticket is not used since he returns to Detroit by private automobile. The ticket for the rail

transportation from Windsor to Detroit does not constitute a ticket for "connecting transportation." Therefore, the amount paid in Windsor for the air transportation from Detroit to Miami is a payment for transportation which begins and ends in the United States and is subject to the tax.

3. A resident of Detroit intends to travel to Dallas. For the purpose of having evidence of an "outside leg" for his trip he goes to Windsor, Ontario, Canada, and purchases a through ticket for transportation from Windsor to Dallas. He actually begins his trip in Windsor. The transportation between Windsor and Detroit is not "connecting transportation" and in determining liability for the tax is disregarded. Therefore, the tax applies to the payment made in Windsor for the transportation from Detroit to Dallas.

4. A resident of Los Angeles who intends to travel to New York goes by private automobile to Tijuana, Mexico, and there purchases a through ticket for transportation from Tijuana to New York. He returns to Los Angeles by private automobile and does not use the portion of the through ticket covering the transportation from Tijuana to Los Angeles which he had purchased as evidence of an "outside leg." The amount paid in Tijuana for the portion of the through ticket representing transportation from Los Angeles to New York is a payment for transportation which begins and ends in the United States, and is, therefore, subject to the tax.

Under the authority of section 3791(b) of the Internal Revenue Code, the conclusions stated in this Revenue Ruling will be applied without retroactive effect as to payments made prior to May 1, 1954, for the type of transportation herein discussed, except that any tax which has been paid on such payments will not be refunded.

Regulations 42, Section 130.58: Motor vehicles with seating capacity of less than ten. Rev. Rul. 54-47

Where limousines are operated to and from an airport and surrounding areas and passengers are picked up or delivered at any place or places designated by them, as distinguished from fixed pickup and discharge points established by the limousine company, such vehicles are not considered operated on an established line within the meaning of section 3469 of the Internal Revenue Code. If such vehicles have a seating capacity of less than 10 adult passengers, including the driver, the tax on the transportation of persons is not applicable to amounts paid for such transportation.

Regulations 42, Section 130.58: Motor vehicles with seating capacity of less than ten. Rev. Rul. 54-108

Limousine-automobiles having a seating capacity of less than ten adult passengers, including the driver, operated for the purpose of conducting sightseeing and pleasure tours where the passengers are picked up or delivered at any place or places designated by them, and where the tours may be varied according to the wishes of the passengers, are not considered to be vehicles operated on an established line within the meaning of section 3469 of the Internal Revenue Code.

Advice is requested whether limousine-automobiles operated for the purpose of conducting sightseeing and pleasure tours, under the following circumstances, constitute vehicles operated on an established line within the meaning of section 3469 of the Internal Revenue Code.

A corporation operates a fleet of limousine-automobiles for the purpose of conducting sightseeing and pleasure tours. The limousines accommodate seven passengers. The company maintains an office where telephone calls for service are received from customers, brokers, and driver-lecturers. It does not, however, maintain an established place or terminal where service begins or ends. Calls for service originate at tourist homes, courts, motels, hotels, inns, cabins, and practically any place tourists stay. Limousines are kept overnight at the homes of the driver-lecturers and they are dispatched in the morning by phone order to the point of origin of the calls to pick up the passengers. The tours are usually for a party of two and seldom exceed four in number, and may be varied according to the wishes of the passengers. While advertised tours mention points of interest to be visited, they are primarily suggestions and general outlines.

In a representative month of operations, over 60 percent of the carrier's tours began at 40 suburban points, while 38 percent of the local tours began at 25 different points. Of the total number of passengers served, less than 2 percent presented themselves for service at the company's office. While the company operated only eight limousines during the month, it conducted 345 tours.

Section 3469(a) of the Code imposes upon the amount paid for the transportation of persons by rail, motor vehicle, water, or air a tax equal to 15 percent of the amount so paid. The tax does not apply to transportation by motor vehicles having a seating capacity of less than 10 adult passengers, including the driver, unless such vehicle is operated on an established line.

Section 130.58 of Regulations 42 provides that the term "operated on an established line" means operated with some degree of regularity between definite points. It does not necessarily mean that strict regularity of schedule is maintained; that the full run is always made; that a particular route is followed; or that intermediate stops are restricted. The term implies that the person rendering the service maintains and exercises control over the direction, route, time, number of passengers carried, etc. It implies also that the primary contract between the operator and the person served is for the transportation of the person and not for the hire or use of the vehicle.

Where limousines are operated for the purpose of conducting sightseeing and pleasure tours and passengers are picked up or delivered at any place or places designated by them, as distinguished from fixed pickup and discharge points established by the limousine company, and where the tours may be varied according to the wishes of the passengers, such vehicles are not considered operated on an established line within the meaning of section 3469 of the Internal Revenue Code. (See Rev. Rul. 54–47, p. 269, this Bulletin.)

It is held that since, in the instant case, the limousines pick up or deliver passengers at any place or places designated by them, and the tours are primarily arranged according to the passengers' wishes, the limousines are not considered to be operated on an established line and the tax on the transportation of persons is not applicable to amounts paid for such transportation.

However, if any particular limousine operation has established a particular tour with definite points regularly visited in a regulated order which will not be disrupted according to the wishes of the passengers and over which a definite periodic service is attempted to be maintained, although strict regularity is not essential, it would be considered a vehicle operated on an established line within the meaning of section 3469 of the Code and the amounts paid for tours would be subject to tax.

REGULATIONS 42, SECTION 130.60: Commutation tickets. Rev. Rul. 54–123

The tax on the transportation of persons imposed by section 3469 of the Internal Revenue Code does not apply to amounts paid by commuters on a weekly basis for daily transportation service between their abodes and their place of employment, where the commuters are not furnished commutation tickets but are given receipts as evidence of payment for the service and are assigned specific seats on the vehicle employed in the transportation service.

Advice is requested whether the tax on the transportation of persons imposed by section 3469 of the Internal Revenue Code applies to amounts paid by commuters for transportation service under the following circumstances.

An operator of buses furnishes transportation exclusively for the accommodation of persons who commute daily to and from their places of employment. Under the franchise issued by the State, the operator is not permitted to transport any passengers other than contract commuters. The commuter makes payment for the transportation on a weekly basis and is entitled to 10 one-way trips a week in accordance with a transportation and rate contract. Tickets are not issued but each commuter is furnished a receipt as evidence of payment and is assigned a specific seat on a bus.

Section 3469(a) of the Code imposes a tax upon amounts paid for the transportation of persons by rail, motor vehicle, water, or air. Amounts paid for certain trips are exempt from such tax under section 3469(b) of the Code, which provides as follows:

(b) EXEMPTION OF CERTAIN TRIPS.—The tax imposed by subsection (a) shall not apply * * * to amounts paid for commutation tickets for one month or less * * *.

In the instant case, the transportation service is furnished to commuters traveling daily from their abodes to their place of employment, the service is contracted for on a weekly basis, the service is used with regularity on each working day of the week, the commuters are assigned specific seats on the vehicles employed in the transportation service, and the commuters are given receipts which identify them as the ones entitled to the service. Thus, there are present in the case substantially all the factors commonly associated with a commutation service for which carriers normally issue commutation tickets for 1 month or less within the contemplation of the exemption provided for by the law. The fact that the service is rendered under such conditions as not to warrant the issuance of regular commutation tickets is not considered material, particularly since the receipt given each person paying for the service serves in practical effect as a commutation ticket.

Based on the facts in the instant case, it is held that the payments which the commuters make to the bus operator are considered payments for commutation tickets within the meaning of section 3469 of the Code and, therefore, are not subject to the tax imposed thereunder.

SUBCHAPTER D.—ADMINISTRATIVE PROVISIONS

SECTION 3470.—PAYMENT OF TAXES

REGULATIONS 42, SECTION 130.75: Refusal to pay taxes.
(Also Section 1715, Section 101.37, Regulations 43; Section 3475, Section 143.55, Regulations 113.)

T. D. 6057

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PARTS 130, 101, AND 143

Regulations 42 (1942 edition), Regulations 43 (1941 edition), and Regulations 113 (1943 edition) amended.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

Regulations 42 (1942 edition) [26 CFR, pt. 130], Regulations 43 (1941 editicn) [26 CFR, pt. 101], and Regulations 113 (1943 edition) [26 CFR, pt. 143] are amended as follows:

PARAGRAPH 1. Section 130.75 of Regulations 42 is amended by striking out the second sentence thereof.

PAR. 2. Section 101.37 of Regulations 43, as amended by Treasury Decision 5349 [C. B. 1944, 639], approved March 17, 1944, is further amended by striking out the last sentence of the fourth undesignated paragraph.

PAR. 3. Section 143.55 of Regulations 113 is amended by striking out the second sentence thereof.

Because this Treasury Decision merely removes from Regulations 42, Regulations 43, and Regulations 113 an instruction with respect to the submission of information by District Directors of Internal Revenue to the Commissioner, it is hereby found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said act.

This Treasury Decision shall be effective upon its filing for publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in secs. 1855, 3472, and 3791 of the Internal Revenue Code (53 Stat. 206, 423, and 467; 26 U. S. C. 1855, 3472, and 3791).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved December 4, 1953.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 9, 1953, 8:50 a. m.)

SUBCHAPTER E.—TRANSPORTATION OF PROPERTY

SECTION 3475.—TRANSPORTATION OF PROPERTY

REGULATIONS 113, SECTION 143.1(f): Meaning of terms. Rev. Rul. 54-102

Foundry facing even though consisting of pulverized coke is not considered "coal" within the meaning of section 3475 of the Internal Revenue Code. An amount paid for the transportation of such material is subject to the tax on transportation of property at the rate of 3 percent of the amount so paid.

REGULATIONS 113, SECTION 143.13: Application of tax. Rev. Rul. 54-54

A person who holds himself out to the public as one who for compensation sells, provides, procures, furnishes, or arranges for the transportation of property is considered to be a person engaged in the business of transporting property for hire within the meaning of section 3475 of the Internal Revenue Code.

Advice is requested concerning the application of the tax on the transportation of property imposed by section 3475 of the Internal Revenue Code under the following circumstances.

M Company receives inquiries from shippers as to the cost and availability of equipment to transport their produce. It also receives inquiries from haulers as to the availability of loads. Shippers contract with the company for the transportation of their produce and the company then assigns the loads to haulers for delivery at an agreed price. After delivery of the loads the haulers return signed papers to the company indicating acceptance of delivery and are paid the agreed price. The company then bills the shippers for the contract price. The gross earnings of M Company are represented by the difference between the charges collected from the shippers and the amounts paid to the haulers.

Under the provisions of section 3475(a) of the Code the tax applies to amounts paid to a person engaged in the business of transporting property for hire, including amounts paid to a freight forwarder, express company, or similar person, but not including amounts paid by a freight forwarder, express company, or similar person for transportation with respect to which a tax has previously been paid under that section.

The term "person engaged in the business of transporting property for hire" for the purpose of the tax imposed by section 3475(a) of the Code, includes not only a carrier who actually transports the property but also a person who holds himself out to the public as one who for compensation sells, provides, procures, furnishes, or arranges for the transportation of property.

Under the circumstances stated above it is held that M Company is engaged in the business of transporting property for hire within the meaning of section 3475(a) of the Code. Accordingly, the tax applies to amounts paid to M Company by the shippers for the transportation of their produce and such company should collect the tax and make return thereof to the Government. However, the tax does not apply to amounts paid by M Company to haulers for transportation with respect to which the tax is payable to such company.

REGULATIONS 113, SECTION 143.13: Application of tax. Rev. Rul. 54–124

Charges made by a carrier to a shipper for shifting empty barges before loading and after unloading in connection with transportation of property by the carrier represent expenses of the nature generally incurred by such carriers and ordinarily reflected in their established tariffs. *Held*, where for any reason such expense items are not included in a single transportation charge but are stated separately, the amounts so stated separately must be included in (or added to) the transportation charge for the purpose of the tax imposed by section 3475 of the Internal Revenue Code.

REGULATIONS 113, SECTION 143.13: Application of tax. Rev. Rul. 54–183

Amounts paid by an agency or instrumentality of the United States to carriers for hauling pursuant to contracts on Standard Form 32 (November 1949 edition) include both the transportation charges and any transportation tax imposed by section 3475 of the Internal Revenue Code for which the agency or instrumentality may be liable.

Advice is requested whether the tax imposed by section 3475 of the Internal Revenue Code on the transportation of property is included in amounts paid by agencies or instrumentalities of the United States to carriers for hauling performed pursuant to contracts on Standard Form 32 (November 1949 edition) entered into with the carriers.

Section 3475 of the Code provides that a tax shall be imposed upon the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. The tax is payable by the person making the taxable transportation payment and is collectible by the person receiving such payment.

Section 307 of the Revenue Act of 1943, effective June 1, 1944, terminated the general exemption from tax on the transportation of property to or from the Government of the United States. See Mim. 6194, C. B. 1947-2, 210. However, pursuant to the provisions of section 307(c) of the Revenue Act of 1943, as amended, the Secretary of the Treasury has continued the exemption with respect to the transportation of property to or from the Government of the United States on United States Government bills of lading. See authorization of the Secretary of the Treasury, dated June 20, 1947, C. B. 1947-2, 211.

In M. T. 21, C. B. 1944, 594, it is held that the specific exemption from Federal taxes provided by statutes creating certain agencies or instrumentalities of the United States listed therein, was not terminated or otherwise affected by section 307 of the Revenue Act of 1943. With respect to the tax on the transportation of property such specific exemption is limited to transportation charges paid directly by such agencies or instrumentalities.

Accordingly, amounts paid to a carrier for the transportation of property to or from agencies or instrumentalities of the United States Government are subject to tax unless (1) the shipments are made on United States Government bills of lading, Standard Form 1103, or (2) the transportation charges are paid directly to the carrier by one of the Government agencies listed in M. T. 21, *supra*.

Where an agency or instrumentality of the United States is not exempt, as stated above, from tax on the transportation of property, the determination of whether the total amount paid under a contract between the agency and a carrier includes the amount of tax for which the agency is liable, depends upon the terms of the contract.

Paragraph 10(b) of Standard Form 32 provides as follows:

> FEDERAL TAXES.—Except as may be otherwise provided in this contract, the contract price includes all applicable Federal taxes in effect on the contract date.

The rule applicable in construing contract provisions with respect to Federal transportation taxes is that in the absence of terms indicating an express agreement between the parties to the effect that the amounts paid to the carrier include both the transportation charges and the transportation tax, the tax will not be considered as so included.

In view of the provisions of paragraph 10(b) of the contract to the effect that "the contract price includes all applicable Federal taxes" it is held that the amount paid to a carrier by an agency of the United States under the provisions of such a contract includes both the transportation charges and any transportation tax for which the agency may be liable.

REGULATIONS 113, SECTION 143.30: Transportation of property beyond the boundaries of the United States. Rev. Rul. 54-8

> The tax on the transportation of property imposed by section 3475 of the Internal Revenue Code does not apply to shipments of automobile chassis in the course of exportation to a foreign country even though the chassis are further manufactured in the foreign country and returned to the United States.

Advice is requested whether property shipped under the circumstances herein described constitutes property in the course of exportation to a foreign destination and exempt from tax on the transportation of property imposed by section 3475 of the Internal Revenue Code.

In the instant case, shipments of automobile chassis are made by the manufacturer from an inland point in the United States to a port of exportation from which port the chassis are shipped to a foreign country where bodies are built thereon and the completed vehicles returned to the manufacturer in the United States.

Section 143.30 of Regulations 113 provides that the tax imposed by section 3475 of the Code will not apply to an amount paid for transportation of property in the course of exportation to a foreign destination or shipment to a possession of the United States.

It is held that shipments of automobile chassis under the circumstances described are considered, for purposes of the tax imposed by section 3475 of the Code, to be in the course of exportation to a foreign country even though the chassis are further manufactured in the foreign country and returned to the United States. Accordingly, the tax on the transportation of property imposed by section 3475 of the Code will not apply to amounts paid for the transportation of the chassis from the point of shipment in the United States to the port of exportation, provided the person paying the transportation charges obtains proof of exportation in accordance with the provisions of Regulations 113.

REGULATIONS 113, SECTION 143.55: Refusal to pay taxes.

Regulations 113 amended. (See T. D. 6057, p. 272.)

CHAPTER 31.—DOCUMENTS AND OTHER INSTRUMENTS

SECTION 3482.—CONVEYANCES

REGULATIONS 71, SECTION 113.82: Rate and computation of tax. Rev. Rul. 54–197

Where realty is purchased subject to an existing mortgage, the mortgage is not removed by the sale of the realty even though the purchaser agrees with the mortgagee to pay the mortgage at the same time that he takes title to the realty and the amount of such mortgage may be excluded from the sale price of the realty in computing the tax on conveyances imposed by section 3482 of the Internal Revenue Code.

Advice is requested concerning the application of the stamp tax on conveyances imposed by section 3482 of the Internal Revenue Code in a transaction where, pursuant to a contract of sale, realty is conveyed by deed to a purchaser, subject to an existing mortgage which the purchaser, by direct negotiation and agreement with the mortgagee, pays off at the time title to the property is conveyed to the purchaser.

Section 3482 of the Code imposes a stamp tax on any deed, instrument, or writing whereby any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers, when the consideration or value of the interest or property conveyed, exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, exceeds $100. Where the net consideration is in excess of $100, the rate of tax is 55 cents on each $500 or fractional part thereof.

It is held that where realty is purchased subject to an existing mortgage, the mortgage is not removed by the sale of the realty even though the purchaser agrees with the mortgagee to pay the mortgage at the same time that he takes title to the realty. The election by the purchaser to pay the mortgage was not a part of the contract of sale but was negotiated independently and collaterally by the purchaser with the mortgagee. Accordingly, since the mortgage was not removed by the sale, the amount of such mortgage may be excluded from the sale price of the realty in computing the tax applicable to the conveyance of the realty.

CHAPTER 36.—COLLECTION

SUBCHAPTER B.—LIEN FOR TAXES

SECTION 3670.—PROPERTY SUBJECT TO LIEN

Rev. Rul. 54–154

Federal tax liens attach to property only to the extent of the delinquent taxpayer's interest therein. Where a taxpayer has only an option to purchase real property at the time the Federal tax lien arises, the lien attaches to the option and not to the real estate. Where his rights under the option are terminable, the Government's rights, by virtue of its lien upon the taxpayer's interest, are likewise terminable, being no greater than those of the taxpayer. Accordingly, when the taxpayer's rights under an option terminate after the Federal tax lien has arisen, the rights of the United States in the option also terminate, since there is no longer any property in the option to which a lien can attach.

SECTION 3672.—VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS

Ct. D. 1764

ADMINISTRATIVE—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. WITHHOLDING AND SOCIAL SECURITY TAXES—LIENS—PRIORITY—FEDERAL AND MUNICIPAL LIENS.

"The first in time is the first in "right" rule applies in determining the relative priority of statutory Federal and municipal liens which attach to the same real estate, where no question of insolvency is involved. The priority of each lien depends on the time it attached to the property and became choate not on the fact that one lien was specific and the other general. The fact that under Federal law the Federal liens were subordinate to a recorded mortgage and that under State law the municipal liens were entitled to priority over the mortgage did not give the municipal liens priority over the Federal liens.

2. JUDGMENT VACATED.

Judgment of the Supreme Court of Errors of the State of Connecticut (94A. (2d) 10 (1952)) vacated and case remanded.

SUPREME COURT OF THE UNITED STATES

The United States of America, petitioner, v. *City of New Britain, Connecticut, et al.*

On writ of certiorari to the Supreme Court of Errors of the State of Connecticut

[February 1, 1954]

OPINION

Mr. Justice MINTON delivered the opinion of the Court.

The question presented by this writ involves the relative priority of statutory Federal and municipal liens to the proceeds of a mortgage foreclosure sale of the property to which the liens attached.

Two mortgages on the real property of a corporation located in the city of New Britain, Connecticut, were foreclosed by judgment sale in the Superior Court of Hartford County, and a gross sum of $28,071.24 was realized. Against this fund, there were claims of some $31,000, including expenses of the sale, the two mortgages, a judgment of record, and various statutory liens asserted by the city and by the United States. The Federal liens, securing unpaid withholding and unemployment taxes and insurance contributions totaling $8,475.13, were created by section 3670 of the Internal Revenue Code.[1] They arose at the times the assessment lists were received in the office of the Collector of Internal Revenue for Connecticut[2] on various dates between April 26, 1948, and September 21, 1950. The city's liens, which attached to the specific real estate sold in the total sum of $3,587.71, are for delinquent real estate taxes and water rent. The real estate taxes became due on various dates in 1947 through 1951, the liens attaching in each case as of October 1 or other assessment date of the prior year;[3] the water rent liens arose upon failure to pay[4] and date from December 1, 1947, to June 1, 1951.

A Connecticut statute provides that real estate tax liens "shall take precedence of all transfers and incumbrances" in any manner affecting the property subject to the lien.[5] Another State law gives the water rent liens "precedence over all other liens or incumbrances except taxes" on the property subject to the liens.[6] The funds available for distribution being insufficient to pay all claimants in full, the superior court directed that the expenses, the city's liens, the mortgages, the judgment lien, and the United States' liens be paid in that order. The United States appealed from the judgment insofar as the statutory liens of the city were given priority over those of the United States. The Supreme Court of Errors of Connecticut affirmed, 139 Conn. 363, 94 A. 2d 10, and we granted certiorari, 346 U. S. 809.

We are here dealing with several statutory liens, some owned by the city and some by the Federal Government, on real estate. The Supreme Court of Errors stated that the city's liens were specific and perfected. Such characterization of a lien by the State is not, of course, conclusive against the Federal Government. *United States* v. *Security Trust & Savings Bank*, 340 U. S. 47, 49 [Ct. D. 1736,

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[1] "SEC. 3670. PROPERTY SUBJECT TO LIEN.

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." I. R. C., sec. 3670, 26 U. S. C. (1946 ed.) sec. 3670.

[2] I. R. C., sec. 3671, 26 U. S. C. (1946 ed.) sec. 3671.

[3] Conn. Gen. Stat., 1949, c. 88, sec. 1853.

[4] Conn. Gen. Stat., 1949, c. 34, sec. 758.

[5] Conn. Gen. Stat., 1949, c. 88, sec. 1853.

[6] Conn. Gen. Stat., 1949, c. 34, sec. 758. As construed by the Supreme Court of Errors of Connecticut in this case, the term "taxes" in sec. 758 includes "only those taxes which may be assessed in favor of the State or some subdivision thereof and which, under the law, are secured by specific liens upon real property." 139 Conn. 363, 367, 94 A. 2d 10, 12.

C. B. 1950–2, 151]; *Illinois* v. *Campbell*, 329 U. S. 362, 371. However, we accept the holding as to the specificity of the city's liens since they attached to specific pieces of real property for the taxes assessed and water rent due. The liens may also be perfected in the sense that there is nothing more to be done to have a choate lien—when the identity of the lienor, the property subject to the lien, and the amount of the lien are established. The Federal tax liens are general and, in the sense above indicated, perfected. But the fact that one group of liens is specific and the other general in and of itself is of no significance in these cases involving statutory liens on real estate only. *United States* v. *City of Greenville*, 118 F. 2d 963, 964 [Ct. D. 1524, C. B. 1941–2, 173]. A mortgage is a specific lien, yet "[a] statutory lien is as binding as a mortgage, and has the same capacity to hold the land so long as the statute preserves it in force." *Rankin* v. *Scott*, 12 Wheat. 177, 179.

Thus, the general statutory liens of the United States are as binding as the specific statutory liens of the city. The city gains no priority by the fact that its liens are specific while the United States' liens are general. Obviously, the State cannot on behalf of the city impair the standing of the Federal liens, without the consent of Congress. *Michigan* v. *United States*, 317 U. S. 338, 340 [Ct. D. 1568, C. B. 1943, 1130]; *United States* v. *Oklahoma*, 261 U. S. 253, 260; *United States* v. *Snyder*, 149 U. S. 210, 214. On the other hand, the Federal statutes do not attempt to give priority in all cases to liens created under the paramount authority of the United States. The statute creating the Federal liens here involved, I. R. C., section 3670, does not in terms confer priority upon them.

When the debtor is insolvent, Congress has expressly given priority to the payment of indebtedness owing the United States, whether secured by liens or otherwise, by section 3466 of the Revised Statutes, 31 U. S. C. (1946 ed.) section 191. In that circumstance, where all the property of the debtor is involved, Congress has protected the Federal revenues by imposing an absolute priority.[7] Where the debtor is not insolvent, Congress has failed to expressly provide for Federal priority, with certain exceptions not relevant here,[8] although the United States is free to pursue the whole of the debtor's property wherever situated. The State, having a lien only upon property within its boundaries, may not reach beyond the State line to fasten its lien upon other property. The record does not establish that the taxpayer in this case was insolvent.

It does not follow, however, that the city's liens must receive priority as a whole. We believe that priority of these statutory liens is determined by another principle of law, namely, "the first in time is the first in right." As stated by Chief Justice Marshall in *Rankin* v. *Scott*, *supra:*

> "The principle is believed to be universal, that a prior lien gives a prior claim, which is entitled to prior satisfaction, out of the subject it binds, unless the lien be intrinsically defective, or be displaced by some act of the party holding it, which shall postpone him in a Court of law or equity to a subsequent claimant." 12 Wheat., at 179.

This principle is widely accepted and applied, in the absence of legislation to the contrary. 33 Am. Jur., Liens, section 33; 53 C. J. S., Liens, section 10b. We think that Congress had this cardinal rule in mind when it enacted section 3670, a schedule of priority not being set forth therein. Thus, the priority of each statutory lien contested here must depend on the time it attached to the property in question and became choate.

The United States in claiming priority for all its liens relies heavily on two recent cases from this court, *United States* v. *Security Trust & Savings Bank*, *supra*, and *United States* v. *Gilbert Associates*, 345 U. S. 361. We do not think they are inconsistent with our decision in this case.

The *Security Trust* case involved an *inchoate* attachment lien that had not ripened into a judgment at the time the Federal tax liens attached. We noted that "[n]umerous contingencies might arise that would prevent the attachment lien from ever becoming perfected by a judgment awarded and recorded." 340 U. S., at 50. Thus, the attachment lien was "merely a *lis pendens* notice that a right to perfect a lien exists." *Ibid.* Such inchoate liens may become certain as to amount, identity of the lienor, or the property subject thereto only

[7] *United States* v. *Gilbert Associates*, 345 U. S. 361 [Ct. D. 1757, C. B. 1953–1, 474]; *United States* v. *Waddill, Holland & Flinn*, 323 U. S. 353 [Ct. D. 1624, C. B. 1945, 459].

[8] *E. g.*, I. R. C., sec. 2800(e), 26 U. S. C. (1946 ed.) sec. 2800(e) (distilled spirits tax lien).

at some time subsequent to the date the Federal liens attach and cannot then be permitted to displace such Federal liens. Otherwise, a State could affect the standing of Federal liens, contrary to the established doctrine, simply by causing an inchoate lien to attach at some arbitrary time even before the amount of the tax, assessment, etc., is determined.[9] Accordingly, we concluded in *Security Trust* "that the tax liens of the United States are superior to the inchoate attachment lien * * *." *Id.*, at 51. In the instant case, certain of the city's tax and water rent liens apparently attached to the specific property and became choate prior to the attachment of the Federal tax liens.

The State and the United States were both holders of general statutory liens in the *Gilbert Associates* case. But the question we have here did not arise there because that was a case involving personal property and insolvency of the taxpayer. We said in that case:

> "Where the lien of the town and that of the Federal Government are both general, and the taxpayer is insolvent, section 3466 [Revised Statutes] clearly awards priority to the United States." 345 U. S., at 366.

Here the contest is between two groups of statutory liens, one specific and one general, attached to the same real estate, with no question of insolvency involved; therefore, "the first in time is the first in right."

The State finds the rule of "first in time, first in right" not applicable because of section 3672 of the Internal Revenue Code,[10] which makes the lien of the United States invalid as to the prior recorded mortgages and the judgment in this case. It points out that the mortgagee could have paid the delinquent real estate taxes and water rent, with the amount so paid becoming part of the mortgage debt covered by the mortgage lien,[11] and suggests that the Federal tax lien would therefore be invalid as to such amount by virtue of section 3672.[12] From this and a belief that Congress did not intend, by giving mortgages and judgments priority over Federal tax liens, to supersede State laws making certain interests superior to mortgages and judgments, the Supreme Court of Errors concluded that by enacting section 3672 Congress "expressed the intention that Federal liens should be subordinated to such mortgages and judgment liens as are described therein and, consequently, subordinated to such other incumbrances as have priority over those mortgages and judgment liens." [13]

We do not agree. The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors. That is a matter of State law. But as to any funds in excess of the amount necessary to pay the mortgage and judgment creditors, Congress intended to assert the Federal lien. There is nothing in the language of section 3672 to show that Congress intended antecedent Federal tax liens to rank behind any but the specific categories of interests set out therein, and the legislative history lends support to this impression.[14]

Under the circumstances, we vacate the judgment of the Supreme Court of Errors of Connecticut and remand the case to that court to have determined the order of priority of the various liens asserted, in accordance with this opinion.

Judgment vacated.

Rev. Rul. 54-93

Procedure with respect to filing of notices of Federal tax liens in the State of New York.

Chapter 536 of the Laws of New York, 1944, "an Act to amend the lien law, in relation to liens for taxes payable to the United States

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[9] See Sarner, Correlation of Priority and Lien Rights in the Collection of Federal Taxes, 95 U. of Pa. L. Rev 739, 755–761.

[10] "SEC. 3672. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

"(a) INVALIDITY OF LIEN WITHOUT NOTICE.—Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector * * *." I. R. C., sec. 3672, as amended, 53 Stat. 882, 26 U. S. C. (1946 ed.) sec. 3672.

[11] Conn. Gen. Stat., 1949, c. 361, sec. 7192.

[12] We need not now pass upon the merits of this suggestion since the situation is not presented by the record in this case.

[13] 139 Conn. 363, 373, 94 A. 2d 10, 15.

[14] See *United States* v. *Gilbert Associates*, 345 U. S. 361, 364; *United States* v. *Security Trust & Savings Bank*, 340 U. S. 47, 51 (concurring opinion).

of America," which authorizes the filing with designated county or other local officials in that State, of notices of Federal tax liens against real or personal property (and of certificates of release or discharge of such liens), is accepted by the Internal Revenue Service as legislation referred to in section 3672 of the Internal Revenue Code, authorizing the filing of notices of Federal tax liens in designated county or other local offices.

The above provisions, as set out in article 10–A of book 32 of McKinney's Consolidated Laws of New York, Annotated, as amended, are as follows:

SECTION 240. NOTICES OF FILING LIENS AND CERTIFICATES OF RELEASE OR DISCHARGE.

1. Notices of liens upon real property for taxes payable to the United States of America and certificates releasing or discharging such liens shall be filed in the office of the clerk of the county in which real property subject to any such lien is situated, except that if real property subject to any such lien is situated in the county of Kings, the county of Queens, the county of New York or the county of Bronx they shall be filed in the office of the city register of the city of New York in such county. If such property be situated in two or more counties, such notice or certificate shall be filed in the office of the clerk or the city register, as the case may be, in each of such counties.

2. Notices of liens upon personal property for taxes payable to the United States of America and certificates releasing or discharging such lien shall be filed in the county within the city of New York or in the town or city where the owner, if a resident of the state, resides at the time the lien arises, and if not a resident, in the county within the city of New York or in the town or city where the property is at such time. If there is more than one owner, such notices or certificates shall be filed in each county within the city of New York or town or city within the state where each owner resides at the time the lien arises, and if any such owner be a nonresident of the state at such time, then also in the county within the city of New York or in the town or city in which the property is at such time. In the city of New York, such notices and certificates shall be filed as follows: In the borough of Brooklyn, in the office of the city register in the county of Kings; in the borough of Queens, in the office of the city register in Queens county; in the borough of Richmond, in the office of the clerk of the county of Richmond; in the borough of Manhattan, in the office of the city register in the county of New York, and in the borough of the Bronx, in the office of the city register in the county of Bronx. In every other town or city of the state, such notices and certificates shall be filed in the office of the town or city clerk, unless there is a county clerk's office in such town or city, in which case they shall be filed therein. If the property is in the city of New York at the time the lien arises, the notice or certificate shall be filed in the county within the city of New York or in the town or city where the owner, or each of several owners who are residents of the state, resides at the time the lien arises, and also in the county where the property is situated. * * *

SEC. 241. FILES, INDEXES, AND ENTRIES.

The officer maintaining each office specified in section two hundred forty shall procure, at the expense of the county, town or city, a file to be styled and labeled "federal tax lien notices," and an index book or card index system to be styled and labeled "Federal tax lien index." When a notice of any such tax lien is presented to him for filing, he shall file it in numerical order in the file, and shall enter it alphabetically in the federal tax lien index. The entry shall show the name and residence of the taxpayer named in the notice, the collector's serial number of the notice, the date, hour and minute of filing and the amount of tax and penalty imposed. * * *

SEC. 242. RELEASE AND DISCHARGE OF LIENS.

When a certificate of release or discharge of any such tax lien, issued by the proper officer, is presented for filing in the office of the officer where the notice of lien is filed, such officer shall permanently attach the certificate to the notice of lien; and shall enter the certificate, with the date in the federal tax lien index or card index system on the line where the notice of lien is entered. Such certificate need not be acknowledged or proved except in accordance with the laws of the United States. * * *

SEC. 243. FEES.

The fee to be paid a clerk or register for filing and indexing each certificate of release or discharge of any such tax lien is fifty cents, except in the county clerk's offices in the city of New York, where the fee shall be as provided in section fifteen hundred fifty-seven-a of the civil practice act. * * *

* * * * * * *

SEC. 245. PURPOSE OF ARTICLE.

This article is passed for the purpose of authorizing the filing of notice of liens in accordance with the provisions of the statutes of the United States of America applicable thereto. * * *

Whenever it becomes necessary to file in the State of New York a notice of Federal tax lien, or a certificate of release or discharge of such lien, district directors of internal revenue should file the same in the office of the county or other local official designated in the above-statute.

Rev. Rul. 54–125

A judgment creditor within the contemplation of section 3672 of the Internal Revenue Code is a creditor who has obtained not only a judgment against his debtor but also (under applicable State law) a lien against the judgment debtor's property prior to the filing of the notice of the Federal tax lien. *Miller* v. *Bank of America, N. T. & S. A., et al.*, 166 Fed. (2d) 415. In the State of New York a judgment creditor acquires a lien against funds of the judgment debtor in the hands of a third party upon service of a subpoena and restraining order in supplementary proceedings under the New York Civil Practice Act. In re: *Airmont Knitting & Undergarment Co., Inc.*, 182 Fed. (2d) 740. (See Rev. Rul. 225, C. B. 1953–2, 467, as to when a judgment creditor acquires a lien against the personal property of a judgment debtor in the State of New York.)

SUBCHAPTER C.—DISTRAINT

PART I.—DISTRAINT OF PERSONAL PROPERTY

SECTION 3692.—LEVY

Rev. Rul. 54–171

Notices of levy to collect delinquent Federal taxes should not be served upon a State employment commission for the purpose of reaching weekly benefits payable to an unemployed taxpayer.

Advice is requested whether the Federal Government, in the collection of Federal taxes, will follow the provisions of a State statute which, among other things, exempts from levy, execution, attachment, or any other remedy whatsoever provided for the collection of debt, unemployment benefits payable to a taxpayer by the State employment commission.

State exemption laws are inapplicable *per se* to debts, including taxes, due from a citizen to the United States. *United States* v. *Howell*, 9 Fed. 674. However, they become applicable when made so by Congress itself. *Fink* v. *O'Neil*, 106 U. S. 272, 276. The matter was summarized in *Bank of the United States* v. *Halstead*, 23 U. S. 51, 63, where the Supreme Court of the United States said:

An officer of the United States cannot, in the discharge of his duty, be governed and controlled by State laws, any farther than such laws have been adopted and sanctioned by the legislative authority of the United States.

Section 1601 of the Internal Revenue Code, relating to credits against tax on employers of eight or more, provides in part as follows:

(a) CONTRIBUTIONS TO STATE UNEMPLOYMENT FUNDS.—

(1) The taxpayer may, to the extent provided in this subsection and subsection (c), credit against the tax imposed by section 1600 the amount of contributions paid by him into an unemployment fund maintained during the taxable year under the unemployment compensation law of a State which is certified for the taxable year as provided in section 1603.

* * * * * * *

(c) LIMIT ON TOTAL CREDITS.—The total credits allowed to a taxpayer under this subchapter shall not exceed 90 per centum of the tax against which such credits are allowable.

Section 1603 of the Code provides, in part, as follows:

(a) REQUIREMENTS.—The Social Security Board [now the Secretary of Labor] shall approve any State law submitted to it, within 30 days of such submission, which it finds provides that—

* * * * * * *

(4) All money withdrawn from the unemployment fund of the State shall be used solely in the payment of unemployment compensation, exclusive of expenses of administration, and for refunds of sums erroneously paid into such fund and refunds paid in accordance with the provisions of section 1606(b) * * *.

The above-quoted provisions of the Internal Revenue Code evidence a Congressional intent that State unemployment compensation laws shall be approved and certified for purposes of securing the tax credit under section 1601(a) of the Code only if the requirements under section 1603(a) of the Code are met. Thus, it appears that Congress has expressly provided that State laws to be approved and certified must require, among other things, that all money withdrawn from the unemployment fund shall be *used solely* in payment of unemployment compensation and certain refunds. Accordingly, for a State unemployment compensation agency to use this money to satisfy outstanding Federal tax liabilities would appear to contravene Congressional intent.

Under the provisions of section 1603(c) of the Code, the State laws are certified each year, which indicates that the provisions thereof and the way in which they are administered are examined annually by the Department of Labor for the purpose of determining whether the above-mentioned requirements are met. In the instant case the State law has been approved and duly certified. (For certification as to 1953, see 19 F. R. 147, dated January 8, 1954.)

In the light of the foregoing, it is clear that Congress intended the State employment commissions to use the money from the unemployment funds *solely* for the payment of unemployment compensation and certain refunds, and not for any other purpose. Accordingly, notices of levy to collect delinquent Federal taxes should not be served upon the State employment commission for the purpose of reaching weekly benefits payable to an unemployed taxpayer.

CHAPTER 38.—MISCELLANEOUS PROVISIONS

SECTION 3797.—DEFINITIONS

REGULATIONS 118, SECTION 39.3797-4: Partnerships. Rev. Rul. 54-84

In 1952 A, a person with capital, B, a lawyer, C, a lease superintendent, and D, a drilling superintendent, entered into an agreement to acquire, explore, and develop oil and gas properties. By the terms of the agreement, B, C, and D were authorized to acquire oil and gas leases, to make contracts and commitments for the drilling of wells for oil and gas, and otherwise to develop the property; they assumed responsibility for the operation and management of the properties acquired. A agreed to furnish all tools, to finance the project, and to bear any losses, but he reserved the right to refuse at any time to contribute further money. It was agreed that A should first be reimbursed out of the income from the property for all cost and expenses, and that thereafter the profits should be divided one-half to A and one-sixth each to B, C, and D. B, C, and D received no compensation except their share of the profits. The arrangement by its terms did not provide the continuity of life and centralization of management characteristic of a corporation. Operations were very successful, and subsequently the parties sold certain of their producing leases held for more than 6 months to an outside purchaser. The leases had been taken in A's name and A had not formally transfererd title therein to B, C, and D prior to the sale, but the contract of sale recited that B, C, and D, as well as A, were owners of interests in the leases.

Held, the arrangement between A, B, C, and D constitute a joint venture or partnership for Federal income tax purposes; B, C, and D were joint venturers with A in the acquisition, exploration, and development of oil and gas properties, rather than agents or employees of A in searching for and leasing such properties. *Cf. W. L. Walls* v. *Commissioner*, 60 F. (2d) 347, and *W. B. Massey et al.* v. *Commissioner*, 143 F. (2d) 429. The leases held for the group in A's name consituted partnership assets, it being immaterial for that purpose that title was held in A's name only. To the extent that such leases constitute "property used in the trade or business" within the meaning of section 117(j) of the Internal Revenue Code, gains or losses resulting from the sale thereof are subject to the provisions of that section.

REGULATIONS 118, SECTION 39.3797-4: Partnerships.

Distributive share of an organization's net income taxable to a partner. (See Rev. Rul. 54-68, p. 151.)

REGULATIONS 118, SECTION 39.3797-4: Partnerships.

Status for self-employment tax purposes of the income derived by a wife from a business carried on by a husband and wife partnership in a State where such partnerships are not valid. (See Rev. Rul. 54-75, p. 169.)

REGULATIONS 118, SECTION 39.3797-5: Limited partnerships.
(Also Section 1623, Section 406.401, Regulations 120.)

Rev. Rul. 54-213

A limited partner, under the laws of the State of Indiana or of any other State having equivalent laws concerning limited partnerships, is not liable above and beyond his capital contribution for the obligations of a limited partnership (which would include Federal withholding taxes due from such a partnership), providing there are no facts showing conduct on his part in connection with the partnership business which would render him liable as a general partner.

Advice is requested relative to the liability of a limited partner in a limited partnership in the State of Indiana for Federal withholding taxes due from the partnership.

In the instant case, the partnership was composed of two persons, a general partner and a limited partner. Bankruptcy proceedings which were filed against the general partner have been closed. There were no proceedings against the limited partner or the partnership itself; neither were they parties to the proceedings against the general partner. There remain unpaid Federal withholding taxes for the four quarters of the year 1951. The partnership was a bona fide limited partnership.

Section 50-121 of chapter 1, title 50, volume 10, part 1, of Burns Indiana Statutes, Annotated (1951 Replacement), provides that a limited partnership is a partnership formed by two or more persons having as members one or more general partners and one or more limited partners. The limited partners as such shall not be bound by the obligations of the partnership. Section 50-127 thereof provides that a limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business. And section 50-136(1)(a) provides that a limited partner shall not receive from a general partner or out of partnership property any part of his contribution until all liabilities of the partnership, except liabilities to general partners and to limited partners on account of their contributions, have been paid or there remains property of the partnership sufficient to pay them.

The above provisions show clearly that under Indiana law a limited partner is not liable above and beyond his contributions for the obligations of a limited partnership (which would include Federal withholding taxes due from such a partnership) unless he takes part in the control of the business. In the absence of a controlling Federal statute, the law of Indiana relative to the liability of a limited partner for debts of the limited partnership is considered to be determinative of the liability of a limited partner for Federal withholding taxes due from a limited partnership organized and operated under the law of that State.

In view of the foregoing, it is held that a limited partner, under the laws of the State of Indiana or of any other State having equivalent laws concerning limited partnerships, is not liable above and beyond his capital contribution for Federal withholding taxes due from such a partnership, providing there are no facts showing conduct on his part in connection with the partnership business which would render him liable as a general partner.

SECTION 3806.—MITIGATION OF EFFECT OF RENEGOTIATION OF WAR CONTRACTS OR DISALLOWANCE OF REIMBURSEMENT

Rev. Rul. 54–82

The provisions of section 3806 of the Internal Revenue Code will not apply to a subcontractor, who, at the direction of the Government agency that was the issuing office for the prime contract, makes a refund to the prime contractor, unless such payment to the prime contractor is made under circumstances which meet the conditions of that section requiring payment to the United States.

Where the provisions of section 3806 of the Code are applicable to a prime or a subcontractor and the excessive profits, applicable to the prior as well as the current year, are repaid, such repayment of excessive profits to the United States Government shall be allocated to the applicable years in the absence of the application of section 3806(a)(4) of the Code. In the event that excessive profits have been repaid without benefit of a tax credit, where such credit is allowable under section 3806(b) of the Code, the credit shall be treated as an overpayment of tax for the prior taxable year. Such overpayment is considered made at the time the payment, repayment or offset was made, for the purpose of computing interest under section 3771(b) of the Code.

