Treasury Department : : : Bureau of Internal Revenue

Internal Revenue Bulletin

Cumulative Bulletin 1949–1

JANUARY–JUNE 1949

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

US Treasury Department : : : : : Bureau of Internal Revenue Service

Internal Revenue Bulletin

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IN THIS ISSUE

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

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

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

UNITED STATES GOVERNMENT PRINTING OFFICE : WASHINGTON : 1949

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The Internal Revenue Bulletin service consists of bulletins issued every other week and semiannual cumulative bulletins.

The bulletins contain the rulings and decisions which are made public and all Treasury Department decisions (known as Treasury Decisions) pertaining to Internal Revenue matters. The semiannual cumulative bulletins contain all rulings and decisions (including Treasury Decisions) published during the previous 6 months.

The complete Bulletin service may be obtained, on a subscription basis, from the Superintendent of Documents, Government Printing Office, Washington 25, D. C., for $2.50 per year; foreign, $3.75. Single copies of the Bulletin, 10 cents each.

Certain issues of cumulative bulletins are out of print and are, therefore, not available. Persons desiring **available** cumulative bulletins may obtain them from the Superintendent of Documents at prices as follows:

Year	Cumulative Bulletin			
	First 6 months		Second 6 months	
1920	*2	$0.25	*3	$0.30
1928	VII–1	.35	VII–2	.50
1929	VIII–1	.50	VIII–2	.55
1930	IX–1	.50	IX–2	.50
1932	XI–1	.30		
1936	XV–1	.55	XV–2	.45
1939	1939–1—		1939–2	.60
	Part 1	.50		
	[1] Part 2	1.00		
1940	1940–1	.30	1940–2	.60
1941	1941–1	.45	1941–2	.60
1942	1942–1	.40	1942–2	.60
1943 [2]		1.25		
1944 [2]		2.25		
1945 [2]		1.50		
1946	1946–1	.50	1946–2	.75
1947	1947–1	.40	1947–2	.75
1948	1948–1	.75	1948–2	1.00
1949	1949–1	.75		

*Contains only income tax rulings.

[1] House, Senate, and conference reports on revenue bills enacted as the Act of October 3, 1913, the Act of October 22, 1914, and the Revenue Acts of 1916 to 1938, inclusive, and on amendments to such Acts.

[2] Printed in one volume.

Persons desiring to obtain the service in digest form may do so at prices as follows: Digest No. 19 (income tax rulings only, April, 1919, to December, 1921, inclusive), 50 cents; Digest No. 13 (1922–24), 60 cents; Digest No. 22 (1925–27), 35 cents; and Digest A (income tax rulings only, April, 1919, to December, 1930, inclusive), $1.50.

All inquiries in regard to these publications and subscriptions should be sent to the Superintendent of Documents, Government Printing Office, Washington 25, D. C.

INTRODUCTORY NOTES

The Internal Revenue Cumulative Bulletin 1949–1, in addition to all decisions of the Treasury Department (called Treasury Decisions) pertaining to Internal Revenue matters, contains opinions of the Chief Counsel for the Bureau of Internal Revenue, and rulings and decisions pertaining to income, estate, gift, sales, excess profits, employment, social security, and miscellaneous taxes, and legislation affecting the revenue statutes, as indicated on the title page of this Bulletin, published in the Bulletins (1949, Nos. 1 to 13, inclusive) for the period January 1 to June 30, 1949. It also contains a cumulative list of announcements relating to decisions of The Tax Court of the United States, formerly the United States Board of Tax Appeals, published in the Internal Revenue Bulletin Service from January 1 to June 30, 1949.

Income tax rulings are printed in two parts. The rulings under the Internal Revenue Code are printed as Part I, the law headings corresponding with the sections of the Code, as amended, and the regulations headings corresponding with the section headings of Regulations 111 or 103. Rulings under the Revenue Act of 1938 and prior revenue acts are printed as Part II, the law headings corresponding with the section headings of those revenue acts and the regulations headings corresponding with the article headings of the applicable regulations.

Rulings under Titles VIII and IX of the Social Security Act and under Subchapters A and C, Chapter 9, of the Internal Revenue Code in force prior to January 1, 1940, are published under article headings of Regulations 91 and 90, respectively; rulings under Subchapters A and C, Chapter 9, of the Code in force on or after January 1, 1940, are published under the section headings of Regulations 106 and 107, respectively; rulings under the Carriers Taxing Act of 1937 and under Subchapter B, Chapter 9, of the Code for periods prior to January 1, 1949, are published under the article headings of Regulations 100, and rulings under Subchapter B, Chapter 9, of the Code for periods subsequent to December 31, 1948, will be published under the section headings of Regulations 114.

ABBREVIATIONS

The following abbreviations are used throughout the Bulletin:

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

Em. T.—Taxes imposed by the Social Security Act, the Carriers Taxing Act of 1937, and Subchapters A, B, and C of the Internal Revenue Code.
E. P. C.—Excess Profits Tax Council ruling or memorandum.
E. T.—Estate Tax Division.
G. C. M.—General Counsel's, Assistant General Counsel's, or Chief Counsel's memorandum.
I. R. B.—Internal Revenue Bulletin.
I. R. C.—Internal Revenue Code.
I. T.—Income Tax Unit.
M, N, X, Y, Z, etc.—The names of corporations, places, or businesses, according to context.
Mim.—Mimeographed letter.
MS. or M. T.—Miscellaneous Division.
O. or L. O.—Solicitor's law opinion.
O. D.—Office decision.
Op. A. G.—Opinion of the Attorney General.
P. T.—Processing Tax Division.
S. T.—Sales Tax Division.
Sil.—Silver Tax Division.
S. M.—Solicitor's memorandum.
Sol. Op.—Solicitor's opinion.
S. R.—Solicitor's recommendation.
S. S. T.—Taxes on Employment by others than carriers.
T.—Tobacco Division.
T. B. M.—Advisory Tax Board memorandum.
T. B. R.—Advisory Tax Board recommendation.
T. C.—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.

ANNOUNCEMENT RELATING TO DECISIONS OF THE TAX COURT OF THE UNITED STATES, FORMERLY KNOWN AS THE UNITED STATES BOARD OF TAX APPEALS

In order that taxpayers and the general public may be informed whether the Commissioner has acquiesced in a decision of The Tax Court of the United States, formerly known as the United States Board of Tax Appeals, disallowing a deficiency in tax determined by the Commissioner to be due, announcement will be made in the bi-weekly Internal Revenue Bulletin at the earliest practicable date. 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 Bureau of Internal Revenue as precedents in the disposition of other cases.

CUMULATIVE CONTENTS

CONTENTS OF CUMULATIVE BULLETINS (I. T.) 1 to 5; S. T. FOR 1920 AND 1921; INTERNAL REVENUE I-1, I-2, II-1, II-2, III-1, III-2, IV-1, IV-2, V-1, V-2, VI-1, VI-2, VII-1, VII-2, VIII-1, VIII-2, IX-1, IX-2, X-1, X-2, XI-1, XI-2, XII-1, XII-2, XIII-1, XIII-2, XIV-1, XIV-2, XV-1, XV-2, 1937-1, 1937-2, 1938-1, 1938-2, 1939-1 (PART 1 AND PART 2), 1939-2, 1940-1, 1940-2, 1941-1, 1941-2, 1942-1, 1942-2; ANNUAL BULLETINS FOR 1943, 1944, AND 1945; SEMIANNUAL BULLETINS 1946-1, 1946-2, 1947-1, 1947-2, 1948-1, 1948-2, AND 1949-1.

Cumulative Bulletin	Ruling Nos.
Income Tax:	
December, 1919 (No. 1)	1-655
January-June, 1920 (No. 2)	656-1033
July-December, 1920 (No. 3)	1034-1368
January-June, 1921 (No. 4)	1369-1710
July-December, 1921 (No. 5)	1711-1996
Sales Tax:	
1920 (S. T. 1-20)	1-112
January-June, 1921	113-265
July-December, 1921	266-356
Internal Revenue Bulletin:	
January-June, 1922 (No. I-1)	1-383
July-December, 1922 (No. I-2)	384-665
January-June, 1923 (No. II-1)	666-956
July-December, 1923 (No. II-2)	957-1276
January-June, 1924 (No. III-1)	1277-1641
July-December, 1924 (No. III-2)	1642-1949
January-June, 1925 (No. IV-1)	1950-2251
July-December, 1925 (No. IV-2)	2252-2523
January-June, 1926 (No. V-1)	2524-2813
July-December, 1926 (No. V-2)	2814-3026
January-June, 1927 (No. VI-1)	3027-3291
July-December, 1927 (No. VI-2)	3292-3557
January-June, 1928 (No. VII-1)	3558-3784
July-December, 1928 (No. VII-2)	3785-4052
January-June, 1929 (No. VIII-1)	4053-4248
July-December, 1929 (No. VIII-2)	4249-4487
January-June, 1930 (No. IX-1)	4488-4683
July-December, 1930 (No. IX-2)	4684-4887
January-June, 1931 (No. X-1)	4888-5124
July-December, 1931 (No. X-2)	5125-5338
January-June, 1932 (No. XI-1)	5339-5531
July-December, 1932 (No. XI-2)	5532-5961
January-June, 1933 (No. XII-1)	5962-6262
July-December, 1933 (No. XII-2)	6263-6581
January-June, 1934 (No. XIII-1)	6582-6871
July-December, 1934 (No. XIII-2)	6872-7224
January-June, 1935 (No. XIV-1)	7225-7563
July-December, 1935 (No. XIV-2)	7564-7884
January-June, 1936 (No. XV-1)	7885-8149
July-December, 1936 (No. XV-2)	8150-8459
January-June, 1937 (1937-1)	8460-8792
July-December, 1937 (1937-2)	8793-9118
January-June, 1938 (1938-1)	9119-9424
July-December, 1938 (1938-2)	9425-9654
January-June, 1939 (1939-1—Part 1 and Part 2)	9655-9896
July-December, 1939 (1939-2)	9897-10126
January-June, 1940 (1940-1)	10127-10304
July-December, 1940 (1940-2)	10305-10548
January-June, 1941 (1941-1)	10549-10761
July-December, 1941 (1941-2)	10762-10943
January-June, 1942 (1942-1)	10944-11138
July-December, 1942 (1942-2)	11139-11302
January-December, 1943 (12 months)	11303-11590
January-December, 1944 (12 months)	11591-11916
January-December, 1945 (12 months)	11917-12200
January-June, 1946 (1946-1)	12201-12332
July-December, 1946 (1946-2)	12333-12465
January-June, 1947 (1947-1)	12466-12580
July-December, 1947 (1947-2)	12581-12721
January-June, 1948 (1948-1)	12722-12841
July-December, 1948 (1948-2)	12842-12998
January-June, 1949 (1949-1)	12999-13119

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 SERVICE FROM JANUARY 1, 1949, TO JUNE 30, 1949, INCLUSIVE

1949-13-13109

The Commissioner acquiesces in the following decisions:

Taxpayer	Docket No.	Report Volume	Report Page
A			
Abercrombie Co., J. S.[1]	6168	7	120
Acampo Winery & Distilleries, Inc	7637	7	629
Adda, Inc.[2]	8883	9	199
Allen, Hamilton, transferee	9771 11916	11	644
Armored Tank Corporation (N. Y.)	9768	11	644
Averbuch, Sam	9349	12	32
B			
Bechhold, Max, transferee	9772 11927	11	644
Bechhold, Siegfried, transferee	9770 11920	11	644
Beveridge, Catherine S.[3] [4]	12919	10	915
Biddle, Jr., et ux., Anthony J. Drexel	9526	11	868
Blum, Arthur N	12739	11	101
Blumberg, Isaac	16104	11	663
Brown, H. L	12419	11	744
Bryant Trust, Harriet M	14508	11	374
C			
Campbell, James E	15709	11	510
Campbell, John Albert	15710	11	510
Campbell, Vincent C	15707	11	510
City Bank Farmers Trust Co., executor of estate of Boies C. Hart	13441	11	16
Commodores Point Terminal Corporation	15421	11	411
D			
Davis, Montell	17195	11	538
Dean, Marjorie N	10018	10	19
Dempsey's Punch Bowl, Inc., Jack	15153	11	1030
Drew, N. B	16418 16419	12	5

[1] Nonacquiescence published in Cumulative Bulletin 1946-2, page 6, withdrawn.
[2] Partial nonacquiescence published in Cumulative Bulletin 1947-2, page 6, withdrawn.
[3] Gift tax decision.
[4] Nonacquiescence published in Internal Revenue Bulletin 1948-22, page 1, withdrawn.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report Volume	Report Page
F			
Farr, Merton E.	11725	11	552
Federal Machine & Welder Co., The	13715	11	952
First National Bank of Chicago, The, executor of estate of Emil A. Stake [1]	15191	11	817
G			
Genesee Valley Trust Co., executor of estate of Elizabeth V. Harper [1]	15948	11	717
Gifford-Hill & Co., Inc.[2]	13841	11	802
Goodman Furniture Co., The J. L.	13552	11	530
Grant-Lawson, Virginia Dean	10019	10	19
H			
Harding, William Barclay [3] [4]	6098	11	1051
Harper, Elizabeth V., estate of [1]	15948	11	717
Hart, Boies C., estate of	13441	11	16
Hart, Eloise Grayston	13441	11	16
Herberts, Curtis A.	11149	10	1053
Hinds, Ernest, estate of [1] [5]	9707	11	314
Hinds, Minnie H. M., executrix of estate of Ernest Hinds [1] [5]	9707	11	314
Holloway, H. M., estate of [3]	11426	10	1045
Holloway, Harvey S., executor of estate of H. M. Holloway [3]	11426	10	1045
Holloway, Mary L.[3]	11428	10	1045
Howe, Frances N., administratrix d. b. n. c. t. a. of estate of William L. Nevin [1]	15218	11	59
Hudson, Edward J.[6]	16380	11	1042
Hunt, E. W., estate of [1]	12659	11	984
Hunt, Viola, executrix of estate of E. W. Hunt [1]	12659	11	984
Hutson et al., Doris, executors of estate of Grace G. McAdow	15789	12	311
I			
Imler, Joseph W.	15670	11	836
Israel, Babette B.	12976	11	1064
J			
Judson Mills	9926	11	25
K			
Kenny, Anna Finley, estate of [1]	15462	11	857
Kenny, Franklin A., executor of estate of Anna Finley Kenny [1]	15462	11	857
Kiser et al., Lucy Peel, executors of estate of W. H. Kiser	12717	12	178
Kiser et al., W. H., estate of	12717	12	178

[1] Estate tax decision.
[2] Acquiescence relates only to the issue whether the taxpayer, on the accrual basis, in computing its excess profits credit under the invested capital method for the taxable year 1943, may include as a part of its accumulated earnings and profits the amount of its postwar credit to be refunded for the year 1942.
[3] Acquiescence relates only to the result.
[4] Gift tax decision.
[5] Acquiescence relates only to the issue involving the decedent's interest in the homestead property which is includible in gross estate and the value of such interest.
[6] Acquiescence relates only to the issue involving the inclusion in gross income for the year 1944 of the face value of certain promissory notes received in that year.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report Volume	Report Page
Knox, William F	11135	10	550
Koepfli, Joseph Blake	11682	11	352
Koppers Co	6232	11	894
Kuzmick, Paul L	12887	11	288
L			
Leach et ux., E. G	17734	12	20
M			
Manton, Eva M	5784	11	831
Maverick-Clarke Litho Co	14083	11	1087
McAdow, Grace G., estate of	15789	12	311
McAdow, Richard C , estate of	15799	12	311
McAdow, Jr., Richard C., executor of estate of Richard C. McAdow	15799	12	311
McArdle, Marion H	14819	11	961
McArdle, T. E	14820	11	961
Michaels, Aaron	9708	12	17
Moorer, William D	16272	12	270
Myers, Eva L	15162	11	495
Myers, R. T	15154	11	495
N			
Nevin, William L., estate of [1]	15218	11	59
Newhall et al., C. Stevenson, surviving and succeeding trustees of Trustees Common Stock John Wanamaker Philadelphia under will of Rodman Wanamaker [2]	15065	11	365
Newton et ux., Bert P	15177	11	512
Northern Coal & Dock Co., The	12746	12	42
Northup, Ethel X	10020	10	19
O			
Odle, R. F	17144	12	201
R			
Rosebault, Charles J., estate of [1]	15393	12	1
Rosebault, Laura D., executrix of estate of Charles J. Rosebault [1]	15393	12	1
S			
Schmidt, Arthur T	9398	10	746
Schutz et al., Dr. Carl Bryant, trustees of Harriet M. Bryant Trust	14508	11	374
Smallwood, Albert DeCaen, estate of [1]	13564	11	740
Smallwood et al., Thomas H., executors of estate of Albert DeCaen Smallwood [1]	13564	11	740
Stake, Emil A., estate of [1]	15191	11	817
Stanard-Tilton Milling Co.[3]	108582	3	1026
Steckler, Philip H., transferee	9769 11919	11	644
Sturman, Emanuel, estate of	14524	11	890
Sturman, Leon H., executor of estate of Emanuel Sturman	14524	11	890

[1] Estate tax decision.
[2] Acquiescence relates only to the issue whether the fiduciary is entitled to deduct amounts of current income retained by it to reimburse itself for inheritance tax advances on behalf of the beneficiary.
[3] Nonacquiescence published in Cumulative Bulletin 1944, page 48, withdrawn.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
T			
Thornley et ux., George H.[1]	105554	2	220
Tobin, Edgar G.	13612	11	928
Tobin, Margaret Batts	13611	11	928
Trustees Common Stock John Wanamaker Philadelphia under will of Rodman Wanamaker[2]	15065	11	365
V			
Veenstra & de Haan Coal Co	15518	11	964
W			
Wall Products, Inc	10277	11	51
Y			
Youghiogheny & Ohio Coal Co., The	12747	12	42

[1] Nonacquiescence published in Cumulative Bulletin 1944, page 49, withdrawn.
[2] Acquiescence relates only to the issue whether the fiduciary is entitled to deduct amounts of current income retained by it to reimburse itself for inheritance tax advances on behalf of the beneficiary.

The Commissioner does NOT acquiesce in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
A			
Allegheny Broadcasting Corporation, transferee	18513	12	552
Amherst Coal Co	12674	11	209
B			
Baird, John B	16382	11	1042
Baird, Mildred Bennett	16383	11	1042
Burgher, Ballard	16615	12	114
Burns et al., Roy, executors of estate of James E. Frizzell [1]	6704	11	576
C			
Clark, Willis W	13686	11	672
Cook, M. M. (Mrs. W. I.), estate of [2]	53044	[a] 27	33
D			
Dallas Downtown Development Co. (dissolved)	16618	12	114
Dallas National Bank, independent executor and trustee of estate of Ivor Elizabeth O'Connor Morgan	16568	12	114
Dallas National Bank, trustee of trust under will of James Charles O'Connor	16567	12	114
Downes, J. R	16385	11	1042
Downes, Mary B	16384	11	1042
F			
First National Bank of Dallas, trustee of Cecil A. Keating Trust	16829	12	114
Frizzell, James E., estate of [1]	6704	11	576
G			
Gifford-Hill & Co., Inc.[3]	13841	11	802
H			
Hinds, Ernest, estate of [1, 4]	9707	11	314
Hinds, Minnie H. M., executrix of estate of Ernest Hinds [1, 4]	9707	11	314
Hudson, Edward J.[5]	16380	11	1042
K			
Kahn, E. M., estate of	16718	12	114
Keating Trust, Cecil A	16829	12	114
L			
Lang, Otto H., estate of	16734	12	114
Lang, W. J., independent executor of estate of Otto H. Lang	16734	12	114

[a] Board of Tax Appeals.
[1] Estate tax decision.
[2] Acquiescence published in Cumulative Bulletin XII-1 (1933), pages 3 and 9, withdrawn.
[3] Nonacquiescence relates only to the issue whether, in determining nontaxable income from exempt excess output under section 735, I. R. C., each mine operation of a particular deposit is to be treated as one deposit of mineral property or as many mineral deposits or properties as there are tracts of land contained therein.
[4] Nonacquiescence relates only to the issue involving inclusion in gross estate of decedent's community interest in certain securities transferred by him to a trust on December 31, 1940.
[5] Nonacquiescence relates only to the issue involving a depletion allowance for the year 1944 with respect to income received from operation of a processing plant in the North Houston field.

NONACQUIESCENCES—Continued

Taxpayer	Docket No.	Report Volume	Report Page
M			
Maracaibo Oil Exploration Corp	17314	11	1042
McCarty, Justin	16616	12	114
McJunkin Trust, Mina G. and Fred, Jr	16665	12	114
McLean, Edward B.[1]	14075	11	543
McReynolds, J. O., estate of	16224	12	114
Meador, Harry L	16729	12	114
Morgan, Ivor Elizabeth O'Connor, estate of	16568	12	114
Motch, Jr., et ux., Edwin R	14621	11	777
N			
Nail et al., R. E., independent executors of estate of M. M. (Mrs. W. I.) Cook [2]	53044	[a] 27	33
Newhall et al., C. Stevenson, surviving and succeeding trustees of Trustees Common Stock John Wanamaker Philadelphia under will of Rodman Wanamaker [3]	15065	11	365
O			
O'Connor, James Charles, trust under will of	16567	12	114
Overton, Jr., W. W	16617	12	114
Overton, Jr., et al., W. W., liquidating trustees of Dallas Downtown Development Co. (dissolved)	16618	12	114
R			
Republic National Bank of Dallas, trustee of Mina G. McJunkin and Fred McJunkin, Jr., trust under will of Fred McJunkin	16665	12	114
Revere Land Co	6967	7	1061
S			
Saalfield Publishing Co., The	15535	11	756
Salmon, Charles Schofield	7515	12	40
Seay, Charles E	16773	12	114
Seay, George E	16774	12	114
Seay, John M	16772	12	114
Seay, Pauline B	16771	12	114
Seay et al., Pauline B., trustees of Pauline B. Seay Trust under will of Dero E. Seay	16780	12	114
Seay Trust, Pauline B	16780	12	114
Sharon, Olive J	14468	10	1177
Sharon, Robert A	14467	10	1177
Sullenger, J. H	15631	11	1076
Sullenger, Lela	15630	11	1076
T			
Taurog, Norman [1]	11429	11	1016
Texas Bank & Trust Co. of Dallas	16614	12	114
Trout-Ware, Inc	14910	11	505

[a] Board of Tax Appeals.

[1] Gift tax decision.

[2] Acquiescence published in Cumulative Bulletin XII-1 (1933), pages 3 and 9, withdrawn.

[3] Nonacquiescence relates only to the issue whether the surrender for cash of shares of John Wanamaker Philadelphia constitutes a taxable dividend transaction under section 115(g) of the Internal Revenue Code.

NONACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
Trust under will of James Charles O'Connor	16567	12	114
Trustees Common Stock John Wanamaker Philadelphia under will of Rodman Wanamaker [1]	15065	11	365
U			
Union Bus Terminal, Inc	15967	12	197
W			
Walsh, Miriam Cooper	16277	11	1093
Weisberg et al., Alex, trustees of estate of E. M. Kahn	16718	12	114
Witchell, Frank O	16731	12	114
Witchell, Frank O., independent executor of estate of Mollie I. Witchell	16732	12	114
Witchell, Mollie I., estate of	16732	12	114
Wozencraft, Mary Victoria McReynolds	17604	12	114
Wozencraft, Mary Victoria McReynolds, independent executrix and sole heir of estate of J. O. McReynolds	16224	12	114

[1] Nonacquiescence relates only to the issue whether the surrender for cash of shares of John Wanamaker Philadelphia constitutes a taxable dividend transaction under section 115(g) of the Internal Revenue Code.

INCOME TAX RULINGS.—PART I

INTERNAL REVENUE CODE

CHAPTER 1.—INCOME TAX

SUBCHAPTER B.—GENERAL PROVISIONS

PART I.—RATES OF TAX

SECTION 11.—NORMAL TAX ON INDIVIDUALS

SECTION 29.11–1: Income tax on individuals. 1949–5–13030
T. D. 5687

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1941

Regulations 111 amended to conform to the Revenue Act of 1948 (Public Law 471, Eightieth Congress) [C. B. 1948–1, 211].

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

To Collectors of Internal Revenue and Others Concerned:

On October 27, 1948, notice of proposed rule making, regarding amendments to the income tax regulations made necessary by the Revenue Act of 1948 (62 Stat. 111), enacted April 2, 1948 [C. B. 1948–1, 211], was published in the Federal Register (13 F. R. 6289). No objection to the rules proposed having been received, the amendments set forth below are hereby adopted. The amendments are made in order to conform Regulations 111 [26 CFR, Part 29], relating to the income tax, to the amendments made to Chapter 1 of the Internal Revenue Code by the Revenue Act of 1948.

PARAGRAPH 1. There is inserted immediately preceding section 29.11–1 the following:

TITLE I—INCOME TAX REDUCTION (REVENUE ACT OF 1948)

SEC. 101. REDUCTION OF NORMAL TAX AND SURTAX.

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

"(c) REDUCTION OF TENTATIVE NORMAL TAX AND TENTATIVE SURTAX.—

"(1) The combined normal tax and surtax under section 11 and subsection (b) of this section shall be the aggregate of the tentative normal tax and tentative surtax, reduced as follows:

If the aggregate is:	The reduction shall be:
Not over $400	17% of the aggregate.
Over $400 but not over $100,000	$68 plus 12% of excess over $400.
Over $100,000	$12,020 plus 9.75% of excess over $100,000.

"(2) In no event shall the combined normal tax and surtax exceed 77 per centum of the net income."

* * * * * * *

SEC. 104. TECHNICAL AMENDMENTS.

(a) Section 11 of the Internal Revenue Code (relating to the normal tax on individuals) is hereby amended by striking out "by 5 per centum thereof" and inserting in lieu thereof "as provided in section 12(c)".

* * * * * * *

(c) Subsections (d), (e), (f), (g), and (h) of section 12 of the Internal Revenue Code are amended to read as follows:

"(e) COMPUTATION OF TAX WITHOUT REGARD TO CREDITS AGAINST TAX.—In the application of this section, the combined normal tax and surtax shall be computed without regard to the credits provided in sections 31, 32, and 35.

"(f) ASCERTAINMENT OF NORMAL TAX AND SURTAX SEPARATELY.—Whenever it is necessary to ascertain the normal tax and the surtax separately, the surtax shall be an amount which is the same proportion of the combined normal tax and surtax as the tentative surtax is of the aggregate of the tentative normal tax and tentative surtax; and the normal tax shall be the remainder of such combined normal tax and surtax.

* * * * * * *

SEC. 105. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE.

The amendments made by this title shall be applicable with respect to taxable years beginning after December 31, 1947. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

SEC. 301. SPLITTING OF INCOME. (REVENUE ACT OF 1948, TITLE III.)

Section 12 of the Internal Revenue Code (relating to surtax of individuals) is hereby amended by adding after subsection (c) of such section the following new subsection:

"(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."

SEC. 305. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1948, TITLE III.)

The amendments made by sections 301, * * * shall be applicable with respect to taxable years beginning after December 31, 1947. * * * For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

PAR. 2. Section 29.11–1, as amended by Treasury Decision 55 [C. B. 1946–2, 8], approved June 12, 1946 [26 CFR 29.11–1], is furtl amended by striking out the last two sentences and inserting in li thereof the following:

For taxable years beginning after December 31, 1945, and before January 1948, the normal tax on individuals is determined by computing a tentat normal tax of 3 percent of the amount of the net income in excess of the cred against net income provided in section 25 for such years and by reducing su tentative normal tax by 5 percent thereof. For taxable years beginning af December 31, 1947, the normal tax on individuals is determined by comput a tentative normal tax of 3 percent of the amount of the net income in exc of the credits against net income provided in section 25 and by reducing su tentative normal tax as provided in section 12(c). See section 29.12–2.] computation of tax in the case of a joint return of husband and wife fo taxable year beginning after December 31, 1947, see section 29.12–4.

For treatment of taxable years beginning in 1945 and ending in 1946, section 29.108–2. For treatment of taxable years beginning in 1947 and end in 1948, see section 29.108–3.

PAR. 3. There is inserted immediately preceding section 29.12-1 the following:

TITLE I—INCOME TAX REDUCTION (REVENUE ACT OF 1948)

SEC. 101. REDUCTION OF NORMAL TAX AND SURTAX.

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

"(c) REDUCTION OF TENTATIVE NORMAL TAX AND TENTATIVE SURTAX.—

"(1) The combined normal tax and surtax under section 11 and subsection (b) of this section shall be the aggregate of the tentative normal tax and tentative surtax, reduced as follows:

If the aggregate is:	The reduction shall be:
Not over $400	17% of the aggregate.
Over $400 but not over $100,000	$68 plus 12% of excess over $400.
Over $100,000	$12,020 plus 9.75% of excess over $100,000.

"(2) In no event shall the combined normal tax and surtax exceed 77 per centum of the net income."

SEC. 102. REDUCTION IN SUPPLEMENT T TAX.

For reduction in the tax under Supplement T of Chapter 1 of the Internal Revenue Code (tax table which may be used by taxpayer at his election if his adjusted gross income is less than $5,000), see section 401.

SEC. 103. INCOME OF HUSBAND AND WIFE.

For tax in case of joint return of husband and wife (the so-called "splitting of income"), see section 301.

SEC. 104. TECHNICAL AMENDMENTS.

* * * * * * *

(b) Section 12(b) of the Internal Revenue Code (relating to the rate of surtax on individuals) is hereby amended by striking out "by 5 per centum thereof" and inserting in lieu thereof "as provided in subsection (c) of this section".

(c) Subsections (d), (e), (f), (g), and (h) of section 12 of the Internal Revenue Code are amended to read as follows:

"(e) COMPUTATION OF TAX WITHOUT REGARD TO CREDITS AGAINST TAX.—In the application of this section, the combined normal tax and surtax shall be computed without regard to the credits provided in sections 31, 32, and 35.

"(f) ASCERTAINMENT OF NORMAL TAX AND SURTAX SEPARATELY.—Whenever it is necessary to ascertain the normal tax and the surtax separately, the surtax shall be an amount which is the same proportion of the combined normal tax and surtax as the tentative surtax is of the aggregate of the tentative normal tax and tentative surtax; and the normal tax shall be the remainder of such combined normal tax and surtax.

"(g) CROSS REFERENCES.—

"(1) ALTERNATIVE TAX.—For alternative tax which may be elected if adjusted gross income is less than $5,000, see Supplement T.

"(2) TAX IN CASE OF CAPITAL GAINS.—For rate and computation of alternative tax in lieu of normal tax and surtax in the case of capital gain from the sale or exchange of capital assets held for more than 6 months, see section 117(c).

"(3) TAX ON PERSONAL HOLDING COMPANIES.—For surtax on personal holding companies, see section 500.

"(4) AVOIDANCE OF SURTAXES BY INCORPORATION.—For surtax on corporations which accumulate surplus to avoid surtax on shareholders, see section 102.

"(5) SALE OF OIL OR GAS PROPERTIES.—For limitation of surtax attributable to the sale of oil or gas properties, see section 105."

SEC. 105. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE.

The amendments made by this title shall be applicable with respect to taxable years beginning after December 31, 1947. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

SEC. 301. SPLITTING OF INCOME (REVENUE ACT OF 1948, TITLE III.)

Section 12 of the Internal Revenue Code (relating to surtax of individuals) is hereby amended by adding after subsection (c) of such section the following new subsection:

"(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."

SEC. 305. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1948, TITLE III.)

The amendments made by sections 301, * * * shall be applicable with respect to taxable years beginning after December 31, 1947. * * * For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

PAR. 4. Section 29.12-1, as amended by Treasury Decision 55 [26 CFR 29.12-1], is further amended by striking out paragraph (and inserting in lieu thereof the following:

(c) *Taxable years beginning after December 31, 1945, and before January 1948.*—For taxable years beginning after December 31, 1945, and before Ja ary 1, 1948, there is imposed, in addition to the normal tax, a surtax termined as specified in section 12 upon the surtax net income of every dividual, resident or nonresident, except nonresident alien individuals s ject to the tax imposed by section 211(a). The surtax net income for such ye is the net income minus the credits provided in section 25(b) prior to its ame ment by the Revenue Act of 1948. Section 12 provides with respect to su taxable years that the surtax shall be 5 percent less than the amount of the t tative surtax computed in accordance with the tentative surtax table contai therein. For treatment of taxable years beginning in 1945 and ending in 19 see section 29.108-2.

(d) *Taxable years beginning after December 31, 1947.*—For taxable years ginning after December 31, 1947, there is imposed, in addition to the normal t a surtax determined as specified in section 12, upon the surtax net income every individual, resident or nonresident, except nonresident alien individu subject to the tax imposed by section 211(a). The surtax net income is the income minus the credits provided in section 25(b). Section 12 specifies t the surtax shall be determined by computing a tentative surtax in accorda with the tentative surtax table contained therein and by reducing such te tive surtax as provided in section 12(c). For treatment of taxable years ginning in 1947 and ending in 1948, see section 29.108-3.

PAR. 5. Section 29.12-2, as amended by Treasury Decision 5 [26 CFR 29.12-2], is further amended by striking out the last sente and inserting in lieu thereof the following:

For taxable years beginning after December 31, 1945, and prior to January 1948, section 12 provides that the surtax shall be 5 percent less than the te tive surtax. Accordingly, the surtax for any of such taxable years upon a sur net income of $63,128 would be $33,122.70, computed as follows:

Tentative surtax on $63,128	$34,866
Less: 5 percent of $34,866	1,743
Surtax	33,122.

For taxable years beginning after December 31, 1947, section 12 provides t the combined normal tax and surtax shall be determined by reducing the gregate of the tentative normal tax and tentative surtax as provided in the following table:

If the aggregate of the tentative normal tax and the tentative surtax is:	The reduction shall be:
Not over $400	17% of the aggregate.
Over $400 but not over $100,000	$68 plus 12% of the excess over $400.
Over $100,000	$12,020 plus 9.75% of the excess over $100,000.

Accordingly, if the normal tax net income and the surtax net income each amounts to $150,000 the combined normal tax and surtax will be $98,647.55, computed as follows:

Tentative normal tax: 3 percent of $150,000	$4,500
Tentative surtax on $150,000 from table	107,320
Aggregate of tentative normal tax and tentative surtax	111,820
Reduction of tentative tax:	
$12,020 plus 9.75 percent of $11,820 (excess of the aggregate tentative tax over $100,000)	13,172.45
Combined normal tax and surtax	98,647.55

Section 12(f), as amended by the Revenue Act of 1948, provides that, whenever it is necessary to ascertain the normal tax and the surtax separately for a taxable year beginning after December 31, 1947, the surtax shall be an amount which is the same proportion of the combined normal tax and surtax as the tentative surtax is of the aggregate of the tentative normal tax and tentative surtax and the normal tax shall be the remainder of such combined normal tax and surtax. Such computation, for example, is necessary for the purpose of section 105, relating to tax on the gain from the sale of oil or gas properties and for the purpose of section 106, relating to tax on amounts received with respect to claims against the United States involving acquisition of property. The surtax on the net income of $150,000 involved in the above example would under section 12(f) be $98,647.55 (combined normal tax and surtax) multiplied by

$$\frac{107{,}320 \text{ (tentative surtax)}}{111{,}820 \text{ (tentative total tax)}}$$

or $94,677.65, and the normal tax would be $98,647.55 minus $94,677.65, or $3,969.90.

For computation of tax in the case of a joint return of husband and wife for a taxable year beginning after December 31, 1947, see section 29.12-4.

PAR. 6. Section 29.12-3, as amended by Treasury Decision 5517 [26 CFR 29.12-3], is hereby further amended as follows:

(A) By inserting immediately after "December 31, 1945," in the second sentence "and before January 1, 1948,".

(B) By inserting at the end thereof the following:

For taxable years beginning after December 31, 1947, the combined normal tax and surtax, computed before the application thereto of the credit provided in section 31 (relating to the credit for foreign income tax), section 32 (relating to the credit for tax withheld at the source under section 143 or section 144), and section 35 (relating to the credit for tax withheld on wages), cannot exceed an amount equal to 77 percent of the taxpayer's net income for the taxable year. For treatment of taxable years beginning in 1947 and ending in 1948, see section 29.108-3.

PAR. 7. There is inserted immediately after section 29.12-3 the following section:

SEC. 29.12-4. COMBINED NORMAL TAX AND SURTAX IN CASE OF JOINT RETURN OF HUSBAND AND WIFE FOR TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1947.—In the case of a joint return of husband and wife (see section 51(b)) for a taxable year beginning after December 31, 1947, the combined normal tax and surtax under section 11 and section 12(b) 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 12(d).) For method of computing gross income and adjusted gross income on a joint return, see section 29.51-1.

The method of computing, under section 12(d), the tax of husband and wife, in the case of a joint return, is as follows:

First, the net income and applicable credits against net income are reduced by one-half. Second, the tentative normal tax and tentative surtax are determined as provided in section 11 and section 12(b), by using the net income and applicable credits so reduced. Third, the tentative normal tax and tentative surtax so determined are aggregated and this aggregate tentative tax is then reduced as provided in section 12(c). Fourth, this reduced aggregate, which is 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, is then multiplied by two, to produce the tax imposed in the case of the joint return.

The limitation under section 12(c) of the combined normal tax and surtax to an amount not in excess of 77 percent of the net income is to be applied before the fourth step above, that is, the limitation is to be applied upon the combined normal tax and surtax determined under section 12(c) as 77 percent of one-half of the net income (such one-half of the net income being the actual aggregate net income of the spouses reduced by one-half). After such limitation is applied, then the combined normal tax and surtax so limited are multiplied by two as provided in section 12(d).

The following computation illustrates the method of application of section 12(d) in the determination of the tax of a husband and wife filing a joint return for the calendar year 1948. If the joint net income is $8,200 and the only allowable credits under section 25 are the two exemptions of the taxpayers under section 25(b)(1)(A), the tax on the joint return for 1948 is $1,244.80, determined as follows:

1. Net income	$8,200.00
2. Net income reduced by one-half	4,100.00
3. Credits against net income under section 25 (2 exemptions under section 25(b)(1)(A))	1,200.00
4. Credits in item 3 reduced by one-half	600.00
5. Net income reduced by one-half (item 2) minus credits reduced by one-half (item 4)	3,500.00
6. Tentative normal tax computed under section 11 on amount in item 5 (3 percent of $3,500)	105.00
7. Tentative surtax computed under section 12(b) on amount in item 5 ($340 plus 19 percent of excess of $3,500 over $2,000)	625.00
8. Aggregate of the tentative normal tax and tentative surtax	730.00
9. Combined normal tax and surtax determined under section 12(c) ($730 reduced by $68 plus 12 percent of the excess of $730 over $400)	622.40
10. Twice the combined normal tax and surtax determined in item 9	1,244.80

If the alternative tax is computed under section 117(c)(2), relating to the alternative tax where a taxpayer (other than a corporation) has a net long-term capital gain in excess of a net short-term capital loss, the partial tax shall be computed under sections 11 and 12 as stated above but without inclusion of such excess in net income, and the total tax shall be such partial tax plus 50 percent of such excess as provided in section 117(c)(2).

For computation of tax under Supplement T in the case of a joint return, see sections 29.400-1 and 29.401-1.

For treatment of taxable years beginning in 1947 and ending in 1948, see section 29.108-3.

PAR. 8. Section 29.22(m)-1, as added by Treasury Decision 5425 [C. B. 1945, 10], approved December 29, 1944 [26 CFR 29.22(m)-1], is amended as follows:

(A) By striking out the second sentence and inserting in lieu thereof the following:

Such compensation, therefore, shall be included in the gross income of the child and reflected in the return rendered by or for such child if the gross income for the taxable year amounts to $500 or more in the case of a taxable year beginning after December 31, 1943, and before January 1, 1948, or to $600 or more in the case of a taxable year beginning after December 31, 1947. See section 29.51-3.

(B) By striking from the third sentence ", whether more or less than $500,".

PAR. 9. There is inserted immediately preceding section 29.23(x)-1 the following:

SEC. 304. DEDUCTION FOR MEDICAL EXPENSES. (REVENUE ACT OF 1948, TITLE III.)

Section 23(x) of the Internal Revenue Code (relating to deduction of medical, etc., expenses) is hereby amended by striking out the second and third sentences thereof and inserting in lieu thereof the following: "The deduction shall not be in excess of $1,250 multiplied by the number of exemptions allowed under section 25(b) for the taxable year (exclusive of exemptions allowed under section 25(b)(1) (B) or (C)), with a maximum deduction of $2,500, except that the maximum deduction shall be $5,000 in the case of a joint return of husband and wife under section 51(b)."

SEC. 305. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1948, TITLE III.)

The amendments made by sections * * * 304 shall be applicable with respect to taxable years beginning after December 31, 1947. * * * For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

PAR. 10. Section 29.23(x)-1, as amended by Treasury Decision 5517 [26 CFR 29.23(x)-1], is further amended as follows:

(A) By striking from the first sentence of the second paragraph "section 29.25-6" and inserting in lieu thereof "sections 29.25-3 and 29.25-6".

(B) By striking out the fifth sentence of the second paragraph and inserting in lieu thereof the following:

If the deduction for the prior year would have been greater but for the limitations on the maximum amount of such deduction provided by section 23(x), then, for purposes of the two preceding sentences, the amount of the compensation received in a subsequent year or years shall be reduced by an amount equal to the amount by which the deduction for the prior year would, but for the applicable maximum limitations, have been increased. For the computations illustrating this rule, see examples (3) and (4) at the end of this section.

(C) By striking out the third sentence of the fifth paragraph and inserting in lieu thereof the following:

The maximum deduction allowable for medical expenses paid in any one taxable year beginning after December 31, 1943, and before January 1, 1948, is $1,250 in the case of a taxpayer having only one exemption under section 25(b) (prior to its amendment by the Revenue Act of 1948), and $2,500 in the case of a taxpayer entitled to more than one exemption under section 25(b) (prior to its amendment by the Revenue Act of 1948). The maximum deduction allowable for medical expenses paid in any one taxable year beginning after December 31, 1947, is $1,250 multiplied by the number of exemptions allowed under section 25(b) (exclusive of exemptions allowed under section 25(b)(1)(B) for taxpayer or spouse attaining the age of 65 years or section 25(b)(1)(C) for blind taxpayer or blind spouse) but not in excess of $2,500 in the case of a single individual or a married individual making a separate return and not in excess of $5,000 in the case of a joint return of husband and wife.

(D) By adding at the end of such section after example (4) the following new example:

Example (5). H and W make a joint return for the calendar year 1948, on which five exemptions are allowed (exclusive of exemptions under section 25(b) (1) (B) or (C)), one for each taxpayer and three for their dependent minor children. The adjusted gross income of H and W in 1948 is $40,000. They pay during that year $9,000 for medical care, no part of which is compensated for by insurance or otherwise. The deduction allowable under section 23(x) for the calendar year 1948 is $5,000, computed as follows:

Payment for medical care in 1948	$9,000
Less: 5 percent of $40,000 (adjusted gross income)	2,000
Excess of medical expenses in 1948 over 5 percent of adjusted gross income	7,000
Allowable deduction for 1948 ($1,250 multiplied by 5 exemptions allowed under section 25(b)(1) (A) and (D) but not in excess of $5,000)	5,000

PAR. 11. There is inserted immediately preceding section 29.23(y)-1 the following:

SEC. 202. TECHNICAL AMENDMENTS. (REVENUE ACT OF 1948, TITLE II.)

* * * * * * *

(e) REPEAL OF DEDUCTION FOR BLIND INDIVIDUALS.—Effective with respect to taxable years beginning after December 31, 1947, section 23(y) of such Code (relating to special deduction for blind individuals) is repealed.

PAR. 12. Section 29.23(y)-1, as amended by Treasury Decision 5451 [C. B. 1945, 120], approved April 17, 1945 [26 CFR 29.23(y)-1], is further amended as follows:

(A) By inserting immediately after "December 31, 1943," in the first sentence the words "and before January 1, 1948,".

(B) By adding at the end of such section the following:

For additional exemptions allowed for taxable years beginning after December 31, 1947, for blind taxpayer or blind spouse, see section 25(b)(1), as amended by the Revenue Act of 1948, and section 29.25-3(d).

PAR. 13. There is inserted immediately preceding section 29.23 (aa)-1 the following:

SEC. 302. STANDARD DEDUCTION. (REVENUE ACT OF 1948, TITLE III.)

(a) INCREASE OF STANDARD DEDUCTION IN CASE OF JOINT RETURN OR RETURN BY UNMARRIED PERSON.—Section 23(aa)(1)(A) of the Internal Revenue Code (relating to the standard deduction) is hereby amended to read as follows:

"(A) Adjusted Gross Income $5,000 or More.—If his adjusted gross income is $5,000 or more, the standard deduction shall be $1,000 or an amount equal to 10 per centum of the adjusted gross income, whichever is the lesser, except that in the case of a separate return by a married individual, the standard deduction shall be $500."

(b) ELECTION BY HUSBAND AND WIFE.—Section 23(aa)(4) of such Code is hereby amended to read as follows:

"(4) HUSBAND AND WIFE.—In the case of husband and wife, the standard deduction shall not be allowed to either if the net income of one of the spouses is determined without regard to the standard deduction."

(c) DETERMINATION OF STATUS.—Section 23(aa) of such Code is hereby amended by adding at the end thereof the following new paragraph:

"(6) DETERMINATION OF STATUS.—For the purposes of this subsection—

"(A) the determination of whether an individual is married shall be made as of the close of his taxable year, unless his spouse dies during his taxable year, in which case such determination shall be made as of the time of such death; and

"(B) an individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married."

SEC. 305. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1948, TITLE III.)

The amendments made my sections * * * 302, * * * shall be applicable with respect to taxable years beginning after December 31, 1947. * * * For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

PAR. 14. Section 29.23(aa)-1, as added by Treasury Decision 5425 [26 CFR 29.23(aa)-1], is amended as follows:

(A) By striking out the third and fourth sentences of paragraph (*a*) and inserting in lieu thereof the following:

In the case of taxpayers whose adjusted gross income is $5,000 or more, the standard deduction for taxable years beginning after December 31, 1943, and before January 1, 1948, is $500. In the case of such taxpayers, the standard deduction for taxable years beginning after December 31, 1947, is $1,000 or 10 percent of adjusted gross income, whichever is the lesser, except that in the case of a separate return by a married individual, the standard deduction is $500. For the purpose of the preceding sentence, the determination of whether an individual is married shall be made as of the close of his taxable year unless his spouse dies during his taxable year, in which case such determination shall be made as of the time of such death; and an individual shall be considered as married even though living apart from his spouse unless legally separated under a decree of divorce or separate maintenance. In the case of taxpayers whose adjusted gross income is less than $5,000, the standard deduction is about 10 percent of the adjusted gross income upon which the tax is determined in the table provided in section 400. A taxpayer having adjusted gross income of less than $5,000, who does not elect to pay the tax imposed by Supplement T, may not take the standard deduction.

In the case of a joint return, there is only one adjusted gross income and only one standard deduction. For example, if a husband has an income of $15,000 and his spouse has an income of $12,000 for the taxable year for which they file a joint return, and they have no deductions allowable for the purposes of computing adjusted gross income, the adjusted gross income is $27,000, and the standard deduction, if the joint return is for a taxable year beginning before January 1, 1948, is $500 (and not $1,000) and if the joint return is for a taxable year beginning after December 31, 1947, is $1,000 (and not $2,000).

(B) By striking out the second sentence of subparagraph (1) of paragraph (*b*) and inserting in lieu thereof the following:

Such taxpayer shall so signify on his return by claiming thereon the deduction in the amount provided for in section 23(aa) instead of itemizing the deductions allowable under section 23 other than those specified in section 22(n). The amount to be claimed on the return by such taxpayer for taxable years beginning after December 31, 1943, and before January 1, 1948, is $500 and for taxable years beginning after December 31, 1947, is $1,000 or 10 percent of the adjusted gross income, whichever is lesser (except that in the case of a separate return by a married individual, the amount is $500).

(C) By striking from the first sentence of paragraph (*c*) the expression "living together" and inserting in lieu thereof the following "(except as qualified below)".

(D) By striking out the last two sentences of the third paragraph of (*c*) and inserting in lieu thereof the following:

For taxable years beginning before January 1, 1948, the restriction applies only in the case of a husband and wife living together and for such purpose the spouses are considered as living together unless they are permanently separated. For taxable years beginning after December 31, 1947, the restriction applies unless the spouses are legally separated under a decree of divorce or separate maintenance. The determination of whether an individual is married and living with his spouse for the purpose of the standard deduction for taxable years beginning before December 31, 1947, shall be made as of the last day of such individual's taxable year unless his spouse dies during such taxable year, in which event the determination shall be made as of the date of death of such spouse. Similarly, the determination of whether an individual is married (whether or not living with his spouse unless legally separated under a decree of divorce or separate maintenance) for the purpose of the allowance of the standard deduction for taxable years beginning after December 31, 1947, shall be made as of the last day of such individual's taxable year unless his spouse dies during such taxable year, in which event the determination shall be made as of the date of death of such spouse.

(E) By adding at the end of such section the following:

Example (3). Taxpayer A and his wife B both make their returns on a calendar year basis. In July, 1948, they enter into a separation agreement and thereafter live apart but no decree of divorce or separate maintenance is issued until March, 1949. If A itemizes and claims his actual deductions on his return for the calendar year 1948 B may not elect the standard deduction on her return for such year since B is considered as married to A (although permanently separated by agreement) on the last day of 1948.

PAR. 15. There is inserted immediately preceding section 29.25–1 the following:

SEC. 201. ADDITIONAL CREDITS AGAINST NET INCOME FOR NORMAL TAX AND SURTAX. (REVENUE ACT OF 1948, TITLE II.)

Paragraphs (1) and (2) of section 25(b) of the Internal Revenue Code are hereby amended to read as follows:

"(1) CREDITS.—There shall be allowed for the purposes of both the normal tax and the surtax, the following credits against net income:

"(A) An exemption of $600 for the taxpayer; and an additional exemption of $600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer;

"(B) (i) An additional exemption of $600 for the taxpayer if he has attained the age of 65 before the close of his taxable year; and

"(ii) An additional exemption of $600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse has attained the age of 65 before the close of such taxable year, and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer;

"(C) (i) An additional exemption of $600 for the taxpayer if he is blind at the close of his taxable year; and

"(ii) An additional exemption of $600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse is blind and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer. For the purposes of this clause the determination of whether the spouse is blind shall be made as of the close of the taxable year of the taxpayer, unless the spouse dies during such taxable year, in which case such determination shall be made as of the time of such death;

"(iii) For the purposes of this subparagraph an individual is blind only if either: his central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or his visual acuity is greater than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees;

"(D) An exemption of $600 for each dependent whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than $500, except that the exemption shall not be allowed in respect of a dependent who has made a joint return with his spouse under section 51 for the taxable year beginning in such calendar year.

"(2) DETERMINATION OF STATUS.—For the purposes of this subsection—

"(A) the determination of whether an individual is married shall be made as of the close of his taxable year, unless his spouse dies during his taxable year, in which case such determination shall be made as of the time of such death; and

"(B) an individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married."

SEC. 203. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1948, TITLE II.)

The amendments made by this title shall be applicable with respect to taxable years beginning after December 31, 1947. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

PAR. 16. Section 29.25-3, as amended by Treasury Decision 5517 [26 CFR 29.25-3], is hereby amended by striking out that portion designated as "(c)" and inserting in lieu thereof the following:

(*c*) *Taxable years beginning after December 31, 1945, and before January 1, 1948.*—For the purpose of the normal tax and surtax on individuals for taxable years beginning after December 31, 1945, and before January 1, 1948, there are allowed as credits against net income the exemptions allowed by section 25(b) prior to its amendment by the Revenue Act of 1948. Except that such exemptions are not designated "surtax exemptions" for such years and that they are allowable for the purpose of the normal tax as well as the surtax for such years, the provisions of (*b*) above are applicable thereto.

(*d*) *Taxable years beginning after December 31, 1947*—(1) *In general.*—For the purposes of the normal tax and the surtax on individuals for taxable years beginning after December 31, 1947, there are allowed as credits against net income the exemptions specified in section 25(b) as amended by the Revenue Act of 1948. Such credits include (i) the exemptions for an individual taxpayer and spouse (the so-called personal exemptions), (ii) the additional exemptions for a taxpayer attaining the age of 65 years and spouse attaining the age of 65 years (the so-called old-age exemptions), (iii) the additional exemptions for a blind taxpayer and a blind spouse, and (iv) the exemptions for dependents of the taxpayer.

(2) *Exemptions for individual taxpayer and spouse (so-called personal exemptions).*—There are allowed by section 25(b)(1)(A) an exemption of $600 for the taxpayer and an additional exemption of $600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer. Since, in the case of a joint return, there are two taxpayers (although under section 51(b) there is only one income for the two taxpayers on such return—i. e. their aggregate income), two exemptions of $600 are allowed on such return, one for each taxpayer spouse. If in any case a joint return is made by the taxpayer and his spouse, no exemption is allowed any other person for such spouse even though such other person would have been entitled to claim an exemption for such spouse as a dependent if such joint return had not been made.

(3) *Exemptions for taxpayer attaining the age of 65 and spouse attaining the age of 65 (so-called old-age exemptions).*—Section 25(b)(1)(B) provides an additional exemption of $600 for the taxpayer if he has attained the age of 65 before the close of his taxable year. An additional exemption of $600 is also allowed to the taxpayer for his spouse if a separate return is made by the taxpayer and if the spouse has attained the age of 65 before the close of the taxable year of the taxpayer and, for the calendar year in which the taxable year of the taxpayer begins, the spouse has no gross income and is not the dependent of another taxpayer. If a husband and wife make a joint return, an old-age exemption of $600 will be allowed as to each taxpayer spouse who has attained the age of 65 before the close of the taxable year for which the joint return is made. The exemptions under section 25(b)(1)(B) are in addition to the exemptions for the taxpayer and spouse under section 25(b)(1)(A).

In determining the age of an individual for the purposes of the exemption for old age, the last day of the taxable year of the taxpayer is the controlling date. Thus, in the event of a separate return by a husband, no additional exemption for old age may be claimed for his spouse unless such spouse has attained the age of 65 on or before the close of the taxable year of the husband. In no event shall the additional exemption for old age be allowed on a separate return of the taxpayer with respect to a spouse who dies before attaining the age of 65 even though such spouse would have attained the age of 65 before the close of the taxable year of the taxpayer. For the purposes of the old-age exemption, an individual attains the age of 65 on the first moment of the day preceding his sixty-fifth birthday. Accordingly, an individual whose sixty-fifth birthday falls on January 1 in a given year attains the age of 65 on the last day of the calendar year immediately preceding.

(4) *Exemptions for the blind.*—Section 25(b)(1)(C) provides an additional exemption of $600 for the taxpayer if he is blind at the close of his taxable year. An additional exemption is also allowed to the taxpayer for his spouse if the spouse is blind and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer. The determination of whether the spouse is blind shall be made as of the close of the taxable year of the taxpayer, unless the spouse dies during such taxable year, in which case such determination shall be made as of the time of such death.

The exemptions for the blind, applicable to taxable years beginning after December 31, 1947, replace the special deduction for the blind provided in section 23(y) prior to its repeal by the Revenue Act of 1948. The exemptions are in addition to the exemptions for the taxpayer and spouse under section 25(b)(1)(A) and are also in addition to the exemptions under section 25(b)(1)(B) for taxpayers and spouses attaining the age of 65 years. Thus, a single individual who has, before the close of his taxable year, attained the age of 65 years and who is blind at the close of his taxable year is entitled, in addition to the so-called personal exemption of $600, to two further exemptions, each of $600, one by reason of his age and the other by reason of his blindness. If a husband and wife make a joint return, an exemption of $600 for the blind will be allowed as to each taxpayer spouse who is blind at the close of the taxable year for which the joint return is made.

A taxpayer claiming an exemption allowed by section 25(b)(1)(C) for a blind taxpayer or a blind spouse shall, if the individual for whom the exemption is claimed is not totally blind as of the last day of the taxable year of the taxpayer (or in the case of a spouse who dies during such taxable year as of the time of such death), attach to his return a certificate from a physician skilled in the diseases of the eye or a registered optometrist stating that as of the applicable status determination date in the opinion of such physician or optometrist (1) the central visual acuity of the individual for whom the exemption is claimed did not exceed 20/200 in the better eye with correcting lenses or (2) such individual's visual acuity was accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees. If such individual is totally blind as of the status determination date there shall be attached to the return a statement by the person or persons making the return setting forth such fact.

(5) *Exemptions for dependents.*—Section 25(b)(1)(D) allows to a taxpayer an exemption of $600 for each dependent whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than $500, who receives more than one-half of his support from the taxpayer for such calendar year and who does not file a joint return with his spouse. For the purposes of this credit a dependent is a person who is related to the taxpayer within one of the following relationships: child; the descendants of such child; stepchild; brother; sister; brother or sister by the half blood; stepbrother or stepsister; parent; the ancestors of such parent; stepfather or stepmother; son or daughter of the taxpayer's brother or sister; brother or sister of the taxpayer's father or mother; son-in-law; daughter-in-law; father-in-law; mother-in-law; brother-in-law; or sister-in-law. In the case of a joint return it is not necessary that the prescribed relationship exist between the person claimed as a dependent and the spouse who furnishes the support; it is sufficient if the prescribed relationship exists with respect to either spouse. Thus, a husband and wife making a joint return may claim as a dependent a daughter of the wife's brother (wife's niece) even though the husband is the one who furnishes the chief support. The relationship of affinity once existing will not terminate by divorce or the death

of a spouse. A legally adopted child of a person shall be considered a child of such person by blood. A citizen or subject of a foreign country may not be claimed as a dependent, unless he is a resident of the United States, Canada, or Mexico at some time during the calendar year in which the taxable year of the taxpayer begins. Whether or not over half of a person's support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer shall be determined by reference to the amount of expense incurred by the taxpayer for such support. A payment to a wife which is includible under section 22(k) or section 171 in the gross income of such wife shall not be considered a payment by her husband for the support of any dependent.

The only exemption allowed for a dependent of the taxpayer is that provided by section 25(b)(1)(D). The exemptions provided by section 25(b)(1)(B) (old-age exemptions) and section 25(b)(1)(C) (exemptions for the blind) are allowed only for the taxpayer or his spouse. Thus, if a taxpayer provides the entire support of his father, who meets all the requirements of a dependent under section 25(b)(3) and who is over the age of 65 years, the taxpayer is entitled only to the one exemption under section 25(b)(1)(D) of $600 for his father as a dependent, and is not entitled to any additional exemption because of his father's age.

(6) *Determination of husband and wife status.*—For the purpose of determining the right of an individual to claim an exemption for his spouse under section 25(b) the determination of whether such individual is married shall be made as of the close of his taxable year, unless his spouse dies during such year, in which case such determination shall be made as of the time of such death. An individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

PAR. 17. There is inserted immediately preceding section 29.51–1 the following:

SEC. 202. TECHNICAL AMENDMENTS. (REVENUE ACT OF 1948, TITLE II.)

* * * * * * *

(c) REQUIREMENT OF RETURNS.—

(1) INDIVIDUAL RETURNS.—Section 51(a) of the Internal Revenue Code (relating to the requirement of individual returns) is hereby amended by striking out "$500" and inserting in lieu thereof "$600".

* * * * * * *

SEC. 203. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1948, TITLE II.)

The amendments made by this title shall be applicable with respect to taxable years beginning after December 31, 1947. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

SEC. 303. JOINT RETURNS OF HUSBAND AND WIFE. (REVENUE ACT OF 1948, TITLE III.)

Section 51(b) of the Internal Revenue Code (relating to joint returns) is hereby amended to read as follows:

"(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.

"(2) NONRESIDENT ALIEN.—No joint return may be made if either the husband or wife at any time during the taxable year is a nonresident alien.

"(3) DIFFERENT TAXABLE YEARS.—No joint return shall be made if the husband and wife have different taxable years; except that if such taxable years begin on the same day and end on different days because of the death of either or of both, then the joint return may be made with respect to the taxable year of each. The above exception shall not apply if the surviving spouse remarries before the close of his taxable year, nor if the taxable year of either spouse is a fractional part of a year under section 47(a).

"(4) JOINT RETURN AFTER DEATH.—In the case of the death of one spouse or both spouses the joint return with respect to the decedent may be made only by his executor or administrator; except that in the case of the death of one spouse the joint return may be made by the surviving spouse with respect to both himself and the decedent if (A) no return for the taxable year has been made by the decedent, (B) no executor or administrator has been appointed, and (C) no executor or administrator is appointed before the last day prescribed by law for filing the return of the surviving spouse. If an executor or administrator of the decedent is appointed after the making of the joint return by the surviving spouse, the executor or administrator may disaffirm such joint return by making, within one year after the last day prescribed by law for filing the return of the surviving spouse, a separate return for the taxable year of the decedent with respect to which the joint return was made, in which case the return made by the survivor shall constitute his separate return.

"(5) DETERMINATION OF STATUS.—For the purposes of this section—

"(A) the status as husband and wife of two individuals having taxable years beginning on the same day shall be determined—

"(i) if both have the same taxable year—as of the close of such year; and

"(ii) if one dies before the close of the taxable year of the other—as of the time of such death; and

"(B) an individual who is legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

"(6) TAX IN/CASE OF JOINT RETURN.—For determination of combined normal tax and surtax under section 11 and section 12(b) in case of joint return under this subsection, see section 12(d). For tax in case of joint return of husband and wife electing to pay the tax under Supplement T, see section 400."

SEC. 305. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1948, TITLE III.)

The amendments made by sections * * * 303, * * * shall be applicable with respect to taxable years beginning after December 31, 1947. The amendment made by section 303 shall also be applicable to taxable years of both husband and wife beginning on the same day in 1947 if at least one of such taxable years ends in 1948. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

PAR. 18. Section 29.51-1, as amended by Treasury Decision 5600 [C. B. 1948-1, 5], approved February 2, 1948 [26 CFR 29.51-1], is further amended as follows:

(A) By inserting before the period in the heading of subparagraph (3) of paragraph (*a*) the following: ", *and before January 1, 1948*".

(B) By inserting in subparagraph (3) of paragraph (*a*) after "December 31, 1945," the following: "and before January 1, 1948,".

(C) By inserting after subparagraph (3) of paragraph (*a*) a new subparagraph (4) to read as follows:

(4) *Taxable years beginning after December 31, 1947.*—For each taxable year beginning after December 31, 1947, a return of income shall be made by each citizen of the United States, whether residing at home or abroad, and every individual residing within the United States though not a citizen thereof, regardless of family or marital status, if such citizen or resident has for such taxable year a gross income of $600 or more, or a gross income in excess of the credit allowed by section 25(b) prorated as provided in section 47(e).

(D) By striking out paragraph (*b*) and inserting in lieu thereof the following:

(*b*) *Joint return*—(1) *In general.*—For taxable years beginning prior to January 1, 1944, a husband and wife, if living together at the close of the taxable year, may elect to make a joint return (see section 51(b)) even though one has no gross income. For taxable years beginning after December 31, 1943, a husband and wife occupying the marital status as of the last day of the taxable year may elect to make a joint return even though one of the spouses has no gross income or deductions, and even though the spouses are not living together at any time during the taxable year. However, for the purpose of filing a joint return for taxable years with respect to which the amendments made to section 51(b) by section 303 of the Revenue Act of 1948 are applicable (taxable years beginning after December 31, 1947, and taxable years of both husband and wife beginning on the same day in 1947 if at least one of such taxable years ends in 1948), an individual legally separated from his spouse under a decree of separate maintenance shall not be considered as married.

A joint return may not be made by a husband and wife for a taxable year if a separate return has been filed by one of the spouses and the time for filing the return of such spouse has expired. Similarly, if a joint return is filed, separate returns may not be made by the spouses after the time for filing the return of either has expired. See, however, subparagraph (2) for the right of an executor to file a late separate return for a deceased spouse and thereby disaffirm a timely joint return made by the surviving spouse.

If a joint return is made, the gross income and adjusted gross income of husband and wife on the joint return are computed in an aggregate amount and the deductions allowed and the net income are likewise computed on an aggregate basis. Deductions limited to a percentage of the adjusted gross income, such as the deduction for charitable contributions under section 23(o), will be allowed with reference to such aggregate adjusted gross income. Similarly, in the case of a joint return, losses of husband and wife from sales or exchanges of capital assets are combined and such combined losses are allowed under section 117(d)(2) only to the extent of the combined gains of the spouses from such sales or exchanges, plus the net income (or adjusted gross income if tax is computed under Supplement T) or $1,000 whichever is smaller. The "net income" referred to in section 117(d)(2) is the net income computed before reduction by one-half for the purposes of income splitting under section 12(d) and is such net income computed without regard to gains and losses from sales or exchanges of capital assets. Although there are two taxpayers on a joint return, there is only one net income. The tax on the joint return shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several. A joint return may not be made if either the husband or wife at any time during the taxable year is a nonresident alien. For computation of tax on the basis of the splitting of income in the case of a joint return for taxable years beginning after December 31, 1947, see section 29.12-4. For tax in the case of a joint return of husband and wife electing to pay the tax under Supplement T, see sections 29.400-1 and 29.401-1.

A joint return of a husband and wife (if not made by an agent) shall be signed by both spouses. An oath is not necessary, but both spouses shall verify the return as provided in section 51. If signed by one spouse as agent for the other, authorization for such action must accompany the return. The spouse acting as agent for the other shall, with the principal, assume the responsibility for making the return and incur liability for the penalties provided for erroneous, false, or fraudulent returns. See section 29.51-2.

(2) *Joint return after death.*—Since in general a joint return may not be made if husband and wife have different taxable years, and since the taxable year of an individual closes as of the date of his death (see section 29.47-1), no joint return may be made for any taxable year, except as provided by section 51(b), as amended by the Revenue Act of 1948, in the case of the death of one or both spouses prior to the last day of such taxable year. Section 51(b), as amended by the Revenue Act of 1948, provides with respect to taxable years of spouses beginning after December 31, 1947 (and with respect to taxable years of spouses beginning on the same day in 1947 if at least one of such taxable years ends in 1948), that a joint return may be made for the survivor and the deceased spouse or for both deceased spouses if the taxable years of such spouses begin on the same day and end on different days only because of the death of either or both. Thus, if a husband and wife make their returns on a calendar year basis, and the wife dies on August 1, 1948, a joint return may be made with respect to the calendar year 1948 of the husband and the taxable year of the wife beginning on January 1, 1948, and ending with her death on August 1, 1948. Similarly, if husband and wife both make their returns on the basis of a fiscal year beginning on July 1 and

the wife dies on October 1, 1947, a joint return may be made with respect to the fiscal year of the husband beginning on July 1, 1947, and ending on June 30, 1948, and with respect to the taxable year of the wife beginning on July 1, 1947, and ending with her death on October 1, 1947. For the purposes of this subparagraph the status of two individuals as husband and wife, if one dies prior to the close of the taxable year of the other, shall be determined as of the time of such death.

The provision allowing a joint return to be made for the taxable year in which the death of either or both spouses occurs is subject to two exceptions. The first exception is that if the surviving spouse remarries before the close of his taxable year, he may not make a joint return with the first spouse who died during the taxable year. In such a case, however, the surviving spouse may make a joint return with his new spouse provided that the other requirements of section 51(b) are met. The second exception is that the surviving spouse may not make a joint return with the deceased spouse if the taxable year of either spouse is a fractional part of a year under section 47(a) resulting from a change of accounting period. For example, if a husband and wife make their returns on the calendar year basis and the wife dies on March 1, 1948, and thereafter the husband receives permission to change his accounting period to a fiscal year beginning July 1, 1948, no joint return may be made for the short taxable year ending June 30, 1948. Similarly, if a husband and wife who make their returns on a calendar year basis receive permission to change to a fiscal year beginning July 1, 1948, and the wife dies on June 1, 1948, no joint return may be made for the short taxable year ending June 30, 1948.

Section 51(b)(4), as added by the Revenue Act of 1948, provides for the method of making a joint return in the case of the death of one spouse or both spouses where the return is for taxable years beginning on the same day after December 31, 1947, or for the taxable years beginning on the same day in 1947 if at least one of such taxable years ends in 1948. The general rule is that, in the case of the death of one spouse, or of both spouses, the joint return with respect to the decedent may be made only by his executor or administrator. By the term executor or administrator is meant the person who is actually appointed to such office and not merely a person who may be in charge of the property of the decedent. An exception is made from this general rule whereby, in the case of the death of one spouse, the joint return may be made by the surviving spouse with respect to both him and the decedent if all the following conditions exist:

(i) No return has been made by the decedent for the taxable year in respect to which the joint return is made.

(ii) No executor or administrator has been appointed at or before the time of making such joint return.

(iii) No executor or administrator is appointed before the last day prescribed by law for filing the return of the surviving spouse.

These conditions are to be applied with respect to the return for each of the taxable years of the decedent for which a joint return may be made if more than one such taxable year is involved. Thus, in the case of husband and wife on the calendar year basis, if the wife dies in February, 1949, a joint return for the husband and wife for 1948 may be made if the conditions set forth above are satisfied with respect to such return. A joint return may also be made by the survivor for both himself and the deceased spouse for the calendar year 1949 if it is separately determined that the conditions set forth above are satisfied with respect to the return for such year. If, however, the deceased spouse should, prior to her death, make a return for 1948, the surviving spouse may not thereafter make a joint return for himself and the deceased spouse for 1948.

If an executor or administrator is appointed at or before the time of making the joint return or before the last day prescribed by law for filing the return of the surviving spouse, the surviving spouse cannot make a joint return for himself and the deceased spouse whether or not a separate return for the deceased spouse is made by such executor or administrator. In such a case, any return made solely by the surviving spouse shall be treated as his separate return. The joint return, if one is to be made, must be made by both the surviving spouse and the executor or administrator. In determining whether an executor or administrator is appointed before the last day prescribed by law for filing the return of the surviving spouse, an extension of time for making the return is included.

If the surviving spouse makes the joint return provided for above, and thereafter an executor or administrator of the decedent is appointed, the executor or administrator may disaffirm such joint return. This disaffirmance, in order o be effective, must be made within one year after the last day prescribed by aw for filing the return of the surviving spouse (including any extension of ime for filing such return) and must be made in the form of a separate return for the taxable year of the decedent with respect to which the joint return was nade. In the event of such proper disaffirmance the return made by the survivor shall constitute his separate return, that is, the joint return made by him shall be treated as his return and the tax thereon shall be computed by excluding all items properly includible in the return of the deceased spouse. The separate return made by the executor or administrator shall constitute the return of the deceased spouse for the taxable year.

The time allowed the executor or administrator to disaffirm the joint return by the making of a separate return does not establish a new due date for the return of the deceased spouse. Accordingly, the provisions of sections 291 and 294, relating to delinquent returns and delinquency in payment of tax, are applicable to such return made by the executor in disaffirmance of the joint return.

PAR. 19. Section 29.51–3, as amended by Treasury Decision 5425 [26 CFR 29.51–3], is further amended as follows:

(A) By inserting before the period in the heading of paragraph (*b*) the following: "*, and before January 1, 1948*".

(B) By inserting in paragraph (*b*) after "December 31, 1943," the following: "and before January 1, 1948,".

(C) By inserting after paragraph (*b*) a new paragraph (*c*) to read as follows:

(*c*) *Taxable years beginning after December 31, 1947.*—For taxable years beginning after December 31, 1947, an individual, although a minor, who is single, is required to render a return of income if he has gross income (including compensation for personal services includible in his gross income under section 22(m)(1)) of $600 or over for the taxable year regardless of the amount of his net income. If the aggregate of the gross income of such a minor from any property which he possesses and from any funds held in trust for him by a trustee or guardian and from his earnings is at least $600, regardless of the amount of his net income, a return, as in the case of any other individual, must be made by him or for him by his guardian or other person charged with the care of his person or property. See section 29.142–2. If he is married, see section 29.51–1.

PAR. 20. There is inserted immediately preceding section 29.58–1 the following:

SEC. 202. TECHNICAL AMENDMENTS. (REVENUE ACT OF 1948, TITLE II.)

(a) DECLARATION OF ESTIMATED TAX.—Section 58(a) of the Internal Revenue Code (relating to requirement of declaration of estimated tax) is hereby amended to read as follows:

"(a) REQUIREMENT OF DECLARATION.—Every individual (other than an estate or trust and other than a nonresident alien with respect to whose wages, as defined in section 1621(a), withholding under Subchapter D of Chapter 9 is not made applicable) shall, at the time prescribed in subsection (d), make a declaration of his estimated tax for the taxable year if—

"(1) his gross income from wages (as defined in section 1621) can reasonably be expected to exceed the sum of $4,500 plus $600 with respect to each exemption provided in section 25(b); or

"(2) his gross income from sources other than wages (as defined in section 1621) can reasonably be expected to exceed $100 for the taxable year and his gross income to be $600 or more."

* * * * * * *

SEC. 203. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1948, TITLE II.)

The amendments made by this title shall be applicable with respect to taxable years beginning after December 31, 1947. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

PAR. 21. Section 29.58-2, as amended by Treasury Decision 5517 [26 CFR 29.58-2], is further amended as follows:

(A) By striking out the headings "DECLARATIONS OF ESTIMATED TAX—TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1944.—(*a*) *General.*" and inserting in lieu thereof the following: "DECLARATIONS OF ESTIMATED TAX.—(*a*) *Taxable years beginning after December 31, 1944, and before January 1, 1948.*—(1) *General.*"

(B) By inserting after "December 31, 1944," in the first sentence thereof "and before January 1, 1948,".

(C) By striking out the designations (1), (2), and (3) where first appearing in the first sentence and inserting in lieu thereof (i), (ii), and (iii).

(D) By striking out the designations (1) and (2) where last appearing in the first sentence and inserting in lieu thereof (*a*) and (*b*).

(E) By striking out the designation "(b)" preceding the heading "Short taxable years." and inserting in lieu thereof "(2)".

(F) By adding at the end of such section the following paragraph:

(*b*) *Taxable years beginning after December 31, 1947*—(1) *General.*—A declaration of estimated tax shall, for taxable years beginning after December 31, 1947, be made by (i) every citizen of the United States, whether residing at home or abroad, (ii) every individual residing in the United States though not a citizen thereof, and (iii) every nonresident alien who is a resident of Canada or Mexico and who has wages subject to withholding at the source under section 1622, if such citizen or resident or alien can reasonably be expected to have for such taxable year—

(*a*) gross income from wages subject to withholding under section 1622 in excess of the sum of $4,500 plus $600 for each exemption allowable as a credit under section 25(b); or

(*b*) gross income of more than $100 from sources other than wages subject to withholding under section 1622 and total gross income of $600 or more.

In the case of a husband and wife, whether or not they are living together, a joint declaration of estimated tax may be made if the gross income of either spouse meets the requirements of section 58(a). If the gross income of each spouse meets the requirements of section 58(a), either a joint declaration must be made or a separate declaration must be made by each. For the purpose of determining whether a declaration of estimated tax is required under the provisions of section 58(a), a married person may not take into account the exemption of his spouse, if his spouse has, or is reasonably expected to have, gross income.

In estimating his gross income for the taxable year a parent should not take into account the income of his minor child. Such income is not includible in the gross income of the parent. See section 22(m).

A nonresident alien who is a resident of Canada or Mexico, who enters into and leaves the United States at frequent intervals, and who has wages subject to withholding under the provisions of section 1622 is required to file a declaration of estimated tax if his gross income meets the requirements of section 58(a). In the case of a nonresident alien gross income means only gross income from sources within the United States. Section 212(a). As to what constitutes gross income from sources within the United States, see section 119 and the regulations thereunder. Thus, for example, a nonresident alien over the age of 65 years, living in Mexico with his wife and one dependent child throughout 1948, makes his return on a calendar year basis. His wife and child are also nonresident aliens. He is employed as an executive in El Paso, Tex., at a salary of $8,000 per annum and enters and leaves the United States at frequent intervals in pursuit of such employment. Neither husband nor wife has any reasonable expectation of any other income from United States sources. Since his wages derived from sources within the United States in 1948 can reasonably be expected to amount to more than $4,500 plus $2,400 (the aggregate of four exemptions, including one exemption for old age), or $6,900, a declaration of estimated tax must be filed for such resident of Mexico for 1948.

An estate or trust, though generally taxed as an individual, is not within the scope of the system of current payment of the tax, and hence is not required to file a declaration.

The application of these provisions may be illustrated by the following examples:

Example (1). H, a taxpayer making his return on the calendar year basis, is married and has two dependent children. Neither his wife nor children have any source of income. H's wife has been blind for several years and it is reasonable to assume that she will not regain her sight in 1948. H's salary from January 1 to June 30, 1948, is at the annual rate of $7,000. However, effective July 1, 1948, his annual salary is increased to $9,000 and under the facts then existing it is reasonable to assume that his salary for the remaining portion of 1948 will remain unchanged and that his total salary for the year will, therefore, be $8,000. Since such amount is in excess of $4,500 plus $3,000 (the aggregate of five exemptions, including the two exemptions for the blind spouse), or $7,500, H is required to file a declaration of estimated tax for 1948. As to when such declaration is required to be filed, see section 29.58-7(b).

Example (2). P, a professional man engaged in the practice of his profession on his own account, has gross income of $400 from such profession for the two months of January and February, 1948. It can reasonably be expected that he will have no income during 1948 from any other source. Since P has gross income which can for 1948 reasonably be expected to exceed $600 and such income does not constitute wages subject to withholding, he is required to file a declaration of estimated tax regardless of his marital status and regardless of the number of exemptions to which he may be entitled for that year.

Example (3). S has been regularly employed for many years prior to January 1, 1948, at which date his weekly wage is $50. S also owns stock in a corporation from which he has derived regularly for many years prior to 1948 annual dividends ranging from $120 to $160. In view of the fact that for 1948 S can reasonably be expected to receive gross income of $600 or more, which includes more than $100 of income from sources other than wages as defined in section 1621(a), he is required to make a declaration of estimated tax for such year regardless of his marital status or the number of exemptions to which he may be entitled.

Example (4). T, a married taxpayer, who makes his return on the calendar year basis, is employed at the beginning of 1948 at an annual salary of $7,500, which, on the basis of facts then existing, will, it is expected, not undergo any change throughout 1948. His wife owns stock upon which dividends ranging from $75 to $100 have been paid regularly during years prior to 1948. T has two dependent children, one of whom has no source of income in 1948; the other child, however, is employed on a part-time basis and may reasonably be expected to receive compensation of $600 in 1948. T also contributes the major portion of the support of his mother whose only source of income is approximately $100 per year from a trust fund. Under these facts for the purpose of determining whether he is required to file a declaration, T may take into account only three exemptions, one for himself, one for his mother, and one for the child expected to receive less than $500 gross income in 1948. Since his expected salary of $7,500 exceeds the sum of $4,500 plus $1,800 (three exemptions), or $6,300, T is required to file a declaration of estimated tax for 1948. In computing his estimated tax on a separate declaration, T may not take into account any exemption for his wife since she is reasonably expected to have gross income in 1948. If, however, a joint declaration is made and the tax is estimated on the basis of the aggregate net income, account may be taken of an exemption for the wife.

(2) *Short taxable years.*—For the purpose of determining whether the anticipated income for a short taxable year necessitates the filing of a declaration, such income shall be placed on an annual basis in the manner prescribed in section 47(c)(1). Thus, for example, a taxpayer who changes from a calendar year basis to a fiscal year basis beginning July 1, 1948, will have a short taxable year beginning January 1, 1948, and ending June 30, 1948. If his anticipated gross income for such short taxable year consists solely of wages (as defined in section 1621(a)) in the amount of $3,000, his total gross income and his gross income from such wages for the purpose of determining whether a declaration is required is $6,000, the amount obtained by placing anticipated income of $3,000 upon an annual basis. Hence, assuming such taxpayer is single and has no dependents, he is required to file a declaration of estimated tax for the short taxable year since his anticipated gross income from wages when placed upon an annual basis is in excess of $5,100 ($4,500 plus $600).

PAR. 21½. Section 29.58-3, as amended by Treasury Decision 5419 [C. B. 1944, 175], approved November 25, 1944 [26 CFR 29.58-3], is further amended as follows:

(A) By striking from the second sentence of the third paragraph of (*a*) the words "living together."

(B) By adding immediately after such second sentence the following parenthetical sentence:

(See, however, section 29.23(aa)-1(c) for exceptions where spouses are legally separated or are not living together.)

PAR. 22. Section 29.58-4, as amended by Treasury Decision 5419 [26 CFR 29.58-4], is further amended by adding at the end of the first paragraph thereof the following sentences:

However, if it is reasonable for a surviving spouse to assume that there will be filed a joint return for himself and the deceased spouse for taxable years which include the last taxable year of the deceased spouse, he may, in making a separate declaration for his taxable year which includes the period comprising such last taxable year of his spouse, estimate net income on an aggregate basis and compute his estimated tax in the same manner as though a joint declaration had been filed. For computation of tax in case of a joint return for taxable years to which splitting of income is applicable, see section 29.12-4.

PAR. 23. Section 29.58-7, as added by Treasury Decision 5419 [26 CFR 29.58-7], is amended by striking out the third sentence of paragraph (*f*) and inserting in lieu thereof the following:

An amended declaration may also be made based upon a change in the number of exemptions (or, for taxable years beginning before January 1, 1946, a change in the number of surtax exemptions) to which the taxpayer may be entitled for the then current taxable year. An amended declaration may be filed jointly by husband and wife even though separate declarations have previously been filed.

PAR. 24. There is inserted immediately preceding section 29.108-1 the following:

SEC. 601. FISCAL YEAR TAXPAYERS. (REVENUE ACT OF 1948, TITLE VI.)

Section 108 of the Internal Revenue Code is hereby amended by striking out "(d)" at the beginning of subsection (d) and inserting in lieu thereof "(e)," and by inserting after subsection (c) the following:

"(d) TAXABLE YEARS OF INDIVIDUALS BEGINNING IN 1947 AND ENDING IN 1948.—In the case of a taxable year of an individual beginning in 1947 and ending in 1948, the tax imposed by sections 11, 12, and 400 shall be an amount equal to the sum of—

"(1) that portion of a tax, computed as if the law applicable to taxable years beginning on January 1, 1947, were applicable to such taxable year, which the number of days in such taxable year prior to January 1, 1948, bears to the total number of days in such taxable year, plus

"(2) that portion of a tax, computed as if the law applicable to taxable years beginning on January 1, 1948, were applicable to such taxable year, which the number of days in such taxable year after December 31, 1947, bears to the total number of days in such taxable year."

PAR. 25. There is added immediately after section 29.108-2 the following section:

SEC. 29.108-3. COMPUTATION OF TAX OF INDIVIDUALS FOR TAXABLE YEARS BEGINNING IN 1947 AND ENDING IN 1948.—For a taxable year beginning in 1947 and ending in 1948, the normal tax, surtax, and optional tax imposed by sections 11, 12, and 400 upon taxpayers other than corporations shall be computed under section 108(d), as amended by the Revenue Act of 1948, as follows:

(*a*) That portion of a tentative tax computed under the law applicable to taxable years beginning on January 1, 1947, which the number of days prior to January 1, 1948, in the taxable year of the taxpayer bears to the total number of days in such taxable year, and

(*b*) That portion of a tentative tax computed under the law applicable to taxable years beginning on January 1, 1948, which the number of days after December 31, 1947, in the taxable year of the taxpayer bears to the total number of days in such taxable year.

The provisions of section 108(d) apply to estates, trusts, and nonresident alien individuals whose tax is computed under sections 11 and 12.

The provisions of section 108(d) apply to a taxable year beginning in 1947 and ending in 1948, whether or not such taxable year is one of less than 12 months. In the case of a taxpayer who is subject to the provisions of section 108(d) and who because of a change in accounting period has a taxable year of less than 12 months, the net income shall be placed on an annual basis under the provisions of section 47(c)(1) for the purpose of both tentative tax computations under section 108(d), or shall be computed under the exception in section 47(c)(2) for the purpose of both such tentative tax computations. Regardless of the method adopted, the amounts of the tentative normal tax and surtax so computed upon the basis of 12 months' income shall be properly reduced under section 47(c) in order to determine the tentative taxes under section 108(d). However, in the case of a taxpayer who is subject to the provisions of section 108(d) and who because of any reason other than a change in accounting period has a taxable year of less than 12 months, the net income shall not be placed on an annual basis under section 47(c)(1) and shall not be computed under the exception in section 47(c)(2).

In any case in which a taxpayer subject to the provisions of section 108(d) has an excess of net long-term capital gains over net short-term capital losses, the alternative tax under section 117(c) shall be an amount equal to the sum of the proper portions of the tentative taxes determined under section 108(d), by computing each such tentative tax pursuant to the alternative tax computation provided in section 117(c), regardless of whether either tentative tax so computed on the alternative basis is larger or smaller than the tentative tax computed without regard to section 117(c).

In the case of a joint return of husband and wife for taxable years beginning on the same day in 1947 and ending on different days because of the death of either spouse or both spouses (where at least one of such taxable years ends in 1948), the number of days to be taken into account for the purpose of computing the portions of the tax under section 108(d) (1) and (2) shall be the number of days prior to January 1, 1948, in the taxable year of the surviving spouse, the number of days after December 31, 1947, in the taxable year of the surviving spouse and the total number of days in the taxable year of the surviving spouse.