Advice is requested as to the application of Rev. Rul. 53, C. B. 1953–1, 479, to price redetermination cases under the following sets of circumstances:

(A) A subcontractor to a prime Government contractor, had a subcontract price redetermination made by the Government agency that was the issuing office for the prime contract, and, at its direction, made a contract price readjustment refund to the prime contractor. A refund was made in 1951, the year in which the applicable subcontract income was accrued. Under the same circumstances a refund was made in 1952, but such refund to the prime contractor covered subcontract income which was accrued in 1951 and 1952.

(B) The prime contractor had a price redetermination made in 1952 and made refund to the Government agency in 1952. Income under the prime contract was accrued in 1951 and 1952. The prime contractor treated such refund, in 1952, as a reduction of sales for such year. No tax credits have been allowed under section 3806 of the Code since the refunds paid were in the amount of the determination.

With respect to (A), above, section 3806(a)(1) states in part as follows:

In the case of a contract with the United States or any agency thereof, or any subcontract thereunder, which is made by the taxpayer, if a renegotiation is made in respect of such contract or subcontract and an amount of excessive profits for a taxable year * * * is eliminated, and * * * the taxpayer *is required to pay or repay to the United States or any agency thereof* * * *. [Italics supplied.]

Since section 3806(a) deals only with payments or repayments required to be made to the United States or any agency thereof, payments made directly to a prime contractor by a subcontractor at the direction of the Government agency do not fall within the provisions of section 3806 of the Code or Rev. Rul. 53, *supra*, unless the payment is made to the prime contractor as an agent of the subcontractor to transmit the payment to the United States and the payment is actually transmitted to the United States by the prime contractor, or unless the payment is made under circumstances which make the prime contractor a trustee of the payment for the benefit of the United States. It is not sufficient, for the purpose of treating such repayments under section 3806 of the Code, that the refund is made to the prime contractor with the understanding that such refund will be taken into consideration when a price redetermination or renegotiation is made in the case of the prime contractor.

With respect to (B), above, since the repayment of excessive profits was made by the prime contractor to the United States Government, the provisions of section 3806 of the Code are applicable to the prime contractor. In the absence of the application of section 3806(a)(4) of the Code to the case, the excessive profits should be properly allocated between 1951 and 1952 in order to comply with the provisions of section 3806(a)(3) of the Code, which reads:

(3) DEDUCTIONS DISALLOWED.—The amount of payment, repayment, or offset described in paragraph (1) or paragraph (2) shall not constitute a deduction for the year in which paid or incurred.

If the excessive profits have been repaid without the benefit of a tax credit, where such credit is allowable under 3806(b), section 3806(c) of the Code provides in part as follows:

(c) CREDIT IN LIEU OF OTHER CREDIT OR REFUND.—* * * If the amount allowable as a credit under subsection (b) exceeds the amount allowed under such subsection, the excess shall, for the purposes of the internal revenue laws relating to credit or refund of tax, be treated as an *overpayment* for the prior taxable year *which was made at the time payment, repayment, or offset was made.* [Italics supplied.]

Accordingly, the provisions of section 3806 of the Internal Revenue Code will not apply to a subcontractor, who, at the direction of the Government agency that was the issuing office for the prime contract, makes a refund to the prime contractor, unless such payment is actually transmitted in full to the United States by the prime contractor as agent for the subcontractor, or unless the prime contractor becomes a trustee of the payment for the benefit of the United States.

Where the provisions of section 3806 of the Code are applicable to a prime or a subcontractor and the excessive profits, applicable to the prior as well as the current year, are repaid, such repayment of excessive profits to the United States Government shall be allocated to the applicable years in the absence of the application of section 3806(a)(4) of the Code. In the event that excessive profits have been repaid without benefit of a tax credit, where such credit is allowable under section 3806(b) of the Code, the credit shall be treated as an overpayment of tax for the prior taxable year. Such overpayment is considered as made at the time the payment, repayment, or offset was made, for the purpose of computing interest under section 3771(b) of the Code.

Rev. Rul. 54–83

Section 3806 of the Internal Revenue Code and Rev. Rul. 53, C. B. 1953–1, 479, do not apply to upward adjustments of income under price redetermination clauses embodied in Government contracts.

Excessive profits on Government contracts, if made the subject of a credit memorandum or a definite commitment to reduce the contract price, preferably in writing, prior to the filing of the return, may be eliminated from income to be reported on the return. The adjustment for the excessive profits is, however, subject to the application of the credit provided for by section 3806(b) of the Code as to any further downward price revision and to the restoration to income of the taxable year in which the amount of the commitment or credit was excluded, of any amount not included in the price redetermination as finally consummated.

Advice is requested as to (1) whether the provisions of section 3806 of the Internal Revenue Code apply to upward adjustments of contract price under price redetermination clauses embodied in Government contracts and (2) what is meant by the terms "definitely determinable" and "repaid" as used in Rev. Rul. 53, C. B. 1953–1, 479.

Section 3806 of the Code is silent on the subject of upward adjustments, referring to downward adjustment only. Such upward adjustments are therefore not subject to the provisions of section 3806 of the Code. The treatment of retroactive upward adjustments is to be determined under the regular rules of accrual of income. The general rule is as stated in section 39.41–1 of Regulations 118 which provides:

The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for.

As to what method may constitute a clear reflection of income, section 39.41–2 of Regulations 118 provides:

Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency.

Ordinarily, to a taxpayer on the accrual basis, such upward adjustment of income is includible in gross income for the taxable year in which the contract is modified to provide for increased prices. *As to downward adjustments only*, section 3806 of the Code requires that such adjustments which represent excessive profits as defined in such section be related back to the year or years in which the original contract prices were included in gross income, unless permission is granted to adopt a different method of accounting under the provisions of section 3806(a)(4) of the Code.

The rules of accounting enforced upon a taxpayer by any regulatory body are not binding on the Internal Revenue Service, except as otherwise specifically provided for by statute, for the determination of tax liability under the Internal Revenue Code. See *Old Colony Railroad Company* v. *Commissioner*, 284 U. S. 552, Ct. D. 456, C. B. XI-1, 274 (1932).

With respect to (2) above, to the extent applicable to goods billed during the taxable year for which the income tax return has not yet been filed, a credit memorandum issued by the taxpayer or a definite commitment to reduce the contract price made to the contracting officer, preferably in writing, prior to the filing of the return, may be considered as rendering the amount of such credit memorandum or commitment "definitely determinable" so that the amount thereof which would otherwise be included in income may be eliminated therefrom in filing the return. Also, where excessive profits have been agreed upon with a local representative of a contracting agency and only the final approval thereof and repayment are necessary to give full effect to the redetermination, the amount agreed upon, to the extent applicable to goods billed during the taxable year, may be eliminated from income to be reported on the income tax return. However, where the taxpayer excludes the amount of such credit memorandum or commitment, a statement to that effect, including the amount and the contract involved, should be made on the return. When the price redetermination is finally consummated, if the amount thereof exceeds the amount of the credit memorandum or commitment which was excluded from income in filing the return, the credit provided for in section 3806(b) is applicable but shall be applied only to such excess. If the amount of the price redetermination as finally consummated is less than the amount of the credit memorandum or commitment, the difference shall be restored to income for the year for which the amount of the credit memorandum or commitment was excluded.

SECTION 3813.—REQUIREMENTS FOR EXEMPTION OF CERTAIN ORGANIZATIONS UNDER SECTION 101(6) AND FOR DEDUCTIBILITY OF CONTRIBUTIONS MADE TO SUCH ORGANIZATIONS

Regulations 118, Section 39.3813-3: Disallowance of certain charitable, etc., deductions.

Exemption of a charitable foundation making distributions to other tax-exempt organizations. (See Rev. Rul. 54-137, below.)

SECTION 3814.—DENIAL OF EXEMPTION UNDER SECTION 101(6) IN THE CASE OF CERTAIN ORGANIZATIONS ACCUMULATING INCOME

Regulations 118, Section 39.3814-1: Denial of exemption under section 101(6) in the case of certain organizations accumulating income.
(Also Section 101(6), Section 39.101(6)-1; Section 3813, Section 39.3813-3.)

Rev. Rul. 54-137

A charitable foundation whose primary purposes and functions consist of making distributions to tax-exempt hospitals and medical

research organizations, but which is not operated primarily for the purpose of actually performing the activities generally carried on by such organizations, is not engaged in providing medical or hospital care within the meaning of section 3813(a)(5) of the Internal Revenue Code and is, therefore, subject to the provisions of section 3814 of the Code relating to accumulation of income. The accumulation of income for a 3-year period from bequests or gifts from the creator who was the sole contributor to the organization is not considered unreasonable in amount or duration within the contemplation of section 3814 of the Code, in the case of a charitable foundation which has for a period of years distributed substantially all contributions received and has accumulated no income, provided that only an amount equal to the charitable grants made from capital in prior years, which under the facts in this case is not more than approximately one year's income, is permanently retained as capital and the balance of the accumulated income is distributed in its entirety at the end of the specific period.

Advice is requested whether a charitable foundation whose primary purposes and functions consist of making distributions to tax-exempt hospitals and medical research organizations is engaged in providing medical or hospital care within the meaning of section 3813(a)(5) of the Internal Revenue Code so as to be excepted from the provisions of section 3814 of the Code relating to accumulation of income and, if not, whether (1) current income or a portion thereof may be set aside until such time as the amount of money expended for charitable purposes out of contributions received during prior years has been recouped; and (2) whether current income over and above that referred to in (1) may be accumulated for a period not exceeding 3 years for the purpose of evolving standards and tests which applicants for charitable aids ought to meet and the relative social needs therefor, and then distributed.

The purposes of the charitable foundation herein involved are generally to take money or property by grant, devise, bequest, gift or transfer; to hold, sell, lease or convey such property; to invest and reinvest the proceeds thereof; to receive the income therefrom; and to apply such income and, in the discretion of the directors, the principal, to religious, charitable, scientific and literary purposes and to corporations and institutions which qualify for exemption from Federal income tax under section 101(6) of the Code. The foundation's major activities in furtherance of such purposes have been to make distributions and grants to hospitals and allied institutions. However, the foundation does not actually perform any activities generally engaged in by hospitals or allied institutions.

From its inception until 1951, the receipts of the foundation consisted solely of the contributions of one donor. Such receipts were neither invested nor accumulated but were distributed as gifts or grants to tax-exempt organizations with the result that substantially all of its contributions for such years were distributed. In 1951, the foundation was the beneficiary under the will of the aforementioned donor, as a result of which income for 1952 and subsequent years will approximate $2x$ to $3x$ dollars a year. The foundation now desires to set aside out of current income all or a portion thereof until such time as it has accumulated $3x$ dollars, an amount equal to about 1 year's income. Furthermore, since the income has now become sizeable, the directors of the foundation feel that they need time to determine proper standards by which its income is to be distributed. To that end, they propose that income be further accumulated during a period of not more than 3 years and that the amount so accumulated be distributed for charitable purposes at the end of the 3-year period.

Section 3814 of the Internal Revenue Code, which relates to the denial of exemption under section 101(6) of the Code in the case of certain organizations accumulating income, provides in part that in the case of any organization described in section 101(6) to which section 3813 of the Code is applicable, if the amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year:

> (1) are unreasonable in amount or duration in order to carry out the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under section 101(6): * * * exemption under 101(6) shall be denied for the taxable year.

Section 3813(a) of the Code lists certain classes of organizations described in section 101(6) which are not subject to the provisions of sections 3813 and 3814 of the Code, among which are:

> (5) an organization, the principal purposes or functions of which are the providing of medical or hospital care or medical education or medical research.

In view of the foregoing, it is held that a charitable foundation whose primary purposes and functions consist of making distributions to tax-exempt hospitals and medical research organizations, but which as its primary activity does not actually perform the activities generally engaged in by such organizations, is not engaged in providing medical or hospital care within the meaning of section 3813(a)(5) of the Internal Revenue Code and is, therefore, subject to the provisions of section 3814 of the Code relating to accumulation of income. However, under the particular facts in this case the accumulation of income for a 3-year period in the manner and to the extent stated is not considered unreasonable in amount or duration within the contemplation of section 3814 of the Code, provided that only an amount equal to the charitable grants made from capital in prior years, which under the facts in this case is not more than approximately 1 year's income, is permanently retained as capital and the balance of the accumulation is distributed to exempt organizations in its entirety at the end of the specific period.

REGULATIONS 118, SECTION 39.3814–1: Denial of exemption under section 101(6) in the case of certain organizations accumulating income. Rev. Rul. 54–227

> An organization exempt from Federal income tax under section 101(6) of the Internal Revenue Code has consistently made annual distributions to charitable and educational organizations in excess of its annual income. The chief support of such organization consists of gifts from its founder. The annual distributions in excess of annual income have resulted in an invasion of its contributed capital in a substantial amount. *Held*, the accumulation by the organization of its capital gains income and a certain minor part of its annual dividend and interest income for a period of ten years, or less, depending upon the extent of gains income, until past invasions of income producing corpus have been restored, will not be considered unreasonable in amount or duration within the meaning of section

3814 of the Internal Revenue Code, provided the remaining income of the organization is distributed to or earmarked for tax-exempt purposes.

Advice is requested whether the accumulation of income under the circumstances set forth below, by an organization exempt from Federal income tax, will be considered unreasonable in amount or duration within the meaning of section 3814 of the Internal Revenue Code.

The organization under consideration is exempt from Federal income tax under the provisions of section 101(6) of the Code. The chief support of the organization consists of gifts from its founder. The policy of the organization has been to make annual distributions to worthy charitable and educational organizations without limitation as to the amount of income received during a particular year. In past years the organization has distributed its entire annual income, and in some years distributions have been made in excess of income received, resulting in an invasion of contributed capital in a substantial amount. The organization maintains no reserves for the purpose of accumulating income. During the years 1948 through 1953 it received total gross income of $900x$ dollars of which amount $500x$ dollars represents gains from the sale of capital assets, and during such years $1,400x$ dollars was distributed to tax-exempt organizations.

In order to restore the income producing corpus which had been so substantially invaded because of its distributions to charitable and educational organizations, the organization proposes to accumulate each year (1) its capital gains income and (2) a certain minor part of its annual dividend and interest income, so as to accomplish such restoration over a period of ten years, or less depending upon the extent of capital gains income.

Section 3814 of the Code provides in part that in the case of any organization described in section 101(6) of the Code to which section 3813 of the Code is applicable (sec. 3813 is applicable to this organization), if amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year are unreasonable in amount or duration in order to carry out the charitable, educational, or other purposes or function constituting the basis for such organization's exemption, such exemption shall be denied for the taxable year. Section 39.3814-1 of Regulations 118 provides in part that amounts accumulated out of income become unreasonable when more income is accumulated than is needed, or when the duration of the accumulation is longer than is needed, in order to carry out the purpose constituting the basis for the organization's exemption. Such section further provides that in determining the reasonableness of an accumulation out of income there will be disregarded (1) gain realized upon the sale or exchange of donated assets to the extent such gain represents the excess of the fair market value of such assets when acquired over their substituted basis in the hands of the organization and (2) gains realized upon the sale or exchange of assets held for the production of investment income (such as dividends, interest, and rents) where the proceeds therefrom are reinvested within a reasonable time in property acquired and held in good faith for the production of income.

Section 39.3814–1 of Regulations 118 specifically provides for the disregarding of the gains of a tax-exempt organization from the sale or exchange of certain of its assets in determining the reasonableness of an accumulation out of income, provided the conditions set forth therein are met. Accordingly, this ruling relates only to the income and gains of the organization which are not to be disregarded under section 39.3814–1 of Regulations 118 in determining the reasonableness of accumulations out of income.

In view of the circumstances here present, it is held that the accumulation each year by the instant organization of its capital gains income and a part of its annual dividend and interest income for the period of ten years, or less by virtue of the accumulation of capital gains in amounts more substantial than contemplated, until past invasions of its income producing corpus have been restored will not be considered an unreasonable accumulation of income within the meaning of section 3814 of the Code, provided the annual income, less the accumulations here involved, is distributed to or earmarked for its tax-exempt purposes. For the purpose of determining whether such annual income is distributed to or earmarked for its tax-exempt purposes there shall be included in such income (1) gains from the sale or exchange of assets which are acquired and held for purposes other than the production of investment income, (2) gains from the sale or exchange of donated assets to the extent such gains represent enhancement in the value of such assets while in the hands of the organization, and (3) gains from the sale or exchange of assets which are held for the production of investment income if the proceeds therefrom are not reinvested within a reasonable time in property acquired and held for the production of investment income.

Since the total amount of income accumulated during the 10-year period is dependent upon contingent circumstances, an expression of opinion is reserved as to whether further accumulation will be permitted at the end of the 10-year period if the amount accumulated is less than is anticipated.

FEDERAL FIREARMS ACT

SECTION 1

Regulations 131, Section 315.2: Definitions.

Classification of a telescopic sight or riflescope and of a tool powered by blank .22 and .38 cartridges. (See Rev. Rul. 54–245, p. 253.)

SECTION 1(3)

Regulations 131, Section 315.2: Definitions.

A device for trapping animals which fires a special plastic cartridge but is not capable of firing projectiles classified. (See Rev. Rul. 54–247, p. 253.)

PART II.—RULINGS AND DECISIONS UNDER PRIOR REGULATIONS

INTERNAL REVENUE CODE

CHAPTER 1.—INCOME TAX

SUBCHAPTER B.—GENERAL PROVISIONS

PART II.—COMPUTATION OF NET INCOME

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

Regulations 111, Section 29.22(a)-21: Trust income taxable to the grantor as substantial owner thereof.

Income of a trust created prior to promulgation of section 29.22(a)-21 of Regulations 111 and of which a charitable corporation is beneficiary. (See Rev. Rul. 54-48, p. 24.)

SECTION 26.—CREDITS OF CORPORATIONS

Regulations 111, Section 29.26-5: Credit for dividends paid on preferred stock of public utilities.

Computation of credit for the purpose of determining the alternative tax. (See Rev. Rul. 54-28, p. 123.)

Regulations 111, Section 29.26-6: Credit for dividends received.

Computation of credit for the purpose of determining the alternative tax. (See Rev. Rul. 54-28, p. 123.)

Regulations 111, Section 29.26-7: Credit of Western Hemisphere trade corporations.

Computation of credit for the purpose of determining the alternative tax. (See Rev. Rul. 54-28, p. 123.)

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT B.—COMPUTATION OF NET INCOME

SECTION 112(f).—RECOGNITION OF GAIN OR LOSS: INVOLUNTARY CONVERSION

REGULATIONS 111, SECTION 29.112(f)-1: Involuntary conversion where disposition of the converted property occurred prior to January 1, 1951. Ct. D. 1763

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF COURT

1. INCOME TAX—RECOGNITION OF GAIN OR LOSS—INVOLUNTARY CONVERSION.

The statutory right under section 112(f) of the Internal Revenue Code to postpone recognition of gain from an involuntary conversion of property is not lost by reason of taxpayer's death but may be exercised by his personal representative.

2. DECISION REVERSED.

Decision of the United States Tax Court, 17 T. C. 1017 (1951), reversed.

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Estate of Isaac Goodman, deceased; Alan S. Goodman, executor, petitioner, v. *Commissioner of Internal Revenue, respondent*

[199 Fed. (2d) 895]

On petition to review a decision of The Tax Court of the United States

Before MARIS, GOODRICH, and STALEY, Circuit Judges

[November 26, 1952]

OPINION

By STALEY, Circuit Judge. Petitioner, the executor of the estate of the deceased taxpayer, seeks to take advantage of the provisions of section 112(f) of the Internal Revenue Code.[1] That section provides, so far as is relevant here, that no gain shall be recognized if property, as a result of an exercise of the power of condemnation, is involuntarily converted into money which is forthwith in good faith, under the Commissioner's regulation, expended in the acquisition of similar property. The Commissioner's ruling, sustained by the Tax Court,[2] was that the reinvestment requirements of the section are satisfied only if carried out in the taxpayer's lifetime and that reinvestment by the executor of the estate of a deceased taxpayer, although satisfying all other requirements of the section, is not enough to enable the estate to claim the statutory benefit.

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[1] Sec. 112(f) of the Internal Revenue Code is as follows:

"(f) INVOLUNTARY CONVERSIONS.—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 shall be recognized, but loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized to the extent of the money which is not so expended (regardless of whether such money is received in one or more taxable years and regardless of whether or not the money which is not so expended constitutes gain)." 26 U. S. C. sec. 112(f).

This section was amended in 1951, but the amendments do not affect the tax problem here. Public Law No. 251, 82d Cong., 1st Sess., sec. 1 (Oct. 31, 1951) [C. B. 1951-2, 353].

[2] 17 T. C. (1952).

The stipulation of facts was adopted by the Tax Court, and the following brief statement is sufficient for an understanding of the problem presented.

Isaac Goodman, the decedent, owned an undivided one-half interest in a building in Philadelphia. The Commonwealth of Pennsylvania condemned the greater part of the building, and he received his share of the condemnation award on October 18, 1944. He died 2 days later, only a part of the award having been expended in the acquisition of property similar to that condemned. His executor continued the acquisition of such property and within 16 months had exhausted the award. Although a substantial gain was realized from the award, in making decedent's final income tax return, the executor did not report that gain, justifying the omission by reliance on section 112(f). The Commissioner's determination of a deficiency was upheld by the Tax Court, and this petition for review followed.

It is conceded that all but one of the statutory requirements have been satisfied.[3] Thus, the only question is the novel and very narrow one of whether the statutory right to postpone recognition of gain dies with the taxpayer. We hold that it does not.

Our reading of section 112(f) convinces us that its primary concern is the fact of reinvestment in the prescribed manner. There is not even a hint as to who must do the reinvesting. The entire section is stated in the passive voice, thus indicating that Congress was less concerned about the identity of the actor, so long as he acted on behalf of the taxpayer, than it was about whether he acted in the statutory fashion. We are not persuaded, therefore, that a literal interpretation of the section supports the Commissioner's position. In reply, the Commissioner points to Treasury Regulation 111, section 29.112(f) (1) and (2) [4] as the basis for the contention that reinvestment must be made during the taxpayer's lifetime. The argument is that the frequent repetition of the word "taxpayer" in the regulation shows that the benefits of section 112(f) are available only if the required acts are performed during his lifetime. We cannot accept such a narrow interpretation of the word "taxpayer." As a matter of semantics, it would be difficult to talk for very long about paying taxes, and still make sense, without here and there using the word "taxpayer." Even the Commissioner admits that the word is sufficiently broad to permit the taxpayer's agent to perform the reinvestment duties.[5] Petitioner further answers

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[3] The Tax Court concluded that the expenditures were made "forthwith" and that the property acquired was similar to that converted. That the "forthwith" requirement was satisfied is shown by Estate of George Herder, 36 B. T. A. 934 (1937), affirmed *sub nom. Herder* v. *Helvering*, 106 F. 2d 153 (C. A. D. C.), cert. denied 308 U. S. 617 (1939); August Buckhardt, 32 B. T. A. 1272 (1935); Paul Haberland, 25 B. T. A. 1370 (1932). Petitioner's good faith and the similarity of the property acquired were not attacked.

[4] Treasury Regulation 111.

"Sec. 29.112(f)-1. Reinvestment of Proceeds of Involuntary Conversion.

* * * * * * *

"In order to avail himself of the benefits of section 112(f) it is not sufficient for the taxpayer to show that subsequent to the receipt of money from a condemnation award he purchased other property similar or related in use. The taxpayer must trace the proceeds of the award into the payments for the property so purchased. It is not necessary that the proceeds be earmarked, but the taxpayer must be able to prove that the same were actually reinvested in such other property similar or related in use to the property converted. The benefits of section 112(f) cannot be extended to a taxpayer who does not purchase other property similar or related in service or use, notwithstanding the fact that there was no other such property available for purchase.

* * * * * * *

"It is incumbent upon a taxpayer 'forthwith' to apply for and receive permission to establish a replacement fund in every case where it is not possible to replace immediately. If an expenditure in actual replacement would be too late, a request for the establishment of a replacement fund would likewise be too late.

"Sec. 29.112(f)-2. Replacement Funds.—In any case where the taxpayer elects to replace or restore the converted property but it is not practicable to do so immediately (for example, because of the taxpayer's inability to obtain priorities, or because of other wartime restrictions), he may obtain permission to establish a replacement fund in his accounts in which part or all of the compensation so received shall be held, without deduction for the payment of any mortgage. In such a case the taxpayer should make application to the Commissioner on Form 1114 for permission to establish such a replacement fund, and in his application should recite all the facts relating to the transaction and declare that he will proceed as expeditiously as possible to replace or restore such property. The taxpayer will be required to furnish a bond with such surety as the Commissioner may require in an amount not in excess of double the estimated additional income taxes which would be payable if no replacement fund were established. * * * U. S. Treasury Regulations 111 (1943), 29 C. F. R. sec. 29.112(f) (1) and (2) (Cum. Supp. 1949).

[5] The stipulation shows that the first reinvestment here was made by decedent's attorney in fact on the day of death. While this reinvestment, because of its amount, does not affect the tax problem here, the Commissioner does not object to it because it was not made by the decedent in person.

this argument of the Commissioner by showing the rather absurd result of its literal application. The regulations set out the many proofs which the taxpayer must establish to bring himself within section 112(f). Suppose a taxpayer reinvests the proceeds of a condemnation award in compliance with the section, and then he dies before he, himself, can make the proofs. Surely, in that case, his estate would not be denied relief. Another instance may be cited to show the error of the Commissioner's position. Section 112(f) allows nonrecognition of the gain if the award is put into a replacement fund and later used in acquiring property similar to that condemned. The regulations require that the taxpayer obtain the Commissioner's permission to establish a replacement fund, and the application for permission must contain a declaration that the taxpayer will proceed as expeditiously as possible to replace the property condemned. Suppose the requisite permission is obtained, but, before the replacement fund can be expended, the taxpayer dies. We doubt that the Commissioner, faced with those facts, would seriously stand on the contention advanced here, that the executor could not make the reinvestment. We think that a fair reading of section 112(f) allows postponement of recognition of the gain even though the reinvestment is made by the executor after the taxpayer's death, assuming, of course, satisfaction of all other requirements. Having so construed the section, we would be forced to declare the regulations invalid if they attempted to deny that right. We need not decide that question, however, for we are of the opinion that the regulations may be construed as being consistent with section 112(f). As we have said, the recurring use of the word "taxpayer" in the regulations need not be read as meaning the taxpayer, during his lifetime. A construction more logical and more consonant with the purpose of the statute is that it means the taxpayer or one acting on his behalf, before or after his death.[6]

In further support of his view, the Commissioner argues that at the taxpayer's death his creditors, heirs, and legatees acquired rights in the fund used by petitioner in purchasing the property, thus showing that the right to make reinvestment ends with the taxpayer's death. The claims of creditors might be a complete bar to reinvestment when they so far consume the estate that there is nothing left to reinvest. But that is not this case. In any event, there is no attempt here to claim the benefit of section 112(f) for creditors, heirs, or legatees. The taxpayer's estate is the beneficiary. Section 142(a)(2) of the Internal Revenue Code[7] requires that the executor file a return for his decedent's final taxable period. We see no reason why the executor may not do what the taxpayer could have done to perfect a right which came into being in that final taxable period.

We have given careful consideration to the other points raised by the Commissioner and find them to be without merit.

For the reasons stated, the judgment of the Tax Court will be reversed.

SECTION 124.—AMORTIZATION DEDUCTION

REGULATIONS 111, SECTION 29.124-0: Definitions. Rev. Rul. 54-214

The decision of the Court of Claims in *Wickes Corporation* v. *United States*, 108 Fed. Supp. 616, holding that emergency facility amortization was allowable under section 124 of the Internal Revenue Code with respect to the entire cost of certain facilities, notwithstanding that the certificate of necessity as issued by the proper certifying authority covered only 35 percent of the cost of some of the facilities and none of the cost of others (as adjusted basis of emergency

[6] We could agree with the Commissioner's narrow view of the meaning of "taxpayer" and still hold that sec. 112(f) and the regulations have been satisfied here. We take "taxpayer" to mean the person subject to the tax. See secs. 3797(a)(14) and 3801(a)(2) of the Internal Revenue Code. Certainly, the decedent is no longer subject to the tax, and, thus, he is not the taxpayer. The tax will be paid, if due, out of the estate. Consequently, the estate is the taxpayer because it is subject to the tax. Furthermore, the estate, acting through the executor, made the reinvestment. Hence, the benefits of sec. 112(f) are available to the estate.

[7] 26 U. S. C. sec. 142.

facilities with respect to which allowance of such amortization is authorized under Code section 124), will not be followed in other cases. The Commissioner of Internal Revenue has no authority to revise, supplement, or enlarge the scope of any such certificate of necessity. See *United States Graphite Co.* v. *Sawyer*, 176 Fed. (2d) 868, affirming per curiam, 71 Fed. Supp. 944, certiorari denied, 339 U. S. 904, wherein the predecessor of Wickes Corporation sought, but was denied, an order to compel the Secretary of Commerce (certifying authority) to issue such a certificate of necessity with respect to the entire cost of all of the same facilities as were involved in the Wickes Corporation tax case, *supra*.

PART III.—ALCOHOL TAX RULINGS AND DECISIONS

INTERNAL REVENUE CODE

CHAPTER 26.—LIQUOR

SECTION 2800.—LIQUOR

REGULATIONS 11, SECTION 189.270: Preservation of marks and brands. T. D. 6062
(Also Section 190.805, Regulations 15.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PARTS 189 AND 190

Amendment of requirements for marks on cases to permit identification of bottle labels and State stamps to be shown on the Government side of cases.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

In order to permit bottlers of taxpaid spirits and wines to affix bottle labels, or other concise data, descriptive of the contents of the cases, including indications of payment of State taxes, or symbols in lieu thereof, on the Government side of cases, provided such additional information does not conflict with, or detract from, the prescribed marks on cases, the following amendments to regulations are hereby adopted:

PARAGRAPH 1. Regulations 11 [26 CFR, pt. 189] is amended by inserting immediately following section 189.270 the following new section:

SEC. 189.270a. ADDITIONAL MARKS.—The assistant regional commissioner may, upon written application from the proprietor, authorize the affixing of bottle labels or other concise data, or symbols in lieu thereof, to the Government side of cases, to describe, for commercial identification purposes, the contents of the cases and to show the payment of State taxes thereon: *Provided,* That such additional information is set apart from and does not in any way detract from, conflict with, or obscure, any of the markings required by this part.

PAR. 2. Regulations 15 [26 CFR, pt. 190] is amended by substituting a colon for the period at the end of section 190.805 and adding the following:

Provided, That the assistant regional commissioner may, upon written application from the proprietor, authorize the affixing of bottle labels or other concise data, or symbols in lieu thereof, to the Government side of cases, to describe, for commercial identification purposes, the contents of the cases and to show the payment of State taxes thereon: *Provided further*, That such additional information is set apart from and does not in any way detract from, conflict with, or obscure, any of the markings required by this part.

Because the changes made are of a liberalizing character, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitations of section 4(c) of said act.

This Treasury Decision shall be effective upon the date of publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in sec. 161 of the Revised Statutes and sec. 3176 of the Internal Revenue Code (sec. 161 R. S.; 5 U. S. C. 22; 53 Stat. 375; 26 U. S. C. 3176).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved February 3, 1954.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Published in the Federal Register February 6, 1954)

REGULATIONS 21, SECTION 191.139: Record and report, Form 52E. T. D. 6063

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 191.—IMPORTATION OF DISTILLED SPIRITS, WINES, AND FERMENTED LIQUORS

Distilled spirits in customs bond for export

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

In order to exempt wholesale liquor dealers who import or purchase distilled spirits in customs bond, for exportation, or who acquire distilled spirits in a foreign country for direct shipment to a foreign customer, from the requirements of keeping Form 52E or Record 52, Regulations 21 [26 CFR, pt. 191] are hereby amended as follows:

PARAGRAPH 1. Section 191.139 is amended by adding a new sentence at the end thereof to read as follows:

Wholesale liquor dealers who import or purchase in customs bond distilled spirits for exportation, or who acquire distilled spirits in a foreign country for direct shipment to a foreign customer, are not required to keep Form 52E or Record 52 and need not submit transcripts or monthly summaries thereof as to such operations.

Because the amendment made by this Treasury Decision is of a liberalizing character, it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitations of section 4(c) of said act.

This Treasury Decision shall be effective on the date of its publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in secs. 3176 and 3791 of the Internal Revenue Code (53 Stat. 375, 467; 26 U. S. C. 3176, 3791).)

T. Coleman Andrews,
Commissioner of Internal Revenue.
D. B. Strubinger,
Acting Commissioner of Customs.

Approved February 3, 1954.
M. B. Folsom,
Acting Secretary of the Treasury.

(Published in the Federal Register February 6, 1954)

SUBCHAPTER A.—DISTILLED SPIRITS

PART I.—PROVISIONS RELATING TO TAX

SECTION 2801.—RECTIFIED SPIRITS

Regulations 7, Section 178.184: Formulae, processes, and samples. Rev. Rul. 54–184
(Also Section 178.211.)

The quantity and percentages of the various vermouths used need not be stated on formulae covering vermouth to be made by blending or mixing two or more vermouths, produced under approved formulae, for the purpose of perfecting them according to commercial standards, except in the case of formulae covering the intermingling of slightly flavored vermouth with other vermouth. Since a sample of one blend of such vermouths would not be representative of all blends authorized to be produced under the formula, the submission of such a sample under section 178.184(b) of Regulations 7 would serve no useful purpose and is not required. Formulae for such vermouths must, of course, be submitted for approval and should show the formula number, approval date, and the manufacturer's name for each vermouth to be used. In the case of formulae covering a vermouth produced by intermingling one or more slightly flavored vermouths with other vermouths, the formula should show the quantity or percentage of each vermouth used and a sample of the product should be submitted.

Regulations 7, Section 178.204: Limitations. Rev. Rul. 54–198

Casein has been approved for use by winemakers in the clarification of standard grape wine, not to exceed two pounds per one thousand gallons of wine, provided it is used only to an extent or in a manner which will not change the basic composition of the wine or eliminate its characteristic elements in accordance with the provisions of section 178.204 of Regulations 7.

Sodium caseinate has been approved for use by winemakers in the clarification of wines provided it is used only to an extent or in a manner which will not change the basic composition of the wine or eliminate its characteristic elements in accordance with section 178.204 of Regulations 7.

Rev. Rul. 25, C. B. 1953-1, 431, is modified to include the above.

An application for the use of malic acid in the clarification of apple wine has been disapproved. Malic acid may be used only for the purpose of correcting natural deficiencies in the fruit or berries or the juice thereof, used to make wine, as provided in section 178.138 of Regulations 7.

REGULATIONS 7, SECTION 178.211: Vermouth or other aperitif wines.

Submission of samples with formulae covering vermouth to be made by blending or mixing two or more vermouths produced under approved formulae. (See Rev. Rul. 54-184, p. 303.)

REGULATIONS 15, SECTION 190.361: Description of formula. Rev. Rul. 54-235

Water, as such, may not be used in the manufacture of a wine product, rectified wine, or wine cocktail, in a rectifying plant. However, this will not preclude the use of a simple syrup or sugar solution of not less than 60° Balling.

REGULATIONS 15, SECTION 190.479: Exemption from tax. Rev. Rul. 54-185

Blends of two or more pure straight whiskies, aged in wood for a period of not less than 4 years, which are exempt from the rectification tax of 30 cents per proof gallon by section 2801 of the Internal Revenue Code and section 190.479 of Regulations 15, may have added thereto not more than 7 ounces of activated carbon for each 400 gallons of spirits for the purpose of clarification provided the character of the whisky is not changed thereby. Formulas on Form 27-B Supplemental, "Formula and Process for Rectified Spirits," covering such blends of pure straight whiskies to which activated carbon is to be added should include a statement as to the amount to be used.

REGULATIONS 15, SECTION 190.499: Compounding with sugar, caramel, essence, etc. Rev. Rul. 54-126

(Also Section 5(e), Federal Alcohol Administration Act, Section 21, FAA Regulations No. 4.)

"May Wine" not expressly defined by Federal regulations, is a product made with unfortified white grape wine as a base, flavored with woodruff herbs, leaves, or essence, and having an alcoholic content not in excess of 14 percent by volume. "May Wine" may be produced only at a rectifying plant, subject to the 30 cent rectification tax prescribed by section 2800(a) (5) of the Internal Revenue Code, plus tax on the increased gallonage as prescribed by section 190.501 of Regulations 15. "May Wine" is not considered an aperitif wine under section 21, class 7 of Federal Alcohol Administration Regulations No. 4. It should be designated and labeled as "May Wine" and there should appear in direct conjunction therewith the words "Light White Wine–Flavored with Woodruff Herbs," "Light White Wine–Flavored with Woodruff Leaves," or "Light White Wine–Flavored with Woodruff Essence," as the case may be.

PART II.—DISTILLING AND RECTIFYING

SECTION 2829.—INSTALLATION OF METERS, TANKS, AND OTHER APPARATUS

REGULATIONS 11, SECTION 189.60: Bottling tanks.

Use of Government locks on stopcocks of gauge glasses on bottling tanks. (See Rev. Rul. 54–215, below.)

REGULATIONS 15, SECTION 190.124: Bottling tanks. Rev. Rul. 54–215
(Also Section 189.60, Regulations 11.)

Government locks now in use for securing the stopcocks on the gauge glasses of bottling tanks in rectifying plants and taxpaid bottling houses may be removed.

Advice is requested whether it is necessary that Government locks be applied to the stopcocks on gauge glasses of bottling tanks.

Section 190.124 of Regulations 15 and section 189.60 of Regulations 11 contain the requirements relative to bottling tanks and provide, in part, that each bottling tank must be closed and any necessary openings therein affording access to the interior or to the contents must be closed and secured with a cover which will be secured by a Government lock or otherwise fastened and sealed.

It is held that the small stopcocks ordinarily attached to gauge glasses on bottling tanks in rectifying plants and taxpaid bottling houses do not constitute openings "affording access to the interior or to the contents" of the tanks within the meaning and contemplation of the regulations. Accordingly, Government locks now in use for securing the stopcocks on the gauge glasses of bottling tanks in rectifying plants and taxpaid bottling houses may be removed.

SECTION 2857.—BOOKS OF RECTIFIERS AND WHOLESALE DEALERS

REGULATIONS 20, SECTION 194.216: Entry of miscellaneous items. Rev. Rul. 54–199

A composite case of liquor, consisting of different brands and kinds of liquors which are the product of one producer or various producers, may be made up on wholesale liquor dealer premises. Section 194.216 of Regulations 20 provides that where the sale of such liquors to the same person on the same day does not exceed 10 gallons, the entry of such items in Record 52 "Wholesale Liquor Dealer's Record" and report, Form 52B, "Wholesale Liquor Dealer's Monthly Report," shall be stated as "Miscellaneous" or "Misc." and shall show the date, the name and address of the person to whom sold, and the quantity. Where the sale of such liquors is in a quantity in excess of 10 gallons, the information required by the headings of columns 4 to 6 (name, registry or permit number, and State or country) of Record 52, Part 2, and transcript thereof on Form 52B shall be furnished. Brackets may be placed around the names of the several producers shown in column 4 and around the applicable serial numbers of the composite cases shown in column 13 of such forms. The serial numbers of the composite cases should be marked with an asterisk, or other mark, identifying such cases.

A wholesale liquor dealer receiving cases made up on other wholesale liquor dealer premises will report such receipts in the normal manner on Record 52, Part 1, and on the transcript thereof on Form 52A, "Wholesale Liquor Dealer's Monthly Report," except that in the column headed "By Whom Distilled, Rectified or Bottled" the name and permit number of the wholesale liquor dealer from whom the liquors were received should be shown.

REGULATIONS 20, SECTION 194.217: Separate record of name of distiller, rectifier, or bottler. Rev. Rul. 54–205

Distilled spirits received by a wholesale liquor dealer from an importer or another wholesale liquor dealer may be reported in Form 52A "Wholesale Liquor Dealer's Monthly Report" without specifying the name of the distiller, rectifier, or bottler of the spirits in column 4 provided the proprietor keeps at his place of business a separate record of such information as required by section 194.217 of Regulations 20 and the registry or permit number of the distiller, rectifier, bottler, or importer, as the case may be, is entered in column 5, and the State or country is entered in column 6.

REGULATIONS 21, SECTION 191.139: Record and report, Form 52E. Rev. Rul. 54–186
(Also FAA Act, Section 4.)

An importer who purchases distilled spirits abroad for shipment to and resale in the United States, upon the order of a second importer to whom title to the distilled spirits passes prior to entry of the spirits into customs, is not required to keep Record 52, "Wholesale Liquor Dealer's Record," covering such spirits. The second importer who files the entry for customs purposes must maintain Record 52 in respect to receipt of the imported spirits and their withdrawal from customs custody, and must keep Record 52 in respect to receipt of the spirits at his wholesale liquor dealer premises and their disposition therefrom.

An importer's basic permit is held to be active if, within 2 years, an entry of distilled spirits, wines, etc., has been filed with customs officials, although within this period the importer has not placed a direct order abroad nor purchased or possessed red strip stamps, and would therefore not be subject to revocation for reasons of inactivity as provided in section 4(e)(2) of the Federal Alcohol Administration Act.

Advice is requested as to the necessary records to be kept on Record 52, "Wholesale Liquor Dealer's Record," where spirits are purchased abroad by one importer but entered into customs custody in the name of a second importer. Advice is also requested whether an importer's basic permit is considered active if, within 2 years, an entry of distilled spirits, wines, etc., has been filed with customs officials, although within this period the importer has not placed a direct order abroad nor purchased or possessed red strip stamps.

In the instant case, a wholesale liquor dealer in Baltimore, Maryland, who possesses an importer's permit, places an order with a New York, N. Y., importer for a certain brand of whisky, the New York importer being the sole agent in the United States for the product. The New York importer forwards the order and the red strip stamps, overprinted by him, abroad. The cases of whisky are consigned to the Baltimore importer and, in addition to other information, they bear the number of his importer's basic permit. Title to the whisky passes to the Baltimore importer prior to entry into customs custody. All pertinent papers are forwarded by the New York importer to the Baltimore importer. These papers are, in turn, sent to a customhouse broker in Baltimore who, upon arrival of the spirits, files an immediate consumption entry in the name of the Baltimore importer. Bond is given and the tax and duty are paid by the Baltimore importer.

Section 191.139 of Regulations 21 provides that every importer who imports and sells distilled spirits in bulk shall keep a record of all distilled spirits imported by him on Form 52E, or he may keep the record of bulk spirits imported on Form 52E and the bottled spirits on Record 52. If bottled spirits only are imported, Record 52 shall be used.

Since the New York importer does not file entries with customs and does not have possession of the spirits, either physically or constructively, Record 52 need not be maintained by him in respect of such spirits.

Record 52 must be maintained by the Baltimore importer in accordance with the provisions of section 191.139 of Regulations 21, showing receipt of the imported spirits and their withdrawal from customs custody. This importer must also maintain Record 52 in respect to receipt of such spirits at his wholesale liquor dealer premises and the disposition of the spirits therefrom as required by section 191.142 of Regulations 21 and section 194.210 of Regulations 20.

The passage of the title to the merchandise prior to arrival of the goods in this country under the stated circumstances does not affect the status of the New York importer as an importer and wholesale liquor dealer. Although he does not actually import the distilled spirits in the sense that he files an entry for the warehousing of such spirits or their withdrawal from customs custody, he does qualify as an importer through the holding of an importer's basic permit, by which he is permitted to purchase and ship red strip stamps abroad in his own name, and through the purchase of foreign spirits for shipment to and resale in the United States.