PAR. 26. There is inserted immediately preceding section 29.113(a)(5)-1 the following:

SEC. 366. BASIS OF SURVIVING SPOUSE'S INTEREST IN COMMUNITY PROPERTY. (REVENUE ACT OF 1948, TITLE III.)

(a) Section 113(a)(5) of the Internal Revenue Code (relating to basis of property transmitted at death) is hereby amended by adding at the end thereof the following new sentences: "For the purposes of this paragraph the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any State, Territory or possession of the United States or any foreign country shall be considered to be property 'acquired by bequest, devise, or inheritance' from the decedent, if the death of the decedent was after December 31, 1947, and if at least one-half of the whole of the community interest in such property was includible in determining the value of the decedent's gross estate under section 811. In the case of property held by a decedent and his surviving spouse under the community property laws of any State, Territory, or possession of the United States or any foreign country, if the value of any part of the surviving spouse's one-half share of such property was included in determining the value of the gross estate of the decedent and a tax under chapter 3 was payable upon the transfer of the net estate of the decedent, then for the purposes of this paragraph such part of such one-half share of the surviving spouse shall be considered to be property 'acquired by bequest, devise, or inheritance' from the decedent, if the death of the decedent was after the date of the enactment of the Revenue Act of 1942 and on or before December 31, 1947; but nothing in this sentence shall reduce basis below that which would exist if the Revenue Act of 1948 had not been enacted."

(b) If the allowance of a credit or refund of any overpayment of tax resulting from the application of this section is prevented on the date of the enactment of this Act, or within one year from such date, by the operation of any law or rule of law (other than section 3761 of the Internal Revenue Code, relating to compromises), credit or refund of such overpayment may, nevertheless, be allowed or made if claim therefor is filed within one year from the date of the enactment of this Act. No interest shall be paid on any overpayment resulting from the application of the last sentence of section 113(a)(5) of such Code, as amended by this section, if such overpayment is for a taxable year beginning before January 1, 1948.

PAR. 27. Section 29.113(a)(5)-1 [26 CFR 29.113(a)(5)-1] is amended as follows:

(A) By striking out the word "and" at the end of subparagraph (1) of paragraph (*a*).

(B) By striking out the period at the end of subparagraph (2) of paragraph (*a*) and inserting in lieu thereof "; and".

(C) By adding at the end thereof the following subparagraph:

(3) to (i) the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property law of any State, Territory, or possession of the United States or any foreign country if the death of the decedent is after December 31, 1947, and if at least one-half of the whole of the community interest in such property is includible in determining the value of the decedent's gross estate under section 811 (whether or not a tax under chapter 3, relating to the estate tax, is payable upon the net estate of the decedent) and (ii) such part of the surviving spouse's one-half share of property held by the decedent and surviving spouse as community property as was included in computing the value of the decedent's gross estate if the death of the decedent was after October 21, 1942, and before January 1, 1948, and if a tax under chapter 3, relating to the estate tax, was payable upon the net estate of the decedent. Section 113(a)(5) shall not, however, be applied in cases described in (ii) above so as to reduce the basis of any property below that which would exist without the application of such section.

(D) By adding at the end of such section the following new paragraph:

(*g*) *Credit or refund to surviving spouse in community property States.*—If on April 2, 1948, or within one year from such date, the allowance of credit or refund of any overpayment of tax to a surviving spouse resulting from the application of the last sentence of section 113(a)(5) to any part of the surviving spouse's one-half share of community property is prevented by the operation of any law or rule of law (other than section 3761, relating to compromises), credit or refund of such overpayment may nevertheless be allowed or made if claim therefor is filed within one year after April 2, 1948.

No interest shall be paid on any overpayment resulting from the application of the last sentence of section 113(a)(5) to any part of the surviving spouse's one-half share of community property if such overpayment is for a taxable year beginning before January 1, 1948.

PAR. 28. There is inserted immediately preceding section 29.142-1 the following:

SEC. 202. TECHNICAL AMENDMENTS. (REVENUE ACT OF 1948, TITLE II.)

* * * * * * *

(c) REQUIREMENT OF RETURNS.—

* * * * * * *

(2) FIDUCIARY RETURNS.—Section 142(a) of such Code (relating to the requirement of fiduciary returns) is hereby amended by striking out "$500" wherever appearing therein and inserting in lieu thereof "$600".

* * * * * * *

SEC. 203. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1948, TITLE II.)

The amendments made by this title shall be applicable with respect to taxable years beginning after December 31, 1947. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

PAR. 29. Section 29.142-1, as amended by Treasury Decision 5425 [26 CFR 29.142-1], is further amended as follows:

(A) By inserting before the period in the heading of paragraph (b) the following: "*, and before January 1, 1948*".

(B) By inserting in paragraph (*b*) after "December 31, 1943," the following: "and before January 1, 1948,".

(C) By changing the designation of paragraph (*c*) from "(*c*)" to "(*d*)".

(D) By inserting after paragraph (*b*) a new paragraph to read as follows:

(*c*) *Taxable years beginning after December 31, 1947.*—Every fiduciary, or at least one of joint fiduciaries, for taxable years beginning after December 31, 1947, must make a return of income—

(1) *Returns for individuals.*—For the individual whose income is in his charge, if the gross income of such individual is $600 or over.

(2) *Returns for estates and trusts.*—For the estate for which he acts if the gross income of such estate is $600 or over, and for the trust for which he acts if the gross income of such trust is $600 or over, or the net income of such trust, as computed under section 162, is $100 or over, or if any beneficiary of such estate or trust is a nonresident alien.

The return in case (1) shall be on Form 1040. In case (2) a return is required on Form 1041.

PAR. 30. Section 29.142-2, as amended by Treasury Decision 5425 [26 CFR 29.142-2], is further amended as follows:

(A) By inserting before the period in the heading of paragraph (*b*) the following: "*, and before January 1, 1948*".

(B) By inserting in paragraph (*b*) after "December 31, 1943," the following: "and before January 1, 1948,".

(C) By adding after paragraph (*b*) the following new paragraph:

(*c*) *Taxable years beginning after December 31, 1947.*—For taxable years beginning after December 31, 1947, a fiduciary acting as the guardian of a minor, or as the guardian or committee of an insane person, having a gross income of $600 or more for the taxable year, must make a return for such person on Form 1040, and pay the tax unless in the case of a minor the minor himself makes a return or causes it to be made. As to the use of the optional return, see section 29.51-2(b).

PAR. 31. Section 29.143-3, as amended by Treasury Decision 5607 [C. B. 1948-1, 80], approved March 12, 1948 [26 CFR 29.143-3], is further amended as follows:

(A) By striking out the second sentence of the next to the last paragraph and inserting in lieu thereof the following:

A nonresident alien individual who is engaged in trade or business within the United States at any time during the taxable year is entitled to the personal exemption for taxable years beginning before January 1, 1944, and to the normal-tax exemption and the surtax exemption allowed by section 25(b) (1) (A) for taxable years beginning after December 31, 1943, and before January 1, 1946, and to the exemption allowed for himself by section 25(b) (1) (A) for taxable years beginning after December 31, 1945.

(B) By adding before the period at the end of the third sentence of the next to the last paragraph the following: ", and before January 1, 1948, and to the exemptions allowed by section 25(b)(1) (B), (C), and (D) for taxable years beginning after December 31, 1947".

(C) By striking out the fifth and sixth sentences of the next to the last paragraph and inserting in lieu thereof the following:

However, in the determination of the tax to be withheld at the source under section 143(b) with respect to remuneration paid on or after July 1, 1943, for labor or personal services performed within the United States by a nonresident alien, the benefit of the personal exemption for taxable years beginning before January 1, 1944, or the normal-tax and surtax exemptions or exemption for both normal tax and surtax for taxable years beginning after December 31, 1943, shall be allowed, prorated upon a daily basis for the period of employment during any portion of which labor or personal services are performed within the United States by such alien. Such proration is on a basis of $1.40 per day for taxable years beginning prior to January 1, 1948, and on a basis of $1.70 per day for taxable years beginning after December 31, 1947. Thus, if A, a nonresident alien seaman employed by X Shipping Corporation, is paid in 1948 upon the termination of the voyage and such voyage covers 100 days, and A performs personal services within the United States during, or incident to, such voyage, the amount of $170 will be allocated as the portion of the exemption to be allowed as a credit against the remuneration of A for personal services performed within the United States during such voyage, and withholding shall be applied against the balance, if any, of such remuneration.

PAR. 32. There is inserted immediately preceding section 29.147-1 the following:

SEC. 202. TECHNICAL AMENDMENTS. (REVENUE ACT OF 1948, TITLE II.)

* * * * * * *

(c) REQUIREMENT OF RETURNS.—

* * * * * * *

(3) INFORMATION RETURNS.—Section 147(a) of such Code (relating to returns of information) is hereby amended by striking out "$500" wherever appearing therein and inserting in lieu thereof "$600".

* * * * * * *

SEC. 203. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1948, TITLE II.)

The amendments made by this title shall be applicable with respect to taxable years beginning after December 31, 1947. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

PAR. 33. Section 29.147-1, as amended by Treasury Decision 5313 [C. B. 1944, 308], approved December 21, 1943 [26 CFR 29.147-1], is further amended as follows:

(A) By amending the heading thereof to read as follows:

RETURN OF INFORMATION AS TO PAYMENT OF $600 ($500 FOR YEARS PRIOR TO 1948).

(B) By striking out the first sentence and inserting in lieu thereof the following:

All persons making payment to another person of fixed or determinable income of $500 or more in any calendar year prior to 1948, and all persons making payment to another person of such income of $600 or more in any calendar year after 1947 must render a return thereof for such year on or before February 15 of the following year except as specified in sections 29.147-3 to 29.147-5, inclusive.

(C) By striking from the third sentence "260 East One Hundred and Sixty-first Street, New York 51, N. Y." and inserting in lieu thereof "C. C. Station, Kansas City 2, Mo."

PAR. 34. Section 29.147-2, as amended by Treasury Decision 5480 [C. B. 1945, 234], approved September 26, 1945 [26 CFR 29.147-2], is amended so that such section shall read as follows:

SEC. 29.147-2. RETURN OF INFORMATION AS TO PAYMENTS TO EMPLOYEES.—The names of all employees to whom payments are made of $500 or more in any calendar year prior to 1948, or of $600 or more in any calendar year after 1947, whether such total sum is made up of wages, salaries, annuities, commissions, or compensation in any other form, must be reported. In the case of any such payments of $500 or more paid during the calendar year 1945 or during any subsequent calendar year prior to 1948, and in the case of any such payments of $600 or more made during any calendar year after 1947, if a portion thereof constitutes wages subject to withholding under section 1622 and such portion is reported on Form W-2, the remainder of such payments must be reported on Form 1099. For example, if such payments made to an employee by his employer in 1948 amount to $700 and $400 thereof represents wages subject to withholding under section 1622, and the remaining $300 represents compensation not subject to withholding, for instance, advances or reimbursements for traveling or other expenses, or insurance premiums which in accordance with section 29.165-6 are income to the employee for the year in which the insurance is purchased, the $400 must be reported on Form W-2 and the $300 must be reported on Form 1099. Heads of branch offices and subcontractors employing labor, who keep the only complete record of payments therefor, should file returns of information in regard to such payments with the Commissioner of Internal Revenue, Processing Division, C. C. Station, Kansas City 2, Mo. When both main office and branch office have adequate records, the return should be filed by the main office.

For years prior to 1945, amounts distributed or made available under an employees' trust governed by the provisions of section 165 to any beneficiary in excess of the sum of his personal exemption and the amounts paid into the fund by him must be reported by the trustee. For the calendar year 1945 and subsequent calendar years amounts distributed or made available under an employees' trust governed by the provisions of section 165, or under an annuity plan to which section 29.22(b)(2)-5 relates, to a beneficiary shall be reported to the extent such amounts are includible in the gross income of such beneficiary where the amounts so includible are $500 or more if distributed or made available in a calendar year prior to 1948 or $600 or more if distributed or made available in a calendar year after 1947.

In the case of payments made by the United States to persons in its service (civil, military, or naval) of wages, salaries, or compensation in any other form, the returns of information shall be made by heads of the executive departments and other United States Government establishments.

For cases where no returns of information are required, see section 29.147-3. (See also section 29.22(a)-3.)

PAR. 35. Section 29.147-3, as amended by Treasury Decision 5425 [26 CFR 29.147-3], is further amended by striking from the first sentence "$500" and inserting in lieu thereof "$600".

PAR. 36. Section 29.147-7, as amended by Treasury Decision 5313 [26 CFR 29.147-7], is further amended by striking therefrom "260 East One Hundred and Sixty-first Street, New York 51, N. Y." and inserting in lieu thereof "C. C. Station, Kansas City 2, Mo."

PAR. 37. Section 29.147-8, as amended by Treasury Decision 5313 [26 CFR 29.147-8], is further amended by striking therefrom "260 East One Hundred and Sixty-first Street, New York 51, N. Y." and inserting in lieu thereof "C. C. Station, Kansas City 2, Mo."

PAR. 38. Section 29.148-1, as amended by Treasury Decision 5313 [26 CFR 29.148-1], is further amended as follows:

(A) By striking from the last sentence of the first paragraph of (*a*) "260 East One Hundred and Sixty-first Street, New York 51, N. Y." and inserting in lieu thereof "C. C. Station, Kansas City 2, Mo."

(B) By striking from the first sentence of paragraph (*b*) "260 East One Hundred and Sixty-first Street, New York 51, N. Y." and inserting in lieu thereof "C. C. Station, Kansas City 2, Mo."

PAR. 39. Section 29.148-3, as amended by Treasury Decision 5356 [C. B. 1944, 220], approved April 19, 1944 [26 CFR 29.148-3], is further amended by striking from the second paragraph "260 East One Hundred and Sixty-first Street, New York 51, N. Y." and inserting in lieu thereof "C. C. Station, Kansas City 2, Mo."

PAR. 40. There is inserted immediately preceding section 29.163-1 the following:

SEC. 202. TECHNICAL AMENDMENTS. (REVENUE ACT OF 1948, TITLE II.)

* * * * * * *

(d) CREDIT OF ESTATE AGAINST NET INCOME.—Section 163(a)(1) of such Code (relating to credits against net income of an estate) is hereby amended by striking out "$500" and inserting in lieu thereof "$600".

* * * * * * *

SEC. 203. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1948, TITLE II.)

The amendments made by this title shall be applicable with respect to taxable years beginning after December 31, 1947. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

PAR. 41. Section 29.163-1, as amended by Treasury Decision 5517 [26 CFR 29.163-1], is further amended by striking out the second sentence of paragraph (*b*) and inserting in lieu thereof the following:

For taxable years beginning after December 31, 1945, and before January 1, 1948, an estate is allowed a credit of $500 against net income for both normal tax and surtax purposes. For taxable years beginning after December 31, 1947, an estate is allowed a credit of $600 against net income for both normal tax and surtax purposes.

PAR. 42. Section 29.217-2 [26 CFR 29.217-2] is amended by striking out the second sentence of the first paragraph of (*b*) and inserting in lieu thereof the following:

A return will not be required, however, in the case of such a nonresident alien individual, a resident of Canada or Mexico, whose sole income from sources within the United States consists of compensation for personal services and does not exceed $500 during the taxable year in the case of a taxable year beginning before January 1, 1948, or $600 during the taxable year in the case of a taxable year beginning after December 31, 1947.

PAR. 43. There is inserted immediately preceding section 29.400-1 the following:

SEC. 401. INDIVIDUALS WITH ADJUSTED GROSS INCOMES OF LESS THAN $5,000. (REVENUE ACT OF 1948, TITLE IV.)

(a) IN GENERAL.—Section 400 of the Internal Revenue Code (relating to optional tax on individuals with adjusted gross incomes of less than $5,000) is hereby amended to read as follows:

"SEC. 400. IMPOSITION OF TAX.

"In lieu of the taxes imposed by sections 11 and 12, there shall be levied, collected, and paid for each taxable year upon the net income of each individual whose adjusted gross income for such year is less than $5,000, and who has elected to pay the tax imposed by this supplement for such year, a tax as follows:

'If adjusted gross income is—		And the number of exemptions is—			
At least	But less than	1	2	3	4 or more
		The tax shall be—			
$0	$675	$0	$0	$0	$0
675	700	3	0	0	0
700	725	7	0	0	0
725	750	11	0	0	0
750	775	14	0	0	0
775	800	18	0	0	0
800	825	22	0	0	0
825	850	26	0	0	0
850	875	29	0	0	0
875	900	33	0	0	0
900	925	37	0	0	0
925	950	40	0	0	0
950	975	44	0	0	0
975	1,000	48	0	0	0
1,000	1,025	52	0	0	0
1,025	1,050	55	0	0	0
1,050	1,075	59	0	0	0
1,075	1,100	63	0	0	0
1,100	1,125	67	0	0	0
1,125	1,150	70	0	0	0
1,150	1,175	74	0	0	0
1,175	1,200	78	0	0	0
1,200	1,225	82	0	0	0
1,225	1,250	85	0	0	0
1,250	1,275	89	0	0	0
1,275	1,300	93	0	0	0
1,300	1,325	96	0	0	0
1,325	1,350	100	1	0	0
1,350	1,375	104	4	0	0
1,375	1,400	108	8	0	0
1,400	1,425	111	12	0	0
1,425	1,450	115	16	0	0
1,450	1,475	119	19	0	0
1,475	1,500	123	23	0	0
1,500	1,525	126	27	0	0
1,525	1,550	130	31	0	0
1,550	1,575	134	34	0	0
1,575	1,600	138	38	0	0
1,600	1,625	141	42	0	0
1,625	1,650	145	45	0	0
1,650	1,675	149	49	0	0
1,675	1,700	153	53	0	0
1,700	1,725	156	57	0	0
1,725	1,750	160	60	0	0
1,750	1,775	164	64	0	0
1,775	1,800	167	68	0	0
1,800	1,825	171	72	0	0
1,825	1,850	175	75	0	0
1,850	1,875	179	79	0	0
1,875	1,900	182	83	0	0
1,900	1,925	186	87	0	0
1,925	1,950	190	90	0	0
1,950	1,975	194	94	0	0
1,975	2,000	197	98	0	0
2,000	2,025	201	101	2	0
2,025	2,050	205	105	6	0
2,050	2,075	209	109	9	0
2,075	2,100	212	113	13	0
2,100	2,125	216	116	17	0
2,125	2,150	220	120	21	0
2,150	2,175	223	124	24	0
2,175	2,200	227	128	28	0
2,200	2,225	231	131	32	0
2,225	2,250	235	135	35	0
2,250	2,275	238	139	39	0
2,275	2,300	242	143	43	0
2,300	2,325	246	146	47	0

If adjusted gross income is—		And the number of exemptions is—									
			2		3						
At least	But less than	1	And if other than a joint return is filed	And if a joint return is filed	And if other than a joint return is filed	And if a joint return is filed	4	5	6	7	8 or more
		The tax shall be—									
$2,325	$2,350	$250	$150	$150	$50	$50	$0	$0	$0	$0	$0
2,350	2,375	253	154	154	54	54	0	0	0	0	0
2,375	2,400	257	157	157	58	58	0	0	0	0	0
2,400	2,425	261	161	161	62	62	0	0	0	0	0
2,425	2,450	265	165	165	65	65	0	0	0	0	0
2,450	2,475	268	169	169	69	69	0	0	0	0	0
2,475	2,500	272	172	172	73	73	0	0	0	0	0
2,500	2,525	276	176	176	77	77	0	0	0	0	0
2,525	2,550	280	180	180	80	80	0	0	0	0	0
2,550	2,575	283	184	184	84	84	0	0	0	0	0
2,575	2,600	287	187	187	88	88	0	0	0	0	0
2,600	2,625	291	191	191	92	92	0	0	0	0	0
2,625	2,650	294	195	195	95	95	0	0	0	0	0
2,650	2,675	298	199	199	99	99	0	0	0	0	0
2,675	2,700	302	202	202	103	103	3	0	0	0	0
2,700	2,725	306	206	206	106	106	7	0	0	0	0
2,725	2,750	309	210	210	110	110	11	0	0	0	0
2,750	2,775	313	214	214	114	114	14	0	0	0	0
2,775	2,800	317	217	217	118	118	18	0	0	0	0
2,800	2,825	321	221	221	121	121	22	0	0	0	0
2,825	2,850	324	225	225	125	125	26	0	0	0	0
2,850	2,875	328	228	228	129	129	29	0	0	0	0
2,875	2,900	332	232	232	133	133	33	0	0	0	0
2,900	2,925	336	236	236	136	136	37	0	0	0	0
2,925	2,950	340	240	240	140	140	40	0	0	0	0
2,950	2,975	345	243	243	144	144	44	0	0	0	0
2,975	3,000	349	247	247	148	148	48	0	0	0	0
3,000	3,050	356	253	253	153	153	54	0	0	0	0
3,050	3,100	364	260	260	161	161	61	0	0	0	0
3,100	3,150	373	268	268	168	168	68	0	0	0	0
3,150	3,200	382	275	275	176	176	76	0	0	0	0
3,200	3,250	391	283	283	183	183	83	0	0	0	0
3,250	3,300	399	290	290	190	190	91	0	0	0	0
3,300	3,350	408	298	298	198	198	98	0	0	0	0
3,350	3,400	417	305	305	205	205	106	6	0	0	0
3,400	3,450	425	312	312	213	213	113	14	0	0	0
3,450	3,500	434	320	320	220	220	121	21	0	0	0
3,500	3,550	443	327	327	228	228	128	29	0	0	0
3,550	3,600	452	335	335	235	235	136	36	0	0	0
3,600	3,650	460	344	342	243	243	143	44	0	0	0
3,650	3,700	469	353	350	250	250	151	51	0	0	0
3,700	3,750	478	362	357	258	258	158	59	0	0	0
3,750	3,800	486	370	365	265	265	166	66	0	0	0
3,800	3,850	495	379	372	273	273	173	73	0	0	0
3,850	3,900	504	388	380	280	280	181	81	0	0	0
3,900	3,950	513	396	387	288	288	188	88	0	0	0
3,950	4,000	521	405	395	295	295	195	96	0	0	0
4,000	4,050	530	414	402	303	303	203	103	4	0	0
4,050	4,100	539	423	410	310	310	210	111	11	0	0
4,100	4,150	547	431	417	317	317	218	118	19	0	0
4,150	4,200	556	440	425	325	325	225	126	26	0	0
4,200	4,250	565	449	432	332	332	233	133	34	0	0
4,250	4,300	574	457	439	341	340	240	141	41	0	0
4,300	4,350	582	466	447	350	347	248	148	49	0	0
4,350	4,400	591	475	454	359	355	255	156	56	0	0
4,400	4,450	600	483	462	367	362	263	163	63	0	0
4,450	4,500	608	492	469	376	370	270	171	71	0	0
4,500	4,550	617	501	477	385	377	278	178	78	0	0
4,550	4,600	626	510	484	393	385	285	186	86	0	0
4,600	4,650	635	518	492	402	392	293	193	93	0	0
4,650	4,700	643	527	499	411	400	300	200	101	1	0
4,700	4,750	652	536	507	420	407	308	208	108	9	0
4,750	4,800	661	544	514	428	415	315	215	116	16	0
4,800	4,850	669	553	522	437	422	322	223	123	24	0
4,850	4,900	678	562	529	446	430	330	230	131	31	0
4,900	4,950	687	571	537	454	437	337	238	138	39	0
4,950	5,000	695	579	544	463	444	345	245	146	46	0"

(b) Taxable Years to Which Applicable.—The amendment made by this section shall be applicable with respect to taxable years beginning after December 31, 1947. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

Par. 44. Section 29.400–1, as amended by Treasury Decision 5517 [26 CFR 29.400–1], is further amended as follows:

(A) By striking from the first sentence of the third paragraph of (*b*) beginning with the words "in the case of husband and wife" the words "living together".

(B) By striking out the fourth paragraph of (*b*) beginning with the words "These restrictions" and inserting in lieu thereof the following:

These restrictions upon the right of a married person to elect to pay the tax under Supplement T are applicable with respect to taxable years beginning before January 1, 1948, only if such person is married and living with his spouse on the last day of his taxable year or, in the event of the death of his spouse during the taxable year, upon the date of such death. For the purpose of the preceding sentence, husband and wife are considered as living together unless they are permanently separated. For taxable years beginning after December 31, 1947, the restrictions upon the right of a married person to elect to pay the tax under Supplement T are applicable unless such person is legally separated from his spouse under a decree of divorce or separate maintenance on the last day of his taxable year or, in the event of the death of his spouse during the taxable year, upon the date of such death. For rules relative to the application of these restrictions, see section 29.23(aa)–1(c).

(C) By inserting immediately before the last paragraph of (*b*) the following:

The tax table in section 400, as amended by the Revenue Act of 1948 and applicable with respect to taxable years beginning after December 31, 1947, contains, in certain areas, double columns, in one of which is computed the tax if a separate return is filed, and in the other of which is computed the tax if a joint return is filed. Since the computations of tax in the case of a joint return reflect the income-splitting method provided in section 12(d), as amended by the Revenue Act of 1948, the tax set forth in the joint return column may be lower than in the separate return column even though the amounts of adjusted gross income and the exemptions are the same. Thus, if H, a married man, has adjusted gross income of $4,925 and his wife has no gross income and his only exemptions under section 25(b) are the exemptions for himself and spouse under section 25(b)(1)(A), the tax on a joint return under Supplement T, as set forth in the second column applicable to a person with two exemptions, is $537. If H should file a separate return, his tax, as set forth in the first column applicable to a person with two exemptions, would be $571. For treatment of taxable years beginning in 1947 and ending in 1948, see section 29.108–3.

Par. 45. Section 29.401–1, as amended by Treasury Decision 5517 [26 CFR 29.401–1], is further amended as follows:

(A) By inserting in the first paragraph of (*b*) immediately before "See section 29.25–3" the following:

For taxable years beginning after December 31, 1947, additional exemptions are allowed under section 25(b)(1) (B) and (C) for a taxpayer or spouse who has attained the age of 65 years and for a blind taxpayer or blind spouse.

(B) By adding after *Example (2)* in paragraph (*b*) the following example:

Example (3). D, a married man with no dependents, attains the age of 65 years on September 1, 1948. The aggregate adjusted gross income of D and his wife for 1948 is $4,840. D and his wife file a joint return for 1948 and are entitled to three exemptions, one for each taxpayer and one additional exemption for D because of his age. Since the adjusted gross income of D and his wife falls within the tax bracket $4,800–$4,850, the tax on a joint return is $422.

PAR. 46. Section 29.402-1, as amended by Treasury Decision 5425 [26 CFR 29.402-1] is further amended as follows:

(A) By adding after "December 31, 1943," in paragraph (*b*) "and before January 1, 1948,".

(B) By adding at the end of paragraph (*b*) the following:

An election under Supplement T once made for the taxable year may not be revoked by an amended return or otherwise, but a new election is allowed for each subsequent taxable year. If for any taxable year the taxpayer makes a return without regard to Supplement T, he may not thereafter elect to have his tax computed under such Supplement for that taxable year.

The provisions of this paragraph (*b*) are also applicable to taxable years beginning after December 31, 1947, except that wherever the prescribed manner of making the election involves the filing of a return on Form W-2 (Rev.) the election shall be made by the filing of Form 1040A instead of Form W-2 (Rev.). See section 29.51-2(b)(2).

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

FRED S. MARTIN,
Acting Commissioner of Internal Revenue.

Approved February 16, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 23, 1949, 8:46 a. m.)

PART II.—COMPUTATION OF NET INCOME

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

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

1949-10-13084
Ct. D. 1721

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF COURT

1. GROSS INCOME—EXCLUSIONS—OIL AND GAS LEASE—INCOME AND EXPENSES ATTRIBUTABLE TO RESERVED "CARRIED WORKING INTEREST."

The assignors of an oil and gas lease retained a one-sixteenth working interest therein. The assignees were to develop and operate the property, advance all funds necessary therefor, were authorized to sell the production accruing to such working interest or to purchase same themselves, and were to recoup their advances only from this source or from the sale of personal property in which the assignors had also retained a one-sixteenth interest. The assignees were to account to the assignors for one-sixteenth of the operating profits as defined by the agreement, if, as, and when realized. During the taxable year 1941 there were no such profits. *Held:* The fact that the assignors received no net operating profits as defined by the contract did not establish that they received no net taxable income therefrom. The assignors in effect mortgaged their interest to the assignees and acquired an undivided one-sixteenth interest in the physical equipment placed upon the property, reserving to themselves a share in net profits that was not disassociated from their retained economic interest but was derived therefrom. Therefore, it was not the duty of the assignees to return for taxes the gross income from the one-sixteenth interest reserved by the assignors. Income is taxable to the owner of the property producing the same, and an assignment in anticipation of such income is ineffective to avoid taxation thereof to the real owner.

2. DECISION AFFIRMED.

Decision of The Tax Court of the United States (7 T. C. 120) affirmed.

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

Commissioner of Internal Revenue, petitioner, v. *J. S. Abercrombie Co., respondent*
[162 Fed. (2d) 338]

Petition for review of decision of The Tax Court of the United States

Before SIBLEY, HOLMES, AND WALLER, Circuit Judges

[June 25, 1947]

OPINION

HOLMES, Circuit Judge: This appeal involves income taxes for the calendar year 1941. The question is whether the assignees of an oil and gas lease—the assignors having retained a one-sixteenth working interest—are taxable for that portion of the gross income (less proper deductions) which is attributable to said interest notwithstanding, under the terms of the assignment, there were no net profits paid or payable to said assignors and the latter were not personally liable for any expenses.

The consideration for the assignment was $600,000 in cash, $2,500,000 payable only out of one-fourth of subsequent production free of all costs and expenses (neither of which items is in controversy here), and in addition a one-sixteenth "carried working interest." The assignees were put in control of the development and operation of the property, were to advance all funds necessary therefor, were authorized to sell the production accruing to said working interest or to purchase same themselves, and were to recoup their advances only from this source or from the sale of personal property; a one-sixteenth interest in the latter also having been reserved by the assignors.

The assignees were required to account to the assignors from time to time for one-sixteenth of the operating profits as defined by the agreement if, as, and when realized. Until July, 1942, there were no such profits. The Tax Court held that, under the contract, one-sixteenth of the gross proceeds from oil production belonged to the assignors, who were chargeable with the expenditures attributable to said interest.

Petitioner's contention, with reference to the amount in controversy, is that the assignors retained nothing more than a right to share in one-sixteenth of the net profits. He agrees with the Tax Court that the assignors possessed an economic interest in the property to the extent that they were entitled to share in the net operating profits. This is in concurrence with *Kirby Petroleum Co.* v. *Commissioner*, 326 U. S. 599 [Ct. D. 1664, C. B. 1946-1, 69], and *Burton-Sutton Oil Co.* v. *Commissioner*, 328 U. S. 25 [Ct. D. 1674, C. B. 1946-1, 237]; but he disagrees with the Tax Court as to the tax consequences of such interest. His position, in substance, is that when there were no net profits and when nothing was paid or payable to the assignors, as was true in the taxable year here involved, they received no gross income from the property, there was nothing to be depleted by them, and nothing that might be excluded or deducted from the income of the assignees.

It is true that language used by the parties in describing what was retained by them is not always conclusive as to the tax consequences of the transaction; but the Tax Court did not find any inconsistency in this case between what the parties did and the language used by them. It did not ignore, but gave full effect to, the statement in the agreement that the assignors did not agree to sell, but reserved and retained in themselves, "as a carried ownership and interest, an undivided one-sixteenth interest in all minerals." Moreover, it does not appear that the assignors, under their agreement with the assignees, were entitled to share operating net income as defined by Federal law and regulations. On the contrary, they were entitled to share only in accumulated net operating profits as defined in the contract between the assignors and assignees.

Since net taxable income may differ from operating profits as defined by the parties (due to the fact that capital items not deductible for Federal income tax purposes do not enter into the calculation of net taxable income), there is no necessary equivalence between net profits payable to the assignors and their taxable income from the leased premises. Hence it does not follow that, because the assignors received no net operating profit as defined by the agreement, they also received no net taxable income from the property. The distributable net operating profit from the reserved one-sixteenth working interest was wholly subject to the will of the parties; but the net taxable income from that interest was governed by Federal statutes and regulations. The difference between the net profits receivable in cash and the net taxable income receivable by the carried interest arises by virtue of the fact that capital items, such as physical equipment, are not deductible for Federal income tax purposes, while in the instant case the parties in their contract gave the operators the right to recoup outlays made by them for physical equipment.

In some instances the law may look through form to substance to get to the right of a controversy, but in ordinary cases tax consequences under Federal law often depend upon property rights under local law, which in turn may be fixed by agreements between owners of the property. In the present case there is no reason to ignore, and the Tax Court declined to ignore, the provisions of the agreement reserving an undivided one-sixteenth working interest in all minerals, stating the relation of the parties as that of independent contractors, limiting the liability of the assignors for any operating loss, and otherwise defining the rights and duties of the contracting parties.

The practical question in this case is whether the assignors or the assignees should have returned for the particular year the gross income from this one-sixteenth interest. Both sides rely upon the Kirby and Burton-Sutton cases, *supra;* but we think our decision is controlled by the fundamental principle that income is taxable to the owner of the property producing the same, and that an assignment in anticipation of such income is ineffective to avoid taxation thereof to the real owner. The economic reality of the transaction was that the assigning coowners mortgaged their interest to their operating coowner; and by so doing they not only reaped the benefit of development but acquired an undivided one-sixteenth interest in valuable physical equipment placed on the property by the operators. The value of the leases was in the oil and gas that could be produced from the demised premises. The assignors desired to participate in the production to the extent of one-sixteenth; and arranged by contract for its exploitation, reserving to themselves a share in the net profits that was not disassociated from the retained economic interest but was derived from such interest and partook of the quality of rent.[1]

Therefore, it was not the duty of the assignees to return for taxes the gross income from the one-sixteenth interest reserved by the assignors. The decision of the Tax Court is

Affirmed.

SIBLEY, Circuit Judge, concurring: I concur in the opinion. It seems to me that the gross income from oil attributable to the reserved one-sixteenth interest belongs each year to the assignors, subject to allowance for depletion. If, as has happened, the assignors' income is kept by the assignees to repay them for one-sixteenth of the development costs, it is because the contract authorizes the assignees to pay it to themselves instead of to the assignors, till their advances are repaid. It does not affect the ownership of the income any more than if it had been ordered to be paid over to some third person.

SECTION 29.22(a)-1: What included in gross income.

1949-2-13008
I. T. 3935

INTERNAL REVENUE CODE

Treatment for Federal income tax purposes of donative assignments of short-lived in-oil payment rights.

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[1] *Palmer* v. *Bender*, 287 U. S. 551 [Ct. D. 641, C. B. XII-1, 235 (1933)]; *Thomas* v. *Perkins*, 301 U. S. 655 [Ct. D. 1237, C. B. 1937-1, 162]; *Anderson* v. *Helvering*, 310 U. S. 404 [Ct. D. 1456, C. B. 1940-1, 108]; *Kirby Petroleum Co.* v. *Commissioner*, 326 U. S. 599; *Burton-Sutton Oil Co., Inc.*, v. *Commissioner*, 328 U. S. 25; *Reynolds* v. *McMurray*, 60 Fed. (2d) 843 [Ct. D. 616, C. B. XII-1, 198 (1933)], certiorari denied, 287 U. S. 664; *Helvering* v. *Armstrong*, 69 Fed. (2d) 370. Cf. *Crane* v. *Commissioner*, 331 U. S. 1, 67 S. Ct. 1047 [Ct. D. 1684, C. B. 1947-1, 97], upon the respective contentions with reference to the assignors not being personally liable for any of the expenditures made on their behalf by the operators.

Advice is requested with respect to the treatment for Federal income tax purposes of donative assignments of short-lived in-oil payment rights carved out of any type of depletable economic interest in oil and gas in place (including a larger in-oil payment right).

It is held that such donative assignments are assignments of future income. The income thus assigned is depletable income to the donor as it arises. Acquiescence (C. B. XII–1, 3, 9 (1933)) in *R. E. Nail et al., Independent Executors of the Estate of M. M. (Mrs. W. I.) Cook* v. *Commissioner* (27 B. T. A. 33) has been withdrawn. (See pages 56, this Bulletin.)

The instant ruling will be applied only to donative assignments made after January 24, 1949, the date of publication of this ruling in the Internal Revenue Bulletin.

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved December 16, 1948.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

SECTION 19.22(a)–14: Cancellation of indebtedness. 1949–4–13022
Ct. D. 1712

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. GROSS INCOME—PURCHASE BY TAXPAYER OF HIS OWN OBLIGATIONS AT DISCOUNT.

A solvent individual taxpayer must include in his gross income, for the tax years in which he made the purchases, the difference between the face amount of his personal indebtedness as the maker of certain leasehold bonds originally issued by him at face value for cash, and a lesser amount paid by him for their purchase. He realized an immediate financial gain from the purchases, and by such acquisition obtained control over the discharge of his obligations. There is no distinction between the sales made directly to the taxpayer and those made indirectly to his law partner acting on his behalf or through brokers or the bondholders' committee. The mere fact that each seller had knowledge that he was selling to the maker of the bond as his only available market did not change the sale into a gift. The gain from each purchase comes within section 22(a) of the Internal Revenue Code and may not be classified as a gift exempt from tax under section 22(b)(3) of the Code.

2. DECISION DISTINGUISHED.

Helvering v. *American Dental Co.*, 318 U. S. 322 (Ct. D. 1577, C. B. 1943, 94), distinguished.

3. DECISION REVERSED.

Decision of the United States Court of Appeals, Seventh Circuit (164 Fed. (2d) 594), reversed.

SUPREME COURT OF THE UNITED STATES

32. *Commissioner of Internal Revenue, petitioner,* v. *Lewis F. Jacobson*

33. *Commissioner of Internal Revenue, petitioner,* v. *Lewis F. Jacobson*

On writs of certiorari to the United States Court of Appeals for the Seventh Circuit
[January 17, 1949]

OPINION

Mr. Justice BURTON delivered the opinion of the Court.

This decision applies the Federal income tax to gains derived by a debtor from his purchase of his own obligations at a discount and his consequent control over their discharge. It presents the specific question whether a solvent natural person, in straitened financial circumstances, must include in his gross income for Federal income tax purposes the difference between (1) the face amount of his personal indebtedness as the maker of secured bonds, originally issued by him at face value for cash, and (2) a lesser amount paid by him for their purchase. The debtor's obligations were not unpaid balances of purchase prices which could be readjusted by the discharge of the obligations. The proceeds of the obligations were not traced into identifiable losses offsetting the debtor's realized gains from the discharge of these obligations. Each seller knew that the bonds he sold were being bought by or for the maker of them. In each sale the bondholder sought to minimize his probable loss by getting as much as possible, directly or indirectly, from the maker of the bonds as the one available purchaser of them. The maker of the bonds, at the same time, sought to reduce his obligations as much as possible by buying the bonds as cheaply as he could. While each seller thus knew that he was receiving from the maker of the bonds less than their face amount, there is no finding that any seller intended to transfer or release something for nothing or to make a gift of any part of his claim, as distinguished from making a sale and assignment of his whole claim for the highest available price. The maker thus realized a gain from each purchase and the Commissioner of Internal Revenue found correctly that, for Federal income tax purposes, the maker must include that gain in his gross income for the tax year in which he made the purchase.

The respondent, Lewis F. Jacobson, in 1938, 1939 and 1940 resided, practiced law and owned or controlled substantial property interests in Chicago, Ill. In 1943 the petitioner, Commissioner of Internal Revenue, found deficiencies in the income taxes paid by the respondent for each of those years. Those deficiencies totaled $3,967.97, of which about $2,500 are now before us. This case arose from the Commissioner's addition to the reported gross income of the respondent of the differences between (1) the principal face amounts of certain leasehold bonds executed by the respondent and (2) the lesser amounts paid by him for their purchase. Such purchases were made by or for him substantially as follows:

Date of purchase	Purchased D—Direct B—Through broker C—Through bondholders' committee	Principal face amount	Purchase price	Percentage of face amount paid by purchaser-maker-taxpayer
1938				
Apr. 9, 1938	D	$450.00	$202.50	45
June 9, 1938	D	3,600.00	1,620.00	45
Aug. 17, 1938	D	900.00	405.00	45
1939				
Feb. 15, 1939	B	1,800.00	900.00	50
June 16, 1939	D	450.00	225.00	50
Oct. 23, 1939	B	180.00	86.50	48
1940				
Apr. 4, 1940	C	270.00	130.00	48
May 21, 1940	C	450.00	210.00	47
May 23, 1940	C	2,700.00	1,080.00	40
June 19, 1940	C	1,800.00	720.00	40
July 1, 1940	B	450.00	200.00	45
July 3, 1940	B	450.00	200.00	15
July 10, 1940	B	450.00	184.50	41
Sept. 23, 1940	B	450.00	185.00	41
Total		14,400.00	6,348.50	

Upon the respondent's petition, the Tax Court reviewed the Commissioner's findings and—

> "*Held* that, as to the bonds acquired by petitioner [Jacobson, the respondent here] through direct negotiations with the bondholders, he is not taxable on the gain therefrom under the doctrine of *Helvering* v. *American Dental Co.* (318 U. S. 322 [Ct. D. 1577, C. B. 1943, 94]); *held, further,* that petitioner is taxable on the gain realized in the purchases from bondholders through the secretary of the bondholders' committee and the security dealers, under the doctrine of the Supreme Court in *United States* v. *Kirby Lumber Co.* (284 U. S. 1 [Ct. D. 420, C. B. X–2, 356 (1931)]), he being at all times solvent." (6 T. C. 1048.)

Six of the 16 judges dissented and 5 of those 6 voted to uphold the Commissioner completely, on the ground that none of the transactions were gratuitous. (6 T. C. 1048, 1057–1059.) The Commissioner petitioned the Court of Appeals for the Seventh Circuit to review that part of the judgment which was unfavorable to him. The respondent did the same as to the remainder of the judgment. That court decided against the Commissioner on both petitions. It held that, because the respective sellers knew that the bonds they sold were being bought by or for the respondent, as the maker of them, any excess of the face values of the bonds over their sales prices should be treated as gifts to the respondent and as exempt from income tax. (164 Fed. (2d) 594.) Due to the importance of the issues in the unsettled field of the taxability of gains derived by a debtor from his discharge of his own obligations at a discount, we granted certiorari in both cases. (333 U. S. 866.) We have heard and decided them together.

The further material facts, as found by the Tax Court or as shown by undisputed evidence, are as follows:

By purchases made in 1922 and 1923 the respondent acquired a 99-year lease, running from May 1, 1914, together with a two-story store, office and apartment building on the leased premises in Chicago. On or about May 1, 1925, he borrowed $90,000 from a nearby bank and, together with his wife, executed in return 200 bonds secured by a trust deed mortgaging to that bank the leasehold and the improvements thereon. The bonds bore interest at 6½ percent per annum and were for the total principal amount of $90,000, with $2,500 maturing semiannually up to and including November 1, 1931. The balance of the bonds, totaling $57,500, were to mature May 1, 1932. The original proceeds were used by the respondent to retire the existing encumbrance, of an undisclosed amount, on the property, pay for a $16,250 addition made by him to the building on the leasehold and pay the necessary brokerage commission of approximately 10 percent of the loan, plus the cost of printing the bonds and other expenses in connection with the loan. A remaining "small surplus" was paid to the respondent. In 1925 the respondent, for the purposes of computing depreciation, allocated $76,580.56 to the improvements, including the new addition, and $40,000 to the leasehold, out of their total cost to him of $116,580.56.

The bonds due on or before November 1, 1931, were paid at or about their maturities. The debtor has never been in default on any interest payment. However, after the trustee bank closed on June 8, 1931, a committee was formed to represent the holders of this issue of bonds. May 1, 1932, the respondent secured from the committee and individual bondholders a 5-year extension of the maturity on all of the bonds and a reduction in the interest rate from 6½ to 5 percent. During this extension the respondent issued his checks in the names of the respective bondholders to cover interest due them. The checks were delivered by the secretary of the bondholders' committee, the respondent kept himself fully informed as to the identity and location of the respective bondholders and they, in turn, frequently visited him to learn about his financial condition and that of the trusteed property. In 1937 he procured a further extension of the maturity of the bonds to May 1, 1942, and, in that connection, paid 10 percent on the principal of each bond, leaving a total outstanding balance of $51,750 payable on these bonds.

The Tax Court found that in 1938 the fair market value of the leasehold and the improvements thereon was $80,000 and that in 1939 and 1940 it was the same, less accrued depreciation. The respondent testified that he valued it at considerably less, even as low as twice the amount of its gross income, or about $32,000. The gross and net income from the trusteed property, after deduction of expenses, depreciation and also the interest on the bonds, was:

Year	*Gross income*	*Net income*
1938	$16,550.00	$1,233.95
1939	16,520.75	1,107.11
1940	15,578.50	1,719.41

The respondent received from his law practice and other sources the following additional gross income: 1938, $38,390.85; 1939, $35,644.78; and 1940, $35,279.59. The Tax Court said that: "On the strength of the showing of petitioner's assets and liabilities, we find petitioner was solvent during each of the taxable years 1938, 1939, and 1940." (6 T. C. at p. 1053.) The court of appeals said: "The Tax Court found that the taxpayer was solvent during each of the taxable years 1938, 1939 and 1940, and we accept the finding, although a perusal of the record makes it quite apparent that he was in straitened financial circumstances." (164 Fed. (2d) at p. 596.)

In his petition to the Tax Court the respondent stated, and it has not been disputed, that the value of the leasehold and building had sharply depreciated since his acquisition of them. The neighborhood had changed, stores were vacant or paid less than half of their previous rents, from 1932 to 1938 the value of the property was substantially less than its cost to him, conditions were getting worse and he felt certain that he would sustain a large loss in connection with the property.[1]

The Tax Court's findings describe each bond sale that is material. Some were to the respondent personally and some to his law partner, acting on his behalf. The rest were made indirectly to the respondent through brokers or through the bondholders' committee. The Tax Court said that each sale that was made through a broker or the committee was closely akin to an open market transaction. It made no finding that any seller intended to transfer or release something for nothing. It referred to all of the respondent's acquisitions of bonds as purchases. Apparently the bonds were payable to bearer and the Tax Court referred to them as negotiable bonds. Each seller made a complete transfer to the respondent of all the seller's rights to or under the bonds. Each seller thus determined the amount of his own loss on his investment. Each knew that the maker of the bond would acquire or secure control over it and would thus be enabled to reduce his liabilities by its face amount. Except for the 10 percent paid on each bond in 1937, there is no evidence that any bondholder at any time received any partial payment on any bond or consented to a reduction of the indebtedness evidenced by the bond. There is no suggestion that any of the respondent's payments made in 1938, 1939 or 1940 were made specifically in partial reduction of the respondent's obligation as evidenced by a bond or that any bondholder specifically discharged him from any part of the balance of that obligation. On the other hand, it does appear that each of such payments was made in consideration of the transfer to the respondent of title to the entire bond. Each bond was delivered to the respondent evidencing his obligation for its full original face amount, less only the 10 percent payment made, on account, in 1937. At the time of the trial, the respondent apparently still held the purchased bonds "intact." The court of appeals repudiated any distinction made by the Tax Court for present purposes between the direct and indirect sales to the respondent. The court of appeals based its decision on each seller's knowledge that he was transferring his bond to the maker of it. Thus far we agree. The court of appeals, however, without any finding of intent by the respective sellers to transfer or release something for nothing, as distinguished from an intent to get the highest available price for their entire claims, treated the respondent's gain from each purchase as exempt from the taxation imposed

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[1] In his petition to the Tax Court, the respondent, in describing the sale of bonds to him at a discount in 1939, said:

"It was self interest and good business judgment exercised by all prudent persons to take cash settlements, when otherwise greater losses might be incurred. I have done that very thing myself, and have advised clients to do so in similar circumstances. Most real estate bonds in Chicago were selling from 5c to 25c on the dollar in 1932 to 1940."

In the instant case the respondent was found to have been solvent before, as well as after, his realization of the gains in question. The payment of the bonds purchased by him was secured by the mortgage of his leasehold property which property had a fair market value substantially in excess of the face amount of the bonds. The record fails to establish any sufficient basis for a claim that the respondent had suffered losses which, for tax purposes, offset his gains from his purchase of the bonds. Little of the $90,000 originally received by him for the bonds was used to purchase property. There is no finding or substantial evidence showing specifically how those funds were invested. Even if they are traced, in part, into the addition made to the building on the leasehold premises and into the discharge of the then existing encumbrance on those premises, the total so used is not shown and the shrinkage in the value of those investments is not clearly ascertained in the taxable years in question. The ratio of the loss in value of the leasehold property indicated by the Tax Court findings is about 32 percent of its cost in 1925 but this loss is merely based upon estimates. The respondent claims a larger shrinkage but there is not a sufficient ascertainment of it to permit consideration of its use as an offset to the respondent's gains in 1938, 1939 or 1940. See 2 Mertens, Law of Federal Income Taxation, section 11.20 and n. 99 (1942).

by section 22(a) of the Revenue Act of 1938 [2] and of the Internal Revenue Code, because that court felt itself obliged by precedent to classify each such gain as a "gift" under section 22(b)(3) of that Act [3] and Code. We hold, however, that those sections do not, in the light of the decisions of this Court, permit that result.

The first test of the taxability of such gains relates to their inclusion within the gross income of the taxpayer under section 22(a), without reference to the specific exclusions made from it by section 22(b). The other test consists of the application to such gains of any of those specific exclusions. We hold that these gains come within section 22(a) but not within any of the exclusions from gross income stated in section 22(b).

The respondent realized an immediate financial gain from his purchase of these bonds at a discount. By that acquisition he was enabled, at will, to cancel them and thus discharge himself from liability to pay them. While the record indicates that he held them "intact," apparently without crediting released indebtedness on them or otherwise physically canceling them in whole or in part (except for the 10 percent payments made by him on each bond in 1937), his possession of them and control over them is not disputed and the petitioner has properly treated their acquisition as constituting a reduction of the respondent's debts to the extent of their face amount. At the time of their purchase the respondent was unconditionally and primarily bound to pay their face amounts on May 1, 1942, with interest. Although in straitened financial circumstances he was solvent, both before and after his acquisition of the bonds, and the bonds apparently were collectible from him in full through appropriate enforcement proceedings. His acquisition, and consequent control over the discharge of these bonds, therefore, improved his net worth by the difference between their face amount and the price he paid for them. It also relieved him of the semiannual interest payments on them of 5 percent per annum. His acquisition of them likewise reduced the face amount of the lien held by others upon his leasehold property. In the first instance he had received the full face amount in cash for these bonds so that his repurchase of them for 50 percent, or less, of that amount reflected a substantial benefit which he had derived from the use of that borrowed money.[4] These were not purchase money bonds. The gains from their cancellation were not akin to reductions in balances due on the prices of previously acquired property. The respective sellers of the bonds bore no relation to the respondent other than that of creditors. The gains derived by the respondent through these purchases were comparable to those he would have realized if he had purchased, at the same discount, like bonds issued by a third party and had resold them at full face value or had turned them in at full value as a credit upon some other indebtedness of the respondent. His gains were comparable in their nature to those which he would have realized if a third party, pursuant to a contract, had paid off his indebtedness on

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[2] "SEC. 22. GROSS INCOME.

"(a) GENERAL DEFINITION.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *" (52 Stat. 457.)

This was reenacted as section 22(a), I. R. C., 53 Stat. 9, and amended in a manner not material here in 53 Stat. 574–575, 26 U. S. C. (1940 ed.), section 22(a). The Revenue Act of 1938 applied to the respondent's income in 1938 and the Internal Revenue Code to that in 1939 and 1940.

[3] "SEC. 22. GROSS INCOME.

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

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"(3) GIFTS, BEQUESTS, AND DEVISES.—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);"

* * * * * * *

(52 Stat. 458.)

This was reenacted as section 22(b)(3), I. R. C., 53 Stat. 10, 26 U. S. C. (1940 ed.), section 22(b)(3), without material change.

[4] See note 1, *supra*, showing the varied uses to which the respondent applied these proceeds and showing that it is not practicable in this case to determine his losses from his resulting investments, and much less to offset them against his gains now at issue. His tax benefits from those losses are thus postponed until some such occasion as the sale of the properties reflecting them makes it possible to ascertain the losses clearly.

these bonds for him to the extent of the discount at which he purchased them.[5]

The nature of the gain derived by a debtor from his purchase of his own obligations at a discount is the same whether the debtor is a corporation or a natural person. That such a gain comes within the meaning of gross income as used in Federal income tax laws was long ago recognized by the Treasury Department's regulations and by this Court in the leading cases in this field.[6] (*United States* v. *Kirby Lumber Co.*, 284 U. S. 1; *Helvering* v. *American Chicle Co.*, 291 U. S. 426 [Ct. D. 809, C. B. XIII–1, 265 (1934)].) Similar provisions appeared in the regulations in effect in 1938–1940.[7]

If section 22(a) stood alone, without the exclusions stated in section 22(b), the gain realized by the respondent in this case unquestionably would constitute gross income for income tax purposes. The provisions of section 22(b) and the decisions of this Court do not change that result. On the contrary, they confirm it.

A striking demonstration of the meaning given by Congress to section 22(a) appears in its amendments to section 22(b) of the Internal Revenue Code by the Revenue Act of 1939, c. 247, 53 Stat. 862, approved June 29, 1939.[8] These amendments then applied only to taxable years beginning after December 31, 1938, and only to discharges of indebtedness occurring on or after June 29, 1939. The value of these amendments for the purposes of the instant case is not so much in the exclusions which they prescribe, as in the clear light which their own limitations shed upon sections 22(a) and 22(b) to the extent that those sections remain unchanged.

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[5] Such discharges of a taxpayer's debts by payments made for his benefit are realizable income to him. In *Douglas* v. *Willcuts* (296 U. S. 1, 9 [Ct. D. 1041, C. B. XIV–2, 250 (1935)]), this Court said:

"The question is one of statutory construction. We think that the definitions of gross income (Revenue Acts, 1926, section 213; 1928, section 22) are broad enough to cover income of that description. They are to be considered in the light of the evident intent of the Congress 'to use its power to the full extent.' (*Irwin* v. *Gavit*, 268 U. S. 161 [T. D. 3710, C. B. IV–1, 123 (1925)]; *Helvering* v. *Stockholms Bank*, 293 U. S. 84, 89 [Ct. D. 887, C. B. XIII–2, 299 (1934)].) We have held that income was received by a taxpayer, when, pursuant to a contract, a debt or other obligation was discharged by another for his benefit. The transaction was regarded as being the same in substance as if the money had been paid to the taxpayer and he had transmitted it to his creditor. (*Old Colony Trust Co.* v. *Commissioner*, 279 U. S. 716 [Ct. D. 80, C. B. VIII–2, 222 (1929)]; *United States* v. *Boston & Maine Railroad*, 279 U. S. 732 [Ct. D. 73, C. B. VIII–2, 315 (1929)].)"

[6] "* * * By the Revenue Act of (November 23,) 1921, c. 136, section 213(a) gross income includes 'gains or profits and income derived from any source whatever,' and by the Treasury regulations authorized by section 1303, that have been in force through repeated reenactments, 'If the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.' Article 545(1)(*c*) of Regulations 62, under Revenue Act of 1921. See Article 544(1)(*c*) of Regulations 45, under Revenue Act of 1918; Article 545(1)(*c*) of Regulations 65, under Revenue Act of 1924; Article 545(1)(*c*) of Regulations 69, under Revenue Act of 1926; Article 68(1)(*c*) of Regulations 74, under Revenue Act of 1928. We see no reason why the regulations should not be accepted as a correct statement of the law.

"* * * The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here." (*United States* v. *Kirby Lumber Co.*, 284 U. S. 1, 2–3.)

[7] "ART. 22(a)–14. CANCELLATION OF INDEBTEDNESS.—(*a*) *In general.*—The cancellation of indebtedness, in whole or in part, may result in the realization of income. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income in the amount of the debt is realized by the debtor as compensation for his services. A taxpayer realizes income by the payment or purchase of his obligations at less than their face value." * * *

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"ART. 22(a)–18. SALE AND PURCHASE BY CORPORATION OF ITS BONDS.—(1) (*a*) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (*b*) If the corporation purchases any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year." * * * Treasury Regulations 101, promulgated under the Revenue Act of 1938.

In Treasury Regulations 103 promulgated under the Internal Revenue Code, sections 19.22(a)–14 and 19.22(a)–18 were identical with the above. Even today they are the same in Treasury Regulations 111, promulgated under the Internal Revenue Code, as sections 29.22(a)–13 and 29.22(a)–17.

[8] These amendments are contained in section 215 of the Internal Revenue Act of 1939, c. 247, 53 Stat. 862, 875–876, 26 U. S. C. (1940 ed.), sections 22(b)(9), 113(b)(3). They added to the Internal Revenue Code section 22(b)(9) and section 113(b)(3), both relating to the discharge of indebtedness. A cross reference is made to the latter in the former. Such section 215, in its entirety, is as follows:

"SEC. 215. DISCHARGE OF INDEBTEDNESS.

"(a) INCOME FROM DISCHARGE OF INDEBTEDNESS.—Section 22(b) of the Internal Revenue Code (relating to exclusions from gross income) is amended by adding at the end thereof the following new paragraph:

"(9) INCOME FROM DISCHARGE OF INDEBTEDNESS.—In the case of a corporation, the the amount of any income of the taxpayer attributable to the discharge, within the

Unless those sections as they stood in 1938 meant that the gains derived by a debtor corporation from its purchases of its own obligations at a discount resulted in gross income under section 22(a), there was no need for these 1939 amendments. Furthermore, as the status of natural persons and corporations is not differentiated in section 22(a), the new amendments make it equally clear that, inasmuch as they relieve only certain corporations from the taxability of gains derived from their purchases of their own obligations at a discount, it must be that similar gains derived by natural persons also remain taxable under section 22(a). The strength of this reflection of the amendments upon the unamended sections is emphasized by their temporary character. The amendments expressly provide that they shall not apply to a taxable year beginning after December 31, 1942. This indicates that, for its permanent program, Congress regarded such gains as properly taxable and it indicates that the amendments were intended to authorize temporary changes in policy and were not clarifications of exisiting or continuing tax policies. While the time limit originally prescribed has been subsequently extended, the extensions have been made by separate Acts, each for a period of one to three years.[9] This repeated emphasis upon their temporary character increases the contrast which they make with the permanent policy of Congress as to the general taxability of this kind of gains under section 22(a).

These amendments describe gains corresponding almost precisely with those derived by the respondent from his transactions in the instant case but the amendments apply only to corporate gains. They thus indicate that such gains were recognized as not having been excluded from gross income by section 22(b)(3) or by any other section. If they had been so excluded there would have been no need for the new amendments to exclude those which they did, even temporarily. Furthermore, those gains are not excluded from gross income

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taxable year, of any indebtedness of the taxpayer or for which the taxpayer is liable evidenced by a security (as hereinafter in this paragraph defined) if—

"(A) it is established to the satisfaction of the Commissioner, or

"(B) it is certified to the Commissioner by any Federal agency authorized to make loans on behalf of the United States to such corporation or by any Federal agency authorized to exercise regulatory power over such corporation.

that at the time of such discharge the taxpayer was in an unsound financial condition, and if the taxpayer makes and files at the time of filing the return, in such manner as the Commissioner, with the approval of the Secretary, by regulations prescribes, its consent to the regulations prescribed under section 113(b)(3) then in effect. In such case the amount of any income of the taxpayer attributable to any unamortized premium (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be included in gross income and the amount of the deduction attributable to any unamortized discount (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be allowed as a deduction. As used in this paragraph the term 'security' means any bond, debenture, note, or certificate, or other evidence of indebtedness, issued by any corporation, in existence on June 1, 1939. This paragraph shall not apply to any discharge occurring before the date of the enactment of the Revenue Act of 1939, or in a taxable year beginning after December 31, 1942.

"(b) BASIS REDUCED.—Section 113(b) of the Internal Revenue Code (relating to the adjusted basis of property) is amended by adding at the end thereof the following new paragraph:

"(3) DISCHARGE OF INDEBTEDNESS.—Where in the case of a corporation any amount is excluded from gross income under section 22(b)(9) on account of the discharge of indebtedness the whole or a part of the amount so excluded from gross income shall be applied in reduction of the basis of any property held (whether before or after the time of the discharge) by the taxpayer during any portion of the taxable year in which such discharge occurred. The amount to be so applied (not in excess of the amount so excluded from gross income, reduced by the amount of any deduction disallowed under section 22(b)(9)) and the particular properties to which the reduction shall be allocated, shall be determined under regulations (prescribed by the Commissioner with the approval of the Secretary) in effect at the time of the filing of the consent by the taxpayer referred to in section 22(b)(9). The reduction shall be made as of the first day of the taxable year in which the discharge occurred except in the case of property not held by the taxpayer on such first day, in which case it shall take effect as of the time the holding of the taxpayer began.

"(c) TAXABLE YEARS TO WHICH APPLICABLE.—The amendments made by this section shall be applicable to taxable years beginning after December 31, 1938." (53 Stat. 875-876.)

See also, Treasury Regulations 103, promulgated under the Internal Revenue Code; section 19.22(b)(9)-1, Income from discharge of indebtedness; section 19.22(b)(9)-2, Making and filing of consent; section 19.113(b)(3)-1, Adjusted basis: Discharge of corporate indebtedness: General rule; section 19.113(b)(3)-2, Adjusted basis: Discharge of corporate indebtedness: Special cases.

[9] While section 22(b)(9) originally did not apply to any discharge occurring in a taxable year beginning after December 31, 1942 (53 Stat. 875), this date was changed to December 31, 1945 (56 Stat. 811); December 31, 1946 (59 Stat. 574); December 31, 1947 (60 Stat. 749); and December 31, 1949 (61 Stat. 179).

for all purposes of the income tax laws. Section 22(b)(9) excludes them only from the ordinary income taxes for the taxable year in which the taxpaying corporation purchases its own securities at a discount.[10] Furthermore, the exclusion under section 22(b)(9), as distinguished from other exclusions under section 22(b), is available only upon the express condition that the taxpayer makes and files at the time of filing the return its consent to the regulations [11] prescribed under section 113(b)(3)[12] then in effect. That section and such regulations require that, where any amount is excluded by a corporation from its gross income under section 22(b)(9) on account of its discharge of its own indebtedness, the whole or a part of such amount shall be applied to the reduction of the basis of property held by the taxpayer during any portion of the taxable year in which such discharge occurs. The amount to be applied and the properties to which the reduction shall be allocated are to be determined by regulations approved by the Secretary of the Treasury. This means that such a gain, instead of being completely excluded as exempt from taxation, is postponed, for income tax purposes, until a later date when the property is disposed of in a way which will permit another form of ascertainment of the taxpayer's gain or loss in its disposition.[13] These provisions therefore demonstrate that Congress, at least since 1939, has prescribed that, in order for a corporate taxpayer to exclude from its gross income under section 22(a) certain gains attributable to the discharge within the taxable year of the taxpayer's indebtedness evidenced by bonds, the taxpayer must consent to the subsequent use of those gains in reducing the basis of property held by the taxpayer during any portion of the taxable year in which such discharge occurred. A corporate taxpayer with gains meeting these specifications but not filing the required consent would be obliged to include those gains in its gross income, unless additional facts brought them under some other exemption. *A fortiori*, a natural person, such as the respondent in the instant case, who has derived gains precisely within these specifications but who, as a natural person, is ineligible to file the required consent is obliged to include those gains in his gross income under section 22(a). It remains, therefore, to consider whether there are facts in this case which bring this respondent's transactions within any exclusion other than that stated in section 22(b)(9).[14]

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[10] The exclusions made by section 22(b) apply to the taxes imposed by the Income Tax Chapter of the Internal Revenue Code. These include the ordinary income taxes but not the additional income taxes such as those imposed on personal holding companies or the excess-profits taxes.

[11] Treasury Regulations 103, *supra*, sections 19.113(b)(3)-1 and 2 cover the subject. They provide a comprehensive procedure for decreasing the cost or other basis of a taxpaying corporation's properties as a condition of its taking advantage of section 22(b)(9). This procedure applies not only in "the case of indebtedness incurred to purchase specific property" but also in "the case of specific property (other than inventory or notes or accounts receivable) against which, at the time of the discharge of the indebtedness, there is a lien (other than a lien securing indebtedness incurred to purchase such property) * * *." It even provides that if any excess of amount excluded from gross income under section 22(b)(9) exceeds those two adjustments, the cost or other basis of all the property of the debtor other than inventory and notes and accounts receivable shall be reduced proportionately and, finally, the balance, if any, of the amount excluded from the debtor's gross income is applied to the reduction of the cost or other basis of the debtor's inventory or notes or accounts receivable. It thus offers affirmatively a broad alternative plan for reaching the corporate debtor's gains from its discharge of its indebtedness at a discount.

[12] See note 8, *supra*.

[13] Subsequent amendments have altered these provisions but have not changed their general effect nor their reflection upon the meaning of section 22(a). For the extension of the temporary nature of the provisions, see note 9, *supra*. The requirement of a specially certified "unsound financial condition" for a corporate taxpayer in order to make section 22(b)(9) applicable was eliminated by the Revenue Act of 1942. That Act also eliminated the limitation to securities in existence on June 1, 1939. (56 Stat. 811.)

In making these temporary provisions Congress had in mind especially the conditions presented by railroads and other corporations then seeking to liquidate heavy indebtedness. The Committees reporting the bills for passage emphasized the limitations that were imposed by these amendments upon corporations seeking to exclude from taxable income the gains derived from their acquisition of their own securities at a discount. (H. R Rep. No. 855, 76th Cong., 1st sess. 5, 23-25 (1939) [C. B. 1939-2, 504]; Sen. Rep. No. 648, 76th Cong., 1st sess. 2-3, 5 (1939) [C. B. 1939-2, 524].) Obviously it was expected that these provisions would decrease the existing burdens of income taxation. It certainly was not intended to impose a burden of postponed taxability upon gains which otherwise would have been completely exempted from taxation by section 22(b)(3).

[14] Several provisions have extended comparable relief to other taxpayers. None of them apply to the respondent. They emphasize, however, the understanding of Congress that, without special provision for their exclusion, the gains of a taxpayer from the discharge of his indebtedness at a discount are required by section 22(a) to be included in his gross income. They recognize that the mere exclusion of "gifts" under section 22(b)(3) is not enough to cover factual situations like those presented in section 22(b)(9) or in the other relief provisions above mentioned.

Among these relief provisions are the following:

Exclusion, from excess profits credit, of income derived from the retirement or discharge by the taxpayer of the taxpayer's own obligations if they have been outstanding more

The only provision for the exclusion of these types of gains from the respondent's gross income that is presented for our consideration is the general exemption of gifts from taxation prescribed by section 22(b)(3).[15] This was applied by this Court in favor of a taxpayer in *Helvering* v. *American Dental Co.*, 318 U. S. 322, as well as by the court below in the instant case. Both the general provision for taxation of income and this provision for the exclusion of gifts from gross income, for income tax purposes, have been in the Federal Income Tax Acts in substantially their present form since the Revenue Act of 1916.[16] The contrast between the provisions is striking. The income taxed is described in sweeping terms and should be broadly construed in accordance with an obvious purpose to tax income comprehensively. The exemptions, on the other hand, are specifically stated and should be construed with restraint in the light of the same policy. Congress could have excluded from the gross income of all taxpayers the gains derived by debtors either from their acquisitions of their own obligations at a discount and their consequent control over them, or from their respective releases from all or part of such obligations by their respective creditors upon the debtor's payment to the creditor of something less than the full amount of the debt. Congress, especially since the Revenue Act of 1938, has been cognizant of this issue and of its power to meet it as stated, but it has chosen to extend such relief only on the above described restricted and temporary basis and only in the case of corporations. In its treatment of the issue Congress also has required the corporate taxpayer's consent to an alternative plan for a reduction of the corporation's basis of property values to be used in later determinations of its gains or losses. This special treatment is far different from the total exclusion of a gain resulting from an exempt gift. If such gains were already exempted as gifts under section 22(b)(3), as representing something transferred to the debtor for nothing, there would have been no need for section 22(b)(9). The conclusion to be drawn is that such transfers as are described in section 22(b)(9) could not, without more, qualify as exempt gifts under section 22(b)(3). The same may be said of the acquisition, by a natural person, of his own obligations as debtor. The facts in the instant case present a situation quite similar to one contemplated by section 22(b)(9) except that the taxpayer here is a natural person. This emphasizes the taxability of the gains before us.

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than 18 months. Internal Revenue Code, sections 711(a)(1)(C), 711(a)(2)(E), and section 711(b)(1)(C) added by the Second Revenue Act of 1940, c. 757 (54 Stat. 976–978), repealed by the Revenue Act of 1945, c. 453 (59 Stat. 568).

Exclusion, from gross income, for income tax purposes, of the income of railroad corporations attributable to their discharge of their indebtedness to the extent realized from a modification or cancellation of indebtedness, pursuant to an order of court. Internal Revenue Code, section 22(b)(10), added by the Revenue Act of 1942, c. 619, 56 Stat. 812, applicable to taxable year beginning after December 31, 1939, but not applicable to any discharge in a taxable year beginning after December 31, 1945; this latter date was extended to December 31, 1946, 59 Stat. 574; December 31, 1947, 60 Stat. 749; and December 31, 1949, 61 Stat. 179.

[15] See note 3, *supra*.

[16] "SEC. 2. (a) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever: * * *

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"SEC. 4. The following income shall be exempt from the provisions of this title [Title I.—Income Tax]:

"The proceeds of life insurance policies paid to individual beneficiaries upon the death of the insured; the amount received by the insured, as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon the surrender of the contract; *the value of property acquired by gift, bequest, devise, or descent* (*but the income from such property shall be included as income*); interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States or its possessions or securities issued under the provisions of the Federal Farm Loan Act of July seventeenth, nineteen hundred and sixteen; the compensation of the present President of the United States during the term for which he has been elected, and the judges of the Supreme and inferior courts of the United States now in office, and the compensation of all officers and employees of a State, or any political subdivision thereof, except when such compensation is paid by the United States Government." [Italics supplied.] (Revenue Act of 1916, c. 463, 39 Stat. 756, 757, 758–759.) See also, An Act To reduce tariff duties and to provide revenue for the Government, and for other purposes. (October 3, 1913.) (38 Stat. 114, 167, section II B.)

In the instant case the relation between the bondholder and the respondent may be assumed in each transaction to have been one in which the ultimate parties were known to each other to be such. There was no suggestion in the evidence or the findings that any bondholder was acting from any interest other than his own. Each transaction was a sale. The seller sought to get as high a price as he could for the bond and the buyer sought to pay as low a price as he could for the same bond. If the transaction had been completely on the open market through a stock exchange, the conduct and intent of each party could have been the same and there would have been little, if any, basis for any claim that the respondent's gain was not taxable income. The mere fact that the seller knew that he was selling to the maker of the bond as his only available market did not change the sale into a gift. In the absence of proof to the contrary, the intent of the seller may be assumed to have been to get all he could for his entire claim. Although the sales price was less than the face of the bond and less than the original issuing price of the bond, there was nothing to indicate that the seller was not getting all that he could for all that he had. There is nothing in the evidence or findings to indicate that he intended to transfer or did transfer something for nothing. The form of the transaction emphasized this relationship. The seller assigned the entire bond to his purchaser. The seller did not first release the maker from a part of the maker's obligation and, having made the maker a gift of that release, then sell him the balance of the bond or vice versa. If the seller actually had intended to give the maker some gift the natural reflection of that gift would have been a credit on the face of the bond or at least some record or testimony evidencing the release. This is not saying that the form of the transaction is conclusive. Assuming that the extension of the maturity of the bonds in the instant case was binding on the creditor, we do not rest this case upon the fact that the sale was made before maturity or that the seller may have received valid consideration for a total release of his claim because the debtor's payment was made before maturity. It is quite possible that a bondholder might make a gift of an entire bond to anyone, including the maker of it. The facts and findings in this case do not establish any such intent of the seller to make a gift in contradiction of the natural implications arising from the sales and assignments which he made. It is conceivable, although hardly likely, that a bondholder, in the ordinary course of business and without any express release of his debtor, might have sold part of his claims on the bonds he held at the full face value of those parts and then have made a gift of the rest of his claims on those bonds to the same debtor "for nothing." It is that kind of extraordinary transaction that the respondent asks us, as a matter of law, to read into the simple sales which actually took place and from which he derived financial gains. We are unable to do so on the findings before us. (Cf. *Bogardus* v. *Commissioner*, 302 U. S. 34 [Ct. D. 1281, C. B. 1937-2, 258].)

The situation in each transaction is a factual one. It turns upon whether the transaction is in fact a transfer of something for the best price available or is a transfer or release of only a part of a claim for cash and of the balance "for nothing." The latter situation is more likely to arise in connection with a release of an open account for rent or for interest, as was found to have occurred in *Helvering* v. *American Dental Co.*, *supra*, than in the sale of outstanding securities, either of a corporation as described in section 22(b)(9), or of a natural person as presented in this case. For these reasons we hold that the Commissioner was justified in finding a taxable gain, rather than an exempt gift, in each of the transactions before us. The judgment of the court of appeals accordingly is reversed and the cause is remanded for further action in accordance with this opinion.

It is so ordered.

Mr. Justice RUTLEDGE, although joining in the Court's judgment and opinion, is of the view that the result is essentially in conflict with that reached in *Helvering* v. *American Dental Co.* (318 U. S. 322).

Dissenting opinion by Mr. Justice REED, with whom Mr. Justice DOUGLAS joins.

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

SECTION 29.22(b)(2)-1: Life insurance—Endowment contracts—Amounts paid other than by reason of the death of the insured. (Also Section 29.22(b)(2)-2.)

1949-3-13014
T. D. 5684

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1941

Regulations 111 amended—Taxation of amounts received as an annuity under an annuity or endowment contract.

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

To Collectors of Internal Revenue and Others Concerned:

On September 30, 1948, notice of proposed rule making relating to taxation of amounts received as an annuity under an annuity or endowment contract was published in the Federal Register (13 F. R. 5663). After consideration of all such relevant matter as was presented by interested persons regarding the proposal, the following amendments to Regulations 111 [26 CFR, Part 29] are hereby adopted.

PARAGRAPH 1. Section 29.22(b)(2)-1 [26 CFR 29.22(b)(2)-1] is amended by adding at the end thereof the following:

For purposes of the preceding sentence, the term "amounts received before the taxable year under such policy" shall not be construed to include so much of any payments as were included in gross income as amounts received as an annuity under an annuity or endowment contract for taxable years ending prior to but not on December 31, 1948. Appropriate adjustment will be required with respect to such payments, or portion thereof, so included as form the basis of a pending or successful claim or suit for refund. For definition of "annuity" see section 29.22(b)(2)-2.

PAR. 2. Section 29.22(b)(2)-2 [26 CFR 29.22(b)(2)-2] is amended as follows:

(A) The first sentence of the first paragraph thereof is stricken out and there is inserted in lieu thereof the following:

As used in section 22(b)(2)(A), "amounts received as an annuity under an annuity or endowment contract" means amounts (based on a computation with reference to life expectancy and mortality tables and payable over a period longer than 1 year) received in periodical installments, whether annually, semiannually, quarterly, monthly, or otherwise. For adjustment in the case of amounts received in periodical installments for a fixed period and included in gross income for taxable years ending prior to but not on December 31, 1948, as an annuity under an annuity or endowment contract see section 29.22(b)(2)-1.

(B) The fourth sentence of the first paragraph thereof is stricken out and there is inserted in lieu thereof the following:

Annuities paid to retired employees pursuant to the Civil Service Retirement Act of May 29, 1930, 46 Stat. 468, 475, as amended (5 U. S. C., chapter 14); and Public Law 426, approved February 28, 1948, 62 Stat. 48, are subject to section 22(b)(2), the aggregate premiums or consideration paid for such annuities being the total of the amounts previously withheld from the compensation of the employees.

PAR. 3. This Treasury Decision shall be effective on the thirty-first day after the date of its publication in the Federal Register.

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

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved January 7, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Published in the Federal Register January 13, 1949)

SECTION 29.22(b)(2)–2: Annuities. 1949–9–13071
I. T. 3949

INTERNAL REVENUE CODE

For Federal income tax purposes, annuity payments received under authority of the Civil Service Retirement Act of May 29, 1930 (46 Stat. 468), as amended by the Act of February 28, 1948 (62 Stat. 48), by survivors of deceased retired civil service employees, or by survivors of deceased civil service employees who died while in service, are taxable to the recipients on the same basis and in the same manner as such payments would have been taxed to the employees if received by them, i. e., in accordance with the "3 percent rule." In applying the "3 percent rule," the unrecovered cost of the annuity at the time of any change in the number of survivors must be prorated to the survivors in proportion to the amount of the annuity to be received by each of them, and the taxable amount of the annuity must likewise be prorated.

Advice is requested as to the proper treatment, for Federal income tax purposes, of annuity payments received by survivors of former civil service employees under the authority of the Civil Service Retirement Act of May 29, 1930 (46 Stat. 468), as amended by the Act of February 28, 1948 (62 Stat. 48).

The above-cited Act, as amended, makes provision, under certain circumstances, for annuity payments to survivors of retired civil service employees and survivors of deceased civil service employees who died while in service. Under section 4 of such Act, a married male employee may, upon retirement, elect a reduced annuity with a continuing annuity upon his death to his widow, and an unmarried employee may make a similar election naming an individual having an insurable interest in the employee. Under section 8 of the Act, each annuitant retired prior to April 1, 1948, was granted an increase in rate and was permitted, in lieu of accepting the increase, to elect to retain his or her original annuity and name his wife (or her husband) to receive annuity benefits after the original annuitant's death. Under section 12(c) of the Act, a specified annuity is payable upon the death of an employee leaving a widow age 50 or over. In general, under the same section, upon the death of an employee or retired employee leaving (1) a widow under age 50 and an unmarried child or children under age 18, or (2) leaving no widow or widower but an unmarried child or children under age 18, specified annuities are payable to the widow and/or children.

Section 29.22(b)(2)–2 of Regulations 111 provides that annuities paid to retired employees pursuant to the Civil Service Retirement

Act, as amended, are subject to the provisions of section 22(b)(2) of the Internal Revenue Code which reads in part as follows:

> * * * Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income under this chapter [Chapter 1 of the Code] or prior income tax laws in respect of such annuity equals the aggregate premiums or consideration paid for such annuity. * * *

In the case of a civil service employee, the cost of annuities for himself and his survivors is the aggregate amount deducted from his salary for such purpose under the Civil Service Retirement Act, as amended, plus any additional amounts voluntarily paid into the retirement fund by him.

It is held that annuity payments received under authority of the Civil Service Retirement Act of May 29, 1930, as amended, by survivors of deceased retired civil service employees, or by survivors of deceased civil service employees who died while in service, are taxable to the recipients on the same basis and in the same manner as such payments would have been taxed to the employees if received by them, i. e., in accordance with the "3 percent rule."

In those cases in which the total cost of annuities has not been recovered tax free by the employee under the "3 percent rule," the surviving widow, or surviving widow and child or children, or surviving child or children, as the case may be, who are in receipt of annuity payments, should report in their gross incomes their *pro rata* shares of an amount equal to 3 percent of the cost of the annuities until the total amount excluded from gross income by the employee and his survivors equals the cost of the annuities to the decedent, after which the full amount of annuity payments received each year must be reported in the gross incomes of the recipients. In applying the "3 percent rule," the unrecovered cost of the annuity at the time of any change in the number of survivors must be prorated to the survivors in proportion to the amount of the annuity to be received by each of them, and the taxable amount of the annuity must likewise be prorated.

Where a survivor's gross income, including his taxable portion of an annuity, amounts to $600 or more, a Federal income tax return must be filed by him or on his behalf; where such gross income is less than $600, no return is required.

SECTION 29.22(b)(2)–2: Annuities.

INTERNAL REVENUE CODE

Regulations 111 amended. (See T. D. 5684, page 50.)

SECTION 22(c).—GROSS INCOME: INVENTORIES

SECTION 29.22(c)–6: Inventories of livestock raisers and other farmers. 1949–2–13009 T. D. 5683

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1941

Section 29.22(c)–6 amended with respect to farmer's change to inventory method of accounting.

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

To Collectors of Internal Revenue and Others Concerned:

On June 9, 1948, notice of proposed rule making with respect to a farmer's change to the inventory method of accounting was published in the Federal Register (13 F. R. 3096). After consideration of all such relevant matter as was presented by interested persons regarding the proposal, the amendments to Regulations 111 [26 CFR, Part 29] set forth below are hereby adopted.

Section 29.22(c)-6 of Regulations 111, as amended by Treasury Decision 5423 [C. B. 1945, 70], approved December 15, 1944, is further amended by striking the first paragraph and by inserting in lieu thereof the following:

A farmer may make his return upon an inventory basis instead of the cash receipts and disbursements basis. It is optional with the taxpayer which of these methods of accounting is used, but, having elected one method, the option so exercised will be binding upon the taxpayer for the year for which the option is exercised and for subsequent years unless another method is authorized by the Commissioner as provided in section 29.41-2.

Formal application for permission to change from the cash receipts and disbursements basis to an inventory basis of accounting shall not be required in the case of a change made for a taxable year beginning before December 30, 1948, the date of approval of Treasury Decision 5683.

In any change of accounting from the cash receipts and disbursements basis to an inventory basis, whether made for a taxable year beginning before or after December 30, 1948, adjustments shall be made, at the option of the taxpayer, in accordance with one or the other of the two methods outlined in (1) and (2) below:

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

GEO. J. SCHOENEMAN,
Commissioner.

Approved December 30, 1948.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 5, 1949, 8: 48 a. m.)

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

SECTION 29.22(d)-1: Inventories under elective method. 1949-11-13092
I. T. 3953

INTERNAL REVENUE CODE

Price indices for January, 1949, published by the Bureau of Labor Statistics under date of March 10, 1949, for use by department stores employing the retail inventory and elective inventory methods.

The following price indices for January, 1949, published by the Bureau of Labor Statistics for use by department stores employing the retail inventory and elective inventory methods, are accepted by the Bureau of Internal Revenue pursuant to Treasury Decision 5605

(C. B. 1948-1, 16), approved March 4, 1948, and Mimeograph 6244 (C. B. 1948-1, 21), dated March 9, 1948, for appropriate application to inventories for taxable years of 12 months ended on December 31, 1948, and January 31, 1949. The indices published herein represent a continuation of department groups and prices shown in Table I, Table II (January to January), and Table III of I. T. 3904 (C. B. 1948-1, 18), as extended by the price indices and data for July, 1948, shown in I. T. 3927 (C. B. 1948-2, 26).

Bureau of Labor Statistics, department store inventory price indices, by department groups

[January, 1941=100]

Group	January, 1948	January, 1949	January, 1948, to January, 1949, percent increase
I. Piece goods, domestics, and draperies	218.6	211.4	-3.3
II. Shoes	190.3	196.2	3.1
III. Ladies' underwear	178.2	180.3	1.2
IV. Ladies' outerwear and girls' wear	181.3	182.8	.8
V. Men's and boys' wear	190.0	189.5	-.3
VI. Furniture and bedding	184.9	192.3	4.0
VII. Home furnishings	162.5	170.7	5.0
VIII. Major appliances and electrical goods	170.1	171.0	.5
IX. Notions and toilet articles	140.5	142.1	1.1
X. Ladies' accessories	180.5	171.2	-5.2
Total, Groups I, II, III, IV, V, IX, and X	184.5	184.7	.1
Total, Groups VI, VII, and VIII	171.0	177.2	3.6
Store total	180.5	182.3	1.0

SECTION 29.22(d)-7: Inventory liquidation and replacement.

INTERNAL REVENUE CODE

Interim allowance in respect of overpayment of tax. (See Mim. 6361, page 126.)

SECTION 22(k).—GROSS INCOME: ALIMONY, ETC., INCOME

SECTION 29.22(k)-1: Alimony and separate maintenance payments—Income to former wife. (Also Section 23(u), Section 29.23(u)-1.)

1949-1-13000
I. T. 3934

INTERNAL REVENUE CODE

Where the time for making payments of alimony under an interlocutory decree of divorce in the State of California is limited to the duration (12 months) of the decree, the payments made pursuant to the decree are not includible in the gross income of the wife under section 22(k) of the Internal Revenue Code, and are not deductible from the gross income of the husband under section 23(u) of the Code.

I. T. 3761 (C. B. 1945, 76) modified.

Advice is requested whether payments received by a wife from her husband during the period of an interlocutory decree of divorce in the State of California, no provision being made for payment of alimony after the final decree, are includible in the gross income of the wife under section 22(k) of the Internal Revenue Code and deductible from the gross income of the husband under section 23(u) of the Code.

Section 22(k) of the Internal Revenue Code provides in part as follows:

SEC. 22. GROSS INCOME.

* * * * * * *

(k) ALIMONY, ETC., INCOME.—In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, periodic payments (whether or not made at regular intervals) received subsequent to such decree in discharge of * * * a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includible in the gross income of such wife * * * Installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property, specified in the decree or instrument shall not be considered periodic payments for the purposes of this subsection; except that an installment payment shall be considered a periodic payment for the purposes of this subsection if such principal sum, by the terms of the decree or instrument, may be or is to be paid within a period ending more than 10 years from the date of such decree or instrument * * *

Section 23(u) of the Code provides in part as follows:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(u) ALIMONY, ETC., PAYMENTS.—In the case of a husband described in section 22(k), amounts includible under section 22(k) in the gross income of his wife, payment of which is made within the husband's taxable year. * * *

The Bureau held in I. T. 3761 (C. B. 1945, 76) that periodic payments made pursuant to an interlocutory decree of divorce in the State of California by a husband for the support of his wife are includible in her gross income under section 22(k) of the Internal Revenue Code, and are deductible by the husband under section 23(u) of the Code.

Under section 139 of Deering's Civil Code of California, permanent alimony may be awarded. However, an award of alimony must be made by the interlocutory decree. If the interlocutory decree does not contain a provision for alimony, the decree may not, after the period for appeal has expired, be modified to include a provision for alimony. (See *Bacigalupi* v. *Bacigalupi*, 72 Cal. App. 654, 238 Pac. 93.) It is stated that many interlocutory decrees in the State of California provide for the payment of alimony in specified monthly amounts for the duration (12 months) of such decrees and that, in such cases, although the court could, in its final decree, provide for permanent alimony, the court does not usually do so.

In view of the foregoing, it is held that where the time for making payments of alimony under an interlocutory decree of divorce in the State of California is limited to the duration (12 months) of the decree, the payments made pursuant to the decree do not qualify as "periodic payments" under section 22(k) of the Internal Revenue Code. Accordingly, such alimony payments are not includible in the gross income of the wife under section 22(k) of the Code and are not deductible from the gross income of the husband under section 23(u) of the Code. (Cf. *J. B. Steinel* v. *Commissioner*, 10 T. C. 409.) I. T. 3761, *supra*, is hereby modified to accord with the conclusion reached herein.

SECTION 29.22(k)-1: Alimony and separate maintenance payments—Income to former wife. (Also Section 23(u), Section 29.23(u)-1.) 1949-7-13053 I. T. 3944

INTERNAL REVENUE CODE

Treatment for Federal income tax purposes of payments for alimony made pursuant to an interlocutory decree of divorce in the State of California.

Withdrawal of modification of I. T. 3761 (C. B. 1945, 76).

Advice is requested relative to payments for alimony pursuant to an interlocutory decree of divorce in the State of California, and particularly with respect to modification of I. T. 3761 (C. B. 1945, 76) by I. T. 3934 (page 54, this Bulletin).

I. T. 3761, *supra*, holds that "periodic payments" made pursuant to an interlocutory decree of divorce in the State of California by a husband for the support of his wife are includible in her gross income under section 22(k) of the Internal Revenue Code and deductible by the husband under section 23(u) of the Code. That ruling relates to payments made pursuant to an interlocutory decree which awards alimony for an *indefinite* period of time.

I. T. 3934, *supra*, holds that where the time for making payments of alimony under an interlocutory decree of divorce in the State of California is limited to the duration (12 months) of the decree, the payments made pursuant to the decree are not includible in the gross income of the wife and are not deductible from the gross income of the husband under sections 22(k) and 23(u) of the Internal Revenue Code, respectively. That ruling relates to payments made pursuant to an interlocutory decree which awards alimony for a *definite* period of time.

Payments to be made for a definite period of time are considered to be "installment payments" and not "periodic payments" within the meaning of section 22(k) of the Code. Accordingly, I. T. 3761, *supra*, and I. T. 3934, *supra*, are distinguishable, and modification of the former ruling is withdrawn.

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

SECTION 29.23(a)-1: Business expenses.

INTERNAL REVENUE CODE

Federal stamp taxes paid by corporation on issuance of its bonds. Nonretroactive application of I. T. 3806 (C. B. 1946-2, 41). (See Mim. 6367, page 63.)

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

SECTION 29.23(c)-1: Taxes. 1949-3-13015
(Also Section 24, Sections 29.24-2 and 29.24-5.) I. T. 3937

INTERNAL REVENUE CODE

The Alabama gross receipts (sales) tax imposed by section 753, article 10, Title 51, Code of Alabama, 1940, is imposed upon the vendor and is deductible by him under section 23(c)(1) of the Internal Revenue Code. Such tax should be capitalized by a vendee who pays the tax in connection with the purchase of equipment for use in trade or business where the cost of such equipment is required to be capitalized for Federal income tax purposes.

The Alabama use tax imposed by section 788 (as amended), article 11, Title 51, Code of Alabama, 1940, is imposed upon the vendee and is deductible by him under section 23(c)(1) of the Internal Revenue Code. Such tax may not be capitalized except as provided in section 24(a)(7) of the Code.

Advice is requested whether a vendee may deduct the Alabama gross receipts (sales) tax and the Alabama use tax, for Federal income tax purposes, where such taxes are paid in connection with the purchase of equipment for use in the vendee's trade or business.

Sections 753 and 776 of article 10, Title 51, Code of Alabama, 1940, provide in part as follows:

SEC. 753. TAX LEVIED ON GROSS RECEIPTS.—There is hereby levied, in addition to all other taxes of every kind now imposed by law, and shall be collected as herein provided, a privilege or license tax against the person on account of the business activities and in the amount to be determined by the application of rates against gross sales, or gross receipts, as the case may be, as follows: (a) Upon every person, firm or corporation engaged, or continuing within this State, in business of selling at retail any tangible personal property whatsoever, including merchandise and commodities of every kind and character, (not including, however, bonds or other evidences of debt or stocks) * * *

* * * * * * *

SEC. 776. TAX TO BE ADDED TO PURCHASE PRICE; REFUNDS UNLAWFUL; PENALTY.—It shall be unlawful for any person, firm, corporation, association or copartnership engaged in or continuing within this State in the business for which a license or privilege tax is required by this article to fail or refuse to add to the sales price and collect from the purchaser the amount due by the taxpayer on account of said tax provided herein, or the amount due by said taxpayer on account of any taxes provided herein * * *

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 23(c)(3) of the Internal Revenue Code, relating to retail sales taxes, provides as follows:

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

as if such amount constituted a tax imposed upon and paid by such purchaser. [Italics supplied.]

Section 23(c)(3) of the Code, *supra*, is not applicable to the instant case since that section precludes the vendee from deducting a retail sales tax where the tax is paid in connection with property purchased for consumption or use in the vendee's trade or business.

It is held that the tax imposed by section 753, article 10, Title 51, Code of Alabama, 1940, is imposed upon the vendor and is deductible by him under section 23(c)(1) of the Internal Revenue Code. Therefore, the amount expended by the vendee is not deductible by him as a tax. If the cost of the equipment purchased by a vendee is required to be capitalized for Federal income tax purposes, the amount of the tax attributable to the equipment should also be capitalized.

With respect to the Alabama use tax, section 788, as amended, and section 791, article 11, Title 51, Code of Alabama, 1940, provide in part as follows:

SEC. 788. PROPERTY TAXED; PERSONS LIABLE.—(a) An excise tax is hereby imposed on the storage, use or other consumption in this State of tangible personal property purchased at retail on or after the first of March, 1939, for storage, use or other consumption in this State * * * regardless of whether the retailer is or is not engaged in business in this State * * * Every person storing, using or otherwise consuming in this State tangible personal property purchased at retail shall be liable for the tax imposed by this article, and the liability shall not be extinguished until the tax has been paid to this State; provided, however, that a receipt from a retailer maintaining a place of business in this State or a retailer authorized by the department [department of revenue of the State of Alabama], under such rules and regulations as it may prescribe, to collect the tax imposed hereby and who shall for the purposes of this article be regarded as a retailer maintaining a place of business in this State, given to the purchaser in accordance with the provisions of section 791 of this title, shall be sufficient to relieve the purchaser from further liability for a tax to which such receipt may refer.

* * * * * * *

SEC. 791. SELLER TO COLLECT TAX; REGULATIONS; PENALTY.—Every such seller making sales of tangible personal property for storage, use or other consumption in this State * * * shall at the time of making such sales or, if the storage, use or other consumption of the tangible personal property is not then taxable hereunder, at the time such storage, use or other consumption becomes taxable hereunder, collect the tax imposed by this article from the purchaser, and give to the purchaser a receipt therefor in the manner and form prescribed by the department. The tax required to be collected by the seller from the purchaser shall be displayed separately from the list, advertised in the premises, marked or other price on the sales check or other proof of sales. It shall be unlawful for any such seller to advertise or hold out or state to the public or to any customer, directly or indirectly, that the tax or any part thereof imposed by this article will be assumed or absorbed by the seller or that it will not be added to the selling price of the property sold, or if added that it or any part thereof will be refunded. * * *

The use tax imposed by section 788 (as amended), article 11, Title 51, Code of Alabama, 1940, is imposed upon the vendee and is deductible by him under the provisions of section 23(c)(1) of the Internal Revenue Code. Therefore, this tax may not be capitalized except as provided in section 24(a)(7) of the Code.

SECTION 29.23(c)-1: Taxes. 1949-3-13016
(Also Section 24, Section 29.24-5.) I. T. 3938

INTERNAL REVENUE CODE

The Ohio use and storage tax imposed by section 5546-26, Ohio General Code, is imposed upon the consumer and is deductible by him under section 23(c)(1) of the Internal Revenue Code. Such tax may not be capitalized for Federal income tax purposes except as provided in section 24(a)(7) of the Code.

Advice is requested whether a vendee may deduct the Ohio use and storage tax for Federal income tax purposes.

The pertinent provisions of the Ohio General Code relating to the use and storage tax read in part as follows:

SEC. 5546-26. TAX LEVY ON STORAGE, USE, ETC.; PURPOSE; RATES; EXCEPTIONS.—For the use of the general revenue fund of the State, an excise tax is hereby levied on the storage, use, or other consumption in this State of tangible personal property purchased on and after the 1st day of January, 1936, for storage, use, or other consumption in this State * * *

* * * * * * *

Each consumer, storing, using, or otherwise consuming in this State tangible personal property purchased for such purpose or purposes, shall be liable for the tax imposed by this act, and such liability shall not be extinguished until the tax has been paid to this State; * * *

* * * * * * *

SEC. 5546-28. COLLECTION AND PAYMENT OF TAX.—Every seller, engaged in the business of selling tangible personal property in this State, for storage, use, or other consumption in this State, to which the provisions of section 5546-26 of the General Code apply, shall and any other seller who is authorized by rule or regulation of the commission to do so may collect from the consumer the full and exact amount of the tax payable in respect of each such storage, use, or consumption * * *

SEC. 5546-29. [RETURN FILED WITH COMMISSION; DUPLICATE AND PAYMENT TO TREASURER; SELLER.]—Every person storing, using, or consuming tangible personal property, the storage, use, or consumption of which is subject to the tax imposed by this act, when such tax was not paid to a seller, shall * * * file with the commission a return * * * At the time of filing each such return, each such person shall file with the treasurer of state an executed duplicate thereof and shall pay to the treasurer of state the amount of tax imposed by this act with respect to the purchases covered by the return. * * *

The payment to the State of the tax, interest and penalty assessed by the commission under this section shall relieve the seller, who sold the property with regard to the storage, use, or other consumption on which the tax was paid to the State under this section, from the payment to the State of the amount of the tax which he is required by this act to collect from the purchaser.

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 29.23(c)-1(*a*) of Regulations 111 provides that in general taxes are deductible only by the person upon whom they are imposed.

It is evident that the Ohio use and storage tax is a tax upon the consumer, and, in general, the seller's responsibility is limited to collection of such tax from consumers and payment of the tax to the State.

Accordingly, it is held that the Ohio use and storage tax imposed by section 5546-26, Ohio General Code, is imposed upon, and deductible by, the consumer under section 23(c)(1) of the Internal Revenue Code. Therefore, this tax may not be capitalized except as provided in section 24(a)(7) of the Code.

SECTION 29.23(c)–1: Taxes.

1949–3–13017
I. T. 3939

INTERNAL REVENUE CODE

The taxes imposed by section 3 of Chapter 27, Extraordinary Session, 1946, Session Laws of Alaska, upon gross sales, exports, and remuneration for services do not constitute retail sales taxes within the meaning of section 23(c)(3) of the Internal Revenue Code, and, for Federal income tax purposes, they are not deductible under that section by a purchaser. Such taxes are deductible under section 23(c)(1) of the Code by the seller of the goods, both at retail and wholesale, and/or the one receiving the remuneration for services.

Advice is requested whether the taxes on gross sales, exports, and/or remuneration for services, levied by the Territory of Alaska, are deductible by the purchaser.

Under section 3 of Chapter 27, Extraordinary Session, 1946, Session Laws of Alaska, the Alaska World War II Veterans' Revolving Fund was created, and a "tax" is levied to carry out the purposes of the World War II Veterans' Act on gross sales, exports, and/or remuneration for services, to be collected and deposited in the revolving fund.

The pertinent provisions of the above-cited act are in part as follows:

(a) * * * There is hereby levied the following tax to carry out the purposes of the Alaska World War II Veterans' Act on gross sales, exports and/or remuneration for services * * *

(1) One per centum of the gross revenue derived from all retail sales made in the Territory, said revenue being computed in dollars and the tax payable by the retailer, and/or 1 per centum of the gross revenue, computed in dollars, derived from services performed in the Territory, payable by the person receiving such remuneration; * * *

(2) One-half of 1 per centum of the gross revenue, computed in dollars, derived from wholesale sales made in the Territory, payable by the wholesaler, and one-half of 1 per centum of the gross market value, computed in dollars at the time of export, of all fish, gold, fur, lumber, and other commodities produced, mined, caught, manufactured or processed in the Territory, payable by the exporter; * * *

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 29.23(c)–1(*a*) of Regulations 111 provides that in general taxes are deductible only by the person upon whom they are imposed.

Section 23(c)(3) of the Internal Revenue Code, relating to retail sales taxes, provides as follows:

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

It is held that the taxes imposed by section 3 of Chapter 27, Extraordinary Session, 1946, Session Laws of Alaska, do not constitute retail sales taxes within the meaning of section 23(c)(3) of the Internal Revenue Code, *supra*, and therefore are not deductible under that section by a purchaser. Such taxes are deductible under section 23(c)(1) of the Code by the seller of the goods, both at retail and wholesale, and/or the one receiving the remuneration for services.

SECTION 29.23(c)-1: Taxes. 1949-10-13085
I. T. 3952

INTERNAL REVENUE CODE

The tax imposed by the Cigarette Tax Act of the State of New Jersey (chapter 65, P. L. 1948, as amended), effective July 1, 1948, is deductible for Federal income tax purposes under section 23(c)(1) of the Internal Revenue Code by licensed distributors who purchase, affix, and cancel the cigarette tax stamps and by licensed consumers who remit the tax directly to the State. The tax is not a retail sales tax and is not deductible by purchasers under section 23(c)(3) of the Code.

Advice is requested whether a purchaser may deduct, for Federal income tax purposes, the tax imposed by the Cigarette Tax Act of the State of New Jersey (chapter 65, P. L. 1948, as amended), which became effective July 1, 1948.

The tax in question is imposed on the sale, use, or possession for sale or use within the State of New Jersey of all cigarettes at the rate of 1½ cents for each 10 cigarettes or fraction thereof. The law defines and provides for the licensing of a "distributor," "wholesale dealer," "retail dealer," and "consumer." Pertinent excerpts from the law provide as follows:

102. DEFINITIONS.

* * * * * * *

c. "Distributor" means and includes any person, wherever resident or located, who brings or causes to be brought into this State unstamped cigarettes purchased directly from the manufacturers thereof; and also any person who manufactures or produces, or causes to be manufactured or produced, cigarettes and sells, uses or distributes the same within this State.

* * * * * * *

f. "Consumer" means any person except a distributor who brings or causes to be brought into this State for consumption, storage or use in this State cigarettes to which New Jersey revenue stamps have not been attached.

* * * * * * *

205. REPORTS REQUIRED; PENALTY REQUIRED FOR NOT FILING REPORTS.

Every licensed distributor shall file with the director [director of the division of taxation, State department of taxation and finance] on or before the twentieth day of each month, a report in such form as the director shall prescribe, which report shall disclose the number of cigarettes on hand on the first and last days of the calendar month immediately preceding the month in which such report is required; together with such information concerning the amount of stamps purchased, used, and on hand during the report period; together with any other information for the report period that the director shall prescribe.

* * * * * * *

Every licensed consumer who has acquired cigarettes for use, storage or consumption subject to the tax shall, on or before the twentieth day of the month following receipt of such cigarettes, complete and file with the director, in such form as the director shall prescribe, a report showing the amount of cigarettes so received. Said report shall be accompanied by a remittance for the full amount of the tax due.

* * * * * * *

401. DIRECTOR TO PROVIDE REVENUE STAMPS.

The taxes imposed and levied by this act shall be paid through the use of stamps, except as provided in section 205 (consumers) of this act. The director shall * * * provide for the sale thereof to licensed distributors. Only licensed distributors shall affix and cancel stamps. * * *

There is no provision of the New Jersey statute requiring wholesale or retail dealers to purchase, affix, and cancel cigarette tax stamps or to make direct remittances of the tax to the designated State official. Therefore, it appears that there are two classes of taxpayers, i. e., licensed distributors who pay the tax by affixing and canceling stamps and licensed consumers who pay the tax directly without the use of stamps.

Section 23(c) of the Internal Revenue Code provides in part as follows:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(c) TAXES GENERALLY.—

(1) ALLOWANCE IN GENERAL.—Taxes paid or accrued within the taxable year, except—

* * * * * * *

(3) RETAIL SALES TAX.—In the case of a tax imposed by any State, * * * upon persons engaged in selling tangible personal property at retail, which * * * is a stated sum per unit of such property sold, * * * if the amount of such tax is separately stated, then to the extent that the amount so stated is paid by the purchaser (otherwise than in connection with the purchaser's trade or business) to such person such amount shall be allowed as a deduction * * *

Section 29.23(c)–1(*a*) of Regulations 111 provides in part that in general taxes are deductible only by the person upon whom they are imposed.

It is clear that the New Jersey cigarette tax which is paid by means of stamps is imposed upon and paid by licensed distributors and that the cigarette tax which is paid by monthly remittances is imposed upon and paid by licensed consumers. It is also clear that "persons engaged in selling tangible personal property at retail" are not subject to the tax.

Accordingly, it is held that the tax imposed by the Cigarette Tax Act of the State of New Jersey is deductible for Federal income tax purposes under section 23(c)(1) of the Internal Revenue Code by licensed distributors who purchase, affix, and cancel the cigarette tax stamps and by licensed consumers who remit the tax directly to the State. The tax does not qualify as a retail sales tax within the meaning of section 23(c)(3) of the Code, and it is not deductible by purchasers.

SECTION 29.23(c)-2: Federal duties and excise taxes. 1949-6-13038 Mim. 6367
(Also Section 23(a), Section 29.23(a)-1; Section 24, Section 29.24-2.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1941

Deductibility of Federal stamp taxes paid on the issuance of bonds; limitation on the effective date of application of a previous ruling.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C., February 23, 1949.

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

SEC. 29.23(c)-2. FEDERAL DUTIES AND EXCISE TAXES.—The following statement is published pursuant to section 3(a)(3) of the Administrative Procedure Act:

Reference is made to that portion of section 23(c) of the Internal Revenue Code, as amended by section 111 of the Revenue Act of 1943, enacted February 25, 1944, which provides that:

In computing net income there shall be allowed as deductions:

* * * * * * *

(c) TAXES GENERALLY.—

(1) ALLOWANCE IN GENERAL.—Taxes paid or accrued within the taxable year, except—

* * * * * * *

(F) Federal import duties, and Federal excise and stamp taxes (not described in subparagraph (A), (B), (D), or (E)), but this subsection shall not prevent such duties and taxes from being deducted under subsection (a).

On the basis of the foregoing, this office issued a ruling designated as I. T. 3806 (C. B. 1946-2, 41) which reads, in part, as follows:

(3) Federal stamp taxes paid by a corporation on the issuance of its bonds upon original financing, or refinancing, are exhaustible capital expenditures, amortizable over the term or life of the bonds;

It has come to the attention of this office that prior to the publication of I. T. 3806 certain corporate taxpayers which paid Federal stamp taxes on the issuance of bonds deducted the entire amounts so paid on their Federal income and excess profits tax returns under the assumption that such taxes were deductible as ordinary and necessary business expenses under the provisions of section 23(a) of the Internal Revenue Code. It appears that retroactive application of the ruling quoted above would create, in these instances, considerable hardship.

Accordingly, it will be the administrative policy not to disturb such treatment with respect to returns filed for taxable years ended prior to the publication of I. T. 3806 where Federal stamp taxes paid by a corporation on the issuance of its bonds were deducted in their entirety in the year of payment or accrual. (See section 3791(b) of the Internal Revenue Code; 26 U. S. C. 3791(b).)

Inasmuch as the rule announced herein merely limits the effective date of application of a previous ruling, and the needs of certain of the taxpayers affected thereby require immediate issuance of the rule, prior notice and public rule-making procedure in connection therewith are hereby found to be impracticable, as they would delay promulgation of the rule.

As this mimeograph is within the parenthetical exception to section 4(c) of the Administrative Procedure Act, it shall be effective upon its filing for publication in the Federal Register.

Correspondence relating to this mimeograph should refer to its number and the symbols IT : EIM.

FRED S. MARTIN,
Acting Commissioner.

Approved February 23, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 1, 1949, 8:49 a. m.)

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

SECTION 29.23(k)-5: Reserve for bad debts. 1949-2-13010
I. T. 3936

INTERNAL REVENUE CODE

Method of accounting for bad debt reserves in the case of banks

Consideration has been given to the question whether banks using, or changing to, the reserve method of accounting for bad debts for Federal income tax purposes may set up and carry such reserves on auxiliary records without including such reserves in their regular books of account. The question has also been presented whether a bank which changes to the reserve method of accounting for bad debts, but which has previously set up on its books contingent reserves or allocations of surplus against bad debt losses, may establish authorized bad debt reserves by transfer out of existing reserves, which were not recognized for Federal income tax purposes, without loss of permissible deductions from taxable income.

It is the position of this office that reserves for bad debts established by banks for Federal income tax purposes should be reflected in the regular books of account. Such reserves are subject to adjustment by officers of the Bureau of Internal Revenue as in the case of other valuation accounts. Any adjustments so made will, of necessity, affect the surplus account rather than the income for the year in which the adjustment is made. Moreover, it is understood that the showing of bad debt reserves against loans and discounts on the regular books of account and in financial reports is required by the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

A. R. R. 377 (C. B. 4, 64 (1921)) and A. R. M. 172 (C. B. I-2, 48 (1922)) are not applicable to reserves for bad debts. Those rulings relate to deductions for depreciation with respect to assets which have been written down to values below the adjusted bases for depreciation and permit the use of supplemental records for recording such bases for Federal income tax purposes, whereas loans and discounts represent a large portion of a bank's assets which are required to be shown on its regular books of account.

In the case of a bank which, at the time of changing to the reserve method of accounting for bad debts, already has on its books contingent reserves or allocations of surplus against future bad debt losses, which reserves or allocations have not been recognized for Federal income tax purposes as other than surplus, there is no objection to the creation of bad debt reserves (by transfer on the books) out of such items of contingent reserves or allocated surplus. Any adjustments in such reserves or allocated surplus will have no effect on the amount allowable as a deduction on account of an addition to a bad debt reserve.

SECTION 29.23(k)-5: Reserve for bad debts. 1949-9-13072
I. T. 3950

INTERNAL REVENUE CODE

Nonretroactive application of I. T. 3936 (page 64, this Bulletin), relating to method of accounting for bad debt reserves in the case of banks.

It appears that prior to publication of I. T. 3936 (page 64, this Bulletin), numerous banks using, or changing to, the reserve method of accounting for bad debts had set up and carried reserves for bad debts on auxiliary records without including them in their regular books of account, which practice was accepted by the Bureau of Internal Revenue.

Under authority contained in section 3791(b) of the Internal Revenue Code, I. T. 3936, *supra*, insofar as it requires a bank's bad debt reserves to be reflected in the regular books of account, will be applied only to taxable years ending after December 31, 1948.

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved April 4, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

SECTION 29.23(k)-5: Reserve for bad debts. 1949-13-13110
I. T. 3957

INTERNAL REVENUE CODE AND REVENUE ACT OF 1926

Use of bad debt reserves by dealers in personal property who report sales income on the installment basis.
I. T. 2365 (C. B. VI-1, 69 (1927)) modified.

Reconsideration has been given to I. T. 2365 (C. B. VI-1, 69 (1927)) which holds in part that the use of a reserve for bad debts is not permissible by a dealer in personal property on the installment plan who reports profits applicable to installment sales in accordance with the installment basis of accounting as contemplated by article 42, Regulations 69. Article 42 of Regulations 69 corresponds to section 29.44-1 of Regulations 111, promulgated under the Internal Revenue Code.

In O. D. 792 (C. B. 4, 86 (1921)), it was held that a taxpayer selling personal property on the installment plan is entitled to deductions for unpaid installment obligations which become worthless and are charged off, without recovery of the property sold, to the extent of the capital portion of the worthless obligation, that is, the unrecovered cost of goods sold. Bad debt deductions are allowable in the case of a taxpayer keeping its accounts and filing its returns on the cash receipts and disbursements basis to the extent of the capital portion of worthless small loan accounts. (See *Estate of Maurice S. Saltstein, Transferee*, v. *Commissioner*, 46 B. T. A. 774, acquiescence, C. B. 1942–1, 14, and Mimeograph 6209, C. B. 1947–2, 26.) In *First National Bank of Omaha* v. *Commissioner* (17 B. T. A. 1358, acquiescence, C. B. IX–2, 20 (1930)), the United States Board of Tax Appeals (now The Tax Court of the United States) said (page 1366): "If the petitioner is entitled to deduct from gross income under its system of bookkeeping and reporting bad debts charged off, it is entitled to the benefits of section 234(a) (5) of the Revenue Act of 1921 with respect to the setting up of a reserve for bad debts and deducting from income the addition made thereto each year." The Board's order in that case was vacated in part (49 Fed. (2d) 70), but that statement of the Board, which statement was quoted with approval in the Saltstein case, *supra*, was not affected.

In the light of the foregoing, it is now the position of the Bureau that taxpayers using the reserve method of accounting for bad debts in accordance with section 23(k) (1) of the Internal Revenue Code and regulations promulgated thereunder, and reporting income from installment sales of personal property on the installment plan in accordance with section 44(a) of the Code, upon adoption of the reserve method of accounting for bad debt losses from installment accounts, will, in computing net income, be entitled to deduct a reasonable addition to the reserve account. I. T. 2365, *supra*, is hereby modified.

The reasonableness of an addition to a reserve for bad debts with respect to installment accounts will depend upon the total amount of the capital portion of such accounts outstanding at the close of the taxable year, the then balance in the reserve account, and the experience of the taxpayer with respect to the installment accounts. As to the determination of the capital portion of such accounts, see section 29.44–1 of Regulations 111 and O. D. 792, *supra*.

The requirements of the Bureau incident to the adoption of the reserve method in the first return of a taxpayer or in connection with a change in accounting for bad debts from the specific charge-off method to the reserve method are the same whether installment sales or noninstallment transactions are involved.

A taxpayer reporting income from installment sales on the installment basis in accordance with section 44(a) of the Internal Revenue Code and accounting for bad debts with respect to accounts other than installment accounts by using the reserve method may adopt such reserve method in accounting for bad debts relating to installment accounts, provided that (1) permission to do so is obtained in accordance with and subject to the terms provided by section 29.23(k)–1(*a*) (2) of Regulations 111 and (2) accurate accounts are kept with respect to the reserve for bad debts relating to the installment accounts separate from those with respect to the bad debt reserve set up against other accounts.

In the case of a taxpayer filing a first return of income and selecting the reserve method of accounting for bad debts, or of a taxpayer filing a return under permission to change to the reserve method in accordance with section 29.23(k)-1 of Regulations 111, the reserve method of accounting for bad debts may, at the election of the taxpayer, be used only with respect to accounts other than installment accounts, or only with respect to installment accounts, or both. If the taxpayer elects to use the reserve method in connection with both kinds of accounts, separate reserves must be maintained.

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

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

1949-10-13086
Ct. D. 1720

INCOME TAX—INTERNAL REVENUE CODE AND REVENUE ACTS OF 1936 AND 1938—DECISION OF COURT

1. GROSS INCOME—DEDUCTIONS—DEPLETION—OIL AND GAS LEASE.

Under a purported oil and gas lease providing for the lessor to receive 50 percent of the net profits instead of a gross royalty, the lessor retained an economic interest in the oil and gas in place and in computing income taxes was entitled to a depletion allowance only from cash payments actually received from the lessee rather than a depletion allowance on one-half of the gross income from the property before deduction of expenses paid by the lessee. The fact that the lease provided for the payment of net profits instead of a gross royalty did not establish that the contract amounted to an absolute sale of the oil before severance.

2. DECISION AFFIRMED.

Memorandum opinion of the Tax Court (December 18, 1942) affirmed.

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

Commissioner of Internal Revenue, petitioner, v. *Felix Oil Co., a corporation, respondent*

Felix Oil Co., a corporation, petitioner, v. *Commissioner of Internal Revenue, respondent*

[144 Fed. (2d) 276]

Upon petitions to review a decision of The Tax Court of the United States

Before DENMAN, STEPHENS, and HEALY, Circuit Judges

[August 2, 1944]

OPINION

HEALY, Circuit Judge: This case is before us on petitions of the Commissioner and the taxpayer to review a decision of the United States Tax Court entered upon a proceeding for the redetermination of deficiencies. The deficiencies were assessed as a result of the Commissioner's disallowance of depletion deductions claimed by the taxpayer in its income returns for 1937, 1938, and 1939, under sections 23(m) and 114(b)(3) of the Revenue Acts of 1936 and 1938. The facts were stipulated.

In December, 1928, the taxpayer was the owner in fee of 160 acres of land located in the Kettleman Hills in California. At that time it entered into a written agreement purporting to lease the land to the Petroleum Securities Co. for the term of 20 years and so long thereafter as oil or gas might continue to be produced. This agreement has since remained in full force and effect. It is in form a lease, and save in one particular its provisions are very similar to those of the typical oil and gas lease. The peculiarity lies in this: instead of retaining a gross royalty, the lessor was to receive 50 percent of the "net profits." The term "net profits" was defined as the proceeds of sale of the oil less the expenses of the lessee in drilling, pumping, storage, and the like, less also a number of other items such as State and county taxes, insurance, and general operating costs. While the agreement recites that it was given in consideration of the sum of $10, the actual amount paid to the lessor at the time of execution was $150,000.

The Commissioner, resting his argument mainly on the provision for the payment of net profits, asserts that the contract is an absolute sale rather than a lease, that is to say, that the contract effected a disposition of all the taxpayer's economic interest in the oil in place. The consideration, he contends, was the $150,000 payment plus a share of the net profits of the operation with no retention of any interest in the underlying oil. If the Commissioner's interpretation of the contract is correct the taxpayer would be entitled to no depletion allowance. *Helvering* v. *Elbe Oil Land Development Co.*, 303 U. S. 372 [Ct. D. 1322, C. B. 1938-1, 293]; *Anderson* v. *Helvering*, 310 U. S. 404 [Ct. D. 1456, C. B. 1940-1, 108]; *Blankenship* v. *United States*, 95 Fed. (2d) 507; *McLean* v. *Commissioner*, 120 Fed. (2d) 942. However, the Tax Court, while recognizing the rule contended for by the Government, was of opinion that the contract did not amount to a sale of the oil before severance. It accordingly held that the deficiency assessments were unwarranted.

Under the terms of the agreement the taxpayer retained all rights of ownership except those specifically disposed of therein. It retained reversionary rights in the property, and the right of forfeiture in the event of the lessee's failure timely to prosecute drilling; also certain rights in fixtures and equipment upon termination of the lease. As stressed by the Tax Court, the instrument gave the lessee the right to explore the land for oil, and in the event oil were found, to operate on the land for the recovery thereof. Said the court: "Ownership of the oil in place remained in petitioner as owner of the land and did not pass to the lessee before severance." It was thought that the provision for an equal division of the net profits of each paying well "was merely the yardstick adopted by the contracting parties to measure the production acquired by the lessee and the production retained by petitioner as lessor." Further, that the lessee received the proceeds of sale and paid the costs and expenses of production, not as the sole owner of the oil, but as one of two parties equally interested in the production and sale. The land, said the court, was furnished by the lessor, and the labor, capital, and management by the lessee. Particular significance was found in a provision to the effect that the lessor, if dissatisfied with the amounts realized by the lessee, might require the latter to sell 50 percent of the production to purchasers of the lessor's own choosing.

We see no reason for rejecting this interpretation of the contract. It is clear that the taxpayer retained an economic interest in the oil in place. It had a capital investment in the land and in the paying wells, and the income it received from production was not, we think, income arising from a sale of the oil before severance. Cf. *Palmer* v. *Bender*, 287 U. S. 551 [Ct. D. 641, C. B. XII-1, 235 (1933)]; *Helvering* v. *Elbe Oil Land Development Co., supra; Helvering* v. *Mountain Producers Corp.*, 303 U. S. 376 [Ct. D. 1321, C. B. 1938-1, 343]. In the case last cited the Supreme Court said (p. 382) that "the term 'gross income from the property' means gross income from the oil and gas * * * and the term should be taken in its natural sense. With the motives which lead the taxpayer to be satisfied with the proceeds he receives we are not concerned."

In making its returns for the years in question the taxpayer deducted the depletion allowance from the cash payments actually made by the lessee for those years. In the proceeding before the Tax Court it claimed it had overpaid its taxes, that is to say, that it was entitled to depletion allowance of $27\frac{1}{2}$ percent on one-half of the gross income from the property before deduction of the expenses paid by the lessee. The Tax Court rejected the contention, holding that there had been no overpayment.

We think the holding is correct. The allowance for depletion under section 114(b)(3) is an amount equal to a stated percentage of the "gross income from the property" of the particular taxpayer. *Helvering* v. *Twin Bell Oil Syndicate*, 293 U. S. 312 [Ct. D. 905, C. B. XIV-1, 253 (1935)]; *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362 [Ct. D. 1323, C. B. 1938-1, 306]. As we read the opinion in *Helvering* v. *Mountain Producers Corp.*, *supra*, a contention virtually identical with that made by the taxpayer here was there rejected, the Court saying (p. 382) that it was not "at liberty to construct a theoretical gross income by recourse to the expenses of production operations."

Affirmed.

SECTION 23(u).—DEDUCTIONS FROM GROSS INCOME: ALIMONY, ETC., PAYMENTS

SECTION 29.23(u)–1: Periodic alimony payments.

INTERNAL REVENUE CODE

Payments made pursuant to an interlocutory decree of divorce in California and limited to its duration. (See I. T. 3934, page 54.)

SECTION 29.23(u)–1: Periodic alimony payments.

INTERNAL REVENUE CODE

Withdrawal of modification of I. T. 3761 (C. B. 1945, 76). (See I. T. 3944, page 56.)

SECTION 23(aa).—DEDUCTIONS FROM GROSS INCOME: OPTIONAL STANDARD DEDUCTION FOR INDIVIDUALS

SECTION 29.23(aa)–1: Standard deduction. (Also Section 25, Section 29.25–3; Section 51, Section 29.51–1.) 1949–6–13039 I. T. 3942

INTERNAL REVENUE CODE

For the purposes of sections 23(aa), 25(b), and 51(b) of the Internal Revenue Code, the parties named in an interlocutory decree of divorce in the State of California are not considered as married.

Advice is requested whether the parties named in an interlocutory decree of divorce in the State of California are considered, for Federal income tax purposes, as married.

Section 201 of the Revenue Act of 1948 (C. B. 1948–1, 211, 213) amends section 25(b)(2) of the Internal Revenue Code to provide in part that:

(B) an individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

This provision relates to the determination of marital status for the purpose of the credits provided by section 25(b) of the Code. Similar provisions for determination of marital status are included in section 23(aa)(6) of the Code (as added by section 302(c) of the Revenue Act of 1948), relating to the standard deduction, and in section 51(b)(5) of the Code (as added by section 303 of the Revenue Act of 1948), relating to joint returns. Congress clearly intended a uniform construction of all of these provisions. The rule with respect to the marital status of an individual legally separated from his spouse under a decree of divorce or separate maintenance is derived from the corresponding provision in section 22(k) of the Code, relating to the tax treatment of alimony and like payments. (See House of Representatives Report No. 1274, C. B. 1948–1, 241, 277, and Senate Report No. 1013, C. B. 1948–1, 285, 324.)

In I. T. 3761 (C. B. 1945, 76), it was held that "periodic" payments made pursuant to an interlocutory decree of divorce in the State of California by a husband for the support of his wife are includible in her gross income under section 22(k) of the Internal Revenue Code, and are deductible by the husband under section 23(u) of the Code. The parties in such a case were considered "divorced or legally separated" for the purposes of section 22(k) of the Code.

It is held that, for the purposes of sections 23(aa), 25(b), and 51(b) of the Internal Revenue Code, the parties named in an interlocutory decree of divorce in the State of California are not considered as married.

SECTION 24.—ITEMS NOT DEDUCTIBLE

SECTION 29.24–2: Capital expenditures.

INTERNAL REVENUE CODE

Alabama gross receipts (sales) tax paid by vendee in connection with purchase of equipment for use in trade or business. (See I. T. 3937, page 57.)

SECTION 29.24–2: Capital expenditures.

INTERNAL REVENUE CODE

Federal stamp taxes paid by corporation on issuance of its bonds. Nonretroactive application of I. T. 3806 (C. B. 1946–2, 41). (See Mim. 6367, page 63.)

SECTION 29.24–5: Taxes and carrying charges chargeable to capital account and treated as capital items.

INTERNAL REVENUE CODE

Alabama use tax. (See I. T. 3937, page 57.)

SECTION 29.24–5: Taxes and carrying charges chargeable to capital account and treated as capital items.

INTERNAL REVENUE CODE

Ohio use and storage tax. (See I. T. 3938, page 59.)

SECTION 19.24–6: Losses from sales or exchanges between certain classes of persons.

1949–10–13087
Ct. D. 1719

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF COURT

1. GROSS INCOME—DEDUCTIONS—LOSSES FROM SALES OR EXCHANGES OF PROPERTY—SALE OF PARTNERSHIP ASSETS TO CORPORATION, AND DISSOLUTION OF PARTNERSHIP.

Taxpayers were members of a partnership which sold most of the assets used by it in their banking business for cash to a corporation formed to take over and continue the business. The majority of the capital stock of the corporation was owned by the taxpayers. The proceeds of the sale were distributed to the taxpayers. At the time of the transfer, certain securities included in the assets showed a gain in value over their cost, while others showed a loss. In computing net income the Commissioner included the capital gains but disallowed the capital losses. Certain securities in default were owned by the partnership which the partners tendered and the corporation accepted, plus cash, as a contribution to the corporate surplus. *Held:* 1. Taxpayers are prohibited by section 24(b)(1)(B) of the Internal Revenue Code from taking a deduction for losses resulting from the sale. 2. Upon the final winding up and liquidation of the partnership, the individual partners are not entitled to a deduction for loss, either in the light of the proper construction of section 24(b)(1)(B) of the Code, or as a proven loss upon the partnership investment. 3. The partners individually made the contribution of the securities in default to the corporation's capital surplus, and there was no sale or exchange resulting in a completed transaction showing a realized loss.

2. DECISION REVERSED IN PART AND AFFIRMED IN PART.

Decision of The Tax Court of the United States (8 T. C. 1019) reversed in part and affirmed in part.

3. CERTIORARI DENIED.

Petition for certiorari denied (335 U. S. 892) December 13, 1948.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

Commissioner of Internal Revenue, petitioner on review, v. *George Whitney, respondent on review*

George Whitney, petitioner on review, v. *Commissioner of Internal Revenue, respondent on review*

and twelve Consolidated Cases

Before SWAN, CLARK, and FRANK, Circuit Judges

On petitions to review decisions of The Tax Court of the United States

[August 11, 1948]

OPINION

CLARK, Circuit Judge: For many years the partnership of J. P. Morgan & Co. carried on a general banking business in New York City in the firm name, and in Philadelphia under the name of Drexel & Co. In the latter part of 1939 the partners decided that their New York business should be incorporated as a trust company, and arrangements to that end—which involved also the complete separation of the Philadelphia business—were completed in March, 1940. On March 29, the State superintendent of banks issued a certificate authorizing J. P. Morgan & Co. Incorporated to transact the business of a trust company in New York City. The following day, Saturday, March 30, a special meeting of the directors of the corporation was held. The directors were the 13 partners of the firm. At this meeting a resolution was adopted authorizing the corporation to purchase the assets and to assume the liabilities and obligations of the firm as set forth in a bill of sale and agreement presented to the meeting. The bill of sale and agreement was executed by the firm, the 13 individual partners, and the corporation on that date. By it "the firm and each of the partners, respectively," sold and transferred to the new banking corporation all title to the firm "assets, rights and properties," detailed by schedule and of the aggregate agreed value of $597,098,131.87, against the assumption by the corporation of liabilities to depositors and others of $584,832,737.78. The difference of $12,265,394.09 was paid to the firm; then it (less the sum of $55,073.01 contributed to the corporation under circumstances stated below) was deposited to the accounts in the bank of the 13 firm members in the proportionate amounts of their interests in the partnership. Among other provisions of the bill of sale and agreement was a promise by each of the partners not to engage in any banking or other business in New York City or elsewhere under the name of J. P. Morgan & Co., or any other similar name, except as an officer, director, or employee of the bank. A stockholders' meeting the same day approved the action of the directors and confirmed the execution and acceptance by the bank of the bill of sale and agreement. The partners owned 72.9 percent of the corporate stock and their relatives owned an additional 5.3

percent. The bank opened for business on Monday, April 1, while the affairs of the partnership were wound up by the settlement of accounts of March 30, 1940.

In the assets transferred by the firm to the corporation certain securities then showed a gain in value over their cost, while others showed a loss. The amounts of such capital gains and losses are not in dispute; but the treatment of them with respect to the 1940 income taxes of the 13 firm members is. In computing the net income of each of the 13 partners, the Commissioner included the capital gains, but disallowed the capital losses on the basis of I. R. C. section 24(b)(1)(B). Judge Leech, however, in a decision reviewed by the full Tax Court without dissent, held that the section did not prohibit deduction of these losses—being "partnership losses"—and therefore directed their allowance. 8 T. C. 1019. The Commissioner's petitions for review in each of the 13 cases raise therefore the question as to the appropriate construction of this statutory provision.

For consideration of this question it is not necessary to set forth the details of each partner's interest or of other relevant facts, particularly as they are stated in the opinion below.[1] For all the partners the short-term capital losses aggregated $1,598,871.01; and the long-term capital losses, after applying the percentages applicable in 1940 under I. R. C. section 117(b), amounted to $1,230,368.01. The taxpayers' cross-petitions bring up separate issues concerning the disallowance by the Tax Court of losses claimed upon certain securities in default contributed by the firm to the corporation; we shall postpone discussion of this phase of the appeal until later.

Section 24(b)(1)(B) prohibits any deduction, in computing net income, for losses from sales or exchanges of property—except in the case of distributions in liquidation—between an individual and a corporation whose stock is more than 50 percent owned by or for him.[2] Our problem is shortly whether this provision includes or excludes partnership holdings. The provision was originally enacted in 1934 as section 24(a)(6)(B); it then included, in addition to the present prohibition, only those between "members of a family." It reached substantially its present form in 1937, when there were added to the prohibited groups: two personal holding companies with stock ownership of more than 50 percent in or for the same individual; the grantor and fiduciary of any trust; the fiduciaries of two trusts from the same grantor; the fiduciary and beneficiary of any trust. Among rules for the determination of stock ownership are subdivisions (B) and (C) of I. R. C. section 24(b)(2), providing that an individual shall be considered as owning "the stock owned, directly or indirectly, by or for his family," and "the stock owned, directly or indirectly, by or for his partner" (the first, B, dating from 1934, and the second, C, from 1937). Further, as is well known, a partnership is not taxable; the individual partners are liable in their individual capacity for both individual income and their respective shares of partnership income computed according to the statutory rules. I. R. C. sections 181–183.

When these detailed statutory provisions are read against the background of the legislative history and the problem as it was presented to the Congress in 1934, we cannot feel that there can be any serious doubt as to the legislative intent or any substantial ground for believing that Congress intended to leave so large a loophole—almost as large as the one it was trying to close—from its prohibition against deductible losses upon transfers between closely related persons or groups. Indeed, the only thing which would give us pause is the unanimous decision of the Tax Court, whose expert view is always entitled to respectful con-

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[1] The partners were: J. P. Morgan, Thomas W. Lamont, Junius S. Morgan, George Whitney, R. C. Leffingwell, Francis D. Bartow, Arthur M. Anderson, Thomas S. Lamont, H. P. Davison, Charles D. Dickey, Henry C. Alexander, I. C. Raymond Atkin, and William A. Mitchell. Three of the partners have since died and are now represented by their executors; J. P. Morgan died before the petitions to the Tax Court, while Francis D. Bartow died during their pendency, and Thomas W. Lamont after the filing of the petitions for review.

[2] SEC. 24. ITEMS NOT DEDUCTIBLE.—

* * * * * * *

(b) LOSSES FROM SALES OR EXCHANGES OF PROPERTY.—

(1) LOSSES DISALLOWED.—In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

* * * * * * *

(B) Except in the case of distributions in liquidation, between an individual and a corporation more than 50 per centum in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

sideration.[3] We cannot avoid believing that it has become entangled in the jurisprudential aspects of so-called legal "entities" to such an extent as to cause it to overlook the real meaning and purpose of these enactments. In fact they had not then been so authoritatively explained as is now the situation since the more recent decision of the Supreme Court in *McWilliams* v. *C. I. R.*, 331 U. S. 694 [Ct. D. 1686, C. B. 1947-2, 34], which we cite below. The circumstances under which a jural *aggregate*—admittedly the status of a partnership under the Federal revenue laws and the Uniform Partnership Act—may become a jural *entity* are fascinating in their possibilities for semantic dispute. But this should not be allowed to go so far as to draw all teeth from a statute carefully directed at what the legislative body viewed as the evil of "tax evasion." We may come back to this jurisprudential debate to discuss briefly some of the suggestions urged upon us; but first and most important must be a consideration of the statute itself against its background.

The statute was passed as a part of the dramatic investigations of and legislative attack upon "tax evasion" which developed as a concomitant of the great loss in security values from 1929 on to the date of the legislation. The volume of realized losses in such investments and the question of realization itself provoked legislative attention. For the investigation in which this very firm prominently appeared had brought out that it was possible for taxpayers to go through the form of realization of a loss by a transfer where the economic attributes of ownership were retained. This we pointed out in dealing with the special restrictions made by this same general legislation upon the offset of partnership capital losses against individual capital gains in reversing the deductions allowed in 3 T. C. 1217 to a partner of this firm. *C. I. R.* v. *Lamont*, 2 Cir., 156 Fed. (2d) 800, certiorari denied 329 U. S. 782. Whether or not the Congress went further than a fair adjustment of equities would require, whether in truth it may be "shocking to the sense of justice," as the taxpayers assert, that capital gains be taxed and losses disallowed, is not for us to say. At least, however, the legislative approach is understandable against this background. But it would hardly be understandable were we to consider the purpose to be to permit just that form of realization of a loss condemned in an individual whenever it was done through the simply added legal device of the partnership, and particularly when this would leave untouched the more spectacular cases which the investigation of the Senate Committee on Banking and Currency had brought to public attention. *C. I. R.* v. *Lamont*, *supra*, 156 Fed. (2d) at page 803.

The only reason for such a differentiation suggested by the Tax Court or by the taxpayers is the difficulty "of determining the bona fides" of transactions showing large tax losses between members of families and between individuals and the corporations they controlled. No reason is suggested why these difficulties of proof would not be, if anything, increased by the interposition of the partnership device. But the Supreme Court has shown that this is at best an inadequate explanation of the legislation. It says, per Mr. Chief Justice Vinson in the case to which we have already referred: "Moreover, we think the evidentiary problem was not the only one which Congress intended to meet. Section 24(b) states an absolute prohibition—not a presumption—against the allowance of losses on any sales between the members of certain designated groups. The one common characteristic of these groups is that their members, although distinct legal entities, generally have a near-identity of economic interests. It is a fair inference that even legally genuine intra-group transfers were not thought to result, usually, in economically genuine realizations of loss, and accordingly that Congress did not deem them to be appropriate occasions for the allowance of deductions." *McWilliams* v. *C. I. R.*, *supra*, 331 U. S. at page 699.

And then the Court goes on to quote from the legislative history of the 1934 legislation to demonstrate that the purpose was this and could not have been to exclude transfers made "through the medium of the Stock Exchange, unless it wanted to leave a loophole almost as large as the one it set out to close." 331

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[3] Notwithstanding legislative repeal of the rule of *Dobson* v. *C. I. R.*, 320 U. S. 489 [Ct. D. 1597, C. B. 1944, 56], by amendment of I. R. C. section 1141(a) by chapter 646, Public Law No. 773, 80th Cong., 2d sess., June 25, 1948, section 36. While this statute does not become effective until Sept. 1, 1948, our question here, being the interpretation of a statute, is reviewable under *McWilliams* v. *C. I. R.*, 331 U. S. 694; *Bingham's Trust* v. *C. I. R.*, 325 U. S. 365, 163 A. L. R. 1175 [Ct. D. 1643, C. B. 1945, 103]; *N. Y. Stocks* v. *C. I. R.*, 2 Cir., 164 Fed. (2d) 75; *C. I. R.* v. *Kohn*, 4 Cir., 158 Fed. (2d) 32 [Ct. D. 1682, C. B. 1947-1, 25].

U. S. at page 701. While the stress in the legislative history is upon what were termed "family losses," there is not the slightest suggestion that the interposition of a partnership would afford a corrective element. Indeed, all the reasoning is to the contrary. H. R. Rept. No. 704, Committee on Ways and Means, 73d Cong., 2d sess., C. B. 1939–1 (Part 2), 554, 571; S. Rept. No. 558, Committee on Finance, 73d Cong., 2d sess., C. B. 1939–1 (Part 2), 586, 607. This is emphasized by the statutory language reaching sales "directly or indirectly" between the prohibited groups. *C. I. R.* v. *Kohn*, 4 Cir., 158 Fed. (2d) 32.[4] A final clinching demonstration of the legislative intent is found in the 1937 amendments, particularly the provision quoted above from section 24(b)(2)(C) that an individual shall be considered to own stock owned by a partner. The desirability of the change to avoid small differentiations in the coverage of the prohibition is explained in H. R. Rept. No. 1546, 75th Cong., 1st sess., C. B. 1939–1 (Part 2), 704, 722–724, which also points out that the statutory examples are not exclusive, since the Government can deny losses where the sales are not in fact bona fide. The view taken by the Tax Court therefore requires a differentiation so fine as that between a joint sale made by an individual and his partner and one made by the partnership itself—a differentiation without substance or reality in the light of the legislative purpose. The Tax Court cited the legislative history discussed in *C. I. R.* v. *Lamont, supra*, as supporting special treatment of partnerships; but that exceptional treatment in the particular instance of the extent to which capital gains might be offset by capital losses is strong evidence of unexceptional treatment elsewhere. Indeed, as we there pointed out, citing *Neuberger* v. *C. I. R.*, 311 U. S. 83 [Ct. D. 1470, C. B. 1940–2, 228], the result was otherwise before the statutory enactment and again after restoration of the earlier law in 1938.

Other provisions of the Internal Revenue Code also appear to us to lend support to the Commissioner's interpretation of the provision here involved. Thus section 3797(a), a section of definitions, goes so far as to provide that, except as otherwise provided or manifestly incompatible with the intent, the term "person" shall be construed to include both an individual and a partnership, and the term "partnership" includes "a syndicate, group, pool, joint venture, or other unincorporated organization" not a trust or estate or a corporation. Surely one could not avoid the effect of this specific prohibitory legislation by associating himself with a *group* or *pool;* nor may the extent of coverage of the Act turn upon how far local law treats a joint venture as a partnership. And there is nothing in the Code which seems to us in any way inconsistent with the Commissioner's approach to the problem.

The chief reliance of the Tax Court and of the taxpayers upon this appeal is upon the concept of a partnership as an entity, owning and transferring property apart from its partners. Thus the court cites as apposite that section of the Uniform Partnership Act (effective in New York) which defines a partner's "interest in the partnership" as "his share of the profits and surplus," N. Y. Partnership Law, section 52, thus overlooking the immediately more apposite provision that the "property rights of a partner" are not only "(*b*) his interest in the partnership, and (*c*) his right to participate in management," but also "(*a*) his rights in specific partnership property." Id., section 50. And the existence of individual rights in specific partnership property is clinched by id., section 51, "A partner is coowner with his partners of specific partnership property holding as a tenant in partnership," the incidents of this tenancy being thereupon set forth in some five subdivisions. It is a matter of well-understood history (to which we have often referred, as in the cases from this circuit cited below) that the drafters of the Act rejected the entity theory for "the common law or aggregate theory." See the authoritative articles by the draftsman, Dean Lewis: The Uniform Partnership Act, 24 Yale L. J. 617, 620; The Uniform Partnership Act, 29 Harv. L. Rev. 158–192, 291–313. Accordingly the assent of all the partners is necessary in order to dispose of the good will of the business, or to do any act making it impossible to carry on its ordinary business, or to assign a partner's right in specific property of the firm. N. Y. Partnership Law, section 20, paragraph 3 (b.c); section 51, paragraph 2(b). See *Klumpp* v. *Gardner*, 114 N. Y. 153, 21 N. E. 99; *Postman* v. *Rowan*, 65 Misc. 50, 119 N. Y. S. 248; *Freeman* v. *Abramson*, 30 Misc. 101, 61 N. Y. S. 839. Here the sale to the cor-

[4] In view of the later decision of *Higgins* v. *Smith*, 308 U. S. 473 [Ct. D. 1434, C. B. 1940–1, 127], refusing to recognize such a sale to a wholly owned corporation, even before the statute, the result might perhaps be the same in the absence of statute. See *Wickwire* v. *United States*, 6 Cir., 116 Fed. (2d) 679; 1 Montgomery's Federal Taxes—Corporations and Partnerships, 1947–48, 720.

poration could not have been validly accomplished without the express assent of the 13 partners, as, of course, they recognized by joining in the bill of sale and agreement and making the transfer of the assets.

In support of its theory, the Tax Court cited certain of its decisions, including Allan S. Lehman, 7 T. C. 1088, the affirmance of which in *C. I. R.* v. *Lehman*, 2 Cir., 165 Fed. (2d) 383, certiorari denied 68 S. Ct. 1085, has become the main reliance of the taxpayers on this appeal. That case applied the unitary concept of a partnership to the extent of reaching a result which, we agree, was in line with ordinary business conceptions and the there practical statutory intent. There the taxpayer had become a partner in a brokerage firm in 1908 and the question was the valuation of a partnership interest sold by the taxpayer in 1937. The court held, for the purpose of finding the capital gain, that the date of acquisition was 1908, thus rejecting several conflicting theories of the Commissioner: the various dates of purchases of items of firm assets, the date of the last change in personnel by the death of a partner, and so on. Judge L. Hand wrote the opinion; although we have pointed out the general acceptance of the "aggregate" theory in the Uniform Act and the Federal taxing statutes in some half dozen or more decisions, most of them written by Judge Hand,[5] these the taxpayers overlook in their emphasis upon this nonanalogous case, which, indeed, had been foreshadowed on its narrow point by earlier cases.[6]

In an acute analysis of the taxation of partnerships it is said that in the broader aspects of partnership law "the Uniform Act has coated the common-law coownership theory with a thin veneer of the equity entity concept; but fundamentally, the relationship is defined in terms of rights and obligations of the individual partners. So, too, the tax law adopts the entity concept as a skin deep accounting expedient, but the framework is that of the individual partner's profit and loss." Rabkin and Johnson, The Partnership under the Federal Tax Laws, 55 Harv. L. Rev. 909, 915. And the authors state by way of conclusion: "In too many instances the Treasury and the courts have shied away from the plain implications of the statutory scheme: an income tax imposed upon the partners as individuals. Basically, the tax law adopts the common-law concept of the partnership as an aggregate of individuals operating the properties of the partnership enterprise as coowners." 55 Harv. L. Rev. at page 949. There is no doubt that generally speaking under the tax law we must approach the partnership as an association of individuals who are coowners of its specific property and who are taxed, while the partnership is not. However justified we have been in following business practices to treat a share of the firm itself apart from the individual interests, *C. I. R.* v. *Lehman, supra*, we cannot find justification in the precedents and the statute for carrying the rule so far as to apply it by analogy to the ownership of specific property or to disregard the direct specifications of individual ownership of partnership property. Certainly we cannot do so against the background of the statutory provisions when disregard of these precepts would substantially emasculate the legislative prohibition. We conclude that on the Commissioner's petitions the decisions of the Tax Court must be reversed for recomputation of the taxes on the basis of exclusion of these losses.

It should be added that the taxpayers make an argument, not presented to the Tax Court, that these losses are within the statutory exception of payments in liquidation of the partnership. There seems a serious question here whether the statutory language of section 24(b)(1)(B) was intended to include more than dividends in liquidation of a corporation. But assuming *arguendo* that it may apply also to a partnership, it is clear that here the payments were not in liquidation of the partnership, but were the fair consideration for the transfer of assets

[5] *Harris* v. *C. I. R.*, 2 Cir., 39 Fed. (2d) 546; *Helvering* v. *Walbridge*, 2 Cir., 70 Fed. (2d) 683, certiorari denied 293 U. S. 594; *Helvering* v. *Archbald*, 2 Cir., 70 Fed. (2d) 720, certiorari denied 293 U. S. 594; *Rossmoore* v. *C. I. R.*, 2 Cir., 76 Fed. (2d) 520 [Ct. D. 1009, C. B. XIV–2, 278 (1935)]; *Helvering* v. *Smith*, 2 Cir., 90 Fed. (2d) 590 [Ct. D. 1297, C. B. 1938–1, 277]; *Williams* v. *McGowan*, 2 Cir., 152 Fed. (2d) 570, 162 A. L. R. 1036—all of them written by Judge L. Hand and cited by him in *C. I. R.* v. *Lehman, supra*. The Harris, Rossmoore, Smith, and Williams cases are particularly emphatic in their statement of the actual rejection, for good or ill, of the entity theory. See also *Benjamin* v. *Hoey*, 2 Cir., 139 Fed. (2d) 945, citing *Neuberger* v. *C. I. R., supra; First Mechanics Bank of Trenton* v. *C. I. R.*, 3 Cir., 91 Fed. (2d) 275; *Burnet* v. *Leininger*, 285 U. S. 136; and cf. *City Bank Farmers Trust Co.* v. *United States, Ct. Cl.*, 47 Fed. Supp. 98, which was not followed in the Lehman case.

[6] As by the cases that appreciation in a partner's contribution to firm capital cannot be considered realized until liquidation of the firm, as in the Walbridge and Archbald cases, note 5 *supra*, and *Chisholm* v. *C. I. R.*, 2 Cir., 79 Fed. (2d) 14, 101 A. L. R. 200, certiorari denied *Helvering* v. *Chisholm*, 296 U. S. 641, which were discussed and followed in *Flannery* v. *United States*, D. C. Md., 25 Fed. Supp. 677, and *Spaid* v. *United States*, D. C. Md., 28 Fed. Supp. 670, affirmed *United States* v. *Flannery*, 4 Cir., 106 Fed. (2d) 315.

to the corporation. This was a sale, not a liquidation. *Mathews* v. *Squire*, D. C. W. D. Wash., 59 Fed. Supp. 827.

The petitions for review by the taxpayers deal with a different set of facts, which the Tax Court viewed differently. Our decision above on the issue raised by the Commissioner is such as to require affirmance on this point also, although the grounds taken by the Tax Court are in themselves adequate. The facts concern certain securities in default owned by the firm, but whose purchase by a trust company the parties believed to be prohibited by the New York banking law. So the partners tendered, and the corporation accepted, the defaulted securities of the value of $1,472,658, together with cash of $55,073.01, or a total of $1,527,731.01, as a contribution to the corporate surplus.[7] There were undisputed short-term and adjusted long-term losses over the cost of these assets in excess of 2 million dollars, but the taxpayers claim only a fractional part thereof, determined by applying a fraction whose denominator is the total contribution just stated and whose numerator is the sum of $856,796.42. This latter figure is the amount of a "special reserve" carried by the firm for the purpose of making payments to its retired employees. Since the partners had considered this fund, with its yearly additions from profit and loss, as entirely devoted to this purpose, so that the individual partners claimed no further interest in it even upon retirement from the firm and took contributions to it as deductions in their income tax returns, with the approval of the revenue authorities, the contention is that these assets are charged with a trust or lien to the extent of the reserve and thus losses to a like extent were deductible.

Nevertheless the Tax Court found that the partners had individually made the contribution to the corporation's capital surplus, and that there had been no sale or exchange resulting in a completed transaction showing a realized loss. This is amply supported by the record. The contribution was in fact and in form made by, and accepted from, the partners, and no reference was made to the "special reserve." Indeed it is conceded that the corporation in making its opening entries respecting the contributed cash and securities overlooked the "special reserve." But in December, 1940, a resolution was passed directing that the sum of $856,796.42 be charged to surplus reserve and credited to the special reserve fund. This transfer was accordingly made on the corporation books. All amounts which had been paid by the corporation to the firm's ex-employees were then charged to the fund, as have been all like payments since. This belated step shows that the contributed securities were not actually subject to a lien or trust and could not be considered more obligated for these payments than any other of the general assets of the firm. As a matter of fact, the corporation had expressly assumed the obligation to pay retirement allowances to these ex-employees by the bill of sale and agreement of March 30, 1940, without mention of or reference to this reserve. Hence both on the ground taken below and the first ground stated in this opinion the taxpayer's appeals must fail.

Finally the taxpayers make an overriding argument of losses to the individual partners upon liquidation of the partnership which is ingeniously audacious. They say that, even if the firm losses are disallowed under section 24(b) (1) (B), nevertheless upon the final winding up and liquidation of the firm on March 30, 1940, each partner sustained a loss measured by the adjusted cost of his interest in the partnership and the amount he received in liquidation. While the Tax Court did not discuss or even state this argument, it did say that losses "were sustained by each of the 13 partners" on the dissolution of the firm, and found the amount of such losses on three alternative hypotheses: (1) on their treatment as ordinary losses; (2) on their treatment as capital losses, with the holding period fixed by the time during which each partner held his partnership interest, and (3) on their treatment as capital losses, with the holding period fixed by the time during which the securities were owned by the firm. On these different hypotheses the losses would run in excess of a total of 5 million dollars if ordinary losses, and slightly above and slightly under half that amount on each of the other assumptions. It is of course interesting that by the application of the first hypothesis, which the taxpayers have particularly stressed on argument here, losses based upon essentially the same set of facts which we have held disallowed under section 24(b) (1) (B) as capital losses to an amount slightly under 3 millions in total become transmuted into ordinary losses totaling in excess of 5 million dollars.

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[7] The cash was added to cause this contribution to balance with certain reserves carried on the partnership books as liabilities, including a general reserve of $260,173.22, the special reserve of $856,796.42 discussed below, and profit and loss of $410,761.37—all totaling $1,527,731.01.

We do not think such deductions may be made by the individual taxpayers either in the light of the proper construction of section 24(b)(1)(B) or, beyond that, as a proven loss upon the partnership investment. Since the whole basis of the refusal of the deduction under section 24(b)(1)(B) is that the transfer is not such a change of economic interest as to be considered executed or closed to the point of realization of loss to the former owner, there is nothing which would change the prohibition by the added fact, obviously a usual one in the situation, of termination of the partnership. There can be little reason for a transfer in substantial amount of firm assets to a corporation except the substitution of the corporate way of doing business for the former partnership one; and the prohibition of section 24(b)(1)(B), unless it is to be meaningless, must be held to apply then equally or especially. But further, we do not see the basis for finding a partnership loss upon this liquidation in any of the amounts stated.

It may indeed be an interesting question how far such a partnership loss on liquidation, apart from the gains or losses the partner may show on his individual items of property, may be established in any event. The cases cited by the taxpayers are not exactly in point, since they deal with matters such as the time of realization of a gain on a capital contribution or of a loss on a liquidation in kind of the contribution of a limited partner.[8] Of course there may well be gain or loss in items as specific property; indeed section 24(b)(1)(B) then directly applies. Beyond that a partnership voluntarily liquidated can hardly suffer a loss of good will in its change of manner of doing business, since it has taken the step of its own choice and free will, and its new form of operation is seemingly preferable to the parties. If, however, as the taxpayers assume, the process must be one of considering partnership gains and losses over the period of business activity to strike a balance at the end, not only does the operation itself suggest doubts as to its validity, but the business history is here lacking to produce the result. True a final ingenuity of argument is shown in the development of a basis of valuation, for the taxpayers argue that the cost price is the amount received for the assets, plus the losses on the securities transferred under their cost, while the realization price is the liquidating amounts paid the partners.[9] Naturally, the amount of loss turns out to be once more the very loss on the securities themselves.

The taxpayers support this result by assuming regularity of proceedings, with proper adjustments of gains and losses, in earlier tax payments, so that at dissolution the partnership situation is properly reflected by the condition of the securities or assets finally disposed of and the receipts therefor and distributions to the partners. Such simplicity of result, leading to a desired, if not already visualized, sum, points to the artificiality of the process. How many problems involving all manner of disallowed losses (as in *C. I. R.* v. *Lamont*, *supra*) or unadmitted gains as on tax-exempt securities would actually arise on a detailed examination of firm history we can only surmise. It seems clear that, if ever a loss upon an investment in a partnership is to be deducted, it must be based upon a more realistic foundation than the mere deduction of cash distributed from cash received, plus investment losses. As the Commissioner suggests, since all adjustments of the partners' interest or capital account are assumed to have been duly made, his interest at dissolution would always equal his distributive cash. Actually any additional loss must be a loss upon some specific property which then is nondeductible under the circumstances here by reason of section 24(b)(1)(B).

Hence on the 13 petitions for review by the Commissioner, the decisions of the Tax Court will be reversed and the proceedings remanded for recomputation of the various taxes upon the basis of exclusion of losses as directed in this opinion. On the 13 petitions for review by the taxpayers, the decisions are affirmed.

[8] Of the first group are the cases cited in note 6 *supra;* of the second group are *Woodruff* v. *Commissioner*, 38 B. T. A. 739, and *Boettcher* v. *Commissioner*, B. T. A. Mem. Op. July 15, 1939, 1939 Prentice-Hall B. T. A. Memorandum Dec., 39,353, C. C. H. Dec. 10,794–A, which have not been authoritatively passed upon by appellate courts. See also U. S. Treas. Reg. 103, section 19.113(*a*)(13)–1 and 2.

[9] As stated above, the amount actually distributed to the partners was $12,210,321.08, representing the excess value of assets over liabilities paid them by the corporation of $12,265,394.09, less the cash item of $55,073.01 which they contributed to the corporation, note 7 *supra*. The partners eventually realized a small additional sum—$30,378.14—on the sale of their interest in Morgan & Cie., of Paris, a French partnership, to Morgan & Cie., Inc., as finally settled in 1945.

SECTION 25.—CREDITS OF INDIVIDUAL AGAINST NET INCOME

SECTION 29.25–3: Personal exemption, surtax exemptions, and exemptions for both normal tax and surtax.

INTERNAL REVENUE CODE

Parties named in an interlocutory decree of divorce in the State of California. (See I. T. 3942, page 69.)

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SECTION 43.—PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN

SECTION 29.43–2: When charges deductible. 1949–12–13102
I. T. 3956

INTERNAL REVENUE CODE

Accrual and deduction, for Federal income tax purposes, of vacation pay in the case of certain railroad corporations which in 1941 entered into agreements with labor unions as to *nonoperating* employees and in 1944 as to *operating* employees, which agreements provide for vacations with pay, or pay in lieu of vacations, for employees who rendered compensated service on not less than 160 days during the preceding calendar year.

Advice is requested as to accrual and deduction, for Federal income tax purposes, of vacation pay of railway employees under certain agreements between railroad corporations and labor unions representing such employees.

The agreement entered into on December 17, 1941, as amended February 23, 1945, between several railroad corporations and 14 labor unions, provides in effect that beginning with 1942 a vacation with pay (varying from 6 to 12 consecutive work days), or pay in lieu of such vacation, will be granted to each *nonoperating* employee who rendered compensated service on not less than 160 days during the preceding calendar year. Similar agreements were entered into on May 17, 1944, and September 1, 1944, which agreements provide in effect that beginning with 1944 a vacation with pay, or pay in lieu of such vacation, will be granted to each *operating* employee who rendered compensated service on not less than 160 days during the preceding calendar year. These two agreements regarding operating employees were combined in a "Consolidated Uniform Vacation Agreement" entered into on June 6, 1945.

The above-mentioned agreements provide that vacations may be taken from January 1 to December 31; that due regard shall be given to the desires and preferences of the employees in seniority order when fixing the dates for their vacations; that the rate to be used in the computation of the employee's vacation pay is, in general, the rate at which he is working at the time of taking the vacation; and that, if a carrier finds that it cannot release an employee for a vacation during the calendar year because of the requirements of the service, then such employee shall be paid an allowance in lieu of a vacation.

Article 8 of the several agreements states that "No vacation with pay, or payment in lieu thereof, will be due an employee whose employment relation with a carrier has terminated prior to the scheduled vacation period * * *, except that employees retiring under the provisions of the Railroad Retirement Act shall receive payment for vacation due." It was agreed on June 10, 1942, by the carriers and the labor unions, that an employee's employment relation is not terminated within the application of article 8 when he is (*a*) laid off or cut off on account of force reduction if he maintains rights to be recalled, (*b*) on furlough or leave of absence, or (*c*) absent on account of sickness or disability.

Section 43 of the Internal Revenue Code provides generally, with an exception that is immaterial here, that deductions and credits shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting used, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

The general rule applicable to taxpayers which keep their accounts and file their returns on the accrual basis is that there should be charged against the income of a taxable year the expenses incurred in and attributable to the process of earning income during that year, even though such expenses may not be paid until a subsequent year. Where all the events which determine the liability of the taxpayer have occurred within the taxable year, the liability may be said to have accrued even though the amount thereof has not been definitely ascertained during the taxable year (*United States* v. *Anderson*, 269 U. S. 422, T. D. 3839, C. B. V-1, 179 (1926), and *Lucas* v. *American Code Co., Inc.*, 280 U. S. 445, Ct. D. 168, C. B. IX-1, 314 (1930)), but if it is uncertain whether any liability exists, there can be no accrual for tax purposes until the contingency disappears and liability becomes fixed and certain (*Brown* v. *Helvering*, 291 U. S. 193, Ct. D. 786, C. B. XIII-1, 223 (1934), and *Highland Milk Condensing Co.* v. *Phillips*, 34 Fed. (2d) 777, Ct. D. 117, C. B. VIII-2, 301 (1929)).

In the instant case, an employee's right to a vacation, or pay in lieu thereof, is established by virtue of his having performed services during the preceding taxable year. As of the end of a taxable year, the employer railroad is obligated to give, in the succeeding taxable year, a vacation with pay (or pay in lieu thereof) with respect to all those employees who have rendered compensated services during the taxable year for the number of days (160) specified in the agreements. After the end of a taxable year, the liability for vacations with pay (or pay in lieu thereof) may, with respect to some employees, be terminated if the employment relation is terminated prior to the scheduled vacation period. This circumstance, however, will not preclude the accrual of vacation pay at the end of the taxable year in which the services are performed, since, with respect to the individual employee at the end of such year, the employer would be justified in anticipating that the liability will be paid (*Helvering* v. *Russian Finance and Construction Corporation et al.*, 77 Fed. (2d) 324) or, with respect to the employees as a group, such circumstance would only make uncertain the ultimate amount of liability to the group (*Lucas* v. *American Code Co., Inc.*, *supra*, and *Continental Tie & Lumber Co.* v. *United States*, 286 U. S. 290, Ct. D. 494, C. B. XI-1, 260 (1932)).

It is the opinion of this office that the liability for vacation payments is fixed as of the close of the taxable year in which the qualifying services were rendered and should not be considered contingent as of that date.

Accordingly, it is held (1) that for each of the calendar years 1941 to 1947, inclusive, the employer should accrue at the end of such year, as a deduction for Federal income tax purposes, the amount of its liability to make vacation payments to *nonoperating* employees in the succeeding taxable year, which amount should equal the amount actually paid in such succeeding taxable year; (2) that for the calendar year 1944 the employer should deduct the amounts paid to its *operating* employees as vacation pay during such year and the accrued amount of such vacation pay as of the close of such year, which accrued amount should equal the amount actually paid in 1945; and (3) that for each of the calendar years 1945, 1946, and 1947 the employer should accrue at the end of the year, as a deduction, the amount of its liability to make vacation payments to *operating* employees in the succeeding taxable year, which amount should equal the amount actually paid in such succeeding taxable year.

With respect to the calendar year 1948 and subsequent calendar years, there should be accrued and deducted for Federal income tax purposes a reasonable estimate, based on the best information available, of the employer's liability to make vacation payments to operating and nonoperating employees during the succeeding taxable year. (Cf. G. C. M. 25261, C. B. 1947-2, 44.) Any adjustments of these accruals in succeeding taxable years to conform to the actual liability may be treated as "overlapping items," as provided by section 29.43-2 of Regulations 111.

The principles set forth herein are not confined to cases involving railroad corporations, but are applicable to all taxpayers employing the accrual method of accounting for Federal income tax purposes who, under labor union agreements, have become liable for vacation pay as of the close of the taxable year in respect of vacations with pay, or pay in lieu thereof, to be taken or received during the succeeding year. However, such taxpayers may accrue and deduct vacation pay for the year in which it is paid if that has been the consistent practice of the taxpayer and if there is a substantial condition to actual payment, such as being in the employ of the employer at the time of the scheduled vacation.

PART V.—RETURNS AND PAYMENT OF TAX

SECTION 51.—INDIVIDUAL RETURNS

SECTION 29.51-1: Individual returns.

INTERNAL REVENUE CODE

Parties named in an interlocutory decree of divorce in the State of California. (See I. T. 3942, page 69.)

SECTION 29.51-1: Individual returns.

INTERNAL REVENUE CODE

Joint return where husband is traveling abroad and wife previously filed a separate return. (See I. T. 3946, below.)

SECTION 53.—TIME AND PLACE FOR FILING RETURNS

SECTION 29.53-3: Extensions of time in the case of foreign organizations, certain domestic corporations, citizens of United States residing or traveling abroad, and nontaxable returns of fiduciaries for estates or trusts. (Also Section 51, Section 29.51-1.)

1949-8-13061
I. T. 3946

INTERNAL REVENUE CODE

The extension of time for filing Federal income tax returns provided by section 29.53-3(*a*) (5) of Regulations 111, for citizens of the United States residing or traveling abroad, is applicable to a joint return filed on or before the 15th day of the sixth month following the close of the taxable year even though the wife has previously filed a separate return.

Advice is requested whether the extension of time for filing Federal income tax returns provided by section 29.53-3(*a*) (5) of Regulations 111, for citizens of the United States residing or traveling abroad, is applicable to a joint return filed on or before the 15th day of the sixth month following the close of the taxable year where the husband is traveling abroad and the wife has previously filed a separate return.

Section 53(a) (2) of the Internal Revenue Code provides as follows:

(2) EXTENSION OF TIME.—The Commissioner may grant a reasonable extension of time for filing returns, under such rules and regulations as he shall prescribe with the approval of the Secretary. Except in the case of taxpayers who are abroad, no such extension shall be for more than six months.

Section 29.53-3(*a*) of Regulations 111, promulgated under the foregoing provision of law, provides in part:

(*a*) An extension of time for filing returns of income for taxable years beginning after December 31, 1941, is hereby granted up to and including the 15th day of the sixth month following the close of the taxable year in the case of:

* * * * * * *

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

O. D. 521 (C. B. 2, 203 (1920)) holds that where a husband and wife file a joint return and an extension of time has been granted to either of them, the benefit of the extension inures to both and it is unnecessary for the other party to secure additional authority.

It is held that the extension of time for filing Federal income tax returns provided by section 29.53-3(*a*) (5) of Regulations 111, *supra*, for citizens of the United States residing or traveling abroad, is applicable to a joint return filed on or before the 15th day of the sixth month following the close of the taxable year even though the wife has previously filed a separate return.

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT B.—COMPUTATION OF NET INCOME

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

SECTION 29.113(a)-2: General rule.

INTERNAL REVENUE CODE

Basis of vessel with respect to which an adjustment has been made under section 9 of the Merchant Ship Sales Act of 1946. (See Mim. 6366, page 270.)

SECTION 117.—CAPITAL GAINS AND LOSSES

SECTION 29.117-4: Determination of period for which capital assets are held. 1949-11-13093 I. T. 3954

INTERNAL REVENUE CODE

Application of I. T. 3919 (C. B. 1948-2, 67), relating to determination of the holding period, for the purpose of section 117 of the Internal Revenue Code, of a commodity received pursuant to a futures purchase contract.

I. T. 3919 (C. B. 1948-2, 67) holds that for the purpose of determining the period during which capital assets are held, under section 117 of the Internal Revenue Code, the period during which a futures purchase contract is held by an individual trader may not be included as part of the holding period of the commodity received pursuant to the contract.

Pursuant to authority contained in section 3791(b) of the Internal Revenue Code, I. T. 3919, *supra*, will be applied only to futures purchase contracts entered into on and after August 23, 1948, the date on which that ruling was promulgated, except that short-term capital loss treatment may be given in cases where, in reliance on the rule contained in I. T. 3919, sales have been made within 6 months after delivery of the commodity under futures purchase contracts entered into prior to such promulgation date.

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved April 20, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

SECTION 119.—INCOME FROM SOURCES WITHIN UNITED STATES

SECTION 29.119-2: Interest.

INTERNAL REVENUE CODE

Interest paid by a domestic corporation to a nonresident foreign (Cuban) corporation on a loan negotiated in Cuba. (See I. T. 3940, page 113.)

SECTION 29.119-4: Compensation for labor or personal services. (Also Section 211, Section 29.211-7.)

1949-6-13040
I. T. 3943

INTERNAL REVENUE CODE

A nonresident alien individual, an employee of a foreign branch of a domestic corporation, is subject to Federal income tax with respect to salary received by him for the period he was in the United States attending an international sales convention and sales promotion meetings.

Advice is requested whether salary received by a nonresident alien individual, an employee of a foreign branch of domestic corporation, for the period during which he was in the United States attending an international sales convention and sales promotion meetings is subject to Federal income tax.

The taxpayer is manager of a foreign branch of a *domestic corporation*. The branch is a self-controlled, autonomous unit, the affairs of which are administered abroad. It keeps its own books of account and sends to the head office in the United States its monthly balance sheets and profit and loss statements in the same manner as would normally be done by a subsidiary corporation. The resident manager of the branch has exclusive authority to accept or reject orders for merchandise. Authority for the performance of all administrative functions of the branch is delegated to the manager by an appropriate power of attorney.

The taxpayer came to the United States for the purpose of attending an international sales convention and sales promotion meetings conducted by the domestic corporation and its subsidiaries. His stay was for a period of approximately 36 days. The general purpose of the convention and meetings was to inform those in attendance as to what was being done by the domestic corporation in promoting sales, and to demonstrate the use of implements, tools, and equipment developed in recent years.

Section 119(a)(3) of the Internal Revenue Code provides as follows:

(a) GROSS INCOME FROM SOURCES IN UNITED STATES.—The following items of gross income shall be treated as income from sources within the United States:

* * * * * * *

(3) PERSONAL SERVICES.—Compensation for labor or personal services performed in the United States, but in the case of a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of ninety days during the taxable year, compensation received by such an individual (if such compensation does not exceed $3,000 in the aggregate) for labor or services performed as an employee of or under a contract with a nonresident alien, foreign partnership, or *foreign corporation*, not engaged in trade or business within the United States, shall not be deemed to be income from sources within the United States; [Italics supplied.]

Section 29.119-4 of Regulations 111 provides in part as follows:

COMPENSATION FOR LABOR OR PERSONAL SERVICES.—Except as provided in section 119(a)(3), gross income from sources within the United States includes compensation for labor or personal services performed within the United States regardless of the residence of the payor, of the place in which the contract for service was made, or of the place of payment. * * *

Section 211(b) of the Code provides in part as follows:

(b) UNITED STATES BUSINESS OR OFFICE.—A nonresident alien individual engaged in trade or business within the United States shall be taxable without regard to the provisions of subsection (a). As used in this section, section 119, * * * the phrase "engaged in trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year, but does not include the performance of personal services for a nonresident alien individual, foreign partnership, or *foreign corporation*, not engaged in trade or business within the United States, by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of ninety days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000. * * * [Italics supplied.]

No personal services could have been performed by the taxpayer in a foreign country during the period in which he was physically present in the United States. It is clear that during that period of time the services for which the taxpayer was compensated were performed in this country. It follows, therefore, that such compensation was from sources within the United States. (Section 119(a)(3), I. R. C.)

Accordingly, it is held that a nonresident alien individual, an employee of a foreign branch of a domestic corporation, is subject to Federal income tax with respect to salary received by him for the period he was in the United States attending an international sales convention and sales promotion meetings.

O. D. 578 (C. B. 3, 128 (1920)) relates to compensation received during a taxable year to which the Revenue Act of 1918 is applicable and should not be followed in applying the provisions of the Internal Revenue Code.

SECTION 122.—NET OPERATING LOSS DEDUCTION

SECTION 29.122-3: Computation of net operating loss in case of a taxpayer other than a corporation. — 1949-9-13073 I. T. 3951

INTERNAL REVENUE CODE

In determining a net operating loss under section 122 of the Internal Revenue Code in the case of a taxpayer other than a corporation, the amount of State income tax paid is allowable as a deduction only to the extent of gross income not derived from a trade or business.

Advice is requested whether the amount of State income tax paid is an allowable deduction in determining a net operating loss under section 122 of the Internal Revenue Code in the case of a taxpayer other than a corporation.

In the instant case, an individual taxpayer who keeps his books and files his Federal income tax returns on the cash receipts and disbursements basis for calendar years, in computing a net operating loss for 1944 deducted the amount of his 1943 State income tax paid in 1944, and in computing a net operating loss for 1945 deducted State income taxes for 1940 and 1941 which were paid in 1945. The taxpayer had no ordinary nonbusiness gross income in either 1944 or 1945.

Section 122 of the Internal Revenue Code provides in part as follows:

SEC. 122. NET OPERATING LOSS DEDUCTION.

(a) DEFINITION OF NET OPERATING LOSS.—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter [Chapter 1 of the Code] over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

* * * * * * *

(d) EXCEPTIONS, ADDITIONS, AND LIMITATIONS.—The exceptions, additions, and limitations referred to in subsections (a), * * * shall be as follows:

* * * * * * *

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. * * *

The specific question presented in the instant case is whether State income tax, an expenditure which is allowable under section 23(c) of the Code as a deduction in computing net income, may be considered as attributable to the operation of the taxpayer's trade or business within the meaning of section 122(d) (5) of the Code, *supra.* If not, then it is deductible in computing a net operating loss only to the extent of the amount of ordinary nonbusiness gross income. (See section 29.122-3(*a*) (7) of Regulations 111.)

Section 451(a) of the Internal Revenue Code (now repealed) provides that "victory tax net income" means gross income minus, *inter alia*, amounts allowable as a deduction by section 23(c), to the extent such amounts are paid or incurred in connection with the carrying on of a trade or business. I. T. 3644 (C. B. 1944, 372) holds that State income taxes are not deductible for victory tax purposes for the implied reason that such taxes are not paid or incurred in connection with the carrying on of the taxpayer's trade or business.

Section 22(n) of the Internal Revenue Code provides that "adjusted gross income" means the gross income minus, *inter alia*, the deductions allowed by section 23 which are attributable to a trade or business carried on by the taxpayer. Section 29.22(n)-1 of Regulations 111 provides in part as follows:

* * * To be deductible for the purposes of determining adjusted gross income, expenses must be those directly, and not those merely remotely, connected with the conduct of the trade or business. For example, taxes are deductible in arriving at adjusted gross income only if they constitute expenditures directly *attributable* to the trade or business * * * Thus, property taxes paid or incurred on real property used in the trade or business are deductible but *State income taxes are not deductible* even though the taxpayer's income is derived from the conduct of a trade or business. [Italics supplied.]

Accordingly, it is held that in determining a net operating loss under section 122 of the Internal Revenue Code in the case of a taxpayer other than a corporation, the amount of State income tax paid is allowable as a deduction only to the extent of gross income not derived from a trade or business.

SUPPLEMENT C.—CREDITS AGAINST TAX

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

SECTION 29.131–2: Meaning of terms.

1949–5–13031
I. T. 3941

INTERNAL REVENUE CODE

Malayan income tax accounted for by a dividend-paying corporation with respect to corporate profits distributed as a dividend is a tax paid by the distributing corporation, and as such should not be claimed as a credit against United States income tax, under section 131(a)(1) of the Internal Revenue Code, by the stockholders.

Advice is requested whether the income tax imposed by the Malayan Income Tax Ordinance, 1947, as amended, accounted for by a dividend-paying corporation with respect to corporate profits distributed as a dividend, is, for the purposes of section 131(a)(1) of the Internal Revenue Code, a tax paid by the distributing corporation or by its stockholders.

In the case under consideration, a domestic corporation (the taxpayer) is engaged in business operations in Malaya. The domestic corporation has a subsidiary which is organized under the laws of Malaya and which is also engaged in business operations there. Both corporations are subject to the Malayan income tax.