The Baltimore importer is required under customs and internal revenue regulations to qualify as an importer since he must file the entry for withdrawal of the distilled spirits from customs custody.

Record 52 need not be maintained by an importer covering distilled spirits purchased in a foreign country by him but title to which has passed from him to a second importer prior to entry of such distilled spirits into customs custody. Record 52 in such case must be maintained by the importer having title to the distilled spirits at the time they are entered into customs custody.

Under the provisions of section 4(e) of the Federal Alcohol Administration Act, a basic permit shall, after due notice and opportunity for hearing, be revoked if it is found that the permittee has not engaged in the operations authorized by the permit for a period of more than 2 years.

An importer's basic permit is considered active if, within 2 years, an entry of distilled spirits, wines, etc., has been filed with customs officials, although within that period the importer has not placed a direct order abroad nor purchased or possessed red strip stamps.

SECTION 2871.—REGULATION OF TRAFFIC IN CONTAINERS OF DISTILLED SPIRITS

REGULATIONS 10, SECTION 185.924: Liquor bottles. T. D. 6071
(Also Section 185.925; Section 2903, Sections 185.940, 185.961, 185.980.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 185.—WAREHOUSING OF DISTILLED SPIRITS

Amendment of requirements to permit bottling in bond of distilled spirits in ½ gallon and 1 gallon size bottles.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

In order that distilled spirits may be bottled in bond, either for domestic use or for exportation, in ½ gallon and 1 gallon size bottles, Regulations 10 [26 CFR, pt. 185] are amended as follows:

PARAGRAPH 1. Section 185.924 is amended by inserting immediately after the colon in the second sentence the following: "1 gallon, ½ gallon,".

PAR. 2. Section 185.925 is amended by inserting immediately after the colon in the first sentence the following: "1 gallon, ½ gallon,".

PAR. 3. Section 185.940 is amended by inserting immediately after the colon in the first sentence the following: "4 bottles containing 1 gallon each; 6 bottles containing ½ gallon each;".

PAR. 4. Section 185.961 is amended by inserting immediately after the colon in the first sentence the following "1 gallon, ½ gallon,".

PAR. 5. Section 185.980 is amended by inserting immediately after the colon in the first sentence the following: "1 gallon, ½ gallon,".

Because the changes made are of a liberalizing character, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitations of section 4(c) of said act.

This Treasury Decision shall be effective upon the date of publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in sec. 3176 of the Internal Revenue Code (53 Stat. 375; 26 U. S. C. 5176).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved May 11, 1954.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Published in the Federal Register May 14, 1954)

REGULATIONS 13, SECTION 175.55: Containers for distilled spirits. Rev. Rul. 54–236
(Also section 175.89.)

Wooden containers of a capacity of one wine gallon or less cannot be approved for the packaging of domestic or imported distilled spirits for sale at retail. Under the provisions of Regulations 13, section 175.55 to section 175.59a, inclusive, and section 175.89 to section 175.94a, inclusive, containers for packaging distilled spirits for sale at retail are restricted to glass, earthenware, or like materials which are made of hard substances which once formed or molded cannot thereafter be altered or changed.

PART III.—INTERNAL REVENUE BONDED WAREHOUSES

SECTION 2872.—ESTABLISHMENT AND CONTROL

REGULATIONS 10, SECTION 185.340: Application of the surety for release from bond. Rev. Rul. 54–187

Section 185.340 of Regulations 10 provides in part that upon the proper filing of an application by the surety for relief from bond, in the case of bond, Form 1571, "Transportation and Warehousing Bond," said surety shall be relieved from liability for spirits transferred or consigned to the internal revenue bonded warehouse wholly subsequent to the date named in the notice, but that if a superseding bond has not been filed by the principal prior to the date named in the surety's notice, the surety shall continue to remain liable under the bond for all spirits on hand or in transit to the internal revenue bonded warehouse on said date, until such spirits have been lawfully disposed of or a new bond has been filed by the principal. However, under the circumstances the warehouseman is barred from receiving additional spirits on the warehouse premises until a superseding bond is filed.

The bottling of distilled spirits remaining in an internal revenue bonded warehouse or in transit thereto on the date given in the application for relief from liability on a transportation and warehousing bond (and no superseding bond is filed) would not affect the bond liability on such spirits and therefore may be permitted in accordance with the applicable provisions of Regulations 10.

SECTION 2878.—DRAWING, GAUGING, AND MARKETING OF DISTILLED SPIRITS

REGULATIONS 4, SECTION 183.561: Application, Form 236. T. D. 6068

(Also Sections 183.564a, 183.572, 183.574, 183.-577a, 183.580; Sections 184.601, 184.604a, 184.612, 184.614, 184.617a, 184.620, Regulations 5; Sections 185.375, 185.692, 185.693, 185.706, 185.707, 185.708, 185.711, 185.712, Regulations 10.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PARTS 183, 184, AND 185

Amendment of requirements for the weighing of packages of distilled spirits upon receipt at Internal Revenue bonded warehouses.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

In order to eliminate the requirement that storekeeper-gaugers weigh packages of distilled spirits at the time of their receipt after transfer in bond from a distillery not on the same or contiguous premises or from another warehouse when such consignor premises are operated by the consignee or an affiliate or subsidiary thereof in the immediate vicinity, or when such packages of spirits are transferred in conveyances sealed with Government cap seals, the following amendments to the regulations are hereby adopted:

PARAGRAPH 1. Wherever the term "supervisor" or "district supervisor" appears in the sections of the regulations revised by this Treasury Decision, such term is hereby amended to read "Assistant Regional Commissioner, Alcohol and Tobacco Tax."

PAR. 2. Regulations 4 [26 CFR, pt. 183] are amended as follows:

(A) Section 183.561 is amended by:

(1) Striking the words "supervisory district" in the first sentence and inserting in lieu thereof the word "region".

(2) Inserting after the second sentence the following new sentence: "If the applicant desires to receive packages of spirits in sealed conveyances without weighing the packages at time of receipt he should indicate on part 1 of Form 236 that the packages are to be transferred in sealed conveyances by entering the phrase 'Government-sealed conveyance.' "

(B) There is inserted immediately following section 183.564 the following new section:

SEC. 183.564a. SEALED CONVEYANCES FOR PACKAGES.—Each conveyance used to transport packages of distilled spirits in bond, which is to be sealed in order that the weighing of spirits upon receipt at an internal revenue bonded warehouse will not be required, must be constructed in such a manner that all openings may be closed and secured by seals in order that access cannot be gained without showing evidence of tampering. Cap seals to be furnished by the Government will be used in sealing the conveyance and such seals will be affixed as soon as the vehicle is loaded. If the conveyance is not constructed in accordance with the provisions of this section, the storekeeper-gauger will notify the consignor proprietor that its use as a sealed conveyance cannot be authorized and, if distilled spirits are conveyed therein, that weighing of the packages at the consignee premises will be required. Under such circumstances, cap seals will not be applied to the conveyance. (53 Stat. 375; 26 U. S. C. 3176.)

(C) There is inserted after the first sentence in section 183.572 the following new sentence: "If the transfer is to be made by sealed conveyance, the storekeeper-gauger will note on Form 236 in the space provided therefor the serial numbers of the cap seals used."

(D) Section 183.574 is amended by:

(1) Striking the words "supervisory district" in the first sentence and inserting in lieu thereof the word "region".

(2) Inserting after the second sentence the following new sentence: "If the applicant desires to receive packages of spirits without weighing such packages at time of receipt he should indicate on part 1 of Form 236 that the packages are to be transferred in sealed conveyances by entering the phrase 'Government-sealed conveyance.' "

(E) There is inserted immediately following section 183.577 the following new section:

SEC. 183.577a. SEALED CONVEYANCE FOR PACKAGES.—If the packages of distilled spirits are to be transported in a sealed conveyance, in order that the weighing of the spirits upon receipt at an internal revenue bonded warehouse will not be required, such conveyance must be constructed and sealed as provided in section 183.564a. (53 Stat. 375; 26 U. S. C. 3176.)

(F) There is inserted immediately after the first sentence in section 183.580 the following new sentence: "If the transfer is to be made by sealed conveyance, the storekeeper-gauger will note on Form 236 in the space provided therefor the serial numbers of the cap seals used."

PAR. 3. Regulations 5 [26 CFR, pt. 184] are amended as follows:

(A) Section 184.601 is amended by:

(1) Striking the words "supervisory district" in the first sentence and inserting in lieu thereof the word "region".

(2) Inserting after the second sentence the following new sentence: "If the applicant desires to receive packages of brandy in sealed conveyances without weighing the packages at time of receipt he should

indicate on part 1 of Form 236 that the packages are to be transferred in sealed conveyances by entering the phrase 'Government-sealed conveyance.'"

(B) There is inserted immediately following section 184.604 the following new section:

SEC. 184.604a. SEALED CONVEYANCES FOR PACKAGES.—Each conveyance used to transport packages of brandy in bond, which is to be sealed in order that the weighing of the brandy upon receipt at an internal revenue bonded warehouse will not be required, must be constructed in such a manner that all openings may be closed and secured by seals in order that access cannot be gained without showing evidence of tampering. Cap seals to be furnished by the Government will be used in sealing the conveyance and such seals will be affixed as soon as the vehicle is loaded. If the conveyance is not constructed in accordance with the provisions of this section, the storekeeper-gauger will notify the consignor proprietor that its use as a sealed conveyance cannot be authorized and, if distilled spirits are conveyed therein, that weighing of the packages at the consignee premises will be required. Under such circumstances, cap seals will not be applied to the conveyance. (53 Stat. 375; 26 U. S. C. 3176.)

(C) There is inserted after the first sentence in section 184.612 the following new sentence: "If the transfer is to be made by sealed conveyance, the storekeeper-gauger will note on Form 236 in the space provided therefor the serial numbers of the cap seals used."

(D) Section 184.614 is amended by:

(1) Striking the words "supervisory district" in the first sentence and inserting in lieu thereof the word "region".

(2) Inserting after the second sentence the following new sentence: "If the applicant desires to receive packages of brandy without weighing such packages at time of receipt he should indicate on part 1 of Form 236 that the packages are to be transferred in sealed conveyances by entering the phrase 'Government-sealed conveyance.'"

(E) There is inserted immediately following section 184.617 the following new section:

SEC. 184.617a. SEALED CONVEYANCE FOR PACKAGES.—If packages of brandy are to be transported in a sealed conveyance, in order that the weighing of the brandy upon receipt at an internal revenue bonded warehouse will not be required, such conveyance must be constructed and sealed as provided in section 184.604a. (53 Stat. 375; 26 U. S. C. 3176.)

(F) There is inserted immediately after the first sentence in section 184.620 the following new sentence: "If the transfer is to be made by sealed conveyance, the storekeeper-gauger will note on Form 236 in the space provided therefor the serial numbers of the cap seals used."

PAR. 4. Regulations 10 [26 CFR, pt. 185] are amended as follows:

(A) Section 185.375 is amended by changing the period at the end of the first sentence to a colon and adding the following proviso: "*Provided*, That the weighing of packages will not be required (a) where spirits are transferred in bond, from any distillery or internal revenue bonded warehouse, in conveyances sealed with Government cap seals in accordance with the provisions of section 185.692 and the conveyances are received with such seals intact, or (b) where spirits are received from a distillery not on the same or contiguous premises, or from another warehouse, operated by the consignee or an affiliate or subsidiary of the consignee in the immediate vicinity so the transfer can be under observation by Government officers at all times; where packages are received without weighing the storekeeper-gauger will so indicate in the appropriate column on Form 1520 or 1619."

(B) Section 185.692 and headnote are amended to read:

SEC. 185.692. SEALED CONVEYANCES FOR PACKAGES.—Each conveyance used to transport packages of distilled spirits in bond, which is to be sealed in order that the weighing of spirits upon receipt at an internal revenue bonded warehouse will not be required, must be constructed in such a manner that all openings may be closed and secured by seals in order that access cannot be gained without showing evidence of tampering. Cap seals to be furnished by the Government will be used in sealing the conveyance and such seals will be affixed as soon as the vehicle is loaded. If the conveyance is not constructed in accordance with the provisions of this section, the storekeeper-gauger will notify the consignor proprietor that its use as a sealed conveyance cannot be authorized and, if distilled spirits are conveyed therein, that weighing of the packages at the consignee premises will be required. Under such circumstances, cap seals will not be applied to the conveyance.

(C) Section 185.693 is amended by:

(1) Striking the words "supervisory district" in the first sentence and inserting in lieu thereof the word "region".

(2) Inserting after the second sentence the following new sentence: "If the applicant desires to receive packages of spirits in sealed conveyances without weighing the packages at time of receipt he should indicate on part 1 of Form 236 that the packages are to be transferred in sealed conveyances by entering the phrase 'Government-sealed conveyance.' "

(D) Section 185.706 is amended by striking the words "tank car" in the first sentence and inserting in lieu thereof "conveyance sealed with Government cap seals".

(E) Section 185.707 is amended by striking the words "tank car" in the two places they appear in the third sentence and inserting in lieu thereof in the first instance "conveyance sealed with Government cap seals," and in the second instance "conveyance".

(F) Section 185.708 is amended by:

(1) Striking the words "supervisory districts" in the first sentence and inserting in lieu thereof the word "regions".

(2) Inserting after the second sentence the following new sentence: "If the applicant desires to receive packages of spirits without weighing such packages at time of receipt he should indicate on part 1 of Form 236 that the packages are to be transferred in sealed conveyances by entering the phrase 'Government-sealed conveyance.' "

(G) Section 185.711 is amended by striking the words "tank car" in the first sentence and inserting in lieu thereof "conveyance sealed with Government cap seals".

(H) Section 185.712 is amended by:

(1) Striking the words "tank car" in the two places they appear in the third sentence and inserting in lieu thereof in the first instance "conveyance sealed with Government cap seals," and in the second instance "conveyance".

(2) Striking the word "district" where it appears in the fourth and fifth sentences and inserting in lieu thereof the word "region".

Because the changes made are of a liberalizing character, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitations of section 4(c) of said act.

This Treasury Decision shall be effective upon the date of publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in sec. 3176 of the Internal Revenue Code (53 Stat. 375; 26 U. S. C. 3176).)

O. Gordon Delk,
Acting Commissioner of Internal Revenue.

Approved March 31, 1954.

M. B. Folsom,
Acting Secretary of the Treasury.

(Published in the Federal Register April 6, 1954)

SECTION 2891.—WITHDRAWAL OF DISTILLED SPIRITS TO MANUFACTURING BONDED WAREHOUSE

Regulations 10, Section 185.827: Bond. Rev. Rul. 54-237

A blanket bond may be filed on Form 1618, "Transportation Bond," covering withdrawals of distilled spirits from several warehouses operated by the same proprietor within an internal revenue region. Each warehouse must be completely identified as to number, name, location, street number, city and State, in a rider attached to the bond for that purpose.

Advice is requested whether a blanket bond on Form 1618 may be filed covering transfers of distilled spirits from internal revenue bonded warehouses at various locations within an internal revenue region to a Class 6 Customs Bonded Manufacturing Warehouse, in lieu of filing a separate bond covering transfers from each warehous.

Section 185.827 of Regulations 10 provides in part that the manufacturer shall execute a bond to cover the transportation of spirits from the internal revenue bonded warehouse from which withdrawn to the customs manufacturing bonded warehouse. Form 1618 is used in those cases where the manufacturer desires to furnish bond under which spirits may be withdrawn from time to time. This section of Regulations 10 also provides that the bond shall be executed in a penal sum sufficient to cover the tax at the rate prescribed by law on the maximum quantity which may be outstanding against the bond at any one time.

There is no provision of regulations which would prohibit the execution of a bond covering the withdrawal of distilled spirits from more than one warehouse operated by the same proprietor for transfer to a Class 6 Customs Bonded Manufacturing Warehouse.

A blanket bond may be filed on Form 1618, "Transportation Bond," covering withdrawals of distilled spirits from several warehouses operated by the same proprietor within an internal revenue region. Each warehouse must be completely identified as to number, name, location, street and number, city and State, in a rider attached to the bond for that purpose.

SECTION 2903.—BOTTLING OF DISTILLED SPIRITS IN BOND

REGULATIONS 10, SECTION 185.974: Proprietor's application, Form 1515. Rev. Rul. 54–188

Application on Form 1515, "Distilled Spirits Bottled in Bond," for permission to bottle distilled spirits in bond may be submitted for approval with the data in part 5 omitted in cases where the warehouseman is not reasonably certain as to the size or sizes of bottles to be filled and the denominations of the domestic bottled in bond strip stamps to be required. In such case, part 5 of the form will be completed when the spirits have been dumped for bottling and prior to the commencement of the bottling.

Permission is requested by the proprietor of an internal revenue bonded warehouse to make application for domestic bottled in bond strip stamps in quantities required for each bottling dump immediately prior to the actual bottling of the spirits rather than estimating the number of stamps of a specified size or sizes when filing application on Form 1515 for permission to bottle.

The requirements of section 185.974 of Regulations 10, if strictly construed, result in a hardship in cases where it is found that the predetermined denomination of stamps according to bottle sizes is changed after the order for stamps is placed. Such hardship could be avoided if the stamps were requested and obtained pursuant to Form 1515 after the spirits have been dumped and prior to the actual bottling of the spirits contained in the bottling tanks.

Application on Form 1515 must be filed for each lot of spirits to be bottled in bond and Regulations 10 requires that such spirits be bottled expeditiously. Therefore, it is not contemplated by the regulations that the spirits will be held in bottling tanks for any length of time during which bottling orders would ordinarily be changed. However, it is possible that a bottling order may be received between the time the application to bottle is filed and the time the spirits are in bottling tanks ready to bottle, which will affect the bottle sizes to be used and the strip stamps required. Accordingly, part 5 of Form 1515, showing the number and denomination of stamps required, may be executed after the spirits have been dumped for bottling and prior to the actual commencement of bottling operations, at which time the quantities and denominations of stamps required may be more accurately determined.

SECTION 2916.—REMOVAL FOR DENATURATION OR DESTRUCTION OF DISTILLATES CONTAINING ALDEHYDES OR FUSEL OIL

REGULATIONS 3, SECTION 182.692: Distillates from distilleries. T. D. 6067
(Also Sections 182.700, 182.779; Section 183.408, Regulations 4; Section 184.441, Regulations 5.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PARTS 182, 183, AND 184

Losses of distillates

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

On December 15, 1953, notice of proposed rulemaking, regarding amendments to Regulations 3 (26 CFR, pt. 182), Regulations 4 (26 CFR, pt. 183), and Regulations 5 (26 CFR, pt. 184), to conform the regulations to the provisions of section 2901, Internal Revenue Code, as amended by Public Law 448, Eighty-first Congress, by providing procedure for the remission of tax on distillates lost while in transit in bond from registered or fruit distilleries to denaturing plants, or while on storage at denaturing plants prior to denaturation, and to provide that the proprietor of the denaturing plant to which distillates are being transferred shall be liable for the tax thereon from the time the distillates are removed from a distillery for transfer to his denaturing plant, was published in the Federal Register (18 F. R. 8206). No comments having been received during the 30-day period prescribed in such notice, the amendments to Regulations 3, 4, and 5 set forth below are hereby adopted:

PARAGRAPH 1. Wherever the term "district supervisor" appears in the sections of the regulations revised by this Treasury Decision, such term is hereby amended to read "Assistant Regional Commissioner, Alcohol and Tobacco Tax."

PAR. 2. Regulations 3 [26 CFR, pt. 182] are amended as follows:

(A) Section 182.692 is amended as follows:

(1) By striking from the first sentence of paragraph (b) the phrase "to cover the receipt," and inserting in lieu thereof the phrase "to assume liability for the payment of the tax on such distillates from the time they leave the registered distillery or fruit distillery from which they are removed, including the transportation, receipt,".

(2) By striking the last sentence of paragraph (c), which begins, "The liability of the distiller".

(3) By adding a new paragraph to read as follows:

(e) *Voluntary destruction.*—If the distillates, after removal from the registered distillery or fruit distillery where produced, are found to be unfit for denaturation, they may be destroyed at the denaturing plant upon filing notice of intent so to do and application for supervision of destruction. The notice and application shall be filed, in triplicate, with the storekeeper-gauger in charge, and shall contain a description of the distillates as shown on the Form 1520 received from the distillery, and shall show the reasons for destruction. The storekeeper-gauger will verify the description of the distillates, including the quantity reported, and will then supervise their destruction. Upon destruction of the distillates, the storekeeper-gauger will prepare a report on the back of the notice and application showing the method of destruction and certifying to the accuracy of the description of the distillates contained in the notice and application, and will forward the original thereof to the assistant regional commissioner, return one copy to the proprietor, and retain the remaining copy for his files. The proprietor shall make proper entry on Form 1468-A covering the destruction of the distillates.

(B) Paragraph (a) of section 182.700 is revoked.

(C) There are inserted, immediately following section 182.700, the following new sections:

SEC. 182.700a. LOSS BY THEFT.—The tax shall be collected on distillates stolen while in transit to a denaturing plant or while stored therein prior to denaturation, unless the denaturer submits proof as to the cause of the loss and establishes to the satisfaction of the assistant regional commissioner that it did not occur as the result of connivance, collusion, fraud, or negligence on the part of the denaturer, distiller, consignor, consignee, bailee, or carrier, or the employees of any of them. Claim for remission of tax on distillates lost by theft shall be filed as provided in sections 182.700f–182.700h. The tax on distillates lost by theft may be remitted or refunded only to the extent that the claimant is not indemnified or recompensed for such tax. (53 Stat. 340 as amended, 346, 358, 364, 375; 26 U. S. C. 2901, 2916, 3105, 3124, 3176.)

SEC. 182.700b. UNAUTHORIZED VOLUNTARY DESTRUCTION.—The tax shall be collected on distillates voluntarily destroyed after removal from the registered distillery or fruit distillery where produced, except as provided in section 182.692(e). (53 Stat. 340 as amended, 346, 358, 364, 375; 26 U. S. C. 2901, 2916, 3105, 3124, 3176.)

SEC. 182.700c. LOSSES EXCEPT BY THEFT.—The tax on distillates lost otherwise than by theft while in transit to the denaturing plant or while stored therein prior to denaturation, may be remitted. In the case of any such loss, the assistant regional commissioner may require the denaturer to submit proof as to the cause of such loss and, where deemed necessary, to file a claim for remission of the tax as provided in sections 182.700f–182.700h. (53 Stat. 340 as amended, 346, 358, 364, 375; 26 U. S. C. 2901, 2916, 3105, 3124, 3176.)

SEC. 182.700d. REPORT OF LOSSES.—Losses of distillates in transit to a denaturing plant or while stored therein prior to denaturation must be reported to the assistant regional commissioner by the denaturer immediately after the losses are discovered. Where losses of distillates in the denaturing plant occur or are discovered while a Government officer is on duty, the officer will immediately make a full report of the loss to the assistant regional commissioner. The reports should set out the nature, cause, and extent of the loss in sufficient detail to bring out all the known material facts and circumstances surrounding the loss. The condition of each tank or other container from which the loss has been sustained, and the quantity lost therefrom, should be reported. (53 Stat. 340 as amended, 346, 358, 364, 375; 26 U. S. C. 2901, 2916, 3105, 3124, 3176.)

SEC. 182.700e. INVESTIGATION BY ASSISTANT REGIONAL COMMISSIONER.—The assistant regional commissioner will consider the nature and extent of any loss reported by the denaturer or Government officer and will immediately make such investigation and require such evidence to be submitted as he may deem necessary. (53 Stat. 340 as amended, 346, 358, 364, 375; 26 U. S. C. 2901, 2916, 3105, 3124, 3176.)

SEC. 182.700f. FILING OF CLAIMS.—Claims for remission of tax on distillates lost on the premises of a denaturing plant or in transit thereto, when required, will be filed promptly with the assistant regional commissioner of the region in which the plant is located. Where a required claim for remission of tax on such distillates is not filed as provided in sections 182.700a and 182.700c, the assistant regional commissioner will require immediate payment of tax on the quantity lost. (53 Stat. 340 as amended, 346, 358, 364, 375; 26 U. S. C. 2901, 2916, 3105, 3124, 3176.)

SEC. 182.700g. FORM OF CLAIMS.—Claims for remission of tax for losses occurring on denaturing plant premises, or in transit thereto, shall be made on letter size paper (original only) and shall set forth, under oath, the following information:

(*a*) The name of the denaturer and the registry number and location of the denaturing plant;

(*b*) The serial numbers of the tanks or other containers from which the distillates were lost;

(*c*) The quantity of distillates lost from each tank or other container, and the total quantity of distillates covered by the claim;

(*d*) The total amount of tax for which the claim is filed;

(*e*) The date of the loss or, if such date is not known, the date on which the loss was discovered, and the cause and nature thereof, together with all the facts surrounding the loss;

(*f*) The name of the carrier, if any;

(*g*) If lost by theft, whether the loss occurred as a result of connivance, collusion, fraud, or negligence on the part of the denaturer, distiller, owner, consignor, consignee, bailee, or carrier, or the employees of any of them;

(*h*) Whether the claimant is indemnified or recompensed for the tax, and, if so, the amount and nature of such indemnity or recompense. The actual value of the distillates, less the tax, must be stated explicitly, and where required, certified copies of all policies of insurance or other documents of indemnity covering the distillates must be furnished.

(53 Stat. 340 as amended, 346, 358, 364, 375; 26 U. S. C. 2901, 2916, 3105, 3124, 3176.)

SEC. 182.700h. SUPPORTING STATEMENTS.—Claims for remission of tax on distillates lost while on the premises of a denaturing plant or in transit thereto, must be supported by affidavits of persons having personal knowledge of the loss. (53 Stat. 340 as amended, 346, 358, 364, 375; 26 U. S. C. 2901, 2916, 3105, 3124, 3176.)

SEC. 182.700i. ACTION ON CLAIM BY ASSISTANT REGIONAL COMMISSIONER.—When a claim for remission of tax is received by the assistant regional commissioner, he will carefully examine the same to see that all the required information has been furnished, and will cause such investigation to be made or require such additional evidence to be submitted as he may deem necessary. Upon completion of his investigation, if any, the assistant regional commissioner will allow or disallow the claim in accordance with existing law and regulations. (53 Stat. 340 as amended, 346, 358, 364, 375; 26 U. S. C. 2901, 2916, 3105, 3124, 3176.)

SEC. 182.700j. RECORDS.—Losses of distillates in transit to the denaturing plant or while stored therein shall be shown as a separate entry in the same columns in which losses of alcohol are shown on Form 1468–A. (53 Stat. 346, 358, 364, 375; 26 U. S. C. 2916, 3105, 3124, 3176.)

(D) Section 182.779 is amended to read as follows:

The tax on distillates lost while in transit to a denaturing plant or while stored therein prior to denaturation may be remitted in accordance with the provisions of sections 182.700a–182.700i.

PAR. 3. Section 183.408 of Regulations 4 [26 CFR, pt. 183] is amended by striking therefrom the last sentence, which reads "The liability of the distiller to tax on such distillates removed for denaturation shall continue until they have been deposited in the denaturing plant."

PAR. 4. Section 184.441 of Regulations 5 [26 CFR, pt. 184] is amended by striking therefrom the last sentence, which reads "The liability of the distiller to tax on such distillates removed for denaturation shall continue until they have been deposited in the denaturing plant."

This Treasury Decision will be effective on the 31st day after publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in secs. 3105, 3124, and 3176 of the Internal Revenue Code (53 Stat. 358, 364, 375; 26 U. S. C. 3105, 3124, 3176).)

T. Coleman Andrews,
Commissioner of Internal Revenue.

Approved March 29, 1954.
M. B. Folsom,
Acting Secretary of the Treasury.

(Published in the Federal Register April 3, 1954)

SUBCHAPTER B.—WINES

SECTION 3030.—TAX

Regulations 7, Section 178.319: Removal free of tax. Rev. Rul. 54-216

Still wine may be removed from bonded wineries and bonded wine storerooms free of tax for use in the manufacture of vinegar in accordance with the provisions of section 178.319 to section 178.328, inclusive, of Regulations 7. It is the responsibility of the proprietor of the vinegar plant to see that the amount of tax on the quantity of wine shipped to him and which may be in transit to, or on hand at the vinegar plant at any one time does not exceed the penal sum of the bond, Form 1676, "Bond Covering Removal to and Use of Wine at Vinegar Plant." The sufficiency of the bond may be checked by the Assistant Regional Commissioner, Alcohol and Tobacco Tax, of the region in which the vinegar plant is located from copies of Forms 1415, "Application to Procure Wine Tax Free for Manufacture of Vinegar," and from the records maintained by the proprietor in accordance with the provisions of section 178.327 of Regulations 7.

It is not imperative that the entire quantity of wine covered by an approved Form 1415 be shipped to the vinegar plant at one time. However, in order to avoid difficulty in determining the penal sum of the bond to be filed by the proprietor of the vinegar factory, the total quantity of wine which may be shipped pursuant thereto should be exhausted before a new Form 1415 is approved for the removal of the same kind of wine from the same vendor. If there are outstanding approved Forms 1415 under which removals have not been made, the quantity of wine covered thereby must be taken into consideration in determining the penal sum of the bond, unless no shipments are to be made thereunder and such Forms 1415 are surrendered for cancellation.

Grapes rejected by fruit packers because of size and/or color may be used in the manufacture of wine and such wine, whether or not fortified and regardless of alcoholic content, may be removed free of tax for use in the manufacture of vinegar.

Still wine which has acetified into vinegar and contains not less than 4 percent of acetic acid and not less than 6 percent of alcohol and acids combined may be removed free of tax for use as vinegar, pursuant to approved application Form 1415 under sections 178.329 and 178.332 of Regulations 7.

No restrictions have been imposed on vinegar plants with respect to the use of wine removed from a bonded winery pursuant to section 178.322 of Regulations 7 other than to keep the prescribed records and premises available for inspection, as required by sections 178.327 and 178.328 of Regulations 7.

SUBCHAPTER C.—INDUSTRIAL ALCOHOL

PART II.—INDUSTRIAL ALCOHOL PLANTS

SECTION 3105.—REGULATIONS FOR ESTABLISHING, BONDING, AND OPERATION OF PLANTS AND WAREHOUSES

REGULATIONS 3, SECTION 182.323: Prohibited hours of operation. Rev. Rul. 54–200

Tank cars of alcohol for shipment in bond which have been loaded, sealed, locked, and documented during daylight hours, in accordance with the provisions of section 182.323(a) of Regulations 3, may be transferred from the industrial alcohol plant premises during the hours between sunset and sunrise. Such tank cars should be moved as expeditiously as possible.

REGULATIONS 3, SECTION 182.874: Form 1482. (Also Section 182.877.) Rev. Rul. 54–160

A report filed on Form 1482, "User's Report of Denatured Alcohol," showing the proper disposition of all specially denatured alcohol by a specially denatured alcohol user who indicated his desire to discontinue use thereof, may be accepted as "Final," although not so marked. It will not be necessary that such permittee continue to file Forms 1482 each month showing "No Transactions" pending final approval of the notice of discontinuance. Such approval may not be given until actual disposition is made of all articles containing specially denatured alcohol. The bond of the manufacturer, if any, should not be canceled until all such articles have been properly disposed of in accordance with the applicable provisions of Regulations 3.

SECTION 3108.—WITHDRAWAL OF ALCOHOL TAX FREE

REGULATIONS 3, SECTION 182.837: Manufacture of ethyl acetate. T. D. 6070
(Also Section 182.838; Section 3109, Sections 182.840, 182.841.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 182.—INDUSTRIAL ALCOHOL

Requirements for denaturing and packaging ethyl acetate amended.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

In order (1) to permit the use of undenatured ethyl acetate in processes where it is shown that it is necessary to use such material in its pure state, (2) to permit the transfer of ethyl acetate in tank cars and tank trucks after the producer has divested himself of ownership, (3) to permit producers to transfer ethyl acetate by pipeline to the premises of an affiliate or wholly owned subsidiary entitled to receive ethyl acetate, and (4) to permit wholesale dealers receiving denatured ethyl acetate in tank cars, tank trucks, and by pipeline to package denatured ethyl acetate in containers not exceeding 55 gallons in capacity, and, subject to authorization of the Assistant Regional Commissioner, to transfer denatured ethyl acetate in tank trucks from their premises to the premises of others entitled to receive denatured ethyl acetate, Regulations 3, (26 CFR pt. 182) are hereby amended as follows:

PARAGRAPH 1. Section 182.837 is amended as follows:

(A) By striking the word "Manufacture" in the headnote and inserting in lieu thereof the word "Denaturation".

(B) By striking the period at the end thereof and adding the following: ": *Provided further*, That upon a showing to the satisfaction of the Commissioner that undenatured ethyl acetate is necessary in a manufacturing process other than for the production of pharmaceutical, scientific, food, or toilet preparations or for the production of specially denatured alcohol he may, as provided in section 182.838, authorize the use and shipment of such undenatured ethyl acetate. Undenatured ethyl acetate procured by a user may not be resold without prior approval of the Commissioner."

PAR. 2. Section 182.838 is amended by striking the entire section with headnote and inserting in lieu thereof the following:

SEC. 182.838. ETHYL ACETATE WITHOUT DENATURANTS OR WITH OPTIONAL DENATURANTS.—Any user desiring to procure undenatured ethyl acetate for use in a manufacturing process other than the production of pharmaceutical, scientific, food, or toilet preparations or for the production of specially denatured alcohol, as provided in section 182.837, shall make application to the Commissioner, stating fully the purpose for which the ethyl acetate is to be used and why he cannot use denatured ethyl acetate. The application shall contain a complete description of the process. Any user desiring to procure ethyl acetate denatured with products or chemicals in lieu of calol ethatate, denaturing grade wood alcohol, or methyl isobutyl ketone, shall make application to the Commissioner, stating fully the purpose for which the ethyl acetate is to be used and why he cannot use ethyl acetate denatured with authorized denaturants. The application shall show the kind and quantity of products or chemicals that he desires to have substituted for the calol ethatate, denaturing grade wood alcohol or methyl isobutyl ketone, in order that it may be determined that such products or chemicals possess satisfactory denaturing properties. The application shall also show the name of the producer of ethyl acetate from whom the applicant desires to procure the ethyl acetate covered by the application. If ethyl acetate is to be procured from a producer located in the same region, the application shall be filed in quadruplicate, and if the ethyl acetate is to be procured from another region, the application shall be filed in quintuplicate. If the Commissioner approves the application, he will note his approval on all copies thereof, retain the original copy, return one copy to the applicant, forward one copy to the producer, and one copy to the Assistant Regional Commissioner of the region in which the applicant is located, and, where shipment is to be made from another region, one copy to the Assistant Regional Commissioner of such region.

PAR. 3. Section 182.840 is amended by striking the entire section and inserting in lieu thereof the following:

Denatured ethyl acetate produced with specially denatured alcohol may be sold by producers thereof to (a) other producers, (b) legitimate users for solvent or other manufacturing purposes satisfactory to the Commissioner, not including manufacture, for sale, or preparations which do not contain sufficient quantities of other materials to definitely change the composition and character of the ethyl acetate, (c) reputable wholesale dealers engaged in a bona fide paint or chemical trade, for resale to legitimate users in the producer's original packages, in tank trucks or in packages not in excess of 55 gallons filled from stationary storage tanks on the premises of the wholesale dealer or from the producer's original packages, and (d) reputable retail dealers engaged in a bona fide paint or chemical trade, for resale in accordance with section 182.843.

Section 182.841 as last amended by Treasury Decision 5767 is further amended by striking paragraph (b) thereof with headnote and inserting in lieu thereof the following:

(*b*) *Transfers in tank cars, tank trucks, or by pipeline.*—Upon written authorization of the Assistant Regional Commissioner, shipments of ethyl acetate may be made by producers in railroad tank cars, or in tank trucks operated by motor carriers as defined in this part, or in tank trucks operated or controlled by producers, their bona fide agents or wholesale dealers, to themselves at other locations, to their bona fide agents and to wholesale dealers; and producers, their bona fide agents and wholesale dealers may make shipment of ethyl acetate by such means to (1) other producers, (2) their bona fide agents, (3) wholesale dealers, and (4) to actual users for solvent or manufacturing purposes and not for resale. Upon written authorization of the Assistant Regional Commissioner, producers may transfer denatured ethyl acetate by pipeline to the premises of an affiliate or a wholly owned subsidiary entitled to receive denatured ethyl acetate. In the case of railroad tank car shipments the consignee must have railroad siding facilities to receive such tank car shipments. In the case of tank car or tank truck shipments the consignee must have sufficient stationary storage tank facilities to receive such tank car or tank truck shipments. The ethyl acetate must be run directly from the tank car or tank truck to the stationary storage tank and may not be drawn into portable, unmarked containers. In the case of transfers by pipeline the pipeline must be connected with stationary storage tanks on the premises of the consignee.

Because the amendments made by this Treasury Decision are of a liberalizing character, it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitations of section 4(c) of said act.

This Treasury Decision shall be effective upon its publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in secs. 3105, 3124, and 3176 of the Internal Revenue Code (53 Stat. 385, 364, 375; 26 U. S. C. 3105, 3124, 3176).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved April 13, 1954.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Published in the Federal Register April 20, 1954)

REGULATIONS 3, SECTION 182.165: Application for permit, Form 1447. Rev. Rul. 54–217
(Also Sections 182.168, 182.266.)

Hospitals, which hold tax-free alcohol permits and are operated by municipal subdivisions of States, controlled by a board of directors or trustees appointed by the governing body of the city or county involved, are not ordinarily required to notify the Assistant Regional Commissioner, Alcohol and Tobacco Tax, of changes in the personnel of the board of directors or trustees.

Advice is requested whether municipally-owned hospitals which are governed by a board of directors or trustees and hold a tax-free alcohol user's permit need give notification in the event there is a change in the personnel of the board of directors or trustees.

Usually, the board of directors or trustees is appointed by the governing body of the city or county involved, and certain members of the board are ex-officio members, such as the mayor of the city, the chairman of the county commissioners, or similar officers.

Section 182.165(a) of Regulations 3 provides in part that applications for permits to use tax-free alcohol by municipal subdivisions of a State or Territory shall be made to the Assistant Regional Commissioner, Alcohol and Tobacco Tax, by the officer duly authorized to procure such alcohol, and evidence of such authority shall be submitted with the application. Section 182.168 of Regulations 3 gives the Commissioner or the Assistant Regional Commissioner, Alcohol and Tobacco Tax, the authority to require persons carrying on business under Regulations 3 to furnish such additional information as he may, at any time in his discretion, deem necessary with respect to the qualifying documents.

In the case of a corporation, section 182.266 of Regulations 3 requires that where there is a change in the officers or directors, the Assistant Regional Commissioner, Alcohol and Tobacco Tax, must be furnished extracts of the minutes of meetings showing such changes. However, the Internal Revenue Service holds that it is not necessary that the Assistant Regional Commissioner, Alcohol and Tobacco Tax, be notified each time there is a change in the board of directors or trustees of a hospital operated by a municipal subdivision of a State where application for a permit to procure tax-free alcohol has been properly filed under section 182.165(a) since such information may, in appropriate cases, be required under section 182.168.

Regulations 3, Section 182.168: Other qualifying documents.

Change in board of directors or trustees of a municipally owned hospital using tax-free alcohol. (See Rev. Rul. 54–217, p. 323.)

Regulations 3, Section 182.266: Changes in officers and directors.

Change in board of directors or trustees of a municipally owned hospital using tax-free alcohol. (See Rev. Rul. 54–217, p. 323.)

SECTION 3108(c).—WITHDRAWAL OF ALCOHOL TAX-FREE: FOR USE IN RESEARCH, HOSPITALS, OR CHARITABLE CLINICS

Regulations 3, Section 182.661: Hospitals, sanitariums, or clinics. Rev. Rul. 54–173

Tax-free alcohol may not be used by a municipally-owned hospital in making tests of any nature for another institution or individual unless such tests are made in pursuance of a recognized function of the hospital. A privately-owned hospital may not use tax-free alcohol withdrawn under its permit to make pathological examinations or tests for other hospitals, for physicians, or for individuals who are not patients of the hospital. A charge or fee may be made or accepted by the hospital, whether municipally or privately owned, provided the payment is for examinations or tests using tax-free alcohol which the hospital is authorized to make.

Advice is requested as to the uses, if any, which may be made of tax-free alcohol withdrawn by a municipally-owned or a privately-owned hospital other than for routine medicinal, mechanical, and scientific purposes of the hospital itself.

Section 182.661 of Regulations 3 provides that tax-free alcohol withdrawn by hospitals, sanitariums, or clinics operated for charity and not for profit, may be used only for medicinal, mechanical, and scientific purposes and in the treatment of patients. The use of the tax-free alcohol and the resultant products shall be confined strictly to the premises of the institution withdrawing the alcohol, except that where any such resulting product does not contain alcohol and is to be used in further research, it may be removed, without sale, for that purpose only. Such further research may be conducted at any scientific university or college of learning, laboratory engaged in scientific research, or hospital or clinic. Bona fide medicines compounded with tax-free alcohol withdrawn by clinics operated for charity and not for profit may be used outside of such clinics for treatment of the patients thereof, but such medicines may not be sold.

The following questions and answers illustrate the application of the foregoing statement of regulations.

Question 1. May a municipally-owned hospital conduct laboratory tests of any nature in which the use of tax-free alcohol is involved for another institution, either permittee, nonpermittee, or individual?

Answer. The use of tax-free alcohol by a municipally-owned hospital is authorized for the use of such hospital for medicinal, mechanical, and scientific purposes and for use in treating its patients. However, the use of the tax-free alcohol in making tests of any nature for another institution or individual is not authorized under the provisions of Regulations 3 unless such tests are made in pursuance of state or county requirements and are in essence a recognized function of the municipally-owned institution.

Question 2. Do the same conditions apply to a privately-owned hospital as apply to a municipally-owned hospital?

Answer. A privately-owned hospital may not use tax-free alcohol withdrawn under its permit to make pathological examinations or tests for other hospitals, for physicians, or for individuals who are not patients of such hospital. Such laboratory work of a privately-owned hospital is not considered distinguishable from that carried on by any commercial laboratory.

Question 3. May a charge be made or a fee accepted by the tax-free permittee in whose laboratory the tests involving tax-free alcohol are made?

Answer. A charge or fee may be made or accepted by the permittee hospital, whether municipally or privately owned, provided the payment is for examinations or tests using tax-free alcohol which the hospital is authorized to make.

Question 4. Would the fact that a patient is charged for the test by the institution, physician, or other person submitting the specimen to the tax-free permittee for analysis have any bearing on the legitimacy of the permittee's use of the tax-free alcohol?

Answer. If a permittee is not authorized to use tax-free alcohol in making examinations for other institutions, for physicians, or other persons submitting specimens to the permittee for analysis, the question of whether the patient is or is not charged by the submitting institution, physician, or other person, would have no bearing on the legitimacy of the permittee's use of tax-free alcohol.

SECTION 3109.—SALE OF DENATURED ALCOHOL TAX FREE

REGULATIONS 3, SECTION 182.840: To whom may be sold.

Regulations 3 amended. (See T. D. 6070, p. 321.)

SECTION 3114.—ALCOHOL PERMITS

REGULATIONS 3, SECTION 182.841: Sales to and by dealers. Rev. Rul. 54–201
(Also Section 182.847.)