Section 10(1)(*d*) of the Malayan ordinance provides that income tax shall be payable in respect of dividends received. Section 26 provides that the dividend income returnable for Malayan income tax purposes is the amount received plus the tax deducted therefrom by the payor corporation, and that where no such deduction has been made, "the income arising shall be the amount of the dividend increased by an amount on account of such taxes corresponding to the extent to which the profits out of which the said dividend has been paid have been charged with such taxes." The tax rate applicable to corporations is prescribed in section 39, which also provides for an adjustment of the tax by the comptroller of income tax upon a showing that dividends have been paid out of "chargeable" income.

Section 40 of the Malayan ordinance, as amended, provides as follows:

40. (1) Every company which is resident in the Federation shall be entitled to deduct from the amount of any dividend paid to any shareholder tax at the rate paid or payable by the company, as reduced by any relief granted under sections 43, 44 or 46 of this ordinance, on the chargeable income of the year of assessment within which the dividend is declared payable:

Provided that—

(i) where tax is not paid or payable by the company on the whole income out of which the dividend is paid, the deduction shall be restricted to that portion of the dividend which is paid out of income on which tax is paid or payable by the company;

(ii) the comptroller may give notice in writing for any year of assessment to a company resident in the Federation requiring it to deduct tax from dividends payable to a particular shareholder at a rate greater than the rate paid or payable by the company, and the company shall thereupon deduct tax from all dividends paid during that year of assessment to that shareholder at the rate mentioned in the notice and the excess tax so deductible shall be a debt due from the company to the Government and shall be recoverable forthwith as such or may be assessed and charged upon the company in addition to any other tax otherwise payable by it.

(2) Every such company shall upon payment of a dividend, whether tax is deducted therefrom or not, furnish each shareholder with a certificate setting forth the amount of the dividend paid to that shareholder and the amount of tax which the company has deducted or is entitled to deduct in respect of that dividend.

Section 42 provides that any tax which the dividend-paying corporation has deducted with respect to a dividend shall, when the dividend is included in the chargeable (taxable) income of the stockholder, be set off against the tax charged to the stockholder with respect to the dividend. Section 89 provides that if the tax paid by any person by deduction or otherwise exceeds the amount with which he is properly chargeable, such person shall be entitled to have the amount of the excess tax refunded.

The taxpayer contends that the tax in respect to corporate earnings distributed as dividends is a tax upon the stockholder, and not upon the dividend-distributing corporation, for the reason that the corporation does not have to account for tax as to that portion of corporate earnings distributed to a particular stockholder if it is shown that he is not taxable, and that the provisions of section 40(1) of the Malayan ordinance confirm that contention.

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

(a) ALLOWANCE OF CREDIT.—If the taxpayer chooses to have the benefits of this section, the tax imposed by this chapter [Chapter 1 of the Code], except the tax imposed under section 102, shall be credited with:

(1) CITIZENS AND DOMESTIC CORPORATIONS.—In the case of * * * a domestic corporation, the amount of any income * * * taxes paid or accrued during the taxable year to any foreign country * * *

In *Biddle* v. *Commissioner* (302 U. S. 573, Ct. D. 1303, C. B. 1938-1, 309), relating to a similar question with respect to British taxes, it is stated that the "decision must turn on the precise meaning of the words in the statute which grants to the citizen taxpayer a credit for foreign 'income taxes paid.' " Paraphrasing the language used by the Supreme Court in the Biddle opinion and applying it to the instant case, section 131 of the Internal Revenue Code does not say that the meaning of its words is to be determined by foreign taxing statutes and decisions, and there is nothing in its language to suggest that in allowing the credit for foreign tax payments, a shifting standard is to be adopted by reference to foreign characterizations and classifications of tax legislation. Inclusion of the deducted amount in the base on which tax is calculated, together with the provisions for refund of excess tax to the stockholder, and the apparent recognition under the Malayan tax ordinance of the stockholder as the taxpayer, are recognitions of the conception under the foreign taxing statute to which our revenue laws give no recognition. Our statutes have never treated the stockholder for any purpose as paying the tax collected from the corporation. Nor have they treated as taxpayers those upon whom no legal duty to pay the tax is laid. Measured by these standards, our statutes afford no basis for saying that the stockholder of a foreign corporation pays the tax which is laid upon and collected from the corporation, and no basis for a decision that section 131 extends to such a stockholder a credit for a tax paid by the corporation—a privilege not granted to stockholders in our own corporations.

Accordingly, it is held that Malayan income tax accounted for by a dividend-paying corporation with respect to corporate profits distributed as a dividend is a tax paid by the distributing corporation, and as such should not be claimed as a credit, under section 131(a)(1) of the Code, against United States income tax by the stockholders.

SECTION 29.131-7: Taxes of subsidiary corporations. 1949-7-13054 I. T. 3945

INTERNAL REVENUE CODE

The taxes imposed by the Mexican Mining Tax and Mining Fee Law of August 30, 1934, with respect to the value of metals, metallic compounds, and nonmetallic ores produced in Mexico, are not income taxes or taxes in lieu of income taxes within the meaning of section 131 (f) and (h) of the Internal Revenue Code, and a credit for such taxes is not allowable under section 131 of the Code.

Advice is requested whether the taxes imposed by the Mexican Mining Tax and Mining Fee Law of August 30, 1934 (published in the Official Journal of August 31, 1934), are income taxes or taxes in lieu of income taxes within the purview of section 131 (f) and (h) of the Internal Revenue Code.

Article 1 of Chapter I of the Mexican law designated as the "Mining Tax and Mining Fee Law" states that the taxes which are assessed on mining are on mining properties, on the production of metals and metallic compounds, and on the production of nonmetallic ores. The rates of taxes on metal production are provided for in Chapter III, article 8 thereof setting forth the specific rates which apply on the values of gold, silver, and other metals in the various stages of production. Provision is made for an increase in the rate of tax in case of increases in values on the New York market. The fixing of the monthly values of metals and metallic compounds by the Mexican Government is provided for in article 13 of Chapter III, and Chapter IV sets forth the places and the times for payment of the taxes. Chapter VII provides for the filing of monthly declarations with respect to the production of ores and metallurgical products, and Chapter X sets forth circumstances under which no tax is assessed. The law in question is not a part of the general Mexican income tax law entitled "Ley del Impuesto sobre la Renta." A mining tax was imposed many years before the enactment of the general income tax law of Mexico in 1924. The first of the present series of mining tax laws was published in the Official Journal on July 3, 1919, and the last one, the law under consideration, was published in the Official Journal on August 31, 1934.

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

(f) TAXES OF FOREIGN SUBSIDIARY.—

(1) FOREIGN SUBSIDIARY OF DOMESTIC CORPORATION.—For the purposes of this section, a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid or deemed to be paid by such foreign corporation to any foreign country * * * upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits. * * *

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

(h) CREDIT FOR TAXES IN LIEU OF INCOME, ETC., TAXES.—For the purposes of this section and section 23(c)(1), the term "income, war-profits, and excess-profits taxes" shall include a tax paid in lieu of a tax upon income, war-profits, or excess-profits otherwise generally imposed by any foreign country * * *

Examination of the provisions of the Mexican Mining Tax and Mining Fee Law does not indicate that the taxes thereunder are imposed on the profits of the mining industry, but indicates that the taxes are imposed on the value of the ore produced. The costs of operation do not constitute factors in the determination of such value. The taxes here involved are applicable regardless of whether there is income from the property, and they appear to be levied for the right and privilege of exploiting mining properties. They are not income taxes as contemplated in section 131(f) of the Internal Revenue Code, *supra.*

With respect to the question whether the mining taxes are taxes in lieu of taxes on income, it is the opinion of this office that the import of section 131(h) of the Code, *supra*, is that, for the purposes of section 131 of the Code, the term "income, war-profits, and excess-profits taxes" includes a tax imposed by statute or decree by a foreign country if (*a*) such country has in force a general income tax, (*b*) such general income tax is not imposed upon the taxpayer, and (*c*) the taxpayer claiming the credit would, in the absence of a specific provision applicable to such taxpayer, be subject to such general income tax. As stated above, Mexico has a general income tax law, and it appears that Mexican mining subsidiaries of United States corporations are subject to the general income tax in addition to being subject to the mining taxes. It appears, therefore, that the mining taxes are not paid in lieu of income taxes.

Accordingly, it is held that the taxes imposed by the Mexican Mining Tax and Mining Fee Law of August 30, 1934, with respect to the value of metals, metallic compounds, and nonmetallic ores produced in Mexico, are not income taxes or taxes in lieu of income taxes within the meaning of section 131 (f) and (h) of the Internal Revenue Code, and a credit for such taxes is not allowable under section 131 of the Code.

SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX

SECTION 141.—CONSOLIDATED RETURNS

SECTION 23.11, REGULATIONS 104: Consolidated returns for subsequent years. 1949–13–13111 I. T. 3958

INTERNAL REVENUE CODE

Affiliated corporations which filed consolidated Federal income tax returns for fiscal years ended in 1948 may, notwithstanding the filing of such returns, file separate Federal income tax returns for fiscal years ending in 1949.

Advice is requested whether affiliated corporations which filed consolidated Federal income tax returns for fiscal years ended in 1948 may elect to file separate Federal income tax returns for fiscal years ending in 1949.

Section 141(a) of the Internal Revenue Code, as amended, provides in part as follows:

(a) PRIVILEGE TO FILE CONSOLIDATED INCOME AND EXCESS-PROFITS-TAX RETURNS.—* * * The making of consolidated returns shall be upon the condition that the affiliated group shall make both a consolidated income-tax return and a consolidated excess-profits-tax return for the taxable year, and that all corporations which at any time during the taxable year have been members of the affiliated group making a consolidated income-tax return consent to all the consolidated income- and excess-profits-tax regulations prescribed under subsection (b) prior to the last day prescribed by law for the filing of such return. * * *

Section 23.11(*a*) of Regulations 104, as amended, relating to consolidated income tax returns of affiliated corporations, provides in part as follows:

(*a*) *Consolidated Returns Required for Subsequent Years.* If a consolidated return is made under these regulations for any taxable year, a consolidated return must be made for each subsequent taxable year during which the affiliated group remains in existence unless * * * (2) Chapter 1 of the Code to the extent applicable to corporations, or these regulations which have been consented to, have been amended and any such amendment is of a character which makes less advantageous to affiliated groups as a class the continued filing of consolidated returns, * * *

It is held that the law applicable to the filing of consolidated Federal income tax returns has been so amended as to make less advantageous to affiliated groups as a class the continued filing of such returns, within the meaning of section 23.11(*a*) of Regulations 104, as amended, for fiscal years ending in 1949. Accordingly, affiliated corporations which filed consolidated Federal income tax returns for fiscal years ended in 1948 may, notwithstanding the filing of such returns, file separate Federal income tax returns for fiscal years ending in 1949.

SECTION 142.—FIDUCIARY RETURNS

SECTION 29.142–1: Fiduciary returns. 1949–13–13112
(Also Section 322, Section 29.322–3.) I. T. 3959

INTERNAL REVENUE CODE

A trustee in bankruptcy has no authority, in his capacity as trustee, to file a Federal income tax return on behalf of a bankrupt individual. Such individual is required to file a return for each of his taxable years, unless otherwise excepted by law. The period for which a return must be made by the bankrupt individual is not affected by the intervention of bankruptcy proceedings, and his return should cover a full taxable year. The return filed by the trustee on behalf of the bankrupt estate should be on Form 1041 and should cover the taxable year of the estate.

The right of a bankrupt individual to a refund of income tax erroneously paid for a period prior to bankruptcy passes to the trustee in bankruptcy upon the filing of the petition, and refund of such tax may be made to the trustee only on the basis of a proper claim for refund filed by him.

Advice is requested with respect to the filing of individual income tax returns by a trustee in bankruptcy on behalf of a bankrupt individual.

In the instant case, the bankrupt is an individual who operated a business in his individual capacity throughout the taxable year 1946. He overpaid his individual Federal income tax for 1946 in the amount of $500. The taxpayer filed a petition in bankruptcy on October 16, 1947, and was adjudicated a bankrupt on November 5, 1947. The trustee in bankruptcy did not file a Federal income tax return for 1947 as trustee, but he did file a return for the bankrupt individual on Form 1040 for the period January 1, 1947, to October 31, 1947. That return shows the individual overpaid his 1946 income tax liability by $500, and a refund of that amount is claimed in the return.

The trustee in bankruptcy is entitled, by operation of the Bankruptcy Act, as amended, to the $500 overpaid by the bankrupt individual. With respect to the trustee's rights and the items of property, or property rights, which he takes over from the individual, section 70 of the Bankruptcy Act, as amended, provides in part as follows:

SEC. 70. TITLE TO PROPERTY.—a. The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition in bankruptcy * * * to all * * * (5) Property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered * * *; (6) Rights of action arising upon contracts, or usury, or the unlawful taking or detention of or injury to his property * * *

Accordingly, the Bankruptcy Act, as amended, operates to transfer (with certain immaterial exceptions) to the trustee in bankruptcy everything which the bankrupt individual owns as of the date the petition in bankruptcy is filed. (See *Chandler* v. *Nathans*, 6 Fed. (2d) 725, decided prior to enactment of the so-called Chandler Act, 52 Stat. 840.)

The $500 overpaid by the bankrupt individual for the taxable year 1946 is an asset of the bankrupt's estate which has not been reduced to possession. Since the bankrupt, as an individual, and the trustee in bankruptcy are two separate taxable entities, each being required to file a Federal income tax return, the proper course for the trustee to follow in order to obtain a refund of the 1946 overpayment is to file a claim for refund on Form 843. (See section 29.322-3 of Regulations 111.)

The trustee in bankruptcy has no authority, in his capacity as trustee, to file a Federal income tax return for the bankrupt individual. The individual is required to file an income tax return for each of his full taxable years, unless otherwise excepted by law, and neither the institution of bankruptcy proceedings nor the adjudication of bankruptcy alters his duty in this regard in any respect. The trustee in bankruptcy is a fiduciary. (See section 3797(a)(6) of the Internal Revenue Code.) As a fiduciary, a trustee in bankruptcy is required by section 142 of the Internal Revenue Code and section 29.142-1 of Regulations 111 to file a return on Form 1041 (United States Fiduciary Income Tax Return) for the estate he is administering, if the income of the estate is sufficient to require a return. Such return should cover the taxable year of the bankrupt estate, calendar or fiscal as the trustee may elect. Any tax which may be due on the basis of such return is imposed by section 161 of the Code, relating to estates and trusts. (See G. C. M. 24617, C. B. 1945, 235.)

In view of the foregoing, a collector of internal revenue is not authorized to accept as a correct return a Form 1040 filed by a trustee in bankruptcy on behalf of a bankrupt individual. Such a return does not qualify as a return for the individual or as a return for the bankrupt estate.

SECTION 143.—WITHHOLDING OF TAX AT SOURCE

SECTION 29.143-1: Withholding tax at source. 1949-6-13041
(Also Section 144, Section 29.144-1.) T. D. 5690

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 7.—TAXATION PURSUANT TO TREATIES.—SUBPART—NETHERLANDS, BEGINNING JANUARY 1, 1947

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 the Netherlands and of Netherlands corporations, as affected by the reciprocal income tax convention between the United States and the Kingdom of the Netherlands proclaimed by the President of the United States on December 8, 1948.

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

To Collectors of Internal Revenue and Others Concerned:

On December 28, 1948, notice of proposed rule making under the income tax convention between the United States and the Kingdom of the Netherlands, proclaimed by the President of the United States on December 8, 1948, was published in the Federal Register (13 F. R. 8401). After consideration of all such relevant matter as was presented by interested persons regarding the proposal, the following regulations are adopted for the purposes of such convention. These regulations are necessary to prescribe rules with respect to release of excess tax withheld, and exemption from, or reduction in the rate of, withholding under sections 143 and 144 of the Internal Revenue Code in the case of residents of the Netherlands and of Netherlands corporations, as affected by such convention.

TABLE OF CONTENTS

SECTION 7.800. INTRODUCTORY.—The income tax convention between the United States and the Kingdom of the Netherlands, signed April 29, 1948, proclaimed by the President of the United States on December 8, 1948, and effective on January 1, 1947 (hereinafter referred to as the convention), provides in part as follows:

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 the Netherlands:

(i) for the application of the provisions of the convention other than Article XX, the income tax and the Netherlands taxes credited against it, the corporation tax and the Netherlands taxes credited against it, the property tax, and the tax on fees of directors and managers of corporations; and

(ii) for the application of Articles XX to XXVIII inclusive (except Articles XXIV and XXVII), the capital accretions tax and the extraordinary capital tax.

(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 overseas part of the Kingdom (in the case of the Netherlands) or overseas territory (in the case of the United States) to which the present convention is extended under Article XXVII, subsequently to the date of the notification of extension.

(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 "Netherlands" means only the Kingdom of the Netherlands in Europe.

(*c*) The term "United States corporation" means a corporation, association, or other organization or juridical entity created 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 "Netherlands corporation" means a corporation, association, or other organization or juridical entity created in the Netherlands or under the laws of the Netherlands.

(*e*) The terms "corporation of one contracting state" and "corporation of the other contracting state" mean a United States corporation or a Netherlands corporation, as the context requires.

(*f*) 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 United States corporation.

(*g*) The term "Netherlands enterprise" means an industrial or commercial enterprise or undertaking carried on in the Netherlands by a citizen or resident of the Netherlands or by a Netherlands corporation.

(*h*) The terms "enterprise of one of the contracting states" and "enterprise of the other contracting state" mean a United States enterprise or a Netherlands enterprise, as the context requires.

(*i*) The term "permanent establishment," when used with respect to an enterprise of one of the contracting states, means a branch, factory, 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 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, broker, or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the contracting states maintains in the other contracting state a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. When a corporation of one contracting state has a subsidiary corporation which is a corporation of 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.

(*j*) 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; in the case of the Netherlands, the Directeur-Generaal der Belastingen or his duly authorized representative;

and, in the case of any part or territory to which provisions of the present convention are extended under Article XXVII, the competent authority for the administration in such part or territory of the taxes to which such provisions apply.

(2) In the application of the provisions of the present convention by either of the contracting states, any term which is not defined in the present convention 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.

* * * * * * *

Article V

Income of whatever nature derived from real property and interest from mortgages secured by real property shall be taxable only in the contracting state in which the real property is situated.

* * * * * * *

Article VII

(1) The rate of United States tax on dividends derived from a United States corporation by a resident or corporation of the Netherlands not engaged in trade or business in the United States through a permanent establishment shall not exceed 15 percent: Provided that such rate of tax shall not exceed 5 percent if such Netherlands corporation controls, directly or indirectly, at least 95 percent of the entire voting power in the corporation paying the dividend, and not more than 25 percent of the gross income of such paying corporation is derived from interest and dividends, other than interest and dividends from its own subsidiary corporation. Such reduction of the rate to 5 percent shall not apply if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing such reduced rate.

(2) Dividends derived from sources within the Netherlands by a resident or corporation of the United States not engaged in trade or business in the Netherlands through a permanent establishment shall be exempt from Netherlands tax.

(3) Either of the contracting states may terminate this article, by giving written notice of termination to the other contracting state through diplomatic channels, on or before the 30th day of June in any year after the first year for which the present convention becomes effective. In such event this article shall cease to be effective on and after the 1st day of January in the year next following that in which such notice is given.

Article VIII

(1) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness), other than interest referred to in Article V of the present convention, derived from sources within the United States by a resident or corporation of the Netherlands not engaged in trade or business in the United States through a permanent establishment, shall be exempt from United States tax; but such exemption shall not apply to such interest paid by a United States corporation to a Netherlands corporation controlling, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation.

(2) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness), other than interest referred to in Article V of the present convention, derived from sources within the Netherlands by a resident or corporation of the United States not engaged in trade or business in the Netherlands through a permanent establishment, shall be exempt from Netherlands tax; but such exemption shall not apply to such interest paid by a Netherlands corporation to a United States corporation controlling, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation.

Article IX

Royalties for the right to use copyrights, patents, designs, secret processes and formulae, trade-marks, and other analogous property, and royalties, including rentals, in respect of motion picture films or for the use of industrial, commercial, or scientific equipment, derived from sources within one of the contracting states by a resident or corporation of the other contracting state not engaged in trade or business in the former state through a permanent establishment, shall be exempt from tax imposed by the former state.

* * * * * * *

ARTICLE XII

Dividends and interest paid by a Netherlands corporation shall be exempt from United States tax except where the recipient is a citizen, resident, or corporation of the United States.

* * * * * * *

ARTICLE XV

* * * * * * *

(2) Private pensions and life annuities derived from within one of the contracting states and paid to individuals 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 "life annuities" as used in this article means a stated sum payable periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration in money or money's worth.

* * * * * * *

ARTICLE XXVI

(1) The authorities of each of the contracting states, in accordance with the practices of that state, may prescribe regulations necessary to carry out the provisions of the present convention.

(2) With respect to the provisions of the present convention relating to exchange of information and mutual assistance in the collection of taxes, the competent authorities may, by common agreement, prescribe rules concerning matters of procedure, forms of application and replies thereto, conversion of currency, disposition of amounts collected, minimum amounts subject to collection, and related matters.

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ARTICLE XXVIII

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(2) The present convention shall become effective on the 1st day of January in the year last preceding the year in which the exchange of instruments of ratification takes place. It shall continue effective for a period of 5 years beginning with that date 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 months' prior notice of termination has been given, the termination to become effective on the 1st day of January following the expiration of the 6-month period.

* * * * * * *

As used in this Treasury Decision, unless the context otherwise requires, the terms defined in the above articles of the convention shall have the meanings so assigned to them.

SEC. 7.801. DIVIDENDS.—(*a*) *General.*—The rate of tax imposed by section 211(a) of the Internal Revenue Code (relating to nonresident alien individuals not engaged in trade or business within the United States) and by section 231(a) of the Internal Revenue Code (relating to foreign corporations not engaged in trade or business within the United States) is 30 percent. Such rate is reduced under Article VII of the convention to 15 percent in the case of dividends received on or after January 1, 1947, from sources within the United States by a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of the Netherlands or a

Netherlands corporation, if such alien or Netherlands corporation is at no time during the taxable year engaged in trade or business, through a permanent establishment, within the United States. As to what is a Netherlands corporation, see Article II(1) (*d*) of the convention. Thus, if a nonresident alien who is a resident of the Netherlands, performs personal services within the United States during the calendar year 1948, 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 such dividend, as provided in Article VII of the convention, even though, by reason of his having rendered personal services within the United States, he is engaged in trade or business therein in that year within the meaning of section 211(b) of the Internal Revenue Code. As to what constitutes a permanent establishment, see Article II(1) (*i*) of the convention.

In the case of dividends paid on or after January 1, 1947, by a Netherlands corporation no withholding of United States tax is required irrespective of the citizenship or residence of the owner of the stock. See Article XII of the convention.

(*b*) *Dividends paid by a United States subsidiary corporation.*—Under the provisions of Article VII(1) of the convention, dividends paid by a domestic corporation to a Netherlands corporation, controlling, directly or indirectly, at the time the dividend is paid, 95 percent or more of the entire voting power in such domestic corporation, are subject to tax at the rate of only 5 percent, if (1) not more than 25 percent of the gross income of such paying corporation for the 3-year period immediately preceding the taxable year in which the dividend is paid consists of dividends and interest (other than dividends and interest paid to such domestic corporation by its own subsidiary corporations, if any) and (2) the relationship between such domestic corporation and such Netherlands corporation has not been arranged or maintained primarily with the intention of securing such reduced rate of 5 percent.

Any domestic corporation which claims or contemplates claiming that dividends paid or to be paid by it on or after January 1, 1947, are subject only to the 5 percent rate shall file, as soon as practicable, with the Commissioner of Internal Revenue, the following information: (1) the date and place of its organization; (2) the number of outstanding shares of stock of the domestic corporation having voting power and the voting power thereof; (3) the person or persons beneficially owning such stock of the domestic corporation and their relationship to the Netherlands corporation; (4) the amount of gross income, by years, of the paying corporation for the 3-year period immediately preceding the taxable year in which the dividend is paid; (5) the amount of interest and dividends, by years, included in the gross income of such domestic corporation, and the amount of interest and dividends, by years, received by such corporation from its subsidiary corporations, if any; and (6) the relationship between the domestic corporation and the Netherlands corporation to which it pays the dividend.

As soon as practicable after such information is filed, the Commissioner of Internal Revenue will determine whether the dividends concerned fall within the scope of the proviso of Article VII(1) of the convention and may authorize the release of excess tax withheld with respect to dividends which come within such proviso. In any case in which the Commissioner of Internal Revenue has notified such domestic corporation that it comes within such proviso, the reduced rate of 5 percent applies to any dividends subsequently paid by such corporation to the Netherlands corporation unless the stock ownership of the domestic corporation, or the character of its income materially changes, and, if such change or changes occur, such corporation shall promptly notify the Commissioner of Internal Revenue of the then existing facts with respect to such stock ownership or income.

(*c*) *Effect on withholding in case of dividends of address in Netherlands.*—For the purposes of withholding of the tax in the case of dividends, every nonresident alien (including a nonresident alien individual, fiduciary, or partnership) whose address is in the Netherlands shall be deemed by United States withholding agents to be a resident of the Netherlands not engaged in trade or business in the United States through a permanent establishment therein and every corporation whose address is in the Netherlands shall be deemed by such withholding agents to be a Netherlands corporation not so engaged in trade or business in the United States.

(*d*) *Rate of withholding.*—On and after January 1, 1949, withholding in the case of dividends paid to nonresident aliens (including a nonresident alien individual, fiduciary, or partnership), and to foreign corporations, whose addresses are in the Netherlands, shall (except (1) in any case in which, prior to the date of payment of such dividend, the Commissioner of Internal Revenue has notified the paying corporation that such dividend falls within the proviso of Article VII(1) of the convention, and (2) in any case in which the Commissioner notifies the withholding agent that the reduced rate shall not apply), be at the rate of 15 percent.

The preceding provisions relative to residents of the Netherlands and to Netherlands corporations 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 the tax upon such dividend. As to action by the recipient who is not the owner of the dividend, see section 7.807.

SEC. 7.802. INTEREST.—(*a*) *General.*—Interest (other than interest falling within the scope of paragraph (*c*) of this section and other than interest from mortgage notes (not including bonds) secured by real property), whether on bonds, securities, notes, debentures, or any other form of indebtedness (including interest on obligations of the United States and on obligations of instrumentalities of the United States) received on or after January 1, 1947, from sources within the United States by (1) a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of the Netherlands, or (2) a Netherlands corporation, is exempt from United States tax under the provisions of Article VIII of the convention if such alien or corporation at no time during the taxable year in which such interest is so received had a permanent establishment in the United States. Such interest is, therefore, not subject to the withholding provisions of the Internal Revenue Code.

(*b*) *Exemption from withholding.*—To obviate withholding at the source in the case of coupon bond interest, the nonresident alien resident in the Netherlands or the Netherlands corporation shall submit Form 1001–N, in duplicate, to the paying agent with each presentation of interest coupons. Such 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 such interest and the amount of such interest. Such form shall contain a statement that the owner is a resident of the Netherlands or a Netherlands corporation and that such owner has no permanent establishment in the United States.

The exemption from United States tax contemplated by Article VIII of the convention, insofar as it concerns coupon bond interest, is an exemption applicable only to the owner of such interest. The person presenting such coupon or on whose behalf it is presented shall, for the purpose of the exemption, 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 is not the owner of the bond, Form 1001, and not Form 1001-N, shall be executed.

The original and duplicate ownership certificates, Form 1001-N, must be forwarded to the Commissioner with the quarterly return, Form 1012, as provided in existing regulations with respect to Form 1001. See section 29.143-7 of this chapter (Regulations 111). Form 1001-N need not be listed on Form 1012.

In the case of interest coupons presented in the Netherlands by a nonresident alien who is not a resident of the Netherlands, or by a foreign corporation other than a Netherlands corporation ownership certificates, Form 1001, shall be filed as provided in existing regulations without reference to the provisions of the convention. See section 29.143-4 of this chapter (Regulations 111).

To avoid withholding at the source in the case of interest, other than interest payable by means of coupons and other than interest from mortgage notes (not including bonds) secured by real property, the nonresident alien who is a resident of the Netherlands, or the Netherlands corporation shall file Form 1001A-N, in duplicate, with the withholding agent in the United States. Such form shall be signed by the owner of the income, trustee, or agent, and shall show the name and address of the obligor and the name and address of the owner of such interest. Such form shall contain a statement that the owner is a resident of the Netherlands, or is a Netherlands corporation, not having a permanent establishment in the United States.

Form 1001A-N must be filed for each three-calendar-year period and the first such form filed by the taxpayer with any withholding agent should be filed not later than 20 days preceding the date of the first payment of income in such period. If the taxpayer files such form with the withholding agent in the calendar year 1948 or in any subsequent calendar year no additional Form 1001A-N need be filed prior to the end of the two calendar years immediately following the calendar year in which such form is so filed unless the Commissioner notifies the withholding agent that an additional Form 1001A-N must be filed by the taxpayer at an earlier date. The duplicate of Form 1001A-N should be immediately forwarded by the withholding agent to the Commissioner of Internal Revenue, Records Division, Washington 25, D. C.

In the case of interest paid on or after January 1, 1947, by a Netherlands corporation no withholding of United States tax is required irrespective of the citizenship or residence of the owner of the interest (see Article XII of the convention).

(*c*) *Exemption not applicable to interest paid by subsidiary corporation to its parent corporation.*—Article VIII(1) of the convention provides in part that the exemption from United States tax of interest shall not apply to interest paid by a domestic corporation to a Netherlands corporation if such foreign corporation controls, directly or indirectly, more than 50 percent of the voting power of all classes of stock of such domestic corporation. The exemption provisions of Article VIII(1) of the convention have, therefore, no application to such interest. In any case in which (1) a Netherlands corporation derives interest from a domestic corporation, and (2) the relationship existing between the Netherlands corporation and the domestic corporation is such as to render uncertain whether the exemption applies to such interest, neither Form 1001–N nor Form 1001A–N should be executed by the Netherlands corporation. In such case a statement of the facts should be filed with the Commissioner of Internal Revenue, Washington 25, D. C. As soon as practicable after such statement is filed the Commissioner of Internal Revenue will determine whether the interest involved is entitled to exemption under the provisions of Article VIII(1) of the convention, and will notify such Netherlands corporation whether the exemption provided in Article VIII(1) of the convention applies in such case. If in such case the Commissioner of Internal Revenue determines that such exemption applies, then Form 1001A–N should be filed together with a copy of the letter from the Commissioner of Internal Revenue.

SEC. 7.803. PATENT AND COPYRIGHT ROYALTIES AND FILM RENTALS.—Royalties and other like amounts received on or after January 1, 1947, by (*a*) a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of the Netherlands or (*b*) a Netherlands corporation, as consideration for the use of, or for the privilege of using copyrights, patents, designs, secret processes and formulae, trade-marks, and other like property, and royalties, including rentals, in respect of motion picture films or for the use of industrial, commercial, or scientific equipment, are exempt from United States tax under the provisions of Article IX of the convention if such alien or corporation had at no time during the taxable year in which such royalty or other amount was so received a permanent establishment within the United States.

Such items are, therefore, not subject to the withholding provisions of the Internal Revenue Code. As to what constitutes a permanent establishment, see Article II(1) (*i*) of the convention.

To obviate withholding at the source, the nonresident alien who is a resident of the Netherlands, or the Netherlands corporation, shall file Form 1001A–N, in duplicate, with the withholding agent in the United States. Such form shall be signed by the owner of the income, trustee, or agent and shall contain the statements provided on such form with respect to interest as set forth in section 7.802 of these regulations, the provisions of which with respect to the effective period of such form are equally applicable with respect to the income falling within the scope of this section.

The duplicate copy of Form 1001A–N should be immediately forwarded by the withholding agent to the Commissioner of Internal Revenue, Records Division, Washington 25, D. C.

SEC. 7.804. PENSIONS AND LIFE ANNUITIES.—Article XV(2) of the convention provides that private pensions and life annuities derived on or after January 1, 1947, from sources within the United States by a nonresident alien individual who is a resident of the Netherlands shall be exempt from United States tax.

The person paying such income should be notified by letter from the resident of the Netherlands that the income is exempt from taxation under the provisions of the convention. Such letter shall contain the address of the individual and a statement that such individual is a resident of the Netherlands. The letter of notification, or a copy thereof, should be immediately forwarded by the recipient to the Commissioner of Internal Revenue, Records Division, Washington 25, D. C. Such letter shall constitute authorization to the payor of the income to pay such income without deduction of the tax at the source unless the Commissioner subsequently notifies such payor that the tax should be withheld with respect to payments made after such notification.

SEC. 7.805. NATURAL RESOURCE ROYALTIES AND REAL PROPERTY RENTALS.—The convention does not change the rate of tax imposed under existing law upon natural resource royalties and real property rentals. The withholding of the tax with respect to such items derived from sources within the United States by nonresident aliens who are residents of the Netherlands and by Netherlands corporations is not affected by the convention. See sections 211(a) and 231(a) of the Internal Revenue Code.

SEC. 7.806. RELEASE OF EXCESS TAX WITHHELD AT SOURCE.—(*a*) *General.*—In order to bring the convention into force and effect at the earliest practicable date

(1) The reduced rate of tax of 15 percent to be withheld at the source on dividends, and

(2) Exemption from tax otherwise withheld at the source on interest, patent royalties, copyright royalties, film rentals, and the like,

are hereby made effective beginning January 1, 1948, in any case in which such dividends, interest, patent royalties, copyright royalties, film rentals, and the like are derived from sources within the United States by (i) a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of the Netherlands, or (ii) a Netherlands corporation.

Accordingly, in the case of dividends paid to a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) whose address at the time of payment was in the Netherlands, or to a Netherlands corporation whose address at the time of payment was in the Netherlands, where tax at the rate of 30 percent has been withheld on or after January 1, 1948, from such dividends, there shall be released by the withholding agent and paid over to the person from whom it was withheld an amount equal to 15 percent of such dividends.

In the case of every such taxpayer who furnishes to the withholding agent Form 1001A–N, as prescribed in section 7.802, or 7.803, where tax at the rate of 30 percent has been withheld on or after January 1, 1948, there shall be released by the withholding agent and paid over to the person from whom there was withheld an amount equal to the amount so withheld in the case of interest (as to coupon bond interest, see next paragraph), patent royalties, copyright royalties, film rentals, and the like.

In the case of every such taxpayer described in the first paragraph of this section who furnishes to the withholding agent Form 1001–N, in duplicate, where tax at the rate of 28 percent or 30 percent, as the case may be, has been withheld on or after January 1, 1948, from coupon bond interest, 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 withheld from such interest. Form 1001–N used for this purpose should be clearly marked "Substitute" in order to replace Forms 1001 previously filed. One Form 1001–N, in duplicate, may be used to replace two or more Forms 1001. The form marked "Substitute" is to be used solely for the release of excess tax withheld in 1948. The use of Form 1001–N for the purpose of exemption upon presentation of interest coupons is set forth in section 7.802(*b*).

(*b*) *Private pensions and life annuities paid in 1948 or subsequent years.*—In order to bring the convention into force and effect at the earliest practicable date, the exemption from tax otherwise withheld at the source on private pensions and life annuities is made effective beginning January 1, 1948, in any case in which such pensions and life annuities are derived from sources within the United States by a nonresident alien individual who is a resident of the Netherlands.

The person paying such income should be notified by letter from the resident of the Netherlands that the income is exempt from taxation under the provisions of Article XV (2), (3), and (4) of the convention. See section 7.804. Such letter will constitute authorization to the payor of the income to release the tax withheld on or after January 1, 1948, from such pensions and life annuities.

(*c*) *Subsidiary's dividends.*—With respect to a dividend paid on or after January 1, 1948, by a domestic corporation to a Netherlands corporation whose address is in the Netherlands, tax shall be withheld in accordance with the provisions of section 7.801 unless prior to the date of payment of such dividend the Commissioner of Internal Revenue has notified the paying corporation that such dividend falls within the scope of the proviso of Article VII(1) of the convention. As soon as practicable after information required under section 7.801(*b*) is filed, the Commissioner of Internal Revenue will determine whether the dividend involved falls within the scope of such proviso and may authorize the release of the excess tax withheld with respect to dividends which come within the scope of such proviso.

SEC. 7.807. ADDRESSEE IN THE NETHERLANDS NOT ACTUAL OWNER.—(*a*) *Netherlands administration office.*—If the recipient in the Netherlands of any dividend or interest from sources within the United States is a Netherlands administration office and the person beneficially entitled to such dividend or interest is not entitled to the reduced rate of tax provided in Article VII of the convention nor to the exemption provided in Article VIII, the banker or commissioner with whom the certificate issued by the administration office is deposited in the Netherlands, or the banker in the Netherlands to whom the dividend coupon or the interest coupon is first presented for payment or sale, will withhold an additional tax. This additional tax is equivalent to the difference between the United States tax which would have been withheld had the convention not been in effect (30 percent as at the date of approval of this Treasury Decision) and the United States tax actually withheld from such dividend or interest. The amounts so withheld by the banker or commissioner will, on or before the fifteenth day after the close of the calendar year quarter in which such withholding has taken place, be deposited, by the banker or commissioner, with the Netherlands Bank (account: Inspector of Taxes at Amsterdam, United States tax), without converting such amounts into dollars. Each banker or commissioner making such deposit shall file with the inspector of taxes at Amsterdam a return, containing the total amount of additional tax so withheld by him, and a specification of the additional tax for each type of security. It has been arranged that the Netherlands Tax Administration will, on or before the fifteenth day after the end of the calendar year quarter in which such deposit is so made with the Netherlands Bank, remit by draft in United States dollars the amounts so paid to the Collector of Internal Revenue, Baltimore, Md., U. S. A., together with the aggregate of any other amounts of United States tax withheld or recovered by the Netherlands Tax Administration.

(*b*) *Other Netherlands addressees not actual owner.*—If the recipient in the Netherlands (including a fiduciary (*Du.* bewindveerder, beheerder van een onverdeelde boedel, executeur-testamentair, faillissements-curator, krachtens de wet aangesteld beheerder, benoemd voogd) and a partnership) of the dividends is a nominee (*Du.* op eigen naam handelend tussenpersoon) or agent (*Du.* gemachtigde) through whom the dividend flows to a person other than the person described in section 7.801(*a*) as being entitled to the reduced rate of 15 percent provided in Article VII of the convention, such recipient in the Netherlands will withhold an additional United States tax equivalent to the difference between the United States tax which would have been withheld had the convention not been in effect and the 15 percent withheld at the source with respect to such dividend as provided in section 7.801 of these regulations.

In any case in which a fiduciary or a partnership with an address in the Netherlands receives, otherwise than as a nominee or as an agent, a dividend from a United States corporation, if a beneficiary of such fiduciary or a partner in such partnership is not entitled to the reduced rate of tax provided in Article VII of the convention, the fiduciary or partnership will withhold an additional tax with respect to the portion of such dividend included in such beneficiary's or partner's net distributive share of the income of such fiduciary or partnership, as the case may be. The rate of the additional tax is calculated in the same manner as is applicable under the first paragraph of the present subsection.

The amounts so withheld by such withholding agent in the Netherlands will be deposited with the Netherlands Bank (account: Inspector of Taxes at Amsterdam, United States tax) in the same manner, and subject to the same provisions, as are applicable in the case of amounts deposited as provided in subsection (*a*) of this section. The withholding agent making such deposit shall file a return in the same manner and subject to the same provisions as are applicable under subsection (*a*) of this section. The amounts so deposited will be remitted to the Collector of Internal Revenue, Baltimore, Md., U. S. A., as are deposits under subsection (*a*) of this section.

SEC. 7.808. RETURN OF TAX WITHHELD AND INFORMATION RETURN WITH RESPECT TO PERSONS WHOSE ADDRESSES ARE IN THE NETHERLANDS.—Every United States withholding agent shall make and file with the collector, in duplicate, an information return on Form 1042E, in addition to the withholding return, Form 1042, for the calendar year 1948 and each subsequent calendar year, with respect to:

(*a*) dividends from which a tax of 15 percent was withheld from persons whose addresses are in the Netherlands (5 percent in the case of dividends falling within the scope of the proviso of Article VII(1) of the convention);

(*b*) royalties and like amounts and interest (other than coupon bond interest reported on Form 1001–N) from which no tax was withheld from persons who have furnished to the withholding agent Form 1001A–N; and

(*c*) all other fixed or determinable annual or periodical income paid to such persons.

SEC. 7.809. REFUND OF EXCESS TAX WITHHELD.—If the tax withheld at the source upon dividends, interest, royalties, private pensions, or life annuities paid during the calendar year 1947 is in excess of the tax due from the taxpayer under the convention, it will be necessary for the taxpayer, in order to compute the tax properly, to file an income tax return, Form 1040NB (Netherlands), for individuals, and Form 1120NB (Netherlands), for corporations, for such taxable year. The taxpayer's total fixed or determinable annual or periodical income from sources within the United States should be reported on such return and in the event securities are held in the name of a person other than the actual owner, the name of such person should be furnished. There shall be included in such return the following statements:

(*a*) That the taxpayer is a nonresident alien (including a nonresident alien individual, fiduciary, or partnership) resident in the Netherlands or is a corporation organized in or under the laws of the Netherlands;

(*b*) That the taxpayer was engaged in trade or business through a permanent establishment in the United States at no time during the taxable year in which the income was received.

However, the statement required by (*b*) is not applicable in the case of a taxpayer whose income from sources within the United States during the calendar year 1947 consisted exclusively of private pensions and life annuities. As to additional information required in the case of a Netherlands corporation claiming a rate of 5 percent on dividends paid by its domestic subsidiary corporation, see section 7.801(*b*).

For the purposes of refund of excess tax withheld resulting from the tax convention, a properly executed return on Form 1040NB (Netherlands) or Form 1120NB (Netherlands) shall constitute a claim for refund or credit within the meaning of section 322 of the Internal Revenue Code for the amount of the overpayment disclosed by such return. Any tax paid in excess of that due from the owner of the income will be refunded by the United States Government as required by law.

SEC. 7.810. BENEFICIARIES OF A DOMESTIC ESTATE OR TRUST.—A nonresident alien who is a resident of the Netherlands and who is a beneficiary of a domestic estate or trust shall be entitled to the exemption, or reduction in the rate of tax, as the case may be, provided in Articles VII, VIII, and IX of the convention with respect to dividends, interest, and royalties to the extent such item or items are included in his distributive share of income of such estate or trust. In such case such beneficiary must, in order to be entitled to the exemption or reduction in the rate of tax in the case of interest or royalties, execute Form 1001A–N and file such form with the fiduciary of such estate or trust in the United States.

Since the purpose of this Treasury Decision is to make effective the exemptions and reduced rates of tax provided in the income tax convention between the United States and the Kingdom of the Netherlands, proclaimed by the President of the United States on December 8, 1948, this Treasury Decision is not subject to the effective date limitation of section 4(c) of the Administrative Procedure Act, approved June 11, 1946.

(This Treasury Decision is issued under the authority of section 62 of the Internal Revenue Code (53 Stat. 32; 26 U. S. C. 62).)

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved March 2, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 7, 1949, 8:51 a. m.)

SECTION 29.143–1: Withholding tax at source. 1949–7–13055
(Also Section 144, Section 29.144–1.) T. D. 5692

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 7.—TAXATION PURSUANT TO TREATIES.—SUBPART—DENMARK; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1947

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 Denmark and of Danish corporations, as affected by the reciprocal income tax convention between the United States and the Kingdom of Denmark, proclaimed by the President of the United States on December 8, 1948.

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

To Collectors of Internal Revenue and Others Concerned:

On December 28, 1948, notice of proposed rule making under the income tax convention between the United States and the Kingdom of Denmark, proclaimed by the President of the United States on December 8, 1948, was published in the Federal Register (13 F. R. 8398). After consideration of all such relevant matter as was presented by interested persons regarding the proposal, the following regulations are adopted for the purposes of such convention. These regulations are necessary to prescribe rules with respect to release of excess tax withheld, and exemption from, or reduction in the rate of, withholding under sections 143 and 144 of the Internal Revenue Code in the case of residents of Denmark and Danish corporations, as affected by such convention.

TABLE OF CONTENTS

SECTION 7.900. INTRODUCTORY.—The income tax convention between the United States and the Kingdom of Denmark, signed May 6, 1948, proclaimed by the President of the United States on December 8, 1948, and effective as to taxable years beginning after December 31, 1947 (hereinafter referred to as the convention), provides in part as follows:

ARTICLE I

(1) The taxes referred to in this convention are:
(*a*) In the case of the United States of America:
The Federal income tax, including surtaxes.
(*b*) In the case of Denmark:
The national income tax, including the war profits tax.
The intercommunal income tax.
The communal income tax.

(2) The present convention shall also apply to any other taxes of a substantially similar character imposed by either contracting state subsequently to the date of signature of the present convention.

ARTICLE II

(1) As used in this convention:
(*a*) The term "United States" means the United States of America, and when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.
(*b*) The term "Denmark" means the Kingdom of Denmark; the provisions of the convention shall not, however, extend to the Faroe Islands; nor do they apply to Greenland.
(*c*) The term "permanent establishment" means a branch office, factory, warehouse, or other fixed place of business, but does not include the casual and temporary use of merely storage facilities, nor does it include an agency unless the agent has and exercises a general authority to negotiate and conclude contracts on behalf of an enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the contracting states shall not be deemed to have a permanent establishment in the other state merely because it carries on business dealings in such other state through a *bona fide* commission agent, broker, or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the contracting states maintains in the other state a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one contracting state has a subsidiary corporation which is a corporation of the other state or which is engaged in trade or business in the other state shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation.
(*d*) The term "enterprise of one of the contracting states" means, as the case may be, "United States enterprise" or "Danish enterprise."
(*e*) The term "enterprise" includes every form of undertaking whether carried on by an individual, partnership, corporation, or any other entity.
(*f*) The term "United States enterprise" means an enterprise carried on in the United States of America by a resident of the United States of America or by a United States corporation or other entity; the term "United States corporation or other entity" means a partnership, corporation, or other

entity created or organized in the United States of America or under the law of the United States of America or of any State or Territory of the United States of America.

(*g*) The term "Danish enterprise" means an enterprise carried on in Denmark by a resident of Denmark or by a Danish corporation or other entity; the term "Danish corporation or other entity" means a partnership, corporation, or other entity created or organized in Denmark or under Danish laws.

(*h*) The term "competent authorities" means, in the case of the United States the Commissioner of Internal Revenue or his authorized representative; and in the case of Denmark, the Chief of the Taxation Department of the Ministry of Finance (Generaldirektøren for Skattevaesenet) or his authorized representative.

(2) In the application of the provisions of the present convention by one of the contracting states any term not otherwise defined shall, unless the context otherwise requires, have the meaning which such term has under its own tax laws.

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ARTICLE VI

(1) Dividends shall be taxable only in the contracting state in which the shareholder is resident or, if the shareholder is a corporation or other entity, in the contracting state in which such corporation or other entity is incorporated or organized.

(2) Each of the contracting states reserves, however, the right to collect and retain the tax which, under its revenue laws, is deductible at the source with respect to such dividends, but the tax shall not exceed 15 percent of the amount of dividends derived from sources within such state by a resident, corporation, or other entity of the other state, if the recipient has no permanent establishment in the contracting state from which the dividends are derived.

(3) It is agreed, however, that the rate of dividend tax at the source shall not exceed 5 percent if the shareholder is a corporation controlling, directly or indirectly, at least 95 percent of the entire voting power in the corporation paying the dividend, and if not more than 25 percent of the gross income of such paying corporation is derived from interest and dividends, other than interest and dividends received from its own subsidiary corporations. Such reduction of the rate to 5 percent shall not apply if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing such reduced rate.

ARTICLE VII

Interest on bonds, securities, notes, debentures, or any other form of indebtedness derived from sources within one of the contracting states by a resident or corporation or other entity of the other contracting state not having a permanent establishment in the former state shall be exempt from tax by such former state.

ARTICLE VIII

Royalties and other amounts derived as consideration for the right to use copyrights, patents, designs, secret processes and formulas, trade-marks, and other like property (including rentals and like payments in respect of motion picture films) derived from sources within one of the contracting states by a resident or corporation or other entity of the other contracting state not having a permanent establishment in the former state shall be exempt from taxation in such former state.

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ARTICLE X

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(2) Private pensions and life annuities derived from within one of the contracting states and paid to individuals residing in the other contracting state shall be exempt from taxation in the former state.

(3) The term "life annuities" as used herein means a stated sum payable periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in consideration of a gross sum paid for such obligation.

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ARTICLE XXII

The competent authorities of the two contracting states may prescribe regulations necessary to interpret and carry out the provisions of this convention. With respect to the provisions of this convention relating to exchange of information and mutual assistance in the collection of taxes, such authorities may, by common agreement, prescribe rules concerning matters of procedure, forms of application and replies thereto, conversion of currency, disposition of amounts collected, minimum amounts subject to collection, and related matters.

ARTICLE XXIII

(1) The present convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) Upon the exchange of instruments of ratification, the present convention shall have effect

(*a*) in the case of United States tax, for the taxable years beginning on or after the 1st day of January of the year in which such exchange takes place;

(*b*) in the case of Danish tax, for the taxable years beginning on or after the 1st day of April of the year in which such exchange takes place.

(3) The present convention shall continue effective for a period of 5 years 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 months' prior notice of termination has been given and, in such event, the present convention shall cease to be effective.

(*a*) as respects United States tax, for the taxable years beginning on or after the 1st day of January next following the expiration of the 6-month period;

(*b*) as respects Danish tax, for the taxable years beginning on or after the 1st day of April next following the expiration of the 6-month period.

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As used in this Treasury Decision, unless the context otherwise requires, the terms defined in the above articles of the convention shall have the meanings so assigned to them.

SEC. 7.901. DIVIDENDS.—(*a*) *General.*—The rate of tax imposed by section 211(a) of the Internal Revenue Code (relating to nonresident alien individuals not engaged in trade or business within the United States) and by section 231(a) of the Internal Revenue Code (relating to foreign corporations not engaged in trade or business within the United States) is 30 percent. Such rate is reduced under Article VI of the convention to 15 percent in the case of dividends received on or after January 1, 1948, from sources within the United States by a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of Denmark or by a Danish corporation if such alien or corporation at no time during the taxable year had a permanent establishment within the United States. As to what is a Danish corporation, see Article II(1)(*g*) of the convention. Thus, if a nonresident alien who is a resident of Denmark, performs personal services within the United States during the calendar year 1948, 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 VI of the convention, even though by reason of his having rendered personal services within the United States he is engaged in trade or business therein in that year within the meaning of section 211(b) of the Internal Revenue Code. As to what constitutes a permanent establishment, see Article II(1)(*c*) of the convention.

(*b*) *Dividends paid by a United States subsidiary corporation.*—Under the provisions of Article VI(3) of the convention, dividends paid by a domestic corporation to a Danish corporation controlling, directly or indirectly, at the time the dividend is paid, 95 percent or more of the entire voting power in such domestic corporation, are subject to tax at the rate of only 5 percent, if (1) not more than 25 percent of the gross income of such paying corporation for the 3-year period immediately preceding the taxable year in which the dividend is paid consists of dividends and interest (other than dividends and interest paid to such domestic corporation by its own subsidiary corporations, if any) and (2) the relationship between such domestic corporation and such Danish corporation has not been arranged or maintained primarily with the intention of securing such reduced rate of 5 percent.

Any domestic corporation which claims or contemplates claiming that dividends paid or to be paid by it on or after January 1, 1948, are subject only to the 5 percent rate shall file, as soon as practicable, with the Commissioner of Internal Revenue, the following information: (1) The date and place of its organization; (2) the number of outstanding shares of stock of the domestic corporation having voting power and the voting power thereof; (3) the person or persons beneficially owning such stock of the domestic corporation and their relationship to the Danish corporation; (4) the amount of gross income, by years, of the paying corporation for the 3-year period immediately preceding the taxable year in which the dividend is paid; (5) the amount of interest and dividends, by years, included in the gross income of such domestic corporation and the amount of interest and dividends, by years, received by such corporation from its subsidiary corporations, if any; and (6) the relationship between the domestic corporation and the Danish corporation to which it pays the dividend.

As soon as practicable after such information is filed, the Commissioner of Internal Revenue will determine whether the dividends concerned fall within the provisions of Article VI(3) of the convention and may authorize the release of excess tax withheld with respect to dividends which come within such provision. In any case in which the Commissioner of Internal Revenue has notified such domestic corporation that the dividends come within such provision, the reduced rate of 5 percent applies to any dividends subsequently paid by such corporation to the Danish corporation unless the stock ownership of the domestic corporation, or the character of its income, materially changes, and, if such change or changes occur, such corporation shall promptly notify the Commissioner of Internal Revenue of the then existing facts with respect to such stock ownership or income.

(*c*) *Effect on withholding in case of dividends of address in Denmark.*—For the purposes of withholding of the tax in the case of dividends, every nonresident alien (including a nonresident alien individual, fiduciary, or partnership) whose address is in Denmark shall be deemed by United States withholding agents to be a resident of Denmark not having a permanent establishment in the United States and every corporation whose address is in Denmark shall be deemed by such withholding agents to be a Danish corporation not having a permanent establishment in the United States.

(*d*) *Rate of withholding.*—On and after January 1, 1949, withholding in the case of dividends paid to nonresident aliens (including a nonresident alien individual, fiduciary, or partnership) and to foreign corporations, whose addresses are in Denmark, shall (except (1) in any case in which prior to the date of payment of such dividend, the Commissioner of Internal Revenue has notified the paying corporation that such dividend falls within the provisions of Article VI(3) of the convention, and (2) in any case in which the Commissioner notifies the withholding agent that the reduced rate shall not apply), be at the rate of 15 percent.

The preceding provisions relative to residents of Denmark and to Danish corporations 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 the tax upon such dividend. As to action by the recipient who is not the owner of the dividend, see section 7.906.

Sec. 7.902. Interest.—(*a*) *General.*—Interest, whether on bonds, securities, notes, debentures, or any other form of indebtedness (including interest on obligations of the United States and on obligations of instrumentalities of the United States), received on or after January 1, 1948, from sources within the United States by (1) a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of Denmark, or (2) a Danish corporation, is exempt from United States tax under the provisions of Article VII of the convention if such alien or corporation at no time during the taxable year in which such interest is so received had a permanent establishment in the United States. Such interest is, therefore, not subject to the withholding provisions of the Internal Revenue Code.

(*b*) *Exemption from withholding.*—To obviate withholding at the source in the case of coupon bond interest, the nonresident alien resident in Denmark or the Danish corporation shall submit Form 1001–D, in duplicate, to the paying agent with each presentation of interest coupons. Such 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 such interest and the amount of such interest. Such form shall contain a statement that the owner is a resident of Denmark or a Danish corporation and that such owner has no permanent establishment in the United States.

The exemption from United States tax contemplated by Article VII of the convention, insofar as it concerns coupon bond interest, is an exemption applicable only to the owner of such interest. The person presenting such coupon or on whose behalf it is presented shall, for the purpose of the exemption, 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 is not the owner of the bond, Form 1001, and not Form 1001–D, shall be executed.

The original and duplicate ownership certificates, Form 1001–D, must be forwarded to the Commissioner with the quarterly return, Form 1012, as provided in existing regulations with respect to Form 1001. See section 29.143–7 of this chapter (Regulations 111). Form 1001–D need not be listed on Form 1012.

In the case of interest coupons presented in Denmark by a nonresident alien who is not a resident of Denmark or by a foreign corporation other than a Danish corporation, ownership certificates, Form 1001, shall be filed as provided in existing regulations without reference to the provisions of the convention. See section 29.143-4 of this chapter (Regulations 111).

To avoid withholding at the source in the case of interest other than interest payable by means of coupons, the nonresident alien who is a resident of Denmark, or the Danish corporation, shall file Form 1001A-D, in duplicate, with the withholding agent in the United States. Such form shall be signed by the owner of the income, trustee, or agent, and shall show the name and address of the obligor and the name and address of the owner of such interest. Such form shall contain a statement that the owner is a resident of Denmark or is a Danish corporation and that the owner has no permanent establishment in the United States.

Form 1001A-D must be filed for each three calendar year period and the first such form filed by the taxpayer with any withholding agent should be filed not later than 20 days preceding the date of the first payment of income in such period. If the taxpayer files such form with the withholding agent in the calendar year 1948 or in any subsequent calendar year no additional Form 1001A-D need be filed prior to the end of the two calendar years immediately following the calendar year in which such form is so filed unless the Commissioner notifies the withholding agent that an additional Form 1001A-D must be filed by the taxpayer at any earlier date. The duplicate of Form 1001A-D should be immediately forwarded by the withholding agent to the Commissioner of Internal Revenue, Records Division, Washington 25, D. C.

SEC. 7.903. PATENT AND COPYRIGHT ROYALTIES AND FILM RENTALS.— Royalties and other like amounts received on or after January 1, 1948, by (*a*) a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of Denmark or (*b*) a Danish corporation, as consideration for the right to use copyrights, patents, designs, secret processes and formulae, trade-marks, and other like property, including rentals and like payments in respect of motion picture films, are exempt from United States tax under the provisions of Article VIII of the convention if such alien or corporation had at no time during the taxable year in which such royalty or other amount was so received a permanent establishment in the United States.

Such items are, therefore, not subject to the withholding provisions of the Internal Revenue Code. As to what constitutes a permanent establishment, see Article II(1) (*c*) of the convention.

To obviate withholding at the source, the nonresident alien who is a resident of Denmark, or the Danish corporation, shall file Form 1001A-D, in duplicate, with the withholding agent in the United States. Such form shall be signed by the owner of the income, trustee, or agent and shall contain the statements provided on such form with respect to interest as set forth in section 7.902 of these regulations, the provisions of which with respect to the effective period of such form are equally applicable with respect to the income falling within the scope of this section. The duplicate copy of Form 1001A-D should be immediately forwarded by the withholding agent to the

Commissioner of Internal Revenue, Records Division, Washington 25, D. C.

SEC. 7.904. PRIVATE PENSIONS AND LIFE ANNUITIES.—Under Article X(2) of the convention private pensions and life annuities derived on or after January 1, 1948, from sources within the United States by a nonresident alien individual who is a resident of Denmark are exempt from United States tax.

The person paying such income should be notified by letter from the resident of Denmark that the income is exempt from taxation under the provisions of Article X(2) of the convention. Such letter shall contain the address of the individual and a statement that such individual is a resident of Denmark. The letter of notification, or a copy thereof, should be immediately forwarded by the recipient to the Commissioner of Internal Revenue, Records Division, Washington 25, D. C. Such letter shall constitute authorization to the payor of the income to pay such income without deduction of the tax at the source unless the Commissioner subsequently notifies such payor that the tax should be withheld with respect to payments made after such notification.

SEC. 7.905. RELEASE OF EXCESS TAX WITHHELD AT SOURCE.—(*a*) *General.*—In order to bring the convention into force and effect at the earliest practicable date:

(1) The reduced rate of tax of 15 percent to be withheld at the source on dividends, and

(2) Exemption from tax otherwise withheld at the source on interest, patent royalties, copyright royalties, film rentals, and the like,

are hereby made effective beginning January 1, 1948, in any case in which such dividends, interest, patent royalties, copyright royalties, film rentals, and the like are derived from sources within the United States by (i) a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) who is a resident of Denmark, or (ii) a Danish corporation.

Accordingly, in the case of dividends paid to a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) whose address at the time of payment was in Denmark, or to a Danish corporation whose address at the time of payment was in Denmark, where tax at the rate of 30 percent has been withheld on or after January 1, 1948, from dividends, there shall be released by the withholding agent and paid over to the person from whom it was withheld an amount equal to 15 percent of such dividends.

In the case of every such taxpayer who furnishes to the withholding agent Form 1001A–D, as prescribed in section 7.902, or 7.903, where tax at the rate of 30 percent has been withheld on or after January 1, 1948, there shall be released by the withholding agent and paid over to the person from whom withheld an amount equal to the amount so withheld in the case of interest (as to coupon bond interest, see next paragraph), patent royalties, copyright royalties, film rentals, and the like.

In the case of every such taxpayer who furnishes to the withholding agent Form 1001–D, in duplicate, where tax at the rate of 28 percent or 30 percent, as the case may be, has been withheld on or after January 1, 1948, from coupon bond interest, 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 withheld from such interest. Form 1001-D used for this purpose should be clearly marked "Substitute" in order to replace Forms 1001 previously filed. One Form 1001-D, in duplicate, may be used to replace two or more Forms 1001. The form marked "Substitute" is to be used solely for the release of excess tax withheld in 1948. The use of Form 1001-D for the purpose of exemption upon presentation of interest coupons is set forth in section 7.902(*b*).

(*b*) *Private pensions and life annuities paid in 1948 or subsequent years.*—In order to bring the convention into force and effect at the earliest practicable date, the exemption from tax otherwise withheld at the source on private pensions and life annuities is made effective beginning January 1, 1948, in any case in which such pensions and life annuities are derived from sources within the United States by a nonresident alien individual who is a resident of Denmark.

The person paying such income should be notified by letter from the resident of Denmark that the income is exempt from taxation under the provisions of Article X(2) of the convention. See section 7.904. Such letter will constitute authorization to the payor of the income to release the tax withheld on or after January 1, 1948, with respect to such pensions or life annuities.

(*c*) *Subsidiary's dividends.*—With respect to a dividend paid on or after January 1, 1948, by a domestic corporation to a Danish corporation whose address is in Denmark, tax shall be withheld in accordance with the provisions of section 7.901 unless prior to the date of payment of such dividend the Commissioner of Internal Revenue has notified the paying corporation that such dividend falls within the scope of Article VI(3) of the convention. As soon as practicable after information required under section 7.901(*b*) is filed, the Commissioner of Internal Revenue will determine whether the dividend involved falls within the scope of Article VI(3) and may authorize the release of the excess tax withheld with respect to dividends which come within the scope of such provision.

SEC. 7.906. ADDRESSEE NOT ACTUAL OWNER.—If the recipient in Denmark of any dividend from sources within the United States is a nominee or representative through whom the dividend flows to a person other than a person described in section 7.901(*a*) as being entitled to the reduced rate of 15 percent provided in Article VI of the convention, such recipient in Denmark will withhold an additional amount of United States tax equivalent to the difference between the United States tax which would have been withheld had the convention not been in effect (30 percent as at the date of approval of this Treasury Decision) and the 15 percent withheld at the source with respect to such dividend pursuant to section 7.901 of these regulations.

In any case in which a fiduciary or a partnership with an address in Denmark receives, otherwise than as a nominee or representative, a dividend from a United States corporation, if a beneficiary of such fiduciary or a partner in such partnership is not entitled to the reduced rate of tax provided in Article VI of the convention, the fiduciary or partnership will withhold an additional amount of United States tax with respect to the portion of such dividend included in such beneficiary's or partner's net distributive share of the income of such fiduciary or partnership, as the case may be. The rate of the additional tax is calculated in the same manner as under the preceding paragraph.

The amounts so withheld by the withholding agent in Denmark will, on or before the fifteenth day, after the close of the calendar year quarter in which such withholding has taken place, be deposited with the Danish National Bank [Danmarks Nationalbank] without converting such amounts into dollars. Each withholding agent making such deposit will accompany such deposit with the appropriate Danish form executed as required by the Danish National Bank. The Danish National Bank has arranged to remit, on or before the end of the calendar month in which such deposit is so made, by draft in United States dollars, the amounts so deposited to the Collector of Internal Revenue, Baltimore, Md., U. S. A., forwarding with such draft the appropriate Danish form filed by the withholding agents.

SEC. 7.907. BENEFICIARIES OF A DOMESTIC ESTATE OR TRUST.—A nonresident alien who is a resident of Denmark and who is a beneficiary of a domestic estate or trust shall be entitled to the exemption, or reduction in the rate of tax, as the case may be, provided in Articles VI, VII, and VIII of the convention with respect to dividends, interest, and royalties to the extent such item or items are included in his distributive share of income of such estate or trust. In such case such beneficiary must, in order to be entitled to the exemption or reduction in the rate of tax, in the case of interest or royalties, execute Form 1001A–D and file such form with the fiduciary of such estate or trust in the United States.

Since the purpose of this Treasury Decision is to make effective the exemptions and reduced rates of tax provided in the income tax convention between the United States and the Kingdom of Denmark, proclaimed by the President of the United States on December 8, 1948, this Treasury Decision is not subject to the effective date limitation of section 4(c) of the Administrative Procedure Act, approved June 11, 1946.

(This Treasury Decision is issued under the authority of section 62 of the Internal Revenue Code (53 Stat. 32; 26 U. S. C. 62).)

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved March 8, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 11, 1949, 9:00 a. m.)

SECTION 144.—PAYMENT OF CORPORATION INCOME TAX AT SOURCE

SECTION 29.144–1: Withholding in the case of nonresident foreign corporations. 1949–4–13023
(Also Section 119, Section 29.119–2.) I. T. 3940

INTERNAL REVENUE CODE

Interest payments made by checks drawn on a New York bank by a domestic corporation with respect to a loan which was obtained from a nonresident foreign corporation, the proceeds of the loan having been credited to the domestic corporation's account with the foreign corporation, constitute fixed or determinable annual or periodical income from sources within the United States, and such payments are subject to withholding of income tax at the source under section 144 of the Internal Revenue Code.

Advice is requested whether interest paid by a domestic corporation on a loan obtained from a nonresident foreign corporation, under the circumstances hereinafter stated, constitutes income from sources within the United States which is subject to withholding of income tax at the source.

In the instant case, the domestic corporation, through its representative in Cuba, obtained a loan from a Cuban bank, a nonresident foreign corporation, the proceeds of the loan being credited to the domestic corporation's account with the creditor bank. The amount of the loan was secured by the pledge of securities deposited in the custody of the bank, and interest was payable in Havana. The securities pledged as collateral were sold, and the proceeds were used to pay the principal of the loan. Interest payments on the loan were made by the domestic corporation by checks drawn on a New York bank to the order of the Cuban bank.

It is evident that the loan in question was an interest-bearing obligation of the domestic corporation and that the interest payable thereon falls within the purview of section 119(a)(1) of the Internal Revenue Code which provides in part as follows:

(a) GROSS INCOME FROM SOURCES IN UNITED STATES.—The following items of gross income shall be treated as income from sources within the United States:

(1) INTEREST.—Interest from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise * * *

Section 144 of the Internal Revenue Code, relating to payment of corporation income tax at the source, provides in part as follows:

In the case of foreign corporations subject to taxation under this chapter [Chapter 1 of the Code] not engaged in trade or business within the United States, there shall be deducted and withheld at the source in the same manner and upon the same items of income as is provided in section 143 a tax equal to 30 per centum thereof * * *

Section 143(b) of the Code provides in part for withholding of income tax at the source of a maximum of 30 percent from payments of interest, dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, to the extent that such items constitute gross income from sources within the United States, paid to any nonresident alien individual.

The instant case is similar to that of *A. C. Monk & Co., Inc.*, v. *Commissioner* (10 T. C. 77). In that case, the petitioner, a domestic corporation which maintained a branch or sales agency in China, paid to its sales agent, a Chinese national, interest on deposits made by him as security. These payments were made by checks drawn by the domestic corporation on its bank accounts in Chinese banks and were charged on its books to the expense of its Chinese branch. The Tax Court held that the interest thus paid constituted income to the Chinese national from sources within the United States, and the domestic corporation should have withheld income tax therefrom.

In I. T. 3059 (C. B. 1937–1, 111), wherein interest on bonds of a domestic corporation was paid to a foreign corporation, not engaged in trade or business in the United States, by another foreign corporation (guarantor), it was held that the source of the income is determined by the situs of the debtor who is obligated to pay the interest, and that since the debtor was a domestic corporation, such interest payments were subject to withholding of income tax at the source. (Cf. I. T. 3280, C. B. 1939–1 (Part 1), 197.)

Accordingly, it is held that interest paid by the domestic corporation in the instant case to the nonresident foreign (Cuban) bank constitutes fixed or determinable annual or periodical income from sources within the United States, which is subject to withholding of income tax at the source under section 144 of the Internal Revenue Code.

SECTION 29.144–1: Withholding in the case of nonresident foreign corporations.

INTERNAL REVENUE CODE

Regulations relating to release of excess tax withheld and exemption from, or reduction in rate of, withholding in the case of Netherlands corporations, as affected by the reciprocal income tax convention between the United States and the Kingdom of the Netherlands. (See T. D. 5690, page 92.)

SECTION 29.144–1: Withholding in the case of nonresident foreign corporations.

INTERNAL REVENUE CODE

Regulations relating to release of excess tax withheld and exemption from, or reduction in rate of, withholding in the case of Danish corporations, as affected by the reciprocal income tax convention between the United States and the Kingdom of Denmark. (See T. D. 5692, page 104.)

SUPPLEMENT E.—ESTATES AND TRUSTS

SECTION 162.—NET INCOME

SECTION 29.162–1: Income of estates and trusts.

1949–5–13032
T. D. 5688

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1941

Amending section 29.162–1 of Regulations 111, relating to income of estates and trusts.

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

To Collectors of Internal Revenue and Others Concerned:

Section 29.162–1 of Regulations 111, as amended by Treasury Decision 5488 [C. B. 1946–1, 19], approved December 29, 1945 [26 CFR 29.162–1], is further amended as follows:

(A) By striking from the third sentence of the first paragraph the words "with the return in which the item is claimed as a deduction."

(B) By inserting immediately after such third sentence the following:

Such statement and waiver should be filed with the return for the year for which the item is claimed as a deduction or with the Commissioner, or with the collector for the district in which such return was filed, for association with the return.

(This Treasury Decision is issued under the authority of sections 62 and 162(e) of the Internal Revenue Code (53 Stat. 32; 56 Stat. 861; 26 U. S. C. 62, 162(e)).)

Because the amendments made by this Treasury Decision merely relieve taxpayers from a limitation applicable under existing regulations, 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 said Act.

FRED S. MARTIN,
Acting Commissioner of Internal Revenue.

Approved Feburary 16, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 23, 1949, 8:46 a. m.)

SECTION 29.162–1: Income of estates and trusts. 1949–11–13094
(Also Section 171, Section 29.171–2.) G. C. M. 25999

INTERNAL REVENUE CODE

Periodic payments made out of income by the estate of a deceased husband to his former wife, in discharge of a legal obligation which was imposed upon the husband by a decree of divorce, are deductible under section 162(b) of the Internal Revenue Code in computing the net income of the estate. Such payments are taxable to the divorced wife under section 22(k) of the Code.

Consideration has been given to the effect, for Federal income tax purposes, of the decision of the Circuit Court of Appeals, Ninth Circuit, in *Estate of Homer Laughlin* v. *Commissioner* (167 Fed. (2d) 828) which involved the treatment under sections 22(k), 23(u), 162(b), and 171(b) of the Internal Revenue Code of periodic payments to a former wife under a decree of divorce.

The facts in that case may be briefly stated as follows: On April 1, 1924, Homer Laughlin and his then wife, Ada Laughlin, entered into a property settlement agreement which was later incorporated into a final decree of divorce. The agreement provided that the husband, or his estate, should pay to the wife $800 a month during her natural life for her support and maintenance, such amount to be reduced to $300 a month should she remarry, a contingency which did not occur. Homer Laughlin died on December 27, 1932. His estate paid to the wife the sum of $9,600 during the year 1942 pursuant to the agreement and the divorce decree. The estate of Homer Laughlin claimed the sum of $9,600 as a deduction in its Federal income tax return for the year 1942, which deduction was disallowed by the Commissioner.

The husband (Laughlin), if living, would have been entitled to deduct, under section 23(u) of the Internal Revenue Code, payments made by him. However, it was contended by the Government that the deduction claimed by his estate was not allowable. (See section 29.23(u)-1, Regulations 111.) The Court, in its opinion, stated as follows:

> We do not agree. We think the deduction here claimed is clearly authorized. Section 22(k) of the Internal Revenue Code provides for the inclusion in the gross income of a divorced or legally separated wife of periodic payments received from her husband "in discharge of a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such decree * * *"

The court recognized that section 23(u) of the Code applies only during a husband's lifetime. The court stated, however, that it was clear that the payments made by the estate were in discharge of a legal obligation imposed by a decree of divorce because of the marital relationship. But the court considered it necessary to refer to sections 162(b) and 171(b) of the Code for the purpose of determining whether the deduction could be taken by the husband's estate after his death. The court observed that, under the provisions of section 171(b) of the Code, in computing the net income of an estate or trust and the net income of the wife described in section 22(k) or section 171(a) of the Code, the wife is considered a "beneficiary." It is to be noted that the amounts paid to the decedent's wife during the taxable year 1942 were paid out of "income of the estate." The court stated that the distributable income of the estate, after all other deductions, was substantially in excess of the $9,600 paid to Ada Laughlin. Had the amounts been paid out of corpus, it would seem that the deduction could not have been allowed under either section 23(u) or section 162(b) of the Code. It is clear that section 23(u) of the Code applies only during the husband's lifetime, and that the deduction provided by section 162(b) of the Code is allowable to an estate or trust only if the payments are made out of income.

Section 162(b) of the Code, relating to the computation of the net income of an estate or trust, provides in part as follows:

> There shall be *allowed as an additional deduction* in computing the net income of the estate or trust the amount of the *income* of the estate or trust for its taxable year which is *to be distributed* currently by the fiduciary to the legatees, heirs, or *beneficiaries, but the amount so allowed as a deduction* shall be included in computing *the net income of the* legatees, heirs, or *beneficiaries* whether distributed to them or not. * * * [Italics supplied.]

Inasmuch as the wife in the instant case was treated as a "beneficiary" of the estate, and the periodic payments were made to her out of the "income" of the estate, such payments are properly deductible under section 162(b) of the Code. For the purpose of the deduction allowable to the husband during his lifetime under section 23(u) of the Code, it is immaterial whether periodic payments are made out of income or capital. Likewise, for the purpose of section 22(k) of the Code, the payments made to the wife are treated as taxable income to her, regardless of whether they are made out of income or capital, and even though she is paid by an estate or trust after the death of the husband. However, such payments, in order to be deductible under section 162(b) of the Code, must be made out of the "income" of the estate or trust. In determining whether the payments are made out of income or capital, section 162(d) of the Code is applicable.

The principles discussed herein, which were enunciated by the court in *Estate of Homer Laughlin* v. *Commissioner*, *supra*, have been accepted by the Bureau.

CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue.

SECTION 165.—EMPLOYEES' TRUSTS

SECTION 29.165-2: Impossibility of diversion under the trust instrument. 1949-13-13113 Mim. 6394

Requirements for compliance with the provisions of section 165(a)(2) of the Internal Revenue Code.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C., May 31, 1949.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, Heads of Field Divisions of the Technical Staff, and Others Concerned:

1. It is recognized that in many jurisdictions an oral agreement may be a sufficient basis for the establishment of a valid trust. However, section 165(a)(2) of the Internal Revenue Code provides that a trust is exempt under section 165(a) of the Code only "if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries." Section 29.165-2 of Regulations 111 interprets the phrase "if under the trust instrument it is impossible" to mean that "the trust instrument must definitely and affirmatively make it impossible for the nonexempt diversion or use to occur * * *" Section 29.165-1(*b*) of Regulations 111 provides in part: "An exempt status must be maintained throughout the entire taxable year of the trust in order for the trust to obtain any exemption for such year." Moreover, contributions are deductible within specified limits under section 23(p)(1)(A) of the Code for a taxable year only "if such taxable year ends within or with a taxable year of the trust for which the trust is exempt under section 165(a) * * *" Section 23(p)(1)(C) of the Code contains a similar requirement. Thus, all of the following conditions must be met prior to the end of the taxable year in order that contributions may be deductible under section 23(p)(1) (A) or (C) of the Code for such year:

(*a*) There must be a valid trust recognized as such under the law prevailing in the jurisdiction to which the trust is subject;

(*b*) The trust must be evidenced by an executed "instrument"; and

(*c*) The instrument must definitely and affirmatively preclude the prohibited diversion.

2. The term "trust instrument," as used in section 165(a)(2) of the Code and section 29.165-2 of Regulations 111, means a document or documents clearly setting forth the terms of the trust. While the "instrument" (document or documents) evidencing the trust agreement must be in writing containing sufficient words to make the prohibited diversion impossible, and be signed by persons competent to bind the parties before the close of the taxable year under consideration, it is not required to be in a specified form but must be in such form that the provisions of the trust agreement could be enforced on the basis of such written evidence alone.

3. Correspondence from the following regarding this mimeograph should refer to its number and the symbols indicated: Collectors of internal revenue, A&C: Col; internal revenue agents in charge, IT: PS; heads of field divisions of the Technical Staff, TS: ARM.

GEO. J. SCHOENEMAN,
Commissioner.

SECTION 171.—INCOME OF AN ESTATE OR TRUST IN CASE OF DIVORCE, ETC.

SECTION 29.171-2: Application of trust rules to alimony payments.

INTERNAL REVENUE CODE

Income of estate paid to deceased divorced husband's former wife. (See G. C. M. 25999, page 116.)

SUPPLEMENT G.—INSURANCE COMPANIES

SECTION 202.—ADJUSTED NORMAL-TAX NET INCOME

SECTION 29.202-1: Reserve and other policy liability credit for adjusted normal-tax net income.

1949-5-13035
T. D. 5689

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1941

Figure to be used in determining reserve and other policy liability credit for life insurance companies.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY OF THE TREASURY,
Washington, D. C., February 21, 1949.

To Officers and Employees of the Treasury Department and Others Concerned:

PARAGRAPH 1. By virtue of the authority vested in me by section 202(b) of the Internal Revenue Code, as amended by section 163 of the

Revenue Act of 1942 (53 Stat. 71, 56 Stat. 870; 26 U. S. C. and Sup., 202(b)), it is hereby determined that the figure to be used in computing the "reserve and other policy liability credit" of life insurance companies for the taxable year 1948 shall be 1.0243.

PAR. 2. It is found that notice and public procedure are unnecessary, since the figure announced in this Treasury Decision is computed from information contained in the income tax returns of life insurance companies for the year 1947 which are not open to public inspection. The public accordingly cannot effectively participate in the determination of such figure.

JOHN W. SNYDER,
Secretary of the Treasury.

(Filed with the Division of the Federal Register February 23, 1949, 10:19 a. m.)

SUPPLEMENT H.—NONRESIDENT ALIEN INDIVIDUALS

SECTION 211.—TAX ON NONRESIDENT ALIEN INDIVIDUALS

SECTION 29.211–7: Taxation of nonresident alien individuals.

INTERNAL REVENUE CODE

Salary received by foreign branch manager while in United States. (See I. T. 3943, page 83.)

SUPPLEMENT L.—ASSESSMENT AND COLLECTION OF DEFICIENCIES

SECTION 274.—BANKRUPTCY AND RECEIVERSHIPS

SECTION 29.274–1: Bankruptcy and receivership proceedings. 1949–8–13062
Ct. D. 1715

FEDERAL TAXES—BANKRUPTCY ACT OF 1898—AMENDMENT OF 1926—CHANDLER ACT (APPROVED JUNE 22, 1938)—DECISION OF SUPREME COURT

BANKRUPTCY—CLAIMS FOR TAXES—INTEREST.

Tax claims in a proceeding in which the taxpayer has been adjudged a bankrupt bear interest only until the date of bankruptcy, that is, the date when the petition was filed instituting the proceeding. The rule that such claims bear interest to date of payment, a rule previously applied in most lower courts, was based upon an interpretation of the provisions of section 64a of the Bankruptcy Act of 1898 which is no longer applicable since the 1926 amendment of section 64a of the Bankruptcy Act and the amendments of sections 64a and 57n of the Bankruptcy Act, as amended, which are contained in the Chandler Act (Public No. 696, Seventy-fifth Congress, third session, approved June 22, 1938), assimilated taxes to debts for all purposes, including denial of post-bankruptcy interest.

SUPREME COURT OF THE UNITED STATES

168. *The City of New York, petitioner,* v. *Lewis H. Saper, as Trustee in Bankruptcy of Spotlight Productions, Inc.*

200. *State of New York, petitioner,* v. *Leonard H. Carter, as Trustee in Bankruptcy of Union Fabrics, Inc.*

201. *The United States of America, petitioner,* v. *Leonard H. Carter, as Trustee in Bankruptcy of Union Fabrics, Inc.*

On writs of certiorari to the United States Court of Appeals for the Second Circuit

[March 7, 1949]

OPINION

Mr. Justice JACKSON delivered the opinion of the Court.

The ultimate issue in these three cases is whether tax claims against a bankrupt bear interest until the date of bankruptcy [1] as held by the court below,[2] or until payment, as previously held by another court of appeals.[3] We granted certiorari [4] to resolve the conflict, the matter being of considerable practical importance [5] in the administration of the Bankruptcy Act.[6]

If the question were one of first impression to be decided in the light of the present statute alone, we should have no difficulty in affirming the court below. More than 40 years ago Mr. Justice Holmes wrote for this Court that the rule stopping interest at bankruptcy had then been followed for more than a century and a half. He said the rule was not a matter of legislative command or statutory construction but, rather, a fundamental principle of the English bankruptcy [7] system which we copied. *Sexton* v. *Dreyfuss*, 219 U. S. 339, 344. Our present statute contains no provision expressly repudiating that principle or allowing an exception in favor of tax claims. Every logical implication from relevant provisions is to the contrary. Section 63(a)(1), 11 U. S. C. section 103(a)(1) allows interest on judgments and written instruments [8] only to date of bankruptcy. Section 63(a)(5), 11 U. S. C. section 103(a)(5) allows interest only to that

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[1] The terms "date of bankruptcy" and "bankruptcy," with reference to time, mean the date when the petition was filed, 30 Stat. 544, as amended 52 Stat. 840–841, and are used accordingly in this opinion.

[2] In No. 168 the district judge allowed New York City interest to the date of payment, 75 Fed. Supp. 458, and the court of appeals reversed, 168 Fed. (2d) 268. In Nos. 200–201, the district judge allowed the United States and the State of New York interest only to the date of bankruptcy, 73 Fed. Supp. 685, and the court of appeals affirmed, 168 Fed. (2d) 272.

[3] *Davie* v. *Green,* 133 Fed. (2d) 451.

[4] 335 U. S. 811–812.

[5] Those most immediately concerned with administration of the Act have frequently expressed dissatisfaction over the inroads taxes and interest thereon make in the fund available for creditors. For discussions of that and similar practical problems see 14 J. N. A. Ref. Bankr. 3; 17 id. 129; 18 id. 17; 19 id. 31; 21 id. 106; 22 id. 41; 44 Com. L. J. 411; and 45 id. 370. See also Judge Bright's opinion below, 73 Fed. Supp. 685, and referees' comments in *Matter of Dorsey*, 46 Am. B. R. (N. S.) 146, and *Matter of D. O. Summers,* 45 Am. B. R. (N. S.) 123. The whole subject of tax claims and interest is discussed at length in 3 Collier, *Bankruptcy* (14th ed., 1941 and 1948 Cum. Supp.) sections 57.22, 57.30, 63.16, 63.26, 64.404, 64.407, 64.408. Comments appear in 61 Harv. L. Rev. 354; 21 Temp. L. Q. 428; 29 Va. L. Rev. 206; 34 id. 835; 23 N. Y. U. L. Q. Rev. 516.

[6] Bankruptcy Act of 1898, c. 541, 30 Stat. 544, as amended by the Chandler Act of June 22, 1938, c. 575, 52 Stat. 840, 11 U. S. C. section 1 et seq.

[7] In England the practice was well established, 2 Blackstone, *Commentaries* * 488; *Bromley* v. *Goodere,* 1 Atk. 75; *Ex parte Bennet,* 2 Atk. 527; and applied to mortgages as well as unsecured debts, *Ex parte Badger,* 4 Ves. Jr. 165; *Ex parte Ramsbottom,* 2 Mont. & Ayrt. 79; *Ex parte Penfold,* 4 DeG. & Sm. 282; *Ex parte Lubbock,* 9 Jur. N. S. 854; *In re Savin,* L. R. 7 Ch. 760, 764; *Ex parte Bath,* 22 Ch. Div. 450, 454; *Quartermaine's Case* [1892] 1 Ch. 639: *In re Bonacino,* 1 Manson 59. Two exceptions were recognized: if the alleged "bankrupt" proved solvent, creditors received post-bankruptcy interest before any surplus reverted to the debtor, *Bromley* v. *Goodere,* 1 Atk. 75; *Ex parte Mills,* 2 Ves. Jr. 295; *Ex parte Clarke,* 4 Ves. Jr. 676; and if securities held by a creditor as collateral produced interest or dividends during bankruptcy such amounts were applied to post-bankruptcy interest, *Ex parte Ramsbottom,* 2 Mont. & Ayrt. 79; *Ex parte Penfold,* 4 DeG. & Sm. 228; *Quartermaine's Case* [1892] 1 Ch. 639. These exceptions have been carried over into our system. See *American Iron Co.* v. *Seaboard Air Line,* 233 U. S. 261, 267; *Sexton* v. *Dreyfuss,* 219 U. S. 339, 346.

[8] Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition by or against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest * * *"

date on debts reduced to judgment[9] after bankruptcy.[10] No provision permits post-bankruptcy interest on other claims in general or tax claims in particular. Section 57(j), 11 U. S. C. section 93(j) forbidding allowance of governmental penalties or forfeitures permits[11] allowance of losses sustained by the acts penalized, with actual costs and "such interest as may have accrued thereon according to law." However, on its face this appears to delimit even such allowable debts as of the date of bankruptcy and to allow no more interest than does section 63 with respect to the claims there specified. Moreover, there is no interest except that which accrues according to law—it is exactly such interest that the "fundamental principle" cuts off as of bankruptcy. Section 57(n), 11 U. S. C. section 93(n) requires governmental claims to be proved in the same manner and within the same time as other debts and only for cause shown may a reasonable extension be granted. Tax claims are treated the same as other debts except for the fourth priority of payment, section 64(a), 11 U. S. C. section 104(a), and the provision making taxes nondischargeable, section 17, 11 U. S. C. section 35. But each of these sections is silent as to interest.

The long-standing rule against post-bankruptcy interest thus appears implicit in our current Bankruptcy Act. To read into such a statute an exception to that rule would be unwarranted and, as an original proposition, we should decline to do so. However, the issue comes here after 40 years of bankruptcy administration under the Act of 1898 followed by 10 years under the 1938 Chandler amendments. Petitioners contend that judicial decisions during those periods have now been incorporated into a legislative policy allowing interest on tax claims to payment, thereby producing a rule of law beyond further judicial scrutiny.

It is contended that decisions under the Act of 1898 definitely established such a rule. And petitioners challenge the lower court's holding, despite those decisions, that the Congress through the Chandler Act completed the assimilation of taxes to debts and manifested an intention that such claims be treated, interest-wise, the same as other debts. They assert that the pre-Chandler Act allowance of interest to date of payment was grounded in judicial construction of section 57(j), approved at least *sub silentio* by this Court in *United States* v. *Childs*, 266 U. S. 304 [T. D. 3671 (C. B. IV–1, 241 (1925))], and adopted by congressional reenactment of that section in the Chandler Act. They also contend that even after the Chandler Act the lower courts, and this Court in *Meilink* v. *Unemployment Commission*, 314 U. S. 564, affirmed the alleged prior interpretation of section 57(j). In such a situation, it is said, the courts cannot modify what has now become legislative policy even though originally it may have been a judicially developed rule and one which now, as a matter of statutory construction, we should reject.

At the outset it may be admitted that in practice under the Act of 1898 the lower courts generally did allow interest on tax claims until paid. The parties and the lower courts trace that practice to *In re Kallak*, 147 Fed. 276, and cases following that decision. But we do not believe those cases support petitioners' contention that the pre-Chandler allowance of post-bankruptcy interest reflects a construction of section 57(j). The Kallak opinion itself refutes that contention insofar as it may be based on that line of cases. The court there first decided that since section 64(a) of the Act of 1898[12] gave taxes absolute priority over claims of every kind, "public taxes do not constitute a 'claim' in bankruptcy." 147 Fed. 276, 277. The statute did not require that taxes be proved but that the trustee should seek them out and pay them in full. In view of that requirement

[9] "* * * (5) provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments * * *"

[10] Although the provisions of section 63(a)(1) requiring a rebate of unearned interest, and of section 63(a)(5) eliminating certain post-bankruptcy interest, may in practice be operative but infrequently, they reflect a principle of long standing. See 2 Blackstone, *Commentaries*, * 488.

[11] "Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

[12] "SEC. 64. DEBTS WHICH HAVE PRIORITY.—a. The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality in advance of payment of dividends to creditors * * * b. The debts to have priority * * * and to be paid in full out of bankrupt estates, and the order of payment shall be * * * [(1) costs of preserving the estate, (2) certain filing fees, (3) administration expenses including attorneys' fees, (4) wages as specified, (5) debts entitled to priority under State or Federal laws * * *]" 30 Stat. 544, 563.

and since taxes were not claims, the court saw no reason why the rule stopping interest on ordinary claims should apply. The court found that rule was based on considerations of expediency and practical convenience not present in the case of taxes. First, it said that allowance of such interest at the varying rates applicable to the different claims sharing the estate would prevent definite determination of each claimant's proportionate share. Secondly, such recurring readjustments would complicate administration of the estate. Since neither difficulty would result from allowing post-bankruptcy interest on taxes not sharing the fund with other obligations, the rule against such interest was held to be inapplicable. This conclusion was grounded entirely in reasons of practical convenience. If the case involved construction of any part of the Act of 1898, it clearly was section 64(a) with its requirements of absolute priority in payment of "all taxes legally due and owing," which, together with the dispensation from proof, the court considered as indicating that taxes enjoyed a status entirely different from that accorded ordinary claims. Those provisions were considered controlling, while section 57(j) was not mentioned in the opinion. Consequently the latter section's reenactment could not be considered a legislative adoption of any "judicial gloss" on that section resulting from the Kallak line of cases. The only section relied upon in Kallak, section 64(a), has been significantly amended to deprive taxes of their preferred status, first by the amendment of 1926, and later by the Chandler Act. The former[13] expressly provided that taxes yield priority to administration expenses and certain wages, neither of which bear interest. The latter amendments finalized the subordination of taxes to other priority items. They also wrote into section 57(n) the requirement of proof, formerly dispensed with under section 64(a). Consequently the argument based on alleged Chandler Act recognition of lower court interpretations of section 57(j) seems entirely without force. And, on the contrary, that enactment did significantly change the provisions of section 64(a) which were decisive in Kallak and similar cases.[14]

Petitioners rely most heavily, however, upon this Court's decision in *United States* v. *Childs*, 266 U. S. 304, reversing *In re J. Menist & Co.*, 290 Fed. 947. It is urged that this decision reflected a construction by this Court of section 57(j) which the Congress adopted in enacting the Chandler amendments. We do not believe this contention survives scrutiny of that case or that it is supported by the legislative history of the Chandler Act. The court of appeals stated that the only issue before it was "whether an exaction of 1 percent a month as the price of delay amounts to a penalty." 290 Fed. 947, 949. It decided that anything in excess of 6 percent per annum would be a penalty barred by section 57(j). It is true that court also stated the allowable interest could run until payment. However, that statement was also based on the "highly preferred" status of taxes and the requirement of section 64(a) that absolute priority be given to "all taxes legally due and owing." Section 57(j) was considered as establishing that 12 percent, as a penalty, could not be allowed but that 6 percent was a "pecuniary loss" within the meaning of that section, and allowable as such, in full. But the Government challenged in this Court only the holding that the 12 percent interest was a penalty barred by section 57(j). This Court reversed as to that point and the opinion makes it clear that it was the only issue considered and decided here. The question whether interest could run to payment, although discussed in respondent's brief on the merits, was not the issue which induced the court to bring the case here, and it is not discussed in the opinion. We cannot agree that the case represents even a *sub-silentio* approval of allowance of post-bankruptcy interest. Even assuming, *arguendo*, such approval to be implicit in the decision, it would not help petitioners, relying solely on reenactment of section 57(j), since we have shown the lower court's holding was based largely on

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[13] Section 15 of the Act of May 27, 1926, c. 406, 44 Stat. 662, 666.

[14] *In re Ashland Emery & Corundum Co.*, 229 Fed. 829, relies entirely on section 64(a) and the Kallak case. *In re Clark Realty Co.*, 253 Fed. 938, discusses section 64(a) but not section 57(j) and relies, erroneously, on *Dayton* v. *Stanard*, 241 U. S. 588, as to which see text. *In re J. Menist & Co.*, 290 Fed. 947, relying on section 64(a), is discussed in the text. *In re A. E. Fountain, Inc.*, 295 Fed. 873, does not discuss the issue, deciding only that taxes bear simple interest. *Horne* v. *Boone County*, 44 Fed. (2d) 920, discusses only whether the levy there was penalty or interest. *In re Martin*, 75 Fed. (2d) 618, does not discuss the issue. *In re Semon*, 11 Fed. Supp. 18, modified 80 Fed. (2d) 81, was based on the Revenue Act of 1928 and the court of appeals decided only that the levy there was not a penalty. *In re Beardsley & Wolcott Mfg. Co.*, 82 Fed. (2d) 239, also involved only the penalty issue. Compare *In re William F. Fisher & Co.*, 148 Fed. 907, denying the claimed interest because section 64(a) contained no provision allowing it; and *dictum* as to interest in *McCormick* v. *Puritan Coal Min. Co.*, 41 Fed. (2d) 213, 214.

provisions of section 64(a) which have since been changed by the Act of 1926 and the Chandler Act.

Other decisions of this court cited by petitioners on this point do not help their cause and require little discussion. *Dayton* v. *Pueblo County*, 241 U. S. 588, approved payment of interest to individuals who, during the course of a bankruptcy, paid off tax liens binding property of the bankrupt. The court's decision was only that such parties, whose tax deeds were invalidated because at the time they were issued the property was in *custodia legis*, could be reimbursed out of the estate's general fund for both their advances and interest at the legal rate. This was simple equity since the claimants had paid taxes which the then section 64(a) required the trustee to seek out and pay in full. *New York* v. *Jersawit*, 263 U. S. 493, is clearly a holding limited to the determination that the claim there asserted was a penalty not allowable under section 57(j). The case was so described in the Childs opinion, 266 U. S. 304, 309, and the discussion there confirms our conclusion that the latter decision was similarly limited to that point. *Coder* v. *Arts*, 213 U. S. 223, states as a subsidiary point only that, where the estate was adequate, interest could properly be allowed on a mortgage which the court had held not to be a voidable preference.

It is thus clear that when the Chandler amendments were under consideration in Congress the reported cases established only that lower courts were allowing interest on tax claims until payment, either as a matter of practical convenience or because section 64(a) gave those claims absolute priority and dispensed with proof. There was no basis for belief that the lower courts, much less this court, had applied any judicial gloss to section 57(j) requiring similar preferred treatment, interest-wise, for tax claims. If any conclusion could have been drawn from the cases it was that section 64(a) might have justified a judicial belief that taxes need not be considered, for any purpose, the same as other debts. And, as we have seen, both significant provisions of that section were amended with adverse effects on the status of tax claims. Consequently, reenactment of section 57(j) does not support petitioners' position on this issue. This conclusion is confirmed by the complete lack of any indication in the legislative history that Congress considered section 57(j) in this connection. Petitioners are in fact asserting that adding to an alleged *sub-silentio* ruling here on section 57(j) congressional silence in reenacting that section, precipitated a legislative command that post-bankruptcy interest be allowed on tax claims which, at the same time, were deliberately being reduced to the level of other debts. Mere statement of the proposition indicates its rejection.

The court of appeals concluded that by the 1926 amendment and the Chandler Act, Congress assimilated taxes to other debts for all purposes, including denial of post-bankruptcy interest. We think this is a sound and logical interpretation of the Act after those amendments to sections 64(a) and 57(n). Considered in conjunction with the general rule against post-bankruptcy interest [15] as well as section 63's limitations of interest on other claims to date of bankruptcy, they compel our conclusion, already stated, that the statute as amended did not contemplate any exception in favor of tax claims.

Petitioners' final contention is that even after the Chandler Act the lower courts continued to allow post-bankruptcy interest, that this Court in *Meilink* v. *Unemployment Commission*, 314 U. S. 564, approved the practice, and that congressional recognition of that interpretation is reflected in an unsuccessful attempt to modify section 57(j). It may be admitted that lower courts, other than the one whose judgment is now being reviewed, did continue to allow such interest after the 1938 amendment.[16] But this Court has not, in the Meilink case or otherwise, passed on the question. That case involved the same issue that had been presented in Childs: whether or not the interest there challenged was in fact a penalty proscribed by section 57(j) which had been left substantially unchanged by the Chandler Act. We decided only that question.

But, irrespective of that decision, petitioners contend that Congress has considered the lower courts' post-Chandler Act decisions as a statutory interpretation which can be overruled only by legislation. The argument is based on a Committee Report accompanying a bill approved by the House during the

[15] See note 7 and text; and see *Thomas* v. *Western Car. Co.*, 149 U. S. 95; *Sexton* v. *Dreyfuss*, 219 U. S. 339; *American Iron Co.* v. *Seaboard Air Line*, 233 U. S. 261.

[16] See, for example, *In re L. Gandolfi & Co., Inc.*, 42 Fed. Supp. 706; *In re Flayton*, 42 Fed. Supp. 1002; *Davie* v. *Green*, 133 Fed. (2d) 451. But see Referee's decision, *In Matter of Union Beverage Co., Inc.*, 50 Am. B. R. (N. S.) 825, 829. And see discussion by the court below in *Hammer* v. *Tuffy*, 145 Fed. (2d) 447, 449, and in *United States* v. *Roth*, 164 Fed. (2d) 575, 577–578.

Eightieth Congress but not acted upon in the Senate. Among Bankruptcy Act amendments proposed in this bill was one designed "both to clarify and modify" section 57(j). The change, it was said in the House Report, was to make it clear that the section referred to interest on the "pecuniary loss" and that such interest stops at bankruptcy. The clarifying clause was "intended to overrule an obsolete rule" as to interest on delinquent taxes. It was stated that although sections 64(a) and 57(n) as amended by the Chandler Act rendered the reasoning of the Kallak case obsolete, nevertheless its rule had not been changed and legislation was necessary, citing *Davie* v. *Green*, 133 Fed. (2d) 451, the case which conflicts with the decision now being reviewed. The text of the section of the report devoted to this proposed amendment is printed in the margin.[17] We believe a fair reading of it leads to the conclusion that the committee believed, not that the Chandler Act either allowed post-bankruptcy interest or left the matter open, but that the courts in allowing such interest were ignoring the necessary and intended implications from the Chandler amendments to sections 57(n) and 64(a). The court below did not have this report before it, but in a well-considered opinion reached the same conclusion. We believe that conclusion is confirmed by the report and that petitioners' contentions find no support in either the Chandler Act or this abortive attempt at clarification.[18]

The case thus presents only the conflict between two courts of appeals as to the proper interpretation of the current statute. We agree with the court below and resolve the conflict by affirming its judgments.[19]

Affirmed.

Mr. Justice REED dissents for the reasons given in *Davie* v. *Green*, 133 Fed. (2d) 451.

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[17] "11. Section 11(a) of the bill is intended both to clarify and modify section 57j of the act. The change in 57j(c) is to make clear that the limitation on interest 'up to the date of bankruptcy' relates only to interest on the 'pecuniary loss,' and further that such interest stops at the date of bankruptcy. The addition of clause (2) in the bill is intended to overrule an obsolete rule as to interest on delinquent tax debts. Interest on general unsecured debts, on unsecured Government debts other than taxes, and on debts entitled to priority under section 64a, is suspended at the date of bankruptcy so that, except in the rare case of a solvent estate, interest is allowable only to such date. (Sec. 63a; *Adams* v. *Napa Cantina Wineries* (C. C. A., 9th Cir.), 36 Am. B. R. (N. S.) 8; *In re Gandolfi & Co., Inc.* (S. D., N. Y.) 51 Am. B. R. (N. S.) 521 (governmental debts and other debts entitled to priority); 3 *Collier on Bankruptcy*, 14th ed., 1835 et seq.; 2 *Remington on Bankruptcy*, 4th ed., secs. 771, 795.) However, interest on delinquent tax debts is allowable to the date of payment (*In re Kallak* (D. C., N. D., 1906) 17 Am. B. R. 414; *In re Ashland Emery and Corundum Co.* (D. C., Mass. 1916) 36 Am. B. R. 194; *In re Clark Realty Co.* (C. C. A. 7th Cir., 1918) 42 Am. B. R. 403; *sub silentio, United States* v. *Childs*, 266 U. S. 304, 307 (1924), 5 Am. B. R. (N. S.) 5). Although, under the Chandler Act, a tax debt is required to be proved (section 57n) and its order of priority ranks below all administration costs and expenses, wages and costs and expenses of creditors successfully opposing a settlement or discharge, or procuring a conviction for an offense (section 64a (1), (2), (3)), thereby rendering obsolete the reasoning in the Kallak case, nevertheless its rule has not been changed, and therefore requires this statutory modification. For further discussion see *In re D. O. Summers* (Ref., N. D. Ohio, 1939), 46 [45] Am. B. R. (N. S.) 123; *In re Dorsey* (Ref., W. D. Wash., 1940), 46 Am. B. R. (N. S.) 146; *Davis*[e] v. *Green* (C. C. A. 1st Cir., 1943) 52 Am. B. R. (N. S.) 603. And on overruling the Kallak case see *In re Union Fabrics, Inc.* (S. D., N. Y., 1947), 73 Fed. Supp. 685, appeal pending.

"The Judicial Conference has more than once expressly approved this amendment to section 57j. Its most recent reaffirmation of its position was in October 1946. (See Report of the Judicial Conference, October 1946, page 15.) The Administrative Office of the United States Courts has stated that the language of section 11 of the bill is satisfactory on this score." H. R. Rept. No. 2083, 80th Cong., 2d sess., page 5.

[18] The United States cites, as confirming the construction it has placed on section 57(j), Federal taxing statutes beginning with the Revenue Act of 1924 which direct that upon nonpayment of the tax there shall be added, as part of the tax, interest at the specified rate from due date to date of payment. It has been held that Federal taxes ordinarily bear interest even in the absence of statute. See *Billings* v. *United States*, 232 U. S. 261, 284–288. But we do not think either such a rule or statutory provision could be permitted to negative the Bankruptcy Act's requirement in that respect if the latter be to the contrary, as we think it is. That Act was early held to take into consideration "the whole range of indebtedness of the bankrupt, National, State and individual," *Guaranty Co.* v. *Title Guaranty Co.*, 224 U. S. 152, 160, and to have been passed "with the United States in the mind of Congress," *Davis* v. *Pringle*, 268 U. S. 315, 317. We do not believe the Revenue Act of 1924 and similar enactments were intended to amend the comprehensive scheme of the Bankruptcy Act, with an effect clearly contrary to specific amendments such as the Act of 1926 and the Chandler Act. This would indeed be a strange way to require, as it would, that Federal tax claims be preferred over State and municipal claims when the Bankruptcy Act itself treats all tax claims equally. This contention, standing by itself, or in support of the argument based on section 57(j), cannot be accepted.

[19] Since we have concluded that neither the alleged legislative treatment of this issue nor prior rulings of this Court support the contrary result, this decision involves no consideration of the principle of *stare decisis*. If it did, the responsible exercise of the judicial process, *Helvering* v. *Hallock*, 309 U. S. 106, 119 [Ct. D. 1440, C. B. 1940–1, 223], would dictate that the express principles and logical implications of the Chandler Act prevail over earlier inconclusive lower court holdings and congressional failure to correct them.

SUPPLEMENT O.—OVERPAYMENTS

SECTION 322.—REFUNDS AND CREDITS

SECTION 29.322-3: Claims for refund by taxpayers. 1949-1-13005
T. D. 5680

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 29.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1941

Amending section 29.322-3 of Regulations 111, relating to claims for refund.

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

To Collectors of Internal Revenue and Others Concerned:

PARAGRAPH 1. Section 29.322-3 of Regulations 111, as amended by Treasury Decision 5425 [C. B. 1945, 10], approved December 29, 1944 [26 CFR 29.322-3], is further amended as follows:

(A) By inserting the word "short" immediately before "Form 1040A" wherever it appears therein.

(B) By inserting immediately after "Form W-2 (Rev.)" wherever it appears therein the following: "or Employee's Optional Form 1040A."

(C) By striking out the eighth sentence of the second paragraph reading: "An 'amended return,' so called, shall not be considered a claim for refund or credit."

Because the amendments made by this Treasury Decision are either of a technical nature or merely relieve taxpayers from a limitation applicable under existing regulations, 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 said Act.

(This Treasury Decision is issued under the authority of section 62 of the Internal Revenue Code (53 Stat. 32; 26 U. S. C. 62).)

FRED S. MARTIN,
Acting Commissioner of Internal Revenue.

Approved December 24, 1948.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 30, 1948, 8:52 a. m.)

SECTION 29.322-3: Claims for refund by taxpayers. 1949-6-13042
Mim. 6361
(Also Section 22(d), Section 29.22(d)-7.)

Interim allowance in respect of overpayment of tax under section 22(d)(6) of the Internal Revenue Code.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C., February 7, 1949.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, Heads of Field Divisions of the Technical Staff, and Others Concerned:

1. The provisions of section 22(d)(6) of the Internal Revenue Code were enacted by the Congress to afford taxpayers using the elective inventory method, commonly referred to as the last-in, first-out (LIFO) inventory method, authorized by section 22(d)(1) of the Code, a measure of relief from the consequences of the involuntary liquidation of goods, inventoried by the LIFO method, attributable wholly to war conditions beyond the control of taxpayers.

2. Under such provisions, in respect of involuntary liquidations occurring in taxable years beginning after December 31, 1940, and prior to January 1, 1948, taxpayers are permitted, in taxable years ending prior to January 1, 1951, to replace, for Federal income and excess profits tax purposes, at the inventory cost basis of the goods replaced, items of merchandise involuntarily liquidated and subject to replacement within the meaning of section 22(d)(6) of the Code. In such cases, net income for the year of liquidation is decreased by the amount of any excess replacement costs incurred to which taxpayers may be subjected in effecting the replacement, and net income for the year of liquidation is increased by any excess of the original inventory cost figure over the actual replacement cost incurred. It is provided that an adjustment must be made of the tax liability for the year of liquidation and for all intervening years insofar as such years are affected by the replacement adjustment. Under the provisions of section 22(d)(6) of the Code, no interest is allowed on overpayments attributable to the replacement adjustment, and, likewise, no interest is charged on any deficiencies in respect of such adjustment.

3. Taxpayers adopting and using the elective inventory method are required under the law to include in taxable income regularly in their returns for the year of liquidation the profits or income derived as a consequence of involuntary liquidations, pay the tax thereon, and then wait until merchandise is acquired in replacement of the items of merchandise involuntarily liquidated before a request may be made for the credit or refund of the tax which, under normal conditions, would not have been imposed upon such taxpayers. In addition, taxpayers, after having made replacements in whole or in part, must face a substantial delay pending a final determination of their tax liabilities before a credit or refund can be made of any overpayment which, under the existing statute, is allowed or made without interest. Under the stated circumstances, the administration of the full measure of relief contemplated by the statute may be delayed for several years.

4. The purpose of this mimeograph is to establish an interim or accelerated refund program in reference to overpayments claimed by taxpayers entitled to the benefits of section 22(d)(6) of the Code, based upon a showing that their Federal income and excess profits taxes have been overpaid. Under such program, an interim or ac-

celerated allowance of 75 percent of the net reduction in taxes attributable to the adjustment will be made to such taxpayers based upon representations submitted with respect to any claimed overpayment of taxes under section 22(d)(6) of the Code. In determining such net reduction, a decrease in any one tax, e. g., the excess profits tax, will be offset by any increase in any other tax, e. g., the normal tax and surtax, resulting from such adjustment. Likewise, overassessments attributable to the replacement adjustment in any year will be applied as credits to deficiencies for other years which are deemed attributable to the adjustment.

5. Taxpayers entitled to the benefits of section 22(d) (6) of the Code and who desire an interim allowance in respect of any overpayment of tax under the provisions of such section must file an application in the manner and in the form outlined in the "Application for Interim Allowance in Respect of Overpayment of Taxes under Section 22(d)(6) of the Internal Revenue Code," published herewith. Such application should set forth fully and clearly all of the information and data substantiating the taxpayer's representations that an interim allowance in respect of an overpayment of tax should be made as a result of involuntary liquidations and replacements. Applications must be filed, under oath, with the collector of internal revenue for the district in which assessment was made or tax paid. Collectors are instructed to transmit, without delay, such applications, together with a certification as to assessment and payment of tax, to the Deputy Commissioner of the Income Tax Unit, Washington 25, D. C., for attention of the Clearing Division, Readjustment Section. In those cases in which involuntary liquidations occurred in more than 1 year, separate applications must be filed for each year. There must be attached to each application two copies of a duly executed agreement, prepared in the manner and in the form outlined in the "Agreement as to Interim Allowance in Respect of Overpayment of Tax under Section 22(d) (6) of the Internal Revenue Code," published herewith.

6. If the application and supporting data, including a properly executed agreement form, constitute a sufficiently complete representation of a potential overpayment, and a limited examination indicates that such representation has merit as determined by reference to section 22(d)(6) of the Code, an interim allowance of 75 percent of such potential overpayment will be made immediately. The amount of any interim allowance will be applied against any outstanding Federal income or excess profits tax then due, and any balance remaining will be refunded immediately to the taxpayer.

7. The adjustments authorized herein will be made by the Clearing Division of the Income Tax Unit. All correspondence should refer to the number of this mimeograph and the symbols IT : Cl : R : LIFO.

GEO. J. SCHOENEMAN,
Commissioner.

Approved February 7, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

Attachment to Com.-Mim., Coll. No. 6361

Application for Interim Allowance in Respect of Overpayment of Taxes Under Section 22(d)(6) of the Internal Revenue Code

If involuntary liquidation occurred in more than one year, file separate application for each year of liquidation	To be filed with the collector of internal revenue where assessment was made or tax paid	Collector's stamp
	---------- (Name of taxpayer)	(Date received)
	---------- (Street and number)	
	---------- (City, town, or post office) (State)	

The undersigned taxpayer hereby makes application pursuant to Mimeograph 6361, dated February 7, 1949, for interim allowance in respect of overpayment of taxes under section 22(d)(6) of the Internal Revenue Code and as a basis therefor represents as follows:

1. The taxable year of involuntary conversion covered by this application is ----------.
2. State the date on which application for adoption and use of the elective method of taking inventories (LIFO) was filed. (Attach copy of Form 970 and accompanying analysis of all inventories previously filed) ----------.
3. Did you comply with the provisions of section 22(d)(2)(B) of the Internal Revenue Code in your annual report for the first year the elective method was adopted? (Answer "Yes" or "No") ----------. Was the report specified in such section ever revised or restated for the first year? (Answer "Yes" or "No") ----------. If so, explain fully ----------.
4. Indicate the manner in which notification was made of intention to effect a replacement of liquidated stock, in whole or in part, and a desire to have applied the provisions of section 22(d)(6) of the Internal Revenue Code ----------.
5. Amount by which taxes previously determined for the year of liquidation, for preceding taxable years, and for all taxable years intervening between the year of liquidation and the year of replacement, are increased or decreased by reason of the involuntary liquidation and replacement adjustment and any related adjustments. (Attach schedules showing computation of taxes previously determined and of the increases and decreases in such taxes.)

Taxable year ended	Date of filing return	Income tax		Declared value excess-profits tax		Excess profits tax	
		Increase	Decrease	Increase	Decrease	Increase	Decrease
----------	----------	$----------	$----------	$----------	$----------	$----------	$----------
----------	----------	----------	----------	----------	----------	----------	----------
----------	----------	----------	----------	----------	----------	----------	----------
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If any other tax is affected by reason of involuntary liquidation and replacement adjustment, attach schedule showing computation of increase or decrease in such tax as previously determined.

6. Excess of the aggregate of the decreases over the aggregate of the increases entered in Item 5, above ---------- $----------.
7. If a claim for refund or credit, Form 843, has been filed for overpayment in any taxable year resulting from involuntary liquidations and replacements, attach copy of such claim together with supporting schedules as part of this application. If a claim has not been filed, a properly executed claim on Form 843 should be filed with this application.

8. An analysis of inventories (LIFO), showing quantities and cost according to acquisition levels, beginning with the opening inventory for the first year of the claimed liquidation and ending with the closing inventory for the last year of claimed replacement of inventory items previously liquidated, accompanies and by reference is made a part of this application. Enter here a list of all supporting schedules______________________________.
9. Attach financial statement of current date and other information affecting financial condition, together with analysis and statement showing need for interim allowance.
10. The agreement required by Mimeograph 6361, dated February 7, 1949, executed in duplicate by the taxpayer, accompanies, and is hereby incorporated by reference in, this application.

Signed ______________________________.

______________________________.

Date ________________.

Sworn to and subscribed before me this ______ day of______________, 19___.

____
(Signature of officer administering oath)

____
(Title)

Applications of individuals must be signed and sworn to by the individual or his duly authorized agent.

Applications of corporations must be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

Attachment to: Com.-Mim., Coll. No. 6361

Agreement as to Interim Allowance in Respect of Overpayment of Tax Under Section 22(d)(6) of the Internal Revenue Code

This agreement made in duplicate by and between the taxpayer ____________ ______________, of ____________________, and the Commissioner of Internal Revenue,

Witnesseth, that

Whereas the taxpayer has filed an application dated ____________________ for an interim allowance in respect of overpayment of his (or its) income and excess profits tax liability for the taxable year(s) ______________ under the provisions of section 22(d)(6) of the Internal Revenue Code, such allowance to be based on a tentative adjustment and subject to final adjustment upon the completion of the Commissioner's final audit for said taxable year(s) __________________, and

Whereas the taxpayer represents that since the taxable year __________ he (or it) has, under and in pursuance of the regulations in that regard prescribed by the Commissioner with the approval of the Secretary of the Treasury, followed the last-in first-out method of inventorying goods permitted by section 22(d)(1) of the Internal Revenue Code; and

Whereas the taxpayer represents that he (or it) properly elected by due and timely notice to the Commissioner at the time of filing his (or its) income tax return(s) for the taxable year(s) ______________ (or within 6 months following the enactment of the Revenue Act of 1943, in the case of a taxable year beginning in 1941), to avail himself (or itself) of the involuntary liquidation and replacement provisions of section 22(d)(6) of the Code, and further represents that the decrease during such taxable year(s) in his (or its) last-in first-out inventory was attributable to an involuntary liquidation as defined in subparagraph (B) of said section 22(d)(6); and

Whereas the Commissioner has not completed the final audit of the taxpayer's income and excess profits tax liability for the taxable year(s) ______________, the year(s) of the claimed involuntary liquidation, and such action may be further delayed for an indefinite period; and

Whereas in reliance upon the taxpayer's representations it has been tentatively determined by the Commissioner that under the provisions of section 22(d)(6), the taxpayer has made an overpayment of income and excess profits taxes, in the amount of $__________ (to be filled in by the Commissioner) for the said taxable year(s) ________________; and

Whereas the provisions of section 22(d)(6) of the Internal Revenue Code were enacted by the Congress as a relief provision for the relief of taxpayers who had regularly adopted the last-in first-out inventory method from involuntary liquidations due to wartime conditions beyond the control of such taxpayers, as defined in subparagraph (B) of section 22(d)(6), with the intention that readjustments of the income and excess profits taxes for the taxable years of the involuntary liquidations by replacements to restore such liquidations would be made as soon as possible; and

Whereas, based upon the representations of the taxpayer, it appears that retention by the United States of the said amount(s), pending final determination of the taxpayer's income and excess profits tax liability for the taxable year(s) ________________ by the Commissioner will result in substantial hardship to the taxpayer,

Now, therefore, the taxpayer and the Commissioner mutually agree:

That upon the execution of this agreement the Commissioner will promptly make an interim allowance to the taxpayer of 75 percent of the amount(s) tentatively determined, as aforesaid, to be the amount(s) by which the taxpayer has overpaid his (or its) income and excess profits tax liability for the taxable year(s) ________________ under the provisions of section 22(d)(6) of the Internal Revenue Code;

That the taxpayer hereby agrees and consents to extend the time for the assessment of a deficiency under the provisions of section 22(d)(6)(E) of the Internal Revenue Code until December 31, 1954, in order to allow the Commissioner sufficient time within which to make his final audit of the taxpayer's income and excess profits tax liability for the taxable year(s) ________________, and the taxpayer hereby also agrees that he (or it) will furnish the Commissioner at his request a further extension of time for a reasonable period under said provision of law if by December 31, 1954, the said final audit for the taxable year(s) ________________ has not been completed, and

That if at any time it is determined by the Commissioner that the interim allowance in respect of income and excess profits taxes for said taxable year(s) as tentatively determined under section 22(d)(6) of the Internal Revenue Code is in excess of the amount(s) properly due the taxpayer as overpayment of such taxes for said taxable year(s) under said provision of law, the taxpayer in consideration of the interim allowance hereby agrees upon notice and demand with or without assessment promptly to repay such excess to the collector with interest at the rate of 6 percent from the time of the interim allowance and notwithstanding such agreement the taxpayer further agrees and hereby consents to extend the time for the assessment of such excess interim allowance and for filing suit for the recovery thereof with or without assessment for and until December 31, 1954.

A condition of this undertaking is that contemporaneously with the execution of this agreement the taxpayer will furnish the Commissioner with a written statement under oath of its financial condition and which will show to the satisfaction of the Commissioner that the taxpayer is in a sound financial condition and that the repayment to the Commissioner of all or any part of the interim allowance will not be jeopardized. The taxpayer further agrees that he (or it) will furnish from time to time during the continuance of this agreement, at the request of the Commissioner, new statements under oath of his (or its) financial condition to the end that the Commissioner may be apprised at all times of the current financial condition of the taxpayer.

The taxpayer further agrees that he (or it) will furnish to the Commissioner, if in the discretion of the Commissioner at any time *after* the making of the interim allowance and prior to the completion of the Commissioner's final audit for the taxable year(s) ________________ such action is necessary to the protection of the Government's interests, such security as the Commissioner may require to assure the repayment to the collector of any excess payment that may be determined by the Commissioner to have been made in the interim allowance which is made under this agreement.

It is understood and agreed by and between the parties hereto that the provisions of this agreement with respect to the assessment or recovery by the Commissioner of any excess payment that may be involved in the interim allowance for the taxable year(s) ________________ are in addition to and independent of the right of the Commissioner under the Internal Revenue Code to make other or further assessments against the taxpayer with respect to the taxable year(s) ________________. It is further understood and agreed by and between the parties hereto that the Commissioner reserves and retains any and all rights under the Internal Revenue Code or otherwise to recover by suit in court any part of this interim allowance in excess of the amount finally determined to be due the taxpayer under the Internal Revenue Code.

In witness hereof the above parties have subscribed their names to these presents in duplicate.

Signed this ------ day of --------------- 19 ----.

--------------------------------.
(Taxpayer)

Signed --------------------
(Date)

-----------------------------------,
Commissioner of Internal Revenue.

SECTION 29.322–3: Claims for refund by taxpayers.

INTERNAL REVENUE CODE

Tax paid by individual prior to bankruptcy. (See I. T. 3959, page 90).

CHAPTER 2.—ADDITIONAL INCOME TAXES

SUBCHAPTER E.—EXCESS PROFITS TAX

PART I

SECTION 710.—IMPOSITION OF TAX

SECTION 35.710–5, REGULATIONS 112: Deferment of payment of tax in case of base period or invested capital abnormality. 1949–1–13001 T. D. 5679
(Also Section 729, Section 35.729–2.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 35.—EXCESS PROFITS TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1941

Regulations 112 amended.—Extension of time for assessment of deferred excess profits tax.

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

To Collectors of Internal Revenue and Others Concerned:

On October 8, 1948, notice of proposed rule making regarding the extension of time for assessment of deferred excess profits tax was published in the Federal Register (13 F. R. 5882). No objection to the rules proposed having been received, the following amendments to Regulations 112 (26 CFR, Part 35) are hereby adopted. The amendments are designed to conform Regulations 112 to section 3 of Public Law 635 (Eightieth Congress) [C. B. 1948–2, 317], approved June 12, 1948.

PARAGRAPH 1. There is inserted immediately before section 35.710–1 [26 CFR 35.710–1] the following:

SEC. 3. EXTENSION OF TIME FOR ASSESSMENT OF DEFERRED EXCESS PROFITS TAX. (PUBLIC LAW 635 (EIGHTIETH CONGRESS), APPROVED JUNE 12, 1948.)

(a) Section 710(a)(5) of the Internal Revenue Code is hereby amended by adding at the end thereof the following: "Notwithstanding any other provision of law or rule of law, to the extent that any amount of tax remaining unpaid pursuant to this paragraph is in excess of the reduction in tax finally determined under section 722, such excess may be assessed at any time before the expiration of one year after such final determination."

(b) The amendment made by this section shall be effective as if made by section 222(b) of the Revenue Act of 1942.

SEC. 201. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1942, TITLE II—APPLICABLE TO SECTION 222(b), REVENUE ACT OF 1942.)

Except as otherwise expressly provided, the amendments made by this title shall be applicable only with respect to taxable years beginning after December 31, 1941.

PAR. 2. Section 35.710–5, as amended by Treasury Decision 5490 [C. B. 1946–1, 179], approved January 24, 1946 [26 CFR 35.710–5], is further amended by adding at the end thereof the following new paragraph:

If the taxpayer defers under section 710(a)(5) payment of an amount in excess of the reduction in tax finally determined under section 722, such excess may be assessed at any time before the expiration of 1 year after such final determination. Such assessment may be made regardless of whether the assessment of a deficiency for such taxable year is otherwise barred by the running of any period of limitations, by the decision of any court, including the Tax Court, or by any other provision (such as section 272(f)) or rule of law. The reduction in tax under section 722 is finally determined, in cases in which the Commissioner's action is subject to review by the Tax Court under section 732, upon the expiration of the period for filing petition for review with the Tax Court or, if such petition is filed, upon the decision of the Tax Court becoming final, and in all other cases upon the Commissioner's sending notice by registered mail to the taxpayer of his final action on the application for relief under section 722. If the Commissioner should, at the request of the taxpayer, agree because of unusual circumstances to reconsider his action on an application, the immediately preceding sentence shall be applied with respect to the Commissioner's second determination.

PAR. 3. Section 35.729–2 [26 CFR 35.729–2] is amended by adding at the end thereof the following new sentence:

For special rules with respect to cases in which the payment of excess profits tax is deferred under section 710(a)(5), see section 35.710–5.

(This Treasury Decision is issued under the authority of section 62 of the Internal Revenue Code (53 Stat. 32; 26 U. S. C. 62), as made applicable by section 729(a) of the Internal Revenue Code (54 Stat. 989; 26 U. S. C. 729 (a)).)

Because the amendments made by this Treasury Decision conform Regulations 112 to the provisions of section 3 of Public Law 635 (Eightieth Congress), approved June 12, 1948, which provisions are applicable to taxable years beginning after December 31, 1941, this Treasury Decision is not subject to the effective date limitation of section 4(c) of the Administrative Procedure Act, approved June 11, 1946.

FRED S. MARTIN,
Acting Commissioner of Internal Revenue.

Approved December 16, 1948.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 22, 1948, 8:51 a. m.)

EXCESS PROFITS TAX COUNCIL

1949–1–13002
E. P. C. 35

Revision of Part VII of the Bulletin on Section 722

1. Part VII(A) of the Bulletin on Section 722 (pp. 130–131. G. P. O. printing) is revised to read as follows:

(A) GENERAL RULE.

In order for a taxpayer to obtain relief under the provisions of section 722 (c), it must be one not entitled to use the excess profits credit based on income and it must establish—

(1) That its excess profits credit based on invested capital is an inadequate standard for determining excess profits because of one or more of the factors enumerated in section 722(c); and

(2) The fair and just amount representing normal earnings to be used as a constructive average base period net income.

Corporations which are thus limited to the use of an excess profits credit based on invested capital, and accordingly the taxpayers to which section 722(c) is applicable, are:

(1) Domestic corporations coming into existence after December 31, 1939, which are not acquiring corporations under section 740(a); and

(2) Domestic corporations coming into existence prior to January 1, 1940, but which (*a*) never engaged in business prior to that date and (*b*) are not acquiring corporations under section 740(a); and

(3) Foreign corporations required to use an excess profits credit based on invested capital under the provisions of section 712(b).

Section 722(c) is intended to afford relief to certain of these corporations by applying the standard applicable to corporations entitled to use an excess profits credit based on income under section 713, i. e., a fair and just amount representing normal earnings.

Each of the Congressional Committee Reports on this section (C. B. 1942-2, p. 480 and p. 653) contains the following statement:

"Under existing law, a taxpayer not entitled to use the excess profits credit based on income is not entitled to relief. This places in a disadvantageous competitive position corporations commencing business after January 1, 1940, as well as other corporations deprived of such credit, if the business is of a type showing a high return on invested capital, or if, for some reason peculiar to the corporation, the invested capital is unusually low. The privilege of using the excess profits credit based on income is, therefore, extended to a taxpayer presently not entitled to use such credit, if the excess profits credit based upon the invested capital of such taxpayer furnishes an inadequate standard for the computation of excess profits because of one or more of the following reasons: * * *."

The right to use a constructive average base period net income is limited to those cases in which—

(1) the business of the taxpayer is of a class in which intangible assets not includible in invested capital under section 718 make important contributions to income; or

(2) the business of the taxpayer is of a class in which capital is not an important income-producing factor; or

(3) the invested capital of the taxpayer is abnormally low.

The term "invested capital" as used in section 722(c) means the invested capital as determined for excess profits tax purposes.

2. Part VII(B) of the Bulletin on Section 722 (pp. 132–134, G. P. O. printing) is revised to read as follows:

(B) BUSINESS OF A CLASS IN WHICH INTANGIBLE ASSETS MAKE IMPORTANT CONTRIBUTIONS TO INCOME.

The following discussion outlines some of the elements which are to be considered in cases where qualification is claimed under section 722(c)(1).

The term "intangible assets" is used in section 722 in the sense in which it is ordinarily understood. While generally accepted legal and accounting definitions are valuable guides, they are not considered controlling for this purpose. Patents, copyrights, licenses, goodwill, franchises, contracts, secret formulas, secret processes, trade-marks, brand names, trade names, subscription lists, and similar assets are illustrative of such intangibles; but the foregoing list is not all-inclusive.

The personal characteristics of individuals or of groups of individuals generally do not constitute intangible assets. So-called "know-how," specialized knowledge, skill, experience, reputation, credit standing, and the like are ordinary and expected characteristics of persons undertaking the conduct of a business.

The taxpayer's rights in the intangible asset, whether legal title, equitable title, license or privilege of use, or any other, must be such that the income contributed by the intangible is properly includible in the taxpayer's income. It is not sufficient if taxpayer is merely the assignee of the income of the intangible. The contribution of the intangible asset to income, while it may be direct or indirect, must be important in the sense that it is significant in relation to the taxpayer's total income.

For the purpose of section 722(c), an asset is includible in invested capital unless it has, in the hands of the taxpayer, (*a*) no unadjusted basis, (*b*) an unadjusted basis of zero, or (*c*) an unadjusted basis which is clearly a nominal amount.

The provision that taxpayer's business must be "of a class" does not imply that there be a division of businesses into trades or industries, or that any other separation into specified groups is required. Here, the word "class" is used in the sense of type, character, or nature, rather than with any requirement that businesses must be segregated into classes. If the nature of the taxpayer's business function, the character of its organization, or the methods it employs in operation are such that intangible assets of the character in question make important contributions to income, it is considered that it falls within the purview of the statute.

3. Part VII(C) of the Bulletin on Section 722 (p. 134, G. P. O. printing) is revised to read as follows:

(C) BUSINESS OF A CLASS IN WHICH CAPITAL IS NOT AN IMPORTANT INCOME-PRODUCING FACTOR.

Section 722(c)(2) deals with those corporations in which capital is not important as an income-producing factor. The principles outlined in section 35.725-2(*e*) of Regulations 112 for determining whether capital is a material income-producing factor should be applied also under section 722(c)(2).

The words "class" and "important," as used in section 722(c)(2), have the same general meaning as in section 722(c)(1).

4. Part VII(D) of the Bulletin on Section 722 (p. 134, G. P. O. printing) is revised to read as follows:

(D) ABNORMALLY LOW INVESTED CAPITAL.

Section 722(c)(3) deals with corporations having abnormally low invested capital. In such cases there must be present some identifiable abnormality in the taxpayer's business situation which affects the amount of its invested capital.

It is sufficient if the abnormality is established by analysis of the circumstances affecting the taxpayer's own invested capital, although comparisons with other corporations may be used. For example, the fact that invested capital is abnormally low might be established by showing an abnormally high ratio of borrowed capital to total invested capital or by showing that a tangible asset, which makes an important contribution to the taxpayer's income, is not includible, as defined in (B) above, in the taxpayer's invested capital.

5. Part VII (E) of the Bulletin on Section 722 (pp. 136–141, G. P. O. printing) is revised to read as follows:

(E) DETERMINATION OF CONSTRUCTIVE AVERAGE BASE PERIOD NET INCOME.

Section 722(c) provides that taxpayers establishing a qualifying factor under section 722(c) (1), (2), or (3) "shall be considered to be entitled to use the excess profits credit based on income, using the constructive average base period net income determined under subsection (a)." Thus, while the grounds for qualification necessarily differ, the measure of relief applicable to all corporations entitled to consideration under section 722 is the same. It follows that the constructive average base period net income for a taxpayer qualifying for relief under section 722(c) should be determined, as nearly as possible, as if such taxpayer had qualified for relief under section 722(b).

The procedures described in the following paragraphs relate primarily to domestic corporations but, except where otherwise stated, are intended also as guides in cases involving foreign corporations.

Section 722(a), in dealing with the post-1939 prohibition and the exceptions thereto, provides that in cases described in section 722(c) "regard shall be had to * * * the nature of the taxpayer and the character of its business * * * to the extent necessary to establish the normal earnings to be used as the constructive average base period net income."

The factors to be taken into account in determining the nature of the taxpayer and the character of its business are numerous and will vary in each case. In many instances the event or condition which is advanced as the qualifying factor under section 722(c) will be the best guide in segregating material from immaterial elements. Experience has, however, suggested the following as indicative of the matters to be considered.

(*a*) *Product or Service.*

(1) Wholesaler, retailer, manufacturer, assembler, broker, or engineering consultant.

(2) Quality, novelty, newness, and sales appeal.

(3) Special protection, such as patent, franchise, and license.

(*b*) *Management.*

(1) Degree of success indicated by past performance and experience.

(2) Assistance available from related or interested enterprises.

(3) Effectiveness of personnel policies with respect to efficient utilization of labor, etc.

(*c*) *Finances.*

(1) Amount and adequacy of available equity and working capital.

(2) Available credit and probable burden of debt charges.

(*d*) *Plant.*

(1) Efficiency, size, and capacity of physical facilities and processes.

(2) Location with respect to market, labor, material, and power.

(*e*) *Material.*

(1) Availability, cost, and transportation.

(*f*) *Distribution.*

(1) Availability and size of market, merchandising program, and probable degree of market penetration.

(2) Character of competition, probable reaction to new enterprise, product, and process.

The nature of the taxpayer and the character of its business will be determined as of the date on which the taxpayer commenced business. In this situation the term "commenced business" has the same significance as in section 722(b)(4). Ordinarily, the nature of the taxpayer and the character of its business should be fully determinable by reference to conditions existing during its first excess profits tax taxable year and, once determined, there generally is no necessity for a new determination for a subsequent excess profits tax taxable year.

The taxpayer's capacity for production or operation on the date its nature and the character of its business are established will be considered to include any change in capacity consummated subsequently as a result of a course of action to which the taxpayer was committed on such date. In determining whether such a change in capacity should be regarded, the term "committed" should be applied in the same manner as is appropriate in cases under section 722(b)(4).

In the case of certain foreign corporations which engaged in business prior to January 1, 1940, there is no necessity for considering events or conditions occurring after December 31, 1939. Thus, where a foreign corporation, but for the provisions of section 712(b), could have determined its excess profits credit under section 713, it will be deemed to have such a credit and generally will be permitted to employ the factors enumerated in section 722(b) in the event that the result otherwise obtained would not be the equivalent of normal earnings for the taxpayer as it existed on December 31, 1939.

The constructive average base period net income of a taxpayer qualifying for relief under section 722(c) will be determined in the same manner as in the case of a corporation which commenced business on December 31, 1939, qualifying for relief under section 722(b)(4). The taxpayer will be deemed to have had under commitment on that date any change in capacity for production or operation actually under commitment on the date its nature and the character of its business were established. For the purpose of determining the constructive level of earnings as of December 31, 1939, the commencement of business or the consummation of any change in capacity to which taxpayer was committed may be assumed to have occurred on December 31, 1937.

Reconstruction based upon the nature of the taxpayer and the character of its business involves problems similar to those encountered in antedating events where the push-back rule is used in cases under section 722(b)(4). The new business is moved back into the pre-1940 economy but its effect on competing or related enterprises must be recognized. Elements, such as war demand, which cannot be moved back under the push-back rule, cannot be moved back under section 722(c). In short, the problem is to determine what the performance of the particular business would have been under pre-1940 economic conditions, as these conditions would have been had it performed during that period.

In reconstruction, appropriate adjustments will be made, where necessary, to avoid duplication of benefits which might arise by reason of affiliations with other taxpayers, deductions for interest on abnormally large amounts of borrowed capital, and the like.

The variable credit rule will apply with respect to any excess profits tax taxable year for which the constructive development assumed in establishing normal earnings would not have been reached by the taxpayer. The principles governing the use of the variable credit rule in push-back cases under section 722(b)(4) will be employed. Likewise, the variable credit rule will be applicable with respect to any excess profits tax taxable year for which a committed change in capacity has not been fully consummated. In this latter instance, the procedure will be the same as in commitment cases under section 722(b)(4).

No adjustment to the excess profits credit based on income should be made under section 713(g) or 743 for capital additions occurring during the period which is used in determining the nature of the taxpayer and the character of its business. Furthermore, when additional capital is acquired subsequent to that period for the purpose of consummating commitments, appropriate adjustments to prevent duplication of credit are required.

When a taxpayer qualifying under section 722(c) establishes that because of industry-wide variant cycle, sporadic profit conditions, or other similar circumstances, the four calendar years 1936 through 1939 do not constitute an appropriate period for the determination of normal earnings, adjustment will be made pursuant to the principles applicable in cases of qualification under section 722(b)(2) or section 722(b)(3).

HENRY J. MERRY,
Chairman, Excess Profits Tax Council.

DECEMBER 15, 1948.

1949–6–13043
E. P. C. 36

Under the facts given, the Council rules that the taxpayer's business is of a class in which intangible assets not includible in invested capital make important contributions to income.

1. In 1928 two individuals, X and Y, formed a partnership and entered the restaurant business in the city of M, located on the New

England seacoast. The M restaurant was widely advertised and in a relatively short time acquired a national reputation. In 1936, the partnership opened a second restaurant, also known as the M Restaurant, but located on the Gulf Coast. This second restaurant was intended, so far as was possible, to capitalize upon the reputation created by the partnership in the operation of the original establishment. Its building was designed to resemble the New England building; it used the same recipes, menus, and advertising, and enjoyed the reputation created by the first restaurant.

2. In 1941, X, Y, and a third individual, Z, who also had restaurant experience, formed a corporation known as K Corporation. Z contributed the capital for preferred stock. The common stock was issued for a nominal consideration to X, Y, and Z in equal shares. The corporation opened a restaurant in a South Atlantic resort city. The restaurant was designed and operated on the same plan, and with the same name, decorations, menus, and recipes as the restaurants of the partnership of X and Y. The partnership continued to own and operate the other units. The corporation paid nothing to the partnership for the use of the name, recipes, and menus.

3. The K Corporation was profitable from its inception. Its restaurant was so closely identified with the first two M restaurants that the general public was not aware of the difference in entities. It has been established that the K Corporation's earnings were substantially attributable to the use of the name "M Restaurant" and the reputation established by the partnership.

4. The K Corporation filed an application for relief under section 722, alleging that its excess profits credit based on invested capital is an inadequate standard for determining excess profits because its business is of a class in which intangible assets not includible in invested capital under section 718 make important contributions to income.

5. In E. P. C. 35 (page 134, this Bulletin), the Council held that ownership of the intangible asset, in a strict legal sense, is not required by section 722(c)(1). The asset here involved is, in fact, the reputation, or goodwill, of the partnership which the taxpayer is using by permission of the partnership. Also involved are the recipes of the partnership, which might be compared with secret formulas of a manufacturer. It is therefore held that the K Corporation's business is of a class in which intangible assets not includible in invested capital make important contributions to income.

HENRY J. MERRY,
Chairman, Excess Profits Tax Council.

FEBRUARY 15, 1949.

1949–6–13044
E. P. C. 37

Under the facts given, the Council rules that the business of taxpayer is of a class in which capital is not an important income-producing factor.

1. Three individuals, prior to 1942, were engaged in the business of an advertising agency as partners. In that year, with a fourth individual, they formed the L Corporation to conduct the business,

transferring to it cash in the amount of $40,000 and office furniture and fixtures having a fair market value of $10,000. The entire capital stock of the L Corporation was issued in equal shares to the four individuals.

2. As a part of the standard issue determination, it was held that the transaction was not within the provisions of section 112(b)(5); that there was no gain or loss upon the exchange of office furniture and fixtures; and that there was no goodwill or other intangible includible in the value of the stock received. The L Corporation had no significant amount of borrowed capital.

3. The L Corporation's business consisted of advising clients on selling and advertising campaigns, preparing advertising material, and arranging for its publication. For this it was paid fees based generally upon the charges of the advertising media for publication. For 1942, gross receipts from its business approximated $4,000,000 and net earnings $200,000; that is, four times its invested capital. In carrying on its activities the corporation's assets, other than office furniture and fixtures and the like, were used to pay the charges of advertising media in advance of collections from the advertisers and for general working capital. The L Corporation regularly employed numerous persons who were not shareholders.

4. In its application for relief under section 722, the L Corporation alleges that its excess profits credit based on invested capital is an inadequate standard for determining excess profits because its business is of a class in which capital is not an important income-producing factor. The taxpayer has conceded that it could not have operated as it did unless some capital were employed, but argues that the relatively small amount required and used by it negatives any presumption that capital is an important income-producing factor, as that term is employed in section 722(c).

5. It is not the position of the Council that the taxpayer must conduct its business wholly without capital in order to meet the requirements of section 722(c)(2). The question for decision is whether the use of capital is incidental and relatively unimportant, and this can be determined only in light of all the facts and circumstances set forth in the record.

6. Considering the facts of this case as a whole, it is the opinion of the Council that the business of the L Corporation is of a class in which capital is not an important income-producing factor.

HENRY J. MERRY,
Chairman, Excess Profits Tax Council.

FEBRUARY 15, 1949.

1949–6–13045
E. P. C. 38

Under the facts given, the Council rules that the taxpayer's invested capital is abnormally low.

1. The M Corporation, a manufacturer of cardboard containers organized in 1940, filed application for relief under section 722, alleging its excess profits credit based on invested capital to be an inadequate standard for determining excess profits because its invested capital is abnormally low.

2. The taxpayer's entire capital stock was issued to the subscribers for $10,000 cash. It was given land and factory buildings having a fair market value of $75,000 by a nonprofit corporation, formed to promote the industrial interests of the city, in order to induce the taxpayer to locate there. The M Corporation installed machinery in the factory buildings and commenced business early in 1941.

3. As a part of the standard issue determination it was held that, under the circumstances in this case, the conveyance of the land and factory buildings to the M Corporation was not a contribution to its capital, or otherwise includible in equity invested capital within the meaning of section 718. It was further held that the taxpayer was not entitled to deduct depreciation on the factory buildings because they had no basis. The M Corporation had no significant amount of borrowed capital.

4. It is the opinion of the Council that the invested capital of the M Corporation is abnormally low within the meaning of section 722(c)(3) for the reason that it had the use of the land and factory buildings, which made important contributions to income and were not reflected in invested capital, without cost either as purchase price or as rent.

HENRY J. MERRY,
Chairman, Excess Profits Tax Council.

FEBRUARY 15, 1949.

1949–6–13046
E. P. C. 39

GENERAL PROCEDURE

1. INTRODUCTION.—In Mimeograph 6044 (C. B. 1946–2, 97), and in E. P. C. 2 (C. B. 1946–2, 110), procedure is set forth governing the processing of applications for relief by Section 722 Field Committees and the preparation of reports of field examination to be furnished to taxpayers who have filed claims under section 722. The present memorandum deals with certain aspects of that procedure which it is considered advisable to clarify and supplement as well as with the procedure followed in processing applications for relief following certification to the Council. (See also Mimeograph 6323, C. B. 1948–2, 102, and E. P. C. 34, C. B. 1948–2, 106.) This memorandum does not apply to cases which are pending before The Tax Court of the United States.

2. REPORT OF FIELD EXAMINATION.—As provided in E. P. C. 2, a comprehensive report of field examination will be prepared by the examining agent for the approval of the committee member having supervision of the particular case. Following such approval, this report is to be reviewed by the committee chairman, or by another committee member designated by the chairman, whereupon it becomes the report of the Section 722 Field Committee and, as such, is transmitted by the internal revenue agent in charge to the taxpayer under cover of a special 30-day letter. During the course of the field examination, and prior to transmittal of the report to the taxpayer, the committee member assigned to the case should hold such discussions and preliminary conferences with the taxpayer as are desirable and practicable.

3. SUPPLEMENTAL REPORT OF FIELD EXAMINATION.—It is the obligation of the taxpayer to submit all evidence and argument during the course of the field examination and at any preliminary conferences held in connection therewith. Otherwise, the report of field examination cannot deal adequately with the claim. It is recognized, however, that in unusual cases additional evidence will be discovered after the report of field examination has been completed, and that this data may be of such importance that a fair determination cannot be made if it is excluded. In such instances, if the report has not already been transmitted to the taxpayer, it should be amended to include discussion of the additional data. If a copy of the original report has already been furnished to the taxpayer, such additional evidence should be made the subject of a supplemental report of field examination, also for transmission to the taxpayer.

4. FIELD CONFERENCES.—In cases where the taxpayer is in agreement with the determination recommended in the report of field examination and does not desire to file a protest with the internal revenue agent in charge, no field conference is required and the report of field examination sets forth the basis of the determination. In cases where no agreement is obtained from the taxpayer and a field conference is desired, the report of field examination is the basis upon which the taxpayer should file its formal protest with the internal revenue agent in charge. In order to serve as the basis for the taxpayer's protest, the report of field examination should adequately reflect the position of the Section 722 Field Committee with respect to the case record as it exists at the time the report is transmitted to the taxpayer. The taxpayer's protest should indicate the areas of disagreement that are to be the subject matter for discussion at the field conference. The field conference should afford the taxpayer and the conferee representing the Section 722 Field Committee the opportunity for full and frank discussion of the case in order that all areas of disagreement may be thoroughly explored.

5. SECTION 722 FIELD COMMITTEE CLOSING LETTER.—Whether or not an agreement has been reached, the Section 722 Field Committee will in each case recommend to the Council the amount of constructive average base period net income it determines to be allowable and will certify to the Council, through the internal revenue agent in charge, the section 722 case record. At the same time the committee will send to the taxpayer, through the internal revenue agent in charge, a closing letter informing the taxpayer that the case is being forwarded to the Council at that time and stating the committee's final position with respect to the case, including the amount, if any, of constructive average base period net income recommended. If the taxpayer has agreed with the determination of the committee, the closing letter should refer to the agreement by date. Whether or not an agreement has been reached, the closing letter should state whether the report of field examination has been sustained or modified and, if modified, should summarize the modifications.

6. COUNCIL PROCEDURE.—The Council serves in a review capacity and considers each agreed or unagreed case on the basis of the record made before the Section 722 Field Committee for the purpose of ascertaining whether the recommendation of the field committee conforms to established principles and is supported by such record.

In every controverted case the taxpayer will be afforded an opportunity to appear before a Council member panel and present oral argument in support of its position. At these hearings it is the policy of the Council to provide the taxpayer every reasonable opportunity to present its views. At the conclusion of the oral hearing, the Council member panel will discuss with the taxpayer the panel's position on each major issue upon which a difference of views exists. If the taxpayer waives oral hearing before representatives of the Council, a Council member panel will make a determination upon the basis of the section 722 case record. Except where the claim is allowed in full, the final determination made with respect to each application for relief is set forth in a statutory notice issued to the taxpayer in accordance with the provisions of section 732.

HENRY J. MERRY,
Chairman, Excess Profits Tax Council.

FEBRUARY 23, 1949.

1949–11–13095
E. P. C. 40

Under the facts given, the Council rules that reconstruction should be based upon the assumption that the taxpayer commenced business on December 31, 1939, under its franchise in its original form and with all the rights and obligations created by the franchise.

1. The N Corporation was organized in 1941 to sell and service a nationally advertised home appliance under an exclusive franchise. By the terms of the franchise, the taxpayer obligated itself to sell only appliances and parts purchased from the particular manufacturer and the manufacturer, in turn, undertook to deliver to the N Corporation a minimum number of new appliances each month, together with the necessary factory-guaranteed parts for the service department.

2. The N Corporation operated under the franchise according to its terms for approximately 6 months when, due to the scarcity of certain materials, production of new appliances declined and monthly deliveries were reduced to a level below the guaranteed minimum. By the middle of 1942, the manufacturer was forced to discontinue the production of new appliances altogether, with the result that the taxpayer's business was restricted to the sale of parts and service. In order to meet this condition, the manufacturer agreed that the N Corporation should also sell parts and service for competing appliances, but only for the duration of the emergency. The franchise, as so modified, was in effect during the entire excess profits tax period.

3. In connection with its applications for relief under section 722 the taxpayer has established that its franchise is an intangible asset not includible in invested capital and that its business is of a class in which such intangibles make important contributions to income. The question at issue involves the determination of the nature of the taxpayer and the character of its business preliminary to the determination of its constructive average base period net income.

4. In E. P. C. 35 [page 134, this Bulletin] the Council took the position that the nature of the taxpayer and the character of its business, for purposes of reconstruction, are to be determined as of the date on

which the taxpayer commenced business. It was further stated in that ruling that such ascertainment should be made in the light of the qualifying factor advanced. This taxpayer qualifies because of its franchise and as it commenced business—and carried on business for the 6 months thereafter—it was a sales and service agency for one particular home appliance. The nature of this taxpayer and the character of its business were fully determinable on or before the end of this 6-month period and the fact that circumstances later dictated the described modifications in the performance under this franchise should not, in the view of the Council, alter that determination.

5. It is the view of the Council, therefore, that reconstruction in this case should be based upon the assumption that the N Corporation commenced business on December 31, 1939, under its franchise in its original form and with all the rights and obligations created by it. For purposes of determining the taxpayer's constructive level of earnings as of December 31, 1939, it should be accorded a development period beginning on December 31, 1937.

HENRY J. MERRY,
Chairman, Excess Profits Tax Council.

MARCH 17, 1949.

1949–11–13096
E. P. C. 41

Under the facts given, the Council rules that the taxpayer is not entitled to relief since its nature and the character of its business are such that, had it commenced business during the base period, it would have had no net income.

1. Throughout the base period the A Corporation was engaged in the manufacture and sale of a certain product. Its business was located in the city of X and it enjoyed a national reputation. Prior to 1940, the A Corporation always had been able to fill promptly all the orders it could procure. During 1941 demand for its product increased to the extent that even with two-shift operation the backlog of unfilled orders rose to the point where it equaled 3 months' production.

2. In October, 1941, M, an individual and the sole shareholder of the A Corporation, formed a new company, the O Corporation, which leased a plant in a suburb of the city of X and in January, 1942, commenced business as a manufacturer of the same product. The entire capital stock of the O Corporation was issued to M. The O Corporation derived its business by reference from the A Corporation which sent it many prospective customers whose orders the A Corporation could not fill. In addition, the A Corporation bought finished products from the O Corporation for resale to the A Corporation's customers. Both the A Corporation and the O Corporation operated at or near capacity throughout 1942.

3. For 1942 the O Corporation filed application for relief under section 722 and for purposes of this memorandum it may be assumed that it has established that its invested capital is abnormally low. Its excess profits credit based on invested capital for 1942 is $320 and its net income for that year is $135,000. The A Corporation's average base period net income computed for purposes of its excess profits

credit for 1942 is $75,000 and its net income for that year is $225,000. The A Corporation has not filed application for relief.

4. The O Corporation contends that its normal earnings should be at least $45,000, computed as follows:

(*a*) 1942 net income of A Corporation	$225,000
(*b*) Average base period net income of A Corporation	$75,000
(*c*) Ratio of (*b*) to (*a*)	⅓
(*d*) 1942 net income of O Corporation	$135,000
(*e*) Constructive average base period net income of O Corporation (⅓×$135,000)	$45,000

5. In the alternative, the O Corporation submitted a reconstruction resulting in a constructive average base period net income of $47,424, computed as follows:

(*a*) 1942 sales of the industry of which O Corporation is a member	$56,250,000
(*b*) 1942 sales of O Corporation	$1,125,000
(*c*) Ratio of (*b*) to (*a*)	0.02
(*d*) 1939 sales of the industry of which O Corporation was a member	$32,500,000
(*e*) 1939 constructive sales of O Corporation (0.02×$32,500,000)	$650,000
(*f*) 1939 average ratio of net income for the industry	0.08
(*g*) 1939 constructive net income of O Corporation (0.08×$650,000)	$52,000
(*h*) Constructive average base period net income (0.912[1]×$52,000)	$47,424

6. It is the view of the Council that the O Corporation is not entitled to any constructive average base period net income.[2] The nature of the taxpayer and the character of its business are such that it procured only the business passed over to it by the A Corporation because the latter during 1942 lacked capacity to handle its orders. There is no reason why the O Corporation's normal earnings should bear the same relationship to its net income for 1942 that existed in the case of the A Corporation. Neither is there any justification under the facts for the assumption that such a marginal producer would have captured a proportion of the 1939 market equal to that which it enjoyed during 1942, when over-all demand was at a much higher level. The conclusion is inescapable that O Corporation, had it commenced business during the base period, would have had no net income.

HENRY J. MERRY,
Chairman, Excess Profits Tax Council.

MARCH 17, 1949.

1949–11–13097
E. P. C. 42

Recognition of decline in the determination of normal earnings

1. In E. P. C. 13 (C. B. 1947–1, 83) the Council provided that, in ascertaining normal earnings for a taxpayer applying for relief under section 722, the taxpayer's base period experience should be adjusted for changes in the character of the business, or in business conditions, which resulted in a relatively permanent increase, during the base period, in the level of the taxpayer's earnings. In connection with the

[1] General Business Index, series C. (See E. P. C. 8 [C. B. 1947–1, 73].)
[2] For this reason, the application of E. P. C. 20 [C. B. 1947–2, 135] need not be considered.

processing of several applications, including those of certain multiple-product corporations, the Council has been asked whether this emphasis upon base period changes having relatively permanent effect applies equally to changes resulting in decreases in the level of earnings.

2. In general, normal earnings should reflect the relatively permanent earning ability of the taxpayer's entire enterprise as that enterprise existed at the end of the base period. Accordingly, regardless of the size or character of the taxpayer's business, or the basis upon which relief is sought, adjustment should be made for all relatively permanent base period changes analogous to the types set forth in section 722(b)(4) and in E. P. C. 13. The changed character and conditions, to the extent that they are determined to be relatively permanent, should be assumed to have existed throughout the entire base period. (See, for example, E. P. C. 30, C. B. 1948–1, 92.)

3. The methods to be employed in reflecting the effects of such changes necessarily will vary according to the circumstances of each case. If products or activities are considered individually, correction should be made for all changes which do not offset each other by adjusting the items of income or expense in the various base period years or by relating the net earnings of the entire enterprise for a period immediately preceding January 1, 1940, to the various base period years through the application of an appropriate index. Where an index is so used, it should be free of the influence of abnormalities and relatively permanent changes and the order of preference given indices in E. P. C. 8 (C. B. 1947–1, 73) must be modified. Thus, where the experience of the taxpayer, its competitors, and its industry reflect the influences of abnormalities or changes, preference should be given to the index based upon series C, Statistics of Income (see Mimeograph 5807, C. B. 1945, 273) or to some other general index which is deemed to be reasonably free of such influences.

HENRY J. MERRY,
Chairman, Excess Profits Tax Council.

MAY 11, 1949.

SECTION 729.—LAWS APPLICABLE

SECTION 35.729–2, REGULATIONS 112: Time for payment of tax.

INTERNAL REVENUE CODE

Regulations 112 amended. (See T. D. 5679, page 132.)

CHAPTER 9.—EMPLOYMENT TAXES

SUBCHAPTER D.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 1622.—INCOME TAX COLLECTED AT SOURCE

SECTION 405.201, REGULATIONS 116: Requirement of withholding.
(Also Sections 405.202, 405.203, 405.205, 405.206, 405.207, and 405.209, Regulations 116.)

1949–3–13018
T. D. 5685

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 405.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

Regulations 116 amended to conform to sections 202(b), 203, 501, 502, and 503 of the Revenue Act of 1948 [C. B. 1948–1, 211], relating to withholding exemptions and reduction in withholding of tax at source on wages.

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

To Collectors of Internal Revenue and Others Concerned:

On October 6, 1948, notice of proposed rule making regarding the Revenue Act of 1948, enacted April 2, 1948 [C. B. 1948–1, 211], was published in the Federal Register (13 F. R. 5827). No objections to the rules proposed have been received, and the following amendments are hereby adopted. Such amendments are necessary in order to conform Regulations 116 [26 CFR, Part 405] to the Revenue Act of 1948.

PARAGRAPH 1. There is inserted immediately preceding section 405.201 the following:

TITLE V—REDUCTION IN WITHHOLDING OF TAX AT SOURCE ON WAGES (REVENUE ACT OF 1948)

SEC. 501. PERCENTAGE METHOD.

Section 1622(a) and section 1622(b)(1) of the Internal Revenue Code (relating to percentage method of withholding) are hereby amended to read as follows:

"(a) REQUIREMENT OF WITHHOLDING.—Every employer making payment of wages shall deduct and withhold upon such wages a tax equal to 15 per centum of the amount by which the wages exceed the number of withholding exemptions claimed multiplied by the amount of one such exemption as shown in subsection (b)(1).

"(b) (1) The table referred to in subsection (a) is as follows:

"Percentage method withholding table

Pay-roll period	Amount of one withholding exemption
Weekly	$13.00
Biweekly	26.00
Semimonthly	28.00
Monthly	56.00
Quarterly	167.00
Semiannual	333.00
Annual	667.00
Daily or miscellaneous (per day of such period)	1.80"

SEC. 502. WAGE BRACKET WITHHOLDING.

The tables contained in section 1622(c)(1) of the Internal Revenue Code (relating to wage bracket withholding) are hereby amended to read as follows:

"If the pay-roll period with respect to an employee is weekly—

And the wages are—		And the number of withholding exemptions claimed is—										
At least	But less than	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$13	15% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$13	$14	$2.00	.10	0	0	0	0	0	0	0	0	0
$14	$15	2.20	.30	0	0	0	0	0	0	0	0	0
$15	$16	2.30	.40	0	0	0	0	0	0	0	0	0
$16	$17	2.50	.50	0	0	0	0	0	0	0	0	0
$17	$18	2.60	.70	0	0	0	0	0	0	0	0	0
$18	$19	2.80	.80	0	0	0	0	0	0	0	0	0
$19	$20	2.90	1.00	0	0	0	0	0	0	0	0	0
$20	$21	3.10	1.10	0	0	0	0	0	0	0	0	0
$21	$22	3.20	1.30	0	0	0	0	0	0	0	0	0
$22	$23	3.40	1.40	0	0	0	0	0	0	0	0	0
$23	$24	3.50	1.60	0	0	0	0	0	0	0	0	0
$24	$25	3.70	1.70	0	0	0	0	0	0	0	0	0
$25	$26	3.80	1.90	0	0	0	0	0	0	0	0	0
$26	$27	4.00	2.00	.10	0	0	0	0	0	0	0	0
$27	$28	4.10	2.20	.30	0	0	0	0	0	0	0	0
$28	$29	4.30	2.30	.40	0	0	0	0	0	0	0	0
$29	$30	4.40	2.50	.60	0	0	0	0	0	0	0	0
$30	$31	4.60	2.60	.70	0	0	0	0	0	0	0	0
$31	$32	4.70	2.80	.90	0	0	0	0	0	0	0	0
$32	$33	4.90	2.90	1.00	0	0	0	0	0	0	0	0
$33	$34	5.00	3.10	1.20	0	0	0	0	0	0	0	0
$34	$35	5.20	3.20	1.30	0	0	0	0	0	0	0	0
$35	$36	5.30	3.40	1.50	0	0	0	0	0	0	0	0
$36	$37	5.50	3.50	1.60	0	0	0	0	0	0	0	0
$37	$38	5.60	3.70	1.80	0	0	0	0	0	0	0	0
$38	$39	5.80	3.80	1.90	0	0	0	0	0	0	0	0
$39	$40	5.90	4.00	2.10	.20	0	0	0	0	0	0	0
$40	$41	6.10	4.10	2.20	.30	0	0	0	0	0	0	0
$41	$42	6.20	4.30	2.40	.50	0	0	0	0	0	0	0
$42	$43	6.30	4.40	2.50	.60	0	0	0	0	0	0	0
$43	$44	6.50	4.60	2.70	.80	0	0	0	0	0	0	0
$44	$45	6.60	4.70	2.80	.90	0	0	0	0	0	0	0
$45	$46	6.80	4.90	3.00	1.10	0	0	0	0	0	0	0
$46	$47	6.90	5.00	3.10	1.20	0	0	0	0	0	0	0
$47	$48	7.10	5.20	3.30	1.40	0	0	0	0	0	0	0
$48	$49	7.20	5.30	3.40	1.50	0	0	0	0	0	0	0
$49	$50	7.40	5.50	3.60	1.60	0	0	0	0	0	0	0
$50	$51	7.50	5.60	3.70	1.80	0	0	0	0	0	0	0
$51	$52	7.70	5.80	3.90	1.90	0	0	0	0	0	0	0
$52	$53	7.80	5.90	4.00	2.10	.20	0	0	0	0	0	0
$53	$54	8.00	6.10	4.20	2.20	.30	0	0	0	0	0	0
$54	$55	8.10	6.20	4.30	2.40	.50	0	0	0	0	0	0
$55	$56	8.30	6.40	4.50	2.50	.60	0	0	0	0	0	0
$56	$57	8.40	6.50	4.60	2.70	.80	0	0	0	0	0	0
$57	$58	8.60	6.70	4.80	2.80	.90	0	0	0	0	0	0
$58	$59	8.70	6.80	4.90	3.00	1.10	0	0	0	0	0	0

"If the pay-roll period with respect to an employee is weekly—Continued

And the wages are—		And the number of withholding exemptions claimed is—										
At least	But less than	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
		15% of wages										
$59	$60	$8.90	$7.00	$5.10	$3.10	$1.20	$0	$0	$0	$0	$0	$0
$60	$62	9.10	7.20	5.30	3.40	1.50	0	0	0	0	0	0
$62	$64	9.40	7.50	5.60	3.70	1.80	0	0	0	0	0	0
$64	$66	9.70	7.80	5.90	4.00	2.00	.10	0	0	0	0	0
$66	$68	10.00	8.10	6.20	4.30	2.30	.40	0	0	0	0	0
$68	$70	10.30	8.40	6.50	4.60	2.60	.70	0	0	0	0	0
$70	$72	10.60	8.70	6.80	4.90	2.90	1.00	0	0	0	0	0
$72	$74	10.90	9.00	7.10	5.20	3.20	1.30	0	0	0	0	0
$74	$76	11.20	9.30	7.40	5.50	3.50	1.60	0	0	0	0	0
$76	$78	11.50	9.60	7.70	5.80	3.80	1.90	0	0	0	0	0
$78	$80	11.80	9.90	8.00	6.10	4.10	2.20	.30	0	0	0	0
$80	$82	12.10	10.20	8.30	6.40	4.40	2.50	.60	0	0	0	0
$82	$84	12.40	10.50	8.60	6.70	4.70	2.80	.90	0	0	0	0
$84	$86	12.70	10.80	8.90	7.00	5.00	3.10	1.20	0	0	0	0
$86	$88	13.00	11.10	9.20	7.30	5.30	3.40	1.50	0	0	0	0
$88	$90	13.30	11.40	9.50	7.60	5.60	3.70	1.80	0	0	0	0
$90	$92	13.60	11.70	9.80	7.80	5.90	4.00	2.10	.20	0	0	0
$92	$94	13.90	12.00	10.10	8.10	6.20	4.30	2.40	.50	0	0	0
$94	$96	14.20	12.30	10.40	8.40	6.50	4.60	2.70	.80	0	0	0
$96	$98	14.50	12.60	10.70	8.70	6.80	4.90	3.00	1.10	0	0	0
$98	$100	14.80	12.90	11.00	9.00	7.10	5.20	3.30	1.40	0	0	0
$100	$105	15.30	13.40	11.50	9.60	7.70	5.70	3.80	1.90	0	0	0
$105	$110	16.10	14.10	12.20	10.30	8.40	6.50	4.60	2.70	.70	0	0
$110	$115	16.80	14.90	13.00	11.10	9.10	7.20	5.30	3.40	1.50	0	0
$115	$120	17.60	15.60	13.70	11.80	9.90	8.00	6.10	4.10	2.20	.30	0
$120	$125	18.30	16.40	14.50	12.60	10.60	8.70	6.80	4.90	3.00	1.10	0
$125	$130	19.00	17.10	15.20	13.30	11.40	9.50	7.60	5.60	3.70	1.80	0
$130	$135	19.80	17.90	16.00	14.00	12.10	10.20	8.30	6.40	4.50	2.60	.60
$135	$140	20.50	18.60	16.70	14.80	12.90	11.00	9.10	7.10	5.20	3.30	1.40
$140	$145	21.30	19.40	17.50	15.50	13.60	11.70	9.80	7.90	6.00	4.10	2.10
$145	$150	22.00	20.10	18.20	16.30	14.40	12.50	10.50	8.60	6.70	4.80	2.90
$150	$160	23.20	21.20	19.30	17.40	15.50	13.60	11.70	9.70	7.80	5.90	4.00
$160	$170	24.70	22.70	20.80	18.90	17.00	15.10	13.20	11.20	9.30	7.40	5.50
$170	$180	26.10	24.20	22.30	20.40	18.50	16.60	14.70	12.70	10.80	8.90	7.00
$180	$190	27.60	25.70	23.80	21.90	20.00	18.10	16.10	14.20	12.30	10.40	8.50
$190	$200	29.10	27.20	25.30	23.40	21.50	19.60	17.60	15.70	13.80	11.90	10.00
		15 percent of the excess over $200 plus—										
$200 and over		29.90	28.00	26.00	24.10	22.20	20.30	18.40	16.50	14.60	12.60	10.70

"If the pay-roll period with respect to an employee is biweekly—

And the wages are—		And the number of withholding exemptions claimed is—										
At least	But less than	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$26	15% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$26	$28	$4.00	.20	0	0	0	0	0	0	0	0	0
$28	$30	4.30	.50	0	0	0	0	0	0	0	0	0
$30	$32	4.60	.80	0	0	0	0	0	0	0	0	0
$32	$34	4.90	1.10	0	0	0	0	0	0	0	0	0
$34	$36	5.20	1.40	0	0	0	0	0	0	0	0	0
$36	$38	5.50	1.70	0	0	0	0	0	0	0	0	0
$38	$40	5.80	2.00	0	0	0	0	0	0	0	0	0
$40	$42	6.10	2.30	0	0	0	0	0	0	0	0	0
$42	$44	6.40	2.60	0	0	0	0	0	0	0	0	0
$44	$46	6.70	2.90	0	0	0	0	0	0	0	0	0
$46	$48	7.00	3.20	0	0	0	0	0	0	0	0	0
$48	$50	7.30	3.50	0	0	0	0	0	0	0	0	0
$50	$52	7.60	3.80	0	0	0	0	0	0	0	0	0
$52	$54	7.90	4.10	.30	0	0	0	0	0	0	0	0
$54	$56	8.20	4.40	.60	0	0	0	0	0	0	0	0
$56	$58	8.50	4.70	.90	0	0	0	0	0	0	0	0
$58	$60	8.80	5.00	1.20	0	0	0	0	0	0	0	0
$60	$62	9.10	5.30	1.50	0	0	0	0	0	0	0	0
$62	$64	9.40	5.60	1.80	0	0	0	0	0	0	0	0

"*If the pay-roll period with respect to an employee is biweekly*—Continued

And the wages are—		And the number of withholding exemptions claimed is—										
At least	But less than	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
		15% of wages										
$64	$66	$9.70	$5.90	$2.00	$0	$0	$0	$0	$0	$0	$0	$0
$66	$68	10.00	6.20	2.30	0	0	0	0	0	0	0	0
$68	$70	10.30	6.50	2.60	0	0	0	0	0	0	0	0
$70	$72	10.60	6.80	2.90	0	0	0	0	0	0	0	0
$72	$74	10.90	7.10	3.20	0	0	0	0	0	0	0	0
$74	$76	11.20	7.40	3.50	0	0	0	0	0	0	0	0
$76	$78	11.50	7.70	3.80	0	0	0	0	0	0	0	0
$78	$80	11.80	8.00	4.10	.30	0	0	0	0	0	0	0
$80	$82	12.10	8.30	4.40	.60	0	0	0	0	0	0	0
$82	$84	12.40	8.60	4.70	.90	0	0	0	0	0	0	0
$84	$86	12.70	8.90	5.00	1.20	0	0	0	0	0	0	0
$86	$88	13.00	9.20	5.30	1.50	0	0	0	0	0	0	0
$88	$90	13.30	9.50	5.60	1.80	0	0	0	0	0	0	0
$90	$92	13.60	9.80	5.90	2.10	0	0	0	0	0	0	0
$92	$94	13.90	10.10	6.20	2.40	0	0	0	0	0	0	0
$94	$96	14.20	10.40	6.50	2.70	0	0	0	0	0	0	0
$96	$98	14.50	10.70	6.80	3.00	0	0	0	0	0	0	0
$98	$100	14.80	11.00	7.10	3.30	0	0	0	0	0	0	0
$100	$102	15.10	11.30	7.40	3.60	0	0	0	0	0	0	0
$102	$104	15.40	11.60	7.70	3.90	.10	0	0	0	0	0	0
$104	$106	15.70	11.90	8.00	4.20	.40	0	0	0	0	0	0
$106	$108	16.00	12.20	8.30	4.50	.70	0	0	0	0	0	0
$108	$110	16.30	12.50	8.60	4.80	1.00	0	0	0	0	0	0
$110	$112	16.60	12.80	8.90	5.10	1.30	0	0	0	0	0	0
$112	$114	16.90	13.10	9.20	5.40	1.60	0	0	0	0	0	0
$114	$116	17.20	13.40	9.50	5.70	1.90	0	0	0	0	0	0
$116	$118	17.50	13.60	9.80	6.00	2.20	0	0	0	0	0	0
$118	$120	17.80	13.90	10.10	6.30	2.50	0	0	0	0	0	0
$120	$124	18.20	14.40	10.60	6.70	2.90	0	0	0	0	0	0
$124	$128	18.80	15.00	11.20	7.30	3.50	0	0	0	0	0	0
$128	$132	19.40	15.60	11.80	7.90	4.10	.30	0	0	0	0	0
$132	$136	20.00	16.20	12.40	8.50	4.70	.90	0	0	0	0	0
$136	$140	20.60	16.80	13.00	9.10	5.30	1.50	0	0	0	0	0
$140	$144	21.20	17.40	13.60	9.70	5.90	2.10	0	0	0	0	0
$144	$148	21.80	18.00	14.20	10.30	6.50	2.70	0	0	0	0	0
$148	$152	22.40	18.60	14.70	10.90	7.10	3.30	0	0	0	0	0
$152	$156	23.00	19.20	15.30	11.50	7.70	3.90	0	0	0	0	0
$156	$160	23.60	19.80	15.90	12.10	8.30	4.50	.60	0	0	0	0
$160	$164	24.20	20.40	16.50	12.70	8.90	5.00	1.20	0	0	0	0
$164	$168	24.80	21.00	17.10	13.30	9.50	5.60	1.80	0	0	0	0
$168	$172	25.40	21.60	17.70	13.90	10.10	6.20	2.40	0	0	0	0
$172	$176	26.00	22.20	18.30	14.50	10.70	6.80	3.00	0	0	0	0
$176	$180	26.60	22.80	18.90	15.10	11.30	7.40	3.60	0	0	0	0
$180	$184	27.20	23.40	19.50	15.70	11.90	8.00	4.20	.40	0	0	0
$184	$188	27.80	24.00	20.10	16.30	12.50	8.60	4.80	1.00	0	0	0
$188	$192	28.40	24.60	20.70	16.90	13.10	9.20	5.40	1.60	0	0	0
$192	$196	29.00	25.20	21.30	17.50	13.70	9.80	6.00	2.20	0	0	0
$196	$200	29.60	25.80	21.90	18.10	14.30	10.40	6.60	2.80	0	0	0
$200	$210	30.60	26.80	23.00	19.10	15.30	11.50	7.60	3.80	0	0	0
$210	$220	32.10	28.30	24.50	20.60	16.80	13.00	9.10	5.30	1.50	0	0
$220	$230	33.60	29.80	26.00	22.10	18.30	14.50	10.60	6.80	3.00	0	0
$230	$240	35.10	31.30	27.40	23.60	19.80	16.00	12.10	8.30	4.50	.60	0
$240	$250	36.60	32.80	28.90	25.10	21.30	17.40	13.60	9.80	6.00	2.10	0
$250	$260	38.10	34.30	30.40	26.60	22.80	18.90	15.10	11.30	7.50	3.60	0
$260	$270	39.60	35.80	31.90	28.10	24.30	20.40	16.60	12.80	8.90	5.10	1.30
$270	$280	41.10	37.30	33.40	29.60	25.80	21.90	18.10	14.30	10.40	6.60	2.80
$280	$290	42.60	38.70	34.90	31.10	27.30	23.40	19.60	15.80	11.90	8.10	4.30
$290	$300	44.10	40.20	36.40	32.60	28.70	24.90	21.10	17.30	13.40	9.60	5.80
$300	$320	46.30	42.50	38.70	34.80	31.00	27.20	23.30	19.50	15.70	11.80	8.00
$320	$340	49.30	45.50	41.60	37.80	34.00	30.10	26.30	22.50	18.70	14.80	11.00
$340	$360	52.30	48.50	44.60	40.80	37.00	33.10	29.30	25.50	21.60	17.80	14.00
$360	$380	55.30	51.40	47.60	43.80	40.00	36.10	32.30	28.50	24.60	20.80	17.00
$380	$400	58.30	54.40	50.60	46.80	42.90	39.10	35.30	31.50	27.60	23.80	20.00
		15 percent of the excess over $400 plus—										
$400 and over		59.80	55.90	52.10	48.30	44.40	40.60	36.80	32.90	29.10	25.30	21.50