Bulk shipments of ethyl acetate and proprietary solvents may be made by barge provided authority is first obtained therefor and the procedure prescribed for tank car and tank truck shipments of such materials as set forth in sections 182.841(b) and 182.847(a) of Regulations 3 is followed. Suitable dock and storage facilities must be made available. The carrier operating the barge in such cases should be one engaged in the regular transportation of merchandise and qualified to make interstate shipments, or the barge should be owned, operated, or controlled by the producer or his bona fide agents. The shipment, sale, and delivery and/or repackaging of the proprietary solvents and ethyl acetate must otherwise conform with the applicable provisions of Regulations 3.

REGULATIONS 3, SECTION 182.847: Containers.

Bulk shipments of proprietary solvents by barge. (See Rev. Rul. 54-201, p. 325.

SECTION 3115.—PENALTIES

Possession of property "intended for use" in unlawfully evading liquor taxes. (See Ct. D. 1765, p. 326.)

SECTION 3116.—FORFEITURES AND SEIZURES

(Also Section 3115.) Ct. D. 1765

CRIMINAL LIABILITY—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. SECTION 3116, INTERNAL REVENUE CODE, ALSO DEFINES A CRIMINAL OFFENSE.

The acts proscribed in section 3116, Internal Revenue Code, not only may result in forfeiture of the offending property but likewise are made criminal and punishable under the general penalty provisions of section 3115, Internal Revenue Code.

SUPREME COURT OF THE UNITED STATES

The United States of America, appellant, v. *Floyd Dixon*

On appeal from the United States District Court for the Northern District of Georgia

[April 5, 1954]

OPINION

Mr. Justice CLARK delivered the opinion of the Court.

The sole question here is whether sections 3116 and 3115 of the Internal Revenue Code make it a criminal offense to possess property intended for use in producing nontaxpaid distilled spirits in violation of the Code. Appellee was indicted under these sections for wilfully and knowingly possessing 800 pounds of sugar and parts of a still for the proscribed purpose. On motion the district court, relying on dictum in a court of appeals decision,[1] dismissed the indictment on the ground that section 3116 is "preventative and remedial rather than criminal, and that it does not define a criminal offense." The Gov-

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[1] *Kent* v. *United States*, 157 F. 2d 1 (1946). See also *United States* v. *Windle*, 158 F. 2d 196 (1946). In those cases the Government had invoked only the forfeiture provisions of the section; as applied to such a civil proceeding, characterization of the section as preventive and remedial was obviously accurate. The two reported cases which previously have faced squarely the present question have upheld the indictments. *United States* v. *Blair*, 97 F. Supp. 718 (1951); *United States* v. *Harvin*, 91 F. Supp. 249 (1950). See also *Godette* v. *United States*, 199 F. 2d 331 (1952), in which the present issue apparently was not raised.

ernment appealed directly to this court under the Criminal Appeals Act, 18 U. S. C. section 3731. 346 U. S. 930.

Section 3116 of the Internal Revenue Code is captioned "Forfeitures and Seizures," and provides in pertinent part: "It shall be unlawful to have or possess any liquor or property intended for use in violating the provisions of this part, or the internal revenue laws * * * and no property rights shall exist in any such liquor or property * * *. Nothing in this section shall in any manner limit or affect any criminal or forfeiture provision of the internal revenue laws, or of any other law. * * *" The section also provides for search warrants and for procedure in seizure and forfeiture. Section 3115 bears the caption "Penalties" and provides that anyone violating any of the provisions of "this part" for which offense a special penalty is not prescribed "shall be liable, for the first offense, to a penalty of not exceeding $1,000, or imprisonment not exceeding thirty days, or both * * *." The two sections are included within the same "part" of the Code.[2]

The appellant's position is that section 3115 makes violation of any of the provisions of "this part" a criminal offense punishable by fine and imprisonment; section 3116 contains a provision making it unlawful to possess property intended for use in violating the provisions of that part or the internal revenue laws; hence the indictment alleging a violation of sections 3116 and 3115 by such possession charges a crime. We agree and so hold. We think the plain language of the two sections read together can lead only to the conclusion that the acts proscribed in section 3116 not only may result in forfeiture but likewise are made criminal and punishable under the general penalty provisions of section 3115.

The sections here involved were borrowed, with changes insignificant for present purposes, from the National Prohibition Act of 1919, 41 Stat. 305 *et seq.* There the sections appeared as sections 25 (compare section 3116) and 29 (compare section 3115) of title II, and presented a statutory pattern virtually identical to the present one. It is most persuasive that the courts consisently upheld criminal prosecutions brought under these sections for the analogous act of possessing property designed for the manufacture of liquor intended for use in violation of title II of the Prohibition Act.[3]

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[2] Part II ("Industrial Alcohol Plants") of Subchapter C ("Industrial Alcohol") of Chapter 26 ("Liquor"). The full text of the two sections is as follows:

"SEC. 3115. PENALTIES.

"(a) VIOLATIONS AS TO OPERATION OF PLANTS OR UNLAWFUL WITHDRAWAL OF TAXABLE ALCOHOL.—Whoever operates an industrial alcohol plant or a denaturing plant without complying with the provisions of this part and lawful regulations made thereunder, or whoever withdraws or attempts to withdraw or secure tax free any alcohol subject to tax, or whoever otherwise violates any of the provisions of this part or of regulations lawfully made thereunder shall be liable, for the first offense, to a penalty of not exceeding $1,000, or imprisonment not exceeding thirty days, or both, and for a second or cognate offense to a penalty of not less than $100 nor more than $10,000, and to imprisonment of not less than thirty days nor more than one year. It shall be lawful for the Commissioner in all cases of second or cognate offense to refuse to issue for a period of one year a permit for the manufacture or use of alcohol upon the premises of any person responsible in any degree for the violation.

"(b) VIOLATIONS IN GENERAL.—Any person violating the provisions of this part or of any regulations issued thereunder, for which offense a special penalty is not prescribed, shall be liable to the penalty or penalties prescribed in subsection (a). It shall be the duty of the prosecuting officer to ascertain, in the case of every violation of this part or the regulations made thereunder, for which offense a special penalty is not prescribed, whether the defendant has been previously convicted and to plead the prior conviction in the affidavit, information, or indictment.

"(c) PREVIOUS CONVICTION.—If any act or offense is a violation of this part, and also of any other law in regard to the manufacture or taxation of, or traffic in, intoxicating liquor, a conviction for such act or offense under the one shall be a bar to prosecution therefor under the other.

"SEC. 3116. FORFEITURES AND SEIZURES.

"It shall be unlawful to have or possess any liquor or property intended for use in violating the provisions of this part, or the internal revenue laws, or regulations prescribed under such part or laws, or which has been so used, and no property rights shall exist in any such liquor or property. A search warrant may issue as provided in title XI of the act of June 15, 1917, 40 Stat. 228, for the seizure of such liquor or property. Nothing in this section shall in any manner limit or affect any criminal or forfeiture provision of the internal revenue laws, or of any other law. The seizure and forfeiture of any liquor or property under the provisions of this part, and the disposition of such liquor or property subsequent to seizure and forfeiture, or the disposition of the proceeds from the sale of such liquor or property, shall be in accordance with existing laws or those hereafter in existence relating to seizures, forfeitures, and disposition of property or proceeds, for violation of the internal revenue laws."

[3] *E. g. Reynolds* v. *United States*, 280 F. 1. (1922); *Adamson* v. *United States*, 296 F. 110 (1924); *Staker* v. *United States*, 5 F. 2d 312 (1925); *Patrilo* v. *United States*, 7 F. 2d 804, 805 (1925). Compare *Page* v. *United State*, 278 F. 41 (1922).

This consistency of interpretation, followed by Congress' utilization in the Code of the same provisions, is also helpful in dealing with the limitation in section 3115 which makes the penalties of that section applicable only where no "special penalty" is provided for the offense. As a *de novo* proposition it might be argued that in section 3116 a special penalty, forfeiture, is provided. But this argument was available with equal force under the Prohibition Act and appears to have barred no prosecution. Moreover, section 3116 contains a provision that "Nothing in this section shall in any manner limit or affect any criminal * * * provision of the internal revenue laws." This would seem to settle the point.

Clearly Congress may impose both a criminal and a civil sanction in respect to the same act; this is neither unusual nor constitutionally objectionable. See *Helvering* v. *Mitchell*, 303 U. S. 391, 399–400 (1938) [C. B. 1938–1, 317]. Likewise it is common in drafting legislation to declare certain acts unlawful in one section and set forth penalties for their commission in another.[4]

The only suggestion on the face of the statute that section 3116 was meant to be remedial and nothing more comes from its caption, "Forfeitures and Seizures," supplied by the codifiers in 1939. But in enacting the Code Congress provided that "The arrangement and classification of the several provisions of the Internal Revenue Title have been made for the purpose of a more convenient and orderly arrangement of the same, and, therefore, no inference, implication or presumption of legislative construction shall be drawn or made by reason of the location or grouping of any particular section or provision or portion thereof, nor shall any outline, analysis, cross reference, or descriptive matter relating to the contents of said Title be given any legal effect." 53 Stat. 1a. To accomplish its primary purpose of bringing together all operative revenue laws and making them more comprehensible, the Code made "liberal use of catchwords."[5] Typically, section 3116 is included in a subchapter entitled "Industrial Alcohol" and in a part entitled "Industrial Alcohol Plants"; yet even under a most narrow interpretation of its terms the section is in no sense limited to industrial alcohol.

So far as light is to be had from legislative history, it is meager and inconclusive, in no way militating against the meaning we attribute to the statute.

Reversed.

Concurring opinion by Mr. Justice Black with whom Mr. Justice Douglas, Mr. Justice Jackson, and Mr. Justice Minton concur.

SUBCHAPTER D.—FERMENTED LIQUORS

SECTION 3150.—TAX

REGULATIONS 18, SECTION 192.250: Beer tax rate. Rev. Rul. 54–248

> The exemption from Federal and local taxes granted to the individual delegates to the United Nations does not entitle them to obtain fermented liquors free of internal revenue tax from a brewery in the United States.

Advice is requested whether members of the delegation of a foreign country to the United Nations may, as members of a Diplomatic Embassy, obtain fermented liquors from a brewery in the United States free of the internal revenue tax.

Section 3150(a) of the Internal Revenue Code provides in part that there shall be levied and collected a tax (at the current rate) on all fermented liquor containing one-half of 1 percent or more of alcohol, brewed or manufactured and sold, or removed for consump-

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[4] *E. g.*, Fair Labor Standards Act, 29 U. S. C. secs. 215, 216; Internal Revenue Code (narcotics), 26 U. S. C. secs. 2553, 2554, 2557.

[5] H. R. Rep. No. 6, 76th Cong., 1st sess. 3; S. Rep. No. 20, 76th Cong., 1st sess. 3.

tion or sale, within the United States. Section 3150(b) of the Internal Revenue Code provides in part that the tax on such fermented malt liquor shall be paid by the owner, agent, or superintendent of the brewery or premises in which such fermented liquors are made.

The internal revenue tax on fermented malt liquors must be paid by the brewer before removal from the brewery premises *for consumption or sale within the United States.* The Internal Revenue Code does not provide any exception to this requirement.

The exemption from Federal and local taxes granted to the individual delegates to the United Nations does not entitle them to obtain fermented liquors free of internal revenue tax from a brewery in the United States.

SECTION 3155.—REQUIREMENTS ON BREWERS

REGULATIONS 18, SECTION 192.440: Form 103.

Regulations 18 amended. (See T. D. 6069, p. 330.)

SECTION 3155(f).—REQUIREMENTS ON BREWERS: BRANDING NAME OF MANUFACTURER AND PLACE OF MANUFACTURE ON CONTAINERS

REGULATIONS 18, SECTION 192.166: Marking and branding. Rev. Rul. 54–127
(Also Sections 192.255 and 192.259.)

Where the name of the brewer has been changed but no change of ownership is involved, the new name may be placed on the metal kegs additionally as successor by indentation such as sandblasting or other appropriate means. After the new name becomes effective the brewer may be allowed reasonable time in which to place the new name on the existing cooperage but he should immediately place a sticker on the kegs bearing the markings prescribed by section 192.255 of Regulations 18 until the kegs can be so branded, which must be done as expeditiously as possible.

REGULATIONS 18, SECTION 192.400: Notice to supervisor. Rev. Rul. 54–103

Under the provisions of section 3155(f) of the Internal Revenue Code and section 192.400 to section 192.403, inclusive, of Regulations 18, a brewer may purchase from another brewer fermented malt liquor in vessels branded with the name and location of the purchasing brewer, the taxpaid stamps to be attached by the producing brewer before removal; however, there is no authority in law or regulations under which brewers may similarly purchase bottled beer. Permission for such a transaction may not be granted. Purchased taxpaid beer may not be received on brewery bottling house premises for labeling.

SECTION 3157.—BOTTLING FERMENTED LIQUORS

REGULATIONS 18, SECTION 192.281: Tax table computations, cases in barrel equivalents. (Also Section 3155, Sections 192.440, 192.441.) T. D. 6069

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 192.—FERMENTED MALT LIQUORS

Amendment of requirements for filling cases and preparing Forms 103 and 139.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C.

To Officers and Employees of the Internal Revenue Service and Others Concerned:

On December 10, 1953, notice of proposed rulemaking, regarding amendments to Regulations 18 [26 CFR, pt. 192], to provide for a more accurate determination of a brewer's tax liability by eliminating the present provisions for packaging an indiscriminate mixture of 7 and 8 ounce bottles or 11 and 12 ounce bottles of beer in one case, and to require that the daily statement of fermented malt liquor bottled be reported on Form 103 in lieu of Form 139 was published in the Federal Register (18 F. R. 8119). No comments having been received during the 30-day period prescribed in such notice, the amendments to Regulations 18 set forth below are hereby adopted:

PARAGRAPH 1. Wherever the term "supervisor" or "district supervisor" appears in the sections of the regulations revised by this Treasury Decision, such term is hereby amended to read "Assistant Regional Commissioner, Alcohol and Tobacco Tax."

PAR. 2. Section 192.281 is amended by changing the colon in the first sentence to a period and striking the proviso which begins "*Provided*, That due to conditions".

PAR. 3. Section 192.440 is amended as follows:

(A) By inserting in the first sentence, immediately after the words "removed from the brewery premises," the phrase "the quantity of fermented liquor bottled,".

(B) By striking the fifth sentence, which begins "The aggregates of quantities bottled".

PAR. 4. Section 192.441 is amended as follows:

(A) By striking from the second sentence the words "bottled and the aggregate quantity".

(B) By striking from the last sentence the words "bottled and entries as to quantities".

This Treasury Decision shall be effective on the 1st day of the 1st month which begins not less than 30 days following the date of publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in sec. 161 of the Revised Statutes and secs. 3176 and 3791 of the Internal Revenue Code (sec. 161 R. S.; 5 U. S. C. 22; 53 Stat. 375, 467; 26 U. S. C. 3176, 3791).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved March 31, 1954.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Published in the Federal Register April 6, 1954)

SECTION 3158.—BREWERY PREMISES

REGULATION 18, SECTION 192.31: Use of brewery premises. Rev. Rul. 54–79

A product prepared from malt, hops, and a grain product, which is not subjected to any fermenting process after brewing, may be produced on brewery premises as an unfermented malt beverage (cereal beverage) in accordance with the provisions of section 3158 of the Internal Revenue Code and section 192.31 of Regulations 18.

The requirements of Regulations 18, contained in section 192.410 to section 192.422, inclusive, with respect to the manufacture, bottling, etc., of cereal beverages, must be followed in the production and distribution of the product.

SUBCHAPTER E.—MISCELLANEOUS GENERAL PROVISIONS

SECTION 3171.—RECORDS, STATEMENTS, AND RETURNS

REGULATIONS 3, SECTION 182.643: Preparation and disposition. Rev. Rul. 54–202

Since alcohol produced from ethylene gas, or other petroleum derivative, may be deposited in an industrial alcohol bonded warehouse and later withdrawn taxpaid, or transferred in bond and later withdrawn taxpaid, the proprietor of the industrial alcohol plant where such alcohol is produced should show "Alcohol—Petroleum Derivative" on Form 1440, "Report of Alcohol Gauged." Accordingly, where the origin of alcohol is required to be shown on packages of ethyl alcohol produced from ethylene gas or other petroleum derivative, such origin should be shown as "Alcohol—Petroleum Derivative."

REGULATIONS 3, SECTION 182.877: Procedure.

Discontinuance of use of specially denatured alcohol by a specially denatured alcohol user. (See Rev. Rul. 54–160, p. 320.)

SECTION 3176.—RULES AND REGULATIONS

REGULATIONS 7, SECTION 178.245: General. Rev. Rul. 54–128

Cases of taxpaid wine bottled on taxpaid bottling house or rectifying plant premises, after receipt of the wine by pipeline from a bonded winery or bonded storeroom, as provided in section 178.245 to section 178.249, inclusive, of Regulations 7, are not required to bear marks showing that the wine has been taxpaid.

REGULATIONS, SECTION 190.706: Rebottling, relabeling and restamping of bottled spirits. Rev. Rul. 54–155

Bottles of unsalable imported distilled spirits may be dumped and rebottled, under the supervision of a Government officer. The rebottling, restamping, and relabeling operations must be conducted in accordance with the applicable provisions of Regulations 15.

SECTION 3179.—EXEMPTION AND DRAWBACK IN CASE OF EXPORTATION

REGULATIONS 28, SECTION 176.15: Export storage room. Rev. Rul. 54–150

Export storage rooms may be established at ports of exportation for the storage of distilled spirits and wines bottled or packaged especially for export with benefit of drawback only in connection with taxpaid bottling houses, rectifying plants and internal revenue bonded warehouses, as authorized by section 176.16 of Regulations 28. Such export storage rooms for the storage of wine may be established only in or contiguous to bonded wineries and bonded storerooms as authorized by section 176.15 of Regulations 28. Export storage rooms may not be established at the port of exportation in or contiguous to wholesale liquor dealer premises. The bottling-in-bond department of an internal revenue bonded warehouse may not be operated alternately as a class 6 customs bonded manufacturing warehouse for export purposes. Applications for withdrawal of export spirits from an export storage room or from an internal revenue bonded warehouse may not be approved by a customs officer in the name of the assistant regional commissioner and such withdrawals may not be made under the supervision of a customs officer. Such approval must be made by the assistant regional commissioner as authorized in section 176.36 of Regulations 28.

CHAPTER 27.—OCCUPATIONAL TAXES

SUBCHAPTER A.—SPECIAL PROVISIONS

PART VII.—LIQUOR

SECTION 3250.—TAX

REGULATIONS 23, SECTION 181.30: Repairs or alterations. Rev. Rul. 54–218

A distiller would not incur liability to special (occupational and commodity) taxes by reason of the replacement of all of the tubes of a condenser at one time, without other modification or change, nor by reason of replacing the entire outer jacket of a condenser without other modification or change.

Advice is requested whether liability is incurred by a distiller to special (occupational and commodity) taxes as a result of the replacement of all copper tubes in a condenser. Advice is also requested whether the replacement of the entire outer jacket of a condenser would subject the distiller to such taxes.

Section 3250 (j) of the Internal Revenue Code provides a special occupational tax of $55 upon manufacturers of stills and a commodity tax of $22 (to be paid by the manufacturer) for each still or worm manufactured. Section 3254 (h) defines a manufacturer of stills as "any person who manufactures any still or worm to be used in distilling."

Section 181.30 of Regulations 23 provides that whenever a still, worm, or condenser, to be used in distilling, is repaired or altered by the addition of new material to such an extent as virtually to result in the construction of a new still, worm, or condenser, the person making such repairs or alterations will be held liable to the special (commodity) tax for each still, worm, or condenser so required or altered and will incur liability to the special (occupational) tax as a manufacturer of stills.

It is not considered that the repair of a condenser by replacing all of the tubes at one time would "virtually result in the construction of a new * * * condenser." The shell and ends were in existence at all times and would have been referred to as a "condenser." Similarly, the replacement of the entire outer jacket of a condenser, without other modification or change, would not constitute the manufacture of a new condenser.

Accordingly, it is held that a distiller would not incur liability to special (occupational and commodity) taxes by reason of (1) the replacement of all of the copper tubes in a condenser, without other modification or change or (2) by reason of the replacement of the entire outer jacket of a condenser, without other modification or change.

SECTION 3251.—CASUAL SALES

REGULATIONS 20, SECTION 194.189: Sales by executor, administrator, or other fiduciary. Rev. Rul. 54-189

Under the provisions of section 3251(a) of the Internal Revenue Code, and section 194.189 of Regulations 20, no special tax will accrue on a sale of distilled spirits, wines, or malt liquors made by a fire insurance company, or its salvaging agents, acting in a fiduciary capacity, which has taken over such products after their damage by fire, provided the products are sold in one parcel only or at public auction in parcels of not less than 20 wine gallons.

SECTION 3254.—DEFINITIONS

REGULATIONS 20, SECTION 194.29: Wholesale dealers in liquors; persons liable. (Also Sections 3, 6, Federal Alcohol Administration Act; Section 1, FAA Regulations No. 1; Section 3.20, FAA Regulations No. 3.) Rev. Rul. 54-129

A retail liquor dealer may purchase warehouse receipts for distilled spirits and have the spirits transferred to an internal revenue bonded warehouse of his choice for the purpose of bottling, on his order pursuant to a contract for payment of Federal, State, and local taxes, plus storage and bottling charges, without incurring liability for special tax as a wholesale liquor dealer and without obtaining a wholesaler's basic permit as long as the distilled spirits are bottled for sale by the retail liquor dealer.

The proprietor of an internal revenue bonded warehouse, holding a special tax stamp as a wholesale liquor dealer, is not precluded by section 2860 of the Internal Revenue Code, from receiving more than 20 wine gallons of distilled spirits owned by a retail liquor dealer when such spirits are received for the purpose of storage and bottling on the order of the retailer and the ownership of the spirits remains with the retail liquor dealer.

Advice is requested whether a retail liquor dealer may, within the intent of the internal revenue laws relating to liquors and of the Federal Alcohol Administration Act, purchase warehouse receipts covering distilled spirits, have such distilled spirits transferred to an internal revenue bonded warehouse for bottling and shipped to him, the retailer, through a wholesale liquor dealer.

A retail liquor dealer purchased warehouse receipts for bulk spirits in excess of 20 wine gallons from a qualified broker. He gave possession of the warehouse receipts to the proprietor of an internal revenue bonded warehouse who had the spirits transferred in bond to his warehouse. The proprietor of the warehouse then issued new receipts to the retail liquor dealer who invoiced them back to the proprietor of the internal revenue bonded warehouse. This transaction was not a sale but merely a bottling agreement. No payment of money or transfer of other consideration was made by the proprietor of the internal revenue bonded warehouse for the warehouse receipts and he continued to treat the whisky as the property of the retail liquor dealer. The warehouse receipts were held by the warehouseman for bottling of the whisky on the order of the retail liquor dealer under an agreement for payment of storage and bottling charges, plus Federal, State, and local taxes. Upon completion of bottling, the bottled whisky was invoiced to the retail liquor dealer through a qualified wholesale liquor dealer who was paid by the retailer for taxes, storage and bottling charges, and the wholesale liquor dealer's charges.

In the instant case, it was necessary that the bottled whisky be consigned to the retailer through a wholesaler to satisfy the requirements of the laws of the State in which the retailer's business is carried on. There are no Federal requirements that a retailer receive bottled distilled spirits through a person holding a wholesaler's basic permit.

Section 6(a) of the Federal Alcohol Administration Act, 49 Stat. 985, reads in part:

> It shall be unlawful for any person * * * to sell or offer to sell, contract to sell, or otherwise dispose of warehouse receipts for distilled spirits in bulk unless such warehouse receipts require that the warehouseman shall package such distilled spirits, before delivery, in bottles labeled and marked in accordance with law, or deliver such distilled spirits in bulk only to persons to whom it is lawful to sell or otherwise dispose of distilled spirits in bulk.

Such provisions and the provision of Regulations No. 3 issued thereunder relating to bulk sales and bottling of distilled spirits, do not prohibit a retail liquor dealer from purchasing warehouse receipts for distilled spirits or from transferring the warehouse receipts to a permittee qualified to bottle such spirits. The agreement between the retailer and the bottler regarding the transfer of the warehouse receipts and the bottling of the whisky is a commercial transaction for which no specific form is specified or required by Federal law or regulations, except that the whisky must be delivered to a person authorized to receive whisky in bulk.

Section 3250(a) of the Internal Revenue Code provides that wholesale dealers in liquors shall pay a special (occupational) tax at a given rate. Under section 3254(b) of the Internal Revenue Code, persons engaged in the business of selling warehouse receipts must pay the special tax as a wholesale dealer in liquors. However, in view of the fact that neither title to nor beneficial ownership of the whisky passed from the retail liquor dealer to the internal revenue bonded warehouse proprietor in the course of the transaction, the giving possession of the receipts is not a sale within the meaning of the special tax laws or under the provisions of Regulations 20.

Section 2860 of the Internal Revenue Code makes it unlawful for any rectifier of distilled spirits, or wholesale or retail liquor dealer, to purchase or receive any distilled spirits in quantities greater than 20 wine gallons from any person other than an authorized rectifier of distilled spirits, distiller, or wholesale dealer.

Each company involved in the instant transaction has paid the special tax as a wholesale liquor dealer except the retailer. Any "purchase" by the bottler of distilled spirits from the retail liquor dealer in quantities greater than 20 wine gallons would make the bottler liable for the penalty of $1,000 prescribed by section 2860 of the Internal Revenue Code. The warehouse receipts represent the whisky and the transfer of the receipts represent constructive or symbolic delivery of the whisky for the purpose of sale. *Taney* v. *Penn. Nat'l Bank*, 232 U. S. 174. However, the transfer of the warehouse receipts, without payment and on the basis of the agreement that the retai liquor dealer would pay taxes and storage and bottling charges, woul(not constitute a "purchase" of the whisky within the meaning of sec tion 2860 of the Internal Revenue Code.

In the case of *U. S.* v. *Fridenburg*, U. S. District Court N. D. Fla (1869), Fed. Cas. No. 15168, the court held that the word "receive' as used in this section means *receive for sale* and that when a rectifie1 or wholesale liquor dealer receives, for storage only and not for sale more than 20 wine gallons of spirits from a person other than on(authorized to sell such spirits, he does not incur the penalty.

The retail liquor dealer did not incur liability for the special tax a: a wholesale liquor dealer through purchase of the warehouse receipt: and did not engage in transactions for which a basic permit is required under the provisions of section 3 of the Federal Alcohol Administration Act.

The giving possession of warehouse receipts to the warehousemar (bottler) by the retail liquor dealer under the agreement for payment of taxes, and storage and bottling charges, did not constitute receipt of the spirits from the retail liquor dealer within the meaning of section 2860 of the Internal Revenue Code.

CHAPTER 28.—PROVISIONS COMMON TO MISCELLANEOUS TAXES

SUBCHAPTER A.—GENERAL PROVISIONS

PART IV.—MISCELLANEOUS PROVISIONS

SECTION 3331.—EXEMPTION FROM TAX OF DOMESTIC GOODS PURCHASED FOR THE UNITED STATES

REGULATIONS 10, SECTION 185.840: Persons entitled to make withdrawals. Rev. Rul. 54–249

Distilled spirits may be bottled in bond for sale, free of tax, to the Armed Services Medical Procurement Agency.

Advice is requested relative to the sale of distilled spirits, free of tax, to the Armed Services Medical Procurement Agency, and the procedure to be followed therefor.

Distilled spirits may be bottled in bond for sale, free of tax, to the Armed Services Medical Procurement Agency. Proprietors of internal revenue bonded warehouses may be authorized to proceed with the bottling of such spirits upon receipt of an order from the Armed Services Medical Procurement Agency in advance of the filing of the application on Form 543, "Application for the Withdrawal of Distilled Spirits Other than Alcohol, Free of Tax, Under the provisions of Section 3331, Internal Revenue Code, for Use of the United States," in order that the serial numbers of the cases may be made available for inclusion in the required bond, Form 544, and the application, Form 543. In such case, a copy of the order from the Armed Services

Medical Procurement Agency must be exhibited to the storekeeper-gauger and the spirits may not be shipped until the necessary permit on Form 1508, "Permit for Withdrawal of Distilled Spirits from Bond, Free of Tax, for Use of the United States," has been received by the warehouseman.

If the spirits are bottled at 100° of proof, the warehouseman may exercise an option regarding the use of green strip stamps on the bottles, based on a preference expressed in the contract by the Armed Services Medical Procurement Agency. However, in order that green strip stamps may be used the spirits must be eligible in all respects for designation as bottled-in-bond spirits in accordance with the provisions of Regulations 10. In the event green strip stamps are to be used, the bottles will be labeled as bottled-in-bond spirits in accordance with the applicable provisions of Regulations 10.

Where the contract calls for spirits of 100° of proof but specifies that green strip stamps are not to be used, plain strips, bearing the legend "Bottled Especially for the Armed Services Medical Procurement Agency," may be substituted therefor. If the spirits are eligible for designation as bottled-in-bond spirits, the bottles will be labeled as bottled-in-bond spirits.

Where the contract calls for spirits of less than 100° of proof plain strips will be used in lieu of green strip stamps and such spirits, as well as spirits of 100° not eligible for designation as bottled-in-bond spirits, will not bear bottled-in-bond caution notices or the designation "In Bond." Government labels or strips of plain paper over the necks of the bottles must bear the legend "Bottled Especially for the Armed Services Medical Procurement Agency."

The distilled spirits may not be stored elsewhere than in the internal revenue bonded warehouse. The bottling of distilled spirits for the Armed Services Medical Procurement Agency may be conducted simultaneously with the bottling in bond of spirits of 100° of proof in the bottling-in-bond department of the internal revenue bonded warehouse provided the bottling lines are entirely separated from each other and the bottled spirits are stored separately.

FEDERAL ALCOHOL ADMINISTRATION ACT

SECTION 3.—UNLAWFUL BUSINESSES WITHOUT PERMIT

FAA Regulations No. 1, Section 1: When required.

Purchase of warehouse receipts by a retail liquor dealer. (See Rev. Rul. 54–129, p. 334.)

SECTION 4.—PERMITS

Distilled spirits purchased abroad by one importer and entered into customs custody in the name of a second importer. (See Rev. Rul. 54–186, p. 306.)

SECTION 5(b).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: TIED HOUSE

FAA REGULATIONS No. 6, SECTION 6.20: Application. Rev. Rul. 54–130

The collection of dues by members of a wholesale liquor dealers' association from retailers on behalf of a retail liquor dealers' association, whether or not the wholesalers are compensated for such collection service, falls within the intent of section 5(b)(3) of the Federal Alcohol Administration Act, and, if the dues collection service results in the direct or indirect inducement of the retailers to purchase from such wholesalers to the exclusion in whole or in part of goods sold or offered for sale by other persons in interstate commerce, violations of the act would ensue.

FAA REGULATIONS No. 6, SECTION 6.20: Application. Rev. Rul. 54–151

The practice, on the part of a producer, importer, or wholesaler of malt beverages, of giving or selling branded or plain glassware to retailers of malt beverages for use on their premises, would fall within the provisions of section 5(b)(3) of the Federal Alcohol Administration Act, if the law of the State in which the retailer is located also prohibits this practice. A violation of the act would ensue if the practice induced retailers to purchase from the industry member making such gifts or sales to the exclusion in whole or in part of similar products sold or offered for sale by others in interstate or foreign commerce.

FAA REGULATIONS No. 6, SECTION 6.20: Application. Rev. Rul. 54–161

Price reductions, rebates, refunds, and discounts given by a wholesale liquor dealer to a retail liquor dealer pursuant to an agreement made at the time of the sale of the merchandise involved are considered a part of the sales transaction, constituting reductions in price pursuant to the terms of the sale. Such transactions do not fall within the purview of section 5(b) of the Federal Alcohol Administration Act, provided they do not involve the imposition of any requirement upon the retailer to take and dispose of a certain quota of the wholesale dealer's products, or do not involve any of the other practices set forth in section 5(a) to 5(d), inclusive, of the Act. This view would hold irrespective of whether the quantity discount was prorated and allowed on each delivery, given in a lump sum after the entire quantity of merchandise purchased had been delivered, or based on dollar volume or on the quantity of merchandise purchased.

Ordinarily, "free" goods are nothing more than price reductions in the same status as discounts and, similarly, are not within the purview of section 5(b) of the Federal Alcohol Administration Act. For example, if a wholesale liquor dealer agreed to "give" a retail liquor dealer a "free" case for each 10 cases purchased, such transaction is essentially a reduction in the usual price. However, if the amount of the product given free with the order is such that the pricing aspect is merely a subterfuge, the transaction would constitute a "gift" within the meaning of this section of the Federal Alcohol Administration Act.

FAA Regulations No. 6, Section 6.23: Signs. (Also Section 5(e); FAA Regulations No. 5, Section 70.) Rev. Rul. 54–203

The term "Texas Fifth" may be used to describe half-gallon bottles of distilled spirits provided the packages are clearly marked to show the actual contents.

The furnishing of things of value by a wholesaler to his salesmen does not come within the provisions of section 5(b)(3) of the Federal Alcohol Administration Act and is therefore permissible.

It is permissible in the case of chain-store operations to place displays not exceeding $10 in cost in any or all of the stores included in the chain. The $10 limitation prescribed by section 6.23 of Regulations No. 6 is applicable to each retail establishment.

Advice is requested whether the term "Texas Fifth" may be used to describe half-gallon bottles of distilled spirits. Advice is also requested whether a wholesale liquor dealer may furnish Texas hats and shirts to his salesmen for the purpose of advertising a product in connection with the use of the term "Texas Fifth," and whether Texas hats may be furnished to retailers for display purposes.

Section 5(e) of the Federal Alcohol Administration Act, among other things, makes it unlawful for any person engaged in business as a manufacturer, bottler, importer, or wholesaler of alcoholic beverages to introduce into interstate commerce any distilled spirits, wine, or malt beverages, unless such products are bottled, packaged, and labeled in conformity with regulations, in such manner as will prohibit deception of the consumer with respect to the quantity of such product.

Since the containers must, under sections 32 and 37 of Regulations No. 5 be clearly marked to show the actual contents, the use of the term "Texas Fifth" to describe the half-gallon bottles is not "deceptive" within the intent of section 5(e) of the Federal Alcohol Administration Act and is permissible.

Section 5(b)(3) of the Federal Alcohol Administration Act, subject to the jurisdictional limitations in respect to malt beverages, prohibits a manufacturer, importer, or wholesaler of alcoholic beverages from inducing a retailer to purchase his products to the exclusion in whole or in part of similar products of other persons sold or offered for sale in interstate or foreign commerce under the conditions stated therein by furnishing, giving, renting, lending, or selling to the retailer any equipment, fixtures, signs, supplies, money, services, or other thing of value, subject to such exceptions as may by regulations be prescribed.

This subsection of the Federal Alcohol Administration Act is applicable only to the furnishing of equipment, fixtures, signs, etc., to retailers. Therefore, there would be no objection to a wholesale liquor dealer furnishing his salesmen with Texas hats and shirts for the purpose of advertising a product distributed by the wholesaler.

Section 6.23 of Regulations No. 6, issued pursuant to the Federal Alcohol Administration Act, provides that signs, posters, placards, etc., bearing advertising matter and for use inside a retail establishment may be furnished, given, rented, loaned, or sold to the retailer if they have no value to the retailer except as advertisements and if the total value of all such materials furnished by any industry member and in use at any one time in any retail liquor dealer's establishment does not exceed $10.

There would be no objection to the wholesaler setting up displays in retail stores by placing merchandise of the retailer around one of the Texas hats furnished by the wholesaler provided the total value of all of the material furnished by the wholesaler (including the cost of setting up the display) will not exceed $10. The $10 limitation referred to in the regulations is applicable to each retail establishment and not to each retailer. Therefore, it would be permissible in the case of chain-store operations to place such a display in each of the stores included in the chain.

Rev. Rul. 54–162

The prohibitions of section 5 (b) (6) of the Federal Alcohol Administration Act against inducing purchases of alcoholic beverages by extending excessive credit to a retailer are not violated so long as a current order from a retailer whose account is in arrears is accompanied with a payment equal to or greater than the value of such current order. This would be true regardless of the manner in which the transaction is handled on the records of the supplier.

Rev. Rul. 54–175

The practice of producers, importers, or wholesalers of alcoholic beverages under the Federal Alcohol Administration Act of furnishing merchandise or other things of value, such as barbecue sets, to retailers of alcoholic beverages, in conjunction with the sale of distilled spirits, or wine, would fall within the coverage of section 5(b) of the Federal Alcohol Administration Act. Violations of the act would ensue if the furnishing of such merchandise induced the retailers to purchase alcoholic beverages from the industry member furnishing the merchandise, to the exclusion in whole or in part of alcoholic beverages sold or offered for sale by other persons in interstate or foreign commerce.

Rev. Rul. 54–176

Any contribution by a wholesale liquor dealer to a cooperative advertisement falls within the coverage of section 5(b) of the Federal Alcohol Administration Act. Therefore, contributions by wholesale liquor dealers (even though in amounts of not exceeding 10 dollars each) towards the cost of advertising for the purpose of celebrating the renovation and redecoration of a retail liquor dealer's cocktail lounge would constitute violation if "inducement" and "exclusion" result therefrom.

Rev. Rul. 54–177

A violation of section 5(b) (3) of the Federal Alcohol Administration Act will ensue if retailers are induced, within the jurisdictional limitations prescribed therein, to purchase a brewer's product to the exclusion in whole or in part of similar products sold or offered for sale by other persons in interstate or foreign commerce as a result of the brewer guaranteeing a manufacturer of refrigerating equipment that he can sell a specific number of mechanical beer cooling cabinets having the trade name of the brewer permanently embossed thereon, and salesmen of the brewer informing retail dealers that they can buy at the wholesale price. The brewer would be furnishing or giving something of value within the meaning of section 5(b)(3) of the Federal Alcohol Administration Act as the purchase of the beer cooling cabinet with the embossed trade-mark would result in savings to the retailer which he could not otherwise get by purchasing cabinets which do not bear the permanently embossed trade-mark.

In the case of malt beverages, section 5(b)(3) of the Federal Alcohol Administration Act applies to transactions between a retailer in a State and a brewer or wholesaler of malt beverages outside such State only to the extent that the law of the State in which the retailer is located imposes similar requirements with respect to transactions between retailers and brewers or wholesalers in the State. Therefore, this ruling would not apply if the retailer were located in a State not having provisions similar to those contained in the Federal Alcohol Administration Act.

SECTION 5(c).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: COMMERCIAL BRIBERY

FAA Regulations No. 6, Section 6.20: Application. — Rev. Rul. 54–131
(Also Section 5(b).)

A premium offer, which states that six stainless steel knives (with a $3 value) will be furnished for $1 and one neck band from a bottle of a particular brand of wine, or a similar offer, is not contrary to any provisions of the Federal Alcohol Administration Act, provided retailers and employees of wholesalers and retailers are excluded from participation therein.

SECTION 5(e).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: LABELING

FAA Regulations No. 4, Section 21: The standards of identity. — Rev. Rul. 54–174

A product which is compounded from grape wine, with herbs and other natural aromatic flavoring materials, and which possesses the taste, aroma, and characteristics generally attributed to vermouth, and has an alcoholic content of less than 15 percent by volume, would be appropriately designated as "A Grape Wine Flavored with Herbs Customarily Used in the Flavoring of Vermouth."

FAA REGULATIONS No. 4, SECTION 21: The standards of identity.

Production and labeling of "May Wine." (See Rev. Rul. 54–126, p. 304.)

FAA REGULATIONS No. 4, SECTION 34: Class and type. Rev. Rul. 54–238

The term "Dry" may be properly applied only to wines less sweet than average wines of the same class and type, but in no event may "Dry" be used on labels of wine having a total solids content of more than 17 grams per hundred cubic centimeters. The words "Extra Dry" may be applied only to wines considerably less sweet than average wines of the same class and type.

FAA REGULATIONS No. 4, SECTION 39: Prohibited practices. Rev. Rul. 54–250

Blended wines composed of two or more distinct vintages may not bear back labels showing the percentages and vintages of each of the blend's components.

SECTION 5(f).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: ADVERTISING

FAA REGULATIONS No. 4, SECTION 64: Prohibited statements. Rev. Rul. 54–163

Section 64(a)(8) of FAA Regulations No. 4 prohibits the use of any statement, design, device, or representation which relates to alcoholic content in the advertising of wine.

It is held that statements of alcoholic content given by oral presentation on radio and television or contained in advertising other than on label reproductions are in violation of the regulations. However, no objection is interposed to the reproduction of an approved wine label, which bears the statement of alcoholic content, on any advertising media, or to the displaying on television of an actual wine bottle showing the approved label bearing the statement of alcoholic content.

SECTION 6.—BULK SALES AND BOTTLING

FAA REGULATIONS No. 3, SECTION 3.20: Distilled spirits in bulk.

Purchase of warehouse receipts by a retail liquor dealer. (See Rev. Rul. 54–129, p. 334.)

PART IV.—LEGISLATION AND TREATIES

PUBLIC LAW 324, EIGHTY-THIRD CONGRESS [SECOND SESSION] H. R. 8224

An Act To reduce excise taxes, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) SHORT TITLE.—This Act may be cited as the "Excise Tax Reduction Act of 1954."

(b) ACT AMENDATORY OF INTERNAL REVENUE CODE.—Except as otherwise expressly provided, wherever in this Act an amendment or repeal is expressed in terms of an amendment to or repeal of a section, subsection, paragraph, or subparagraph, the reference shall be considered to be made to a provision of the Internal Revenue Code.

TITLE I—RETAILERS' EXCISE TAXES

SEC. 101. RETAILERS' EXCISE TAX ON LUGGAGE, ETC.

Section 1651(a) (relating to retailers' excise tax on luggage, etc.) is hereby amended by striking out "20 per centum" and inserting in lieu thereof "10 per centum".

SEC. 102. RETAILERS' EXCISE TAXES ON JEWELRY, FURS, AND TOILET PREPARATIONS.

For reduction in rate of retailers' excise taxes on jewelry, furs, and toilet preparations, see section 504(a).

SEC. 103. EFFECTIVE DATE OF TITLE I.

For effective date of this title see section 505(a).

TITLE II—TAXES ON ADMISSIONS AND DUES

SEC. 201. TAX ON ADMISSIONS.

(a) PERMANENT USE OR LEASE OF BOXES OR SEATS.—Section 1700(b)(1) (relating to tax on permanent use or lease of boxes or seats) is hereby amended by striking out "11 per centum" and inserting in lieu thereof "10 per centum".

(b) SALES OUTSIDE BOX OFFICE.—Section 1700(c)(1) (relating to tax on sales outside box office) is hereby amended by striking out "11 per centum" and inserting in lieu thereof "10 per centum".

(c) CABARETS, ROOF GARDENS, ETC.—The first sentence of section 1700(e)(1) (relating to tax on cabarets, roof gardens, etc.) is hereby amended to read as follows: "A tax equivalent to 20 per centum of all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit, by or for any patron or guest who is entitled to be present during any portion of such performance."

(d) SINGLE OR SEASON TICKETS AND SUBSCRIPTIONS.—For reduction in rate of tax on admission by single or season ticket or subscription, see section 504(a).

(e) RATE TO APPLY TO MAJOR FRACTIONS.—Section 1700(a)(1) (relating to rate of tax on single or season tickets and subscriptions) is hereby amended by striking out "fraction" and inserting in lieu thereof "major fraction".

(f) EXEMPTION OF ADMISSIONS OF FIFTY CENTS OR LESS.—Section 1700(a)(1) (relating to rate of single or season tickets and subscriptions) is hereby amended by striking out the second sentence thereof and inserting in lieu thereof the following: "No tax shall be imposed under this paragraph on the amount paid for admission—

"(A) if the amount paid for admission is 50 cents or less, or

"(B) in the case of a season ticket or subscription, if the amount which would be charged to the holder or subscriber for a single admission is 50 cents or less."

(g) ADMISSIONS TO CERTAIN RACE TRACKS.—

(1) Section 1700(a) (relating to rate of tax on single or season tickets and subscriptions) is hereby amended by adding at the end thereof the following:

"(3) CERTAIN RACE TRACKS.—In lieu of the tax imposed under paragraph (1), a tax of 1 cent for each 5 cents or major fraction thereof of the amount paid for admission to any place (including admission by season ticket or subscription) if the principal amusement or recreation offered with respect to such admission is horse or dog racing at a race track. The tax imposed under this paragraph shall be paid by the person paying for such admission."

(2) Section 1700(b) (relating to rate of tax on permanent use or lease of boxes or seats) is hereby amended—

(A) by striking out "paragraph (1) of subsection (a)" and inserting in lieu thereof "paragraph (1) or (3) of subsection (a)"; and

(B) by inserting after "per centum" the following: "(20 per centum if paragraph (3) of subsection (a) would otherwise apply)".

(3) Section 1700(c) (relating to rate of tax on sales outside box office) is hereby amended—

(A) by striking out "paragraph (1) of subsection (a)" and inserting in lieu thereof "paragraph (1) or (3) of subsection (a)"; and

(B) by inserting after "per centum" the following: "(20 per centum if paragraph (3) of subsection (a) applies)".

(4) The last sentence of section 1700(e)(1) (relating to tax on cabarets, roof gardens, etc.) is hereby amended by striking out "subsection (a)(1)" and inserting in lieu thereof "paragraph (1) or (3) of subsection (a)".

(h) CERTAIN ATHLETIC GAMES FOR BENEFIT OF HOSPITALS FOR CRIPPLED CHILDREN.—Section 1701(a)(2) (relating to nonexempt admissions) is hereby amended by striking out "between two elementary or secondary schools" and inserting in lieu thereof the following: "between teams composed of students from elementary or secondary schools".

(i) EXEMPTION OF SCHOOL OR COLLEGE ATHLETIC EVENTS.—Section 1701(a)(2) (relating to nonexempt admissions) is hereby amended by adding at the end thereof the following new sentence: "Clauses (A) and (B) shall not apply in the case of any athletic event between educational institutions held during the regular athletic season for such event, if the proceeds therefrom inure exclusively to the benefit of such institutions."

(j) HISTORIC SITES, MUSEUMS, AND PLANETARIUMS.—Section 1701(e)(2) (relating to exemption from admissions tax of historic sites) is hereby amended to read as follows:

"(2) HISTORIC SITES, MUSEUMS, AND PLANETARIUMS.—Any admission to an historic site, house, or shrine, to a museum of history, art, or science, to a planetarium, or to any exhibition in connection with any of the foregoing, operated—

"(A) by any State or political subdivision thereof or by the United States or any agency or instrumentality thereof—if the proceeds therefrom inure exclusively to the benefit of the State, political subdivision, United States, agency, or instrumentality, or

"(B) by any society or organization not organized for profit—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual.

For the purposes of subparagraph (A), the term 'State' includes Alaska, Hawaii, and the District of Columbia."

(k) CERTAIN AMATEUR THEATER PERFORMANCES.—Section 1701 (relating to exemptions from the admissions tax) is hereby amended—

(1) by striking out the period at the end of subsection (e) and inserting in lieu thereof "; or"; and

(2) by adding at the end thereof a new subsection as follows:

"(f) CERTAIN AMATEUR THEATER PERFORMANCES.—Any admission to an amateur performance presented and performed by a civic or community theater group or organization—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual."

SEC. 202. TAX ON DUES.

(a) DUES OR MEMBERSHIP FEES.—Section 1710(a)(1) (relating to tax on dues or membership fees) is hereby amended by striking out "11 per centum" and inserting in lieu thereof "20 per centum".

(b) INITIATION FEES.—Section 1710(a) (2) (relating to tax on initiation fees) is hereby amended by striking out "11 per centum" and inserting in lieu thereof "20 per centum".

SEC. 203. EFFECTIVE DATE OF TITLE II.

The amendments made by section 201 (other than subsection (b) thereof) shall apply only with respect to amounts paid for admissions on or after April 1, 1954. In addition, such amendments shall apply—

(1) in the case of any season ticket or subscription, only if all the admissions under such ticket or subscription can occur only on or after April 1, 1954; and

(2) in the case of the permanent use of a box or seat or a lease for the use of such box or seat, only if all the performances or exhibitions at which the box or seat is used or reserved by or for the lessee or holder can occur only on or after April 1, 1954.

The amendment made by subsection (b) shall apply only with respect to amounts paid on or after April 1, 1954, for admissions on or after such date.

TITLE III—MANUFACTURERS' EXCISE TAXES

SEC. 301. EXCISE TAXES IMPOSED BY THE REVENUE ACT OF 1941.

(a) TAX ON SPORTING GOODS.—Section 3406(a)(1) (relating to manufacturers' excise tax on sporting goods) is hereby amended by striking out "15 per centum, except that on and after April 1, 1954, the rate shall be 10 per centum;".

(b) TAX ON PHOTOGRAPHIC APPARATUS.—Section 3406(a)(4) (relating to manufacturers' excise tax on photographic apparatus) is hereby amended by striking out "20 per centum" and inserting in lieu thereof "10 per centum".

(c) TAX ON ELECTRIC LIGHT BULBS AND TUBES.—Section 3406(a)(10) (relating to manufacturers' excise tax on electric light bulbs and tubes) is hereby amended to read as follows:

"(10) ELECTRIC LIGHT BULBS AND TUBES.—Electric light bulbs and tubes, not including articles taxable under any other provision of this subchapter, 10 per centum."

SEC. 302. TAX ON MECHANICAL PENCILS, FOUNTAIN AND BALL-POINT PENS, AND MECHANICAL LIGHTERS FOR CIGARETTES, CIGARS, AND PIPES.

Section 3408(a) (relating to tax on mechanical pencils, fountain and ball-point pens, and mechanical lighters for cigarettes, cigars, and pipes) is hereby amended by striking out "15 per centum" and inserting in lieu thereof "10 per centum".

SEC. 303. TAX ON MATCHES.

Section 3409(a) (relating to manufacturers' excise tax on matches) is hereby amended by striking out "2 cents per 1,000 matches" and inserting in lieu thereof the following: "2 cents per 1,000 matches but not more than 10 per centum of the price for which so sold".

SEC. 304. CUTTING OILS.

Section 3413 (relating to tax on lubricating oils) is hereby amended—

(a) by inserting after "6 cents a gallon" the following: "(except that, in the case of cutting oils, the tax shall not exceed 10 per centum of the price for which so sold)"; and

(b) by adding at the end of such section a new sentence as follows: "For the purposes of this section, the term "cutting oils" means oils used primarily in cutting and machining operations (including forging, drawing, rolling, shearing, punching, and stamping) on metals and known commercially as cutting oils."

SEC. 305. REDUCTION OF TAX ON REFRIGERATORS AND QUICK-FREEZE UNITS AND ON ELECTRIC, GAS, AND OIL HOUSEHOLD APPLIANCES.

(a) Reduction of Tax.—Section 3405 (relating to manufacturers' excise tax on refrigerators, quick-freeze units, and self-contained air-conditioning units) is hereby amended by striking out "10 per centum" and inserting in lieu thereof the following: "5 per centum (10 per centum in the case of articles subject to tax under subsection (c))"; and section 3406(a)(3) (relating to manufacturers' excise tax on electric, gas, and oil appliances) is hereby amended by striking out "10 per centum" and inserting in lieu thereof "5 per centum".

(b) Floor Stocks Refund.—Subchapter A of chapter 29 (relating to manufacturers' excise taxes) is hereby amended by adding at the end thereof a new section as follows:

"SEC. 3416. FLOOR STOCKS REFUND ON REFRIGERATORS, QUICK-FREEZE UNITS, AND ELECTRIC, GAS, AND OIL HOUSEHOLD APPLIANCES.

"(a) In General.—Where before April 1, 1954, any article subject to the tax imposed by section 3405(a), section 3405(b), or section 3406(a)(3) has been sold by the manufacturer, producer, or importer, and on such date is held by a dealer and has not been used and is intended for sale, there shall be credited or refunded (without interest) to the manufacturer, producer, or importer an amount equal to the difference between the tax paid by such manufacturer, producer, or importer on his sale of the article and the tax made applicable to such article on and after April 1, 1954, if such manufacturer, producer, or importer—

"(1) has paid such amount as reimbursement to the dealer who held such article on April 1, 1954; and

"(2) files claim for such credit or refund before August 1, 1954.

"(b) Definition of Dealer.—As used in this section, the term 'dealer' includes a wholesaler, jobber, distributor, or retailer. For the purposes of this section, an article shall be considered as 'held by a dealer' if title thereto has passed to such dealer (whether or not delivery to him has been made), and if for purposes of consumption title to such article or possession thereof has not at any time been transferred to any person other than a dealer.

"(c) Limitation on Eligibility.—No person shall be entitled to credit or refund under this section unless he has in his possession such evidence of the inventories with respect to which he has made the reimbursements described in subsection (a) as may be required by regulations prescribed under this section.

"(d) Penalties and Administrative Procedures.—All provisions of law, including penalties, applicable in respect of the taxes imposed under sections 3405(a), 3405(b), and 3406(a)(3) shall, insofar as applicable and not inconsistent with this section, be applicable in respect of the credits and refunds provided for in this section to the same extent as if such credits or refunds constituted credits or refunds of such taxes."

SEC. 306. EFFECTIVE DATE OF TITLE III.

For effective date of this title, see section 505(a).

TITLE IV—TAX ON COMMUNICATIONS

SEC. 401. TAX ON TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES.

(a) Telephone Messages, Etc.—Section 3465(a)(1)(A) (relating to tax on telephone messages, etc.) is hereby amended by striking out "20 per centum" and inserting in lieu thereof "10 per centum".

(b) Telegraph, Cable, and Radio Dispatches.—Section 3465(a)(1)(B) relating to tax on telegraph, cable, and radio dispatches or messages) is hereby amended by striking out "15 per cent of the amount so paid, except that in the case of each international telegraph, cable, or radio dispatch or message the rate shall be 10 per centum" and inserting in lieu thereof the following: "10 per centum of the amount so paid".

(c) LEASED WIRE SERVICE.—Section 3465(a)(2)(A) (relating to tax on leased wire service, etc.) is hereby amended by striking out "15 per centum" and inserting in lieu thereof "10 per centum".

(d) WIRE AND EQUIPMENT SERVICE.—Section 3465(a)(2)(B) (relating to tax on wire and equipment service) is hereby amended to read as follows:

"(B) A tax equivalent to 8 per centum of the amount paid for any wire and equipment service (including stock quotation and information services, burglar alarm or fire alarm service, and all other similar services, but not including service described in subparagraph (A))."

(e) LOCAL TELEPHONE SERVICE.—For reduction in rate of tax on local telephone service, see section 504(a).

SEC. 402. EFFECTIVE DATE OF TITLE IV.

(a) IN GENERAL.—Subject to the provisions of subsection (b), the amendments made by section 401 shall apply with respect to amounts paid on or after April 1, 1954, for services rendered on or after such date.

(b) AMOUNTS PAID PURSUANT TO BILLS RENDERED.—The amendments made by section 401 shall not apply with respect to amounts paid pursuant to bills rendered before April 1, 1954. In the case of amounts paid pursuant to bills rendered on or after such date for services for which no previous bill was rendered, such amendments shall apply except with respect to such services as were rendered more than 2 months before such date. In the case of services rendered more than 2 months before such date the provisions of sections 1650 and 3465 of the Internal Revenue Code in effect at the time such services were rendered shall apply to the amounts paid for such services.

(c) TECHNICAL AMENDMENT.—Section 1658 is hereby repealed.

TITLE V—MISCELLANEOUS TAXES

SEC. 501. TAX ON SAFE DEPOSIT BOXES.

Section 1850(a) (relating to tax on the use of safe deposit boxes) is hereby amended by striking out "20 per centum" and inserting in lieu thereof "10 per centum".

SEC. 502. TAX ON PISTOLS AND REVOLVERS.

Section 2700(a) (relating to tax on pistols and revolvers) is hereby amended by striking out "11 per centum" and inserting in lieu thereof "10 per centum".

SEC. 503. TAX ON TRANSPORTATION OF PERSONS, ETC.

For reduction in rate of taxes on the transportation of persons and on seats, berths, etc., see section 504(a).

SEC. 504. TECHNICAL AMENDMENTS.

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

(b) RATE REDUCTION DATE.—Section 1659 (relating to definition of "rate reduction date") is hereby amended to read as follows:

"SEC. 1659. DEFINITION OF 'RATE REDUCTION DATE'.

"For the purpose of this chapter the term 'rate reduction date' means April 1, 1954."

(c) FLOOR STOCKS REFUNDS ON ELECTRIC LIGHT BULBS.—Section 1657(a) (relating to floor stocks refunds on electric light bulbs) is hereby amended (1) by striking out "the tax that would have been paid if section 1650 had not been applicable" and inserting in lieu thereof the following: "the tax that would have been paid if the applicable rate had been 10 per centum"; and (2) by striking out "prior to the expiration of three months after the rate reduction date" and inserting in lieu thereof the following: "prior to August 1, 1954, based upon a request for reimbursement submitted by such person to the manufacturer or producer of such article prior to July 1, 1954".

(d) BOWLING ALLEYS AND BILLIARD AND POOL TABLES.—The first sentence of section 3268(a) (relating to tax on bowling alleys, and billiard and pool tables) is hereby amended to read as follows: "Every person who operates a bowling alley, billiard room, or pool room shall pay a special tax of $20 per year for each bowling alley, billiard table, or pool table."

SEC. 505. EFFECTIVE DATES.

(a) The amendments made by title I, title III, and section 502, and the amendment made by section 504(a) insofar as it affects the rates of the retailers' excise taxes imposed by sections 2400, 2401, and 2402 of the Internal Revenue Code and the rate of the manufacturers' excise tax imposed by section 3406(a)(10) of such Code, shall apply only with respect to articles sold on or after April 1, 1954. For the purposes of the preceding sentence, an article shall not be considered sold before April 1, 1954, unless possession or right to possession passes to the purchaser before such date. In the case of—

(1) a lease,

(2) a contract for the sale of an article wherein it is provided that the price shall be paid by installments and title to the article sold does not pass until a future date notwithstanding partial payment by installments,

(3) a conditional sale, or

(4) a chattel mortgage arrangement wherein it is provided that the sales price shall be paid in installments,

entered into before April 1, 1954, payments made on or after April 1, 1954, shall, for purposes of this subsection, be considered as payments made with respect to articles sold on or after April 1, 1954.

(b) The amendment made by section 501 shall apply only with respect to amounts paid on or after April 1, 1954.

(c) The amendment made by section 504(a) shall apply—

(1) insofar as it affects the rate of the tax imposed by section 1700(a)(1) of the Internal Revenue Code, with respect to amounts paid for admissions on or after April 1, 1954, but, in the case of any season ticket or subscription, only if all the admissions under such ticket or subscription can occur only on or after April 1, 1954;

(2) insofar as it affects the rates of the taxes imposed by subsections (b), (c), and (e) of section 1700 of the Internal Revenue Code, as though the rates listed under the heading "Old Rate" in the table in section 1650 of such Code were the rates established by the amendments made by title II of this Act;

(3) insofar as it affects the rates of the taxes imposed by subsections (a)(1)(A), (a)(2)(A), and (a)(2)(B) of section 3465 of the Internal Revenue Code, as though the rates listed under the heading "Old Rate" in the table in section 1650 of such Code were the rates established by the amendments made by section 401 of this Act;

(4) insofar as it affects the rate of the tax imposed by section 3456(a)(3) of the Internal Revenue Code, as though such amendment were an amendment made by section 401 of this Act; and

(5) insofar as it affects the rates of the taxes imposed by section 3469 of the Internal Revenue Code, with respect to amounts paid for or in connection with transportation which begins on or after April 1, 1954.

SEC. 506. SPECIAL CREDIT OR REFUND OF TRANSPORTATION AND ADMISSIONS TAXES.

Notwithstanding any other provision of law, in any case in which tax has been collected prior to April 1, 1954, at the rate in effect (without regard to the amendments made by this Act) prior to April 1, 1954, for or in connection with the transportation of persons which begins on or after April 1, 1954, or for admissions (referred to in section 201, other than subsections (b), (c), and (g) thereof, of this Act) on or after April 1, 1954, the person who collected the tax shall pay the same over to the United States; but credit of refund (without interest) of the tax collected in excess of that applicable (by reason of the amendments made by this Act) on or after April 1, 1954, shall be allowed to the person who collected the tax as if such credit or refund were a credit or refund under the applicable provision of the Internal Revenue Code, but only to the extent that, prior to the time such transportation has begun or prior to the event to which the right to admission relates, he has repaid the amount of such excess to the person from whom he collected the tax, or has obtained the consent of such person to the allowance of the credit or refund. For the purpose of this Act, transportation shall not be considered to have begun on or after April 1, 1954, if any part of the transportation paid for (or for which payment has been obligated) commenced before April 1, 1954.

SEC. 507. SPECIAL FUELS.

(a) EXEMPTION FROM MANUFACTURERS' EXCISE TAX.—

(1) AMENDMENT OF SECTION 3412(c).—Section 3412(c)(2) (relating to manufacturers' excise tax on gasoline) is hereby amended to read as follows:

"(2) the term 'gasoline' means all products commonly or commercially known or sold as gasoline (including casinghead and natural gasoline)."

(2) CREDITS AND REFUNDS.—Except in the case of any liquid with respect to which tax was paid under section 3412 as in effect prior to the effective date of this section, clause (iii) of section 3443(a)(3)(A) is hereby repealed, and clauses (iv), (v), (vi), and (vii) of section 3443(a)(3)(A) are redesignated clauses (iii), (iv), (v), and (vi), respectively.

(b) IMPOSITION OF RETAILERS' EXCISE TAX.—Section 2450 of the Internal Revenue Code is hereby amended to read as follows:

"SEC. 2450. TAX.

"(a) DIESEL FUEL.—There is hereby imposed a tax of 2 cents a gallon upon any liquid (other than any product taxable under section 3412)—

"(1) sold by any person to an owner, lessee, or other operator of a diesel-powered highway vehicle, for use as a fuel in such vehicle; or

"(2) used by any person as a fuel in a diesel-powered highway vehicle unless there was a taxable sale of such liquid under paragraph (1).

"(b) SPECIAL MOTOR FUELS.—There is hereby imposed a tax of 2 cents a gallon upon benzol, benzene, naphtha, liquefied petroleum gas, or any other liquid (other than kerosene, gas oil, or fuel oil, or any product taxable under section 3412 or subsection (a) of this section)—

"(1) sold by any person to an owner, lessee, or other operator of a motor vehicle, motorboat, or airplane for use as a fuel for the propulsion of such motor vehicle, motorboat, or airplane; or

"(2) used by any person as a fuel for the propulsion of a motor vehicle, motorboat, or airplane unless there was a taxable sale of such liquid under paragraph (1).

"(c) RATE REDUCTION.—On and after April 1, 1955, the taxes imposed by this section shall be 1½ cents a gallon in lieu of 2 cents a gallon."

(c) TECHNICAL AMENDMENTS.—

(1) CREDITS AND REFUNDS.—Section 2452(a) (relating to credits and refunds) is hereby amended to read as follows:

"(a) NONTAXABLE USE OR SALE BY VENDEE.—A credit against tax under this chapter, or a refund, may be allowed or made to a person in the amount of tax paid by him under this chapter with respect to his sale of any liquid to a vendee for use as fuel in a diesel-powered highway vehicle, or with respect to his sale of benzol, benzene, naphtha, liquefied petroleum gas, or any other liquid to a vendee for use as fuel for the propulsion of a motor vehicle, motorboat, or airplane, if such person establishes, in accordance with regulations prescribed by the Secretary, that—

"(1) either—

"(A) the vendee used such liquid otherwise than as fuel in such a vehicle, motorboat, or airplane or resold such liquid; or

"(B) such liquid was used or was resold for use for any of the purposes, but subject to the conditions, provided in section 3451; and

"(2) such person has repaid or agreed to repay the amount of such tax to such vendee, or has obtained the consent of the vendee to the allowance of the credit or refund.

No interest shall be allowed with respect to any amount of tax credited or refunded under the provisions of this subsection."

(2) TAX-FREE SALES.—Section 2453 (relating to tax-free sales) is hereby amended by striking out "as fuel in a diesel-powered highway vehicle" and inserting in lieu thereof "covered by this chapter."

(3) CERTAIN VESSELS.—Chapter 20 (relating to special fuels) is hereby amended by adding at the end thereof the following new section:

"SEC. 2456. EXEMPTION OF SPECIAL MOTOR FUELS USED FOR CERTAIN VESSELS.

"The exemption from tax under chapter 29 provided in section 3451 shall also apply to the tax imposed under section 2450(b)."

(4) CLERICAL AMENDMENT.—The heading of chapter 20 is hereby amended to read as follows:

"CHAPTER 20.—SPECIAL FUELS"

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect on the first day of the first month which begins more than ten days after the date of the enactment of this Act. However, the tax imposed under section 2450(b) shall not apply to any liquid which has been sold by a producer or importer prior to the effective date of this section and which is taxable under section 3412 (relating to gasoline tax) as in effect prior to the effective date of this section.

TITLE VI—ONE-YEAR EXTENSION OF CERTAIN EXCISE TAX RATES

SEC. 601. ONE-YEAR EXTENSION OF CERTAIN EXCISE TAX RATES.

(a) EXTENSION OF RATES.—The following provisions are hereby amended by striking out "April 1, 1954" each place it appears and inserting in lieu thereof "April 1, 1955":

(1) The second sentence of section 2800(a)(1) (relating to distilled spirits generally).

(2) The last sentence of section 2800(a)(3) (relating to imported perfumes containing distilled spirits).

(3) Section 3030(a)(1)(A) (relating to tax on still wines).

(4) Section 3030(a)(2) (relating to tax on sparkling wines, liqueurs, and cordials).

(5) The second sentence of section 3150(a) (relating to tax on fermented malt liquors).

(6) The second sentence of section 3412(a) (relating to tax on gasoline).

(7) Section 2000(c)(2) (relating to tax on cigarettes).

(8) Section 3403 (relating to tax on automobiles, etc.).

(b) TECHNICAL AMENDMENTS.—

(1) Section 1656 (relating to floor stocks refunds on distilled spirits, wines and cordials, and fermented malt liquors) is hereby amended by striking out "April 1, 1954" each place it appears and inserting in lieu thereof "April 1, 1955", and by striking out "May 1, 1954" and inserting in lieu thereof "May 1, 1955".

(2) Section 3412(g) (relating to floor stocks refunds on gasoline) is hereby amended by striking out "April 1, 1954" each place it appears and inserting in lieu thereof "April 1, 1955", and by striking out "July 1, 1954" and inserting in lieu thereof "July 1, 1955".

(3) Section 2000(g) (relating to floor stocks refunds on cigarettes) is hereby amended by striking out "April 1, 1954" each place it appears and inserting in lieu thereof "April 1, 1955", and by striking out "July 1, 1954" and inserting in lieu thereof "July 1, 1955".

(4) Section 3250(1)(5) (relating to drawback in the case of distilled spirits used in the manufacture of certain nonbeverage products) is hereby amended by striking out "March 31, 1954" and inserting in lieu thereof "March 31, 1955".

(5) Section 497 of the Revenue Act of 1951 (relating to refunds on articles from foreign trade zones) is hereby amended by striking out "April 1, 1954" each place it appears and inserting in lieu thereof "April 1, 1955".

(c) FLOOR STOCKS REFUNDS ON AUTOMOBILES, ETC.—Section 3403 (relating to tax on automobiles, etc.) is hereby amended by adding at the end thereof the following new subsection:

"(f) FLOOR STOCKS REFUNDS.—

"(1) Where before April 1, 1955, any article subject to the tax imposed by subsection (a) or (b) has been sold by the manufacturer, producer, or importer, and is on such date held by a dealer and has not been used and is intended for sale, there shall be credited or refunded (without interest) to the manufacturer, producer, or importer an amount equal to the difference between the tax paid by such manufacturer, producer, or importer on his sale of the article and the amount of tax made applicable to such article on and after April 1, 1955.

"(2) As used in this subsection, the term 'dealer' includes a wholesaler, jobber, distributor, or retailer. For the purposes of this subsection, an article shall be considered as 'held by a dealer' if title thereto has passed to such dealer (whether or not delivery to him has been made), and if for purposes of consumption title to such article or possession thereof has not at any time been transferred to any person other than a dealer.

"(3) Under regulations prescribed by the Secretary, the refund provided by this subsection may be made to the dealer instead of the manufacturer, producer, or importer, if the manufacturer, producer, or importer waives any claim for the amount so to be refunded.

"(4) When the credit or refund provided for in this subsection has been allowed to the manufacturer, producer, or importer, he shall remit to the dealer to whom was sold the article in respect of which the credit or refund was allowed so much of that amount of the tax corresponding to the credit or refund as was included in or added to the price paid or agreed to be paid by the dealer.

"(5) No person shall be entitled to credit or refund under this subsection unless (A) he has in his possession such evidence of the inventories with respect to which the credit or refund is claimed as may be required by regulations prescribed under this subsection, and (B) claim for such credit or refund is filed with the Secretary before July 1, 1955.

"(6) All provisions of law, including penalties, applicable in respect of the tax imposed under subsections (a) and (b) shall, insofar as applicable and not inconsistent with this subsection, be applicable in respect of the credits and refunds provided for in this subsection."

Approved March 31, 1954.

COMMITTEE REPORTS

EXCISE TAX REDUCTION ACT OF 1954

[House of Representative Report No. 1307, Eighty-third Congress, Second Session]

[March 4, 1954]

Mr. Reed of New York, from the Committee on Ways and Means, submitted the following report [to accompany H. R. 8224]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 8224) to reduce excise taxes, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

GENERAL STATEMENT

Those excise tax rates which are now above 10 percent are reduced to 10 percent under this bill. The committee believes that this reduction will stimulate business and employment, not only in those industries directly affected by these taxes, but also in other industries, since consumers will pay less for many of these taxed items and have more money available for other purchases. Some of these taxes enter directly into business costs and a reduction of such costs is desirable. Furthermore, this change provides a more equitable tax system by leveling down those rates which are now excessively high and thus removes discrimination.

The following table lists the taxes which are reduced under this bill, showing the rates under present law, and the estimated reductions in excise tax collections:

	Rates under present law	Rates under this bill	Reduction in excise-tax collections (full year effect)
Retailers' excises:	*Percent*	*Percent*	*Mil. dol.*
Furs	20	10	20
Jewelry	20	10	100
Luggage	20	10	40
Toilet preparations	20	10	55
Total			215
Manufacturers' excises:			
Sporting goods	[1] 15	10	3
Mechanical pens, pencils, lighters	15	10	4
Electric light bulbs and tubes	20	10	20
Pistols and revolvers	11	10	Negligible
Firearms, shells, and cartridges	11	10	1
Cameras, lenses, and film	20	10	15
Total			43
Miscellaneous excises:			
Telephone, telegraph, radio, cable	(2)	10	235
Local telephone	15	10	125
Transportation of persons	15	10	95
Leases of safe deposit boxes	20	10	5
Admissions:			
General	[3] 20	10	175
Cabarets	20	10	
Club dues, initiation fees	20	10	19
Total			654
Grand total			912

1 Under present law this rate is scheduled for reduction to 10 percent on Apr. 1, 1954.
2 Telephone or radio telephone messages, toll charges over 24 cents, 25 percent; domestic telegraph, cable, and radio dispatches, 15 percent; international telegraph, cable and radio dispatches, 10 percent; leased wire service, teletypewriter, or talking circuit special service, 25 percent.
3 Under present law a penalty tax of 50 percent is imposed on sales by proprietors in excess of the established tax; this rate is not reduced.

The bill also provides that those excise taxes which, under present law, would be reduced on April 1, 1954, will remain at present levels except in the case of the tax on sporting goods. In his budget message, the President stated that because of the present need for revenue he recommended continuation of the excises scheduled to be reduced April 1, and this bill carries out that recommendation. The tax on sporting goods is the only ad valorem tax above 15 percent in this group; hence it was included in the group reduced to 10 percent. It is contemplated that the committee will review excise tax rates next year.

The taxes which are continued at present rates are listed below and the estimates of increased tax collections due to continuation are shown:

Excise tax rates increased by the Revenue Act of 1951 continued under the bill

	Unit of tax	Present rate continued under bill	Rate prior to Revenue Act of 1951	Increased collections due to continuation (full year effect)
Liquor taxes:				*Million*
Distilled spirits	Per proof gallon	$10.50	$9	$150
Fermented malt liquors	Per barrel	$9	$8	87
Wine:				
Still wine:				
Containing less than 14 percent alcohol.	Per wine gallon	17 cents	15 cents	
Containing 14 to 21 percent alcohol	do	67 cents	60 cents	
Containing 21 to 24 percent alcohol	do	$2.25	$2	
Containing more than 24 percent alcohol.	do	$10.50	$9	8
Sparkling wines, liqueurs, cordials, etc.:				
Champagne or sparkling wine	Per ½ pint	17 cents	15 cents	
Liqueurs, cordials, etc., and artificially carbonated wines.	do	12 cents	10 cents	
Tobacco taxes: Cigarettes	Per 1,000	$4	$3.50	191
Manufacturers' excises:				
Gasoline	Per gallon	2 cents	1½ cents	225
Passenger cars and motorcycles	Manufacturers' sale price.	10 percent	7 percent	276
Trucks, buses, truck trailers	do	8 percent	5 percent	75
Parts and accessories	do	do	do	60
Miscellaneous excises: Diesel fuel used for highway vehicles.	Per gallon	2 cents	(1)	5
Total				1,077

[1] No excise tax prior to Revenue Act of 1951.

EFFECTIVE DATE

For the retail and manufacturers' taxes and safe-deposit boxes the new tax rates are to apply to transactions on or after April 1, 1954. However, in the case of (1) leases, (2) installment sales, (3) conditional sales, or (4) chattel mortgage installment arrangements, entered into before April 1, 1954, payments made after April 1, 1954, are to be subject to the new rates.

For admissions, the new tax rates apply to amounts paid on or after April 1, 1954, for admissions on or after that date. For the carbaret tax, the new rates apply with respect to periods after 10 a. m. on April 1. For dues, the new tax rates apply to amounts paid on or after April 1 as dues or membership fees for periods beginning on or after April 1 or as initiation fees.

The new communications tax rates will apply with respect to amounts paid pursuant to bills rendered on and after April 1, 1954, for services rendered on and after such date, and for any services rendered in February and March for which no previous bill was rendered.

The new rate of tax on transportation of persons applies with respect to amounts paid on and after April 1, 1954, for or in connection with transportation which begins on or after such date.

CHANGES IN EXISTING LAW

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as introduced, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE

CHAPTER 9A—WAR TAXES AND WAR TAX RATES

SEC. 1650. WAR TAX RATES OF CERTAIN MISCELLANEOUS TAXES.

In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period beginning with the effective date of title III of the Revenue Act of 1943 *and ending March 31, 1954*, shall be the rates set forth under the heading, "War Tax Rate":

Section	Description of tax	Old rate	War tax rate
1700(a)	Admissions	1 cent for each 10 cents or fraction thereof.	1 cent for each 5 cents or major fraction thereof.
1700(b)	Permanent use or lease of boxes or seats.	11 per centum	20 per centum.
1700(c)	Sales of tickets outside box office.	11 per centum	20 per centum.
1700(e)	Cabarets, roof gardens, etc	5 per centum	20 per centum.
1710(a)(1)	Dues or membership fees	11 per centum	20 per centum.
1710(a)(2)	Initiation fees	11 per centum	20 per centum.
2400 (except as respects watches selling at retail for not more than $65 and alarm clocks selling at retail for not more than $5).	Jewelry	10 per centum	20 per centum.
2401	Furs	10 per centum	20 per centum.
2402	Toilet preparations	10 per centum	20 per centum.
3268	Billiard and pool tables; and bowling alleys.	$10 per year per table; $10 per year per alley.	$20 per year per table; $20 per year per alley.
3406(a)(10)	Electric light bulbs and tubes	5 per centum	20 per centum.
3465(a)(1)(A)	Telephone, long distance	20 per centum	25 per centum.
3465(a)(2)(A)	Leased wires, etc	15 per centum	25 per centum.
3465(a)(2)(B)	Wire and equipment service	5 per centum	8 per centum.
3465(a)(3)	Local telephone service	10 per centum	15 per centum.
3469(a)	Transportation of persons	10 per centum	15 per centum.
3469(c)	Seats, berths, etc	10 per centum	15 per centum.

SEC. 1651. RETAILERS' EXCISE TAX ON LUGGAGE, ETC.

(a) TAX.—There is hereby imposed upon the following articles (including in each case fittings or accessories therefor sold on or in connection with the sale thereof) sold at retail a tax equivalent to [20] *10* per centum of the price for which so sold:

(1) Trunks, valises, traveling bags, suitcases, satchels, overnight bags, hat boxes for use by travels, beach bags, bathing suit bags, brief cases made of leather or imitation leather, and salesmen's sample and display cases.

(2) Purses, handbags, pocketbooks, wallets, billfolds, and card, pass, and key cases.

(3) Toilet cases and other cases, bags, and kits (without regard to size, shape, construction, or material from which made) for use in carrying toilet articles or articles of wearing apparel.

* * * * * * *

SEC. 1657. FLOOR STOCKS REFUNDS ON ELECTRIC LIGHT BULBS.

(a) IN GENERAL.—With respect to any article upon which tax is imposed under section 3406 (a) (10), upon which internal revenue tax at the rate prescribed in section 1650 has been paid, and which, on the rate reduction date is held by any person and intended for sale, or for use in the manufacture or production of any article intended for sale, there shall be credited or refunded to the manufacturer or producer of such article (without interest), subject to such regulations as may be prescribed by the Commissioner with the approval of the Secretary, an amount equal to so much of the difference between the tax so paid and the tax that would have been paid if [section 1650 had not been applicable] *the applicable rate had been 10 per centum*, as has been paid by such manufacturer or producer to such person as reimbursement for the tax reduction on such articles, if claim for such credit or refund is filed with the Commissioner prior to the expiration of three months after the rate reduction date.

* * * * * * *

[SEC. 1658. TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES.

[Notwithstanding section 1650, the rates therein prescribed with respect to the taxes imposed by section 3465 (a) (1), (2), and (3) shall continue to apply with respect to amounts paid pursuant to bills rendered prior to the rate reduction date; and, in the case of amounts paid pursuant to bills rendered on or after the rate reduction date for services for which no previous bill was rendered, the decreased rates shall apply except with respect to such services as were rendered more than two months before such date; and, in the case of services rendered more than two months before such date, the provisions of sections 1650 and 3465 in effect at the time such services were rendered shall be applicable to the amounts paid for such services.]

SEC. 1659. DEFINITION OF "RATE REDUCTION DATE".

For the purposes of this chapter the term "rate reduction date" means [such date as the Congress shall by law prescribe] *April 1, 1954.*

CHAPTER 10—ADMISSIONS AND DUES

SUBCHAPTER A—ADMISSIONS

SEC. 1700. TAX.

There shall be levied, assessed, collected, and paid—

* * * * * * *

(b) PERMANENT USE OR LEASE OF BOXES OR SEATS.—

(1) RATE.—In the case of persons having the permanent use of boxes or seats in an opera house or any place of amusement or a lease for the use of such box or seat in such opera house or place of amusement (in lieu of the tax imposed under paragraph (1) of subsection (a)), a tax equivalent to [11] *10* per centum of the amount for which a similar box or seat is sold for each performance or exhibition at which the box or seat is used or reserved by or for the lessee or holder.

***Note.*—The rate of tax presently in effect on permanent use or lease of boxes or seats is the temporary war rate of 20 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

* * * * * * *

(c) SALES OUTSIDE BOX OFFICE.—

(1) RATE.—Upon tickets or cards of admission to theaters, operas, and other places of amusement, sold at news stands, hotels, and places other than the ticket offices of such theaters, operas, or other places of amusement, at a price in excess of the sum of the established price therefor at such ticket offices plus the amount of any tax imposed under paragraph (1) of subsection (a), a tax equivalent to [11] *10* per centum of the amount of such excess.

***Note.*—The rate of tax presently in effect on sales outside box offices is the temporary war rate of 20 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

* * * * * * *

(e) TAX ON CABARETS, ROOF GARDENS, ETC.—

(1) RATE.—A tax equivalent to [5] *10* per centum of all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit, by or for any patron or guest who is entitled to be present during any portion of such performance. * * *

***Note.*—The rate of tax presently in effect on cabarets, roof gardens, etc., is the temporary war rate of 20 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

* * * * * * *

SUBCHAPTER B—DUES

SEC. 1710. TAX.

(a) RATE.—There shall be levied, assessed, collected, and paid—

(1) DUES OR MEMBERSHIP FEES.—A tax equivalent to [11] *10* per centum of any amount paid as dues or membership fees to any social, athletic, or sporting club or organization, if the dues or fees of an active resident annual member are in excess of $10 per year.

Note.—**The rate of tax presently in effect on dues or membership fees is the temporary war rate of 20 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

(2) INITIATION FEES.—A tax equivalent to [11] *10* per centum of any amount paid as initiation fees to such a club or organization, if such fees amount to more than $10, or if the dues or membership fees, not including initiation fees, of an active resident annual member are in excess of $10 per year.

Note.—**The rate of tax presently in effect on initiation fees is the temporary war rate of 20 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

* * * * * * *

CHAPTER 12—SAFE DEPOSIT BOXES

SEC. 1850. TAX.

(a) RATE.—There shall be imposed a tax equivalent to [20] *10* per centum of the amount collected for the use of any safe deposit box.

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CHAPTER 15—TOBACCO, SNUFF, CIGARS, AND CIGARETTES

SUBCHAPTER A—RATE AND PAYMENT OF TAX

SEC. 2000. RATE OF TAX.

* * * * * * *

(c) CIGARS AND CIGARETTES.—Upon cigars and cigarettes manufactured in or imported into the United States, which are sold by the manufacturer or importer, or removed for consumption or sale, there shall be levied, collected, and paid the following taxes:

* * * * * * *

(2) CIGARETTES.—On cigarettes made of tobacco, or any substitute therefor, and weighing not more than three pounds per thousand, $4 per thousand [until April 1, 1954, and $3.50 per thousand on and after April 1, 1954];

Weighing more than three pounds per thousand, $8.40 per thousand; except that if more than 6½ inches in length they shall be taxable at the rate provided in the preceding paragraph, counting each 2¾ inches (or fraction thereof) of the length of each as one cigarette.

The tax imposed by this subsection shall be in addition to any import duties imposed upon imported cigars and cigarettes.

* * * * * * *

[(g) FLOOR STOCKS REFUNDS ON CIGARETTES.—

[(1) IN GENERAL.—With respect to cigarettes, weighing not more than three pounds per thousand, upon which the tax imposed by subsection (c)(2), or upon which floor stocks tax imposed by subsection (f), has been paid, and which, on April 1, 1954, are held by any person and intended for sale, or are in transit from foreign countries or insular possessions of the United States to any person in the United States for sale, there shall be credited or refunded to such person (without interest), subject to such regulations as may be prescribed by the Secretary, an amount equal to the difference between the tax paid on such cigarettes and the tax made applicable to such articles on April 1, 1954, if claim for such credit or refund is filed with the Secretary prior to July 1, 1954.

[(2) LIMITATIONS ON ELIGIBILITY FOR CREDIT OR REFUND.—No person shall be entitled to credit or refund under paragraph (1) unless (A) such person, for such period or periods both before and after April 1, 1954 (but not extending beyond one year thereafter), as the Secretary shall by regulations prescribe, makes and keeps, and files with the Secretary such records of inventories, sales, and purchases as may be prescribed in such regulations; and (B) such person establishes to the satisfaction of the Secretary, with respect to the cigarettes for which credit or refund is claimed by him under this section, that on and after April 1, 1954, and until the expiration of three months thereafter, the price at which cigarettes of such class were sold (until a number equal at least to the number on hand on April 1, 1954, were sold) reflected, in such manner as the Secretary may by regulations prescribe, the amount of the tax reduction.

[(3) PENALTY AND ADMINISTRATIVE PROCEDURES.—All provisions of law, including penalties, applicable in respect of internal revenue taxes on cigarettes shall, insofar as applicable and not inconsistent with this subsection, be applicable in respect of the credits and refunds provided for in this subsection to the same extent as if such credits or refunds constituted credits or refunds of such taxes.]

* * * * * * *

CHAPTER 20—DIESEL FUEL

SEC. 2450. TAX ON DIESEL FUEL.

There is hereby imposed a tax of 2 cents a gallon upon any liquid (other than any product taxable under section 3412)—

(1) sold by any person to an owner, lessee, or other operator of a diesel-powered highway vehicle, for use as a fuel in such vehicle, or

(2) used by any person as a fuel in a diesel-powered highway vehicle unless there was a taxable sale of such liquid under clause (1).

[On and after April 1, 1954, the tax imposed by this section shall be 1½ cents a gallon in lieu of 2 cents a gallon.]

* * * * * * *

CHAPTER 25—FIREARMS

SUBCHAPTER A—PISTOLS AND REVOLVERS

SEC. 2700. TAX.

(a) RATE.—There shall be levied, assessed, collected, and paid upon pistols and revolvers sold or leased by the manufacturer, producer, or importer, a tax equivalent to [11%] *10 per centum* of the price for which so sold or leased.

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CHAPTER 26—LIQUOR

SUBCHAPTER A—DISTILLED SPIRITS

PART I—PROVISIONS RELATING TO TAX

SEC. 2800. TAX.

(a) RATE.—

(1) DISTILLED SPIRITS GENERALLY.—There shall be levied and collected on all distilled spirits in bond or produced in or imported into the United States an internal revenue tax at the rate of $10.50 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the distiller or importer when withdrawn from bond. [On and after April 1, 1954, the rate of tax imposed by this paragraph shall be $9 in lieu of $10.50.]

* * * * * * *

(3) IMPORTED PERFUMES CONTAINING DISTILLED SPIRITS.—There shall be levied and collected upon all perfumes imported into the United States containing distilled spirits, a tax of $10.50 per wine gallon, and a proportionate tax at a like rate on all fractional parts of such wine gallon. Such tax shall be collected by the collector of customs and deposited as internal revenue collections, under such rules and regulations as the Commissioner, with the approval of the Secretary, may prescribe. [On and after April 1, 1954, the rate of tax imposed by this paragraph shall be $9 in lieu of $10.50.]

* * * * * * *

SUBCHAPTER B—WINES

SEC. 3030. TAX.

(a) RATE.—

(1) STILL WINES.—

(A) Imposition.—Upon all still wines, including vermouth, and all artificial or imitation wines or compounds sold as still wine, produced in or imported into the United States on or after the effective date of section 452 (a) of the Revenue Act of 1951, or which on such date were on any winery premises or other bonded premises or in transit thereto or at any customhouse, there shall be levied, collected, and paid taxes at rates as follows, when sold, or removed for consumption or sale:

On wines containing not more than 14 per centum of absolute alcohol, 17 cents per wine-gallon, the per centum of alcohol under this section to be reckoned by volume and not by weight [, except that on and after April 1, 1954, the rate shall be 15 cents per wine-gallon];

On wines containing more than 14 per centum and not exceeding 21 per centum of absolute alcohol, 67 cents per wine-gallon [, except that on and after April 1, 1954, the rate shall be 60 cents per wine-gallon];

On wines containing more than 21 per centum and not exceeding 24 per centum of absolute alcohol, $2.25 per wine-gallon [, except that on and after April 1, 1954, the rate shall be $2 per wine-gallon];

All such wines containing more than 24 per centum of absolute alcohol by volume shall be classed as distilled spirits and shall pay tax accordingly.