"If the pay-roll period with respect to an employee is semimonthly—

And the wages are—		And the number of withholding exemptions claimed is—										
At least	But less than	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$28	15% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$28	$30	$4.30	.20	0	0	0	0	0	0	0	0	0
$30	$32	4.60	.50	0	0	0	0	0	0	0	0	0
$32	$34	4.90	.80	0	0	0	0	0	0	0	0	0
$34	$36	5.20	1.10	0	0	0	0	0	0	0	0	0
$36	$38	5.50	1.40	0	0	0	0	0	0	0	0	0
$38	$40	5.80	1.70	0	0	0	0	0	0	0	0	0
$40	$42	6.10	2.00	0	0	0	0	0	0	0	0	0
$42	$44	6.40	2.30	0	0	0	0	0	0	0	0	0
$44	$46	6.70	2.60	0	0	0	0	0	0	0	0	0
$46	$48	7.00	2.90	0	0	0	0	0	0	0	0	0
$48	$50	7.30	3.20	0	0	0	0	0	0	0	0	0
$50	$52	7.60	3.50	0	0	0	0	0	0	0	0	0
$52	$54	7.90	3.80	0	0	0	0	0	0	0	0	0
$54	$56	8.20	4.10	0	0	0	0	0	0	0	0	0
$56	$58	8.50	4.40	.20	0	0	0	0	0	0	0	0
$58	$60	8.80	4.70	.50	0	0	0	0	0	0	0	0
$60	$62	9.10	5.00	.80	0	0	0	0	0	0	0	0
$62	$64	9.40	5.30	1.10	0	0	0	0	0	0	0	0
$64	$66	9.70	5.60	1.40	0	0	0	0	0	0	0	0
$66	$68	10.00	5.90	1.70	0	0	0	0	0	0	0	0
$68	$70	10.30	6.20	2.00	0	0	0	0	0	0	0	0
$70	$72	10.60	6.50	2.30	0	0	0	0	0	0	0	0
$72	$74	10.90	6.80	2.60	0	0	0	0	0	0	0	0
$74	$76	11.20	7.10	2.90	0	0	0	0	0	0	0	0
$76	$78	11.50	7.40	3.20	0	0	0	0	0	0	0	0
$78	$80	11.80	7.70	3.50	0	0	0	0	0	0	0	0
$80	$82	12.10	8.00	3.80	0	0	0	0	0	0	0	0
$82	$84	12.40	8.30	4.10	0	0	0	0	0	0	0	0
$84	$86	12.70	8.50	4.40	.20	0	0	0	0	0	0	0
$86	$88	13.00	8.80	4.70	.50	0	0	0	0	0	0	0
$88	$90	13.30	9.10	5.00	.80	0	0	0	0	0	0	0
$90	$92	13.60	9.40	5.30	1.10	0	0	0	0	0	0	0
$92	$94	13.90	9.70	5.60	1.40	0	0	0	0	0	0	0
$94	$96	14.20	10.00	5.90	1.70	0	0	0	0	0	0	0
$96	$98	14.50	10.30	6.20	2.00	0	0	0	0	0	0	0
$98	$100	14.80	10.60	6.50	2.30	0	0	0	0	0	0	0
$100	$102	15.10	10.90	6.80	2.60	0	0	0	0	0	0	0
$102	$104	15.40	11.20	7.10	2.90	0	0	0	0	0	0	0
$104	$106	15.70	11.50	7.40	3.20	0	0	0	0	0	0	0
$106	$108	16.00	11.80	7.70	3.50	0	0	0	0	0	0	0
$108	$110	16.30	12.10	8.00	3.80	0	0	0	0	0	0	0
$110	$112	16.60	12.40	8.30	4.10	0	0	0	0	0	0	0
$112	$114	16.90	12.70	8.60	4.40	.30	0	0	0	0	0	0
$114	$116	17.20	13.00	8.90	4.70	.60	0	0	0	0	0	0
$116	$118	17.50	13.30	9.20	5.00	.90	0	0	0	0	0	0
$118	$120	17.80	13.60	9.50	5.30	1.20	0	0	0	0	0	0
$120	$124	18.20	14.10	9.90	5.80	1.60	0	0	0	0	0	0
$124	$128	18.80	14.70	10.50	6.40	2.20	0	0	0	0	0	0
$128	$132	19.40	15.30	11.10	7.00	2.80	0	0	0	0	0	0
$132	$136	20.00	15.90	11.70	7.60	3.40	0	0	0	0	0	0
$136	$140	20.60	16.50	12.30	8.20	4.00	0	0	0	0	0	0
$140	$144	21.20	17.10	12.90	8.80	4.60	.50	0	0	0	0	0
$144	$148	21.80	17.70	13.50	9.40	5.20	1.10	0	0	0	0	0
$148	$152	22.40	18.30	14.10	10.00	5.80	1.70	0	0	0	0	0
$152	$156	23.00	18.90	14.70	10.60	6.40	2.30	0	0	0	0	0
$156	$160	23.60	19.50	15.30	11.20	7.00	2.90	0	0	0	0	0
$160	$164	24.20	20.10	15.90	11.80	7.60	3.50	0	0	0	0	0
$164	$168	24.80	20.70	16.50	12.40	8.20	4.10	0	0	0	0	0
$168	$172	25.40	21.20	17.10	12.90	8.80	4.60	.50	0	0	0	0
$172	$176	26.00	21.80	17.70	13.50	9.40	5.20	1.10	0	0	0	0
$176	$180	26.60	22.40	18.30	14.10	10.00	5.80	1.70	0	0	0	0
$180	$184	27.20	23.00	18.90	14.70	10.60	6.40	2.30	0	0	0	0
$184	$188	27.80	23.60	19.50	15.30	11.20	7.00	2.90	0	0	0	0
$188	$192	28.40	24.20	20.10	15.90	11.80	7.60	3.50	0	0	0	0
$192	$196	29.00	24.80	20.70	16.50	12.40	8.20	4.10	0	0	0	0
$196	$200	29.60	25.40	21.30	17.10	13.00	8.80	4.70	.50	0	0	0
$200	$210	30.60	26.50	22.30	18.20	14.00	9.90	5.70	1.60	0	0	0
$210	$220	32.10	28.00	23.80	19.70	15.50	11.40	7.20	3.10	0	0	0
$220	$230	33.60	29.50	25.30	21.20	17.00	12.90	8.70	4.60	.40	0	0

"If the pay-roll period with respect to an employee is semimonthly—Continued

And the wages are—		And the number of withholding exemptions claimed is—										
At least	But less than	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$230	$240	15% of wages $35.10	$31.00	$26.80	$22.70	$18.50	$14.40	$10.20	$6.10	$1.90	$0	$0
$240	$250	36.60	32.50	28.30	24.20	20.00	15.90	11.70	7.60	3.40	0	0
$250	$260	38.10	33.90	29.80	25.60	21.50	17.30	13.20	9.00	4.90	.70	0
$260	$270	39.60	35.40	31.30	27.10	23.00	18.80	14.70	10.50	6.40	2.20	0
$270	$280	41.10	36.90	32.80	28.60	24.50	20.30	16.20	12.00	7.90	3.70	0
$280	$290	42.60	38.40	34.30	30.10	26.00	21.80	17.70	13.50	9.40	5.20	1.10
$290	$300	44.10	39.90	35.80	31.60	27.50	23.30	19.20	15.00	10.90	6.70	2.60
$300	$320	46.30	42.20	38.00	33.90	29.70	25.60	21.40	17.30	13.10	9.00	4.80
$320	$340	49.30	45.20	41.00	36.90	32.70	28.60	24.40	20.30	16.10	12.00	7.80
$340	$360	52.30	48.10	44.00	39.80	35.70	31.50	27.40	23.20	19.10	14.90	10.80
$360	$380	55.30	51.10	47.00	42.80	38.70	34.50	30.40	26.20	22.10	17.90	13.80
$380	$400	58.30	54.10	50.00	45.80	41.70	37.50	33.40	29.20	25.10	20.90	16.80
$400	$420	61.30	57.10	53.00	48.80	44.70	40.50	36.40	32.20	28.10	23.90	19.80
$420	$440	64.20	60.10	55.90	51.80	47.60	43.50	39.30	35.20	31.00	26.90	22.70
$440	$460	67.20	63.10	58.90	54.80	50.60	46.50	42.30	38.20	34.00	29.90	25.70
$460	$480	70.20	66.10	61.90	57.80	53.60	49.50	45.30	41.20	37.00	32.90	28.70
$480	$500	73.20	69.10	64.90	60.80	56.60	52.50	48.30	44.20	40.00	35.90	31.70
		15 percent of the excess over $500 plus—										
$500 and over		74.70	70.60	66.40	62.30	58.10	54.00	49.80	45.70	41.50	37.40	33.20

"If the pay-roll period with respect to an employee is monthly—

And the wages are—		And the number of withholding exemptions claimed is—										
At least	But less than	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$56	15% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$56	$60	$8.70	.40	0	0	0	0	0	0	0	0	0
$60	$64	9.30	1.00	0	0	0	0	0	0	0	0	0
$64	$68	9.90	1.60	0	0	0	0	0	0	0	0	0
$68	$72	10.50	2.20	0	0	0	0	0	0	0	0	0
$72	$76	11.10	2.80	0	0	0	0	0	0	0	0	0
$76	$80	11.70	3.40	0	0	0	0	0	0	0	0	0
$80	$84	12.30	4.00	0	0	0	0	0	0	0	0	0
$84	$88	12.80	4.50	0	0	0	0	0	0	0	0	0
$88	$92	13.40	5.10	0	0	0	0	0	0	0	0	0
$92	$96	14.00	5.70	0	0	0	0	0	0	0	0	0
$96	$100	14.60	6.30	0	0	0	0	0	0	0	0	0
$100	$104	15.20	6.90	0	0	0	0	0	0	0	0	0
$104	$108	15.80	7.50	0	0	0	0	0	0	0	0	0
$108	$112	16.40	8.10	0	0	0	0	0	0	0	0	0
$112	$116	17.00	8.70	.40	0	0	0	0	0	0	0	0
$116	$120	17.60	9.30	1.00	0	0	0	0	0	0	0	0
$120	$124	18.20	9.90	1.60	0	0	0	0	0	0	0	0
$124	$128	18.80	10.50	2.20	0	0	0	0	0	0	0	0
$128	$132	19.40	11.10	2.80	0	0	0	0	0	0	0	0
$132	$136	20.00	11.70	3.40	0	0	0	0	0	0	0	0
$136	$140	20.60	12.30	4.00	0	0	0	0	0	0	0	0
$140	$144	21.20	12.90	4.60	0	0	0	0	0	0	0	0
$144	$148	21.80	13.50	5.20	0	0	0	0	0	0	0	0
$148	$152	22.40	14.10	5.80	0	0	0	0	0	0	0	0
$152	$156	23.00	14.70	6.40	0	0	0	0	0	0	0	0
$156	$160	23.60	15.30	7.00	0	0	0	0	0	0	0	0
$160	$164	24.20	15.90	7.60	0	0	0	0	0	0	0	0
$164	$168	24.80	16.50	8.20	0	0	0	0	0	0	0	0
$168	$172	25.40	17.10	8.80	.50	0	0	0	0	0	0	0
$172	$176	26.00	17.70	9.40	1.10	0	0	0	0	0	0	0
$176	$180	26.60	18.30	10.00	1.70	0	0	0	0	0	0	0

"If the pay-roll period with respect to an employee is monthly—Continued

And the wages are—		And the number of withholding exemptions claimed is—										
At least	But less than	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
		15% of wages										
$180	$184	$27.20	$18.90	$10.60	$2.30	$0	$0	$0	$0	$0	$0	$0
$184	$188	27.80	19.50	11.20	2.90	0	0	0	0	0	0	0
$188	$192	28.40	20.10	11.80	3.50	0	0	0	0	0	0	0
$192	$196	29.00	20.70	12.40	4.10	0	0	0	0	0	0	0
$196	$200	29.60	21.30	13.00	4.70	0	0	0	0	0	0	0
$200	$204	30.20	21.90	13.60	5.30	0	0	0	0	0	0	0
$204	$208	30.80	22.50	14.20	5.90	0	0	0	0	0	0	0
$208	$212	31.40	23.10	14.80	6.50	0	0	0	0	0	0	0
$212	$216	32.00	23.70	15.40	7.10	0	0	0	0	0	0	0
$216	$220	32.60	24.30	16.00	7.70	0	0	0	0	0	0	0
$220	$224	33.20	24.90	16.60	8.30	0	0	0	0	0	0	0
$224	$228	33.80	25.50	17.20	8.90	.60	0	0	0	0	0	0
$228	$232	34.40	26.10	17.80	9.50	1.20	0	0	0	0	0	0
$232	$236	35.00	26.70	18.40	10.10	1.80	0	0	0	0	0	0
$236	$240	35.60	27.30	19.00	10.70	2.40	0	0	0	0	0	0
$240	$248	36.50	28.20	19.90	11.60	3.30	0	0	0	0	0	0
$248	$256	37.60	29.30	21.00	12.70	4.40	0	0	0	0	0	0
$256	$264	38.80	30.50	22.20	13.90	5.60	0	0	0	0	0	0
$264	$272	40.00	31.70	23.40	15.10	6.80	0	0	0	0	0	0
$272	$280	41.20	32.90	24.60	16.30	8.00	0	0	0	0	0	0
$280	$288	42.40	34.10	25.80	17.50	9.20	.90	0	0	0	0	0
$288	$296	43.60	35.30	27.00	18.70	10.40	2.10	0	0	0	0	0
$296	$304	44.80	36.50	28.20	19.90	11.60	3.30	0	0	0	0	0
$304	$312	46.00	37.70	29.40	21.10	12.80	4.50	0	0	0	0	0
$312	$320	47.20	38.90	30.60	22.30	14.00	5.70	0	0	0	0	0
$320	$328	48.40	40.10	31.80	23.50	15.20	6.90	0	0	0	0	0
$328	$336	49.60	41.30	33.00	24.70	16.40	8.10	0	0	0	0	0
$336	$344	50.80	42.50	34.20	25.90	17.60	9.30	1.00	0	0	0	0
$344	$352	52.00	43.70	35.40	27.10	18.80	10.50	2.20	0	0	0	0
$352	$360	53.20	44.90	36.60	28.30	20.00	11.70	3.40	0	0	0	0
$360	$368	54.40	46.10	37.80	29.50	21.20	12.90	4.60	0	0	0	0
$368	$376	55.60	47.30	39.00	30.70	22.40	14.10	5.80	0	0	0	0
$376	$384	56.80	48.50	40.20	31.90	23.60	15.30	7.00	0	0	0	0
$384	$392	58.00	49.70	41.40	33.10	24.80	16.50	8.20	0	0	0	0
$392	$400	59.20	50.90	42.60	34.30	26.00	17.70	9.40	1.10	0	0	0
$400	$420	61.30	53.00	44.70	36.40	28.10	19.80	11.50	3.20	0	0	0
$420	$440	64.20	55.90	47.60	39.30	31.00	22.70	14.40	6.10	0	0	0
$440	$460	67.20	58.90	50.60	42.30	34.00	25.70	17.40	9.10	.80	0	0
$460	$480	70.20	61.90	53.60	45.30	37.00	28.70	20.40	12.10	3.80	0	0
$480	$500	73.20	64.90	56.60	48.30	40.00	31.70	23.40	15.10	6.80	0	0
$500	$520	76.20	67.90	59.60	51.30	43.00	34.70	26.40	18.10	9.80	1.50	0
$520	$540	79.20	70.90	62.60	54.30	46.00	37.70	29.40	21.10	12.80	4.50	0
$540	$560	82.20	73.90	65.60	57.30	49.00	40.70	32.40	24.10	15.80	7.50	0
$560	$580	85.20	76.90	68.60	60.30	52.00	43.70	35.40	27.10	18.80	10.50	2.20
$580	$600	88.10	79.80	71.50	63.20	54.90	46.60	38.30	30.00	21.70	13.40	5.10
$600	$640	92.60	84.30	76.00	67.70	59.40	51.10	42.80	34.50	26.20	17.90	9.60
$640	$680	98.60	90.30	82.00	73.70	65.40	57.10	48.80	40.50	32.20	23.90	15.60
$680	$720	104.60	96.30	88.00	79.70	71.40	63.10	54.80	46.50	38.20	29.90	21.60
$720	$760	110.60	102.30	94.00	85.70	77.40	69.10	60.80	52.50	44.20	35.90	27.60
$760	$800	116.50	108.20	99.90	91.60	83.30	75.00	66.70	58.40	50.10	41.80	33.50
$800	$840	122.50	114.20	105.90	97.60	89.30	81.00	72.70	64.40	56.10	47.80	39.50
$840	$880	128.50	120.20	111.90	103.60	95.30	87.00	78.70	70.40	62.10	53.80	45.50
$880	$920	134.50	126.20	117.90	109.60	101.30	93.00	84.70	76.40	68.10	59.80	51.50
$920	$960	140.40	132.10	123.80	115.50	107.20	98.90	90.60	82.30	74.00	65.70	57.40
$960	$1,000	146.40	138.10	129.80	121.50	113.20	104.90	96.60	88.30	80.00	71.70	63.40
		15 percent of the excess over $1,000 plus—										
$1,000 and over		149.40	141.10	132.80	124.50	116.20	107.90	99.60	91.30	83.00	74.70	66.40

"If the pay-roll period with respect to an employee is a daily pay-roll period or a miscellaneous pay-roll period—

And the wages divided by the number of days in such periods are—		And the number of withholding exemptions claimed is—										
		0	1	2	3	4	5	6	7	8	9	10 or more
At least	But less than	The amount of tax to be withheld shall be the following amount multiplied by the number of days in such period—										
$0	$2.00	15% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$2.00	$2.25	$0.30	.05	0	0	0	0	0	0	0	0	0
$2.25	$2.50	.35	.10	0	0	0	0	0	0	0	0	0
$2.50	$2.75	.40	.10	0	0	0	0	0	0	0	0	0
$2.75	$3.00	.45	.15	0	0	0	0	0	0	0	0	0
$3.00	$3.25	.45	.20	0	0	0	0	0	0	0	0	0
$3.25	$3.50	.50	.25	0	0	0	0	0	0	0	0	0
$3.50	$3.75	.55	.25	0	0	0	0	0	0	0	0	0
$3.75	$4.00	.60	.30	.05	0	0	0	0	0	0	0	0
$4.00	$4.25	.60	.35	.05	0	0	0	0	0	0	0	0
$4.25	$4.50	.65	.40	.10	0	0	0	0	0	0	0	0
$4.50	$4.75	.70	.40	.15	0	0	0	0	0	0	0	0
$4.75	$5.00	.75	.45	.20	0	0	0	0	0	0	0	0
$5.00	$5.25	.75	.50	.20	0	0	0	0	0	0	0	0
$5.25	$5.50	.80	.55	.25	0	0	0	0	0	0	0	0
$5.50	$5.75	.85	.55	.30	0	0	0	0	0	0	0	0
$5.75	$6.00	.90	.60	.35	.05	0	0	0	0	0	0	0
$6.00	$6.25	.90	.65	.35	.10	0	0	0	0	0	0	0
$6.25	$6.50	.95	.70	.40	.15	0	0	0	0	0	0	0
$6.50	$6.75	1.00	.70	.45	.15	0	0	0	0	0	0	0
$6.75	$7.00	1.05	.75	.50	.20	0	0	0	0	0	0	0
$7.00	$7.25	1.05	.80	.50	.25	0	0	0	0	0	0	0
$7.25	$7.50	1.10	.85	.55	.30	0	0	0	0	0	0	0
$7.50	$7.75	1.15	.85	.60	.30	.05	0	0	0	0	0	0
$7.75	$8.00	1.20	.90	.65	.35	.10	0	0	0	0	0	0
$8.00	$8.25	1.20	.95	.65	.40	.10	0	0	0	0	0	0
$8.25	$8.50	1.25	1.00	.70	.45	.15	0	0	0	0	0	0
$8.50	$8.75	1.30	1.00	.75	.45	.20	0	0	0	0	0	0
$8.75	$9.00	1.35	1.05	.80	.50	.25	0	0	0	0	0	0
$9.00	$9.25	1.35	1.10	.80	.55	.25	0	0	0	0	0	0
$9.25	$9.50	1.40	1.15	.85	.60	.30	.05	0	0	0	0	0
$9.50	$9.75	1.45	1.15	.90	.60	.35	.05	0	0	0	0	0
$9.75	$10.00	1.50	1.20	.95	.65	.40	.10	0	0	0	0	0
$10.00	$10.50	1.55	1.25	1.00	.70	.45	.15	0	0	0	0	0
$10.50	$11.00	1.60	1.35	1.05	.80	.50	.25	0	0	0	0	0
$11.00	$11.50	1.70	1.40	1.15	.85	.60	.30	.05	0	0	0	0
$11.50	$12.00	1.75	1.50	1.20	.95	.65	.40	.10	0	0	0	0
$12.00	$12.50	1.85	1.55	1.30	1.00	.75	.45	.20	0	0	0	0
$12.50	$13.00	1.90	1.65	1.35	1.10	.80	.55	.25	0	0	0	0
$13.00	$13.50	2.00	1.70	1.45	1.15	.90	.60	.35	.05	0	0	0
$13.50	$14.00	2.05	1.80	1.50	1.25	.95	.70	.40	.15	0	0	0
$14.00	$14.50	2.15	1.85	1.60	1.30	1.05	.75	.50	.20	0	0	0
$14.50	$15.00	2.20	1.95	1.65	1.40	1.10	.85	.55	.30	0	0	0
$15.00	$15.50	2.30	2.00	1.75	1.45	1.20	.90	.65	.35	.10	0	0
$15.50	$16.00	2.35	2.10	1.80	1.55	1.25	1.00	.70	.45	.15	0	0
$16.00	$16.50	2.45	2.15	1.90	1.60	1.35	1.05	.80	.50	.25	0	0
$16.50	$17.00	2.50	2.25	1.95	1.70	1.40	1.15	.85	.60	.30	.05	0
$17.00	$17.50	2.60	2.30	2.05	1.75	1.50	1.20	.95	.65	.40	.10	0
$17.50	$18.00	2.65	2.40	2.10	1.85	1.55	1.30	1.00	.75	.45	.20	0
$18.00	$18.50	2.75	2.45	2.20	1.90	1.65	1.35	1.10	.80	.55	.25	0
$18.50	$19.00	2.80	2.55	2.25	2.00	1.70	1.45	1.15	.90	.60	.35	.05
$19.00	$19.50	2.90	2.60	2.35	2.05	1.80	1.50	1.25	.95	.70	.40	.15
$19.50	$20.00	2.95	2.70	2.40	2.15	1.85	1.60	1.30	1.05	.75	.50	.20
$20.00	$21.00	3.05	2.80	2.50	2.25	1.95	1.70	1.45	1.15	.90	.60	.35
$21.00	$22.00	3.20	2.95	2.65	2.40	2.10	1.85	1.55	1.30	1.05	.75	.50
$22.00	$23.00	3.35	3.10	2.80	2.55	2.25	2.00	1.70	1.45	1.20	.90	.65
$23.00	$24.00	3.50	3.25	2.95	2.70	2.40	2.15	1.85	1.60	1.35	1.05	.80
$24.00	$25.00	3.65	3.40	3.10	2.85	2.55	2.30	2.00	1.75	1.50	1.20	.95
$25.00	$26.00	3.80	3.55	3.25	3.00	2.70	2.45	2.15	1.90	1.65	1.35	1.10
$26.00	$27.00	3.95	3.70	3.40	3.15	2.85	2.60	2.30	2.05	1.80	1.50	1.25
$27.00	$28.00	4.10	3.85	3.55	3.30	3.00	2.75	2.45	2.20	1.95	1.65	1.40
$28.00	$29.00	4.25	4.00	3.70	3.45	3.15	2.90	2.60	2.35	2.05	1.80	1.55
$29.00	$30.00	4.40	4.15	3.85	3.60	3.30	3.05	2.75	2.50	2.20	1.95	1.70
		15 percent of the excess over $30 plus—										
$30.00 and over		4.50	4.20	3.95	3.65	3.40	3.10	2.85	2.55	2.30	2.05	1.75"

SEC. 503. EFFECTIVE DATE.

The amendments made by this title shall be applicable only with respect to wages paid on or after May 1, 1948.

PAR. 2. Section 405.201, as amended by Treasury Decision 5492 [C. B. 1946–1, 195], approved January 30, 1946 [26 CFR 405.201], is further amended as follows:

(A) By inserting in the paragraph beginning with the words "In using the percentage method with respect to wages paid on or after January 1, 1946," immediately after the expression "January 1, 1946," which occurs twice in such paragraph, the expression "and before May 1, 1948,".

(B) By inserting immediately preceding the paragraph beginning with the words "Where the withholding" the following:

In using the percentage method with respect to wages paid on or after May 1, 1948, reference must be made to the percentage method withholding table in section 1622(b)(1) as amended by the Revenue Act of 1948. The steps in computing the tax under such method with respect to wages paid on or after May 1, 1948, are summarized as follows:

Step 1. Multiply the amount of one withholding exemption by the number of exemptions claimed by the employee.

Step 2. Subtract the amount determined in step 1 from the employee's wages.

Step 3. Multiply the difference by 0.15.

The result is the amount of tax to be withheld.

Example. After April 30, 1948, an employee has a weekly pay-roll period, for which he is paid $75, and has in effect a withholding certificate claiming three exemptions. His employer, using the percentage method, computes the tax to be withheld as follows:

Step 1:	
Amount of one withholding exemption	$13.00
Multiplied by number of exemptions claimed on Form W-4	×3
Total withholding exemptions	39.00
Step 2:	
Total wage payment	75.00
Less amount determined in step 1	39.00
Balance subject to tax	36.00
Step 3:	
Tax to be withheld (balance multiplied by 0.15)	5.40

PAR. 3. Section 405.202, as amended by Treasury Decision 5492 [26 CFR 405.202], is further amended as follows:

(A) By inserting immediately after *Example* (*4*) in (*a*) the following:

Example (*5*). After April 30, 1948, employee E is paid wages and has a weekly pay-roll period. The number of withholding exemptions claimed by E is two. E's wages are determined at the rate of $1.20 per hour. During a certain pay-roll period he works 40 hours and earns $48. In computing the tax, the amount of two withholding exemptions, or $26, is allowable, and the balance of $22 is subject to tax.

Example (*6*). After April 30, 1948, employee F is paid wages and has a weekly pay-roll period. The number of withholding exemptions claimed by F is zero. F's wages are determined at the rate of $10 per day. During a certain week F worked only 2 days and resigned. The tax is computed on the entire amount of $20.

(B) By striking from the next to the last sentence of the example in (*b*) the words "or a subsequent year" and inserting in lieu thereof ", 1947, or before May 1 in 1948."

(C) By inserting immediately after the last sentence of such example in (*b*) the following:

If, however, the wages were paid on or after May 1, 1948, the amount of the withholding exemption allowable for the 12-day period in computing the tax at the 15 percent rate is $43.20 (12×(2×$1.80)).

(D) By inserting after *Example* (*2*) in (*c*) the following:

Example (*3*). On April 1, 1948, C was employed by the Z Real Estate Co. to sell real estate on a commission basis, commissions to be paid only upon consummation of sales. The number of withholding exemptions is one. On May 20, 1948, C received a commission of $300. Again on June 15, 1948, C received a commission of $400. The amount of the withholding exemption in respect of the commission paid on May 20 is $90 ($1.80×50). In respect of the commission paid on June 15 the amount of the withholding exemption is $46.80 ($1.80×26).

(E) By inserting immediately after *Example* (*4*) in (*d*) the following:

Example (*5*). After May 1, 1948, an employee having a daily pay-roll period is paid wages of $12 per day. The number of withholding exemptions claimed by such employee is one. The amount of each such daily wage payment subject to withholding is $10.20. ($12.00—$1.80).

Example (*6*). An employee works for a certain employer for 4 days and after April 30, 1948, he is paid $36. The number of withholding exemptions claimed by the employee is two. The amount of the withholding exemption allowable is $14.40 (4×$3.60).

(F) By inserting immediately after "January 1, 1946," in the next to the last sentence of the paragraph in (*d*) which begins with the words "To illustrate," the words "and before May 1, 1948,".

(G) By inserting at the end of such paragraph in (*d*) beginning with the words "To illustrate" the following:

Under the same set of facts, if the wages are paid on or after May 1, 1948, the amount of the withholding exemption is $26 (2×$13).

Par. 4. Section 405.203, as amended by Treasury Decision 5492 [26 CFR 405.203], is further amended as follows:

(A) By inserting immediately after "January 1, 1946," in the last sentence of (*a*) the words "and before May 1, 1948,".

(B) By inserting at the end of (*a*) the following:

With respect to wages paid on or after May 1, 1948, the wage bracket tables contained in section 1622(c) as amended by the Revenue Act of 1948 are to be used.

(C) By striking "or a subsequent year" from the last sentence of the example in (*c*) and inserting in lieu thereof ", 1947, or before May 1 in 1948."

(D) By inserting immediately after such last sentence in (*c*) the following:

If, however, the wages were paid on or after May 1, 1948, the tax required to be withheld under the table applicable to a miscellaneous period would be $0.60 multiplied by the number of days in such period or $7.20 for the 12-day period.

(E) By inserting immediately after *Example* (*2*) in (*d*) the following:

Example (*3*). On April 1, 1948, C is hired by the Z Real Estate Co. to sell real estate on a commission basis, commissions to be paid only upon consummation of sales. The number of withholding exemptions claimed by C is one. On May 20, 1948, C received a commission of $300. Again on June 15, 1948, C received a commission of $400. Under the wage bracket method, the amount of tax to be deducted and withheld in respect of the commission paid on May 20 is $32.50, which amount is obtained by multiplying $0.65 (tax under wage bracket table for a daily or a miscellaneous pay-roll period where wages are at least $6 but less than $6.25 a day) by 50 (number of days elapsed); and the amount of tax to be withheld with respect to the commission paid on June 15 is $52, which amount is obtained by multiplying $2 (tax under wage bracket table for a daily or a miscellaneous pay-roll period where wages are at least $15 but less than $15.50 a day) by 26 (number of days elapsed).

(F) By inserting immediately after *Example (4)* in *(e)* the following:

Example (5). After April 30, 1948, an employee having a daily pay-roll period is paid wages of $7 per day. The number of withholding exemptions claimed by the employee is one. Under the table applicable to a daily pay-roll period, the amount of tax to be deducted and withheld from each such payment of wages is $0.80.

Example (6). During 1948 an individual is hired for 4 days and on or after May 1, 1948, he is paid wages of $36. The number of withholding exemptions claimed by him is two. The amount of tax to be deducted and withheld under the wage bracket method is $3.20 (4 ×$0.80).

(G) By striking out the last sentence of *(f)* and inserting in lieu thereof the following:

Thus, with respect to wages paid on or after May 1, 1948, if the pay-roll period of an employee is weekly and the wage payment of such employee is $255.25 the employer may compute the 15 percent of the excess over $200 as if the excess were $55 instead of $55.25.

PAR. 5. There is inserted immediately preceding section 405.205 the following:

SEC. 202. TECHNICAL AMENDMENTS. (REVENUE ACT OF 1948, TITLE II.)

* * * * * * *

(b) WITHHOLDING EXEMPTIONS.—

(1) IN GENERAL.—Section 1622(h)(1) of the Internal Revenue Code is hereby amended to read as follows:

"(1) IN GENERAL.—An employee receiving wages shall on any day be entitled to the following withholding exemptions:

"(A) An exemption for himself.

"(B) One additional exemption for himself if, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 25(b)(1)(B)(i) (relating to old age) for the taxable year under Chapter 1 in respect of which amounts deducted and withheld under this subchapter in the calendar year in which such day falls are allowed as a credit.

"(C) One additional exemption for himself if, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 25(b)(1)(C)(i) (relating to the blind) for the taxable year under Chapter 1 in respect of which amounts deducted and withheld under this subchapter in the calendar year in which such day falls are allowed as a credit.

"(D) If the employee is married, any exemption to which his spouse is entitled, or would be entitled if such spouse were an employee receiving wages, under subparagraph (A), (B), or (C), but only if such spouse does not have in effect a withholding exemption certificate claiming such exemption.

"(E) An exemption for each individual with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 25(b)(1)(D) for the taxable year under Chapter 1 in respect of which amounts deducted and withheld under this subchapter in the calendar year in which such day falls are allowed as a credit."

(2) STATUS DETERMINATION DATE.—In the case of an individual entitled to an additional withholding exemption under section 1622(h)(1) of the Internal Revenue Code by reason of the amendment made thereto by paragraph (1) of this subsection, the term "status determination date" as used in section 1622(h)(3)(B) of such Code includes also the ninetieth day after the date of the enactment of this Act.

* * * * * * *

SEC. 201. ADDITIONAL CREDITS AGAINST NET INCOME FOR NORMAL TAX AND SURTAX. (REVENUE ACT OF 1948, TITLE II.)

Paragraphs (1) and (2) of section 25(b) of the Internal Revenue Code are hereby amended to read as follows:

"(1) CREDITS.—There shall be allowed for the purposes of both the normal tax and the surtax, the following credits against net income:

"(A) An exemption of $600 for the taxpayer; and an additional exemption of $600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer;

"(B) (i) An additional exemption of $600 for the taxpayer if he has attained the age of 65 before the close of his taxable year; and

"(ii) An additional exemption of $600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse has attained the age of 65 before the close of such taxable year, and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer;

"(C) (i) An additional exemption of $600 for the taxpayer if he is blind at the close of his taxable year; and

"(ii) An additional exemption of $600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse is blind and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer. For the purposes of this clause the determination of whether the spouse is blind shall be made as of the close of the taxable year of the taxpayer, unless the spouse dies during such taxable year, in which case such determination shall be made as of the time of such death;

"(iii) For the purposes of this subparagraph an individual is blind only if either: his central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or his visual acuity is greater than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees;

"(D) An exemption of $600 for each dependent whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than $500, except that the exemption shall not be allowed in respect of a dependent who has made a joint return with his spouse under section 51 for the taxable year beginning in such calendar year.

"(2) DETERMINATION OF STATUS.—For the purposes of this subsection—

"(A) the determination of whether an individual is married shall be made as of the close of his taxable year, unless his spouse dies during his taxable year, in which case such determination shall be made as of the time of such death; and

"(B) an individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married."

SEC. 203. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1948, TITLE II.)

The amendments made by this title shall be applicable with respect to taxable years beginning after December 31, 1947. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

PAR. 6. Section 405.205, as amended by Treasury Decision 5492 [26 CFR, 405.205], is further amended as follows:

(A) By inserting immediately after the paragraph beginning with the words "The number of exemptions" the following:

With respect to wages paid on or after May 1, 1948, the number of exemptions to which an employee is entitled on any day depends also on his status as to old age and blindness.

(B) By inserting after the paragraph beginning with the words "A single person" the following:

With respect to wages paid on or after May 1, 1948, a single person may also be entitled to withholding exemptions for old age and blindness, as explained below.

(C) By inserting immediately after the paragraph beginning with the words "A married person" the following:

With respect to wages paid on or after May 1, 1948, a married person may also be entitled to withholding exemptions for himself and for his spouse because of old age or blindness, as explained below.

(D) By striking "For" from the first sentence of the paragraph beginning with the words "For the purpose of determining" and inserting in lieu thereof "With respect to wages paid before May 1, 1948, for."

(E) By inserting immediately preceding the paragraph beginning with the words "Subject to" the following paragraph:

With respect to wages paid on or after May 1, 1948, for the purpose of determining the number of withholding exemptions to which an employee is entitled for himself and his spouse on any day, the employee's status as a single person or a married person and, if married, whether a withholding exemption is claimed by his spouse shall be determined as of such day, but, in the case of a married person, the withholding exemption for his spouse may be claimed by him for that portion of the taxable year which occurs after the spouse's death. For example, a married employee on a calendar year basis having no dependents has in effect a withholding exemption certificate claiming one exemption for himself and one for his wife. On May 3, 1948, his wife dies. On May 4, 1948, the employee may continue to claim his wife's withholding exemption. Accordingly, he is not required to file a new withholding exemption certificate until December 1, 1948.

(F) By inserting at the end thereof the following:

If an employee will have attained 65 years before the end of the taxable year he may claim an additional withholding exemption on account of age with respect to wages paid on or after May 1, 1948. If the employee's spouse will have attained 65 years before the end of such employee's taxable year and such spouse has no withholding exemption certificate in effect claiming such exemption, the employee may also claim an additional withholding exemption on account of age with respect to wages paid on or after May 1, 1948. If the employee is blind, he may claim an additional withholding exemption for blindness with respect to wages paid on or after May 1, 1948. If the employee's spouse is blind and has no withholding exemption certificate in effect claiming such exemption, the employee may also claim an additional withholding exemption for blindness with respect to wages paid on or after May 1, 1948. If both husband and wife are employees receiving wages subject to withholding and the wife is over the age of 65 and has in effect a withholding exemption certificate claiming only one exemption, then her husband may claim one exemption for her on his certificate.

For the purposes of claiming a withholding exemption for blindness, an individual shall be considered blind only if either his central visual acuity does not exceed 20/200 in the better eye with correcting lenses or his visual acuity is greater than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees.

PAR. 7. Section 405.206, as amended by Treasury Decision 5492 [26 CFR 405.206], is further amended by inserting immediately after "dies" in (*a*) "before January 1, 1948."

PAR. 8. Section 405.207 [26 CFR 405.207] is amended by inserting immediately after the sentence beginning with the words "For the purposes" the following:

The additional status determination date provided by the Revenue Act of 1948 for employees claiming the exemption for age or blindness coincides with a regular determination date, namely, July 1, 1948.

PAR. 9. Section 405.209, as amended by Treasury Decision 5492 [26 CFR 405.209], is further amended as follows:

(A) By inserting in the second sentence thereof immediately after "paid" the expression "before May 1, 1948."

(B) By inserting immediately after *Example* (*4*) in (*a*) the following:

With respect to wages paid on or after May 1, 1948, the rules for supplemental wages set forth above are also applicable, but if tax has been withheld from the employee's regular wages, an alternative method may be used. Under this method, the employer may determine the tax to be withheld from supplemental wages by using a flat rate of 15 percent without allowance for exemption and without reference to any regular payment of wages.

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

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved January 7, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 18, 1949, 8:55 a. m.)

CHAPTER 36.—COLLECTION

SUBCHAPTER A.—GENERAL PROVISIONS

SECTION 3657.—PAYMENT BY UNITED STATES NOTES AND CERTIFICATES OF INDEBTEDNESS

1949-4-13024
T. D. 5686

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER E, PART 471.—ACCEPTANCE OF TREASURY NOTES IN PAYMENT OF INCOME, ESTATE, AND GIFT TAXES

Regulations governing the acceptance of Treasury notes of Tax Series A-1943, B-1943, A-1944, B-1944, A-1945, Treasury notes of Tax Series C, and Treasury savings notes, Series C and Series D, in payment of income (including excess profits), estate, and gift taxes.

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

To Collectors of Internal Revenue and Others Concerned:

SECTION 471.1. ACCEPTANCE OF TREASURY NOTES OF TAX SERIES A–1943, B–1943, A–1944, B–1944, A–1945, TREASURY NOTES OF TAX SERIES C, AND TREASURY SAVINGS NOTES, SERIES C AND SERIES D, IN PAYMENT OF INCOME (INCLUDING EXCESS PROFITS), ESTATE, AND GIFT TAXES.—Notes of the United States designated as Treasury notes of Tax Series A–1943, B–1943, A–1944, B–1944, A–1945, Treasury notes of Tax Series C, and Treasury savings notes, Series C and Series D, may be accepted in payment of income taxes (current and back personal and corporation taxes, and excess profits taxes) and estate and gift taxes (current and back), at par and interest accrued to the month, inclusive, in which presented (but no accrual beyond the maturity date). Collectors of internal revenue are authorized and directed to accept such notes during and after the second calendar month after the month of purchase (as shown by the issuing agent's dating stamp on each note). For example, a note of Tax Series A–1945 purchased in September, 1942, may be accepted in November, 1942, but such a note purchased in October, 1942, may not be accepted until December, 1942.

Such notes may be accepted only in payment of income (including excess profits), estate, and gift taxes (current and back) due from the original purchaser thereof or his estate. Such notes shall be in the name of the taxpayer (individual, corporation, or other entity) and may be presented for tax payment by only the taxpayer, his agent, or his estate. There is no limit upon the amount of such notes which may be accepted in payment of income (including excess profits), estate, or gift taxes.

Such notes, inscribed in the name of a taxpayer, may be accepted in payment of income tax withheld at the source by such taxpayer, and such notes inscribed in the name of a taxpayer may be accepted in payment of transferee liability assessed against such taxpayer for income (including excess profits), estate, or gift taxes.

Collectors of internal revenue shall not in any case allow credit to a taxpayer on account of such notes, or accept such notes, for an amount greater than their principal amount plus accrued interest, nor shall such notes be accepted in an amount (including accrued interest) greater than the unpaid liability of the taxpayer. Such notes shall be forwarded to the collector of internal revenue with whom the tax return is filed, at the risk and expense of the taxpayer, and, for the taxpayer's protection, should be forwarded by registered mail, if not presented in person.

SEC. 471.2. PROCEDURE WITH RESPECT TO TREASURY NOTES OF TAX SERIES A–1943, B–1943, A–1944, B–1944, A–1945, TREASURY NOTES OF TAX SERIES C, AND TREASURY SAVINGS NOTES, SERIES C AND SERIES D.—Deposits of Treasury notes of Tax Series A–1943, B–1943, A–1944, B–1944, A–1945, Treasury notes of Tax Series C, and Treasury savings notes, Series C and Series D, received in payment of taxes shall be made by the collector of internal revenue in a Federal Reserve bank or a branch Federal Reserve bank. Prior to deposit the collector of internal revenue will certify on the reverse side of the notes that they were received in payment of income (including excess profits), estate, or gift tax, as the case may be, and will show in the indorsement stamp the date of deposit.

SEC. 471.3. PRIOR TREASURY DECISION SUPERSEDED.—Treasury Decision 5308 [C. B. 1943, 984], approved December 1, 1943 [26 CFR, Part 471], is hereby superseded.

(This Treasury Decision is issued under the authority of sections 3657 and 3791 of the Internal Revenue Code (53 Stat. 447, 467, 26 U. S. C. 3657, 3791).)

Because this Treasury Decision merely revises existing regulations governing the acceptance of Treasury notes and Treasury savings notes in payment of income (including excess profits), estate, and gift taxes so as to make such regulations applicable also to Treasury savings notes, Series D, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(c) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved January 31, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 3, 1949, 8:49 a. m.)

CHAPTER 38.—MISCELLANEOUS PROVISIONS

SECTION 3797.—DEFINITIONS

SECTION 29.3797-2: Association. 1949-8-13069
(Also Section 29.3797-4.) I. T. 3948

INTERNAL REVENUE CODE

Clarification of I. T. 3930 (C. B. 1948-2, 126) and I. T. 3933 (C. B. 1948-2, 130), relative to the status for Federal income tax purposes of joint operating agreements commonly entered into between coowners of oil and gas properties.

Advice has been requested respecting the application of I. T. 3930 (C. B. 1948-2, 126) in cases (1) where the operator or some other person is, by the terms of the joint operating agreement or by separate contract, given the contractual right or the option to purchase some or all of the oil and gas produced from the jointly operated properties; (2) where there are outstanding contracts which will dispose of oil and gas produced by the joint operation in taxable periods extending beyond the effective date of I. T. 3930, as extended by I. T. 3933 (C. B. 1948-2, 130) to the first day of a taxable year beginning on or after July 1, 1949; and (3) of contracts entered into by an agent (authorized to act for the time being only) for the sale of oil or gas for periods of time regarded by the industry as minimum commitments under the circumstances.

I. T. 3930, *supra*, treats joint operating agreements commonly entered into between coowners of oil and gas properties as creating associations taxable as corporations under the Internal Revenue Code only if such agreements create organizations with a joint profit objective. That is, organizations created by such agreements are considered corporations if some person or persons are irrevocably authorized to act in a representative capacity for a fixed or determinable period of time to sell the production from the joint operation for the joint account of two or more of the coowners. Thus, the test of an association in such cases is therefore essentially organizational, depending upon the existence of collective irrevocable representative capacity which, arising from the irrevocable vesting of authority in one representative (including cases where such representative capacity is vested jointly in more than one person) to market the oil and gas produced from the jointly operated properties for two or more coowners, marks an organization with a joint profit objective.

Association status turns upon the existence of such collective irrevocable representative capacity. Consequently, where such capacity exists, classification as an association under the Internal Revenue Code may be avoided only if such capacity is withdrawn prior to the first day of a taxable year beginning on or after July 1, 1949, the effective date of I. T. 3930. Moreover, where such withdrawal is timely, no modification of sale or option contracts entered into prior to such effective date is necessary.

A coowner who reserves the right to take his share of the production in kind, or to direct its sale, may contract to sell or grant options to purchase his share as he sees fit without creating an association taxable as a corporation for Federal income tax purposes. Representative capacity under I. T. 3930 is not involved in such a case. Also, the fact that some or all of the coowners execute identical contracts, or the same instrument, with the same purchaser or optionee, each thereby contracting to sell all or any fractional part of his own share, or to grant options to buy any fractional part of such share, will not be held as achieving a different tax consequence since obviously no representative capacity is involved. Each owner in such a case has exercised his own business discretion.

It seems equally clear that one coowner may authorize a person or persons (so long as that person or persons is not another coowner who is also selling his share of the production) to sell his individual share of the production, or to grant options as respects such share, without creating an association taxable as a corporation. Such representative capacity, even though irrevocable, (1) does not involve an authorization to act jointly for more than the one coowner, (2) does not indicate a joint profit objective, and (3) is deemed the equivalent of a personal exercise of his own business discretion by the one coowner. However, under I. T. 3930, the same representative or representatives may not act for more than one of the coowners (including himself) without creating an association taxable as a corporation as respects the coowners so represented, unless such authorization is for the time being only (i. e., revocable at will), because, in such a case, collective irrevocable representative capacity indicative of an organization with a joint profit objective would be present.

There remains for clarification the limitations inherent in the distinction drawn in I. T. 3930 between revocable representative capacity (authority to act for more than one coowner for the time being) and collective irrevocable representative capacity (authority to act for more that one coowner including himself). As an association, like a formal corporation, may be organized for a short as well as a long period of time, revocable representative capacity must be terminable at will to avoid the formation of an association with a joint profit objective. However, an agent may find it desirable or necessary to enter into sale or option contracts for an extended period of time rather than to market production on a day-to-day basis. For instance, to state an extreme example, in cases of certain cycling operations, it is necessary to contract for production for a minimum period of one year. Accordingly, discretionary authority terminable at will granted to a person or persons representing two or more coowners to enter into contracts committing the principals for such reasonable periods of time as are consistent with the minimum needs of the industry under the circumstances, but not to exceed one year, will not be regarded as inconsistent with revocable representative capacity in the sense that term is used herein and in I. T. 3930. Of course, as pointed out above, the coowners acting for themselves as principals may enter into such contracts for indefinite periods, as such action does not involve collective irrevocable representative capacity.

SECTION 29.3797–4: Partnerships.

INTERNAL REVENUE CODE

Joint operating agreements with respect to oil and gas properties. I. T. 3930 (C. B. 1948–2, 126) and I. T. 3933 (C. B. 1948–2, 130) clarified. (See I. T. 3948, page 161.)

SECTION 3806.—MITIGATION OF EFFECT OF RENEGOTIATION OF WAR CONTRACTS OR DISALLOWANCE OF REIMBURSEMENT

1949–11–13098
I. T. 3955

INTERNAL REVENUE CODE

The principles stated in I. T. 3577 (C. B. 1942–2, 163), I. T. 3611 (C. B. 1943, 978), and I. T. 3671 (C. B. 1944, 465), relating to the effect, for Federal income and excess profits tax purposes, of renegotiation of Government contracts or subcontracts, are applicable to renegotiation under the Renegotiation Act of 1948 (62 Stat. 259; C. B. 1948–1, 238).

Advice is requested whether the principles set forth in I. T. 3577 (C. B. 1942–2, 163), I. T. 3611 (C. B. 1943, 978), and I. T. 3671 (C. B. 1944, 465) are applicable to renegotiation pursuant to the Renegotiation Act of 1948 (62 Stat. 259; C. B. 1948–1, 238).

The Renegotiation Act of 1948 provides in part: "In eliminating excessive profits the Secretary shall allow the contractor or subcontractor credit for Federal income and excess profits taxes as provided in section 3806 of the Internal Revenue Code." Section 3806(a) (1) (A) of the Internal Revenue Code provides as follows:

(A) The term "renegotiation" includes any transaction which is a renegotiation within the meaning of section 403 of the Sixth Supplemental National Defense Appropriation Act (Public 528, Seventy-seventh Congress, second session) or such section, as amended, any modification of one or more contracts with the United States or any agency thereof, and any agreement with the United States or any agency thereof in respect of one or more such contracts or subcontracts thereunder.

It is held that the principles stated in I. T. 3577, *supra*, I. T. 3611, *supra*, and I. T. 3671, *supra*, are applicable to renegotiation under the Renegotiation Act of 1948.

INCOME TAX RULINGS.—PART II

REVENUE ACT OF 1938 AND PRIOR REVENUE ACTS

SUBTITLE B.—GENERAL PROVISIONS

PART II—COMPUTATION OF NET INCOME

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

ARTICLE 22(a)-1, REGULATIONS 101: What included in gross income.

1949-9-13074
Ct. D. 1718

INCOME AND DECLARED VALUE EXCESS-PROFITS TAXES—REVENUE ACT OF 1938—DECISION OF SUPREME COURT

1. GROSS INCOME—PARENT AND SUBSIDIARY CORPORATIONS—TAXABILITY OF INCOME TO SUBSIDIARIES.

Taxpayer corporations were subsidiaries utilized by the parent corporation as operating companies in the major fields of operation in which it was engaged. The contracts under which they operated provided, in substance, that the subsidiaries were employed as agents to manage and operate production plants and to sell the products of such plants. The parent furnished working capital, executive management, and office facilities for its subsidiaries, which, in turn, agreed to pay to the parent all profits in excess of 6 percent on their outstanding capital stock, which in each case was nominal in amount. Title to the assets utilized by the subsidiaries was held by them, and amounts advanced by the parent for the purchase of assets and working capital were shown on their books as accounts payable to the parent. *Held:* The relationship between parent and subsidiaries was not that of principal and agent, and all profits of the subsidiaries were taxable against them rather than merely the 6 percent they retained. When a corporation carries on a business activity the fact that the owner retains direction of its affairs, provides all of its assets, and takes all of its profits can make no difference tax-wise.

2. DECISION AFFIRMED.

Decision of the United States Court of Appeals, Second Circuit (167 Fed. (2d) 304), reversing decision of The Tax Court of the United States (8 T. C. 594), affirmed.

3. DECISION DISTINGUISHABLE.

Decision in the case of *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330 (1918), clearly distinguishable.

SUPREME COURT OF THE UNITED STATES

151. *National Carbide Corp., petitioner,* v. *Commissioner of Internal Revenue*

152. *Air Reduction Sales Co., petitioner,* v. *Commissioner of Internal Revenue*

153. *Pure Carbonic, Inc., petitioner,* v. *Commissioner of Internal Revenue*

On writs of certiorari to the United States Court of Appeals for the Second Circuit

[March 28, 1949]

OPINION

Mr. Chief Justice VINSON delivered the opinion of the Court.

Petitioners are three wholly owned subsidiaries of Air Reduction Corp. (Airco). They seek a determination of the question whether deficiencies in income and declared value excess-profits taxes for the year 1938 found by the Commissioner of Internal Revenue are properly chargeable to them. Their contention is that they are corporate agents of Airco, that the income from their operations is income of Airco, and that income and excess profits taxes must be determined on that basis.

By a series of combinations and dissolutions of previously acquired subsidiary companies, Airco had, prior to 1938, reduced the number of its subsidiaries to four. All operated strictly in accordance with contracts with Airco.[1] The subsidiaries were utilized by Airco as operating companies in the four major fields of operation in which it was engaged. Air Reduction Sales Co. carried on the manufacture and sale of the gaseous constituents of air; National Carbide Corp., the manufacture and sale of calcium carbide; Pure Carbonic, Inc., the manufacture and sale of carbon dioxide; and Wilson Welder & Metals Co., the manufacture and sale of welding machines, equipment and supplies.[2]

The contracts between Airco and its subsidiaries provided, in substance, that the latter were employed as agents to manage and operate plants designed for the production of the products assigned to each, and as agents to sell the output of the plants. Airco was to furnish working capital, executive management and office facilities for its subsidiaries. They in turn agreed to pay Airco all profits in excess of 6 percent on their outstanding capital stock, which in each case was nominal in amount.[3] Title to the assets utilized by the subsidiaries was held by them, and amounts advanced by Airco for the purchase of assets and working capital were shown on the books of the subsidiaries as accounts payable to Airco. The value of the assets of each company thus approximated the amount owed to Airco. No interest ran on these accounts.

Airco and its subsidiaries were organized horizontally into six overriding divisions: corporate, operations, sales, financial, distribution, and research. Officers heading each division were, in turn, officers of the subsidiaries. Top officials of Airco held similar positions in the subsidiary companies. Directors of the subsidiaries met only to ratify the actions of the directors and officers of Airco.

Airco considered the profits turned over to it by the subsidiaries pursuant to the contracts as its own income and reported it as such. Petitioners reported as income only the 6 percent return on capital that each was entitled to retain. Similarly, in declaring the value of their capital stock for declared value excess-profits tax purposes, the subsidiaries reported only the nominal amounts at which the stock was carried on the books of each. The Commissioner notified petitioners of substantial income and excess profits tax deficiencies in their 1938 returns, having taken the position that they are taxable on the income turned over to Airco as well as the nominal amounts retained. The Tax Court held, however, that the income from petitioners' operations in excess of 6 percent of their capital stock was income and property of Airco. Three judges dissented. The Court of Appeals for the Second Circuit reversed. 167 Fed. (2d) 304. We granted the petition for a writ of certiorari, 335 U. S. 810, because of this conflict

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[1] The substance of a typical subsidiary-parent contract is as follows: "Airco hereby employs Sales as its agent to manage and operate, during the term of this contract, all plants for the production of oxygen, acetylene and other gases and for the manufacture of apparatus and containers for the utilization and transportation of such gases * * *; and likewise employs Sales as its agent to market and sell, during the term of this contract, the output of all such plants * * * Airco agrees (1) to give Sales the use of all cylinders, containers, motortrucks, equipment, and shipping facilities, which it now owns or may hereafter acquire; (2) to supply such working capital as Sales may need; (3) to provide such executive management (but not accounting, bookkeeping, and clerical service), and office accommodation and facilities as may be necessary for the proper conduct of Sales business * * * Sales agrees (1) to manage and operate * * * all of said plants; (2) to maintain the same in first-class condition, charging necessary repairs and replacements to operating expense and setting aside and charging to operating expense proper reserves for depreciation * * * (3) to distribute, market and sell, the product manufactured in said plants as efficiently as possible * * * (4) to pay all expenses of such operation, maintenance and selling, and to discharge all expenses and liabilities incurred therein or thereby and to collect all accounts receivable or other proceeds resulting therefrom; (5) to credit monthly on its books to Airco all profits accruing to it from the operation of its entire business over and above an amount equal to 6 percent (6%) per annum on its outstanding capital stock, which said amount it is hereby authorized to deduct and retain, and it hereby agrees to accept as full compensation for its services hereunder; and (6) to pay over to Airco upon demand any profits becoming due and credited to Airco as aforesaid."

[2] Wilson Welder had a net deficit during the year here involved and is not a petitioner in this action.

[3] Sales had outstanding 125 shares of stock of $100 par value; Carbide's outstanding capital stock was 50 shares of $100 par value; Carbonic also had 50 shares of $100 par value.

of opinion and the disagreement between courts as to the continuing vitality of *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330 (1918).

Petitioners' contention is, in substance, that our decision in *Moline Properties, Inc.*, v. *Commissioner*, 319 U. S. 436 (1943) [Ct. D. 1584, C. B. 1943, 1011], which held that the tax laws require taxation of the corporate entity if it engages in "business activity," expressly excepted the situation in which the corporation is the agent of its owner; that *Southern Pacific Co.* v. *Lowe, supra*, defines the content of "agency" for tax purposes; and that, as the Tax Court found, this Court's characterization of the relationship between the corporations in the Southern Pacific case is "aptly descriptive" of the relationship between Airco and petitioners. It must follow, according to petitioners, that income received by them and transmitted to Airco is taxable only to Airco.

Respondent does not quarrel with the first and third propositions. The collision occurs at the second. The issue as presented by petitioners is, therefore, whether the principal-agent relationship described in the Southern Pacific case—and the similar arrangement between Airco and petitioners—contains the "usual incidents of an agency relationship," as that phrase was used in *Moline Properties, Inc.*, v. *Commissioner, supra*.

Petitioners' contention that the Southern Pacific case established a concept of agency that has survived our later decisions may be dealt with rather summarily. That case treated income earned by a wholly owned subsidiary before March 1, 1913, the effective date of the Income Tax Act of 1913, as having accrued to its parent prior to that date despite the fact that the actual transfer of funds by declaration of dividends occurred subsequent thereto. The theory of the case was that the two corporations could be treated as identical, for the purposes of the 1913 Act, because of the complete domination and control exercised by the parent over its subsidiary.

By this decision, this Court is said to have "looked beyond the corporate form,"[4] and "ignored the separate entity of a corporation."[5] Whatever the dialectics employed, courts and commentators have agreed that parent and subsidiary were treated as one corporation for the purposes of the taxes there in question; transfer of earnings to the parent was merely "a paper transaction." The Southern Pacific case did not, and did not purport to rest on any principle of agency. The only reference to the subsidiary (Central Pacific) as an agent is made in this context:

> "* * * the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and in other capacities. While the two companies were separate legal entities, yet in fact, and for all practical purposes they were merged, the former being but a part of the latter, acting merely as its agent and subject in all things to its proper direction and control." 247 U. S. at 337.

It is thus clear beyond doubt that the subsidiary was not referred to as an agent of the parent in the usual or technical sense. "Agency" and "practical identity," as those words are used in the Southern Pacific case, are unquestionably opposite sides of the same coin.[6] The close relationship between corporations because of complete ownership and control of one by the other was the basis for the result reached, whatever its articulation.

That basis has been repudiated by subsequent decisions of this Court. Whatever the vitality of *Southern Pacific Co.* v. *Lowe* on its special facts, we have held that a corporation formed or operated for business purposes must share the tax burden despite substantial identity, in practical operation, with its owner. Complete ownership of the corporation, and the control primarily dependent upon such ownership—the important ingredients of the Southern Pacific case—are no longer of significance in determining taxability. *Moline Properties, Inc.*, v.

[4] Mertens, Law of Federal Income Taxation (1948 ed.), vol. 10A, p. 237.

[5] Finkelstein, The Corporate Entity and the Income Tax, 44 Yale L. J. 436, 448.

[6] In Ballantine, Separate Entity of Parent and Subsidiary Corporations, 14 Cal. L. Rev. 12, 18, the writer discusses this use of the agency concept as follows: "What is meant by such terms as 'adjunct,' 'agency,' 'instrumentality,' 'creature' or 'mouthpiece'? What conditions must exist to warrant a court in treating the A corporation as the mere adjunct of the B corporation? The word 'agency' is often used as a synonym of 'adjunct,' whatever that may mean, and as descriptive of a relation variously defined in the cases as 'alter ego,' 'alias,' 'device,' 'dummy,' 'branch,' 'tool,' 'corporate double,' 'business conduit,' 'instrumentality,' etc., but all in the sense of 'means' through which a corporation's own business is actively prosecuted."

Commissioner, supra; Burnet v. *Commonwealth Improvement Co.*, 287 U. S. 415 (1932)[7] [Ct. D. 622, C. B. XII-1, 277 (1933)].

In both of the cases last cited, the agency argument now urged upon us was made and rejected. In both cases, *Southern Pacific Co.* v. *Lowe, supra*, was relied upon by the taxpayers. In both, we found that the contention that the corporation was the agent of its owner was simply the argument that the subsidiary had no corporate identity distinct from its stockholders in a different form. It is true that petitioners here do not ask that they be ignored completely for tax purposes. They are willing to pay taxes on the nominal amounts they retain as Airco's "agents." But this fact serves to emphasize the inapplicability of the Southern Pacific case, upon which they rely. There, as in Commonwealth Improvement Co. and Moline Properties cases, the decision turned upon the question whether the corporate entity was or was not to be completely ignored for tax purposes. If the Central Pacific had been accorded any tax status in the Southern Pacific case, it unquestionably would have been taxed on the entire income it received. In fact, it was so taxed upon all income received after March 1, 1913; only income received prior thereto was considered income of the parent directly.[8]

We think, therefore, that petitioners' argument is without merit because based on an erroneous interpretation of *Southern Pacific Co.* v. *Lowe, supra.* The agency argument, to quote the opinion in Moline Properties, "is basically the same argument of identity in a different form * * * the question of agency or not depends upon the same legal issues as does the question of identity previously discussed."[9] Ownership of a corporation and the control incident thereto can have no different tax consequences when clothed in the garb of agency than when worn as a removable corporate veil.

But it is necessary to go farther. The Tax Court did not, as petitioners seem to think, consider the argument that they were agents of Airco as different from or having any greater validity than the argument of identity of Airco and its subsidiaries. The court, in characterizing petitioners as Airco's agents, used that term exactly as it had been used in the Southern Pacific, Commonwealth Improvement Co., and Moline Properties cases. According to the Tax Court's opinion:

"The issue which [was decided] in this proceeding is: Whether, as the respondent has determined, the income from the operations of the three petitioners belonged not to Airco, the parent but to the petitioners and was taxable to them; or whether, as the three petitioners contend, the income from the operations of the petitioners in 1938, exclusive of the small amounts paid to petitioners under the contracts, belonged and was taxable to Airco, the parent company, both because the petitioners were in fact incorporated departments, divisions or branches of Airco's business and because the petitioners operated pursuant to express contract with Airco."[10]

The theory upon which the Tax Court expunged the deficiencies apparently was that since the Southern Pacific Co. case was not expressly overruled by Moline Properties, the "business purpose" rule laid down in the latter is not absolute, but that the corporate entity may be disregarded (or the corporation treated as an agent of its owner) for tax purposes when the facts of ownership and control of the corporation approximate those presented by the Southern

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[7] The case other than Southern Pacific relied upon by the Tax Court was *Munson Steamship Co.* v. *Commissioner*, 77 Fed. (2d) 849. That case was explained in *Moline Properties, Inc.*, v. *Commissioner, supra*, as depending upon a particular legislative purpose which justified disregarding the separate entity.

[8] Plaintiff's Exhibit P, No. 452, October Term 1917, is an income tax statement of the subsidiary, Central Pacific Co., showing payment of income taxes on $3,333,846.18, its total net income for 1913 less one-sixth (i. e., making an allowance for the 2 months before the income tax law went into effect March 1).

[9] 319 U. S. at 440–441.

[10] 8 T. C. 594, 611. After enumerating the facts considered pertinent, the court concluded: "It is true, of course, that taken separately some of the foregoing facts would not be sufficient in themselves to make inoperative the general rule that corporations are separate juristic persons and are to be so treated for tax purposes. We think, however, that when all these facts are viewed together they bring petitioners within the rule announced by the Supreme Court in *Southern Pacific Co.* v. *Lowe, supra.*" Id. at 614.

It should be added that the court of appeals, whose opinion was written by its chief judge, did not so much as mention the agency argument now made by petitioners. Its only references to agency were isolated quotations from the Tax Court's opinion and the contracts quoted in footnote 1. The court's opinion phrases the question as "when a wholly owned subsidiary of a parent corporation shall be treated for purposes of income taxation as a separate taxable person, and when as merely a part of the corporate activities of the parent." 167 Fed. (2d) 304, 305.

Pacific case. The court of appeals disagreed. It held that under our decisions, when a corporation carries on business activity the fact that the owner retains direction of its affairs down to the minutest detail, provides all of its assets and takes all of its profits can make no difference tax-wise. The court concluded that "Even though *Southern Pacific Co.* v. *Lowe*, *supra*, set up a different test, we regard it as *pro tanto* no longer controlling." [11]

The result reached by the court of appeals is clearly required by our later decisions. Our reluctance to erase Southern Pacific from the books has been due not to any belief that it lays down a correct rule for tax purposes generally, but to the fact that it concerns "very peculiar facts" which make it clearly distinguishable from later cases involving the tax status of a subsidiary or other wholly owned corporation.[12] For that reason, we have, instead, held that it lays down no rule for tax purposes. *Burnet* v. *Commonwealth Improvement Co.*, *supra*, at page 419; *Moline Properties, Inc.*, v. *Commissioner*, *supra*, at page 439. That the concept of identity of the corporation with its owner set out in the Southern Pacific case is incompatible with later decisions of this Court may be demonstrated by a consideration of the facts enumerated and relied upon by the Tax Court, which based such reliance on the emphasis placed upon similar facts in the Southern Pacific case. These facts relate to the ownership, control, and right to income reserved by the parent.

So far as control is concerned, we can see no difference in principle between Airco's control of petitioners and that exercised over Moline Properties, Inc., by its sole stockholder. Undoubtedly the great majority of corporations owned by sole stockholders are "dummies" in the sense that their policies and day-to-day activities are determined not as decisions of the corporation but by their owners acting individually. We can see no significance, therefore, in findings of fact such as, "The Airco Board held regular meetings and exercised complete control over Airco and each of the petitioners," and "The chairman, vice chairman and president of Airco were in charge of the administration and management of the activities of each petitioner and carried out the policies and directives with respect to each petitioner as promulgated by the Airco board." [13] We reversed the Board of Tax Appeals in Moline Properties in the face of its finding that "Full beneficial ownership was in Thompson [the sole stockholder], who continued to manage and regard the property as his own individually." [14]

Some stress was placed by the Tax Court, and by petitioners in argument here, upon the form of ownership of assets adopted by Airco and its subsidiaries. Petitioners' capital stock was, as has been stated, nominal in amount. Assets of considerable value, to which title was held by the subsidiaries, were balanced by accounts payable to Airco on the books of each. The Tax Court thought it material that "All assets held by petitioner were furnished to it by Airco, which paid for them with its own cash or stock. Airco supplied all the working capital of each petitioner."

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[11] Id. at 307.

[12] Two basic distinctions between the Southern Pacific case and subsequent cases (except *Gulf Oil Co.* v. *Lewellyn*, 248 U. S. 71 (1918), which followed Southern Pacific) are immediately apparent. First, the Southern Pacific case involved taxation of the parent-owner rather than the subsidiary corporation; second, the question was *when* the income had been earned, rather than *who* had earned it. The importance of these distinctions is indicated by the fact that the subsidiary paid income taxes upon income received subsequent to March 1, 1913 (see footnote 8, *supra*), and that the parent did not dispute its tax liability for dividends from post-1913 earnings of the subsidiary. The decision is based on an interpretation of the Income Tax Act of 1913. The court felt that it was not the intent of the Act to tax earnings prior to the effective date of the Act, and that the Central Pacific's pre-1913 income had actually accrued to the parent before the effetive date of the Act. The opinion states that "The case turns upon its very peculiar facts, and is distinguishable from others in which the question of the identity of a controlling stockholder with his corporation has been raised." 247 U. S. at 338–339. By its very terms, the decision is limited to its precise facts.

[13] Much of the testimony introduced by petitioners had to do with the intercorporate relationship between Airco and its subsidiaries, the use of certain facilities by two or more of the subsidiaries, the duties of various officers who held positions with Airco and its subsidiaries, and the services performed for all of the subsidiaries by certain departments of Airco. So far as this testimony shows the integration of the corporate system and its direction by Airco, it is, as we have indicated, immaterial. So far as it indicates that the subsidiaries received the use of equipment and services for which they were not charged, it is relevant as showing that their income was distorted to that extent, but it does not indicate that the income received "belonged" to Airco at the time of its receipt. The Commissioner made allowance for this distortion by allocating over $400,000 of the expenses reported by Airco to petitioners under the authority given him by section 45 of the Revenue Act of 1938, 26 U. S. C. section 45.

[14] 45 B. T. A. 647, 650.

If Airco had supplied assets to its subsidiaries in return for stock valued at amounts equal to the value of the assets, no question could be raised as to the reality of ownership of the assets by the subsidiaries. Airco would then have been in a position comparable, so far as ownership of the assets of petitioners is concerned, to that of the sole stockholder in Moline Properties. We think that it can make no difference that financing of the subsidiaries was carried out by means of book indebtednesses in lieu of increased book value of the subsidiaries' stock. A corporation must derive its funds from three sources: capital contributions, loans, and profits from operations. The fact that Airco, the sole stockholder, preferred to supply funds to its subsidiaries primarily by the second method, rather than either of the other two,[15] does not make the income earned by their utilization income to Airco. We need not decide whether the funds supplied to petitioners by Airco were capital contributions rather than loans. It is sufficient to say that the very factors which, as petitioners contend, show that Airco "supplied" and "furnished" their assets also indicate that petitioners were the recipients of capital contributions rather than loans.[16]

Nor do the contracts between Airco and petitioners by which the latter agreed to pay all profits above a nominal return to the former, on that account, become "agency" contracts within the meaning of our decisions. The Tax Court felt that the fact that Airco was entitled to the profits by contract shows that the income "belonged to Airco" and should not, for that reason, be taxed to petitioners. Our decisions requiring that income be taxed to those who earn it, despite anticipatory agreements designed to prevent vesting of the income in the earners, foreclose this result. *Lucas* v. *Earl*, 281 U. S. 111 (1930); *Helvering* v. *Clifford*, 309 U. S. 331 (1940) [Ct. D. 1444, C. B. 1940-1, 105]; *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44 (1942) [Ct. D. 1540, C. B. 1942-1, 196]; *Commissioner* v. *Sunnen*, 333 U. S. 591 (1948) [Ct. D. 1698, C. B. 1948-1, 7]. Of course one of the duties of a collection agent is to transmit the money he receives to his principal according to their agreement.[17] But the fact that petitioners were required by contract to turn over the money received by them to Airco, after deducting expenses and nominal profits, is no sure indication that they were mere collection agents. Such an agreement is entirely consistent with the corporation-sole stockholder relationship whether or not any agency exists, and with other relationships as well.[18]

What we have said does not foreclose a true corporate agent or trustee from handling the property and income of its owner-principal without being taxable therefor. Whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money received to the principal, and whether receipt of income is attributable to the services

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[15] As a practical matter, a considerable part of the assets of petitioners was supplied out of profits from their operations. Even though assets were purchased directly out of the earnings of a subsidiary, however, the amount withdrawn was entered in the accounts payable by the subsidiary and in the accounts receivable of Airco, since substantially all profits of the subsidiaries were, by contract, payable only to the parent.

[16] Since petitioners were required to pay all profits except very small amounts to Airco each year, it was obviously impossible for them to pay the accounts payable to Airco. See note 15. Mr. C. E. Adams, chairman of Air Reduction Corp., testified that the assets of the subsidiaries represented by the accounts payable could be realized by Airco only upon dissolution of the subsidiaries. In other words, there was never any expectation that the accounts would be paid prior to dissolution. Since no interest ran on these accounts, the "loans" were identical, except in name, with contributions of capital. See *American Cigar Co.* v. *Commissioner*, 66 Fed. (2d) 425 [Ct. D. 824, C. B. XIII-1, 260 (1933)]; *Hoyt* v. *Commissioner*, 145 Fed. (2) 634; *Van Clief* v. *Helvering*, 135 Fed. (2d) 254; *Reading Co.* v. *Commissioner*, 132 Fed. (2d) 306. Levy and Simonds, Stockholder Advances to Corporations * * * Are They Loans or Capital Contributions? 25 Taxes 127, 128, state that "intention to lend and expectation of repayment are necessary to the existence of a valid debt." The fact that no interest ran on these "loans" is, of course, further indication that they are capital contributions. *Barry Motor Car Co.*, B. T. A. Memo. Op. Dkt. 99963, January 25, 1941.

Title to gas cylinders used by petitioners, amounting in value to about $13,000,000, was retained by Airco, but the cylinders were used by the subsidiaries without charge. Whether these, too, were capital contributions we find it unnecessary to decide in this case. Free use of the cylinders by petitioners, if they were merely on loan, may have distorted the subsidiaries' income beyond the allocations made by the Commissioner, but that problem is not before us.

[17] Restatement of Agency, section 427.

[18] In *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44 (1942), a lessee railroad agreed to pay rental payments to the lessor's stockholders directly. The lessor thereafter carried on no active business. It was nevertheless held taxable on the income received by its stockholders, since they received the payments only because they held its stock.

of employees of the principal and to assets belonging to the principal[19] are some of the relevant considerations in determining whether a true agency exists. If the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case. Its business purpose must be the carrying on of the normal duties of an agent.[20] Absence of the factors mentioned above, and the essentiality of ownership of the corporation to the existence of any "agency" relationship in the Moline Properties, Commonwealth Improvement Co., and Southern Pacific cases indicates the fallacy of the agency argument made in those cases.

The same fallacy is apparent in the contention that petitioners are agents of Airco. They claim that they should be taxable on net income aggregating only $1,350, despite the fact that during the tax year (1938) they owned assets worth nearly 20 million dollars, had net sales of approximately 22 million dollars, and earned nearly 4½ million dollars net. Their employees number in the thousands. We have passed the question whether Airco's interest in these assets is that of owner of the subsidiaries or lender, but whatever the answer, they do not belong to Airco as principal. The entire earnings of petitioners, except for trifling amounts, are turned over to Airco not because the latter could command this income if petitioners were owned by third persons, but because it owns, and thus completely dominates the subsidiaries. Airco, for sufficient reasons of its own, wished to avoid the burdens of principalship.[21] See *Moline Properties, Inc.*, v. *Commissioner, supra; Sheldon Building Corp.* v. *Commissioner*, 118 Fed. (2d) 835 (1941). Compare *Forshay* v. *Commissioner*, 20 B. T. A. 537 (1930). It cannot now escape the tax consequences of that choice, no matter how bona fide its motives or long standing its arrangements. When we referred to the "usual incidents of the agency relation" in the Moline Properties case, we meant just that—not the identity of ownership and control disclosed by the facts of this case.

We have considered the other arguments made by petitioners and find them to be without merit. The judgment of the court of appeals is

Affirmed.

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[19] ART. 22(a)-1 of Treasury Regulations 101, promulgated under the Revenue Act of 1938, provides:

"ART. 22(a)-1. WHAT INCLUDED IN GROSS INCOME.—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22(b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets * * *" See *Eisner* v. *Macomber*, 252 U. S. 189, 207 (1920) [T. D. 3010, C. B. 3, 25 (1920)]; *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 519 (1921) [T. D. 3173 (Ct. D. 6), C. B. 4, 34 (1921)].

In the case of a subsidiary who supplies the labor and the capital with which the income is earned, as is true of petitioners here, it can hardly be contended that it did not earn the income.

[20] Of course even a corporation which satisfies the usual tests of agency may be disregarded by the Commissioner if it is a sham or unreal. *Higgins* v. *Smith*, 308 U. S. 473 (1940) [Ct. D. 1434, C. B. 1940-1, 127]; *Gregory* v. *Helvering*, 293 U. S. 465 (1935) [Ct. D. 911, C. B. XIV-1, 193 (1935)]. Escaping taxation is not a "business" activity. See *National Investors Corp.* v. *Hoey*, 144 Fed. (2d) 466.

[21] The two main purposes for the adoption by Airco of the corporate subsidiary method of operation, as related by Mr. C. E. Adams, chairman of Air Reduction Corp., were these:

"Frankly, in 1918 and still, Air Reduction, Inc., was and is a New York corporation. Even at that early date it became evident, as I already said, we were going to have plants scattered all over the United States. We didn't want to domicile the parent company in 48 States of the Union and have us subject to service in all those States, that is, have the parent company subject to service in all those States, and that was distinctly a reason for using this corporate setup in connection with operations to be run as divisions, just as the contract sets forth.

"Now, in addition to that, as a practical matter, out in the field and on the firing line, to have a representative, an officer, we will say, of Pure Carbonic, when trouble arises with a customer, a vice president of Pure Carbonic, who is not an officer of Air Reduction, Inc., at all, who goes in and straightens that out with that customer, increases his cudos, helps him with all his negotiating efforts, with their competitors on the outside."

It is thus apparent that Airco was attempting to avoid the status of principal vis-à-vis its subsidiaries. As principal it would have been subject to service of process through its agents; as owner of the subsidiary it was not. See *Peterson* v. *Chicago, R. I. & P. R. Co.*, 205 U. S. 364, 391 (1907); *Cannon Mfg. Co.* v. *Cudahy Co.*, 267 U. S. 333 (1925). The purpose of having officers of subsidiaries who could deal directly with customers does not indicate an agency relationship. On the contrary, the very purpose of the organization adopted was to lead customers to believe that they were dealing with top men in the company actually manufacturing and selling the products they purchased.

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

ARTICLE 22(a)–14, REGULATIONS 101: Cancellation of indebtedness.

REVENUE ACT OF 1938

Purchase by an individual of his own obligations at a discount. (See Ct. D. 1712, page 40.)

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

ARTICLE 23(m)–1, REGULATIONS 101: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.

REVENUE ACTS OF 1936 AND 1938

Assignor's depletion allowance based on net profits from oil and gas property. (See Ct. D. 1720, page 67.)

SUBTITLE C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT B.—COMPUTATION OF NET INCOME

SECTION 115.—DISTRIBUTIONS BY CORPORATIONS

ARTICLE 115–11, REGULATIONS 94: Effect on earnings or profits of certain tax-free exchanges and tax-free distributions.

1949–9–13075
Ct. D. 1717

INCOME TAX—REVENUE ACT OF 1936—DECISION OF SUPREME COURT

1. TAX-FREE REORGANIZATION—LIQUIDATION OF SUBSIDIARIES BY PARENT CORPORATION—DISTRIBUTION OF EARNINGS AND PROFITS—EARNINGS AND PROFITS OF PARENT NOT REDUCED BY NET DEFICIT OF SUBSIDIARIES—SANSOME RULE.

At the time of a tax-free liquidation by a parent corporation of some of its subsidiaries in 1936, the parent had accumulated earnings and profits available for distribution as dividends, and the subsidiaries had an aggregate net deficit. During 1937 respondent received from the parent her share of a *pro rata* cash distribution to preferred stockholders. *Held:* The distribution was taxable as a dividend under section 115 of the Revenue Act of 1936, and constituted ordinary income. The deficit of a subsidiary does not reduce earnings of the parent for dividend purposes after a tax-free liquidation. The Sansome rule (60 Fed. (2d) 931 [Ct. D. 607, C. B. XI–2, 175 (1932)]) is grounded not on a theory of continuity of the corporate enterprise but on the necessity to prevent escape of earnings and profits from taxation.

2. DECISION REVERSED.

Decision of the United States Court of Appeals, Tenth Circuit (167 Fed. (2d) 117), reversed.

SUPREME COURT OF THE UNITED STATES

Commissioner of Internal Revenue, petitioner, v. *Margaret R. Phipps*

On writ of certiorari to the United States Court of Appeals for the Tenth Circuit

[March 14, 1949]

OPINION

Mr. Justice MURPHY delivered the opinion of the Court.

This case involves a tax-free liquidation by a parent corporation of some of its subsidiaries. At the time of the liquidation the parent had earnings and profits available for distribution, and the subsidiaries had an aggregate net deficit. The issue now before us is whether the rule of *Commissioner* v. *Sansome*, 60 Fed. (2d) 931 [Ct. D. 607, C. B. XI–2, 175 (1932)], requires the subtraction of the subsidiaries' deficit from the parent's earnings and profits, in determining whether a subsequent distribution by the parent constituted dividends or a return of capital to its stockholders.

The Sansome case, *supra*, arose from a tax-free reorganization in which the transferor corporation had a surplus in earnings and profits available for distribution. It was there held that those earnings and profits, for purposes of a subsequent distribution by the transferee corporation to its stockholders, retain their status as earnings or profits and are taxable to the recipients as dividends. The rule has been held to include liquidations of a subsidiary by its parent. *Robinette* v. *Commissioner*, 148 Fed. (2d) 513; U. S. Treas. Reg. 101, art. 115–11, promulgated under the Revenue Act of 1938 and made retroactive.

The facts were stipulated, and so found by the Tax Court. So far as relevant, they are as follows: In December, 1936, Nevada-California Electric Corp. liquidated five of its wholly owned subsidiaries by distributing to itself all of their assets, subject to their liabilities, and by redeeming and canceling all of their outstanding stock. No gain or loss on the liquidation was recognized for income tax purposes under section 112(b)(6) of the Revenue Act of 1936.[1] On the date of liquidation, one of the subsidiaries had earnings and profits accumulated after February 28, 1913, in the amount of $90,362.77. The four others had deficits which aggregated $3,147,803.62. On December 31, 1936, the parent had earnings and profits accumulated after February 28, 1913, in the amount of $2,129,957.81, which amount does not reflect the earnings or deficits of the subsidiaries. In 1937, Nevada-California had earnings of $390,387.02. In the years 1918 to 1933 inclusive the parent and its subsidiaries filed consolidated income tax returns.[2]

Respondent was the owner of 2,640 shares of the preferred stock of Nevada-California. During 1937 that corporation made a *pro rata* cash distribution to its preferred stockholders in the amount of $802,284, of which respondent received $18,480. The Commissioner determined that the distribution was a dividend under section 115 of the Revenue Act of 1936[3] and constituted ordinary income in its entirety.

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[1] "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.—

"(6) PROPERTY RECEIVED BY CORPORATION ON COMPLETE LIQUIDATION OF ANOTHER.—No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation * * *"

[2] It does not appear in what years occurred the subsidiaries' losses which resulted in their deficits, or to what extent they were set off against the net income of the parent in consolidated return years. To the extent that such set-offs did exist, the basis of the subsidiaries' stock to Nevada-California had been reduced and the losses realized by the parent and availed of for tax purposes prior to the liquidation. U. S. Treas. Reg. 94, art 113(b)–1, promulgated under the Revenue Act of 1936.

[3] "SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

"(a) DEFINITION OF DIVIDEND.—The term 'dividend' when used in this title (except in section 203(a)(3) and section 207(c)(1), relating to insurance companies) 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 (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 the earnings and profits at the time the distribution was made.

"(b) SOURCE OF DISTRIBUTIONS.—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113."

Of the 1937 distribution, approximately 49 percent was chargeable to earnings and profits of the taxable year. Consequently, respondent conceded in the Tax Court that that percentage of her share, or about nine thousand dollars, was taxable as a dividend under section 115(a)(2). The Tax Court held in her favor that the balance was not a taxable dividend out of earnings and profits, on the theory that all of Nevada-California's accumulated earnings and profits, plus the accumulated earnings and profits of the subsidiary that had a surplus, were erased by the aggregate deficits of the other four subsidiaries.[4] 8 T. C. 190. The court of appeals affirmed by a divided court, 167 Fed. (2d) 117. We brought the case here on a writ of certiorari, 335 U. S. 807, because of its importance in the administration of the revenue laws, and because of an alleged conflict of the decision below with that of the Court of Appeals for the Ninth Circuit in *Cranson* v. *United States*, 146 Fed. (2d) 871.

Commissioner v. *Sansome*, 60 Fed. (2d) 931, arose thus: A Corporation sold out all its assets to B Corporation, both organized under the laws of New Jersey. B Corporation assumed all liabilities and issued its stock to the stockholders of A Corporation, without change in the proportions of their holdings. The only change was that the charter of B Corporation gave it slightly broader powers. At the time of the reorganization, A Corporation had on its books a large surplus and undivided profits. The new corporation made no profit and the company soon dissolved. The liquidating distributions in 1923, the year when the dissolution was begun, did not exhaust the amount of accumulated profits of the predecessor corporation, and the Commissioner contended that those distributions were taxable to the stockholders as dividends and not, as claimed by them, as a return of capital. The Court of Appeals for the Second Circuit agreed with the Commissioner, and held that since the reorganization was nontaxable under section 202(c)(2) of the Revenue Act of 1921, the accumulated earnings and profits of the transferor retained their character as such for tax purposes in the hands of the transferee and were consequently taxable on distribution as ordinary income under section 201 of the same Act.[5] The view of the court was thus expressed by Judge Learned Hand: "Hence we hold that a corporate reorganization which results in no 'gain or loss' under section 202(c)(2) (42 Stat. 230) does not toll the company's life as continued venture under section 201, and that what were 'earnings or profits' of the original, or subsidiary, company remain, for purposes of distribution, 'earnings or profits' of the successor, or parent, in liquidation." 60 Fed. (2d) 931, 933. The rule has been consistently followed judicially[6] and has received explicit congressional approval.[7]

The rationale of the Sansome decision as a "continued venture" doctrine has been often repeated in the cases, and in some of them the fact that the successor corporation has differed from the predecessor merely in identity or form[8] has lent it plausibility. Other cases, however, demonstrate that the "continued venture" analysis does not accurately indicate the basis of the decisions. The

[4] Respondent agrees that the earnings and profits of the subsidiary with a surplus become, by virtue of the Sansome rule, earnings and profits of the parent, whatever the ultimate treatment of the deficits of the other subsidiaries.