Any such wines may, under such regulations as the Commissioner may prescribe, with the approval of the Secretary, be sold or removed tax-free for the manufacture of vinegar, or for the production of dealcoholized wines containing less than one-half of 1 per centum of alcohol by volume.

The taxes imposed by this subparagraph (A) of this paragraph shall not apply to dealcoholized wines containing less than one-half of 1 per centum of alcohol by volume; nor, subject to regulations prescribed by the Commissioner, with the approval of the Secretary, to wines produced for the family use of the duly registered producer thereof and not sold or otherwise removed from the place of manufacture and not exceeding in any case two hundred gallons per year.

* * * * * * *

(2) SPARKLING WINES, LIQUEURS, AND CORDIALS.—Upon the following articles which are produced in or imported into the United States, on or after the effective date of section 452 (a) of the Revenue Act of 1951, or which on such date are on any winery premises or other bonded premises or in transit thereto or at any customhouse, there shall be levied, collected, and paid, in lieu of the internal-revenue taxes imposed thereon by law prior to such date, taxes at rates as follows, when sold, or removed for consumption or sale:

On each bottle or other container of champagne or sparkling wine, 17 cents on each one-half pint or fraction thereof [, except that on and after April 1, 1954, the rate shall be 15 cents on each one-half pint or fraction thereof];

On each bottle or other container of artificially carbonated wine, 12 cents on each one-half pint or fraction thereof [, except that on and after April 1, 1954, the rate shall be 10 cents on each one-half pint or fraction thereof];

On each bottle or other container of liqueurs, cordials, or similar compounds, by whatever name sold or offered for sale, containing sweet wine, citrus-fruit wine, peach wine, cherry wine, berry wine, apricot wine, prune wine, plum wine, pear wine, pawpaw wines, papaya wines, pineapple wines, cantaloup wines, or apple wine, fortified, respectively, with grape brandy, citrus-fruit brandy, peach brandy, cherry brandy, berry brandy, apricot brandy, prune brandy, plum brandy, pear brandy, pawpaw brandy, papaya brandy, pineapple brandy, cantaloup brandy, or apple brandy, 12 cents on each one-half pint or fraction thereof [, except that on and after April 1, 1954, the rate shall be 10 cents on each one-half pint or fraction thereof];

Any of the foregoing articles containing more than 24 per centum of absolute alcohol by volume (except vermouth, liqueurs, cordials, and similar compounds made in rectifying plants and containing tax-paid sweet wine, citrus-fruit wine, peach wine, cherry wine, berry wine, apricot wine, prune wine, plum wine, pear wine, pawpaw wines, papaya wines, pineapple wines, cantaloup wines, or apple wine, fortified, respectively with grape brandy, citrus-fruit brandy, peach brandy, cherry brandy, berry brandy, apricot brandy, prune brandy, plum brandy, pear brandy, pawpaw brandy, papaya brandy, pineapple brandy, cantaloup brandy, or apple brandy) shall be classed as distilled spirits and shall be taxed accordingly.

The Commissioner, under regulations prescribed by him, with the approval of the Secretary, is authorized to remit, refund, and pay back the amount of all taxes on such liqueurs, cordials, and similar compounds paid by or assessed against rectifiers at the distilled spirits rate prior to June 26, 1936.

* * * * * * *

SUBCHAPTER D—FERMENTED LIQUORS

SEC. 3150. TAX.

(a) RATE.—There shall be levied and collected on all beer, lager beer, ale, porter, and other similar fermented liquor, containing one-half of 1 per centum, or more, of alcohol, brewed or manufactured and sold, or removed for consumption or sale, within the United States, or imported into the United States, by whatever name such liquors may be called, a tax of $9 for every barrel containing not more than thirty-one gallons, and at a like rate for any other quantity or for the fractional parts of a barrel authorized and defined by law. ⟦On and after April 1, 1954, the tax imposed by the preceding sentence shall be at the rate of $8 in lieu of $9.⟧ In estimating and computing such tax, the fractional parts of a barrel shall be halves, thirds, quarters, sixths, and eighths; and any fractional part of a barrel, containing less than one-eighth, shall be accounted one-eighth; more than one-eighth, and not more than one-sixth, shall be accounted one-sixth; more than one-sixth, and not more than one-fourth, shall be accounted one-fourth; more than one-fourth, and not more than one-third, shall be accounted one-third; more than one-third, and not more than one-half, shall be accounted one-half; more than one-half, and not more than one barrel, shall be accounted one barrel; and more than one barrel, and not more than sixty-three gallons, shall be accounted two barrels, or a hogshead.

The provisions of this section requiring the accounting of hogsheads, barrels, and fractional parts of barrels at the next higher quantity shall not apply where the contents of such hogsheads, barrels, or fractional parts of barrels are within the limits of tolerance established by the Commissioner by regulations which he is hereby authorized to prescribe with the approval of the Secretary; and no assessment shall be made and no tax shall be collected for any excess in any case where the contents of the hogsheads, barrels, or fractional parts of barrels heretofore or hereafter used are within the limits of the tolerance so prescribed.

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CHAPTER 27—OCCUPATIONAL TAXES

SUBCHAPTER A—SPECIAL PROVISIONS

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PART X—BOWLING ALLEYS, AND BILLARD AND POOL TABLES

SEC. 3268. TAX ON BOWLING ALLEYS, AND BILLIARD AND POOL TABLES.

(a) RATE.—Every person who operates a bowling alley, billiard room, or pool room shall pay a special tax of ⟦$10⟧ *$20* per year for each bowling alley, billiard table, or pool table. Every building or place where bowls are thrown or where games of billiards or pool are played, except in private homes, shall be regarded as a bowling alley, billiard room, or pool room, respectively. No tax shall be imposed under this section with respect to a billiard table or pool table in a hospital if no charge is made for the use of such table. The tax imposed under this section shall not apply for any period beginning after June 30, 1952, with respect to any bowling alley, billiard table, or pool table maintained exclusively for the use of members of the Armed Forces on any property owned, reserved, or used by, or otherwise acquired for the use of, the United States if no charge is made for their use.

***Note.*—The rate of tax presently in effect on bowling alleys and billiard and pool tables is the temporary war rate of $20 as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

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CHAPTER 29—MANUFACTURERS' EXCISE AND IMPORT TAXES

SUBCHAPTER A—MANUFACTURERS' EXCISE TAXES

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SEC. 3403. TAX ON AUTOMOBILES, ETC.

There shall be imposed upon the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold:

(a) Automobile truck chassis, automobile truck bodies, automobile bus chassis, automobile bus bodies, truck and bus trailer and semitrailer chassis, truck and bus trailer and semitrailer bodies, tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer (including in each of the above cases parts or accessories therefor sold on or in connection therewith or with the sale thereof), 8 per centum[, except that on and after April 1, 1954, the rate shall be 5 percentum]. A sale of an automobile truck, bus, truck or bus trailer or semitrailer shall, for the purposes of this subsection, be considered to be a sale of the chassis and of the body.

(b) OTHER CHASSIS AND BODIES, ETC.—Other automobile chassis and bodies, chassis and bodies for trailers and semitrailers (other than house trailers) suitable for use in connection with passenger automobiles, and motorcycles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof), except tractors, 10 per centum[, except that on and after April 1, 1954, the rate shall be 7 per centum]. A sale of an automobile, trailer, or semitrailer shall, for the purposes of this subsection, be considered to be a sale of the chassis and of the body.

(c) Parts or accessories (other than tires and inner tubes and other than radio and television receiving sets) for any of the articles enumerated in subsection (a) or (b), 8 per centum[, except that on and after April 1, 1954, the rate shall be 5 per centum]. For the purposes of this subsection and subsections (a) and (b), spark plugs, storage batteries, leaf springs, coils, timers, and tire chains, which are suitable for use on or in connection with, or as component parts of, any of the articles enumerated in subsection (a) or (b), shall be considered parts or accessories for such articles, whether or not primarily adapted for such use. This subsection shall not apply to chassis or bodies for automobile trucks or other automobiles. Under regulations prescribed by the Commissioner, with the approval of the Secretary, the tax under this subsection shall not apply in the case of sales of parts or accessories by the manufacturer, producer, or importer to a manufacturer or producer of any of the articles enumerated in subsection (a) or (b). If any such parts or accessories are resold by such vendee otherwise than on or in connection with, or with the sale of, an article enumerated in subsection (a) or (b) and manufactured or produced by such vendee, then for the purposes of this section the vendee shall be considered the manufacturer or producer of the parts or accessories so resold. In determining the sale price of a rebuilt automobile part or accessory there shall be excluded from the price, in accordance with regulations prescribed by the Secretary, the value of a like part or accessory accepted in exchange.

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SEC. 3406. EXCISE TAXES IMPOSED BY THE REVENUE ACT OF 1941.

(a) IMPOSITION.—There shall be imposed on the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to the rate, on the price for which sold, set forth in the following paragraphs (including in each case parts or accessories of such articles sold on or in connection therewith, or with the sale thereof):

(1) SPORTING GOODS.—Badminton nets; badminton rackets (measuring 22 inches over all or more in length); badminton racket frames (measuring 22 inches over all or more in length); badminton racket strings; badminton shuttlecocks; badminton standards; billiard and pool tables (measuring 45 inches over all or more in length); billiard and pool balls and cues for such tables; bowling balls and pins; clay pigeons and traps for throwing clay pigeons; cricket balls; cricket bats; croquet balls and mallets; curling stones; deck tennis rings, nets, and posts; golf bags (measuring 26 inches or more in length); golf balls; golf clubs (measuring 30 inches or more in length); lacrosse balls; lacrosse sticks; polo balls; polo mallets; skis; ski poles; snow shoes; snow toboggans and sleds (measuring more than 60

inches over all in length); squash balls; squash rackets (measuring 22 inches over all or more in length); squash racket frames (measuring 22 inches over all or more in length); squash racket string; table tennis tables, balls, nets, and paddles; tennis balls; tennis nets; tennis rackets (measuring 22 inches over all or more in length); tennis racket frames (measuring 22 inches over all or more in length); tennis racket string; [15 per centum, except that on and after April 1, 1954, the rate shall be 10 per centum;] fishing rods, creels, reels, and artificial lures, baits, and flies; 10 per centum.

* * * * * * *

(4) PHOTOGRAPHIC APPARATUS.—Cameras and camera lenses, and unexposed photographic film in rolls (including motion picture film), [20] *10* per centum. The tax imposed under this paragraph shall not apply to X-ray cameras, to cameras weighing more than four pounds exclusive of lens and accessories, to still camera lenses having a focal length of more than one hundred and twenty millimeters, to motion picture camera lenses having a focal length of more than thirty millimeters, to X-ray film, to unperforated microfilm, to film more than one hundred and fifty feet in length, or to film more than twenty-five feet in length and more than thirty millimeters in width. Any person who acquires unexposed photographic film not subject to tax under this paragraph and sells such unexposed film in form and dimensions subject to tax hereunder (or in connection with a sale cuts such film to form and dimensions subject to tax hereunder) shall for the purposes of this subsection be considered the manufacturer of the film so sold by him.

* * * * * * *

(10) ELECTRIC LIGHT BULBS AND TUBES.—Electric light bulbs and tubes, not including articles taxable under any other provision of this subchapter, [5] *10* per centum.

***Note*.—The rate of tax presently in effect on electric light bulbs and tubes is the temporary war rate of 20 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

SEC. 3407. TAX ON FIREARMS, SHELLS, AND CARTRIDGES.

There shall be imposed upon firearms, shells, and cartridges, sold by the manufacturer, producer, or importer, a tax equivalent to [11] *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 any State, Territory of the United States, or political subdivision thereof, or the District of Columbia, or (2) to pistols and revolvers.

The taxes imposed by this section shall not apply to any firearm on which the tax provided by section 2720 has been paid.

The provisions of section 3452 (relating to expiration of taxes) shall not apply to the tax imposed by this section.

SEC. 3408. TAX ON MECHANICAL PENCILS, FOUNTAIN AND BALLPOINT PENS, AND MECHANICAL LIGHTERS FOR CIGARETTES, CIGARS, AND PIPES.

(a) IMPOSITION OF TAX.—There shall be imposed on the following articles, sold by the manufacturer, producer, or importer, a tax equal to [15] *10* per centum of the price for which so sold: Mechanical pencils, fountain pens, and ballpoint pens; mechanical lighters for cigarettes, cigars, and pipes.

* * * * * * *

SEC. 3412. TAX ON GASOLINE.

(a) There shall be imposed on gasoline sold by the producer or importer thereof, or by any producer of gasoline, a tax of 2 cents a gallon, except that under regulations prescribed by the Commissioner with the approval of the Secretary the tax shall not apply in the case of sales to a producer of gasoline. [On and after April 1, 1954, the tax imposed by this section shall be 1½ cents a gallon in lieu of 2 cents a gallon.]

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

(c) As used in this section—

(1) the term "producer" includes a refiner, compounder, or blender, and a dealer selling gasoline exclusively to producers of gasoline, as well as a producer.

(2) the term gasoline means (A) all products commonly or commercially known or sold as gasoline (including casinghead and natural gasoline), benzol, benzene, or naphtha, regardless of their classifications or uses; and (B) any other liquid of a kind prepared, advertised, offered for sale or sold for use as, or used as, a fuel for the propulsion of motor vehicles, motorboats, or airplanes; except that it does not include any of the foregoing (other than products commonly or commercially known or sold as gasoline) sold for use otherwise than as a fuel for the propulsion of motor vehicles, motorboats, or airplanes, and otherwise than in the manufacture or production of such fuel, and does not include kerosene, gas oil, or fuel oil.

(d) Every person subject to tax under this section or section 3413 shall, before incurring any liability for tax under such sections register with the collector for the district in which is located his principal place of business (or, if he has no principal place of business in the United States, with the collector at Baltimore, Maryland) and shall give a bond, to be approved by such collector, conditioned that he shall not engage in any attempt, by himself or by collusion with others, to defraud the United States of any tax under such sections; that he shall render truly and completely all returns, statements, and inventories required by law or regulations in pursuance thereof and shall pay all taxes due under such sections; and that he shall comply with all requirements of law and regulations in pursuance thereof with respect to tax under such sections. Such bond shall be in such sum as the collector may require in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, but not less than $2,000. The collector may from time to time require new or additional bond in accordance with this subsection. Every person who fails to register or give bond as required by this subsection, or who in connection with any purchase of gasoline or lubricating oil falsely represents himself to be registered and bonded as provided by this subsection, or who wilfully makes any false statement in an application for registration under this subsection, shall upon conviction thereof be fined not more than $5,000 or imprisoned not more than five years, or both, together with the costs of prosecution. If the Commissioner finds that any manufacturer or producer has at any time evaded any Federal tax on gasoline or lubricating oil, he may revoke the registration of such manufacturer or producer, and no sale to, or for resale to, such manufacturer or producer thereafter shall be tax-free under section 3413, this section, or section 3442, but such manufacturer or producer shall not be relieved of the requirement of giving bond under this subsection.

(e) Under regulations prescribed by the Commissioner with the approval of the Secretary, records required to be kept with respect to taxes under section 3413, or this section, and returns, reports, and statements with respect to such taxes filed with the Commissioner or a collector, shall be open to inspection by such officers of any State or Territory or political subdivision thereof or the District of Columbia as shall be charged with the enforcement or collection of any tax on gasoline or lubricating oils. The Commissioner and each collector shall furnish to any of such officers, upon written request, certified copies of any such statements, reports, or returns filed in his office upon the payment of a fee of $1 for each one hundred words or fraction thereof in the copy or copies requested.

(f) 1951 Floor Stocks Tax.—On gasoline subject to tax under this section which, on the effective date of section 489 (a) of the Revenue Act of 1951, is held and intended for sale, there shall be levied, assessed, collected, and paid a floor stocks tax at the rate of ½ cent per gallon. The tax shall not apply to gasoline in retail stocks held at the place where intended to be sold at retail, nor to gasoline held for sale by a producer or importer of gasoline. The provisions of section 3443 shall be applicable to the floor stocks tax imposed by this subsection so as to entitle, subject to all the provisions of such section, (1) any manufacturer or producer to a refund or credit of such tax under subsection (a) (1) of such section, and (2) any person paying such floor stocks tax to a refund or credit thereof where gasoline is by such person or any other person used or resold for any of the purposes specified in subparagraphs (A) (i), (ii), and (iii) of subsection (a) (3) of such section.

[(g) Floor Stocks Refunds on Gasoline.—

[(1) In general.—With respect to any gasoline taxable under this section, upon which tax (including floor stocks tax) at the applicable rate has been paid, and which, on April 1, 1954, is held and intended for sale by any person, there shall be credited or refunded (without interest) to the producer or importer who paid the tax, subject to such regulations as may be prescribed by the Secretary, an amount equal to so much of the difference between the tax so paid and the amount of tax made applicable to such gasoline on and after April 1, 1954, as has been paid by such producer or importer to such person as reimbursement for the tax reduction on such gasoline, if claim for such credit or refund is filed with the Secretary prior to July 1, 1954. No credit or refund shall be allowable under this subsection with respect to gasoline in retail stocks held at the place where intended to be sold at retail, nor with respect to gasoline held for sale by a producer or importer of gasoline.

[(2) LIMITATION ON ELIGIBILITY FOR CREDIT OR REFUND.—No producer or importer shall be entitled to a credit or refund under paragraph (1) unless he has in his possession satisfactory evidence of the inventories with respect to which he has made the reimbursements described in such paragraph, and establishes to the satisfaction of the Secretary with respect to the quantity of gasoline as to which credit or refund is claimed under such paragraph, that on or after April 1, 1954, such quantity of gasoline was sold to the ultimate consumer at a price which reflected the amount of the tax reduction.

[(3) PENALTY AND ADMINISTRATIVE PROCEDURES.—All provisions of law, including penalties, applicable in respect of the tax imposed under this section shall, insofar as applicable and not inconsistent with this subsection, be applicable in respect of the credits and refunds provided for in this subsection to the same extent as if such credits or refunds constituted credits or refunds of such taxes.]

*   *   *   *   *   *   *

CHAPTER 30—TRANSPORTATION AND COMMUNICATION

*   *   *   *   *   *   *

SUBCHAPTER B—TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES

SEC. 3465. IMPOSITION AND RATE OF TAX.

(a) There shall be imposed:

(1) TELEPHONE AND TELEGRAPH, ETC.—

(A) On the amount paid within the United States for each telephone or radio telephone message or conversation for which the toll charge is more than 24 cents, a tax equal to [20] *10* per centum of the amount so paid. If a bill is rendered the taxpayer for the services described in this subparagraph, the amount upon which the tax shall be based shall be the sum of all such charges included in the bill, and the tax shall not be based upon the charge for each item, separately, included in the bill.

***Note.*—The rate of tax presently in effect on long distance telephone messages is the temporary war rate of 25 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

(B) On the amount paid within the United States for each telegraph, cable, or radio dispatch or message a tax equal to [15 per centum of the amount so paid, except that in the case of each international telegraph, cable, or radio dispatch or message the rate shall be 10 per centum] *10 per centum of the amount so paid.* If a bill is rendered the taxpayer for the services described in this subparagraph, the amount upon which the tax at each of the rates in this subparagraph shall be based shall be the sum of all such charges at that rate included in the bill, and the tax shall not be based upon the charge for each item, separately, included in the bill.

If the tax under subparagraph (A) or (B) is paid by inserting coins in coin-operated telephones, the tax shall be computed to the nearest multiple of 5 cents, except that where the tax is midway between multiples of 5 cents, the next higher multiple shall apply. Only one payment of a tax imposed by subparagraph (A) or (B) shall be required notwithstanding the lines or stations of one or more persons are used in the transmission of such dispatch, message, or conversation.

(2) LEASED WIRES, ETC.—

(A) A tax equivalent to [15] *10* per centum of the amount paid for leased wire, teletypewriter, or talking circuit special service, but not including an amount paid for leased wire, teletypewriter, or talking circuit special service used exclusively in rendering a service taxable under subparagraph (B).

***Note.*—The rate of tax presently in effect on leased wires, etc., is the temporary war rate of 25 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

(B) A tax equivalent to [5] *8* per centum of the amount paid for any wire and equipment service (including stock quotation and information services, burglar alarm or fire alarm service, and all other similar services, but not including service described in subparagraph (A)).

The tax shall apply under this paragraph whether or not the wires or services are within a local exchange area.

***Note.*—The rate of tax presently in effect on wire and equipment service is the temporary war rate of 8 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

MINORITY VIEWS

We supported the excise tax reductions in this bill. We object, however, to the hasty action of the committee and the inadequate consideration given to the subject of excise taxes.

Involved in the bill is a total of $1.989 billion in excise tax revenue, made up by reductions in excise taxes of $912 million and increases of $1.077 billion. The next effect is an increase of $165 million in excise taxes.

The bill was not available to the members of the committee until we met to consider it in executive session, and deliberations on it were completed in 1 day. In all our experience in handling tax legislation, there has never been such hasty consideration of legislation involving so much revenue.

We deny the claim that the bill "reduces a number of excise tax rates on a selective basis." The only selection involved in this bill is more or less a line-of-sight proposition where an ad valorem rate that stands up above 10 percent is leveled to 10 percent. Such a selection completely ignores any excise tax which is below 10 percent, or which is levied on a dollar-and-cents basis per unit taxed.

We do not mean that relief is not needed in the areas covered in the bill, but we do believe that consideration should be given to other areas of excise taxes and the voluminous testimony which the committee received last summer relating to administrative problems in the excise tax field.

Frankly, we were not prepared ourselves on such short notice to make well-considered recommendations for other adjustments in the field of excise taxes. We did fall back on the adjustments which were recommended in the revenue bill of 1950 as it passed the House, which provided for excise tax reductions of $1 billion. It will be recalled that these reductions were deleted in the Senate, due to the advent of the Korean conflict and the necessity of increasing rather than decreasing revenues. The recommendations in the revenue bill of 1950 were made by the committee after long hearings and consideration, and there were justifiable reasons for making them. Most of the reductions contained in the current bill were also contained in that bill.

Among the additional adjustments which we attempted to make in the current bill and which were defeated by the majority were the following, many of which were also included in the revenue bill of 1950: to repeal the tax on handbags, billfolds, key cases, etc.; watches selling for less than $65, and clocks and alarm clocks selling for less than $5; household water heaters; mechanical pens and pencils; admissions; admissions where the admission price is 50 cents or under; admissions to moving picture theaters where the admission price is 50 cents or under; admissions to amusement parks and rides where the admission price does not exceed 15 cents; household ironers and driers; communications; leased wire service furnished to shut-in students; local telephone calls; college and school athletic games; and bowling alleys, billiard and pool tables operated without charge by nonprofit organizations or governmental agencies. We also proposed to cut the tax on transportation of property in half.

These may not be the only, or necessarily the most deserving, cases for adjustments or for reductions at this time, but due to the fact that the bill was considered on such short notice we were not as fully prepared to make adjustments as we would like to have been.

Another unusual feature of this bill which seems to us to be difficult to defend on its face is the fact that the net effect of the bill amounts to an increase in excise taxes of $165 million. It is piously claimed in the title of the bill that it reduces excise taxes. We dispute this. A more appropriate title would be "A bill to increase excise taxes."

We are also disturbed by the fact that the majority are not just continuing the increases in excise taxes that were provided in the Revenue Act of 1951 to finance defense preparations for the Korean conflict for a temporary period—they are making them permanent. This contrasts to their proposal to continue present corporate taxes at their present level for only 1 year. This increase in excise taxes amounts to over $1 billion. Our only purpose in increasing these excise tax rates in the Revenue Act of 1951 was to finance these defense preparations, and we inserted a termination date so that the taxes would expire automatically.

We attempted in the current bill to permit the reductions to take place on April 1 as scheduled, because these excise tax rates are even higher than they were during World War II, and, since they are selective, it seems to us that these particular industries should not be singled out from all others to bear such a heavy load. Failing in this, we attempted to assure these industries that these high rates would be continued only for 1 year. The majority defeated us in both of these attempts, and the effect of their action, as we stated, is to make these increases permanent.

The majority was determined to present this bill to the House as it was introduced, and all our efforts at making it more equitable were precluded from success even before they were made.

The majority also ignored the Treasury Department, which felt that the only adjustments in excise taxes which should be made at this time are in distressed industries, which they name as being the fur industry and the movie industry. The usual procedure of the committee in consulting the Treasury Department on legislation which it is considering was not followed in this case.

We would like to point out that this is the third instance in which the majority party has increased taxes, despite their claims during the last presidential campaign that they were not only going to reduce taxes but also balance the budget. We do not mean that we believe that the fiscal condition of the Treasury may not require the revenue involved in these increases, but we are concerned about the misleading promises which the majority party made. It will be recalled that the excess profits tax was continued from June 30, 1953, to December 31, 1953. The committee has already voted to continue the corporate tax at 52 percent for another year, and in this bill the excise tax rate increases made in the Revenue Act of 1951 are being made permanent. These increases in taxes and the estimated deficit of almost $3 billion in the current year's budget is a case, in our opinion, of actions again speaking louder than words.

Jere Cooper.
John D. Dingell.
Wilbur D. Mills.
Noble J. Gregory.
A. Sidney Camp.
Aime J. Forand.
Herman P. Eberharter.
Cecil R. King.
Thomas J. O'Brien.
Hale Boggs.

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EXCISE TAX REDUCTION ACT OF 1954

[Senate Report No. 1085, Eighty-third Congress, Second Session. Calendar No. 1086]

[March 19 (legislative day, March 1), 1954]

Mr. Millikin, from the Committee on Finance, submitted the following report [to accompany H. R. 8224]:

The Committee on Finance, to whom was referred the bill (H. R. 8224) to reduce excise taxes, and for other purposes, having considered the same, report favorably thereon, with amendments, and recommend that the bill do pass.

I. General Statement

The bill as passed by the House provides that all ad valorem excise taxes (i. e., tax expressed as a percent of the price at which articles or services are sold) which are now above 10 percent are to be reduced to 10 percent. The House bill also extended for 1 more year the rates scheduled for reduction on April 1, 1954, by present law (except the tax on sporting goods).

The report of the House committee with respect to the rate reductions suggests that these reductions will stimulate business and employment, not only in those industries directly affected by these taxes, but also in other industries, since consumers will pay less for many of these taxed items and have more money available for other purchases. It was also suggested that some of these taxes enter directly into business costs and that a reduction in such costs is desirable. Furthermore, it is suggested that these changes provide a more equitable tax system by leveling down those rates which are now excessively high and thus discriminatory.

In general your committee agrees with the reasons presented in the House report for making excise reductions at this time. However, it does not believe that a certain few of the present tax rates above 10 percent constitute a hardship either to the person supplying the article or service or to the person purchasing it. It is believed that this is true with respect to the tax on admissions to racetracks for horse and dog racing; the tax on club dues and initiation fees; and the tax on safe deposit boxes. As a result your committee continues the 20-percent tax rates in these cases.

Your committee also believes that the admissions tax constitutes a special hardship in certain cases. It is believed that this is true in the case of small theaters and others where the charge is 60 cents or less; in the case of college athletic events (not including postseason games such as bowl games); in the case of museums of history, art, or science operated by a governmental unit or nonprofit organization; and in the case of athletic events between students of several elementary or secondary schools where the proceeds inure to the benefit of a hospital for crippled children. As a result your committee exempts admissions charged in such cases from the 10-percent admissions tax.

Your committee's attention has also been called to certain manufacturers' excise taxes not levied on the basis of price where the tax is equal to more than 10 percent of the manufacturer's price. The tax on ordinary matches which is 2 cents per 1,000 usually represents something like 17 percent of the retail price for matches and cutting oil which is subjected to the 6 cents per gallon tax on lubricating oil is substantially above 10 percent of the manufacturer's price. Your committee in these cases provided that in no event is the tax to exceed 10 percent of the manufacturer's price. This will give these excises equal treatment with those levied on an ad valorem basis which were reduced to 10 percent by the House bill.

Your committee has added another amendment to the bill which does not affect the payment of taxes in any way but does have the effect of eliminating the unnecessary collection and subsequent refund of the 2 cents per gallon tax on gasoline substitutes. In the case of benzol, benzene, naphtha, or other liquids (not including gasoline), present law requires that this tax be paid by the producer and then if this liquid is used, or sold for use, in farm tractors or other than for use in motor vehicles, motorboats, or airplanes, a refund or credit of the tax is provided. This unnecessary tax collecting and refunding is avoided under the amended bill by collecting the tax at the retail level in the case of these fuels where they are used for a motor vehicle, motorboat or airplane and by collecting no tax at all where they are used for other purposes.

Several technical amendments have also been made by your committee. Most of these deal with the transition to the new reduced rates. In the case of the retail and manufacturers excises, an amendment has been adopted to provide that an article is not to be considered as sold prior to April 1, 1954, unless possession, or right to possession, of the article has passed before such date. This makes the reduced rates applicable in the case of "lay-aways" where possession passes after April 1, 1954.

For both the admissions tax and the transportation-of-persons tax an amendment was adopted providing that where tickets were purchased prior to April 1, 1954, for admissions or transportation on or after that date, the purchasers of the tickets are to be eligible for refunds (to be obtained through the issuer of the ticket) equal to the tax reduction provided in the bill.

The floor stock refund provision for electric light bulbs was modified by your committee to provide that the manufacturer is to have 4 rather than 3 months after the reduction date in which to file his claim for refund or credit. However, those to whom the manufacturer sold the bulbs must still submit their requests for refunds to the manufacturer within 3 months of this date.

A technical change was also made in the manner in which the admissions tax is to be applied. Your committee's bill provides that this tax is to be 1 cent for each 10 cents or "major" fraction thereof. This is the rule under existing law. The House bill provided that the tax was to be 1 cent for each 10 cents or fraction thereof. This was the rule in effect prior to the enactment of the Revenue Act of 1943.

Your committee made no change in the House provision extending until April 1, 1955, the rate reductions (other than the reduction in the tax on sporting goods) scheduled under present law to take effect April 1, 1954. Nor did it make any changes in the floor-stock refunds provided for automobiles and trucks, gasoline, cigarettes, and alcoholic beverages. Many requests were received to provide expiration or reduction dates for excises not so provided for by the House bill. Your committee did not believe it was desirable to do so because of the adverse effect such dates are likely to have on sales and because of the time limitations at present if this bill is to take effect as of April 1, 1954.

A start has been made in this bill toward reducing excise taxes by bringing down to 10 percent oppressive and discriminatory rates above the 10-percent level. Your committee would have liked to have made reductions in excise tax rates which were at or below the 10-percent level. This was not possible because of the present state of the budget. As soon as the budget will permit, it is the intention of the committee to make a comprehensive revision of the entire excise tax system. Many of the excise taxes now in effect were imposed during World War II or at the outbreak of the Korean war and need to be completely overhauled or eliminated. Among the taxes which are particularly troublesome and which will receive attention as soon as the state of the budget will permit are those relating to home appliances and the tax on transportation of property.

II. Rate Changes and Exemptions

The following table lists the taxes which are reduced under this bill, showing the rates under present law, and the estimated reductions in excise tax collections.

TABLE 1.—*Excise rate reductions effective Apr. 1, 1954, H. R. 8224 as passed by the House, and as reported by Senate Committee on Finance*

	Rates under present law	House bill: Rates	House bill: Reduction in excise tax collections (full-year effect)	Finance Committee bill: Rates	Finance Committee bill: Reduction in excise tax collections (full-year effect)
			Millions of dollars		*Millions of dollars*
Retailers' excises:					
Furs	20 percent	10 percent	20	10 percent	*20
Jewelry	do	do	100	do	*100
Luggage	do	do	40	do	*40
Toilet preparations	do	do	55	do	*55
Manufacturers' excises:					
Sporting goods	15 percent [1]	do	3	do	*3
Mechanical pencils and pens, and lighters.	do	do	4	do	*4
Electric light bulbs and tubes	20 percent	do	20	do	*20
Pistols and revolvers	11 percent	do	neg.	do	*neg.
Firearms, shells and cartridges	do	do	1	do	*1
Cameras, lenses, and film	20 percent	do	15	do	*15
Matches	2 cents per thousand.	No change		Not to exceed 10 percent.	4
Lubricating oil	6 cents per gallon.	do			
Cutting oil	do	do		Not to exceed 10 percent.	1
Miscellaneous excises:					
Long distance telephone, telegraph, etc	([2])	10 percent	235	10 percent	*235
Local telephone	15 percent	do	125	do	*125
Transportation of persons	do	do	95	do	*95
Leases of safe-deposit boxes	20 percent	do	5	20 percent	
Admissions:					
General	do	do	152	10 percent if price exceeds 60 cents.[4]	[4] 217
Cabarets	do	do	23	10 percent	*23
Club dues and initiation fees	do	do	19	20 percent	
Total			912		958

[1] Under present law this rate is scheduled for reduction to 10 percent on Apr. 1, 1954.
[2] Telephone or radio-telephone messages, toll charges over 24 cents, 25 percent; domestic telegraph, cable, and radio dispatches, 15 percent; international telegraph, cable and radio dispatches, 10 percent; leased wire service, teletypewriter, or talking circuit special service, 25 percent.
[3] Under present law a penalty tax of 50 percent is imposed on sales by proprietors in excess of the established tax; this rate is not reduced.
[4] The rate on all admissions to horse and dog races remains at 20 percent with no 60-cent exemption. Admissions to college athletics (excluding postseason games) and to museums are exempt from tax.
*No change from House bill.

TABLE 2.—*Excise tax rates extended to Apr. 1, 1955*

	Unit of tax	Present rate continued under bill	Rate after Apr. 1, 1955	Increased collections due to continuation (full-year effect)
Liquor taxes:				*Million*
Distilled spirits	Per proof gallon	$10.50	$9	$150
Fermented malt liquors	Per barrel	$9	$8	87
Wine:				
Still wine:				
Containing less than 14 percent alcohol.	Per wine gallon	17 cents	15 cents	
Containing 14 to 21 percent alcohol.	do	67 cents	60 cents	
Containing 21 to 24 percent alcohol.	do	$2.25	$2	
Containing more than 24 percent alcohol.	do	$10.50	$9	8
Sparkling wines, liqueurs, cordials, etc.:				
Champagne or sparkling wine	Per ½ pint	17 cents	15 cents	
Liqueurs, cordials, etc., and artifically carbonated wines.	do	12 cents	10 cents	
Tobacco taxes: Cigarettes	Per 1,000	$4	$3.50	191
Manufacturers' excises:				
Gasoline	Per gallon	2 cents	1½ cents	225
Passenger cars and motorcycles	Manufacturers' sale price.	10 percent	7 percent	276
Trucks, buses, truck trailers	do	8 percent	5 percent	75
Parts and accessories	do	do	do	60
Miscellaneous excises: Diesel fuel used for highway vehicles.	Per gallon	2 cents	1½ cents	5
Total				1,077

III. Hot Tractor Fuel and Other Gasoline Substitutes

Under existing law, gasoline is defined for purposes of the manufacturers' excise tax to mean: (A) All products commonly or commercially known or sold as gasoline (including casinghead and natural gasoline); and (B) benzol, benzene, or naphtha, and any other liquid of a kind prepared, advertised, offered for sale or sold for use as, or used as, a fuel for the propulsion of motor vehicles, motorboats, or airplanes. The second group of products are referred to in the regulations (regulations 44 relating to the taxes on gasoline, lubricating oil, and matches), as "class B products," and it is these class B products with which your committee's amendment bill is concerned.

Class B products are subject to tax only if offered for sale, sold as, or used as fuel for the propulsion of motor vehicles, motorboats, or airplanes. An important proportion of these products is not used for such purposes, however, but for such exempt uses as solvents and tractor fuel. The manufacturer may sell these products free of tax if he obtains a certificate prior to or at the time of sale from the purchaser who certifies that he is going to use them for a nontaxable purpose. However, manufacturers generally have to sell the products on a tax-paid basis because the purchasers usually are distributors or dealers who buy the products for resale and not for use. In this situation, a class B product may be sold free of tax by the dealer to the ultimate consumer if the latter certifies that he is going to use it for a nontaxable purpose. The exemption certificate signed by the consumer must then be sent by the dealer to the manufacturer so that the latter may take a credit or obtain a refund for the tax originally paid. The manufacturer can then adjust the dealer's account. Since there are a considerable number of consumers who buy class B products for nontaxable purposes, this procedure is cumbersome and costly.

Your committee's amendment rectifies this problem by changing the method of taxation of class B motor fuels. It eliminates the tax on those products at the manufacturers' level and imposes it at the retail dealers' level. It also provides that if the tax is not collected at the time of retail sale, and the consumer made a taxable use of the product, liability for tax then is to be incurred by the consumer. This is the system which now is used for the tax on diesel fuel.

Liquid fuels, which have been subject to tax when used for the propulsion of a motor vehicle, motorboat, or airplane under existing law because they are within the distillation range of class B products (as provided in sec. 314.30 of regulations 44), remain subject to tax under your committee's bill. Liquid fuels which presently are nontaxable as being within the distillation range of kerosene, gas oil, or fuel oil continue their nontaxable status under the bill. The taxes on diesel fuel and products commonly or commercially known or sold as gasoline will continue to be taxed as under existing law.

IV. Effective Date

For the retail and manufacturers' taxes the new tax rates are to apply to sales on or after April 1, 1954. Articles are not to be considered as sold prior to April 1, 1954, unless possession, or right to possession, of the article passes before that date. However, in the case of (1) leases, (2) installment sales, (3) conditional sales, or (4) chattel mortgage installment arrangements, entered into before April 1, 1954, payments made after April 1, 1954, are to be subject to the new rates.

For admissions the new tax rates apply to amounts paid for admissions on or after April 1, 1954. Amounts collected before that date for admission on or after that date, to the extent of the rate reduction, are to be allowed as a credit or refund to the person who collected the tax if prior to the time of the admission he has repaid this amount to the person who bought the ticket. For the cabaret tax, the new rates apply with respect to periods after 10 a. m. on April 1, 1954.

The new communications tax rates will apply with respect to amounts paid pursuant to bills rendered on and after April 1, 1954, for services rendered on and after such date, and for any services rendered in February and March for which no previous bill was rendered.

The new rate of tax on transportation of persons applies with respect to amounts paid on and after April 1, 1954, for or in connection with transportation which begins on or after such date. A refund or credit provision similar to that described above in the case of the admissions tax is applicable with respect to transportation tickets purchased before April 1, 1954, for use on or after that date. However, in this case the bill also provides that transportation is not to be considered as having begun on or after April 1, 1954, if any part of the transportation paid for (or for which payment has become obligated for) commenced before April 1, 1954.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is inclosed in black brackets; new matter is printed in italics; existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE

CHAPTER 9A—WAR TAXES AND WAR TAX RATES

SEC. 1650. WAR TAX RATES OF CERTAIN MISCELLANEOUS TAXES.

In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period beginning with the effective date of title III of the Revenue Act of 1943 *and ending March 31, 1954,* shall be the rates set forth under the heading "War Tax Rate":

Section	Description of tax	Old rate	War tax rate
1700(a)	Admissions	1 cent for each 10 cents or fraction thereof.	1 cent for each 5 cents or major fraction thereof.
1700(b)	Permanent use or lease of boxes or seats.	11 per centum	20 per centum.
1700(c)	Sales of tickets outside box office.	11 per centum	20 per centum.
1700(e)	Cabarets, roof gardens, etc	5 per centum	20 per centum.
1710(a)(1)	Dues or membership fees	11 per centum	20 per centum.
1710(a)(2)	Initiation fees	11 per centum	20 per centum.
2400 (except as respects watches selling at retail for not more than $65 and alarm clocks selling at retail for not more than $5).	Jewelry	10 per centum	20 per centum.
2401	Furs	10 per centum	20 per centum.
2402	Toilet preparations	10 per centum	20 per centum.
3268	Billiard and pool tables; and bowling alleys.	$10 per year per table; $10 per year per alley.	$20 per year per table; $20 per year per alley.
3406(a)(10)	Electric light bulbs and tubes	5 per centum	20 per centum.
3465(a)(1)(A)	Telephone, long distance	20 per centum	25 per centum.
3465(a)(2)(A)	Leased wires, etc	15 per centum	25 per centum.
3465(a)(2)(B)	Wire and equipment service	5 per centum	8 per centum.
3465(a)(3)	Local telephone service	10 per centum	15 per centum.
3469(a)	Transportation of persons	10 per centum	15 per centum.
3469 (c)	Seats, berths, etc	10 per centum	15 per centum.

SEC. 1651. RETAILERS' EXCISE TAX ON LUGGAGE, ETC.

(a) TAX.—There is hereby imposed upon the following articles (including in each case fittings or accessories therefor sold on or in connection with the sale thereof) sold at retail a tax equivalent to [20] *10* per centum of the price for which so sold:

(1) Trunks, valises, traveling bags, suitcases, satchels, overnight bags, hat boxes for use by travelers, beach bags, bathing suit bags, brief cases made of leather or imitation leather, and salesmen's sample and display cases.

(2) Purses, handbags, pocketbooks, wallets, billfolds, and card, pass, and key cases.

(3) Toilet cases and other cases, bags, and kits (without regard to size, shape, construction, or material from which made) for use in carrying toilet articles or articles of wearing apparel.

* * * * * * *

SEC. 1656. FLOOR STOCKS REFUNDS ON DISTILLED SPIRITS, WINES AND CORDIALS, AND FERMENTED MALT LIQUORS.

(a) IN GENERAL.—With respect to any article upon which tax is imposed under section 2800(a), 3030(a), or 3150(a), upon which internal revenue tax (including floor stocks tax) at the applicable rate prescribed by such section has been paid, and which, on April 1, [1954] *1955*, is held by any person and intended for sale or for use in the manufacture or production of any article intended for sale, there shall be credited or refunded to such person (without interest), subject to such regulations as may be prescribed by the Secretary, an amount equal to the difference between the tax so paid and the rate made applicable to such articles on and after April 1, [1954] *1955*, by such section, if claim for such credit or refund is filed with the Secretary prior to May 1, [1954] *1955*.

(b) LIMITATIONS ON ELIGIBILITY FOR CREDIT OR REFUND.—No person shall be entitled to credit or refund under subsection (a) unless (1) such person, for such period or periods both before and after April 1, [1954] *1955* (but not extending beyond one year thereafter), as the Commissioner with the approval of the Secretary shall by regulations prescribe, makes and keeps, and files with the Commissioner, such records of inventories, sales, and purchases as may be prescribed in such regulations; and (2) such person establishes to the satisfaction of the Commissioner, with respect to each kind of article for which refund is claimed by him under this section, that on and after April 1, [1954] *1955* and until the expiration of three months thereafter, the price at which articles of such kind were sold (until a number equal at least to the number on hand on

April 1, [1954] *1955* were sold) reflected, in such manner as the Commissioner may by regulations prescribe with the approval of the Secretary, the amount of the tax reduction.

(c) All provisions of law, including penalties, applicable in respect of internal revenue taxes on distilled spirits, wines, liqueurs and cordials, imported perfumes containing distilled spirits, and fermented malt liquors shall, insofar as applicable and not inconsistent with this section, be applicable in respect of the credits and refunds provided for in this section to the same extent as if such credits or refunds constituted credits or refunds of such taxes.

* * * * * * *

SEC. 1657. FLOOR STOCKS REFUNDS ON ELECTRIC LIGHT BULBS.