[5] Section 201 of the 1921 Act specifies what corporate distributions are taxable as dividends; section 202(c)(2) provides for the nonrecognition of gain or loss from certain corporate reorganizations.

[6] *Commissioner* v. *Munter*, 331 U. S. 210 [Ct. D. 1685, C. B. 1947–1, 48]; *United States* v. *Kauffmann*, 62 Fed. (2d) 1045; *Murchison's Estate* v. *Commissioner*, 76 Fed. (2d) 641; *Harter* v. *Helvering*, 79 Fed. (2d) 12; *Georday Enterprises, Ltd.*, v. *Commissioner*, 126 Fed. (2d) 384; *Reed Drug Co.* v. *Commissioner*, 130 Fed. (2d) 288; *Robinette* v. *Commissioner*, 148 Fed. (2d) 513; *Putnam* v. *Commissioner*, 149 Fed. (2d) 721. See also *Coudon* v. *Tait*, 61 Fed. (2d) 904, which was decided a few months after Sansome and reached the same result independently.

[7] The Senate Finance Committee Report on section 115(h) of the Revenue Act of 1936, S. Rept. No. 2156, 74th Cong., 2d sess., p. 19 (C. B. 1939–1 (Part 2), 678, 690), recognized the rule of the Sansome case, and said that the amendment made by that Act intended no change in existing law, but was added only in the interest of clarity. U. S. Treas. Reg. 94, art. 115–11, promulgated under the 1936 Act, incorporates the substance of the report. The Revenue Act of 1938 amended section 115(h) only by extending its application to distributions of "property or money" as well as of "stock or securities"; the effect was to make section 115(h) harmonize with section 112(b) (6) and (7); and Regulations 101, promulgated under the 1938 Act, was amended to conform. The Internal Revenue Code contains the section substantially unchanged.

Section 501 of the Second Revenue Act of 1940 added section 115(l) to the Internal Revenue Code, to elaborate the law with regard to the effect of tax-free distributions on earnings and profits. The reports accompanying the bill in Congress, H. R. Rept. No. 2894, 76th Cong., 3d sess., p. 41 (C. B. 1940–2, 496, 526), and S. Rept. No. 2114, 76th Cong., 3d sess., p. 25 (C. B. 1940–2, 528, 546–547), both recognize the application of "the principle under which the earnings and profits of the transferor become the earnings and profits of the transferee." Ibid., p. 25. The reports do not mention deficits.

[8] See, e. g., *Murchison's Estate* v. *Commissioner*, *Reed Drug Co.* v. *Commissioner*, *United States* v. *Kauffmann*, all *supra*, n. 6.

rule that earnings and profits of a corporation do not lose their character as such by virtue of a tax-free reorganization or liquidation has been applied where more than one corporation has been absorbed or liquidated,[9] where there has been a "split-off" reorganization,[10] and where the reorganization has resulted in substantial changes in the proprietary interests.[11]

In *Commissioner* v. *Munter*, 331 U. S. 210, this Court reversed a decision of the Court of Appeals for the Third Circuit which had held in favor of the taxpayer on the ground that the ownership of the successor corporation was so different from that of the two predecessors that there was not sufficient continuity of the corporate entity to apply the Sansome doctrine. The opinion of the Court stated our unanimous view of the basis of the rule: "A basic principle of the income tax laws has long been that corporate earnings and profits should be taxed when they are distributed to the stockholders who own the distributing corporation. * * * Thus unless those earnings and profits accumulated by the predecessor corporations and undistributed in this reorganization are deemed to have been acquired by the successor corporation and taxable upon distribution by it, they would escape the taxation which Congress intended. * * * The congressional purpose to tax all stockholders who receive distributions of corporate earnings and profits cannot be frustrated by any reorganization which leaves earnings and profits undistributed in whole or in part." 331 U. S. at 214, 215. See *Murchison's Estate* v. *Commissioner*, 76 Fed. (2d) 641, 642; *Putnam* v. *United States*, 149 Fed. (2d) 721, 726; *Samuel L. Slover*, 6 T. C. 884, 886. We conclude from the cases that the Sansome rule is grounded not on a theory of continuity of the corporate enterprise but on the necessity to prevent escape of earnings and profits from taxation.

The decision of the Court of Appeals for the Second Circuit in *Harter* v. *Helvering*, 79 Fed. (2d) 12, is not inconsistent with this view. In that case the situation was as follows: A Corporation and B Corporation, each of which had accumulated earnings and profits merged to form C Corporation. By the operation of the Sansome rule, the earnings and profits retained their character as such in the hands of C. Sometime later, D Corporation acquired all the stock of C, and thereafter liquidated it in a transaction in which no gain or loss was recognized. At the time of the liquidation of C Corporation, D Corporation, the parent, had a deficit in earnings and profits. The court held, in determining the amount of earnings and profits available to D Corporation after the liquidation for distribution as dividends, that its deficit should be deducted from the accumulated earnings and profits acquired from its subsidiary. It is vigorously contended that the logic of the Harter case compels the allowance of a deduction of the deficits of the subsidiaries from the accumulated earnings and profits of the parent. We believe this view to be the product of inadequate analysis.[12] The difference between the Harter situation and the problem before us may perhaps be clarified by comparing them taxwise if neither liquidation had occurred. Briefly stated, in the case of a distribution to a corporation with a deficit from either current or prior losses, the corporation receiving the distribution has no taxable income or earnings or profits available for current distribution until current income exceeds current losses, and no accumulated earnings or profits until its actual deficit from prior losses is erased. See 1 Mertens, Law of Federal Income Taxation, section 9.30, and cases cited therein n. 44 et seq. In the instant situation, however, the parent did have accumulated earnings and profits available for distribution as dividends, absent the liquidation. Congressional intent to tax such earnings and profits on their distribution cannot be prevented by the fact of an intervening reorganization or liquidation.[13]

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[9] *Harter* v. *Helvering*, *Baker* v. *Commissioner*, *supra*, n. 6.

[10] *Barnes* v. *United States*, 22 Fed. Supp. 282 [Ct. D. 1332, C. B. 1938-1, 240]; *Estate of McClintic*, 47 B. T. A. 188; *Stella K. Mandel*, 5 T. C. 684.

[11] *Commissioner* v. *Munter*, *supra*, n. 6.

[12] See note, The Effect of Tax-Free Reorganizations on Subsequent Corporate Distributions, 48 Col. L. Rev. 281; Atlas, The Case of the Disappearing Earnings and Profits, in Seventh Annual Institute of Federal Taxation, 1155; cf. 1 Mertens, Law of Federal Income Taxation, section 9.58 (1942); 1 Montgomery, Federal Taxes—Corporations and Partnerships 1948-49, 154 (1948); Green, Recent Trends Under the Sansome Rule, in Sixth Annual Institute on Federal Taxation, 338; cf. Rudick, "Dividends" and "Earnings or Profits" Under the Income Tax Law: Corporate Non-Liquidating Distributions, 89 U. Pa. L. Rev. 865, 896.

[13] *Senior Investment Co.*, 2 T. C. 124, did not involve the question before us, but was concerned with the applicability, for purposes of computing surtax on undistributed profits, of sections 26(c)(1) and 26(c)(3) of the Revenue Act of 1936, the latter as amended by section 501(a)(2) of the Revenue Act of 1942, to the transferor corporation in a tax-free reorganization. The question of "inheritance" of a deficit was not in issue. See Green, *supra*, note 12, at 341.

The operation of the Sansome rule on the taxation of corporate distributions is brought into high relief by consideration of the economic relation between a parent corporation and its subsidiary. Congress requires that earnings and profits, current or accumulated, be taxed to the recipients thereof as dividends on their distribution.[14] If a subsidiary has a surplus in earnings and profits, the parent has a choice of two methods by which it may "realize" this surplus. It may cause the subsidiary to declare a dividend, or it may liquidate its interest or part of its interest in the subsidiary. In the former case, the distribution would of course be taxable as ordinary income to the parent insofar as that distribution, plus the parent's other income, represented net income to it. If the parent uses the second method, two alternatives again are available: the liquidation may take the form of a sale outright, or may be performed within the framework of the reorganization sections of the Internal Revenue Code or its predecessor acts. If the former, gain is of course realized, and is also recognized for tax purposes. We note in passing, in this connection, that such gain will correspond, if at all, only by coincidence with the amount of earnings and profits of the subsidiary. If the latter, Congress has determined that the gain shall not be recognized at that time, but that such recognition shall be deferred. If the subsidiary has a deficit in earnings and profits, the deficit may be "realized" by the parent only by liquidation, and the same two alternatives are present as when the subsidiary has a surplus: sale, and reorganization within section 112. Again, in the former case, loss is realized and also recognized. And in the case of a reorganization or liquidation in the framework of the Code, the recognition of loss is deferred by congressional mandate to a later time.

If the assets of the parent and subsidiary are combined via a tax-free reorganization or liquidation, the effect of the Sansome rule is simply this: a distribution of assets that would have been taxable as dividends absent the reorganization or liquidation does not lose that character by virtue of the tax-free transaction. Respondent's contention that the logic of the Sansome rule requires subtracting the deficit of the subsidiary from the earnings and profits of the parent as a corollary of carrying over the earnings and profits of the subsidiary has a superficial plausibility; but the plausibility disappears when it is noted that the taxpayer thus attempts to obtain an advantage taxwise that would not be available absent the liquidation, since there is no way to "declare" a deficit, and thus no method of loss realization open to the parent parallel to a declaration of dividends as a mode of realizing the profits of a subsidiary.

It is urged upon us that the deficits of the subsidiaries should be subtracted from the earnings and profits of the parent in order to make the tax consequences of the liquidation correspond with corporate accounting practice. The answer is brief. The Sansome rule itself, as applied to earnings and profits, has never been thought to be controlled by ordinary corporate accounting concepts; its uniform effect is to treat for tax purposes as earnings or profits assets which are properly considered capital for many if not most corporate purposes, and it has long been a commonplace of tax law that similar divergences often occur. See *Commissioner* v. *Wheeler*, 324 U. S. 542, 546 [Ct. D. 1637, C. B. 1945, 349]; *Putnam* v. *United States*, 149 Fed. (2d) 721, 726; 1 Mertens, *op. cit.* section 9.33; Rudick, *op. cit.* 878-906.[15]

Congress has expressed its purpose to tax all stockholders who receive distributions of earnings and profits. In order to facilitate simplification of corporate financial structures, it has further provided that certain intercorporate transactions shall be free of immediate tax consequences to the corporations. There has been judicially superimposed by the Sansome rule, with the subsequent explicit ratification of Congress, the doctrine that tax-free reorganizations shall not disturb the status of earnings and profits otherwise available for distribution.

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[14] The operation of the Sansome rule is restricted, of course, to earnings and profits which are not considered to be distributed to its own stockholders by the transferor corporation in a tax-free reorganization. *Commissioner* v. *Munter*, 331 U. S. 210, 215-16; *Samuel L. Slover*, 6 T. C. 884. Cf. U. S. Treas. Reg. 111, art. 29.112(b)(6)-4 as to the effect of a tax-free reorganization on minority stockholders of the transferor corporation.

[15] Respondent's brief sets out several hypothetical examples of reorganizations to demonstrate the validity of her contention. Her argument fails to take into account the difference between the concept of surplus or deficit, which is a summary of the operations of the corporation reporting it, and the concept of gain or loss, which reports the effect of the tax-free transaction itself. So various are the possible permutations and combinations of the economic factors that equivalence of surplus or deficit in the accounts of the subsidiary with the gain or loss to the parent would be mere coincidence. Consider for example the case where a corporation acquires all the stock of another which at the time has a large deficit. If the subsidiary is soon liquidated, the deficit will still be large, and the parent may realize little or no loss on the liquidation. See the first two texts cited note 12, *supra*.

Nevada-California at the time of the 1937 distribution to respondent had such earnings and profits. Since we believe that to allow deduction from these earnings of the deficits of its subsidiaries would be in effect to recognize losses the tax effects of which Congress has explicitly provided should be deferred, the judgment of the court of appeals is reversed.

Reversed.

Mr. Justice DOUGLAS concurs in the result.

SUPPLEMENT H.—NONRESIDENT ALIEN INDIVIDUALS

SECTION 214(a)(7).—DEDUCTIONS ALLOWED INDIVIDUALS: BAD DEBTS

ARTICLE 155, REGULATIONS 69: Reserve for bad debts.

REVENUE ACT OF 1926

Use of bad debt reserves by dealers in personal property who report sales income on the installment basis; I. T. 2365 (C. B. VI-1, 69 (1927)) modified. (See I. T. 3957, page 65.)

EMPLOYMENT TAX RULINGS

INTERNAL REVENUE CODE

CHAPTER 9, SUBCHAPTER A.—FEDERAL INSURANCE CONTRIBUTIONS ACT

SECTION 1426: Definitions. 1949-9-13076
REGULATIONS 106, SECTION 402.204: Who are employees. Mim. 6381
(Also Subchapter C (Federal Unemployment Tax Act), Section 1607; Regulations 107, Section 403.204; and Social Security Act, Sections 811 and 907; Regulations 91 and 90, Articles 3 and 205.)

Status for Federal employment tax purposes of directors and other individuals performing services on committees of banks.

Mimeograph 5217 (C. B. 1941-2, 220) modified, and S. S. T. 82 (C. B. 1937-1, 372) revoked.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C., March 28, 1949.

Collectors of Internal Revenue and Others Concerned:

1. The Bureau of Internal Revenue has given further consideration to the status under Titles VIII and IX of the Social Security Act, the Federal Insurance Contributions Act, and the Federal Unemployment Tax Act of directors of banks who are appointed to and serve on various committees of banks. The provisions of this mimeograph relating to the status of directors have application only with respect to directors serving on those committees which are created pursuant to a Federal or State statute or corporate bylaws, or pursuant to authority vested in the board of directors.

2. Section 402.204 of Regulations 106 and section 403.204 of Regulations 107, issued pursuant to the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively, provide that a director of a corporation, *as such*, is not an employee of the corporation. These sections further provide that a director who performs services for the corporation other than those required by attendance at and participation in meetings of the board of directors may be an employee of the corporation. Regulations 91 and 90, issued pursuant to Titles VIII and IX, respectively, of the Social Security Act, contain similar provisions. The regulations, however, do not provide that a director is under all circumstances an employee with respect to services performed other than by attendance at and participation in meetings of the full board of directors, but rather leave open for consideration in each case the question of whether such other services are performed under an employer-employee relationship.

3. Where a committee of the type to which this mimeograph relates is comprised entirely of directors, it is presumed that each member of the committee is acting in his capacity as a director, *as such*, within

the meaning of Regulations 106 and 107, *supra*, and therefore is not an employee for Federal employment tax purposes. Where the membership of a committee of the type here involved consists primarily of directors but includes one or more individuals who are not directors and the manner of operation of such committee does not differ materially from that usually present in cases involving committees composed solely of directors, each director appointed to and serving on such committee is deemed to be acting in his capacity as a director, *as such*, and accordingly should not be treated as an employee. With respect to those committee members who are not directors there is a presumption that the relationship of employer and employee exists between the bank and such individuals and in accordance with the presumption they must be treated as employees unless and until the employer is advised in writing by the collector of internal revenue or the Commissioner that on the basis of evidence submitted it has been determined that the presumption has been rebutted.

4. The position of the Bureau as set forth in Mimeograph 5217 (C. B. 1941–2, 220), dated July 15, 1941, holding that directors of banks performing services on various committees of the banks are employees thereof for social security and employment tax purposes, is modified to the extent of its inconsistency with the foregoing. In view of the promulgation of this mimeograph the ruling published as S. S. T. 82 (C. B. 1937–1, 372) is revoked.

5. This mimeograph is to be applied with retroactive effect, subject to the applicable statute of limitations.

6. Correspondence in regard to the contents of this mimeograph should refer to its number and to the symbols EmT : RR.

Geo. J. Schoeneman,
Commissioner.

CHAPTER 9, SUBCHAPTER C.—FEDERAL UNEMPLOYMENT TAX ACT

Section 1607: Definitions.
Regulations 107, Section 403.204: Who are employees.

Directors and other individuals performing services on committees of banks. (See Mim. 6381, page 179.)

TAXES UNDER SOCIAL SECURITY ACT

TITLE VIII.—TAXES WITH RESPECT TO EMPLOYMENT

Section 811: Definitions.
Regulations 91, Article 3: Who are employees.

Directors and other individuals performing services on committees of banks. (See Mim. 6381, page 179.)

TITLE IX.—TAX ON EMPLOYERS OF EIGHT OR MORE

Section 907: Definitions.
Regulations 90, Article 205: Employed individuals.

Directors and other individuals performing services on committees of banks. (See Mim. 6381, page 179.)

MISCELLANEOUS TAX RULINGS

ESTATE TAX

INTERNAL REVENUE CODE

REGULATIONS 105, SECTIONS 81.2, ETC. 1949–12–13103
T. D. 5699

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 81.—ESTATE TAX UNDER CHAPTER 3 OF THE INTERNAL REVENUE CODE, AS AMENDED

Regulations 105 amended to conform to the Revenue Act of 1948 [C. B. 1948–1, 211], and to Public Law 869, Eightieth Congress [C. B. 1948–2, 323].

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

To Collectors of Internal Revenue and Others Concerned:

On November 6, 1948, notice of proposed rule making, regarding the estate tax provisions of the Revenue Act of 1948 [C. B. 1948–1, 211], enacted April 2, 1948, and Public Law 869, Eightieth Congress [C. B. 1948–2, 323], approved July 1, 1948, was published in the Federal Register (13 F. R. 6564). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendments to Regulations 105 [26 CFR, Part 81] set forth below are hereby adopted. Such amendments are necessary in order to conform such regulations to the Revenue Act of 1948 and Public law 869, Eightieth Congress.

PARAGRAPH 1. Section 81.2, as amended by Treasury Decision 5239 [C. B. 1943, 1081], approved March 10, 1943 [26 CFR 81.2], is further amended by striking out the next to the last sentence.

PAR. 2. There is inserted immediately preceding section 81.8 [26 CFR 81.8] the following:

SEC. 363. CREDIT FOR GIFT TAX. (REVENUE ACT OF 1948; ENACTED APRIL 2, 1948.)

(a) Section 813(a)(2)(A) of the Internal Revenue Code (relating to credit for gift tax) is hereby amended by inserting before the period at the end thereof the following: "reduced by the aggregate amount of the deductions allowed under subsections (d) and (e) of section 812."

(b) Subparagraph (B) of section 813(a)(2) of the Internal Revenue Code (relating to credit for gift tax) is hereby amended to read as follows:

"(B) In applying, with respect to any gift, the ratio stated in subparagraph (A), the value at the time of the gift or at the time of the death, referred to in such ratio, shall be reduced—

"(i) by such amount as will properly reflect the amount of such gift which was excluded in determining (for the purposes of section 1003(a), or of section 504(a) of the

Revenue Act of 1932) the total amount of gifts made during the year in which the gift was made;

"(ii) if a deduction with respect to such gift is allowed under section 812(e) (the so-called 'marital deduction')—then by an amount which bears the same ratio to such value (reduced as provided in clause (i) of this subparagraph) as the aggregate amount of the marital deductions allowed under section 812(e) bears to the aggregate amount of such marital deductions computed without regard to subparagraph (H) of section 812(e)(1); and

"(iii) if a deduction with respect to such gift is allowed under section 812(d) (the so-called 'charitable deduction')—then by the amount of such value, reduced as provided in clause (i) of this subparagraph.

"(C) Where the decedent was the donor of the gift but, under the provisions of section 1000(f), the gift was considered as made one-half by his spouse—

"(i) the term 'the amount of the tax paid under chapter 4,' as used in subparagraph (A) of this paragraph, includes the amounts paid with respect to each half of such gift, the amount paid with respect to each being computed in the manner provided in subparagraph (D); and

"(ii) in applying, with respect to such gift, the ratio stated in subparagraph (A) of this paragraph, the value at the time of the gift or at the time of the death, referred to in such ratio, includes such value with respect to each half of such gift, each such value being reduced as provided in clause (i) of subparagraph (B) of this paragraph.

"(D) (i) For the purposes of subparagraph (A), the amount of tax paid under chapter 4, or under Title III of the Revenue Act of 1932, with respect to any gift shall be an amount which bears the same ratio to the total tax paid for the year in which the gift was made as the amount of such gift bears to the total amount of net gifts (computed without deduction of the specific exemption) for such year.

"(ii) For the purposes of clause (i) the 'amount of such gift' shall be the amount included with respect to such gift in determining (for the purpose of section 1003(a), or of section 504(a) of the Revenue Act of 1932) the total amount of gifts made during such year, reduced by the amount of any deduction allowed with respect to such gift under section 1004(a)(2), or under section 505(a)(2) of the Revenue Act of 1932 (the so-called 'charitable deduction'), or under section 1004(a)(3) (the so-called 'marital deduction')."

(c) Section 936(b)(1) of the Internal Revenue Code (relating to credit for gift tax) is hereby amended by inserting after the words "entire gross estate" in clause (A) thereof the following: "reduced by the aggregate amount of the deductions allowed under subsections (d) and (e) of section 812".

(d) Paragraph (2) of section 936(b) of the Internal Revenue Code (relating to credit for gift tax) is hereby amended to read as follows:

"(2) In applying, with respect to any gift, the ratio stated in clause (A) of paragraph (1), the value at the time of the gift or at the time of the death, referred to in such ratio, shall be reduced—

"(A) by such amount as will properly reflect the amount of such gift which was excluded in determining (for the purposes of section 1003(a), or of section 504(a) of the Revenue Act of 1932) the total amount of gifts made during the year in which the gift was made;

"(B) if a deduction with respect to such gift is allowed under section 812(e) (the so-called 'marital deduction')—then by an amount which bears the same ratio to such value (reduced as provided in subparagraph (A) of this paragraph) as the aggregate amount of the marital deductions allowed under section

812(e) bears to the aggregate amount of such marital deductions computed without regard to subparagraph (H) of section 812(e)(1); and

"(C) if a deduction with respect to such gift is allowed under section 812(d) (the so-called 'charitable deduction')—then by the amount of such value, reduced as provided in subparagraph (A) of this paragraph.

"(3) Where the decedent was the donor of the gift but, under the provisions of section 1000(f), the gift was considered as made one-half by his spouse—

"(A) the term 'the amount of the tax paid under chapter 4,' as used in paragraph (1) of this subsection, includes the amounts paid with respect to each half of such gift, the amount paid with respect to each being computed in the manner provided in paragraph (4); and

"(B) in applying, with respect to such gift, the ratio stated in clause (A) of paragraph (1), the value at the time of the gift or at the time of the death, referred to in such ratio, includes such value with respect to each half of such gift, each such value being reduced as provided in subparagraph (A) of paragraph (2).

"(4) (A) For the purposes of paragraph (1), the amount of tax paid under chapter 4, or under Title III of the Revenue Act of 1932, with respect to any gift shall be an amount which bears the same ratio to the total tax paid for the year in which the gift was made as the amount of such gift bears to the total amount of net gifts (computed without deduction of the specific exemption) for such year.

"(B) For the purposes of subparagraph (A) the 'amount of such gift' shall be the amount included with respect to such gift in determining (for the purposes of section 1003(a), or of section 504(a) of the Revenue Act of 1932) the total amount of gifts made during such year, reduced by the amount of any deduction allowed with respect to such gift under section 1004(a)(2), or under section 505(a)(2) of the Revenue Act of 1932 (the so-called 'charitable deduction'), or under section 1004(a)(3) (the so-called 'marital deduction')."

(e) The amendments made by this section shall be applicable only with respect to the estates of decedents dying after December 31, 1947.

PAR. 3. Section 81.8, as amended by Treasury Decision 5239 [26 CFR 81.8], is further amended to read as follows:

SEC. 81.8. CREDIT FOR GIFT TAX.—(*a*) *Priority of credits.*—If the decedent died after October 21, 1942, the credits authorized against the basic estate tax imposed by section 810 or section 860 are to be deducted in the following order: *First*, the credit for estate, inheritance, legacy, or succession taxes under section 81.9, *second*, the credit for gift tax under paragraph (*b*) of this section, and, *third*, the credit for gift tax under paragraph (*c*) of this section. If the decedent died on or before October 21, 1942, such credits are to be deducted in the following order: *First*, the credit for gift tax under paragraph (*b*) of this section, *second*, the credit for gift tax under paragraph (*c*) of this section, and, *third*, the credit for estate, inheritance, legacy, or succession taxes under section 81.9.

(*b*) *Credit for gift tax paid under Revenue Act of 1924.*—Credit against the basic estate tax imposed by section 810 or section 860 is authorized by section 813(a)(1) for gift tax paid under the Revenue Act of 1924 in respect of property included in the gross estate. If the decedent died on or before October 21, 1942, such credit may not exceed the total amount of the basic estate tax; if the decedent died after such date, such credit may not exceed the amount of such estate tax after deduction of the credit allowed, if any, for estate, inheritance, legacy, or succession taxes paid to any State or Territory, possession of the United States, or the District of Columbia. (See section

81.9.) No credit for gift tax paid under the Revenue Act of 1924 is allowable against the additional estate tax imposed by section 935.

If only a part of the property included for the purpose of the gift tax imposed for a certain calendar year under the Revenue Act of 1924 is also included in the decedent's gross estate for the purpose of the estate tax, the gift tax paid in respect of such part of the property is an amount which bears the same ratio to the total gift tax paid for such calendar year as the value of such part of the property bears to the total amount of gifts included for the purpose of the gift tax imposed for such year. For the purpose of computing this proportion, the values finally determined for the purpose of the gift tax will control.

(c) *Credit for gift tax paid under chapter 4 of the Internal Revenue Code or under the Revenue Act of 1932.*—(1) *In general.*—Credit against both the basic estate tax imposed by section 810 or section 860 and the additional estate tax imposed by section 935 is authorized by sections 813(a)(2) and 936(b) for gift tax paid under chapter 4 of the Code or under the Revenue Act of 1932 in respect of property included in the gross estate.

The credit is allowable even though the gift tax is paid by the executor after the decedent's death and the amount of the gift tax is deductible from the gross estate as a debt of the decedent.

The credit under this paragraph in respect of any gift included in the gross estate is limited to the smaller of the following amounts—

(i) the amount of gift tax paid in respect of such gift, computed as set forth under subparagraph (2) of this paragraph.

(ii) the amount of the basic and additional estate taxes attributable to such gift, computed as set forth under subparagraph (3) of this paragraph.

Where more than one gift is included in the gross estate of a decedent dying after December 31, 1947, a separate computation of the two limitations on the credit is to be made with respect to each gift.

(2) *First limitation.*—If only one gift was made during a certain calendar year, and such gift is wholly included in the decedent's gross estate for the purpose of the estate tax, the credit with respect to such gift is limited to the amount of the gift tax paid for such calendar year. If more than one gift was made during a certain calendar year, the credit with respect to any such gift which is included in the decedent's gross estate for the purpose of the estate tax is limited to an amount, A, which bears the same ratio to B (the total gift tax paid for such calendar year) as C (the amount of such gift, reduced by any portion of such amount excluded under section 1003(b) of the Code or section 504(b) of the Revenue Act of 1932 or deducted under section 1004(a) (2) or (3) of the Code or section 505(a)(2) of the Revenue Act of 1932) bears to D (the total amount of net gifts for such year, computed without deduction of the specific exemption). The values finally determined for the purpose of the gift tax are to be used in computing this ratio, irrespective of the values determined for the purpose of the estate tax. A like computation is to be made in case only a portion of any gift is included in the decedent's gross estate for the purpose of the estate tax.

Example. A donor, who had used $20,000 specific exemption in prior years, made gifts during the calendar year 1948 on which gift tax was determined as shown below:

Gift of property to son on February 1		$13,000
Gift of property to wife on May 1		86,000
Gift to charitable organization on May 15		10,000
Total gifts		109,000
Less exclusions ($3,000 for each gift)		9,000
Total included amount of gifts		100,000
Marital deduction (for gift to wife)	$43,000	
Charitable deduction	7,000	
Specific exemption	10,000	
Total deductions		60,000
Net gifts		40,000
Total gift tax paid for calendar year 1948		3,600

The donor's gift to his wife was made in contemplation of death and is thereafter included in his gross estate for the purpose of the estate tax. Under the "first limitation," the credit with respect to such gift cannot exceed

$$\frac{\text{40,000 (gift to wife, less \$3,000 exclusion and \$43,000 marital deduction)}}{\text{50,000 (total amount of net gifts increased by specific exemption allowed)}} \times \$3{,}600 \text{ (gift tax paid)} = \$2{,}880$$

(3) *Second limitation.*—The credit with respect to any gift of property included in the gross estate for the purpose of the estate tax is also limited to an amount, E, which bears the same ratio to F (the total gross basic and additional estate taxes, reduced by any credit under paragraph (*b*) of this section, and, in case the decedent died after October 21, 1942, by any credit under section 81.9) as G (the value, adjusted as hereinafter indicated, of such property transferred by gift and included in the gross estate) bears to H (the value of the entire gross estate, reduced, in case the decedent died after December 31, 1947, by the total deductions allowed under section 812 (d) and (e)). In computing this ratio, the value of the property transferred by gift and included in the gross estate (amount G of the ratio) is the value determined for the purpose of the gift tax or the value determined for the purpose of the estate tax, whichever is lower. Such value (amount G of the ratio) does not include the portion, if any, of the gift excluded, under section 1003(b) of the Code or section 504(b) of the Revenue Act of 1932, in determining the gift tax. For example: A donor, in contemplation of death, transferred property valued at $100,000 to his five children in 1941 and paid the resulting gift tax. The amount of $20,000 was excluded under the provisions of section 1003(b)(2), and the amount of $80,000 was included for the purpose of the gift tax. The property is thereafter included in his gross estate for the purpose of the estate tax at a value of $90,000. The lower of the two values ($90,000) is to be used in computing the second limitation. Amount G of the ratio is $72,000, the value

$$\left(\frac{80{,}000}{100{,}000} \times \$90{,}000\right)$$

of the portion of the gift included for the purpose of the gift tax.

If in determining the estate tax in the case of a decedent who died after December 31, 1947, a "marital deduction" under section 812(e) or a "charitable deduction" under section 812(d) is allowable for a portion of a particular gift, then in computing the "second limitation" such portion of the gift is not to be included in amount G of the ratio. (See sections 81.47a to 81.47e, inclusive, relating to the marital deduction, and sections 81.44 to 81.47, inclusive, relating to the charitable deduction.) Therefore, if a particular gift is made solely to the decedent's surviving spouse or solely to a charitable, etc., organization, and a deduction under section 812 (d) or (e) is allowed for the full value of the gift, no credit with respect to such gift may be taken. If the gift was (in whole or in part) to the decedent's surviving spouse, and if the aggregate marital deduction allowed is less than the amount of such deduction computed without regard to the limitation stated in section 81.47d, then the portion of the gift which is not to be included in computing the "second limitation" is an amount, I, which bears the same ratio to J (the amount of such gift not excluded in determining the gift tax, and for which a marital deduction would be allowed except for the limitation stated in section 81.47d) as K (the aggregate marital deduction allowed) bears to L (the aggregate marital deduction computed without regard to the limitation stated in section 81.47d).

Example. The facts are the same as in the example in subparagraph (2) of the computation of the "first limitation" with the following additions. The donor was survived by his wife. The value of the donor's gross estate is $350,000. Assume that a marital deduction of $150,000 is actually allowed in determining the net estate, and that the amount of such deduction computed without regard to the limitation under section 81.47d is $250,000. There is no charitable deduction allowed in this example for the purpose of the estate tax. The total basic and additional estate taxes less the credit allowed under section 81.9 amount to $17,500. No credit under paragraph (*b*) of this section is allowed in this example. The property given by the donor to his wife is included in the gross estate at a value of $90,000, and is property for which a marital deduction may be taken. The value of $86,000 determined for the purpose of the gift tax is lower than such value determined for the purpose of the estate tax and is, therefore, to be used in computing the "second limitation," as shown below:

Portion of gift included for the purpose of the gift tax ($86,000 less $3,000 exclusion) ---------- $83,000

Portion of gift so included and for which a marital deduction is allowed in determining the estate tax—

$$\frac{150{,}000\ \text{(marital deduction allowed for purpose of estate tax)}}{250{,}000\ \text{(marital deduction computed without regard to limitation under section 81.47d)}} \times \$83{,}000 \left\{\begin{array}{l}\text{portion of gift so included}\\ \text{and for which a marital de-}\\ \text{duction would be allowed in}\\ \text{full except for limitation under}\\ \text{section 81.47d}\end{array}\right. = \$49{,}800$$

Portion of gift to be used in computing the "second limitation" ($83,000 less $49,800) ---------- $33,200

"Second limitation" upon the credit with respect to such gift—

$$\frac{33{,}200}{200{,}000\ \text{(gross estate less marital and charitable deductions)}} \times \$17{,}500 \left\{\begin{array}{l}\text{total basic and additional}\\ \text{taxes less credit under section}\\ \text{81.9}\end{array}\right\} = \$2{,}905$$

Since the amount of the "first limitation" upon the credit ($2,880) is lower, such amount is the allowable credit.

(4) *Credit for "split gifts."*—Where the decedent made a gift of property which is thereafter included in his gross estate, and, under the provisions of section 1000(f), such gift was considered for the purpose of the gift tax as made one-half by the decedent and one-half by his spouse, credit against the estate tax is authorized for the gift tax paid with respect to both halves of the gift. The "first limitation" is to be separately computed with respect to each half of the gift. For example: A donor, in contemplation of death, transferred property valued at $106,000 to his son on June 1, 1948, and he and his wife consented that the gift should be considered as made one-half by him and one-half by his wife. Assume that the property is thereafter included in the donor's gross estate for the purpose of the estate tax. Under the "first limitation" the amount of the gift tax of the donor paid with respect to the half of the gift considered as made by him is determined to be $11,250, and the amount of the gift tax of his wife paid with respect to the half of the gift considered as made by her is determined to be $1,200. Under the "second limitation" the amount of estate tax attributable to the property is determined to be $28,914. The credit allowed ($11,250 plus $1,200) is $12,450.

(5) *Allocation of credit.*—The amount computed under the lower of the two limitations is the total credit authorized with respect to the gift against both the basic and additional estate taxes. The amount of such credit authorized against the basic estate tax is the lower of (i) the amount computed under the "first limitation" and (ii) the amount of the basic estate tax attributable to the gift, computed in the manner described under the "second limitation." The amount of such credit authorized against the additional estate tax is the lower of (*a*) the amount computed under the "first limitation" less the credit allowed against the basic estate tax and (*b*) the amount of the additional estate tax attributable to the gift, computed in the manner described under the "second limitation."

PAR. 4. There is inserted immediately preceding section 81.10 [26 CFR 81.10] the following:

SEC. 364. OPTIONAL VALUATION. (REVENUE ACT OF 1948; ENACTED APRIL 2, 1948.)

(a) The last sentence of section 811(j) of the Internal Revenue Code (relating to optional valuation) is hereby amended to read as follows: "In case of an election made by the executor under this subsection, then—

"(A) for the purposes of the deduction under section 812(d) or section 861(a)(3), any bequest, legacy, devise, or transfer enumerated therein, and

"(B) for the purposes of the deduction under section 812(e), any interest in property passing to the surviving spouse,

shall be valued as of the date of the decedent's death with adjustment for any difference in value (not due to mere lapse of time or the occurrence or nonoccurrence of a contingency) of the property as of the date one year after the decedent's death (substituting, in the case of property distributed by the executor or trustee, or sold, exchanged, or otherwise disposed of, during such one-year period, the date thereof)."

(b) The amendment made by this section shall be applicable only with respect to estates of decedents dying after December 31, 1947.

PAR. 5. Section 81.11 [26 CFR 81.11] is amended by changing the second sentence of the third paragraph from the end to read as follows:

The amount of any deduction under section 812(d) or section 861(a)(3) with respect to property passing to or for public, charitable, religious, etc., uses, or any deduction under section 812(e) with respect to property passing to the decedent's surviving spouse, shall be determined by the value of such property as of the date of the decedent's death, subject, however, to adjustment for any difference in its value as of the date one year after such death, or as of the date of its distribution, sale, exchange, or other disposition, whichever date first occurs.

PAR. 6. There is inserted immediately after section 401 of the Revenue Act of 1942 (inserted by Treasury Decision 5239), and preceding section 302(c) of the Revenue Act of 1926 (as originally enacted), which precedes section 81.15 [26 CFR 81.15], the following:

SEC. 351. REPEAL OF COMMUNITY PROPERTY ESTATE TAX AMENDMENTS. (REVENUE ACT OF 1948; ENACTED APRIL 2, 1948.)

(a) Effective with respect to estates of decedents dying after December 31, 1947, sections 811(d)(5), 811(e)(2) and 811(g)(4) of the Internal Revenue Code (relating to community property) are hereby repealed.

* * * * * * *

(c) Notwithstanding the repeal of sections 811(d)(5), 811(e)(2), and 811(g)(4) provided in subsection (a), the taxes imposed under chapter 3 of the Internal Revenue Code upon the transfer of the net estate of any decedent dying after December 31, 1947, and on or before the date of the enactment of this Act shall not exceed the taxes which would have been imposed under such chapter 3 upon such transfer if this section had not been enacted.

PAR. 7. Section 81.15, as amended by Treasury Decision 5239 [26 CFR 81.15], is further amended as follows:

(A) By inserting immediately after "October 21, 1942," each time it appears in the second paragraph thereof the following: "and on or before December 31, 1947,".

(B) By inserting at the end of such second paragraph the following sentence:

(With respect to estates of decedents dying after December 31, 1947, and on or before April 2, 1948, involving transfers of community property, see section 81.23.)

PAR. 8. There is inserted immediately preceding section 81.22 [26 CFR 81.22] the following:

SEC. 351. REPEAL OF COMMUNITY PROPERTY ESTATE TAX AMENDMENTS. (REVENUE ACT OF 1948; ENACTED APRIL 2, 1948.)

(a) Effective with respect to estates of decedents dying after December 31, 1947, sections 811(d)(5), 811(e)(2) and 811(g)(4) of the Internal Revenue Code (relating to community property) are hereby repealed.

(b) Such section 811(e) is further amended—

(1) by striking out of the heading of such subsection the words "AND COMMUNITY"; and

(2) by striking out of paragraph (1) the following: "JOINT INTERESTS.—".

(c) Notwithstanding the repeal of sections 811(d)(5), 811(e)(2), and 811(g)(4) provided in subsection (a), the taxes imposed under chapter 3 of the Internal Revenue Code upon the transfer of the net estate of any decedent dying after December 31, 1947, and on or before the date of the enactment of this Act shall not exceed the taxes which would have been imposed under such chapter 3 upon such transfer if this section had not been enacted.

PAR. 9. Section 81.22, as amended by Treasury Decision 5239 [26 CFR 81.22], is further amended as follows:

(A) By inserting immediately after "October 21, 1942," each time it appears in the last paragraph thereof the following: "and on or before December 31, 1947,".

(B) By inserting at the end of such last paragraph the following sentence:

(With respect to estates of decedents dying after December 31, 1947, and on or before April 2, 1948, involving joint tenancies or tenancies by the entirety created by the transfer of community property, see section 81.23.)

PAR. 10. Section 81.23, as amended by Treasury Decision 5239 [26 CFR 81.23], is further amended as follows:

(A) By inserting immediately after "October 21, 1942," in the first sentence thereof the following: "and on or before December 31, 1947,".

(B) By striking out the last paragraph and by inserting in lieu thereof the following paragraphs:

With respect to estates of decedents dying after October 21, 1942, and on or before December 31, 1947, see the provisions of section 81.15, section 81.22, and section 81.27(*b*), relating, respectively, to the inclusion of transfers of community property during life, the treatment of joint tenancies and tenancies by the entirety created by the transfer of community property, and the treatment of insurance upon the decedent's life held as, or acquired with, community property.

In the case of a decedent who died after December 31, 1947, and on or before April 2, 1948, the provisions contained in the first two paragraphs of this section and those provisions of sections 81.15, 81.22, and 81.27(*b*) referred to in the preceding paragraph may have a limited effect. Although such provisions are not applicable for the purpose of determining the value of the decedent's gross estate, the estate tax payable is, nevertheless, not to exceed the estate tax which would be imposed if such provisions were applicable.

PAR. 11. Section 81.24(*b*)(1), as amended by Treasury Decision 5658 [C. B. 1948–2, 153], approved October 1, 1948 [26 CFR 81.24(b)(1)], is further amended by inserting immediately after the second undesignated paragraph thereof the following new paragraph:

To take another example of the scope of the term "power of appointment," assume that the community property laws of a State confer upon the wife a power of testamentary disposition over property in which she does not have a vested interest. Subject to the exceptions stated in (2) and (3) hereunder, such a power is a power of appointment and the property subject thereto is includible in the wife's gross estate.

PAR. 12. There is inserted immediately preceding section 81.25 [26 CFR 81.25] the following:

SEC. 351. REPEAL OF COMMUNITY PROPERTY ESTATE TAX AMENDMENTS. (REVENUE ACT OF 1948; ENACTED APRIL 2, 1948.)

(a) Effective with respect to estates of decedents dying after December 31, 1947, sections 811(d)(5), 811(e)(2) and 811(g)(4) of the Internal Revenue Code (relating to community property) are hereby repealed.

* * * * * * *

(c) Notwithstanding the repeal of sections 811(d)(5), 811(e)(2), and 811(g)(4) provided in subsection (a), the taxes imposed under chapter 3 of the Internal Revenue Code upon the transfer of the net estate of any decedent dying after December 31, 1947, and on or before the date of the enactment of this Act shall not exceed the taxes which would have been imposed under such chapter 3 upon such transfer if this section had not been enacted.

PAR. 13. Section 81.26 [26 CFR 81.26] is amended by inserting at the end thereof the following:

Where the proceeds of insurance made payable to the decedent's estate are community assets under the local community property law, as a result of which one-half of such proceeds belongs to the decedent's spouse, then only one-half of such insurance is considered to be receivable by the executor within the meaning of section 811(g)(1).

PAR. 14. Section 81.27, as amended by Treasury Decision 5239 [26 CFR 81.27], is further amended as follows:

(A) By striking out "this subsection" and "subsection (*a*)" wherever they appear in such section and by inserting in lieu thereof "this paragraph" and "paragraph (*a*)".

(B) By changing the heading and first sentence of paragraph (*a*) to read as follows:

(*a*) *In case of decedent dying after December 31, 1947.*—The regulations prescribed under this paragraph (except as otherwise indicated in this section) are applicable only in the case of decedents who died after December 31, 1947.

(C) By changing the third undesignated paragraph of paragraph (*a*) (which undesignated paragraph, prior to the amendment made by (A), began with the words "For the purposes of this subsection") to read as follows:

For the purposes of this paragraph, where premiums or other consideration are paid with property held as community property by the decedent and his spouse, the decedent shall (in the absence of additional circumstances showing payment indirectly by the decedent) be deemed to have paid only one-half of such premiums or other consideration. The general rule stated in the preceding sentence is not applicable unless the decedent and his spouse had equal and existing interests in the community property used in the payment of the premiums or other consideration. An example of additional circumstances showing payment indirectly by the decedent which will render inapplicable the general rule is a transfer of property by the decedent to the community for the purpose of purchasing the insurance.

(D) By striking from paragraph (*a*) the last sentence of the sixth undesignated paragraph (which paragraph begins with the words "For the purposes of (1)").

(E) By changing the third sentence of the last undesignated paragraph of paragraph (*a*) to read as follows:

For examples of "incidents of ownership" see paragraph (*c*) of this section.

(F) By inserting at the end of paragraph (*a*) the following:

In determining whether the decedent possessed an incident of ownership in a policy or in any part of a policy, regard must be given to the effect of the State or other applicable law upon the terms of the policy. As an example, assume that the decedent purchased a policy of insurance on his life with funds held by him and his surviving wife as community property, designating their son as beneficiary but retaining the right to surrender the policy. Under the local law, the proceeds upon surrender would have inured to the marital community, and the wife's transfer of her one-half interest in the policy was not considered absolute prior to the decedent's death. Upon the wife's prior death, one-half of the value of the policy would have been included in her gross estate. Under these circumstances, the power of surrender possessed by the decedent as agent for his wife with respect to one-half of the policy is not, for the purposes of this paragraph, considered an "incident of ownership", and the decedent is, therefore, deemed to possess an incident of ownership in only one-half of the policy.

With respect to estates of decedents dying after December 31, 1947, and on or before April 2, 1948, involving insurance held as community property by the decedent and spouse, or acquired with property so held, see section 81.23.

(*b*) *In case of decedent dying after October 21, 1942, and on or before December 31, 1947.*—The regulations prescribed under this paragraph (except as otherwise indicated in this section) are applicable only in the case of decedents who died after October 21, 1942, and on or before December 31, 1947. In such cases, the regulations prescribed under paragraph (*a*) with respect to estates of decedents dying after December 31, 1947, are also applicable (except to the extent inconsistent with this paragraph). For the purposes of this paragraph, premiums or other consideration paid with property held as community property by the insured and spouse under the law of any State, Territory, or possession of the United States, or any foreign country, shall be considered to have been paid by the insured, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the decedent's spouse or derived originally from such compensation or from separate property of such spouse. With respect to the meaning of property derived originally from such compensation or from separate property of the decedent's spouse, see section 81.23. Section 811(g)(4) provides that the term "incidents of ownership" includes incidents of ownership possessed by the decedent as manager of the community where the insurance policy is property held as community property by the decedent and spouse.

(G) By striking out the heading and first sentence of the original paragraph (*b*) and by inserting in lieu thereof the following:

(*c*) *In case of decedent dying on or before October 21, 1942.*—The regulations prescribed under this paragraph (except as otherwise indicated in this section) are applicable only in the case of decedents who died on or before October 21, 1942.

PAR. 15. There is inserted immediately preceding section 81.41 [26 CFR 81.41] the following:

SEC. 362. PROPERTY PREVIOUSLY TAXED. (REVENUE ACT OF 1948; ENACTED APRIL 2, 1948.)

(a) Section 812(c) of the Internal Revenue Code (relating to the deduction for property previously taxed) is hereby amended by adding after the first paragraph two new paragraphs to read as follows:

"The following property shall not, for the purposes of this subsection, be considered as property with respect to which a deduction may be allowed: (A) property received from a prior decedent who died after December 31, 1947, and was at the time of such death the decedent's spouse, (B) property received by gift after the date of the enactment of the Revenue Act of 1948 from a donor who at the time of the gift was the decedent's spouse, and (C) property acquired in exchange for property described in clause (A) or (B).

"Where, under the provisions of section 1000(f), a gift received by the decedent was considered as made one-half by the donor and one-half by the donor's spouse, one-half of the gift shall be considered as received by the decedent from each such spouse."

(b) Section 812(c) is further amended by striking out "subsections (a) and (d)" and inserting in lieu thereof "subsections (a), (d), and (e)".

PAR. 16. Section 81.41, as amended by Treasury Decision 5239, and by Treasury Decision 5408 [C. B. 1944, 578], approved October 14, 1944 [26 CFR 81.41], is further amended as follows:

(A) By inserting at the end of (*a*) (4) of the first paragraph the following sentence:

Where, under the provisions of section 1000(f), a gift received by the decedent was considered as made one-half by the donor and one-half by the donor's spouse, the deduction may not be taken in respect of the half of the gift considered as made by the donor unless a gift tax was paid by or on behalf of the donor, nor in respect of the half of the gift considered as made by the donor's spouse unless a gift tax was paid by or on behalf of such spouse.

(B) By inserting immediately after (*a*) (5) of the first paragraph the following:

(6) The property (or property given in exchange therefor) must not have been received (by gift or otherwise) from a prior decedent who died after December 31, 1947, and was at the time of such death the decedent's spouse, and must not have been received by gift after April 2, 1948, from a donor who at the time of the gift was the decedent's spouse. This rule, added by section 362 of the Revenue Act of 1948, is effective even though the decedent (surviving spouse) died after December 31, 1947, and on or before April 2, 1948; but the estate tax payable by the estate of such spouse is, nevertheless, not to exceed the estate tax which would have been imposed if the Revenue Act of 1948 had not been enacted.

(C) By striking from the second sentence of (*b*) (3) "subsections (*a*) and (*d*)" and by inserting in lieu thereof the following: "subsections (*a*), (*d*), and (*e*)".

(D) By inserting in the next to the last paragraph, immediately after that sentence thereof which reads in part "Second: The balance of $12,800", the following sentence:

(The deduction under section 812(e) is not involved in this example.)

PAR. 17. There is inserted immediately after section 81.47 [26 CFR 81.47] the following:

DEDUCTIONS—BEQUESTS, ETC., TO SURVIVING SPOUSE

SEC. 812. [PART II, SUBCHAPTER A.] NET ESTATE.

For the purpose of the 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—

* * * * * * *

(e) BEQUESTS, ETC., TO SURVIVING SPOUSE.—(As added by section 361(a) of the Revenue Act of 1948, enacted April 2, 1948, and amended by Public Law 869, Eightieth Congress, approved July 1, 1948.)

(1) ALLOWANCE OF MARITAL DEDUCTION.—

(A) In General.—An amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

(B) Life Estate or Other Terminable Interest.—Where, upon the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur, such interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed with respect to such interest—

(i) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and

(ii) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse;

and no deduction shall be allowed with respect to such interest (even if such deduction is not disallowed under clauses (i) and (ii))—

(iii) if such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.

For the purposes of this subparagraph, an interest shall not be considered as an interest which will terminate or fail merely because it is the ownership of a bond, note, or similar contractural obligation, the discharge of which would not have the effect of an annuity for life or for a term.

(C) Interest in Unidentified Assets.—Where the assets (included in the decedent's gross estate) out of which, or the proceeds of which, an interest passing to the surviving spouse may be satisfied include a particular asset or assets with respect to which no deduction would be allowed if such asset or assets passed from the decedent to such spouse, then the value of such interest passing to such spouse shall, for the purposes of subparagraph (A), be reduced by the aggregate value of such particular assets.

(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.

(E) Valuation of Interest Passing to Surviving Spouse.—In determining for the purposes of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—

(i) there shall be taken into account the effect which a tax imposed by this chapter, or any estate, succession, legacy, or inheritance tax, has upon the net value to the surviving spouse of such interest; and

(ii) where such interest or property is incumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such incumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined.

(F) Trust With Power of Appointment in Surviving Spouse.—In the case of an interest in property passing from the decedent in trust, if under the terms of the trust his surviving spouse is entitled for life to all the income from the corpus of the trust, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire corpus free of the trust (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the corpus to any person other than the surviving spouse—

(i) the interest so passing shall, for the purposes of subparagraph (A), be considered as passing to the surviving spouse, and

(ii) no part of the interest so passing shall, for the purposes of subparagraph (B) (i), be considered as passing to any person other than the surviving spouse.

This subparagraph shall be applicable only if, under the terms of the trust, such power in the surviving spouse to appoint the corpus, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

(G) Life Insurance or Annuity Payments With Power of Appointment in Surviving Spouse.—In the case of an interest in property passing from the decedent consisting of proceeds under a life insurance, endowment, or annuity contract, if under the terms of the contract such proceeds are payable in installments or are held by the insurer subject to an agreement to pay interest thereon (whether the proceeds, upon the termination of any interest payments, are payable in a lump sum or in annual or more frequent installments), and such installment or interest payments are payable annually or at more frequent intervals, commencing not later than thirteen months after the decedent's death, and all amounts payable during the life of the surviving spouse are payable only to such spouse, and such spouse has the power to appoint all amounts payable under such contract (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), with no power in any other person to appoint to any person other than the surviving spouse any part of the amounts payable under such contract—

(i) such proceeds shall, for the purposes of subparagraph (A), be considered as passing to the surviving spouse, and

(ii) no part of such proceeds shall, for the purposes of subparagraph (B)(i), be considered as passing to any person other than the surviving spouse.

This subparagraph shall be applicable only if, under the terms of the contract, such power in the surviving spouse to appoint, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

(H) Limitation on Aggregate of Deductions.—The aggregate amount of the deductions allowed under this paragraph (computed without regard to this subparagraph) shall not exceed 50 per centum of the value of the adjusted gross estate, as defined in paragraph (2).

(2) Computation of adjusted gross estate.—

(A) General Rule.—Except as provided in subparagraph (B) of this paragraph the adjusted gross estate shall, for the purposes of paragraph (1)(H), be computed by subtracting from the entire value of the gross estate the aggregate amount of the deductions allowed by subsection (b) of this section.

(B) Special Rule in Cases Involving Community Property.—If the decedent and his surviving spouse at any time held property as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, then the adjusted gross estate shall, for the purposes of paragraph (1)(H), be determined by subtracting from the entire value of the gross estate the sum of:

(i) the value of property which is at the time of the death of the decedent held as such community property; and

(ii) the value of property transferred by the decedent during his life, if at the time of such transfer the property was held as such community property; and

(iii) the amount receivable as insurance under policies upon the life of the decedent to the extent purchased with premiums or other consideration paid out of property held as such community property; and

(iv) an amount which bears the same ratio to the aggregate of the deductions allowed under subsection (b) of this section which the value of the property included in the gross estate, diminished by the amount subtracted under clauses (i), (ii), and (iii) of this subparagraph, bears to the entire value of the gross estate.

For the purposes of clauses (i), (ii), and (iii) community property (except property which is considered as community property solely by reason of the provisions of subparagraph (C) of this paragraph) shall be considered as not "held as such community property" as of any moment of time, if, in the case of the death of the decedent at such moment, such property (and not merely one-half thereof) would be or would have been includible in determining the value of his gross estate without regard to the provisions of section 811(e)(2). The amount to be subtracted under clause (i), (ii), or (iii) shall not exceed the value of the interest in the property described therein which is included in determining the value of the gross estate.

(C) Same—Conversion Into Separate Property.—

(i) If during the calendar year 1942 or after the date of the enactment of the Revenue Act of 1948, property held as such community property (unless considered by reason of subparagraph (B) of this paragraph as not so held) was by the decedent and the surviving spouse converted, by one transaction or a series of transactions, into separate property of the decedent and his spouse (including any form of coownership by them), the separate property so acquired by the decedent and any property acquired at any time by the decedent in exchange therefor (by one exchange or a series of exchanges shall, for the purposes of clauses (i), (ii), and (iii) of subparagraph (B), be considered as "held as such community property."

(ii) Where the value (at the time of such conversion) of the separate property so acquired by the decedent exceeded the value (at such time) of the separate property so acquired by the decedent's spouse, the rule in clause (i) shall be applied only with respect to the same portion of such separate property of the decedent as the portion which the value (as of such time) of such separate property so acquired by the decedent's spouse is of the value (as of such time) of the separate property so acquired by the decedent.

(3) Definition.—For the purposes of this subsection an interest in property shall be considered as passing from the decedent to any person if and only if—

(A) such interest is bequeathed or devised to such person by the decedent; or

(B) such interest is inherited by such person from the decedent; or

(C) such interest is the dower or curtesy interest (or statutory interest in lieu thereof) of such person as surviving spouse of the decedent; or

(D) such interest has been transferred to such person by the decedent at any time; or

(E) such interest was, at the time of the decedent's death, held by such person and the decedent (or by them and any other person) in joint ownership with right of survivorship; or

(F) the decedent had a power (either alone or in conjunction with any person) to appoint such interest and if he appoints or has appointed such interest to such person, or if such person takes such interest in default upon the release or nonexercise of such power; or

(G) such interest consists of proceeds of insurance upon the the life of the decedent receivable by such person.

Except as provided in subparagraph (F) or (G) of paragraph (1), where at the time of the decedent's death it is not possible to ascertain the particular person or persons to whom an interest in property may pass from the decedent, such interest shall, for the purposes of clauses (i) and (ii) of subparagraph (B) of paragraph (1), be considered as passing from the decedent to a person other than the surviving spouse.

(4) DISCLAIMERS.—

(A) By Surviving Spouse.—If under this subsection an interest would, in the absence of a disclaimer by the surviving spouse, be considered as passing from the decedent to such spouse, and if a disclaimer of such interest is made by such spouse, then such interest shall, for the purposes of this subsection, be considered as passing to the person or persons entitled to receive such interest as a result of the disclaimer.

(B) Disclaimer by Any Other Person.—If under this subsection an interest would, in the absence of a disclaimer by any person other than the surviving spouse, be considered as passing from the decedent to such person, and if a disclaimer of such interest is made by such person and as a result of such disclaimer the surviving spouse is entitled to receive such interest, then such interest shall, for the purposes of this subsection, be considered as passing, not to the surviving spouse, but to the person who made the disclaimer, in the same manner as if the disclaimer had not been made.

SEC. 361. MARITAL DEDUCTION. (REVENUE ACT OF 1948; ENACTED APRIL 2, 1948.)

* * * * * * *

(b) The amendment made by subsection (a) of this section shall be applicable only with respect to estates of decedents dying after December 31, 1947.

JOINT RESOLUTION. (PUBLIC LAW 869, EIGHTIETH CONGRESS, SECOND SESSION, APPROVED JULY 1, 1948.)

* * * * * * *

SEC. 2. The amendment made by this joint resolution shall be applicable with respect to estates of decedents dying after December 31, 1947.

SEC. 81.47a. BEQUESTS, ETC., TO SURVIVING SPOUSE.—(*a*) *Allowance of marital deduction.*—In the case of the estate of a citizen or resident of the United States dying after December 31, 1947, there may be deducted the value of any property interest (except as otherwise provided in section 81.47b and 81.47d) which passed from the decedent to his surviving spouse. Such deduction is hereinafter referred to as the "marital deduction." The marital deduction is generally not available in case the decedent's gross estate consists exclusively of property held by him and his surviving spouse as community property under the law of any State, Territory, or possession of the United States, or any foreign country. (See section 81.47d.) The Internal Revenue Code does not authorize a marital deduction in the case of the estate of a nonresident not a citizen of the United States. However, if the decedent was a citizen or resident, his estate is not deprived of the right to the marital deduction by reason of the fact that his surviving spouse was a nonresident not a citizen.

In order to obtain the marital deduction with respect to any property interest the executor must establish the following facts:

(1) That the decedent was survived by his spouse;

(2) That such property interest passed from the decedent to such spouse (see paragraphs (*b*) to (*g*), inclusive, of this section);

(3) That such property interest is a "deductible interest" (see section 81.47b);

(4) The value of such property interest (see section 81.47c); and

(5) The value of the "adjusted gross estate" (see section 81.47d).

Where the order of deaths of the decedent and his spouse cannot be established by proof, a presumption (whether supplied by local law, the decedent's will, or otherwise) that the decedent was survived by his spouse will be recognized as satisfying requirement (1) only to the extent that it has the effect of giving to such spouse an interest in property includible in her gross estate under section 811. Under such circumstances, if an estate tax return is required to be filed for the estate of the decedent's spouse, the marital deduction will not be allowed in the final audit of the estate tax return of the decedent's estate with respect to any property interest which has not been finally determined to be includible in the gross estate of his spouse.

For convenience the surviving spouse is generally referred to in the feminine gender, but if the decedent is a woman the reference is to her surviving husband.

(*b*) *Definitions.*—(1) *Passed from the decedent.*—As used in this and the three succeeding sections, the expressions "passed from the decedent," "passed from the decedent to his surviving spouse," and "passed from the decedent to a person other than his surviving spouse," have the meanings stated in this paragraph. Except as otherwise indicated in subparagraphs (2) and (3) of this paragraph, the following rules are applicable in determining the person to whom any property interest "passed from the decedent":

(i) Property interests devolving upon any person (or persons) as surviving coowner with the decedent under any joint ownership wherein the right of survivorship existed are considered as having passed from the decedent to such person (or persons).

(ii) Property interests at any time subject to decedent's power to appoint (whether alone or in conjunction with any person) are considered as having passed from the decedent to the appointee under his exercise of the power, or, in case of release or nonexercise, as having passed from the decedent to the taker in default of exercise.

(iii) The dower or curtesy interest (or statutory interest in lieu thereof) of the decedent's surviving spouse is considered as having passed from the decedent to such spouse.

(iv) In the case of insurance upon the life of the decedent, the proceeds are considered as having passed from the decedent to the person who, at the time of the decedent's death, was entitled to receive such proceeds.

(v) Subject to the rules stated in subdivisions (i) to (iv), inclusive, of this subparagraph, any property interest transferred during life, bequeathed or devised by the decedent, or inherited from the decedent, is considered as having passed to the person to whom he transferred, bequeathed, or devised such interest, or to the person who inherited such interest from him.

It is comprehended by the foregoing definition that where the surviving spouse had, immediately prior to the decedent's death, merely an expectant interest in property held by her and the decedent under community property laws, such interest is considered as having passed from the decedent to such spouse. As to the circumstances under which the interest of the surviving spouse under community property laws is regarded as merely expectant, see paragraph (*b*) of section 81.47d.

(2) *Passed from the decedent to his surviving spouse.*—In general, the definition stated in subparagraph (1) of this paragraph is applicable in determining the property interest which "passed from the decedent to his surviving spouse." Special rules are provided, however, in the case of certain trusts with power of appointment in the surviving spouse and in the case of proceeds held by the insurer under a life insurance, endowment, or annuity contract, with power of appointment in the surviving spouse. (As to such rules, see paragraphs (*c*) and (*d*) of this section.) As to the rules applicable in case of disclaimer by the surviving spouse or by any other person, in case of election by the surviving spouse, and in case of a controversy involving the decedent's will, see paragraphs (*e*) to (*g*), inclusive, of this section.

Except to the extent otherwise provided in paragraphs (*c*) and (*d*) of this section, the marital deduction may be taken with respect to a property interest only if it passed to the surviving spouse as beneficial owner. For this purpose, where a property interest passed from the decedent in trust, such interest is considered to have passed from him to his surviving spouse to the extent of her beneficial interest therein. The deduction may not be taken with respect to a property interest which passed to such spouse merely as trustee, or subject to a binding agreement by such spouse to dispose of such interest in favor of a third person.

The following are given as illustrative: (i) A property interest bequeathed in trust by H (the decedent) is considered as having passed from him to W (his surviving spouse) if the trust income is payable to W for life and upon her death the corpus is distributable to her executors or administrators, or if W is entitled to the trust income for a term of years following which the corpus is to be paid to W or her estate, or if the trust income is to be accumulated for a term of years or for W's life and the augmented fund paid to W or her estate, or if the terms of the trust meet the requirements of paragraph (*c*) of this section; (ii) where H devised property to A for life with remainder absolutely to W or her estate, the remainder interest is considered to have passed from H to W; (iii) proceeds of insurance upon the life of H are considered as having passed from H to W if the terms of the contract meet the requirements of paragraph (*d*) of this section, or if under the terms of the contract the proceeds are payable to W in a lump sum, or are payable in installments to W for life and after her death any remaining installments are payable to her estate, or if interest on the proceeds is payable to W for life and upon her death the principal amount is payable to her estate. However, with respect to the foregoing illustrations which involve interests which are distributable to W's estate (or to her executors or administrators) in the event of the termination of a trust or of a precedent interest at or after her death, it should be noted that the interest so distributable is to be considered as having passed from H to W only if such interest would be includible in her gross estate under section 811(a).

(3) *Passed from the decedent to a person other than his surviving spouse.*—The expression "passed from the decedent to a person other than his surviving spouse" refers to any property interest which, under the definition stated in subparagraph (1) of this paragraph, is considered as having "passed from the decedent" and which, under the rules referred to in subparagraph (2) of this paragraph, is not considered as having "passed from the decedent to his surviving spouse."

(*c*) *Trust with power of appointment in surviving spouse.*—In the case of property interests which passed from the decedent to a trust, the terms of which satisfy the five conditions stated in this paragraph, the expression "passed from the decedent to his surviving spouse" embraces not only the beneficial interest therein of such spouse but also the interest therein subject to her power to appoint. (As to the treatment of trusts not meeting such conditions, see paragraph (*b*) (2) of this section.) The five conditions which must be satisfied by the terms of the trust are as follows:

(1) The surviving spouse must be entitled for life to all the income from the corpus of the trust.

(2) Such income must be payable annually or at more frequent intervals.

(3) The surviving spouse must have the power, exercisable in favor of herself or of her estate, to appoint the entire corpus free of the trust.

(4) Such power in the surviving spouse must be exercisable by such spouse alone and (whether exercisable by will or during life) must be exercisable in all events.

(5) The corpus of the trust must not be subject to a power in any other person to appoint any part thereof to any person other than the surviving spouse.

In determining whether the above-stated conditions (1) to (5), inclusive, are satisfied by the terms of the trust, regard is to be had to the applicable provisions of the law of the jurisdiction governing the administration of the trust. For example, silence of the trust as to the frequency of payment will not be regarded as a failure to satisfy condition (2) in case the applicable law requires payment to be made annually or more frequently.

The surviving spouse is "entitled for life to all the income from the corpus of the trust," within the meaning of section 812(e) (1) (F), if the effect of the trust is to give her substantially that degree of beneficial enjoyment of the trust property during her life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust. Such degree of enjoyment is given only if it was the decedent's intention, as manifested by the terms of the trust instrument and the surrounding circumstances, that the trust should produce for the surviving spouse during her life such an income, or that the spouse should have such use of the trust property, as is consistent with the value of the trust corpus and with its preservation. The designation of the spouse as sole income beneficiary for life will be sufficient to qualify the trust unless the terms of the trust considered as a whole evidence an intention to deprive the spouse of the requisite degree of enjoyment. In determining whether a trust evidences such intention the treatment required or permitted with respect to individual items must be considered in relation to the entire system provided for the administration of the trust.

If the over-all effect of the trust is to give to the surviving spouse such enforceable rights as will preserve to her the requisite degree of enjoyment, it is immaterial whether such result is effected by rules specifically stated in the trust instrument, or, in their absence, by the rules for the management of the trust property and the allocation of receipts and expenditures supplied by the State law. For example, where the State law does not provide for amortization of bond premium, a provision in the trust instrument for such amortization by appropriate periodic charges to interest will not disqualify the trust.

The rules to be applied by the trustee in allocation of receipts and expenses between income and corpus must be considered in relation to the nature and expected productivity of the assets passing in trust, the nature and frequency of occurrence of the expected receipts, and any provisions as to change in the form of investments. Where it is evident from the nature of the trust assets and the rules provided for management of the trust that the allocation to income of such receipts as rents, ordinary cash dividends and interest will give to the spouse the substantial enjoyment during life required by the statute, provisions that such receipts as stock dividends and proceeds from the conversion of trust assets shall be treated as corpus will not disqualify the trust. Similarly, provision for a depletion charge against income in the case of trust assets which are subject to depletion will not disqualify the trust, unless the effect is to deprive the spouse of the requisite beneficial enjoyment. The same principle is applicable in the case of depreciation, trustees' commissions, and other charges.

Provisions granting administrative powers to the trustee will not have the effect of disqualifying the trust unless the grant of such powers evidences the intention to deprive the surviving spouse of the beneficial enjoyment required by the statute. Such intention will not be considered to exist if the entire terms of the instrument are such that the local courts will impose reasonable limitations upon the exercise of such powers. Among the powers which if subject to such limitations will not disqualify the trust are the power to allocate receipts between income and corpus, the power to determine the charges which shall be made against income and corpus, the power to apply the income for the benefit of the spouse, and the power to retain the assets passing to the trust. For example, a power to retain trust assets which consist substantially of unproductive property will not disqualify if the applicable rules for the administration of the trust require the trustee to either make the property productive or convert it within a reasonable time. Nor will such a power disqualify if such applicable rules require the trustee to use the degree of judgment and care in the exercise of the power which a prudent man would use if he were owner of the trust assets. A power to retain a residence for the spouse or other property for her personal use will not disqualify the trust.

A trust will not qualify if its primary purpose is to safeguard property without providing the spouse with the required beneficial enjoyment. Such trusts include not only trusts which expressly provide for the accumulation of the income but also trusts which indirectly accomplish a similar purpose. For example, assume that the corpus of a trust consists substantially of property which is not likely to be income producing during the life of the surviving spouse and that such spouse cannot compel the trustee to convert or otherwise deal with the property as described above. Such a trust will not qualify unless the trustee is directed to provide the required beneficial enjoyment, such as by payments to the spouse out of other assets of the trust.

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. However, such conditions may be satisfied by one or more of several separate trusts created by the decedent. An undivided interest in property may constitute the corpus of a trust, and the will or a single trust instrument may create more than one trust.

In the case of a trust created during the decedent's life, it is immaterial whether the trust satisfied conditions (1) to (5) prior to the decedent's death. In the case of a trust which may be terminated during the life of the surviving spouse, under her exercise of a power of appointment or by distribution of the corpus to her, the trust satisfies condition (1) if such spouse is entitled to the income until the trust terminates.

A trust fails to satisfy condition (1) if the income is required to be accumulated in whole or in part or may be accumulated in the discretion of any person other than the surviving spouse, if the consent of any person other than the surviving spouse is required as a condition precedent to distribution of the income, if any person other than the surviving spouse has the power to alter the terms of the trust so as to deprive such spouse of her right to the income, or if any person other than the surviving spouse is entitled to any part of the income during the life of such spouse. A trust will not fail to satisfy condition (1) merely because its terms provide that the right of the surviving spouse to the income shall not be subject to assignment, alienation, pledge, attachment or claims of creditors.

The terms "entitled for life" and "payable annually or more frequently," as used in conditions (1) and (2), require that under the terms of the trust the income referred to must be currently (at least annually) distributable to the spouse or that she must have such command over the income that it is virtually hers. Thus, conditions (1) and (2) are satisfied in this respect if, under the terms of the trust instrument, the spouse has the right exercisable annually (or more frequently) to require distribution to herself of the trust income, and otherwise the trust income is to be accumulated and added to corpus. Similarly, as respects the income for the period between the last distribution date and the date of the spouse's death, it is sufficient if such income is subject to the spouse's power to appoint.

A trust is not to be regarded as failing to satisfy conditions (1) and (2) merely because the spouse is not entitled to the income from estate assets for the period prior to distribution of such assets to the trustee, unless the executor is, by the decedent's will, authorized or directed to delay such distribution beyond the period reasonably required therefor. As to the valuation of the property interest passing to the spouse in trust where the right to income is postponed, see section 81.47c(*a*).

In order to satisfy conditions (3) and (4), the power of the surviving spouse to appoint the entire corpus free of the trust must fall within one of the following categories:

(i) A power so to appoint fully exercisable in her own favor at any time following the decedent's death (as, for example, an unlimited power to invade).

(ii) A power so to appoint exercisable in favor of her estate. Such power, if exercisable during life, must be fully exercisable at any time during life, or, if exercisable by will, must be fully exercisable irrespective of the time of her death.

(iii) A combination of the powers described under (i) and (ii). For example, the surviving spouse may until she attains the age of 50 years have a power to appoint to herself and thereafter have a power to appoint to her estate. However, condition (4) is not satisfied unless irrespective of when the surviving spouse may die the trust corpus will at the time of her death be subject to one or the other such power.

The power in the surviving spouse must be a power to appoint the corpus to herself as unqualified owner or to appoint the corpus as a part of her estate, that is, in effect, to dispose of it to whomsoever she pleases. Thus, if the surviving spouse entered into a binding agreement with the decedent to exercise the power only in favor of their issue, condition (3) is not met. The trust will not be regarded as failing to satisfy condition (3) merely because takers in default of the surviving spouse's exercise of the power are designated by the decedent. The decedent may provide that, in default of exercise of the power, the trust shall continue for an additional period.

In order for condition (4) to be satisfied, the power in the surviving spouse to appoint the corpus to herself or to her estate must be exercisable without the joinder or consent of any other person. The power is not "exercisable in all events," as required by section 812(e) (1) (F), if it can be terminated during the life of the surviving spouse by any event other than her complete exercise or release thereof. For example, a power which is not exercisable in the event of the spouse's remarriage is not exercisable in all events.

The power in the surviving spouse is exercisable in all events only if it exists immediately following the decedent's death. For example, if the power given to the surviving spouse is exercisable during life, but cannot be effectively exercised prior to distribution of the trust assets by the executor to the trustee, such power is not exercisable in all events. Similarly, if the power is exercisable by will, but cannot be effectively exercised in the event the surviving spouse dies before receipt of the trust assets by the trustee, such power is not exercisable in all events. However, the trust will not be disqualified by the mere fact that, in the event the power is exercised during administration of the estate, payment of the assets to the appointee will be delayed for the period of administration. If the power is in existence at all times following the decedent's death, limitations of a formal nature will not disqualify. Examples of formal limitations on a power exercisable during life are requirements that exercise must be in a particular form, that it must be filed with the trustee, that reasonable notice must be given, or that reasonable intervals must elapse between successive partial exercises. Examples of formal limitations on a power exercisable by will are that it must be exercised by a will executed by the surviving spouse after the decedent's death or that exercise must be by specific reference to the power.

The trust will fail to satisfy condition (5) if the decedent created a power in the trustee, or in another person, to invade the corpus of the trust for the benefit of any person other than the surviving spouse. However, only powers in other persons which are in opposition to that of the surviving spouse will cause the trust to fail to satisfy condition (5). For example, assume that a decedent created a trust, designating his surviving spouse as income beneficiary for life and as donee of a power to appoint the corpus. The decedent further provided that in the event the surviving spouse should die without having exercised the power, the trust should continue for the life of his son with power in such son to appoint the corpus. Since the power in the son could become exercisable only after the death of the surviving spouse, the trust is not regarded as failing to satisfy condition (5).

(*d*) *Proceeds held by the insurer under a life insurance, endowment, or annuity contract, with power of appointment in surviving spouse.*—Section 812(e) (1) (G) provides a special rule in the case of a property interest which passed from the decedent in the form of proceeds held by the insurer under the terms of a life insurance, endowment, or annuity contract which satisfy the five conditions hereinafter stated. With respect to such proceeds, the expression "passed from the decedent to his surviving spouse" embraces not only the interest of such spouse under the contract but also the interest thereunder subject to her power to appoint. The five conditions which must be satisfied by the terms of the contract are as follows:

(1) The proceeds must be held by the insurer subject to an agreement either to pay the proceeds in installments, or to pay interest thereon, with all such amounts payable during the life of the surviving spouse payable only to her.

(2) Such installments or interest must be payable annually, or more frequently, commencing not later than 13 months after the decedent's death.

(3) The surviving spouse must have the power, exercisable in favor of herself or of her estate, to appoint all amounts so held by the insurer.

(4) Such power in the surviving spouse must be exercisable by such spouse alone and (whether exercisable by will or during life) must be exercisable in all events.

(5) The amounts payable under such contract must not be subject to a power in any other person to appoint any part thereof to any person other than the surviving spouse.

If the interest of the surviving spouse under a life insurance, endowment, or annuity contract is in proceeds held by the insurer which do not, however, represent the entire amount payable under such contract, the provisions of section 812(e) (1) (G) nevertheless apply to such proceeds so held to which all five of the above conditions apply. For example, an insurance contract on the decedent's life may provide for payment of the proceeds into two funds to be held by the insurer. In such case, if all five of the above conditions are satisfied with respect to all amounts payable into one such fund, then the special rule of section 812(e) (1) (G) is applicable to the proceeds held in such fund.

The provisions of section 812(e) (1) (G) are applicable with respect to a property interest which passed from the decedent in the form of proceeds of a policy of insurance upon the decedent's life, a policy of insurance upon the life of a person who predeceased the decedent, a matured endowment policy, or an annuity contract, but only in case such proceeds are to be held by the insurer. With respect to proceeds under any such contract which are to be held by a trustee, with power of appointment in the surviving spouse, see paragraph (*c*) of this section. As to the treatment of proceeds not meeting the requirements of such paragraph (*c*) or of this paragraph, see paragraph (*b*) of this section.

In the case of a contract under which payments by the insurer commenced during the decedent's life, it is immaterial whether conditions (1) to (5) were satisfied prior to the decedent's death.

Conditions (1) and (2) are satisfied if, under the terms of the contract, the spouse has the right exercisable annually (or more frequently) to require distribution to herself of installments of the proceeds, or interest on the proceeds, as the case may be, and otherwise such installments or interest is to be accumulated and held by the insurer pursuant to the terms of the contract. A contract which otherwise requires the insurer to make annual or more frequent payments to the surviving spouse following the decedent's death, will not be disqualified merely because the surviving spouse must comply with certain formalities in order to obtain the first payment. For example, the contract may satisfy conditions (1) and (2) even though it requires the surviving spouse to furnish proof of death before the first payment is made. Condition (1) is satisfied where interest on the proceeds is payable, annually or more frequently, for a term, or until the occurrence of a specified event, following which the proceeds are to be paid in annual or more frequent installments.

In determining whether the terms of the contract satisfy conditions (3), (4), and (5), the principles stated in paragraph (*c*) of this section are applicable. As stated in such paragraph (*c*), the surviving spouse's power to appoint is "exercisable in all events" only if it is in existence immediately following the decedent's death. For examples of formal limitations on the power which will not disqualify the contract, see such paragraph (*c*). Where the power is exercisable from the moment of the decedent's death, the contract is not disqualified merely because the insurer may require proof of the decedent's death as a condition to making payment to the appointee. Where the submission of proof of the decedent's death is a condition to the exercise of the power, the power will not be considered "exercisable in all events" unless, in the event the surviving spouse had died immediately following the decedent, her power to appoint would have been considered to exist at the time of her death, within the meaning of section 811(f) (3). (See section 81.24(*b*) (1).)

It is sufficient for the purposes of condition (3) if the surviving spouse has the unqualified power, exercisable in favor of herself or her estate, to appoint all amounts held by the insurer which are payable after her death. Such power to appoint need not extend to installments or interest which will be paid to such spouse during her life.

It is not necessary that the phrase "power to appoint" be used in the contract. For example, condition (3) is satisfied by terms of a contract which give the surviving spouse a right which is in substance and effect a power to appoint to herself or her estate, such as a right to withdraw the amount remaining in the fund held by the insurer, or a right to direct that any amount held by the insurer under the contract at her death shall be paid to her estate.

(*e*) *Effect of disclaimer.*—Section 812(e) (4) (A) provides that where the surviving spouse makes a disclaimer of any property interest which would otherwise be considered as having passed from the decedent to such spouse, such disclaimed interest is to be considered as having passed from the decedent to the person or persons entitled to receive such interest as a result of the disclaimer. A disclaimer is a complete and unqualified refusal to accept the rights to which one is entitled. It is, therefore, necessary, for the purpose of section 812(e) (4) (A), to distinguish between the surviving spouse's disclaimer of a property interest and her acceptance and subsequent disposal of a property interest. For example, if proceeds of insurance are payable to the surviving spouse and she refuses such proceeds which consequently pass to an alternative beneficiary designated by the decedent, the provisions of section 812(e)(4)(A) are applicable and the proceeds are considered as having passed from the decedent to the alternative beneficiary. On the other hand, if the surviving spouse directs the insurance company to hold the proceeds at interest during her life and, upon her death, to pay the principal sum to another person designated by her, thus effecting a transfer of a remainder interest therein, such proceeds are considered as having passed from the decedent to such spouse.

However, under the provisions of section 812(e)(4)(B), it is unnecessary to distinguish, for the purposes of the marital deduction, between a disclaimer by a person other than the surviving spouse and a transfer by such person. Such section provides that where the surviving spouse becomes entitled to receive an interest in property from the decedent as a result of a disclaimer made by some other person, such interest is, nevertheless, considered as having passed from the decedent, not to the surviving spouse, but to the person who made the disclaimer, as though the disclaimer had not been made. Where, as a result of a disclaimer made by a person other than the surviving spouse, a property interest passes to a trust which meets the conditions set forth in paragraph (c) of this section, the rule stated in the preceding sentence applies, not only with respect to the portion of such interest which beneficially vests in the surviving spouse, but also with respect to the portion over which such spouse acquires a power to appoint. Such rule applies also in the case of proceeds under a life insurance, endowment, or annuity contract, which, as a result of a disclaimer made by a person other than the surviving spouse, are held by the insurer subject to the conditions set forth in paragraph (*d*) of this section.

(*f*) *Effect of election by surviving spouse.*—The following rules are applicable where the surviving spouse may elect between a property interest offered to her under the decedent's will or other instrument and a property interest to which she is otherwise entitled (such as dower, a right in the decedent's estate, or her interest under community property laws) of which adverse disposition was attempted under such will or other instrument. If the surviving spouse elects to take against the will or other instrument, then (1) the property interest offered thereunder is not considered as having "passed from the decedent to his surviving spouse" and (2) the dower or other property interest retained by her is considered as having so passed only if it otherwise so qualifies under this section. If the surviving spouse elects to take under the will or other instrument, then (i) the dower or other property interest relinquished by her is not considered as having "passed from the decedent to his surviving spouse" (irrespective of whether it otherwise comes within the definition stated in paragraph (*b*) of this section) and (ii) the interest taken under the will or other instrument is considered as having so passed only if it otherwise so qualifies under this section. As to the valuation of the property interest taken under the will or other instrument, see paragraph (*b*) of section 81.47c.

(*g*) *Will contests.*—If as a result of a controversy involving the decedent's will, or involving any bequest or devise thereunder, his surviving spouse assigns or surrenders a property interest in settlement of such controversy, the interest so assigned or surrendered is not considered as having "passed from the decedent to his surviving spouse."

If as a result of a controversy involving the will, or involving any bequest or devise thereunder, a property interest is assigned or surrendered to the surviving spouse, the interest so acquired will be regarded as having "passed from the decedent to his surviving spouse" only if such assignment or surrender was a bona fide recognition of enforceable rights of the surviving spouse in the decedent's estate. Such a bona fide recognition will be presumed where such assignment or surrender was pursuant to a decision of a local court upon the merits in an adversary proceeding following a genuine and active contest. However, such a decree will be accepted only to the extent that the court passed upon the facts upon which deductibility of the property interest depends. If such assignment or surrender was pursuant to a decree rendered by consent, or pursuant to an agreement not to contest the will or not to probate the will, it will not necessarily be accepted as a bona fide evaluation of the rights of the spouse.

SEC. 81.47b. NONDEDUCTIBLE INTERESTS.—(*a*) *General.*—The property interests which passed from the decedent to his surviving spouse (as set forth in section 81.47a) fall within two general categories: (1) those with respect to which the marital deduction is authorized, and (2) those with respect to which the marital deduction is not authorized. Such categories are hereinafter referred to as "deductible interests" and "nondeductible interests," respectively. As to the several classes of "nondeductible interests," see paragraphs (*b*) to (*f*), inclusive, of this section. Subject to the limitation set forth in section 81.47d, the marital deduction is equal in amount to the aggregate value of the "deductible interests," that is, the property interests which passed from the decedent to his surviving spouse and do not fall within any of the classes described in such paragraphs (*b*) to (*f*).

(*b*) *Interests not included in gross estate.*—Any property interest which passed from the decedent to his surviving spouse is a "nondeductible interest" to the extent it is not included in the decedent's gross estate.

(*c*) *Interests with respect to which a deduction is taken under section 812(b).*—Where a deduction taken under section 812(b) specifically pertains to a property interest which passed from the decedent to his surviving spouse, such interest is, to the extent of such deduction under section 812(b), a "nondeductible interest." Thus, a property interest which passed from the decedent to his surviving spouse in satisfaction of a deductible claim of such spouse against the estate is, to the extent of the claim, a "nondeductible interest." (See paragraph (*b*) of section 81.47c.) If during settlement of the estate a loss deductible under section 812(b) occurs with respect to a property interest, then such interest is, to the extent of the deductible loss, a "nondeductible interest" for the purposes of the marital deduction. Amounts deducted under section 812(b)(5) for any allowance for the support of the surviving spouse during the settlement of the estate, or under section 812(b)(2) for commissions allowed to the surviving spouse as executor do not come within the definition of interests which "passed from the decedent to his surviving spouse." As to the valuation, for the purpose of the marital deduction, of any property interest which passed from the decedent to his surviving spouse subject to a mortgage or other incumbrance, see paragraph (*b*) of section 81.47c.

(*d*) *Interest in property which another person may possess or enjoy.*—Section 812(e)(1)(B) provides that no marital deduction shall be allowed with respect to certain property interests (referred to generally as "terminable interests") which passed from the decedent to his surviving spouse, in case—

(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 from the decedent to his surviving spouse.

The foregoing provision is applicable only where interests in the same property passed from the decedent both to his surviving spouse, and to some other person (for less than an adequate and full consideration in money or money's worth), and is applicable irrespective of whether both such interests passed from the decedent at the same time or under the same instrument. Under such circumstances, if the other person to whom an interest passed may, by reason thereof, possess or enjoy any part of the property after the termination or failure of the interest therein which passed from the decedent to his surviving spouse, the latter interest is a "nondeductible interest." As to the meaning of the term "passed from the decedent to a person other than his surviving spouse," see paragraph (*b*) of section 81.47a.

In determining whether an interest in the same property passed from the decedent both to his surviving spouse and to some other person, a distinction is to be drawn between "property," as such term is used in section 812(e), and an "interest in property." The term "property" refers to the underlying property in which various interests exist; each such interest is not for this purpose to be considered as "property."

Interests which passed to a person other than the surviving spouse include interests so passing under the decedent's exercise, release, or nonexercise of a nontaxable power to appoint. It is immaterial whether the property interest which passed from the decedent to a person other than his surviving spouse is included in the decedent's gross estate.