(a) IN GENERAL.—With respect to any article upon which tax is imposed under section 3406(a)(10), upon which internal revenue tax at the rate prescribed in section 1650 has been paid, and which, on the rate reduction date is held by any person and intended for sale, or for use in the manufacture or production of any article intended for sale, there shall be credited or refunded to the manufacturer or producer of such article (without interest), subject to such regulations as may be prescribed by the Commissioner with the approval of the Secretary, an amount equal to so much of the difference between the tax so paid and the tax that would have been paid if [section 1650 had not been applicable] *the applicable rate had been 10 per centum,* as has been paid by such manufacturer or producer to such person as reimbursement for the tax reduction on such articles, if claim for such credit or refund is filed with the Commissioner [prior to the expiration of three months after the rate reduction date] *prior to August 1, 1954, based upon a request for reimbursement submitted by such person to the manufacturer or producer of such article prior to July 1, 1954.*

* * * * * * *

[SEC. 1658. TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES.

[Notwithstanding section 1650, the rates therein prescribed with respect to the taxes imposed by section 3465(a) (1), (2), and (3) shall continue to apply with respect to amounts paid pursuant to bills rendered prior to the rate reduction date; and, in the case of amounts paid pursuant to bills rendered on or after the rate reduction date for services for which no previous bill was rendered, the decreased rates shall apply except with respect to such services as were rendered more than two months before such date; and, in the case of services rendered more than two months before such date, the provisions of section 1650 and 3465 in effect at the time such services were rendered shall be applicable to the amounts paid for such services.]

SEC. 1659. DEFINITION OF "RATE REDUCTION DATE."

For the purposes of this chapter the term "rate reduction date" means [such date as the Congress shall by law prescribe] *April 1, 1954.*

CHAPTER 10—ADMISSIONS AND DUES

SUBCHAPTER A—ADMISSIONS

SEC. 1700. TAX.

There shall be levied, assessed, collected, and paid—

(a) SINGLE OR SEASON TICKET; SUBSCRIPTION—

(1) RATE.—A tax of 1 cent for each 10 cents or *major* fraction thereof of the amount paid for admission to any place, including admission by season ticket or subscription. [No tax shall be imposed on the amount paid for admission of a child under 12 years of age if the amount paid is less than 10 cents.] *No tax shall be imposed under this paragraph on the amount paid for admission—*

(A) if the amount paid for admission is 60 cents or less, or

(B) in the case of a season ticket or subscription, if the amount which would be charged to the holder or subscriber for a single admission is 60 cents or less.

***Note.*—The rate of tax presently in effect for admission, including admission by season ticket or subscription, is the temporary war rate of 1 cent for each 5 cents or major fraction thereof as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

(2) BY WHOM PAID.—The tax imposed under paragraph (1) shall be paid by the person paying for such admission.

(3) CERTAIN RACE TRACKS—In lieu of the tax imposed under paragraph (1), a tax of 1 cent for each 5 cents or major fraction thereof of the amount paid for admission to any place (including admission by season ticket or subscription) if the principal amusement or recreation offered with respect to such admission is horse or dog racing at a race track. The tax imposed under this paragraph shall be paid by the person paying for such admission.

(b) PERMANENT USE OR LEASE OF BOXES OR SEATS.—

(1) RATE.—In the case of persons having the permanent use of boxes or seats in an opera house or any place of amusement or a lease for the use of such box or seat in such opera house or place of amusement (in lieu of the tax imposed under paragraph (1) *or (3)* of subsection (a)), a tax equivalent to [11] *10* per centum *(20 per centum if paragraph (3) of subsection (a) would otherwise apply)* of the amount for which a similar box or seat is sold for each performance or exhibition at which the box or seat is used or reserved by or for the lessee or holder.

***Note.*—The rate of tax presently in effect on permanent use or lease of boxes or seats is the temporary war rate of 20 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

* * * * * * *

(c) SALES OUTSIDE BOX OFFICE.—

(1) RATE.—Upon tickets or cards of admission to theaters, operas, and other places of amusement, sold at news stands, hotels, and places other than the ticket offices of such theaters, operas, or other places of amusement, at a price in excess of the sum of the established price therefor at such ticket offices plus the amount of any tax imposed under paragraph (1) *or (3)* of subsection (a), a tax equivalent to [11] *10* per centum *(20 per centum if paragraph (3) of subsection (a) would otherwise apply)* of the amount of such excess.

***Note.*—The rate of tax presently in effect on sales outside box office is the temporary war rate of 20 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

* * * * * * *

(e) TAX ON CABARETS, ROOF GARDENS, ETC.—

(1) RATE.—A tax equivalent to [5] *10* per centum of all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit, by or for any patron or guest who is entitled to be present during any portion of such performance. * * * *No tax shall be applicable under this paragraph on account of an amount paid for an admission with respect to which tax is imposed under subsection (a)(3).*

***Note.*—The rate of tax presently in effect on cabarets, roof gardens, etc., is the temporary war rate of 20 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

SEC. 1701. EXEMPTIONS FROM TAX.

No tax shall be levied under this subchapter in respect of—

(a) CERTAIN RELIGIOUS, EDUCATIONAL, OR CHARITABLE ENTERTAINMENTS, ETC.—

(1) IN GENERAL.—Except as provided in paragraph (2), any admissions all the proceeds of which inure—

(A) exclusively to the benefit of—

(i) a church or a convention or association of churches;

(ii) an educational institution which is exempt under section 101(6) or which is an educational institution of a government or political subdivision thereof, if such organization normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on;

(iii) a corporation or any community chest, fund, or foundation organized and operated exclusively for charitable purposes, exempt under section 101(6), if such corporation or organization is supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or is primarily supported by contributions from the general public;

(iv) a society or organization conducted for the sole purpose of maintaining symphony orchestras or operas and receiving substantial support from voluntary contributions;

(v) an organization (organized prior to October 1, 1951) which is exempt under section 101(6) and which is operated for the purpose of conducting an annual chautauqua program of educational, cultural, and religious activities at a permanent location—

if no part of the net earnings thereof inures to the benefit of any private stockholder or individual;

(B) exclusively to the benefit of National Guard organizations, Reserve officers' associations or organizations, posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private stockholder or individual; or

(C) exclusively to the benefit of a police or fire department of any city, town, village, or any municipality or exclusively to a retirement, pension, or disability fund for the sole benefit of members of such a police or fire department or to a fund for the heirs of such members.

(2) NONEXEMPT ADMISSIONS.—The exemption provided under paragraph (1) shall not apply in the case of admissions to (A) any athletic game or exhibition unless the proceeds inure exclusively to the benefit of an elementary or secondary school or unless in the case of an athletic game [between two elementary or secondary schools] *between teams composed of students from elementary or secondary schools*, the entire gross proceeds from such game inure to the benefit of a hospital for crippled children, (B) wrestling matches, prize fights, or boxing, sparring, or other pugilistic matches or exhibitions, (C) carnivals, rodeos, or circuses in which any professional performer or operator participates for compensation, or (D) any motion picture exhibition. *Clauses (A) and (B) shall not apply in the case of any athletic event between educational institutions held during the regular athletic season for such event, if the proceeds therefrom inure exclusively to the benefit of such institutions.*

* * * * * * *

(e) (1) HOME AND GARDEN TOURS.—Any admission to a home or garden which is temporarily opened to the general public as part of a program conducted by a society or organization to permit the inspection of historical homes and gardens—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual.

[(2) HISTORIC SITES.—Any admissions to historic sites, houses, and shrines, and museums conducted in connection therewith, maintained and operated by a society or organization devoted to the preservation and maintenance of such historic sites, houses, shrines, and museums—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual.]

(2) HISTORIC SITES, MUSEUMS, AND PLANETARIUMS.—Any admission to an historic site, house, or shrine, to a museum of history, art, or science, to a planetarium, or to any exhibition in connection with any of the foregoing, operated—

(A) by any State or political subdivision thereof or by the United States or any agency or instrumentality thereof—if the proceeds therefrom inure exclusively to the benefit of the State, political subdivision, United States, agency, or instrumentality, or

(B) by any society or organization not organized for profit—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual.

For the purposes of subparagraph (A), the term "State" includes Alaska, Hawaii, and the District of Columbia.

SUBCHAPTER B—DUES

SEC. 1710. TAX.

(a) RATE.—There shall be levied, assessed, collected, and paid—

(1) DUES OR MEMBERSHIP FEES.—A tax equivalent to [11] *20* per centum of any amount paid as dues or membership fees to any social, athletic, or sporting club or organization, if the dues or fees of an active resident annual member are in excess of $10 per year.

***Note.*—The rate of tax presently in effect on dues or membership fees is the temporary war rate of 20 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

(2) INITIATION FEES.—A tax equivalent to [11] *20* per centum of any amount paid as initiation fees to such a club or organization, if such fees amount to more than $10, or if the dues or membership fees, not including initiation fees, of an active resident annual member are in excess of $10 per year.

***Note.*—The rate of tax presently in effect on initiation fees is the temporary war rate of 20 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

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CHAPTER 15—TOBACCO, SNUFF, CIGARS, AND CIGARETTES

SUBCHAPTER A—RATE AND PAYMENT OF TAX

SEC. 2000. RATE OF TAX.

* * * * * * *

(c) CIGARS AND CIGARETTES.—Upon cigars and cigarettes manufactured in or imported into the United States, which are sold by the manufacturer or importer, or removed for consumption or sale, there shall be levied, collected, and paid the following taxes:

* * * * * * *

(2) CIGARETTES.—On cigarettes made of tobacco, or any substitute therefor, and weighing not more than three pounds per thousand, $4 per thousand until April 1, [1954] *1955*, and $3.50 per thousand on and after April 1, [1954] *1955;*

Weighing more than three pounds per thousand, $8.40 per thousand; except that if more than 6½ inches in length they shall be taxable at the rate provided in the preceding paragraph, counting each 2¾ inches (or fraction thereof) of the length of each as one cigarette.

The tax imposed by this subsection shall be in addition to any import duties imposed upon imported cigars and cigarettes.

* * * * * * *

(g) FLOOR STOCKS REFUNDS ON CIGARETTES.—

(1) IN GENERAL.—With respect to cigarettes, weighing not more than three pounds per thousand, upon which the tax imposed by subsection (c) (2), or upon which floor stocks tax imposed by subsection (f), has been paid, and which, on April 1, [1954] *1955*, are held by any person and intended for sale, or are in transit from foreign countries or insular possessions of the United States to any person in the United States for sale, there shall be credited or refunded to such person (without interest), subject to such regulations as may be prescribed by the Secretary, an amount equal to the difference between the tax paid on such cigarettes and the tax made applicable to such articles on April 1, [1954] *1955*, if claim for such credit or refund is filed with the Secretary prior to July 1, [1954] *1955.*

(2) LIMITATIONS ON ELIGIBILITY FOR CREDIT, OR REFUND.—No person shall be entitled to credit or refund under paragraph (1) unless (A) such person, for such period or periods both before and after April 1, [1954] *1955* (but not extending beyond one year thereafter), as the Secretary shall by regulations prescribe, makes and keeps, and files with the Secretary such records of inventories, sales, and purchases as may be prescribed in such regulations; and (B) such person establishes to the satisfaction of the Secretary, with respect to the cigarettes for which credit or refund is claimed by him under this section, that on and after April 1, [1954] *1955*, and until the

expiration of three months thereafter, the price at which cigarettes of such class were sold (until a number equal at least to the number on hand on April 1, [1954] *1955*, were sold) reflected, in such manner as the Secretary may by regulations prescribe, the amount of the tax reduction.

(3) PENALTY AND ADMINISTRATIVE PROCEDURES.—All provisions of law, including penalties, applicable in respect of internal revenue taxes on cigarettes shall, insofar as applicable and not inconsistent with this subsection, be applicable in respect of the credits and refunds provided for in this subsection to the same extent as if such credits or refunds constituted credits or refunds of such taxes.

* * * * * * *

CHAPTER 20—[DIESEL FUEL] *SPECIAL FUELS*

SEC. 2450. TAX ON DIESEL FUEL.

[There is hereby imposed a tax of 2 cents a gallon upon any liquid (other than any product taxable under section 3412)—

[(1) sold by any person to an owner, lessee, or other operator of a diesel-powered highway vehicle, for use as a fuel in such vehicle, or

[(2) used by any person as a fuel in a diesel-powered highway vehicle unless there was a taxable sale of such liquid under clause (1).

On and after April 1, 1954, the tax imposed by this section shall be 1½ cents a gallon in lieu of 2 cents a gallon.]

(a) DIESEL FUEL.—There is hereby imposed a tax of 2 cents a gallon upon any liquid (other than any product taxable under section 3412)—

(1) sold by any person to an owner, lessee, or other operator of a diesel-powered highway vehicle, for use as a fuel in such vehicle; or

(2) used by any person as a fuel in a diesel-powered highway vehicle unless there was a taxable sale of such liquid under paragraph (1).

(b) SPECIAL MOTOR FUEL.—There is hereby imposed a tax of 2 cents a gallon upon benzol, benzene, naphtha, liquefied petroleum gas, or any other liquid (other than kerosene, gas oil, or fuel oil, or any product taxable under section 3412 or subsection (a) of this section)—

(1) sold by any person to an owner, lessee, or other operator of a motor vehicle, motorboat, or airplane for use as a fuel for the propulsion of such motor vehicle, motorboat, or airplane; or

(2) used by any person as a fuel for the propulsion of a motor vehicle, motorboat, or airplane unless there was a taxable sale of such liquid under paragraph (1).

(c) RATE REDUCTION.—On and after April 1, 1955, the taxes imposed by this section shall be 1½ cents a gallon in lieu of 2 cents a gallon.

* * * * * * *

SEC. 2452. CREDITS AND REFUNDS.

[(a) NON-TAXABLE USE OR SALE BY VENDEE.—A credit against tax under this chapter, or a refund, may be allowed or made to a person in the amount of tax paid by him under this chapter with respect to his sale of any liquid to a vendee for use as fuel in a diesel-powered highway vehicle, if such person establishes, in accordance with regulations prescribed by the Secretary, that—

[(1) the vendee used such liquid otherwise than as fuel in such a vehicle or resold such liquid, and

[(2) such person has repaid or agreed to repay the amount of such tax to such vendee, or has obtained the consent of the vendee to the allowance of the credit or refund.

No interest shall be allowed with respect to any amount of tax credited or refunded under the provisions of this subsection.]

(a) NONTAXABLE USE OR SALE BY VENDEE.—A credit against tax under this chapter, or a refund, may be allowed or made to a person in the amount of tax paid by him under this chapter with respect to his sale of any liquid to a vendee for use as fuel in a diesel-powered highway vehicle, or with respect to his sale of benzol, benzene, naphtha, liquefied petroleum gas, or any other liquid to a vendee for use as fuel for the propulsion of a motor vehicle, motorboat, or airplane, if such person establishes, in accordance with regulations prescribed by the Secretary, that—

(*1*) *either—*

(*A*) *the vendee used such liquid otherwise than as fuel in such a vehicle, motorboat, or airplane or resold such liquid; or*

(*B*) *such liquid was used or was resold for use for any of the purposes, but subject to the conditions, provided in section 3451; and*

(*2*) *such person has repaid or agreed to repay the amount of such tax to such vendee, or has obtained the consent of the vendee to the allowance of the credit or refund.*

No interest shall be allowed with respect to any amount of tax credited or refunded under the provisions of this subsection.

* * * * * * *

SEC. 2453. TAX-FREE SALES.

Under regulations prescribed by the Secretary, no tax under this chapter shall be imposed with respect to the sale of any liquid for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia, or with respect to the use by any of the foregoing of any liquid [as fuel in a diesel-powered highway vehicle.] *covered by this chapter.*

* * * * * * *

SEC. 2456. EXEMPTION OF SPECIAL MOTOR FUELS USED FOR CERTAIN VESSELS.

The exemption from tax under chapter 29 provided in section 3451 shall also apply to the tax imposed under section 2450(b).

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CHAPTER 25—FIREARMS

SUBCHAPTER A—PISTOLS AND REVOLVERS

SEC. 2700. TAX.

(a) RATE.—There shall be levied, assessed, collected, and paid upon pistols and revolvers sold or leased by the manufacturer, producer, or importer, a tax equivalent to [11] *10* per centum of the price for which so sold or leased.

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CHAPTER 26—LIQUOR

SUBCHAPTER A—DISTILLED SPIRITS

PART I—PROVISIONS RELATING TO TAX

SEC. 2800. TAX.

(a) RATE.—

(1) DISTILLED SPIRITS GENERALLY.—There shall be levied and collected on all distilled spirits in bond or produced in or imported into the United States an internal revenue tax at the rate of $10.50 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the distiller or importer when withdrawn from bond. On and after April 1, [1954] *1955*, the rate of tax imposed by this paragraph shall be $9 in lieu of $10.50.

* * * * * * *

(3) IMPORTED PERFUMES CONTAINING DISTILLED SPIRITS.—There shall be levied and collected upon all perfumes imported into the United States containing distilled spirits, a tax of $10.50 per wine gallon, and a proportionate tax at a like rate on all fractional parts of such wine gallon. Such tax shall be collected by the collector of customs and deposited as internal revenue collections, under such rules and regulations as the Commissioner, with the approval of the Secretary, may prescribe. On and after April 1, [1954] *1955*, the rate of tax imposed by this paragraph shall be $9 in lieu of $10.50.

* * * * * * *

SUBCHAPTER B—WINES

SEC. 3030. TAX.

(a) RATE.—

(1) STILL WINES.—

(A) Imposition.—Upon all still wines, including vermouth, and all artificial or imitation wines or compounds sold as still wine, produced in or imported into the United States on or after the effective date of section 452(a) of the Revenue Act of 1951, or which on such date were on any winery premises or other bonded premises or in transit thereto or at any customhouse, there shall be levied, collected, and paid taxes at rates as follows, when sold, or removed for consumption or sale:

On wines containing not more than 14 per centum of absolute alcohol, 14 cents per wine-gallon, the per centum of alcohol under this section to be reckoned by volume and not by weight, except that on and after April 1, [1954] *1955*, the rate shall be 15 cents per wine-gallon;

On wines containing more than 14 per centum and not exceeding 21 per centum of absolute alcohol, 67 cents per wine-gallon, except that on and after April 1, [1954] *1955*, the rate shall be 60 cents per wine-gallon;

On wines containing more than 21 per centum and not exceeding 24 per centum of absolute alcohol, $2.25 per wine-gallon, except that on and after April 1, [1954] *1955*, the rate shall be $2 per wine-gallon;

All such wines containing more than 24 per centum of absolute alcohol by volume shall be classed as distilled spirits and shall pay tax accordingly.

Any such wines may, under such regulations as the Commissioner may prescribe, with the approval of the Secretary, be sold or removed tax-free for the manufacture of vinegar, or for the production of dealcoholized wines containing less than one-half of 1 per centum of alcohol by volume.

The taxes imposed by this subparagraph (A) of this paragraph shall not apply to dealcoholized wines containing less than one-half of 1 per centum of alcohol by volume; nor, subject to regulations prescribed by the Commissioner, with the approval of the Secretary, to wines produced for the family use of the duly registered producer thereof and not sold or otherwise removed from the place of manufacture and not exceeding in any case two hundred gallons per year.

* * * * * * *

(2) SPARKLING WINES, LIQUEURS, AND CORDIALS.—Upon the following articles which are produced in or imported into the United States, on or after the effective date of section 452(a) of the Revenue Act of 1951, or which on such date are on any winery premises or other bonded premises or in transit thereto or at any customhouse, there shall be levied, collected, and paid, in lieu of the internal-revenue taxes imposed thereon by law prior to such date, taxes at rates as follows, when sold, or removed for consumption or sale:

On each bottle or other container of champagne or sparkling wine, 17 cents on each one-half pint or fraction thereof, except that on and after April 1, [1954] *1955*, the rate shall be 15 cents on each one-half pint or fraction thereof;

On each bottle or other container of artificially carbonated wine, 12 cents on each one-half pint or fraction thereof, except that on and after April 1, [1954] *1955*, the rate shall be 10 cents on each one-half pint or fraction thereof;

On each bottle or other container of liqueurs, cordials, or similar compounds, by whatever name sold or offered for sale, containing sweet wine, citrus-fruit wine, peach wine, cherry wine, berry wine, apricot wine, prune wine, plum wine, pear wine, pawpaw wines, papaya wines, pineapple wines, cantaloup wines, or apple wine, fortified, respectively, with grape brandy, citrus-fruit brandy, peach brandy, cherry brandy, berry brandy, apricot brandy, prune brandy, plum brandy, pear brandy, pawpaw brandy, papaya brandy, pineapple brandy, cantaloup brandy, or apple brandy, 12 cents on each one-half pint or fraction thereof, except that on and after April 1, [1954] *1955*, the rate shall be 10 cents on each one-half pint or fraction thereof;

Any of the foregoing articles containing more than 24 per centum of absolute alcohol by volume (except vermouth, liqueurs, cordials, and similar compounds made in rectifying plants and containing tax-paid sweet wine, citrus-fruit wine, peach wine, cherry wine, berry wine, apricot wine, prune wine, plum wine, pear wine, pawpaw wines, papaya wines, pineapple wines, cantaloup wines, or apple wine, fortified, respectively with grape brandy, citrus-fruit brandy, peach brandy, cherry brandy, berry brandy, apricot brandy, prune brandy, plum brandy, pear brandy, pawpaw brandy, papaya brandy, pineapple brandy, cantaloup brandy, or apple brandy) shall be classed as distilled spirits and shall be taxed accordingly.

The Commissioner, under regulations prescribed by him, with the approval of the Secretary, is authorized to remit, refund, and pay back the amount of all taxes on such liqueurs, cordials, and similar compounds paid by or assessed against rectifiers at the distilled spirits rate prior to June 26, 1936.

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SUBCHAPTER D—FERMENTED LIQUORS

SEC. 3150. TAX.

(a) RATE.—There shall be levied and collected on all beer, lager beer, ale, porter, and other similar fermented liquor, containing one-half of 1 per centum, or more, of alcohol, brewed or manufactured and sold, or removed for consumption or sale, within the United States, or imported into the United States, by whatever name such liquors may be called, a tax of $9 for every barrel containing not more than thirty-one gallons, and at a like rate for any other quantity or for the fractional parts of a barrel authorized and defined by law. On and after April 1, ⟦1954⟧ *1955*, the tax imposed by the preceding sentence shall be at the rate of $8 in lieu of $9. In estimating and computing such tax, the fractional parts of a barrel shall be halves, thirds, quarters, sixths, and eighths; and any fractional part of a barrel, containing less than one-eighth, shall be accounted one-eighth; more than one-eighth, and not more than one-sixth, shall be accounted one-sixth; more than one-sixth, and not more than one-fourth, shall be accounted one-fourth; more than one-fourth, and not more than one-third, shall be accounted one-third; more than one-third, and not more than one-half, shall be accounted one-half; more than one-half, and not more than one barrel, shall be accounted one barrel; and more than one barrel, and not more than sixty-three gallons, shall be accounted two barrels, or a hogshead.

The provisions of this section requiring the accounting of hogsheads, barrels, and fractional parts of barrels at the next higher quantity shall not apply where the contents of such hogsheads, barrels, or fractional parts of barrels are within the limits of tolerance established by the Commissioner by regulations which he is hereby authorized to prescribe with the approval of the Secretary; and no assessment shall be made and no tax shall be collected for any excess in any case where the contents of the hogsheads, barrels, or fractional parts of barrels heretofore or hereafter used are within the limits of the tolerance so prescribed.

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CHAPTER 27—OCCUPATIONAL TAXES

SUBCHAPTER A—SPECIAL PROVISIONS

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PART VII—LIQUOR

SEC. 3250. TAX.

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(l) MANUFACTURERS OR PRODUCERS OF DESIGNATED NONBEVERAGE PRODUCTS.—

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(5) DRAWBACK.—In the case of distilled spirits tax-paid and used as provided in this subsection, a drawback shall be allowed—

(A) at the rate of $6 on each proof gallon upon which tax is paid at a rate of $9 per proof gallon prior to the effective date of section 462 of the Revenue Act of 1951,

(B) at the rate of $9.50 on each proof gallon upon which tax is paid at a rate of $10.50 per proof gallon on and after the effective date of section 462 of the Revenue Act of 1951, and

(C) at the rate of $8 on each proof gallon upon which tax is paid at a rate of $9 per proof gallon after March 31, [1954] *1955.*

Such drawback shall be due and payable quarterly upon filing of a proper claim with the Secretary. No claim under this subsection shall be allowed unless filed with the Secretary within the three months next succeeding the quarter for which the drawback is claimed.

* * * * * * *

PART X—BOWLING ALLEYS, AND BILLIARD AND POOL TABLES

SEC. 3268. TAX ON BOWLING ALLEYS, AND BILLIARD AND POOL TABLES.

(a) RATE.—Every person who operates a bowling alley, billiard room, or pool room shall pay a special tax of [$10] *$20* per year for each bowling alley, billiard table, or pool table. Every building or place where bowls are thrown or where games of billiards or pool are played, except in private homes, shall be regarded as a bowling alley, billiard room, or pool room, respectively. No tax shall be imposed under this section with respect to a billiard table or pool table in a hospital if no charge is made for the use of such table. The tax imposed under this section shall not apply for any period beginning after June 30, 1952, with respect to any bowling alley, billiard table, or pool table maintained exclusively for the use of members of the Armed Forces on any property owned, reserved, or used by, or otherwise acquired for the use of, the United States if no charge is made for their use.

***Note.*—The rate of tax presently in effect on bowling alleys and billiard and pool tables is the temporary war rate of $20 as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

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CHAPTER 29—MANUFACTURERS' EXCISE AND IMPORT TAXES

SUBCHAPTER A—MANUFACTURERS' EXCISE TAXES

* * * * * * *

SEC. 3403. TAX ON AUTOMOBILES, ETC.

There shall be imposed upon the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold:

(a) Automobile truck chassis, automobile truck bodies, automobile bus chassis, automobile bus bodies, truck and bus trailer and semitrailer chassis, truck and bus trailer and semitrailer bodies, tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer (including in each of the above cases parts or accessories therefor sold on or in connection therewith or with the sale thereof), 8 per centum, except that on and after April 1, [1954] *1955,* the rate shall be 5 per centum. A sale of an automobile truck, bus, truck or bus trailer or semitrailer shall, for the purposes of this subsection, be considered to be a sale of the chassis and of the body.

(b) OTHER CHASSIS AND BODIES, ETC.—Other automobile chassis and bodies, chassis and bodies for trailers and semitrailers (other than house trailers) suitable for use in connection with passenger automobiles, and motorcycles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof), except tractors, 10 per centum, except that on and after April 1, [1954] *1955,* the rate shall be 7 per centum. A sale of an automobile, trailer, or semitrailer shall, for the purposes of this subsection, be considered to be a sale of the chassis and of the body.

(c) Parts or accessories (other than tires and inner tubes and other than radio and television receiving sets) for any of the articles enumerated in subsection (a) or (b), 8 per centum, except that on and after April 1, [1954] *1955,* the rate shall be 5 per centum. For the purposes of this subsection and subsections (a) and (b), spark plugs, storage batteries, leaf springs, coils, timers, and tire chains, which are suitable for use on or in connection with, or as component parts of, any of the articles enumerated in subsection (a) or (b), shall be considered parts or accessories for such articles, whether or not primarily adapted for such use. This subsection shall not apply to chassis or bodies for automobile trucks or other automobiles. Under regulations prescribed by the Commissioner, with the approval of the Secretary, the tax under this subsection shall not apply in the case of sales of parts or accessories by the manufacturer, producer, or importer to a manufacturer or producer of any of the articles enumerated in subsection (a) or (b). If any such parts or accessories are resold by such vendee otherwise than on or in connection with, or with the sale of, an article enumerated in subsection (a) or (b) and manufactured or produced by such vendee, then for the purposes of this section the vendee shall be considered the manufacturer or producer of the parts or accessories so resold. In determining the sale price of a rebuilt automobile part or accessory there shall be excluded from the price, in accordance with regulations prescribed by the Secretary, the value of a like part or accessory accepted in exchange.

* * * * * * *

(f) FLOOR STOCKS REFUNDS.—

(1) Where before April 1, 1955, any article subject to the tax imposed by subsection (a) or (b) has been sold by the manufacturer, producer, or importer, and is on such date held by a dealer and has not been used and is intended for sale, there shall be credited or refunded (without interest) to the manufacturer, producer, or importer an amount equal to the difference between the tax paid by such manufacturer, producer, or importer on his sale of the article and the amount of tax made applicable to such article on and after April 1, 1955.

(2) As used in this subsection, the term "dealer" includes a wholesaler, jobber, distributor, or retailer. For the purposes of this subsection, an article shall be considered as "held by a dealer" if title thereto has passed to such dealer (whether or not delivery to him has been made), and if for purposes of consumption title to such article or possession thereof has not at any time been transferred to any person other than a dealer.

(3) Under regulations prescribed by the Secretary, the refund provided by this subsection may be made to the dealer instead of the manufacturer, producer, or importer, if the manufacturer, producer, or importer waives any claim for the amount so to be refunded.

(4) When the credit or refund provided for in this subsection has been allowed to the manufacturer, producer, or importer, he shall remit to the dealer to whom was sold the article in respect of which the credit or refund was allowed so much of that amount of the tax corresponding to the credit or refund as was included in or added to the price paid or agreed to be paid by the dealer.

(5) No person shall be entitled to credit or refund under this subsection unless (A) he has in his possession such evidence of the inventories with respect to which the credit or refund is claimed as may be required by regulations prescribed under this subsection, and (B) claim for such credit or refund is filed with the Secretary before July 1, 1955.

(6) All provisions of law, including penalties, applicable in respect of the tax imposed under subsections (a) and (b) shall, insofar as applicable and not inconsistent with this subsection, be applicable in respect of the credits and refunds provided for in this subsection.

* * * * * * *

SEC. 3406. EXCISE TAXES IMPOSED BY THE REVENUE ACT OF 1941.

(a) IMPOSITION.—There shall be imposed on the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to the rate, on the price for which sold, set forth in the following paragraphs (including in each case parts or accessories of such articles sold on or in connection therewith, or with the sale thereof):

(1) SPORTING GOODS.—Badminton nets; badminton rackets (measuring 22 inches over all or more in length); badminton racket frames (measuring 22 inches over all or more in length); badminton racket string; badminton shuttlecocks; badminton standards; billiard and pool tables (measuring 45 inches over all or more in length); billiard and pool balls and cues for such tables; bowling balls and pins; clay pigeons and traps for throwing clay pigeons; cricket balls; cricket bats; croquet balls and mallets; curling stones; deck tennis rings, nets, and posts; golf bags (measuring 26 inches or more in length); golf balls; golf clubs (measuring 30 inches or more in length); lacrosse balls; lacrosse sticks; polo balls; polo mallets; skis; ski poles; snow shoes; snow toboggans and sleds (measuring more than 60 inches over all in

length); squash balls; squash rackets (measuring 22 inches over all or more in length); squash racket frames (measuring 22 inches over all or more in length); squash racket string; table tennis tables, balls, nets, and paddles; tennis balls; tennis nets; tennis rackets (measuring 22 inches over all or more in length); tennis racket frames (measuring 22 inches over all or more in length); tennis racket string; [15 per centum, except that on and after April 1, 1954, the rate shall be 10 per centum;] fishing rods, creels, reels, and artificial lures, baits, and flies; 10 per centum.

* * * * * * *

(4) PHOTOGRAPHIC APPARATUS.—Cameras and camera lenses, and unexposed photographic film in rolls (including motion picture film), [20] *10* per centum. The tax imposed under this paragraph shall not apply to X-ray cameras, to cameras weighing more than four pounds exclusive of lens and accessories, to still camera lenses having a focal length of more than one hundred and twenty millimeters, to motion picture cameras lenses having a focal length of more than thirty millimeters, to X-ray film, to unperforated microfilm, to film more than one hundred and fifty feet in length, or to film more than twenty-five feet in length and more than thirty millimeters in width. Any person who acquires unexposed photographic film not subject to tax under this paragraph and sells such unexposed film in form and dimensions subject to tax hereunder (or in connection with a sale cuts such film to form and dimensions subject to tax hereunder) shall for the purposes of this subsection be considered the manufacturer of the film so sold by him.

* * * * * * *

(10) ELECTRIC LIGHT BULBS AND TUBES.—Electric light bulbs and tubes, not including articles taxable under any other provision of this subchapter, [5] *10* per centum.

***Note.*—The rate of tax presently in effect on electric light bulbs and tubes is the temporary war rate of 20 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

SEC. 3407. TAX ON FIREARMS, SHELLS, AND CARTRIDGES.

There shall be imposed upon firearms, shells, and cartridges, sold by the manufacturer, producer, or importer, a tax equivalent to [11] *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 any State, Territory of the United States, or political subdivision thereof, or the District of Columbia, or (2) to pistols and revolvers.

The taxes imposed by this section shall not apply to any firearm on which the tax provided by section 2720 has been paid.

The provisions of section 3452 (relating to expiration of taxes) shall not apply to the tax imposed by this section.

SEC. 3408. TAX ON MECHANICAL PENCILS, FOUNTAIN AND BALL-POINT PENS, AND MECHANICAL LIGHTERS FOR CIGARETTES, CIGARS, AND PIPES.

(a) IMPOSITION OF TAX.—There shall be imposed on the following articles, sold by the manufacturer, producer, or importer, a tax equal to [15] *10* per centum of the price for which so sold: Mechanical pencils, fountain pens, and ball-point pens; mechanical lighters for cigarettes, cigars, and pipes.

* * * * * * *

SEC. 3409. TAX ON MATCHES.

(a) MANUFACTURERS' TAX.—There shall be imposed upon matches sold by the manufacturer, producer, or importer, a tax of 2 cents per 1,000 matches *but not more than 10 per centum of the price for which so sold*, except that in the case of fancy wooden matches and wooden matches having a stained, dyed, or colored stick or stem, packed in boxes or in bulk, the tax shall be 5½ cents per 1,000 matches.

* * * * * * *

SEC. 3412. TAX ON GASOLINE.

(a) There shall be imposed on gasoline sold by the producer or importer thereof, or by any producer of gasoline, a tax of 2 cents a gallon, except that under regulations prescribed by the Commissioner, with the approval of the Secretary, the tax shall not apply in the case of sales to a producer of gasoline. **On and after** April

1, [1954] *1955*, the tax imposed by this section shall be 1½ cents a gallon in lieu of 2 cents a gallon.

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

(c) As used in this section—

(1) the term "producer" includes a refiner, compounder, or blender, and a dealer selling gasoline exclusively to producers of gasoline, as well as a producer.

(2) the term gasoline means [(A)] all products commonly or commercially known or sold as gasoline (including casinghead and natural gasoline) [, benzol, benzene, or naptha, regardless of their classifications or uses; and (B) any other liquid of a kind prepared, advertised, offered for sale or sold for use as, or used as, a fuel for the propulsion of motor vehicles, motorboats, or airplanes; except that it does not include any of the foregoing (other than products commonly or commercially known or sold as gasoline) sold for use otherwise than as a fuel for the propulsion of motor vehicles, motorboats, or airplanes, and otherwise than in the manufacture or production of such fuel, and does not include kerosene, gas oil, or fuel oil].

(d) Every person subject to tax under this section or section 3413 shall, before incurring any liability for tax under such sections register with the collector for the district in which is located his principal place of business (or, if he has no principal place of business in the United States, with the collector at Baltimore, Maryland) and shall give a bond, to be approved by such collector, conditioned that he shall not engage in any attempt, by himself or by collusion with others, to defraud the United States of any tax under such sections; that he shall render truly and completely all returns, statements, and inventories required by law or regulations in pursuance thereof and shall pay all taxes due under such sections; and that he shall comply with all requirements of law and regulations in pursuance thereof with respect to tax under such sections. Such bond shall be in such sum as the collector may require in accordance with regulations prescribed by the Commissioner, with the approval of the Secretary, but not less than $2,000. The collector may from time to time require new or additional bond in accordance with this subsection. Every person who fails to register or give bond as required by this subsection, or who in connection with any purchase of gasoline or lubricating oil falsely represents himself to be registered and bonded as provided by this subsection, or who wilfully makes any false statement in an application for registration under this subsection, shall upon conviction thereof be fined not more than $5,000 or imprisoned not more than five years, or both, together with the costs of prosecution. If the Commissioner finds that any manufacturer or producer has at any time evaded any Federal tax on gasoline or lubricating oil, he may revoke the registration of such manufacturer or producer, and no sale to, or for resale to, such manufacturer or producer thereafter shall be tax-free under section 3413, this section, or section 3442, but such manufacturer or producer shall not be relieved of the requirement of giving bond under this subsection.

(e) Under regulations prescribed by the Commissioner with the approval of the Secretary, records required to be kept with respect to taxes under section 3413, or this section, and returns, reports, and statements with respect to such taxes filed with the Commissioner or a collector, shall be open to inspection by such officers of any State or Territory or political subdivision thereof or the District of Columbia as shall be charged with the enforcement or collection of any tax on gasoline or lubricating oils. The Commissioner and each collector shall furnish to any of such officers, upon written request, certified copies of any such statements, reports, or returns filed in his office upon the payment of a fee of $1 for each one hundred words or fraction thereof in the copy or copies requested.

(f) 1951 Floor Stocks Tax.—On gasoline subject to tax under this section which, on the effective date of section 489 (a) of the Revenue Act of 1951, is held and intended for sale, there shall be levied, assessed, collected, and paid a floor stocks tax at the rate of ½ cent per gallon. The tax shall not apply to gasoline in retail stocks held at the place where intended to be sold at retail, nor to gasoline held for sale by a producer or importer of gasoline. The provisions of section 3443 shall be applicable to the floor stocks tax imposed by this subsection so as to entitle, subject to all the provisions of such section, (1) any manufacturer or producer to a refund or credit of such tax under subsection (a) (1) of such section, and (2) any person paying such floor stocks tax to a refund or credit thereof where gasoline is by such person or any other person used or resold for any of the purposes specified in subparagraphs (A) (i), (ii), and (iii) of subsection (a)(3) of such section.

(g) FLOOR STOCKS REFUNDS ON GASOLINE.—

(1) IN GENERAL.—With respect to any gasoline taxable under this section, upon which tax (including floor stocks tax) at the applicable rate has been paid, and which, on April 1, [1954] *1955*, is held and intended for sale by any person, there shall be credited or refunded (without interest) to the producer or importer who paid the tax, subject to such regulations as may be prescribed by the Secretary, an amount equal to so much of the difference between the tax so paid and the amount of tax made applicable to such gasoline on and after April 1, [1954] *1955*, as has been paid by such producer or importer to such person as reimbursement for the tax reduction on such gasoline, if claim for such credit or refund is filed with the Secretary prior to July 1, [1954] *1955*. No credit or refund shall be allowable under this subsection with respect to gasoline in retail stocks held at the place where intended to be sold at retail, nor with respect to gasoline held for sale by a producer or importer of gasoline.

(2) LIMITATION ON ELIGIBILITY FOR CREDIT OR REFUND.—No producer or importer shall be entitled to a credit or refund under paragraph (1) unless he has in his possession satisfactory evidence of the inventories with respect to which he has made the reimbursements described in such paragraph, and establishes to the satisfaction of the Secretary with respect to the quantity of gasoline as to which credit or refund is claimed under such paragraph, that on or after April 1, [1954] *1955*, such quantity of gasoline was sold to the ultimate consumer at a price which reflected the amount of the tax reduction.

(3) PENALTY AND ADMINISTRATIVE PROCEDURES.—All provisions of law, including penalties, applicable in respect of the tax imposed under this section shall, insofar as applicable and not inconsistent with this subsection, be applicable in respect of the credits and refunds provided for in this subsection to the same extent as if such credits or refunds constituted credits or refunds of such taxes.

SEC. 3413. TAX ON LUBRICATING OILS.

There shall be imposed upon lubricating oils sold in the United States by the manufacturer or producer a tax at the rate of 6 cents a gallon (*except that, in the case of cutting oils, the tax shall not exceed 10 per centum of the price for which so sold*), to be paid by the manufacturer or producer. Every person liable for tax under this section shall register and file bond as provided in section 3412 (d). Under regulations prescribed by the Commissioner with the approval of the Secretary, no tax shall be imposed under this section upon lubricating oils sold to a manufacturer or producer of lubricating oils for resale by him, but for the purposes of this chapter such vendee shall be considered the manufacturer or producer of such lubricating oils. *For the purposes of this section, the term "cutting oils" means oils used primarily in cutting and machining operations on metals and known commercially as cutting oils.*

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SUBCHAPTER C—GENERAL ADMINISTRATIVE PROVISIONS

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SEC. 3443. CREDITS AND REFUNDS.

(a) A credit against tax under this chapter, or a refund, may be allowed or made—

* * * * * * *

(3) to a manufacturer, producer, or importer, in the amount of tax paid by him under this chapter with respect to the sale of any article to any vendee, if the manufacturer, producer, or importer has in his possession such evidence as the regulations may prescribe that—

(A) such article was, by any person—

(i) resold for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia, or, in the case of musical instruments embraced in section 3404(d), resold for the use of any religious or nonprofit educational institution for exclusively religious or educational purposes;

(ii) used or resold for use for any of the purposes, but subject to the conditions, provided in section 3451;

[(iii) in the case of products embraced in paragraph (2) of section 3412(c) used or resold for use otherwise than as fuel for the propulsion of motor vehicles, motor boats, or airplanes, and otherwise than in the production of such fuel: *Provided, however*, That no credit or refund shall be allowed or made under this paragraph in the case of sales or uses of products commonly or commercially known or sold as gasoline, including casinghead and natural gasoline;]

[(iv)] *(iii)* in the case of lubricating oils, used or resold for nonlubricating purposes.

[(v)] *(iv)* in the case of unexposed motion picture films, used or resold for use in the making of news reel motion picture films;

[(vi)] *(v)* in the case of articles taxable under section 3403(c) (other than spark plugs, storage batteries, leaf springs, coils, timers, and tire chains), used or resold for use as repair or replacement parts or accessories for farm equipment (other than equipment taxable under subsection (a) or (b) of section 3403);

[(vii)] *(vi)* in the case of a communication, detection, or navigation receiver of the type used in commercial, military, or marine installations, resold to the United States for its exclusive use.

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CHAPTER 30—TRANSPORTATION AND COMMUNICATION

* * * * * * *

SUBCHAPTER B—TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES

SEC. 3465. IMPOSITION AND RATE OF TAX.

(a) There shall be imposed:

(1) TELEPHONE AND TELEGRAPH, ETC.—

(A) On the amount paid within the United States for each telephone or radio telephone message or conversation for which the toll charge is more than 24 cents, a tax equal to [20] *10* per centum of the amount so paid. If a bill is rendered the taxpayer for the services described in this subparagraph, the amount upon which the tax shall be based shall be the sum of all such charges included in the bill, and the tax shall not be based upon the charge for each item, separately, included in the bill.

***Note.*—The rate of tax presently in effect on long distance telephone messages is the temporary war rate of 25 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

(B) On the amount paid within the United States for each telegraph, cable, or radio dispatch or message a tax equal to [15 per centum of the amount so paid, except that in the case of each international telegraph, cable, or radio dispatch or message the rate shall be 10 per centum] *10 per centum of the amount so paid.* If a bill is rendered the taxpayer for the services described in this subparagraph, the amount upon which the tax at each of the rates in this subparagraph shall be based shall be the sum of all such charges at that rate included in the bill, and the tax shall not be based upon the charge for each item, separately, included in the bill.

If the tax under subparagraph (A) or (B) is paid by inserting coins in coin-operated telephones, the tax shall be computed to the nearest multiple of 5 cents, except that where the tax is midway between multiples of 5 cents, the next higher multiple shall apply. Only one payment of a tax imposed by subparagraph (A) or (B) shall be required notwithstanding the lines or stations of one or more persons are used in the transmission of such dispatch, message, or conversation.

(2) LEASED WIRES, ETC.—

(A) A tax equivalent to [15] *10* per centum of the amount paid for leased wire, teletypewriter, or talking circuit special service, but not including an amount paid for leased wire, teletypewriter, or talking circuit special service used exclusively in rendering a service taxable under subparagraph (B).

Note.—**The rate of tax presently in effect on leased wires, etc., is the temporary war rate of 25 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

(B) A tax equivalent to [5] *8* per centum of the amount paid for any wire and equipment service (including stock quotation and information services, burglar alarm or fire alarm service, and all other similar services, but not including service described in subparagraph (A)).

The tax shall apply under this paragraph whether or not the wires or services are within a local exchange area.

Note.—**The rate of tax presently in effect on wire and equipment service is the temporary war rate of 8 per centum as provided in section 1650 of the Internal Revenue Code, which under the bill expires March 31, 1954.**

EXCISE TAX REDUCTION ACT OF 1954

[House of Representatives Report No. 1446, Eighty-third Congress, Second Session]

[March 29, 1954]

Mr. Reed of New York, from the committee of conference, submitted the following conference report [to accompany H. R. 8224]:

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H. R. 8224) to reduce excise taxes, and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the Senate recede from its amendments numbered 1, 2, 4, 21, 22, 23, 24, 26, 27, 28, 29, 32, 33, 34, 37, 38, and 39.

That the House recede from its disagreement to the amendments of the Senate numbered 3, 5, 8, 9, 10, 12, 13, 15, 16, 17, 20, 25, 30, 31, 35, 36, 40, 41, 42, 43, 46, 47, 48, 49, 50, 51, 52, 53, and 54 and agree to the same.

Amendment numbered 6:

That the House recede from its disagreement to the amendment of the Senate numbered 6, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

(f) EXEMPTION OF ADMISSIONS OF FIFTY CENTS OR LESS.—Section 1700 (a) (1) (relating to rate of tax on single or season tickets and subscriptions) is hereby amended by striking out the second sentence thereof and inserting in lieu thereof the following: "No tax shall be imposed under this paragraph on the amount paid for admission—

"(A) if the amount paid for admission is 50 cents or less, or

"(B) in the case of a season ticket or subscription, if the amount which would be charged to the holder or subscriber for a single admission is 50 cents or less."

And the Senate agree to the same.

Amendment numbered 7:

That the House recede from its disagreement to the amendment of the Senate numbered 7, and agree to the same with an amendment as follows:

On page 3, of the Senate engrossed amendments, strike out lines 16 through 22, inclusive, and insert:

subsection (a) applies)".

(4) The last sentence of section 1700(e)(1) (relating to tax on cabarets, roof gardens, etc.) is hereby amended by striking out "subsection (a)(1)" and inserting in lieu thereof "paragraph (1) or (3) of subsection (a)".

And the Senate agree to the same.

Amendment numbered 11:

That the House recede from its disagreement to the amendment of the Senate numbered 11, and agree to the same with amendments as follows:

On page 5, line 16, of the Senate engrossed amendments, strike out "Civic" and insert *Certain Amateur*

On page 6, of the Senate engrossed amendments, strike out lines 1 through 5, inclusive, and insert:

"(f) CERTAIN AMATEUR THEATER PERFORMANCES.—*Any admission to an amateur performance presented and performed by a civic or community theater group or organization—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual.*"

And the Senate agree to the same.

Amendment numbered 14:

That the House recede from its disagreement to the amendment of the Senate numbered 14, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

The amendments made by section 201 (other than subsection (b) thereof) shall apply only with respect to amounts paid for admissions on or after April 1, 1954. In addition, such amendments shall apply—

(1) in the case of any season ticket or subscription, only if all the admissions under such ticket or subscription can occur only on or after April 1, 1954; and

(2) in the case of the permanent use of a box or seat or a lease for the use of such box or seat, only if all the performances or exhibitions at which the box or seat is used or reserved by or for the lessee or holder can occur only on or after April 1, 1954.

The amendment made by subsection (b) shall apply only with respect to amounts paid on or after April 1, 1954, for admissions on or after such date.

And the Senate agree to the same.

Amendment numbered 18:

That the House recede from its disagreement to the amendment of the Senate numbered 18, and agree to the same with an amendment as follows:

On page 7, line 21, of the Senate engrossed amendments, after "machining operations", insert (*including forging, drawing, rolling, shearing, punching, and stamping*); and the Senate agree to the same.

Amendment numbered 19:

That the House recede from its disagreement to the amendment of the Senate numbered 19, and agree to the same with amendments as follows:

Beginning on page 8, line 25, of the Senate engrossed amendments, strike out "is held on such date" and insert *on such date is held*

On page 9, line 4, of the Senate engrossed amendments, strike out "one-half" and insert *the difference between*

On page 9, line 5, of the Senate engrossed amendments, strike out "article," and insert *article and the tax made applicable to such article on and after April 1, 1954,*

On page 10, line 6, of the Senate engrossed amendments, after "section", insert *to the same extent as if such credits or refunds constituted credits or refunds of such taxes*

And the Senate agree to the same.

Amendment numbered 44:

That the House recede from its disagreement to the amendment of the Senate numbered 44, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

SEC. 506. SPECIAL CREDIT OR REFUND OF TRANSPORTATION AND ADMISSION TAXES.

Notwithstanding any other provision of law, in any case in which tax has been collected prior to April 1, 1954, at the rate in effect (without regard to the amendments made by this Act) prior to April 1, 1954, for or in connection with the transportation of persons which begins on or after April 1, 1954, or for admissions (referred to in section 201, other than subsections (b), (c), and (g) thereof, of this Act) on or after April 1, 1954, the person who collected the tax shall pay the same over to the United States; but credit or refund (without interest) of the tax collected in excess of that applicable (by reason of the amendments made by this Act) on or after April 1, 1954, shall be allowed to the person who collected the tax as if such credit or refund were a credit or refund under the applicable provision of the Internal Revenue Code, but only to the extent that, prior to the time such transportation has begun or prior to the event to which the right to admission relates, he has repaid the amount of such excess to the person from whom he collected the tax, or has obtained the consent of such person to the allowance of the credit or refund. For the purpose of this Act, *transportation shall not be considered to have begun on or after April 1, 1954, if any part of the transportation paid for (or for which payment has been obligated) commenced before April 1, 1954.*

And the Senate agree to the same.

Amendment numbered 45:

That the House recede from its disagreement to the amendment of the Senate numbered 45, and agree to the same with an amendment as follows:

On page 13, line 10, of the Senate engrossed amendments, strike out "506" and insert *507*; and the Senate agree to the same.

DANIEL A. REED,
THOMAS A. JENKINS,
RICHARD M. SIMPSON,
JERE COOPER,
W. D. MILLS,
Managers on the Part of the House.
E. D. MILLIKIN,
HUGH BUTLER,
EDWARD MARTIN,
ED C. JOHNSON,
Managers on the Part of the Senate.

STATEMENTS OF THE MANAGERS ON THE PART OF THE HOUSE

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H. R. 8224) to reduce excise taxes, and for other purposes, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

Amendments Nos. 1 and 2: These are clerical amendments. The Senate recedes.

Amendment No. 3: Under existing law the admissions tax in the case of roof gardens, cabarets, and similar places is 20 percent. The bill as passed the House would have reduced the rate of tax to 10 percent. The Senate amendment continues the 20 percent rate. The House recedes.

Amendment No. 4: This a clerical amendment. The Senate recedes.

Amendment No. 5: This amendment provides that the tax on admissions shall be 1 percent for each 10 cents or major fraction thereof. Under the House bill the tax would be 1 cent for each 10 cents or fraction thereof. The House recedes.

Amendment No. 6: This amendment (for which there is no corresponding provision in the House bill) provides that the tax on admissions under section 1700 (a) (1) of the Internal Revenue Code will not apply in the case of any admission of 60 cents or less. The House recedes with an amendment under which such tax will not apply in the case of any admission of 50 cents or less.

Amendment No. 7: This amendment (for which there is no corresponding provision in the House bill) retains the existing rate of 1 cent for each 5 cents or major fraction thereof in the case of admissions, if the principal amusement or recreation offered with respect thereto is horse or dog racing at a race track. This amendment also contains technical provisions with respect to the tax on permanent use or lease of box seats, sales outside the box office, and cabarets, which are necessary because of the higher rate of tax on admissions to such racing events. The House recedes with a technical amendment.

Amendment No. 8: Under this amendment (for which there is no corresponding provision in the House bill) admissions to an athletic game between teams composed of students from elementary or secondary schools would be exempt from tax, if the entire gross proceeds from such game inure to the benefit of a hospital for crippled children. Under existing law the game must be between two elementary or secondary schools. The House recedes.

Amendment No. 9: Under this amendment (for which there is no corresponding provision in the House bill) admissions to athletic games and exhibitions and to wrestling and boxing matches between educational institutions will be exempt if held during the regular athletic season for such event and if the proceeds therefrom inure exclusively to the benefit of such institutions. The House recedes.

Amendment No. 10: Under existing law admissions to historic sites, houses, and shrines, and museums conducted in connection therewith, maintained and operated by certain societies and organizations are exempt from tax. Under the Senate amendment (for which there is no corresponding provision in the House bill) the existing exemption is continued. In addition, this amendment exempts from tax admissions to certain museums of history, art, and science and to planetariums operated by States or their political subdivisions, by the United States, or by nonprofit societies and organizations. The amendment also extends the existing exemption for historic sites, houses, and shrines to those operated by States or their political subdivisions or by the United States. The House recedes.

Amendment No. 11: Under this amendment (for which there is no corresponding provision in the House bill) there is exempted from tax admissions to performances presented by a civic theater or community theater group or organization, if no part of the net earnings thereof inures to the benefit of any private stockholder or individual. The House recedes with amendments making it clear that the exemption is to apply only in the case of amateur performances which are presented and performed by a civic or community theater group or organization.

Amendments Nos. 12 and 13: The House bill reduced the tax on dues and memberships, and the tax on initiation fees, from the existing rate of 20 percent to 10 percent. The Senate amendments continue the 20 percent rate for both taxes. The House recedes.

Amendment No. 14: This is a technical amendment relating to the effective date for the changes in the taxes on admissions and dues. The House recedes with technical and conforming changes.

Amendment No. 15: The House bill reduced the tax on firearms, shells, and cartridges from 11 percent to 10 percent. Under the Senate amendment the existing 11 percent rate is retained. The House recedes.

Amendment No. 16: This is a clerical amendment. The House recedes.

Amendment No. 17: Under this amendment (for which there is no corresponding provision in the House bill) it is provided that the existing rate of tax of 2 cents per 1,000 matches shall not exceed 10 percent of the price for which the matches are sold by the producer, manufacturer, or importer. The House recedes.

Amendment No. 18: Under this amendment (for which there is no corresponding provision in the House bill) it is provided that the existing rate of tax on lubricating oils of 6 cents a gallon shall not, in the case of oils used primarily in cutting and machining operations on metals and known commercially as cutting oils, exceed 10 percent of the price for which such cutting oils are sold by the manufacturer or producer. The House recedes with an amendment making it clear that the term "cutting and machining operations", as used in the Senate amendment, includes forging, drawing, rolling, shearing, punching, and stamping.

Amendment No. 19: Under this amendment (for which there is no corresponding provision in the House bill) the manufacturers' excise taxes on refrigerators, quick-freeze units, and electric, gas, and oil appliances are reduced from 10 percent to 5 percent. The Senate amendment also includes a provision for floor stocks refunds on such articles. The House recedes with technical amendments to the floor stocks refund provisions.

Amendment No. 20: This is a clerical amendment. The House recedes.

Amendment No. 21: This is a clerical amendment. The Senate recedes.

Amendment No. 22: This is a clerical amendment. The Senate recedes.

Amendment No. 23: The House bill reduced from 20 to 10 percent the tax on the use of safe deposit boxes. Under the Senate amendment, the existing 20 percent rate is retained. The Senate recedes.

Amendment No. 24: This is a clerical amendment. The Senate recedes.

Amendment No. 25: This is a technical amendment to correct an error in the House bill. The House recedes.

Amendment No. 26: This is a clerical amendment. The Senate recedes.

Amendment No. 27: This is a clerical amendment. The Senate recedes.

Amendment No. 28: This is a clerical amendment. The Senate recedes.

Amendment No. 29: This is a technical amendment relating to the effective date for the termination of the war tax rate insofar as it relates to roof gardens, cabarets, and similar places. The Senate recedes.

Amendments Nos. 30 and 31: These amendments provide that, in the case of floor stocks refunds on electric light bulbs and tubes, claim for credit or refund must be filed before August 1, 1954, and based on a request for reimbursement by the person holding the light bulbs or tubes which is submitted to the manufacturer or producer before July 1, 1954. The House recedes.

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Amendment No. 32: This is a clerical amendment. The Senate recedes.

Amendment No. 33: This is a clerical amendment. The Senate recedes.

Amendment No. 34: This is a clerical amendment. The Senate recedes.

Amendment No. 35: This is a technical amendment relating to the effective date of certain provisions of the bill. The amendment provides that in determining whether such provisions apply, an article shall not be considered sold before April 1, 1954, unless possession or right to possession passes to the purchaser before such date. The House recedes.

Amendment No. 36: This is a technical amendment made necessary by amendment No. 35. The House recedes.

Amendment No. 37: This was a technical amendment made necessary by amendment No. 23. The Senate recedes.

Amendments Nos. 38 and 39: These were clerical amendments. The Senate recedes.

Amendments Nos. 40, 41, 42, and 43: These amendments make technical and clerical changes made necessary by other amendments. The House recedes.

Amendment No. 44: This amendment adds to the bill a new section relating to the crediting or refunding of overpayments of tax on admissions and on transportation where an excessive amount of tax is collected before April 1, 1954, for transportation of persons beginning on or after April 1, 1954, or for admissions on or after such date. The House recedes with technical and conforming changes.

Amendment No. 45: Under existing law, the tax on benzol, benzene, naphtha, and certain other liquids is paid by the producer, and then if the liquid is sold for use or used in farm tractors or other than in motor vehicles, motorboats, or airplanes, a refund or credit is allowable. Under the Senate amendment, the tax will be collected at the retail level if the fuels are sold for use or used in motor vehicles, motorboats, or airplanes, and no tax will be collected if they are sold or used for other purposes. Under the Senate amendment the rates of tax are the same as under the bill as it passed the House. The House recedes with a clerical amendment which changes the section number.

Amendment No. 46: This amendment strikes out matter which becomes surplusage by reason of amendment No. 45. The House recedes.

Amendments Nos. 47, 48, 49, 50, 51, 52, 53, and 54: These are clerical amendments made necessary by amendments Nos. 45 and 46. The House recedes.

Daniel A. Reed,
Thomas A. Jenkins,
Richard M. Simpson,
Jere Cooper,
W. D. Mills,
Managers on the Part of the House.

UNITED STATES-UNITED KINGDOM DEATH TAX CONVENTION

T. D. 5565, Section 82.108: Claim for credit or refund and interest on refund. Rev. Rul. 54–78
(Also Section 925, Internal Revenue Code, Section 81.79(b), Regulations 105.)

The provisions of Article VI(1) of the death duty convention between the United States and the United Kingdom, C. B. 1947-1, 125, insofar as it concerns the limitation period for claiming credit against or refund of Federal estate tax or British estate duty in case of deferment of tax attributable to a reversionary interest, apply only where the estate elects such deferment under such terms and conditions as are prescribed by the statutes of the contracting party involved. (In the United States, secs. 925 and 926 of the Internal Revenue Code. In the United Kingdom, sec. 7(6) of the Finance Act of 1894.)

PART V.—ADMINISTRATIVE AND MISCELLANEOUS MATTERS

Rev. Rul. 54-104 *

Interim allowances in respect of net renegotiation rebates

1. In the case of a renegotiation made prior to a recomputation of an amortization deduction pursuant to section 124(d) of the Internal Revenue Code in connection with the determination of taxes imposed by chapters 1, 2A, 2B, 2D and 2E of the Code for the fiscal year to which the excess profits determined by the renegotiation are attributable, the Renegotiation Act (Sixth Supplemental National Defense Appropriation Act, 1942, as amended) provides that there shall be repaid by the United States (without interest) to a contractor or subcontractor after such recomputation, the amount of a "net renegotiation rebate", as defined by the act. Under existing procedures (Mim. 6023, C. B. 1946-2, 187 and Mim. 6023, Supp. 1, C. B. 1951-1, 155) the "Federal tax benefit" from the renegotiation which is a necessary factor in determining the amount of the net renegotiation rebate to be repaid, is computed on the basis of the taxpayer's taxable income as adjusted and is furnished the Renegotiation Rebate Branch, General Services Administration, by the Internal Revenue Service, only after there has been a determination of the tax liability for the renegotiated year. In cases involving non-agreed or litigated issues, claims for relief under section 722 of the Code, and other features which preclude an early determination of the tax liability, this has resulted in substantial delays in completing action on contractors' applications for net renegotiation rebate payments under the act.

2. The purpose of this Revenue Ruling is to provide a procedure for the determination of a "tentative Federal tax benefit" in order that the Renegotiation Rebate Branch may approve interim payments of net renegotiation rebates in those cases where there has been a determination of the "gross renegotiation rebate" by the Renegotiation Rebate Branch but where the Federal tax benefit cannot be computed under existing procedures because there has been no final determination of the tax liability for the renegotiated year.

3. Contractors or subcontractors desiring to avail themselves of these interim payment provisions may do so by filing with the General Services Administration, Renegotiation Rebate Branch, an "Application for Interim Payment of Net Renegotiation Rebate" in the form of Exhibit A, page 21. The application should be submitted in triplicate and, as indicated therein, should include a computation of the Federal tax benefit which the contractor or subcontractor determines, from its own knowledge, to be applicable to the gross renegotiation rebate determined by the Renegotiation Rebate Branch.

*Originally issued as IR-Mimeograph No. 54-6, dated January 12, 1954.

4. Upon approval of the contractor's application by the Renegotiation Rebate Branch two copies will be transmitted to the National Office, Internal Revenue Service (Attention: O:C:ACR) with a request for a statement of the tentative Federal tax benefit applicable to the gross renegotiation rebate.

5. In order to adequately protect the interests of the Government and to assure that the interim payment will not exceed the net renegotiation rebate which would be due on the basis of a final determination of tax liability, the Federal tax benefit computed by corporation contractors, as shown in their applications, will be compared with the Federal tax benefit which would result if, in the case of the particular applicant, the maximum tax rates for the year involved were applicable. Since this will not be feasible in the cases of applicants other than corporations, and in view of the very limited number of such applicants, applications in other than corporation cases will be referred to the appropriate District Director's office for consideration and determination of a tentative Federal tax benefit on the basis of the facts existing in the particular case, using as a guide the general rule that each determination should be made upon the basis which will afford the contractor (taxpayer) the largest possible interim payment while at the same time safeguarding the Government's interests. The same procedure will be followed in certain corporation cases as described in paragraph 9 below. If the facts in the case are such that a tentative benefit may not be determined with sufficient definiteness to accomplish the purposes of this Revenue Ruling and at the same time assure protection of the Government's interest, the Renegotiation Rebate Branch will be advised that no tentative Federal tax benefit can be determined.

6. For the above purposes the gross renegotiation rebate as shown in any corporation application approved and forwarded by the Renegotiation Rebate Branch, will be multiplied by the appropriate percentage (maximum effective rate) from the following table according to the particular taxable year or years involved:

Taxable year		*Applicable percent (rate)*
Calendar years 1942 and 1943, or fiscal years ended in 1943		90
Fiscal years:		
Beginning	*Ending*	
Feb. 1, 1943	Jan. 31, 1944	90. 424660
Mar. 1, 1943	Feb. 29, 1944	90. 819670
Apr. 1, 1943	Mar. 31, 1944	91. 243170
May 1, 1943	Apr. 30, 1944	91. 653005
June 1, 1943	May 31, 1944	92. 076505
July 1, 1943	June 30, 1944	92. 486340
Aug. 1, 1943	July 31, 1944	92. 909835
Sept. 1, 1943	Aug. 31, 1944	93. 333335
Oct. 1, 1943	Sept. 30, 1944	93. 743170
Nov. 1, 1943	Oct. 31, 1944	94. 166665
Dec. 1, 1943	Nov. 30, 1944	94. 576505
Calendar years 1944 and 1945, or fiscal years ended in 1945		85. 5

7. If the Federal tax benefit as shown by the corporation in its application equals or exceeds the amount determined by the method described in the preceding paragraph, the amount shown in such appli-

cation will be furnished the Renegotiation Rebate Branch by the Internal Revenue Service as the "tentative Federal tax benefit."

8. If the Federal tax benefit as shown in the corporation's application is less than the amount determined by the method described in paragraph 6, but is at least 95 percent of such amount, then the amount determined by the method described in paragraph 6 will be furnished as the "tentative Federal tax benefit."

9. If the tax benefit shown in the application is less than 95 percent of the amount determined by the method described in paragraph 6, a copy of the application will be forwarded to the office of the District Director having audit jurisdiction of the case for verification of the amount of the Federal tax benefits shown in the application on the basis of the facts existing in the particular case or, where necessary to protect the Government's interest, a recomputation of a different amount as a "tentative Federal tax benefit."

10. Existing procedures for the determination of Federal tax benefits in renegotiation rebate cases, by field offices of the Internal Revenue Service, and for the furnishing of statements of such benefits to the Renegotiation Rebate Branch, General Services Administration, continue in effect and are not changed by this Revenue Ruling, irrespective of whether or not any application for an interim payment is made under its provisions. However, the statement of Federal tax benefit computed after there has been a determination of the tax liability for the renegotiated year under the provisions of Mimeograph 6023 (formerly forwarded with the file upon submission of the case for post-review action in Washington) will, in all cases not presently requiring routing to the National Office for review action, be routed to the National Office, Attention: O:C:ACR.

EXHIBIT A

General Services Administration
Renegotiation Rebate Branch
18th and F Streets, N. W.
Washington 25, D. C.

On or about ____________, 19____, the undersigned filed a claim for a net renegotiation rebate in accordance with subsection (a)(4)(D) of the Renegotiation Act, and the regulations promulgated thereunder. Since no determination has been made of the amount of the net renegotiation rebate properly payable on such claim, application is hereby made for an interim payment on account of such rebate, and in support thereof the following facts are submitted:

(*a*) Name and address of claimant:
____
____
____

(*b*) Fiscal year to which claim relates: ______________________________
(Ended)

(*c*) Original renegotiation settlement: Pursuant to agreement No. ________ ______ (or order) dated ______________________________

(*d*) Amount of gross renegotiation rebate: ______________________________

(*e*) Federal tax benefit (Attach schedules showing computation)* ______________________________

(*f*) Net renegotiation rebate ((d) minus (e)) ______________________________

____
(Name of claimant)

By ______________________

____
(Signature and title of authorized official)**

CERTIFICATION ***

I hereby certify that the facts set forth herein and in the appended schedules and statements are true and correct to the best of my knowledge, information and belief.

(Title of officer authorized to execute claim)**

(Date)

*All applications and supporting documents must be filed in triplicate.

**An application filed by a corporation must be executed by an authorized officer of corporation. For procedure for filing and execution of applications by partnerships see par. RR 383.3(3)(c). Certification must be signed by same officer or person executing application, if corporation or proprietorship, if partnership, by one general partner having knowledge of facts.

***Title 18, U. S. C., sec. 1001, makes it a criminal offense to make a willfully false statement or representation to any department or agency of the United States as to any matter within its jurisdiction.

Rev. Rul. 54–142

A substitute power of attorney executed in accordance with the terms of the original power does not destroy the rights of the original attorney or agent to represent the principal in matters before the Treasury Department unless such intent is indicated in the original power of attorney.

Advice is requested whether the execution of a substitute power of attorney destroys the rights given an attorney or agent under the original power of attorney.

A general power of attorney executed by the principal gave his attorney or agent the right to represent him in all matters before the Treasury Department with full powers of substitution and revocation. There was no indication in the power as to the intent of the principal to limit the right of his agent when the power of substitution was exercised.

If the attorney or agent designated in a power of attorney with power of substitution become ineligible to practice before the Treasury Department such ineligibility operates to defeat the rights of the attorney or agent under the substitute power of attorney. See section 10.9 of D. C. 230 (Rev.) C. B. 1952–2, 275, at 289.

From the foregoing, it is apparent that in the absence of any evidence of the intent of the principal that his attorney or agent has destroyed his own rights, the original attorney or agent would not be disassociated from a case by virtue of the execution of a substitute power of attorney.

Accordingly, it is held that a substitute power of attorney executed in accordance with the terms of the original power does not destroy the rights of the original attorney or agent to represent the principal in matters before the Treasury Department unless such intent is indicated in the original power of attorney. However, where a substitution is made the instrument of substitution should indicate the person who will actually be representing the principal at that time and to whom correspondence should be addressed.

Rev. Rul. 54–172*

Outline of the authority and general procedures of the National Office of the Internal Revenue Service and of the offices of the District

*Originally issued as IR-Mimeograph No. 54–82, dated May 10, 1954.

Directors with respect to issuing rulings and determination letters to taxpayers and entering into closing agreements on specific issues.

Rev. Rul. 10, C. B. 1953–1, 488, superseded; Rev. Rul. 32, C. B. 1953–1, 265, and Mim. 6293, C. B. 1948–2, 59, modified.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to describe the authority and general procedures of the various offices of the Internal Revenue Service in issuing rulings and determination letters to taxpayers and in entering into closing agreements on specific issues as to the interpretation or application of the income tax, profits tax, estate tax, gift tax, employment tax, and excise tax laws (other than alcohol, tobacco, and certain firearms taxes). This Revenue Ruling is intended to inform taxpayers and their representatives of the appropriate offices of the Internal Revenue Service to which they may direct requests for rulings, determination letters, or closing agreements in order to promote the efficient handling of their inquiries by the Internal Revenue Service.

SEC. 2. GENERAL POLICY AND DEFINITIONS.

.01 It is the policy of the Internal Revenue Service to answer inquiries of individuals and organizations, whenever appropriate in the interest of sound tax administration, as to their status for tax purposes and as to the tax effects of their acts or transactions, prior to their filing of returns or reports as required by the revenue laws. One of the functions of the National Office of the Internal Revenue Service is the issuance of rulings on such matters. District Directors of Internal Revenue apply the statute, regulations and rulings of the National Office in the determination of tax liability and the collection of taxes, and are authorized, as provided in this Revenue Ruling, to issue determination letters within the scope of their functions in answer to taxpayers' inquiries or requests.

.02 The term "ruling" is used to describe a written statement issued by the National Office of the Internal Revenue Service which is an expression of the official interpretation or policy of the office of the Commissioner of Internal Revenue. Rulings are issued by the Commissioner, or under his authority, and are intended to serve the purpose of establishing principles and policies of the Service in the interpretation and application of substantive tax law. Rulings are issued only by the National Office of the Internal Revenue Service. The Assistant Commissioner (Technical), acting under a delegation of authority from the Commissioner, is in general responsible for the issuance of rulings. This authority is, subject to appropriate supervision, redelegated to the Tax Rulings Division and its Branches.

.03 The term "determination letter" is used to describe a written statement issued by a District Director of Internal Revenue in response to an inquiry by an individual or an organization, and solely by way of application to the facts involved in a particular inquiry or request of the principles and policies previously established by the National Office. Determination letters are issued only where a determination can be made on the basis of clearly established rules as set forth in the statute, Treasury Decisions or Regulations, or rulings, opinions or court decisions published in the Internal Revenue Bulletin. Where such a determination cannot be made (such as where the question presented involves a novel issue) or the matter is excluded from the jurisdiction of a District Director of Internal Revenue by the provisions of this Revenue Ruling, a determination letter will not be issued by the District Director.

.04 The term "closing agreement" is used to describe an agreement between the Commissioner of Internal Revenue and a taxpayer with respect to a specific issue or issues pursuant to section 3760 of the Internal Revenue Code. Such closing agreements are based on rulings which have been signed by the Commissioner and in which the Commissioner indicates that he will enter into a closing agreement upon the basis of the holding of the ruling letter.

SEC. 3. RULINGS ISSUED BY THE NATIONAL OFFICE IN WASHINGTON, D. C.

.01 *In income, profits, estate, and gift tax* matters the National Office will exercise jurisdiction with respect to prospective transactions and with respect to completed transactions affecting returns to be filed, except that it will not ordinarily issue rulings to taxpayers or their representatives in connection with returns to be filed if the identical issue is also involved in a return or returns of the taxpayer already filed for a taxable period or periods with respect to which the statutory period of limitation on assessment or refund of tax has not expired. As to inquiries involving the qualification of a plan under section 165(a) of the Internal Revenue Code, and the exempt status of an organization under section 101 of the Internal Revenue Code, see sections 4.04 and 4.05 of this Revenue Ruling.

.02 *In employment and excise tax* matters the National Office will exercise jurisdiction over requests for rulings received in the National Office whether such request is received direct from the taxpayer or whether it is received through the office of a District Director of Internal Revenue, except that the National Office will not ordinarily issue a ruling to a taxpayer or his representative if it knows or has reason to believe that the issue is before the District Director in an active examination or audit of the liability of the taxpayer. Likewise, the National Office will not ordinarily take jurisdiction of an issue with respect to future action if it knows or has reason to believe that the identical issue is before the District Director in an active examination or audit of the liability of the taxpayer for a prior period.

SEC. 4. DETERMINATION LETTERS ISSUED BY DISTRICT DIRECTORS OF INTERNAL REVENUE.

.01 *In income, profits, estate, and gift tax* matters District Directors of Internal Revenue are authorized to issue determination letters in response to taxpayers' requests submitted to their offices involving completed transactions only, which affect returns required to be filed in their districts, but only if the question presented is covered specifically by statute, Treasury Decision or Regulations, or specifically by a ruling, opinion, or court decision published in the Internal Revenue Bulletin. Determination letters will not usually be issued with respect to a question which involves an income, profits, estate, or gift tax return or returns to be filed by the taxpayer if the identical question is involved in a return or returns already filed by the taxpayer. District Directors of Internal Revenue may not issue determination letters as to the income, profits, estate, or gift tax consequence of prospective or proposed transactions, except as provided in paragraph .04 of this section.

.02 *In employment and excise tax* matters District Directors of Internal Revenue are authorized to issue determination letters in response to requests from taxpayers who have filed or who are required to file returns in the district over which they have jurisdiction, but only if the question presented is covered specifically by statute, Treasury Decision or Regulations, or specifically by a ruling, opinion, or court decision published in the Internal Revenue Bulletin. Because of the impact of these taxes upon the business operations of the taxpayer and because of the peculiar problems of administration both to the Service and to the taxpayer, District Directors of Internal Revenue shall take appropriate action in regard to such requests received whether the request is in regard to completed or prospective transactions or a return previously filed or to be filed.

.03 Notwithstanding the provisions of paragraphs .01 and .02 of this section, a District Director of Internal Revenue may not issue a determination letter in response to an inquiry, although presenting a question covered specifically by statute, regulations, or a ruling, etc., published in the Internal Revenue Bulletin, where (1) it appears that a similar inquiry from the taxpayer has been directed to the National Office, (2) the determination letter is requested by an industry, trade association, or similar group, or (3) the request involves an industry-wide problem. Under no circumstance will a District Director of Internal Revenue issue a determination letter unless it is clearly indicated that the inquiry is with regard to a taxpayer or taxpayers in the district under the supervison of the District Director who receives the request. Notwithstanding the provisions of paragraph .02 of this section, the District Director of Internal Revenue may not issue a determination letter on an employment tax question when the specific question involved has been or is being considered by the National Office or the Social Security Administration. Nor may the District Director of Internal Revenue issue a determination letter on an excise tax question if the request is for a determination of fair market price under sections 3441(b) and 3444 of the Internal Revenue Code or for a determination of fair charges under section 3460 of the Internal Revenue Code.

.04 The authority and procedure provided in Revenue Ruling 32, C. B. 1953-1, 265, with respect to the disposition by District Directors of requests covering the qualification of plans under section 165(a) of the Internal Revenue Code is continued, but for this purpose the letters issued by District Directors in response to such requests shall be considered and designated as "determination letters."

.05 District Directors of Internal Revenue have authority to issue determination letters as to the qualification of certain organizations for exemption from Federal income tax under section 101 of the Internal Revenue Code in accordance with instructions issued in this connection. See Rev. Rul. 54-164, p. 88, this Bulletin.

.06 A request received by a District Director of Internal Revenue with respect to a question involved in an income, profits, estate, or gift tax return or returns already filed will, in general, be considered in connection with the examination of the return or returns. However, if response to such inquiry is made prior to an examination or audit, it will not be considered a determination letter but will be considered a tentative finding in any subsequent examination or audit of the return.

SEC. 5. DISCRETIONARY AUTHORITY TO ISSUE RULINGS AND DETERMINATION LETTERS.

.01 Except as provided in paragraph .02 of this section, the Internal Revenue Service has discretionary authority to issue determination letters or rulings (or to approve closing agreements pursuant to section 3760 of the Internal Revenue Code). That discretion will be exercised in the light of all relevant circumstances, including the business or other reasons motivating the transaction, and with a view to issuing determination letters or rulings (or approving closing agreements) only to the extent consistent with a wise administration of the revenue system.

.02 Rulings will be made in the National Office on prospective transactions where the law or regulations provide for a determination of the effect of a proposed transaction for tax purposes, as in the case of a transfer coming under the provisions of section 1250 and section 1251 of the Internal Revenue Code, or an exchange coming under the provisions of section 112(i) of the Code.

SEC. 6. QUESTIONS ON WHICH NO RULING OR DETERMINATION LETTER WILL BE ISSUED.

In addition to the other situations described herein, rulings or determination letters ordinarily will not be issued in connection with income, profits, estate, and gift tax matters where the determination requested is primarily one of fact, e. g., (1) market value of property, (2) whether compensation is reasonable in amount, (3) whether a transfer is one in contemplation of death, (4) whether retention of earnings and profits by a corporation is for the purpose of avoiding surtax on its shareholders, or (5) whether a transfer or acquisition is within section 15(c) or section 129 of the Internal Revenue Code.

SEC. 7. INSTRUCTIONS TO TAXPAYERS.

.01 Requests for determination letters and rulings should be submitted in duplicate if more than one issue is presented in the request or if a closing agreement is also requested with respect to the issue presented. Requests relating to prospective transactions should not contain alternative plans. Each request for a determination letter or a ruling on either a prospective transaction or a completed transaction must include the following:

(a) A complete statement of the facts regarding the transaction, including the names and addresses of all the interested parties, together with a copy of each contract or other document necessary to present such facts. (Inasmuch as exhibits and documents will be retained in the Service files, original documents should not be furnished.) If the subject matter is a corporate reorganization, distribution, or similar or related transaction, there should also be submitted the corporate balance sheet nearest the date of the transaction (the most recent balance sheet if the transaction is prospective).

(b) A full and precise statement of the business reasons, if any, for the transaction.

(c) If the taxpayer is contending for a particular determination, an explanation of the ground for such contention, together with a memorandum of relevant authorities.

.02 If the request is with respect to the qualification of a plan under section 165 of the Code, see Rev. Rul. 32, *supra*. If the request is with respect to the qualification of an organization for exemption from Federal income tax under section 101 of the Code, see Rev. Rul. 54–164, 5, *supra*.

.03 A request by or on behalf of a taxpayer must be signed by the taxpayer or his duly authorized representative. If the matter is being handled by a representative of the taxpayer, the conference and practice requirements regarding the furnishing of power of attorney, evidence of enrollment to practice, etc., must be met. Requests with respect to matters on which a ruling is desired from the National Office should be addressed to the Commissioner of Internal Revenue, Washington 25, D. C. Requests with respect to matters on which a determination letter from a District Director of Internal Revenue is desired should be addressed to the office of the District Director with which the tax return of the taxpayer has been filed or is required to be filed. In this connection see also Rev. Rul. 32, and Rev. Rul. 54–164, *supra*.

.04 A taxpayer or his representative who desires an oral discussion of the issue or issues involved should indicate such desire in writing when filing the request or shortly thereafter in order that the conference may be arranged at that stage of the consideration when it will be most helpful. Since a conference is usually more helpful during earlier stages of the consideration, the taxpayer or his representative should not request that the conference be deferred until Internal Revenue Service action (whether or not in accord with the taxpayer's contention) is imminent. More than one conference should not be sought unless the taxpayer has important new matters to present, or unless the problems involved require consideration of the case by different divisions or offices of the Internal Revenue Service. If the Service finds that additional conferences are necessary the taxpayer or his representative will be so advised.

.05 It is the practice of the Service to process requests for rulings or determination letters in regular order and as expeditiously as possible. Compliance with a request for consideration of a particular matter ahead of its regular order tends to delay the disposition of other matters. However, requests for processing ahead of the regular order, made in writing and showing clear need for such treatment, will be given consideration as the particular circumstances warrant.

.06 Where a taxpayer receives a determination letter or a ruling prior to the filing of his return he should attach to his return the determination letter or ruling (or a copy thereof) with respect to any transaction which has been consummated and which is relevant to the return being filed.

SEC. 8. REFERENCE OF MATTERS TO THE NATIONAL OFFICE.

.01 Requests for determination letters received from taxpayers by District Directors of Internal Revenue and which, in accordance with the provisions of this Revenue Ruling, are not to be acted upon by the

District Director shall be forwarded to the National Office for reply, and the taxpayer advised accordingly. Any question as to the authority of the District Director to act on a specific matter should be resolved in favor of referring the matter to the National Office.

.02 District Directors of Internal Revenue are authorized to refer to the National Office any request for a determination letter which, in their judgment, warrants the attention of the National Office. Likewise, District Directors are authorized, in the audit or examination of a return or returns, to request technical advice from the National Office, by addressing such requests to the Assistant Commissioner (Operations), who will refer the matter to the Assistant Commissioner (Technical). A technical advice memorandum will be issued to the District Director of Internal Revenue by the Assistant Commissioner (Technical) or his delegate. The practice provided for under Com.-Mimeograph 6293, C. B. 1948-2, 59, for hearings in the National Office where the District Director refers an issue to the National Office for technical advice will continue, with the appropriate substitution of the titles of offices and officers as provided by orders issued to implement Reorganization Plan No. 1 of 1952.

SEC. 9. REFERENCE OF MATTERS TO DISTRICT DIRECTORS.

Requests for rulings received from taxpayers by the National Office which, in accordance with the foregoing provisions, are not to be acted upon by the National Office shall be forwarded for appropriate action to the District Office in which the return has been or will be filed. The taxpayer shall be advised of the action taken.

SEC. 10. WITHDRAWAL OF REQUESTS.

The taxpayer's request for a ruling or a determination letter may be withdrawn at any time prior to the signing of the letter of reply. The withdrawal of the request will not prevent the National Office from furnishing its views to the District Director in whose office the return has been or will be filed. Neither shall such withdrawal prevent a District Director of Internal Revenue from considering the information submitted in a subsequent audit or examination of the taxpayer's return. Even though a request is withdrawn all correspondence and exhibits shall be retained in the files of the Internal Revenue Service and may not be returned to the taxpayer.

SEC. 11. ORAL ADVICE TO TAXPAYERS.

It is the policy of the Service not to issue rulings or determination letters upon oral request. For reasons of sound administration, oral opinions or advice given to taxpayers by employees or officers of the Internal Revenue Service are considered as aids to taxpayers only.

SEC. 12. EFFECT OF RULINGS.

.01 Generally no statement by any official of the Internal Revenue Service, other than a closing agreement under section 3760 of the Internal Revenue Code, is final and conclusive upon the Internal Revenue Service. However, see paragraphs .05, .06, and .07 of this section.

.02 As part of the determination of a taxpayer's liability, it is the responsibility of the District Director to ascertain whether any ruling previously issued to the taxpayer has been properly applied. Thus, it should be determined whether the representations upon which the ruling was based reflected an accurate statement of the material facts and whether the transaction actually was carried out substantially as proposed.

.03 If, in the course of the determination of the tax liability, it is the view of the District Director that a ruling previously issued to the taxpayer should be modified or revoked, the findings and recommendations of the District Director should be forwarded to the National Office for consideration of the matter prior to further action. Such reference to the National Office will be considered a request for technical advice and the procedures applicable to such requests will be followed. Otherwise, the ruling is to be applied by the District Director in his determination of the taxpayer's liability.

.04 Appropriate coordination with the National Office shall be undertaken in the event that any other field official having jurisdiction of a return or other matter proposes to reach a conclusion contrary to a ruling previously issued to the taxpayer.

.05 A ruling found to be in error or no longer in accord with the position of the Internal Revenue Service may be modified or revoked. Modification or revocation may be effected by a notice to the taxpayer to whom the ruling originally was issued, or by a ruling or other statement published in the Internal Revenue Bulletin. However, it is the general policy of the Internal Revenue Service to limit the revocation or modification of a ruling issued to or with respect to a particular taxpayer to a prospective application only, (a) if there has been no misstatement or omission of material facts, (b) the facts subsequently developed are not materially different from the facts on which the ruling was based, (c) there has been no change in the applicable law, and (d) such taxpayer acted in good faith in reliance upon such ruling and a retroactive revocation would be to his detriment.

.06 With respect to rulings published in the Internal Revenue Bulletin, it is the general policy of the Service that taxpayers may rely upon such rulings in determining the rule applicable to their own transactions and need not request a specific ruling applying the principles of the published ruling to the facts of the taxpayer's particular case where otherwise applicable. See, however, .08 of this section. In the event of revocation or modification of a ruling published in the Internal Revenue Bulletin, it is the general practice of the Service to make such revocation or modification prospective only.

.07 Under the provisions of section 1108(b) of the Revenue Act of 1926 (which is regarded as still in effect even though not incorporated in the Internal Revenue Code), a ruling holding that the sale or lease of a particular article is subject to the manufacturers' excise or the retailers' excise tax must be limited in its retroactive application in any case, where (1) such ruling reverses a prior ruling holding the particular article to be nontaxable, and (2) the taxpayer in reliance upon such ruling parted with possession or ownership of such article without passing the tax on to his customer.

.08 Since each ruling represents the conclusion of the Service as to the application of the law to the entire state of facts involved, revenue officials and others concerned are cautioned against reaching the same conclusion in other cases unless the facts and circumstances are substantially the same. Furthermore, Service personnel and others concerned should, in this connection, consider the effect of subsequent legislation, regulations, court decisions, and rulings.

SEC. 13. EFFECT OF DETERMINATION LETTERS.

A determination letter issued by a District Director, in accordance with this Revenue Ruling, shall be given the same effect upon examination of the return of the taxpayer to whom the determination letter was issued as is described in section 12, in the case of a ruling issued to a taxpayer, except that reference to the National Office is not necessary where upon the examination of the return it is the opinion of the District Director that a conclusion contrary to that expressed in the determination letter is indicated. A District Director is not authorized to limit the revocation of a determination letter to a prospecive application only, but may refer the matter to the National Office for exercise by the Commissioner, or his delegate, of the authority so to limit the revocation.

SEC. 14. EFFECT ON OTHER DOCUMENTS.

.01 Rev. Rul. 10, C. B. 1953-1, 488, is superseded by this Revenue Ruling.

.02 Rev. Rul. 32, C. B. 1953-1, 265, is amended as provided in section 4.04 of this Revenue Ruling.

.03 Mim. 6293, C. B. 1948-2, 59, is amended as provided in section 8.02 of this Revenue Ruling.

SEC. 15. EFFECTIVE DATE.

The effective date of this Revenue Ruling is May 24, 1954.

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