The term "person other than his surviving spouse" includes the possible unascertained takers of a property interest, as, for example, the members of a class to be ascertained in the future. As another example, assume that the decedent created a power of appointment over a property interest, which does not come within the purview of paragraph (*c*) or (*d*) of section 81.47a. In such a case, the term "person other than his surviving spouse" refers to the possible appointees and possible takers in default (other than the spouse) of such property interest. Whether there is a possibility that the "person other than his surviving spouse" (or the heirs or assigns of such person) may possess or enjoy the property following termination or failure of the interest therein which passed from the decedent to his surviving spouse is to be determined as of the time of the decedent's death.

In the following examples it is assumed that the property interest which passed from the decedent to a person other than his surviving spouse was not for an adequate and full consideration in money or money's worth:

(i) H (the decedent) devised real property to W (his surviving wife) for life, with remainder to A and his heirs. The interest which passed from H to W is a "nondeductible interest" since it will terminate upon her death and A (or his heirs or assigns) will thereafter possess or enjoy the property.

(ii) H devised real property to W for life, and created in W a power, exercisable by will, to appoint the remainder interest to any person. In default of appointment by W, the remainder interest was to go to A and his heirs. Assuming that under the local law W did not take the real property as absolute owner, nor as trustee of a trust meeting the requirements of section 81.47a(*c*), the interest which passed from H to W is a "nondeductible interest" since such interest will terminate upon her death and A (or his heirs or assigns) may thereafter possess or enjoy the property. (As to cases in which a "deductible interest" may exist where a life interest is coupled with a power to appoint under a trust or insurance contract, see paragraphs (*c*) and (*d*) of section 81.47a.)

(iii) H bequeathed the residue of his estate in trust for the benefit of W and A. The trust income is to be paid to W for life, and upon her death the corpus is to be distributed to A or his issue. However, if A should die without issue, leaving W surviving, the corpus is then to be distributed to W. The interest which passed from H to W is a "nondeductible interest" since it will terminate in the event of her death if A or his issue survive, and A or his issue will thereafter possess or enjoy the property.

(iv) H during his lifetime purchased an annuity contract providing for payments to himself for life and then to W for life if she should survive him. Upon the death of the survivor of H and W, the excess, if any, of the cost of the contract over the annuity payments theretofore made was to be refunded to A. The interest which passed from H to W is a "nondeductible interest" since A may possess or enjoy a part of the property following the termination of the interest of W. If, however, the contract provided for no refund upon the death of the survivor of H and W, or provided that any refund was to go to the estate of the survivor, then the interest which passed from H to W is (to the extent it is included in H's gross estate) a "deductible interest."

(v) H devised property to W and A as joint tenants with right of survivorship. The interest which passed from H to W is a "nondeductible interest" since, if the tenancy is not severed and A survives W, the interest of W will terminate and A will continue to possess or enjoy the property.

(vi) H, in contemplation of death, transferred a residence to A for life with remainder to W provided W survives A, but if W predeceases A, the property is to pass to B and his heirs. If it is assumed that H died during A's lifetime, and the value of the residence was included in determining the value of his gross estate, the interest which passed from H to W is a "nondeductible interest" since such interest will terminate if W predeceases A and the property will thereafter be possessed or enjoyed by B (or his heirs or assigns). This result is not affected by B's assignment of his interest during H's lifetime, whether made in favor of W or another person, since the term "assigns" (as used in section 812(e)(1)(B)) includes such assignee. However, if it is assumed that A predeceased H, the interest of B in the property was extinguished, and, viewed as of the time of the subsequent death of H, the interest which passed from him to W is the entire interest in the property and, therefore, a "deductible interest."

(vii) H transferred real property to A, reserving the right to the rentals of the property for a term of 20 years. H died within such 20-year term, bequeathing the right to the remaining rentals to a trust. The terms of the trust satisfy the five conditions stated in paragraph (*c*) of section 81.47a, so that the property interest which passed in trust is considered to have passed from H to W. Such interest is a "nondeductible interest" since it will terminate upon the expiration of the term and A will thereafter possess or enjoy the property.

(viii) H bequeathed a patent to W and A as tenants in common. In this case, the interest of W will terminate upon the expiration of the term of the patent, but possession or enjoyment of the property by A must necessarily cease at the same time. Therefore, since A's possession or enjoyment cannot outlast the termination of W's interest, the latter is a "deductible interest."

The above-stated provision is to be applied with respect to the property interests which actually passed from the decedent. Subsequent conversions of the property are immaterial for this purpose. Thus, where a decedent bequeathed his estate to his wife for life with remainder to his children, the interest which passed to his wife is a "nondeductible interest," even though the wife agrees with the children to take a fractional share of the estate in lieu thereof, or sells the life estate for cash, or acquires the remainder interest of the children either by purchase or gift.

Section 812(e) (1) (D) provides an exception to the general rule stated in this paragraph. In general, the object of section 812(e) (1) (D) is to prevent a property interest from being classified as "nondeductible" where (*a*) the only condition under which it will terminate is the death of the surviving spouse within 6 months after the decedent's death, or the death of such spouse as a result of a common disaster which also resulted in the decedent's death, and (*b*) such condition does not in fact occur. The following examples illustrate the application of the exception provided by section 812(e) (1) (D):

Example (1). A decedent bequeathed his entire estate to his spouse on condition that she survive him by 6 months. In the event his spouse failed to survive him by 6 months, his estate was to go to his niece and her heirs. The decedent was survived by his spouse. It will be observed that, as of the time of the decedent's death, it was possible that the niece would, by reason of the interest which passed to her from the decedent, possess or enjoy the estate after the termination of the interest therein which passed to the spouse. Hence, under the general rule set forth in this paragraph, the interest which passed to the spouse would be regarded as a "nondeductible interest." If the surviving spouse in fact died within 6 months after the decedent's death, such general rule is to be applied, and the interest which passed to such spouse is a "nondeductible interest." However, if such spouse in fact survived the decedent by 6 months, thus extinguishing the interest of the niece, the case comes within the exception provided by section 812(e) (1) (D), and the interest which passed to such spouse is a "deductible interest." (It is assumed for the purpose of this example that no other factor which would cause such interest to be "nondeductible" is present.)

Example (2). The facts are the same as in example (1) except that the will provided that the estate was to go to the niece either in case the decedent and his spouse should both die as a result of a common disaster, or in case the spouse should fail to survive the decedent by 3 months. It is assumed that the decedent was survived by his spouse. In this example, the interest which passed from the decedent to his surviving spouse is to be regarded as a "nondeductible interest" in case the surviving spouse in fact died either within 3 months after the decedent's death or as a result of a common disaster which also resulted in the decedent's death. However, if such spouse in fact survived the decedent by 3 months, and did not thereafter die as a result of a common disaster which also resulted in the decedent's death, the exception provided under section 812(e) (1) (D) will apply.

Where the only condition which will cause the interest taken by the surviving spouse to terminate is of such nature that it can occur only within 6 months following the decedent's death, the exception provided under section 812(e) (1) (D) will apply, provided the condition does not in fact occur. However, where such condition (unless it relates to death as a result of a common disaster) is one which may occur either within such 6-month period or thereafter, the exception provided under section 812(e) (1) (D) will not apply.

Where a property interest passed from the decedent to his surviving spouse subject to the condition that she does not die as a result of a common disaster which also resulted in the decedent's death, the exception provided under section 812(e)(1)(D) will not be applied in the final audit of the return if there is still a possibility that the surviving spouse may be deprived of such property interest by operation of the common disaster provision as given effect by the local law.

(*e*) *Terminable interest to be acquired by executor or trustee.*—Section 812(e)(1)(B) also provides that no marital deduction may be taken with respect to a life estate or other "terminable interest" which is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by a trustee. Other examples of "terminable interests" are an annuity, an estate for years, a patent, and a copyright. Section 812(e)(1)(B) provides that a property interest shall not be considered a "terminable interest" merely because it is the ownership of a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or for a term.

The foregoing provision is applicable only with respect to any property interest which the decedent directed his executor or a trustee to expend, subsequently to his death, in the acquisition of a life estate, annuity, or other "terminable interest" for his surviving spouse. In such a case the property interest which is to be so expended is a "nondeductible interest." The foregoing provision is not applicable, however, in the case of a general authorization to reinvest property, whereunder the executor or trustee may acquire either "terminable interests" or other property interests.

Example. A decedent bequeathed $100,000 to his wife, subject to a direction to his executor to use such bequest for the purchase of an annuity for the wife. The bequest is of a "nondeductible interest."

(*f*) *Interest payable out of a group of assets.*—Section 812(e)(1)(C) provides that where the assets (included in the decedent's gross estate) out of which, or the proceeds of which, an interest passing to the surviving spouse may be satisfied include a particular asset or assets with respect to which no deduction would be allowed if such asset or assets passed from the decedent to such spouse, then the value of such interest passing to such spouse shall, for the purpose of the marital deduction, be reduced by the aggregate value of such particular assets.

In order for the foregoing provision to apply, two circumstances must coexist, as follows:

(1) The property interest which passed from the decedent to his surviving spouse must be payable out of a group of assets included in the gross estate. Examples of property interests payable out of a group of assets are a general legacy, a bequest of the residue of the decedent's estate or of a portion of the residue, and a right to a share of the corpus of a trust upon its termination.

(2) The group of assets out of which the property interest is payable must include one or more particular assets which, if passing specifically to the surviving spouse, would be "nondeductible interests."

If the above circumstances are both present, the property interest payable out of the group of assets is (except as to any excess of its value over the aggregate value of the particular asset or assets which would not be deductible if passing specifically to the surviving spouse) a "nondeductible interest."

Example. A decedent bequeathed one-third of the residue of his estate to his wife. The property passing under the decedent's will included a right to the rentals of an office building for a term of years, reserved by the decedent under a deed of the building by way of gift to his son. The decedent did not make a specific bequest of the right to such rentals. Such right, if passing specifically to the wife, would be a "nondeductible interest." (See paragraph (*d*) of this section.) If it is assumed that the value of the bequest of one-third of the residue of the estate to the wife was $85,000, and that the right to the rentals was included in the gross estate at a value of $60,000, then the bequest is, to the extent of $60,000, a "nondeductible interest."

SEC. 81.47c. VALUATION OF PROPERTY INTEREST PASSING TO SURVIVING SPOUSE.—(*a*) *In general.*—The value, for the purpose of the martital deduction, of any "deductible interest" which passed from the decedent to his surviving spouse is to be determined as of the date of the decedent's death, unless the executor elects the optional valuation method in accordance with the provisions of section 81.11, in which case the value of any such interest is to be determined as of such date with adjustment as explained in section 81.11. The marital deduction may be taken only with respect to the net value of any "deductible interest" which passed from the decedent to his surviving spouse, the same principles being applicable as if the amount of a gift to such spouse were being determined. In determining the value of the interest in property passing to the spouse account must be taken of the effect of any material limitations upon her right to income from the property. An example of a case in which this rule may be applied is a case in which the decedent bequeaths property in trust for the benefit of his spouse but the income from such property from the date of the decedent's death until distribution of the property to the trustee is to be used to pay expenses incurred in the administration of the estate.

(*b*) *Property interest subject to an incumbrance or obligation.*—Section 812(e)(1)(E) provides that where a property interest passed from the decedent to his surviving spouse subject to a mortgage or other incumbrance, or where an obligation is imposed upon the surviving spouse by the decedent in connection with the passing of a property interest, the value of such property interest is to be reduced by the amount of such mortgage, other incumbrance, or obligation. The passing of a property interest subject to the imposition of an obligation by the decedent does not include a bequest, devise, or transfer in lieu of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate. The passing of a property interest subject to the imposition of an obligation by the decedent does, however, include a bequest, etc., in lieu of the interest of his surviving spouse under community property laws unless such interest was, immediately prior to the decedent's death, a mere expectancy. (As to the circumstances under which the interest of the surviving spouse is regarded as a mere expectancy see paragraph (*b*) of section 81.47d.)

The following are illustrative of property interests which passed from the decedent to his surviving spouse subject to the imposition of an obligation by the decedent:

(1) A decedent devised a residence valued at $25,000 to his wife, with a direction that she pay $5,000 to his sister. For the purpose of the marital deduction, the value of the property interest passing to the wife is only $20,000.

(2) A decedent devised real property to his wife in satisfaction of a debt owing to her. The debt is a deductible claim under section 812(b)(3). Since the wife is obliged to relinquish such claim as a condition to acceptance of the devise, the value of the devise is, for the purpose of the marital deduction, to be reduced by the amount of such claim.

(3) A decedent bequeathed certain securities to his wife in lieu of her interest in property held by them as community property under the law of the State of their residence. The wife elected to relinquish her community property interest and to take the bequest. For the purpose of the marital deduction, the value of the bequest is to be reduced by the value of the community property interest relinquished by the wife.

(*c*) *Effect of death taxes.*—Section 812(e)(1)(E) provides that in the determination of the value of any property interest which passed from the decedent to his surviving spouse, there shall be taken into account the effect which the Federal estate tax, or any estate, succession, legacy, or inheritance tax, has upon the net value to the surviving spouse of such property interest.

For example, assume that the only bequest to the surviving spouse is of $100,000 and such spouse is required to pay State inheritance tax in the amount of $1,500. If no other death taxes affect the net value of the bequest, such value, for the purpose of the marital deduction, is $98,500.

To take another example, assume that a decedent devised to his wife real property having a value for Federal estate tax purposes of $100,000, and also bequeathed to her a "nondeductible" interest for life under a trust. The State of residence values the real property at $90,000 and the life interest at $30,000, and imposes an inheritance tax (at graduated rates) of $4,800 with respect to the two interests. If it is assumed that such inheritance tax is required to be paid by the wife, the amount thereof to be ascribed to the devise is—

$$\frac{90,000}{120,000} \times \$4,800 = \$3,600$$

Accordingly, if no other death taxes affect the net value of the bequest, such value, for the purpose of the marital deduction, is $100,000 less $3,600, or $96,400.

If the decedent bequeaths his residuary estate, or a portion thereof, to his surviving spouse, and his will contains a direction that all death taxes shall be payable out of such residuary estate, the value of the bequest, for the purpose of the marital deduction, is based upon the amount of the residue as reduced pursuant to such direction. If the residuary estate, or a portion thereof, is bequeathed to the surviving spouse, and by the local law the Federal estate tax is payable out of the residuary estate, the value of the bequest, for the purpose of the marital deduction, may not exceed the amount thereof as reduced by the Federal estate tax.

(*d*) *Remainder interests.*—Where the income from property is made payable to another individual for life, or for a term of years, with remainder absolutely to the surviving spouse or to her estate, the marital deduction is based upon the present value of the remainder. The present value of the remainder is to be determined in accordance with the rules stated in section 81.10(*i*). For example, if the surviving spouse is to receive $50,000 upon the death of a person aged 31 years, the present value of the remainder is $15,631. (See example in section 81.10(*i*) (4).) If the remainder is such that its value is to be determined by a special computation (see section 81.10(*i*) (3)), a request for a specific factor accompanied by a statement of the date of birth of each person, the duration of whose life may affect the value of the remainder, and by copies of the relevant instruments may be submitted to the Commissioner who in his discretion may supply the factor requested. If the Commissioner does not furnish the factor, the claim for deduction must be supported by a full statement of the computation of the present worth made, in accordance with the principles set forth in section 81.10(*i*), by one skilled in actuarial computations.

SEC. 81.47d. LIMITATION ON AMOUNT OF MARITAL DEDUCTION.—(*a*) *In general.*—The allowable marital deduction is limited to the smaller of the following amounts:

(1) The aggregate value of the "deductible interests" which passed from the decedent to his surviving spouse, as determined under sections 81.47a to 81.47c.

(2) Fifty percent of the value of the "adjusted gross estate," as determined under this section.

Except as provided in paragraph (*b*) of this section (relating to community property), the "adjusted gross estate" is to be determined by subtracting from the entire value of the gross estate the aggregate amount of the deductions allowed under section 812(b). (See sections 81.29 to 81.40.)

Example. The value of a decedent's gross estate is $200,000 and the aggregate amount of the deductions allowed by section 812(b) is $30,000. (It is assumed for the purpose of this example that the decedent and his spouse never held any property as community property.) The value of the "adjusted gross estate" is, therefore, $200,000 less $30,000, which is $170,000. It is assumed that the aggregate value of the "deductible interests" which passed from the decedent to his surviving spouse is $100,000. The allowable marital deduction is limited to $85,000 (50 percent of the value of the "adjusted gross estate").

(*b*) *Special rule in case involving community property.*—If the decedent and his surviving spouse at any time held property as "community property," as hereinafter defined, the "adjusted gross estate" referred to in paragraph (*a*) of this section is to be determined by subtracting from the entire value of the gross estate the sum of the following values and amounts:

(1) The value of any property included in the gross estate which was at the time of the decedent's death held by him and his surviving spouse as "community property," as hereinafter defined.

(2) The value of property (to the extent included in the gross estate) transferred by the decedent during his life, if at the time of such transfer the property was held by him and his surviving spouse as "community property," as hereinafter defined.

(3) The amount (to the extent included in the gross estate) receivable as insurance under policies upon the life of the decedent to the extent purchased with premiums or other consideration paid out of property then held by him and his surviving spouse as "community property," as hereinafter defined.

(4) An amount, A, which bears the same ratio to B (the aggregate amount of the deductions allowed by section 812(b)) as C (the value of the gross estate, diminished by the aggregate amount subtracted under subparagraphs (1), (2), and (3) of this paragraph) bears to D (the entire value of the gross estate).

Where a policy of insurance upon the life of the decedent was purchased partly with property held by him and his surviving spouse as "community property," as hereinafter defined, and partly with other property, the amount receivable under such policy is considered, for the purpose of subparagraph (3) of this paragraph, to have been purchased with such "community property" in the proportion that the payments made with such "community property" bear to the total amount paid. If only a portion of the proceeds of a policy is included in the gross estate, only such portion of the proceeds, and only the premiums or other consideration paid for such portion, are to be included in the computation stated in the preceding sentence. (See section 81.27.)

In determining the "adjusted gross estate" under this paragraph, property held by the decedent and his surviving spouse as "community property," at the time of the death of the decedent (for the purpose of subparagraph (1) of this paragraph), at the time of the transfer (for the purpose of subparagraph (2) of this paragraph), or at the time of the payment of insurance premiums or other consideration (for the purpose of subparagraph (3) of this paragraph), is considered to include:

(i) Any property held by them at such time as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, except such property in which the surviving spouse had at such time merely an expectant interest.

(ii) Separate property acquired by the decedent as a result of a "conversion" (during the calendar year 1942 or after April 2, 1948) of property held by him and his surviving spouse as community property under the law of any State, Territory, or possession of the United States, or of any foreign country (except such property in which the surviving spouse had at the time of the "conversion" merely an expectant interest) into their separate property.

(iii) Property acquired by the decedent in exchange (by one exchange or a series of exchanges) for separate property acquired as set forth under (ii) of this paragraph.

The surviving spouse is regarded as having merely an expectant interest in property held as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, (*a*) at the time of the decedent's death if the entire value of such property (and not merely one-half thereof) is includible in the decedent's gross estate, or (*b*) at the time of any transfer, payment of insurance premiums or other consideration, or "conversion" if, in case of the death of the decedent at such time, the entire value of the property involved in such transfer, payment, or "conversion" (and not merely one-half thereof) would, without regard to the provisions of section 811(e)(2), have been so includible.

The characteristics of property which acquired a noncommunity instead of a community status by reason of an agreement (whether antenuptial or postnuptial) are such that section 812(e)(2)(C) classifies the property as community property of the decedent and his surviving spouse in the computation of the "adjusted gross estate." In distinguishing property which thus acquired a noncommunity status from property which acquired such a status solely by operation of the community property law, section 812(e)(2)(C) refers to the former category of property as "separate property" acquired as a result of a "conversion" of "property held as such community property." As used in section 812(e)(2)(C), the phrase "property held as such community property" is used to denote the body of property comprehended within the community property system; the expression "separate property" includes any noncommunity property (whether held in joint tenancy, tenancy by the entirety, tenancy in common, or otherwise);

and the term "conversion" includes any transaction or agreement which transforms property from a community status into a noncommunity status.

The separate property which section 812(e)(2)(C) classifies as community property is not limited to that which was in existence at the time of the conversion. The following are illustrative of the scope of section 812(e)(2)(C): A partition of community property between husband and wife, whereby a portion of such property became the separate property of each, is a conversion of such property; a transfer of community property into some other form of co-ownership, such as a joint tenancy, is a conversion of such property; an agreement (whether made before or after marriage) that future earnings and gains which would otherwise be community property shall be shared by them as separate property effects a conversion of such earnings and gains; a change in the form of ownership of property which causes the future rentals therefrom, which would otherwise have been acquired as community property, to be acquired as separate property effects a conversion of such rentals.

The rules of section 812(e)(2)(C) are applicable, however, only if the conversion took place during the calendar year 1942 or after April 2, 1948, and only to the extent stated herein.

Where the value of the separate property acquired by the decedent as a result of a conversion did not exceed the value of the separate property thus acquired by the surviving spouse, the entire separate property thus acquired by the decedent is to be considered, for the purposes of this paragraph, as held by him and his surviving spouse as community property. Where the value (at the time of the conversion) of the separate property so acquired by the decedent exceeded the value (at such time) of the separate property so acquired by the spouse, only a part of the separate property so acquired by the decedent (and only the same fractional part of property acquired by him in exchange for such separate property) is to be considered, for the purposes of this paragraph, as held by him and his surviving spouse as community property. The part of such separate property (or property acquired in exchange therefor) which is considered as so held is the same proportion thereof which the value (at the time of the conversion) of the separate property so acquired by the spouse is of the value (at such time) of the separate property so acquired by the decedent.

Example (1). The value of a decedent's gross estate is $300,000, of which $200,000 represents his separate property and $100,000 represents his one-half interest in community property. The decedent's separate property was inherited from his father. The deductions allowed under section 812(b) total $45,000. In this example, the "adjusted gross estate" is computed as follows:

Value of gross estate		$300,000
Reduction under subparagraph (1)	$100,000	
Reduction under subparagraph (4) (200,000/300,000 of $45,000)	30,000	
Total reduction		130,000
Adjusted gross estate		170,000

In this example the marital deduction will be $85,000 (one-half the value of the "adjusted gross estate") in case the aggregate value of the "deductible interests" which passed from the decedent to his surviving spouse equals or exceeds such amount.

Example (2). The facts are the same as in example (1) except that the decedent's separate property was not inherited from his father, but was acquired under the following transaction:

On November 1, 1942, the decedent and his surviving spouse partitioned certain community property then having a value of $224,000. A portion of such property, then having a value of $160,000, was converted into the decedent's separate property, and the remaining portion, then having a value of $64,000, was converted into his spouse's separate property. The portion of the separate property so acquired by the decedent which is considered as held as community property at the time of his death is represented by that proportion of $200,000 (the value, at the time of death, of such separate property) which $64,000 (the value, at the time of the conversion, of the separate property so acquired by his spouse) bears to $160,000 (the value, at the time of the conversion, of the separate prop-

erty so acquired by the decedent), which proportion equals **$80,000. The "adjusted gross estate" is computed as follows:**

Value of gross estate		$300,000
Reduction under subparagraph (1) ($100,000 plus $80,000)	$180,000	
Reduction under subparagraph (4) (120,000/300,000 of $45,000)	18,000	
Total reduction		198,000
Adjusted gross estate		102,000

The burden of establishing the extent to which separate property of the decedent was acquired other than as described in (ii) and (iii) of this paragraph rests upon the executor.

SEC. 81.47e. PROOF REQUIRED.—The executor must submit such proof as is necessary to establish the right of the estate to the marital deduction, including any evidence requested by the Commissioner.

PAR. 18. Section 81.53, as amended by Treasury Decision 5239 [26 CFR 81.53], is further amended as follows:

(A) By striking out "the three following exceptions" and by inserting in lieu thereof the following: "the four following exceptions".

(B) By inserting at the end thereof the following subparagraph:

(4) The condition set forth under section 81.41(a)(6) should be disregarded in determining whether the deduction is available.

PAR. 19. There is inserted immediately preceding section 81.83 [26 CFR 81.83] the following:

SEC. 365. LIABILITY OF LIFE INSURANCE BENEFICIARIES, ETC. (REVENUE ACT OF 1948; ENACTED APRIL 2, 1948.)

(a) Section 826(c) of the Internal Revenue Code (relating to liability of life insurance beneficiaries) is hereby amended by adding at the end thereof the following new sentence: "In the case of such proceeds receivable by the surviving spouse of the decedent for which a deduction is allowed under section 812(e) (the so-called 'marital deduction'), this subsection shall not apply to such proceeds except as to the amount thereof in excess of the aggregate amount of the marital deductions allowed under such subsections."

(b) Section 826(d) of the Internal Revenue Code (relating to liability of recipient of property over which decedent had power of appointment) is hereby amended by adding at the end thereof the following new sentence: "In the case of such property received by the surviving spouse of the decedent for which a deduction is allowed under section 812(e) (the so-called 'marital deduction'), this subsection shall not apply to such property except as to the value thereof reduced by an amount equal to the excess of the aggregate amount of the marital deductions allowed under section 812(e) over the amount of proceeds of insurance upon the life of the decedent receivable by the surviving spouse for which proceeds a marital deduction is allowed under such subsection."

(c) The amendments made by this section shall be applicable only with respect to estates of decedents dying after December 31, 1947.

PAR. 20. Section 81.79(*b*) [26 CFR 81.79(b)] is amended by inserting immediately preceding the period at the end of the first sentence of the fourth undesignated paragraph thereof the following: "; (5) the portion of the marital deduction allowed under the provisions of section 812(e) on account of bequests, etc., of such interests to the decedent's surviving spouse."

(This Treasury Decision is issued under authority contained in section 3791 of the Internal Revenue Code (53 Stat. 467; 26 U. S. C. 3791) and pursuant to the provisions of Public Laws 471 and 869, Eightieth Congress.)

FRED S. MARTIN,
Acting Commissioner of Internal Revenue.

Approved May 13, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register May 18, 1949, 8:50 a. m.)

SECTION 811(c)

REGULATIONS 105, SECTION 81.17: Transfers intended to take effect at or after the decedent's death. — 1949–4–13025 Ct. D. 1710

ESTATE TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. GROSS ESTATE—TRANSFER IN TRUST—INTENDED TO TAKE EFFECT IN POSSESSION OR ENJOYMENT AT OR AFTER DEATH.

A trust agreement was executed in 1924 by decedent, in which he and two brothers were named trustees. Decedent reserved no power to alter, amend or revoke, but required the trustees to pay him the trust income for life. *Held:* The transfer was intended to take effect in possession or enjoyment at decedent's death because the trust agreement reserved to him a life income in the property, and the value of the trust corpus is includible in the decedent's gross estate under the provisions of section 811(c) of the Internal Revenue Code.

2. DECISION REVERSED.

Decision of the United States Court of Appeals, Third Circuit (161 Fed. (2d) 11), reversed.

3. DECISION FOLLOWED.

Helvering v. *Hallock*, 309 U. S. 106 (Ct. D. 1440, C. B. 1940–1, 223), followed.

4. DECISION OVERRULED.

May v. *Heiner*, 281 U. S. 238 (Ct. D. 186, C. B. IX–1, 382 (1930)), overruled.

SUPREME COURT OF THE UNITED STATES

Commissioner of Internal Revenue, petitioner, v. *Estate of Francois L. Church, Deceased, Edward E. Black, Executor*

On writ of certiorari to the United States Court of Appeals for the Third Circuit

[January 17, 1949]

OPINION

Mr. Justice BLACK delivered the opinion of the Court.

This case raises questions concerning the interpretation of that part of section 811(c) of the Internal Revenue Code which for estate tax purposes requires including in a decedent's gross estate the value of all the property the decedent had transferred by trust or otherwise before his death which was "intended to take effect in possession or enjoyment at or after his death * * *" *Estate of Spiegel* v. *Commissioner, post*, page —, involves questions which also depend upon interpretation of that provision of section 811(c). After argument and consideration of the cases at the October 1947 term, an order was entered restoring them to the docket and requesting counsel upon reargument particularly to discuss certain questions broader in scope than those originally presented and argued. (Journal Supreme Court, 297–298, June 21, 1948.) Those additional questions have now been fully treated in briefs and oral arguments.

This case involves a trust executed in 1924 by Francois Church, then 21 years of age, unmarried and childless. He executed the trust in New York in accordance with State law. Church and two brothers were named cotrustees. Certain corporate stocks were transferred to the trust with grant of power to the trustees to hold and sell the stocks and to reinvest the proceeds. Church reserved no power to alter, amend, or revoke, but required the trustees to pay him the income for life. This reservation of life income is the decisive factor here.

At Church's death in 1939 the trust was to terminate and the trust agreement contained some directions for distribution of the trust assets when he died. These directions as to final distribution did not, however, provide for all possible contingencies. If Church died without children and without any of his brothers or sisters, or their children, surviving him, the trust instrument made no provision for disposal of the trust assets. Had this unlikely possibility come to pass (at his death there were living, 5 brothers, 1 sister, and 10 of their children) the distribution of the trust assets would have been controlled by New York law. It has been the Government's contention that under New York law had there been no such surviving trust beneficiaries the corpus would have reverted to the decedent's estate. This possibility of reverter plus the retention by the settlor of the trust income for life, the Government has argued, requires inclusion of the value of the trust property in the decedent's gross estate under our holding in *Helvering* v. *Hallock* (309 U. S. 106 [Ct. D. 1440, C. B. 1940-1, 223]).

The Hallock case held that where a person while living makes a transfer of property which provides for a reversion of the corpus to the donor upon a contingency terminable at death, the value of the corpus should be included in the decedent's gross estate under the "possession or enjoyment" provision of section 811(c) of the Internal Revenue Code.[1] In this case, the Tax Court, relying upon its former holdings[2] declared that "The mere possibility of reverter by operation of law upon a failure of the trust, due to the death of all the remaindermen prior to the death of decedent, is not such a possibility as to come within the Hallock case." This holding made it unnecessary for the Tax Court to decide the disputed question as to whether New York law operated to create such a reversionary interest. The United States Court of Appeals for the Third Circuit, one judge dissenting, affirmed on the ground that it could not identify a clear-cut mistake of law in the Tax Court's decision. (161 Fed. (2d) 11.) The United States Court of Appeals for the Seventh Circuit in the Spiegel case found that under Illinois law there was a possibility of reverter and reversed the Tax Court, holding that possible reversion by operation of law required inclusion of a trust corpus in a decedent's estate. (*Commissioner* v. *Spiegel's Estate*, 159 Fed. (2d) 257.) Other United States courts of appeal have held the same.[3] Because of this conflict we granted certiorari in this and the Spiegel case.

Counsel for the two estates have strongly contended in both arguments of these cases that the law of neither New York nor Illinois provides for a possibility of reverter under the circumstances presented. They argue further that even if under the law of those States a possibility of reverter did exist, it would be an unjustifiable extension of the Hallock rule to hold that such a possibility requires inclusion of the value of a trust corpus in a decedent's estate. The respondent in this case pointed out the extreme improbability that the decedent would have outlived all his brothers, his sister, and their 10 children. He argues that the happening of such a contingency was so remote, the money value of such a reversionary interest was so infinitesimal, that it would be entirely unreasonable to hold that the Hallock rule requires

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[1] The Hallock case considered the "possession or enjoyment" language of section 811(c) which appeared in section 302(c) of the 1926 Revenue Act (44 Stat. 9, 70), as amended by section 803(a) of the Revenue Act of 1932 (47 Stat. 169, 279, 26 U. S. C., section 811(c)).

[2] *Estate of Cass* (3 T. C. 562), *Commissioner* v. *Kellogg* (119 Fed. (2d) 54, affirming 40 B. T. A. 916), *Estate of Downe* (2 T. C. 967), *Estate of Houghton* (2 T. C. 871), *Estate of Goodyear* (2 T. C. 885), *Estate of Delaney* (1 T. C. 781).

[3] *Commissioner* v. *Bayne's Estate* (155 Fed. (2d) 475), *Commissioner* v. *Bank of California* (155 Fed. (2d) 1), *Thomas* v. *Graham* (158 Fed. (2d) 561), *Beach* v. *Busey* (156 Fed. (2d) 496).

an estate tax because of such a contingency. But see *Fidelity-Philadelphia Trust Co.* v. *Rothensies* (324 U. S. 108, 112 [Ct. D. 1630, C. B. 1945, 406]).

Arguments and consideration of this and the Spiegel case brought prominently into focus sharp divisions among courts, judges and legal commentators, as to the intended scope and effect of our Hallock decision, particularly whether our holding and opinion in that case are so incompatible with the holding and opinion in *May* v. *Heiner* (281 U. S. 238 [Ct. D. 186, C. B. IX–1, 382 (1930)]), that the latter can no longer be accepted as a controlling interpretation of the "possession or enjoyment" provision of section 811(c).[4] *May* v. *Heiner* held that the corpus of a trust transfer need not be included in a settlor's estate, even though the settlor had retained for himself a life income from the corpus. We have concluded that confusion and doubt as to the effect of our Hallock case on *May* v. *Heiner* should be set at rest in the interest of sound tax and judicial administration. Furthermore, if *May* v. *Heiner* is no longer controlling, the value of the Church trust corpus was properly included in the gross estate, without regard to the much discussed State law question, since Church reserved a life estate for himself. For reasons which follow, we conclude that the Hallock and *May* v. *Heiner* holdings and opinions are irreconcilable. Since we adhere to Hallock, the *May* v. *Heiner* interpretation of the "possession or enjoyment" provisions of section 811(c) can no longer be accepted as correct.

The "possession or enjoyment" provision appearing in section 811(c) seems to have originated in a Pennsylvania inheritance tax law in 1826.[5] As early as 1884 the Supreme Court of Pennsylvania held that where a legal transfer of property was made which carried with it a right of possession with a reservation by the grantor of income and profits from the property for his life, the transfer was not intended to take effect in enjoyment until the grantor's death: "One certainly cannot be considered, as in the actual enjoyment of an estate, who has no right to the profits or incomes arising or accruing therefrom." (*Reish, Adm'r* v. *Commonwealth*, 106 Pa. 521, 526.) That court further held that the "possession or enjoyment" clause did not involve a mere technical question of title, but that the law imposed the death tax unless one had parted during his life with his possession and his title and his enjoyment. It was further held in that case that the test of "intended" was not a subjective one, that the question was not what the parties intended to do, but what the transaction actually effected as to title, possession and enjoyment.

Most of the States have included the Pennsylvania-originated "possession or enjoyment" clause in death tax statutes, and with what appears to be complete unanimity, they have up to this day, despite *May* v. *Heiner*, substantially agreed with this 1884 Pennsylvania Supreme Court interpretation.[6] Congress used the "possession or enjoyment" clause in death tax legislation in 1862, 1864, and 1898. (12 Stat. 432, 485; 13 Stat. 223, 285; 30 Stat. 448, 464.) In referring to the provision in the 1898 Act, this Court said that it made "the liability for taxation depend, not upon the mere vesting in a technical sense of title to the gift, but upon the actual possession or enjoyment thereof." *Vanderbilt* v. *Eidman*, 196 U. S. 480, 493.) And 5 years before the 1916 estate tax statute incorporated the "possession or enjoyment" clause to frustrate estate tax evasions, 39 Stat. 756, 780, this Court had affirmed a judgment of the New York Court of Appeals sustaining the constitutionality of its State inheritance tax in an opinion which said: "It is true that an ingenious mind may devise other means of avoiding an inheritance tax, but the one commonly used is a transfer with reservation of a life estate." (*Matter of Keeney*, 194 N. Y. 281, 287; *Keeney* v. *New York*, 222 U. S. 525.) And see *Helvering* v. *Bullard* (303 U. S. 297, 302 [Ct. D. 1318, C. B. 1938–1, 495]), where the foregoing quotation was repeated with seeming approval.

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[4] Cf. *Estate of Hughes* (44 B. T. A. 1196), with *Estate of Bradley* (1 T. C. 518, affirmed *sub. nom. Helvering* v. *Washington Trust Co.*, 140 Fed. (2d) 87). See *New York Trust Co.* v. *United States* (51 F. Supp. 733). Cf. Montgomery, Federal Taxes—Estates, Trusts and Gifts, 461–462, 480–482 (1946) with Paul, Federal Estate and Gift Taxation, 1946 Supp. sections 7.15, 7.23. See also note, Inter Vivos Transfers and the Federal Estate Tax, 49 Yale L. J. 1118 (1940); Eisenstein, Estate Taxes and the Higher Learning of the Supreme Court, 3 Tax L. Rev. 395 (1948).

[5] Note, Origin of the Phrase, "Intended To Take Effect in Possession or Enjoyment At or After * * * Death" (section 811(c), Internal Revenue Code), 56 Yale L. J. 176 (1946).

[6] See cases collected in 49 A. L. R. 878–892; 67 A. L. R. 1250–1254; 100 A. L. R. 1246–1254. See also Rottschaefer, Taxation of Transfers Taking Effect in Possession at Grantor's Death, 26 Iowa L. Rev. 514 (1941); Oliver, Property Rationalism and Tax Pragmatism, 20 Tex. L. Rev. 675, 704–709 (1942).

From the first estate tax law in 1916 until *May* v. *Heiner*, *supra*, was decided in 1930, trust transfers which were designed to distribute the corpus at the settlor's death and which reserved a life income to the settlor had always been treated by the Treasury Department as transfers "intended to take effect in possession or enjoyment at * * * his death." The regulations had so provided and millions of dollars had been collected from taxpayers on this basis. See *e. g.*, T. D. 2910, 21 Treas. Dec. 771 (1919); and see 74 Cong. Rec. 7078, 7198–7199 (March 3, 1931). This principle of estate tax law was so well settled in 1928, that the Circuit Court of Appeals decided *May* v. *Heiner* in favor of the Government in a one-sentence *per curiam* opinion. (32 Fed. (2d) 1017.) Nevertheless, March 2, 1931, this Court followed *May* v. *Heiner* in three cases in *per curiam* opinions, thus upsetting the century-old historic meaning and the long standing Treasury interpretation of the "possession or enjoyment" clause. (*Burnet* v. *Northern Trust Co.*, 283 U. S. 782; *Morsman* v. *Burnet*, 283 U. S. 783; *McCormick* v. *Burnet*, 283 U. S. 784.)

March 3, 1931, the next day after the three *per curiam* opinions were rendered, Acting Secretary of the Treasury Ogden Mills wrote a letter to the Speaker of the House explaining the holdings in *May* v. *Heiner* and the three cases decided the day before. He pointed out the disastrous effects they would have on the estate tax law and urged that Congress "in order to prevent tax evasion," immediately "correct this situation" brought about by *May* v. *Heiner* and the other cases. (74 Cong. Rec. 7198, 7199 (1931).) He expressed fear that without such action the Government would suffer "a loss in excess of one-third of the revenue derived from the Federal estate tax, with anticipated refunds of in excess of $25,000,000." The Secretary's surprise at the decisions and his apprehensions as to their tax evasion consequences were repeated on the floor of the House and Senate. (74 Cong. Rec. *supra*.) Senator Smoot, chairman of the Senate Finance Committee, said on the floor of the Senate that this judicial interpretation of the statute "came almost like a bombshell, because nobody ever anticipated such a decision." (74 Cong. Rec. 7078.) Both houses of Congress unanimously passed and the President signed the requested resolution that same day.[7]

February 28, 1938, this Court held that neither passage of the resolution nor its later inclusion in the 1932 Revenue Act was intended to apply to trusts created before its passage. (*Hassett* v. *Welch*, *Helvering* v. *Marshall*, 303 U. S. 303 [Ct. D. 1317, C. B. 1938-1, 490].) Accordingly, if the corpus of the Church trust executed in 1924 is to be included in the settlor's estate without this court's involvement in the intricacies of State property law, it must be done by virtue of the possession and enjoyment section as it stood without the language added by the joint resolution.

Crucial to the court's holding in *May* v. *Heiner* was its finding that no interest in the corpus passed at the settlor's death because legal title had passed from the settlor irrevocably when the trust was executed; for this reason the grantor's reservation of the trust income for his life[8]—one of the chief bundle-of-ownership interests—was held not to bring the transfer within the category of transfers "intended to take effect in * * * enjoyment at * * * his death." This Court had never before so limited the possession or enjoyment section.[9] Thus

[7] "(c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, *including a transfer under which the transferor has retained for his life or any period not ending before his death (1) the possession or enjoyment of, or the income from, the property or (2) the right to designate the persons who shall possess or enjoy the property or the income therefrom* * * *." The italics are added to indicate the additions made by the amendments to section 302(c) of the Revenue Act of 1926. Joint Resolution of March 3, 1931, 46 Stat. 1516–1517.

[8] The *May* v. *Heiner* trust provided for the income to go to Barney May during his lifetime, after his death to his wife, Pauline May, the grantor, and upon her death the corpus was to be distributed to the grantor's four children. The court said that the record failed clearly to disclose whether Mrs. May survived her husband, but held this was of no special importance.

[9] The court also quoted from and relied heavily on *Reinecke* v. *Northern Trust Co.* (278 U. S. 339, 345 [T. D. 4261, C. B. VIII-1, 305 (1929)]). This Court there held that the corpus of two trusts that reserved a life income to the grantor plus a power to revoke should have been included in the decedent's estate. The corpus of five other trusts were held not includable. These five trusts did not reserve a power in the grantor alone to revoke, nor did they reserve a life estate to the grantor, but they provided for accumulation of that income during the settlor's life, and at his death it was to go to the beneficiaries, subject to prior use by the beneficiaries as directed by the settlor. Thus, this case did not directly support the *May* v. *Heiner* holding. Nor is *May* v. *Heiner* supported by *Shukert* v. *Allen* (273 U. S. 545 [T. D. 4071, C. B. VI-2, 349 (1927)]), as shown by reference to *Shukert* v. *Allen* in the Reinecke opinion at page 347.

was formal legal title rather than the substance of a transaction made the sole test of taxability under section 811(c). For from the viewpoint of the grantor the significant effect of this transaction was his continued enjoyment and retention of the income until his death; the important consequence to the remaindermen was the postponement of their right to this enjoyment of the income until the grantor's death.

The effect of the court's interpretation of this estate tax section was to permit a person to relieve his estate from the tax by conveying its legal title to trustees whom he selected, with an agreement that they manage the estate during his life, pay to him all income and profits from the property during his life, and deliver it to his chosen beneficiaries at death. Preparation of papers to defeat an estate tax thus became an easy chore for one skilled in the "various niceties of the art of conveyancing." (*Klein* v. *United States*, 283 U. S. 231, 234 [Ct. D. 333, C. B. X–1, 462 (1931)].) And by this simple method one could, despite the "possession or enjoyment" clause, retain and enjoy all the fruits of his property during life and direct its distribution at death, free from taxes that others less skilled in tax technique would have to pay. Regardless of these facts *May* v. *Heiner* held that such an instrument preserving the beneficial use of one's property during life and providing for its distribution and delivery at death was "not testamentary in character." (*May* v. *Heiner*, *supra* at 243. Cf. *Keeney* v. *New York*, *supra* at 535, 536.)

One year after *May* v. *Heiner*, this Court decided *Klein* v. *United States*, *supra*. There the grantor made a deed conveying property to her husband for his life with provisions that if he survived the wife he should "by virtue of this convey-Code. (47 Stat. 169, 279, 26 U. S. C., section 811(c).) The particular provision remain vested in" the wife should her husband die first. This Court pointed out that in general and under the law of Illinois where the deed was made, vesting of title in the grantee "depended upon the condition precedent that the death of the grantor happen *before* that of the grantee." Thus, since it was found that under Illinois law, legal title to the land had been retained by the wife, it was held that the value of the land should be included in her gross estate under the "possession or enjoyment" section. The court did not cite *May* v. *Heiner*.

In 1935, this Court decided *Helvering* v. *St. Louis Trust Co.* (296 U. S. 39 [Ct. D. 1046, C. B. XIV–2, 339 (1935)]) and *Becker* v. *St. Louis Trust Co.* (296 U. S. 48 [Ct. D. 1044, C. B. XIV–2, 337 (1935)]). In each of these cases the court again, as in *May* v. *Heiner*, delved into the question of legal title under rather subtle property law concepts and decided that the legal title of the trust properties there, unlike the situation in the Klein transfer, had passed irrevocably from the grantor. This passage of bare legal title was held to be enough to render the possession or enjoyment section inapplicable. These cases were expressly overruled by *Helvering* v. *Hallock*.

Helvering v. *Hallock* was decided in 1940. Three separate trusts were considered in the Hallock case. These three trusts as those considered in the St. Louis Trust and Becker cases, had been executed with provisions for reversion of the trust properties to the grantors should the grantors outlive the beneficiaries. The trusts had been executed in 1917, 1919, and 1925. In the Hallock case this Court was again asked to limit the effect of section 811(c) by emphasis upon the formal passage of legal title. By such concentration on elusive legal title, the Court was invited to lose sight of the plain fact that complete enjoyment had been postponed. We declined to limit the effectiveness of the possession or enjoyment provision of section 811(c) by attempting to define the nature of the interest which the decedent retained after his *inter vivos* transfer. We called attention to the snares which inevitably await an attempt to restrict estate tax liability on the "niceties of the art of conveyancing" at page 117. We declared that the statute now under consideration "taxes not merely those interests which are deemed to pass at death according to refined technicalities of the law of property. It also taxes *inter vivos* transfers that are too much akin to testamentary dispositions not to be subjected to the same excise," page 112, and *inter vivos* gifts "resorted to, as a substitute for a will, in making dispositions of property operative at death," page 114.

As pointed out by the dissent in Hallock, we there directly and unequivocally rejected the only support that could possibly suffice for the holdings in *May* v. *Heiner*. That support was the court's conclusion in *May* v. *Heiner*, that retention of possession or enjoyment of his property was not enough to require inclusion of its value in the gross estate if a trust grantor had succeeded in passing bare legal title out of himself before death. In Hallock we emphasized our removal of that support by declaring that section 811(c) "deals with property not technically passing at death but with interests theretofore created. The taxable event is a transfer *inter vivos*. But the measure of the tax is the value of the transferred property at the time when death brings it into enjoyment," pages 110–111.

Moreover, the Hallock case, page 114, stands plainly for the principle that "In determining whether a taxable transfer becomes complete only at death we look to substance, not to form * * * However we label the device [if] it is but a means by which the gift is rendered incomplete until the donor's death" the "possession or enjoyment" provision applies.

How is it possible to call this trust transfer "complete" except by invoking a fiction? Church was sole owner of the stocks before the transfer. Probably their greatest property value to Church was his continuing right to get their income. After legal title to the stocks was transferred, somebody still owned a property right in the stock income. That property right did not pass to the trust beneficiaries when the trust was executed; it remained in Church until he died. He made no "complete" gift effective before that date, unless we view the trust transfer as a "complete" gift to the trustees. But Church gave the trustees nothing, either partially or completely. He transferred no right to them to get and spend the stock income. And under the teaching of the Hallock case, quite in contrast to that of *May* v. *Heiner*, passage of the mere technical legal title to a trustee is not necessarily crucial in determining whether and when a gift becomes "complete" for estate tax purposes. Looking to substance and not merely to form, as we must unless we depart from the teaching of Hallock, the inescapable fact is that Church retained for himself until death a most valuable property right in these stocks—the right to get and to spend their income. Thus Church did far more than attach a "string" to a remotely possible reversionary interest in the property, a sufficient reservation under the Hallock rule to make the value of the corpus subject to an estate tax. Church did not even risk attaching an unbreakable cable to the most valuable property attribute of the stocks, their income. He simply retained this valuable property, the right to the income, for himself until death, when, for the first time the stock with all its property attributes "passed" from Church to the trust beneficiaries. Even if the interest of Church was merely "obliterated," in *May* v. *Heiner* language, it is beyond all doubt that simultaneously with his death, Church no longer owned the right to the income; the beneficiaries did. It had then "passed." It never had before. For the first time, the gift had become "complete."

Thus, what we said in Hallock was not only a repudiation of the reasoning which was advanced to support the two cases (St. Louis Trust and Becker) that Hallock overruled, but also a complete rejection of the rationale of *May* v. *Heiner* on which the two former cases had relied. Hallock thereby returned to the interpretation of the "possession or enjoyment" section under which an estate tax cannot be avoided by any trust transfer except by a bona fide transfer in which the settlor, absolutely, unequivocally, irrevocably, and without possible reservations, parts with all of his title and all of his possession and all of his enjoyment of the transferred property. After such a transfer has been made, the settlor must be left with no present legal title in the property, no possible reversionary interest in that title, and no right to possess or to enjoy the property then or thereafter. In other words such a transfer must be immediate and out and out, and must be unaffected by whether the grantor lives or dies. See *Shukert* v. *Allen* (273 U. S. 545, 547); *Smith* v. *Shaughnessy* (318 U. S. 176 [Ct. D. 1575, C. B. 1943, 1144]). We declared this to be the effect of the Hallock case in *Goldstone* v. *United States* (325 U. S. 687, 690, 691 [Ct. D. 1644, C. B. 1945, 398]). There we said with reference to section 811(c) in connection with our Hallock ruling: "* * * It thus sweeps into the gross estate all property the ultimate possession or enjoyment of which is held in suspense until the moment of the decedent's death or thereafter. * * * Testamentary dispositions of an *inter vivos* nature cannot escape the force of this section by hiding behind legal niceties contained in devices and forms created by conveyancers." And see *Fidelity-Philadelphia Trust Co.* v. *Rothensies*, *supra*, and *Commissioner* v. *Estate of Field* (324 U. S. 113 [Ct. D. 1631, C. B. 1945, 408]).

It is strongly urged that we continue to regard *May* v. *Heiner* as controlling and leave its final repudiation to Congress. Little effort is made to defend the *May* v. *Heiner* interpretation of "possession or enjoyment" on the ground that it truly reflects the congressional purpose, nor do we think it possible to attribute such a purpose to Congress. There is no persuasive argument, if any at all, that trusts reserving life estates with remainders over at grantors' deaths are not satisfactory and effective substitutes for wills. In fact, the purpose of this settlor as expressed in his trust papers was to make "provision for any lawful issue" he might "leave at the time of his death as well as provide an income for himself for life." This paper, labeled a trust, but providing for all the substantial purposes of a will, was intended to and did postpone until the settlor's death the right of his relatives to possess and enjoy his property. There may be trust instruments that fall more clearly within the class intended to be treated as substitutes for wills by the "possession or enjoyment" clause, but we doubt it.

The argument for continuing the error of *May* v. *Heiner* is not on the merits but is advanced in the alleged interest of tax stability and certainty, *stare decisis* and a due deference to the just expectations of those who have relied on the *May* v. *Heiner* doctrine. Special stress is laid on Treasury regulations which since the *Hassett* v. *Welch* holding in 1938 have accepted the *May* v. *Heiner* doctrine and have not provided that the value of a trust corpus must be included in the decedent's gross estate where a grantor had reserved the trust income. It is even argued that Congress in some way ratified the *May* v. *Heiner* doctrine when it passed the joint resolution and that if not, the decision in the Hassett and Marshall cases set at rest all questions as to the soundness of the *May* v. *Heiner* interpretation. We find no merit in these contentions.

What was said in the Hallock opinion on the question of *stare decisis* would appear to be a sufficient answer to that contention here. The Hallock opinion also answers the argument as to recent Treasury regulations, all of which were made by the Treasury under compulsion of this court's cases. Furthermore, the history of the struggle of the Treasury to subject such transfers as this to the estate tax law, a history shown in part in the *Hassett* v. *Welch* opinion, has served to spotlight the abiding conviction of the Treasury that the *May* v. *Heiner* statutory interpretation should be rejected. In view of the struggle of the Treasury in this tax field, the variant judicial and Tax Court opinions, our opinion in the Hallock case and others which followed, it is not easy to believe that taxpayers who executed trusts prior to the 1931 joint resolution felt secure in a belief that *May* v. *Heiner* gave them a vested interest in protection from estate taxes under trust transfers such as this one. And so far as this trust is concerned, Treasury regulations required the value of its corpus to be included in the gross estate when it was made in 1924, and most of the period from then up to the settlor's death in 1939.

Moreover, the *May* v. *Heiner* doctrine has been repudiated by the Congress and repeatedly challenged by the Treasury. It certainly is not an overstatement to say that this Court's Hallock opinion and holding treated *May* v. *Heiner* with scant respect. We said Congress had "displaced" the *May* v. *Heiner* construction of section 811(c); in overruling the St. Louis Trust cases we pointed out that those cases had relied in part on the "congressionally discarded *May* v. *Heiner* doctrine"; we thought Congress "had in principle already rejected the general attitude underlying" the *May* v. *Heiner* and St. Louis Trust cases; and finally our Hallock opinion demolished the only reasoning ever advanced to support the *May* v. *Heiner* holding. And in the Hallock case, trusts created in 1917, 1919, and 1925 were held subject to the estate tax under the provisions included in section 811(c). What we said and did about *May* v. *Heiner* in the Hallock case took place in 1940, 2 years after *Hassett* v. *Welch* had held that the 1931 and 1932 amendments could not be applied to trusts created before 1931. Certainly, *May* v. *Heiner* cannot be granted the sanctuary of *stare decisis* on the ground that it has had a long and tranquil history free from troubles and challenges.

Nor does the joint resolution or the opinion in the *Hassett* v. *Welch* and *Helvering* v. *Marshall* cases, decided together, support an argument that the *May* v. *Heiner* doctrine be left undisturbed. It would be impossible to say that Congress in 1931 intended to accept and ratify decisions that hit the Congress like a "bombshell." [10] And in *Hassett* v. *Welch* the Government did not ask this Court to reexamine or overrule *May* v. *Heiner* or the three *per curiam* cases that

[10] A May 22, 1931, bulletin of the Treasury Department indicates a strong reason for the Treasury Department's construction of the resolution as inapplicable to pre-1931 trust transfers. (T. D. 4314, X–1, Cum. Bull. 450–451 (1931).) That reason was obviously a fear that this Court might hold that the tax could not constitutionally be applied to trusts previously created under the *Nichols* v. *Coolidge* (274 U. S. 531 [T. D. 4072, C. B. VI–2, 351 (1927)]) line of cases. This same apprehension may well have been the underlying reason for a statement, relied on by the dissent, made on the floor of the House that the resolution was not made "retroactive for the reason that we were afraid that the Senate would not agree to it." (74 Cong. Rec. 7199 (1931).) Recent cases have indicated that the fear of such a constitutional interpretation is not a valid one. (*Central Hanover Bank* v. *Kelly*, 319 U. S. 94, 97–98; *Fernandez* v. *Wiener*, 326 U. S. 340, 355 [Ct. D. 1657, C. B. 1946–1, 270].)

relied on *May* v. *Heiner*. In fact, the Government brief argued that *May* v. *Heiner* on its facts was distinguishable from *Hassett* v. *Welch*. The Government brief also pointedly insisted that its position in *Hassett* v. *Welch* did "not require a reexamination of the three *per curiam* decisions of March 2, 1931." It was the Government's sole contention in the Hassett and Marshall cases that the 1932 reenactment of the joint resolution was not limited in application to trusts thereafter created, but was intended to make the new 1932 amendment applicable to past trust agreements. That contention was rejected. The holding was limited to that single question.

The plain implications of the Hallock opinion recognize that the Hassett and Marshall cases did not reaffirm the *May* v. *Heiner* doctrine. In the Marshall case the trust, created in 1920, contained a provision that should the settlor outlive the trust beneficiary, the trust corpus would revert to the settlor. That is the very type of provision which we held in Hallock would require inclusion of its value in the settlor's estate. Since the Hallock case did not overrule the Marshall case involving a trust created in 1920, it must have accepted the Marshall and Hassett cases as deciding no more than that the value of the trust properties there could not be included in the decedent's gross estate where the Government's sole reliance was on a retroactive application of the 1931 and 1932 amendments to the estate tax law.

That the Hallock opinion did not treat the Hassett and Marshall cases as having reaffirmed this court's interpretation of the pre-1931 possession or enjoyment clause is further emphasized by the effect of the Hallock case on the type of trust in *McCormick* v. *Burnet* (283 U. S. 784), a trust created before 1931. The United States Court of Appeals in that case had held that the trust property should be included in the decedent's estate chiefly because of the trust provision that the corpus should revert to the settlor in the event that she outlived her three children. (43 Fed. (2d) 277.) This Court in its *per curiam* opinion reversed the court of appeals and held that the McCormick corpus need not be included in the decedent's estate. Our Hallock case held directly the contrary, for since Hallock, the McCormick corpus would have to be taxed under the pre-1931 language of section 811(c). In so interpreting the pre-1931 language in the Hallock case, we necessarily rejected the contention made there that the Congress by passage of the resolution and this Court by the Hassett and Marshall opinions had accepted as correct the *May* v. *Heiner* restrictive interpretation of section 811(c). It is plain that this Court in the Hallock case considered that the Hassett and Marshall cases held no more than that the 1931 and 1932 amendments were prospective, and that neither the congressional resolution nor the Hassett and Marshall cases were designed to give new life and vigor to the *May* v. *Heiner* doctrine.[11]

The reliance of respondent here on the Hassett and Marshall cases is misplaced. We hold that this trust agreement, because it reserved a life income in the trust property, was intended to take effect in possession or enjoyment at the settlor's death and that the Commissioner therefore properly included the value of its corpus in the estate.

Reversed.

Mr. Justice JACKSON concurs in the result.

Dissenting opinions by Mr. Justice REED, Mr. Justice FRANKFURTER, and Mr. Justice BURTON.

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[11] A dissent filed in this case has an appendix citing "DECISIONS DURING THE PAST DECADE IN WHICH LEGISLATIVE HISTORY WAS DECISIVE OF CONSTRUCTION OF A PARTICULAR STATUTORY PROVISION." Many other decisions of less recent date could also be cited to establish this well known fact which nobody disputes. But we think here, in the language of our opinion in the Hallock case, which opinion was written by the author of today's dissent, that the actions of Congress relied on in the dissent have not "under any rational canons of legislative significance * * * impliedly enacted into law a particular decision which, in the light of later experience, is seen to create confusion and conflict in the application of a settled principle of internal revenue legislation." (*Helvering* v. *Hallock*, 309 U. S. 106, 121, note 7.) The basic "settled principle" now as when Hallock was written is that where a trust agreement reserves the settlor's possession or enjoyment of part or all of the trust property until death, the value of the trust should be included in the settlor's gross estate.
The arguments in dissent here based on *stare decisis*, legislative history, and possible consequences of this Court's holding, are strikingly like the forceful arguments made in the Hallock dissent. But the persuasive and sound arguments advanced by the Court's spokesman in Hallock were there considered by the majority of this Court to be a sufficient answer to what was said in the Hallock dissent. Particularly forceful was this Court's statement in the Hallock opinion that "we walk on quicksand when we try to find in the absence of corrective legislation a controlling legal principle."

REGULATIONS 105, SECTION 81.17: Transfers intended to take effect at or after the decedent's death.

1949-4-13026
Ct. D. 1711

ESTATE TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. GROSS ESTATE—TRANSFER IN TRUST—INTENDED TO TAKE EFFECT IN POSSESSION OR ENJOYMENT AT OR AFTER DEATH—POSSIBILITY OF REVERTER.

In 1920 decedent made a transfer in trust of certain stocks to himself and another. During his life the trust income was to be divided among his three children; if they did not survive him, to any of their surviving children. On his death the corpus was to be distributed in the same manner, but no provision was made for distribution of corpus and accumulated income should decedent survive all of his children and grandchildren. *Held:* The value of the trust property and accumulated income is includible in decedent's gross estate under the rule declared in *Helvering* v. *Hallock*, 309 U. S. 106 (Ct. D. 1440, C. B. 1940-1, 223), because under the applicable Illinois law the trust agreement left the way open for the property to revert to decedent in case he outlived all the beneficiaries. Inclusion in the gross estate of a trust corpus under section 811(c) of the Internal Revenue Code is not dependent upon the value of the contingent reversionary interest, but upon whether after a trust transfer some present or contingent right or interest in the property still remains in the settlor so that full and complete title, possession or enjoyment does not absolutely pass to the beneficiaries until at or after the settlor's death.

2. DECISION AFFIRMED.

Decision of the United States Court of Appeals, Seventh Circuit (159 Fed. (2d) 257), affirmed.

SUPREME COURT OF THE UNITED STATES

Estate of Sidney M. Spiegel, Deceased, Katherine J. Spiegel and Robert Michels, Surviving Executors under the Last Will and Testament of Sidney M. Spiegel, Deceased, petitioners, v. *Commissioner of Internal Revenue*

On writ of certiorari to the United States Court of Appeals for the Seventh Circuit

[January 17, 1949]

OPINION

Mr. Justice BLACK delivered the opinion of the Court.

This is a Federal estate tax controversy. Here, as in *Commissioner* v. *Church*, *ante*, page —, we granted certiorari to consider questions dependent upon the meaning and application of a provision of section 811(c) of the Internal Revenue Code. (47 Stat. 169, 279, 26 U. S. C., section 811(c).) The particular provision requires including in a decedent's gross estate the value at his death of all property "To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise * * * intended to take effect in possession or enjoyment at or after his death. * * *"

In 1920 Sidney M. Spiegel, a resident of Illinois, made a transfer by trust of certain stocks to himself and another. He died in 1940. During his life the trust income was to be divided among his three children; if they did not survive him, to any of their surviving children. On his death the trust provided that the corpus was to be distributed in the same manner. But no provision was made for distribution of the corpus and its accumulated income should Mr. Spiegel survive all of his children and grandchildren. For this reason the Government has contended that under controlling State law the property would have reverted to Mr. Spiegel had he survived his designated beneficiaries.

The value of the corpus of this trust was not included in the Spiegel estate tax return. The Commissioner concluded that its value with accumulated income, about $1,140,000, should have been included in the gross estate under section 811(c). The Tax Court held otherwise in an unreported opinion. The Court of

Appeals for the Seventh Circuit reversed. (159 Fed. (2d) 257.) It held that the possession or enjoyment provision of section 811(c) required inclusion of the value of the trust property and accumulated income under the rule declared in *Helvering* v. *Hallock* (309 U. S. 106 [Ct. D. 1440, C. B. 1940–1, 223]), because under State law the trust agreement left the way open for the property to revert to Mr. Spiegel in case he outlived all the beneficiaries. This holding rested on the agreement of parties that whether there was a right of reverter depended on Illinois law, and the court's conclusion that under Illinois law a right of reverter did exist.[1]

The Hallock case on which the court of appeals relied held that the value of trust properties should have been included in a settlor's gross estate under the "possession or enjoyment" provision where trust agreements had expressly provided that the corpus should revert to the settlor in the event he outlived the beneficiaries. The taxpayer has contended here, as in the Tax Court and the court of appeals, that the Hallock rule is not applicable to this trust, where the settlor's chance to get back his property depended on State law and not on an express reservation by the settlor. This contention of the taxpayer rests in part on the argument that section 811(c) imposes a tax only where it can be shown that the settlor's intent was to reserve for himself a contingent reversionary interest in the property. Another contention is that the value of this contingent reversionary interest was so small in comparison with the total value of the corpus that the Hallock rule should not be applied. A third contention is that the court of appeals holding was erroneous in that under Illinois law the corpus of this trust would not have reverted to the settlor had all the beneficiaries died while the settlor was still living. Petitioners urge that in that event the Illinois courts would have held that the corpus passed to the heirs of the last surviving beneficiary.

We hold that the Hallock rule was rightly applied by the court of appeals and we accept its holding as to the applicable Illinois law.

First. In *Commissioner* v. *Church*, *ante*, page —, we have discussed the Hallock holding in relation to the scope of the "possession or enjoyment" provision of section 811(c) and need not elaborate what we said there. What we said demonstrates that the taxability of a trust corpus under this provision of section 811(c) does not hinge on a settlor's motives, but depends on the nature and operative effect of the trust transfer. In the Church case we stated that a trust transaction cannot be held to alienate all of a settlor's "possession or enjoyment" under section 811(c) unless it effects "a bona fide transfer in which the settlor, absolutely, unequivocally, irrevocably, and without possible reservations, parts with all of his title and all of his possession and all of his enjoyment of the transferred property. After such a transfer has been made, the settlor must be left with no present legal title in the property, no possible reversionary interest in that title, and no right to possess or to enjoy the property then or thereafter. In other words such a transfer must be immediate and out and out, and must be unaffected by whether the grantor lives or dies." We add to that statement, if it can be conceived of as an addition, that it is immaterial whether such a present or future interest, absolute or contingent, remains in the grantor because he deliberately reserves it or because, without considering the consequences, he conveys away less than all of his property ownership and attributes, present or prospective. In either event the settlor has not parted with all of his presently existing or future contingent interests in the property transferred. He has therefore not made that "complete" kind of trust transfer that section 811(c) commands as a prerequisite to a showing that he has certainly and irrevocably parted with his "possession or enjoyment." Any requirement less than that which we have outlined, such as a postdeath attempt to probe the settlor's thoughts in regard to the transfer, would partially impair the effectiveness of the "possession or enjoyment" provision as an instrument to frustrate estate tax evasions. To this extent it would defeat the precise purpose for which the provision was originated and which prompted Congress to include it in section 811(c).

Determination of such issues as ownership, possession, enjoyment, whether transfers have been made and the reach of those transfers, may involve many questions of fact. And we have held in many cases that to the extent the determination of such issues depends upon fact finding, many different facts may be

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[1] This court of appeals interpretation and application of section 811(c) was in conflict with the holding of the Third Circuit in *Commissioner of Internal Revenue* v. *Church's Estate* (161 Fed. (2d) 11). We granted certiorari in both cases, arguments have been heard together, and we have today reversed the Church case, *ante*, page —.

relevant. These fact issues in Federal tax cases are for the Tax Court to decide in cases brought before it.

In this case the Tax Court made findings of fact and then decided against the Government. It did so, however, by holding as a matter of law that those facts did not require inclusion of the value of this corpus in the settlor's estate.[2] But the Tax Court's findings of fact showed that the trust contained no provision for disposition of the corpus should the settlor outlive the beneficiaries. This finding of fact, which we accept, plus the court of appeals determination of controlling Illinois law, without more, brings this trust transaction within the scope of the possession or enjoyment provision of section 811(c) as we have interpreted that section in the Hallock and Church cases. And petitioner has not contended that it was denied an opportunity to present any relevant evidence concerning ownership, possession, or enjoyment. It is therefore not necessary to remand the case to the Tax Court for any further finding of facts. See *Hormel* v. *Helvering* (312 U. S. 552, 559–560 [Ct. D. 1498, C. B. 1941–1, 315]).

Second. It is contended that since the monetary value of the settlor's contingent reversionary interest is small in comparison with the total value of the corpus, the possession or enjoyment provision of section 811(c) should not be applied. But inclusion of a trust corpus under that provision is not dependent upon the value of the reversionary interest. (*Fidelity-Philadelphia Trust Co.* v. *Rothensies*, 324 U. S. 108, 112 [Ct. D. 1630, C. B. 1945, 406]; *Commissioner* v. *Estate of Field*, 324 U. S. 113, 116 [Ct. D. 1631, C. B. 1945, 408]; see *Goldstone* v. *United States*, 325 U. S. 687, 691 [Ct. D. 1644, C. B. 1945, 398].) The question is not how much is the value of a reservation, but whether after a trust transfer, considered by Congress to be a potentially dangerous tax evasion transaction, some present or contingent right or interest in the property still remains in the settlor so that full and complete title, possession or enjoyment does not absolutely pass to the beneficiaries until at or after the settlor's death. See *Smith* v. *Shaughnessy* (318 U. S. 176, 181).

Third. It is contended that under Illinois law the corpus of this trust would not have reverted to the settlor had he outlived the beneficiaries. The record reveals that the State law problem here is not an easy one, but under this Court's decision in *Meredith* v. *Winter Haven* (320 U. S. 228), the difficulty involved did not relieve the court of appeals of its duty to make a decision. The questioned ruling was made by three judges who are constantly required to pass upon Illinois law questions. One of the three judges has long been a resident and lawyer of Illinois. Examination of the Illinois State court opinions pressed upon us leaves us unable to say with any degree of certainty that the court of appeals holding was wrong. It is certainly neither novel nor unreasonable for State law to provide that when all trust beneficiaries die the trust corpus should revert to the donor. It would be wholly unprofitable for us to analyze Illinois cases on the point here urged. It is sufficient for us to say that we think reasonable arguments can be made based on Illinois cases to support a determination of this question either for or against the petitioner's contention. Under these circumstances we will follow our general policy and leave undisturbed this court of appeals holding on a question of State law.[3]

All other arguments of the petitioners have been noted and we find them without merit.

Affirmed.

Mr. Justice JACKSON dissents.

Concurring opinion by Mr. Justice REED.

Dissenting opinions by Mr. Justice FRANKFURTER and Mr. Justice BURTON.

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[2] The Tax Court's conclusion of law that the "possession or enjoyment" clause of section 811(c) was inapplicable to the facts of this trust rested in part on its belief that *Reinecke* v. *Northern Trust Co.* (278 U. S. 339 [T. D. 4261, C. B. VIII–1, 305 (1929)]) had decided the issue. But the Hallock case was decided after Reinecke, and the question here involved was not specifically raised in the Reinecke case. Nor did the Court's opinion in that case, written by the late Chief Justice Stone, indicate that a transfer of bare legal title in a transfer must always be accepted as a conclusive showing that the possession and enjoyment provision of section 811(c) cannot be applied to the trust corpus. Cf. Court's opinion in *Harrison* v. *Schaffner* (312 U. S. 579 [Ct. D. 1503, C. B. 1941–1, 321]), written by Chief Justice Stone.

[3] *Helvering* v. *Stuart* (317 U. S. 154, 162–165 [Ct. D. 1566, C. B. 1942–2, 198]); cf. *Steele* v. *General Mills* (329 U. S. 433).

SECTION 812(d), AS AMENDED

REGULATIONS 105, SECTION 81.44: Transfer for public, charitable, religious, etc., uses. (Also Section 81.46.)

1949–3–13019
Ct. D. 1709

ESTATE TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. GROSS ESTATE—DEDUCTIONS—CHARITABLE BEQUEST IN REMAINDER—POSSIBILITY OF INVASION OF CORPUS FOR BENEFIT OF LIFE BENEFICIARY.

Under the terms of decedent's will, his entire gross estate was bequeathed to trustees to hold in trust for his mother during her life. The will directed payment of $750 a month to be used by his mother as she saw fit, and in the event the trust income was insufficient, the executors and trustees were empowered to encroach on corpus to pay such amount. In addition, they were authorized to use in their discretion either income or principal "for the pleasure, comfort and welfare of my mother," a paragraph in the will stating that "The first object to be accomplished * * * is to take care of and provide for my mother in such manner as she may desire * * *." At the mother's death, after the payment of certain legacies, the balance of the estate was to be paid to four named charities, in equal shares. *Held:* The possibility of invasion of corpus on behalf of decedent's mother prevented the ultimate charitable interest, at his death, from being "presently ascertainable, and hence severable from the interest in favor of the private use," within the meaning of section 81.44 of Regulations 105. It is not significant that the trust corpus was intact at the mother's death, for the test of present ascertainability of the ultimate charitable interest is applied at the death of the decedent.

2. DECISION FOLLOWED.

Merchants Bank v. *Commissioner*, 320 U. S. 257 (Ct. D. 1591, C. B. 1943, 1123), followed.

3. DECISION REVERSED.

Decision of the United States Court of Appeals, Sixth Circuit (166 Fed. (2d) 993), reversing 74 Fed. Supp. 113, reversed.

SUPREME COURT OF THE UNITED STATES

Lipe Henslee, individually, now residing in Davidson County, Tenn., Collector of Internal Revenue, District of Tennessee, petitioner, v. *Union Planters National Bank & Trust Co., a national bank at Memphis, Tenn., et al., etc.*

On writ of certiorari to the United States Court of Appeals for the Sixth Circuit

[January 3, 1949]

OPINION

PER CURIAM: Respondents are the executors and trustees of the estate of William Bate Williams. They brought this action for refund, with interest, of $35,899.12 of Federal estate taxes and interest paid under protest. The relevant facts, set forth in respondents' complaint and admitted by the collector's motion to dismiss, are as follows:

William Bate Williams died in 1943. Under the terms of his will, the entire gross estate of $508,411.17 was bequeathed to respondents to hold in trust for the testator's

"beloved mother, Elizabeth Bate Williams, for and during her natural life, with the full power and authority herein conferred.

"I hereby direct both my executors and my trustees to pay to my mother the sum of seven hundred fifty (750.00) dollars a month to be used by her as she sees fit. In the event the income from my estate is not sufficient to pay the said seven hundred fifty ($750.00) dollars each month, then my executors and trustees are hereby empowered, authorized and directed to

> encroach on the corpus of the estate to pay said amount and to sell any of my property, real or personal, for this purpose.
>
> "In addition to this amount my said executors and trustees are authorized and empowered to use and expend in their discretion any portion of my estate, either income or principal, for the pleasure, comfort and welfare of my mother.
>
> "The first object to be accomplished in the administration and management of my estate and this trust is to take care of and provide for my mother in such manner as she may desire and my executors and trustees are fully authorized and likewise directed to manage my estate primarily for this purpose."

The will went on to provide for distribution of the corpus of the estate remaining at the mother's death. Twenty-five percent of the total remaining estate was bequeathed to the testator's cousin, and stated sums in cash were left to other named legatees. After these legacies, the balance of the estate was directed to be paid over to four named charities, in equal shares.

At the time of the testator's death the estate was earning a net income of approximately $15,000 per year, $6,000 more than the amount directed to be paid, at $750 per month, to the testator's mother. The mother at that time was 85 years old, lived on substantially less than $750 per month, and had independent investments worth approximately $100,000 which netted her an income of about $300 per month. A woman of moderate needs and without dependents, she died 3 years later without having requested respondents to invade the trust corpus in her behalf.

The disputed estate tax liability resulted from respondents' attempt to deduct from the gross estate the portion bequeathed to the four charities, in reliance on the charitable deduction provision of section 812(d) of the Internal Revenue Code.[1] The Commissioner denied the deduction. The collector here resists the refund claim, on the ground that the possibility of invasion of the corpus on behalf of the testator's mother prevented the ultimate charitable interest, at the testator's death, from being "presently ascertainable, and hence severable from the interest in favor of the private use," within the meaning of the applicable Treasury Regulation.[2]

On the authority of *Merchants Bank* v. *Commissioner*, 320 U. S. 256 [Ct. D. 1591, C. B. 1943, 1123], the district court granted the collector's motion to dismiss. (74 Fed. Supp. 113.) The court of appeals reversed. (166 Fed. (2d) 993.) It held that, notwithstanding the language of the testamentary provision for the "pleasure, comfort and welfare" of the mother, the complaint's allegations of the mother's great age, independent means and modest tastes raised a triable issue of fact as to whether the trust corpus was threatened with invasion and the charitable interest hence subject to depletion in favor of the testator's mother.

We agree with the district court that this case is governed by the decision in the Merchants Bank case and that the suit should be dismissed. It is apparent on the face of the complaint that this testator's will did not limit the trustees' disbursements to conformity with some ready standard—as where, for example, trustees are to provide the prime beneficiary with such sums as "may be necessary to suitably maintain her in as much comfort as she now enjoys." (*Ithaca Trust Co.* v. *United States*, 279 U. S. 151, 154 [Ct. D. 61, C. B. VIII-1, 313 (1929)].) The stated income here directed to be paid to the mother was "to be used by her as she sees fit." Beyond this the trustees were empowered to invade or wholly utilize the corpus of the estate for the mother's "pleasure, comfort and welfare," bearing in mind the testator's injunction that "The first object to be accomplished * * * is to take care of and provide for my

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[1] 26 U. S. C., section 812(d), 53 Stat. 124–125, as amended by Revenue Act of 1942, section 408(a), 56 Stat. 949, and Revenue Act of 1943, section 511(a), 58 Stat. 74–75.

[2] "If a trust is created for both a charitable and a private purpose, deduction may be taken of the value of the beneficial interest in favor of the former only insofar as such interest is presently ascertainable, and hence severable from the interest in favor of the private use. * * *" (U. S. Treasury Regulations 105, section 81.44 (1942).) Cf. id. at section 81.46: "If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of such power."

mother in such manner as she may desire * * *"[3] As in the Merchants Bank case, where the trustees had discretion to disburse sums for the "comfort, support, maintenance, and/or happiness" of the prime beneficiary, so here we think it the "salient fact * * * that the purposes for which the widow could, and might wish to have the funds spent do not lend themselves to reliable prediction." (320 U. S. 256, 262.)

We do not overlook the unlikelihood that a woman of the mother's age and circumstances would abandon her customary frugality and squander her son's wealth. But, though there may have been little chance of that extravagance which would waste a part or consume the whole of the charitable interest, that chance remained. What common experience might regard as remote in the generality of cases may nonetheless be beyond the realm of precise prediction in the single instance. The contingency which would have diminished or destroyed the charitable interest here considered might well have been insured against, but such an arithmetic generalization of experience would not have made this charitable interest "presently ascertainable."[4] "Rough guesses, approximations, or even the relatively accurate valuations on which the market place might be willing to act are not sufficient." (*Merchants Bank* v. *Commissioner, supra,* at 261.)

Nor do we think it significant that the trust corpus was intact at the mother's death, for the test of present ascertainability of the ultimate charitable interest is applied "at the death of the testator." (Ibid.) The charitable deduction is a matter of congressional grace, and it is for Congress to determine the advisability of permitting amendment of estate tax returns at such time as the probable vesting of the charitable interest has reduced itself to unalterable fact.

Reversed.

Mr. Justice DOUGLAS and Mr. Justice JACKSON dissent upon the grounds stated in dissent in *Merchants Bank* v. *Commissioner,* 320 U. S. 257, at 263.

Dissenting opinion by Mr. Justice FRANKFURTER.

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[3] In view of the express priority accorded the mother's wishes, respondents' fiduciary duty to the ultimate beneficiaries, private and charitable, was ineffective to guarantee preservation of any predictable fraction of the corpus for disposition after the mother's death. The testator, indeed, made the gifts to charity subordinate not only to his mother's interest but to that of all the private beneficiaries, stating in his will that the charitable interest "is a residuary bequest * * * and is not to infringe on any of the other legacies hereinbefore provided."

[4] "* * * [T]he fundamental question in the case at bar, is not whether this contingent interest can be insured against or its value guessed at, but what construction shall be given to a statute. Did Congress in providing for the determination of the net estate taxable, intend that a deduction should be made for a contingency, the actual value of which cannot be determined from any known data? Neither taxpayer, nor revenue officer—even if equipped with all the aid which the actuarial art can supply—could do more than guess at the value of this contingency. It is clear that Congress did not intend that a deduction should be made for a contingent gift of that character." (*Humes* v. *United States,* 276 U. S. 487, 494 [T. D. 4185, C. B. VII–2, 378 (1928)].)

GIFT TAX

INTERNAL REVENUE CODE

REGULATIONS 108, SECTIONS 86.2(a), ETC.

1949–12–13104
T. D. 5698

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B. PART 86.—GIFT TAX UNDER CHAPTER 4 OF THE INTERNAL REVENUE CODE, AS AMENDED

Regulations 108 amended to conform to the Revenue Act of 1948

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

To Collectors of Internal Revenue and Others Concerned:

On November 6, 1948, notice of proposed rule making, regarding the gift tax provisions of the Revenue Act of 1948, enacted April 2, 1948, was published in the Federal Register (13 F. R. 6576). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendments to Regulations 108 [26 CFR, Part 86] set forth below are hereby adopted. Such amendments are necessary in order to conform such regulations to the Revenue Act of 1948.

PARAGRAPH 1. There is inserted immediately preceding section 86.1 [26 CFR 86.1] the following:

SEC. 371. GIFTS OF COMMUNITY PROPERTY. (REVENUE ACT OF 1948; ENACTED APRIL 2, 1948.)

Section 1000(d) of the Internal Revenue Code (relating to gifts of property held as community property) is amended by adding at the end thereof a new sentence to read as follows: "This subsection shall be applicable only to gifts made after the calendar year 1942 and on or before the date of the enactment of the Revenue Act of 1948."

SEC. 374. GIFT OF HUSBAND OR WIFE TO THIRD PARTY. (REVENUE ACT OF 1948; ENACTED APRIL 2, 1948.)

Section 1000 of the Internal Revenue Code (relating to imposition of gift tax) is hereby amended by adding at the end thereof a new subsection to read as follows:

"(f) GIFT OF HUSBAND OR WIFE TO THIRD PARTY.—

"(1) CONSIDERED AS MADE ONE-HALF BY EACH.—

"(A) In General.—A gift made after the date of the enactment of the Revenue Act of 1948 by one spouse to any person other than his spouse shall, for the purposes of this chapter, be considered as made one-half by him and one-half by his spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States. This subparagraph shall not apply with respect to a gift by a spouse of an interest in property if he creates in his spouse a power of appointment, as defined in subsection (c) of this section, over such interest. For the purposes of this subsection an individual shall be considered as the spouse of another individual only if he is married to such individual at the time of the gift and does not remarry during the remainder of the calendar year.

"(B) Consent of Both Spouses.—Subparagraph (A) shall be applicable only if both spouses have signified (in accordance with the regulations provided for in paragraph (2)) their consent to the application of subparagraph (A) in the case of all such gifts made during the calendar year by either while married to the other.

"(2) MANNER AND TIME OF SIGNIFYING CONSENT.—

"(A) Manner.—A consent under this subsection shall be signified in such manner as is provided under regulations prescribed by the Commissioner with the approval of the Secretary.

"(B) Time.—Such consent may be so signified at any time after the close of the calendar year in which the gift was made, subject to the following limitations—

"(i) the consent may not be signified after the 15th day of March following the close of such year, unless before such 15th day no return has been filed for such year by either spouse, in which case the consent may not be signified after a return for such year is filed by either spouse;

"(ii) the consent may not be signified after a notice of deficiency with respect to the tax for such year has been sent to either spouse in accordance with section 1012(a).

"(3) REVOCATION OF CONSENT.—Revocation of a consent previously signified shall be made in such manner as is provided under regulations prescribed by the Commissioner with the approval of the Secretary, but the right to revoke a consent previously signified with respect to a calendar year—

"(A) shall not exist after the 15th day of March following the close of such year if the consent was signified on or before such 15th day; and

"(B) shall not exist if the consent was not signified until after such 15th day.

"(4) JOINT AND SEVERAL LIABILITY FOR TAX.—If the consent required by paragraph (1)(B) is signified with respect to a gift made in any calendar year the liability with respect to the entire tax imposed by this chapter of each spouse for such year shall be joint and several."

PAR. 2. Section 86.2(*a*) [26 CFR 86.2(a)] is amended as follows:

(A) By inserting immediately after the seventh sentence (in parentheses), the following:

Where a joint income tax return is filed under chapter 1 by husband and wife for a taxable year the payment by one spouse of all or part of the income tax liability for such year is not treated as resulting in a transfer which is subject to gift tax. The same rule is applicable to the payment of gift tax for a calendar year in the case of husband and wife who have consented to the application of section 1000(f) for such year.

(B) By inserting at the end thereof the following:

(9) Where property held by a husband and wife as community property is used to purchase insurance upon the husband's life and a third person is revocably designated as beneficiary and under the State law the husband's death is considered to make absolute the transfer by the wife, there is a gift by the wife at the time of such death of one-half the amount of the proceeds of such insurance. (For special provisions with respect to transfers of community property after 1942 and on or before April 2, 1948, see subsection (*c*) of this section.)

PAR. 3. Section 86.2(*c*) [26 CFR 86.2(c)] is amended as follows:

(A) By inserting in the heading immediately following "*1942*" and preceding the period the following: "*and on or before April 2, 1948*".

(B) By striking from the first sentence "During the calendar year 1943 and any calendar year thereafter any gift" and by inserting in lieu thereof the following: "Any gift after December 31, 1942, and on or before April 2, 1948,".

(C) By striking from the last sentence of the second undesignated paragraph "on or after January 1, 1943" and by inserting in lieu thereof the following: "after December 31, 1942, and on or before April 2, 1948".

PAR. 4. There is inserted immediately following section 86.3 [26 CFR 86.3] the following:

SEC. 86.3a. GIFT OF HUSBAND OR WIFE TO THIRD PARTY AFTER APRIL 2, 1948.—(*a*) *In general.*—Section 1000(f), as added by section 374 of the Revenue Act of 1948, makes provision whereby a gift made after April 2, 1948, by one spouse to a person other than his spouse may, for the purpose of the gift tax, be considered as made one-half by him and one-half by his spouse, but only if at the time of the gift each spouse was a citizen or resident of the United States. For the purposes of section 1000(f) an individual is to be considered as the spouse of another individual only if he is married to such individual at the time of the gift and does not remarry during the remainder of the calendar year.

The provisions of section 1000(f) will apply only if both spouses consent. As to the manner and time of signifying such consent, see paragraph (*b*) of this section. Such consent, if signified with respect to any calendar year, is effective with respect to all gifts made to third parties during such year, except as follows:

(1) If the consenting spouses were not married to each other during a portion of the calendar year, the consent is not effective with respect to any gift made during such portion of the calendar year.

(2) If either spouse was a nonresident not a citizen of the United States during any portion of the calendar year, the consent is not effective with respect to any gift made during such portion of the calendar year.

(3) The consent is not effective with respect to a gift by one spouse of a property interest if he created in his spouse a power of appointment (as defined in section 1000(c)) over such property interest.

(4) If one spouse transferred property in part to his spouse and in part to third parties, the consent is effective with respect to the interest transferred to third parties only insofar as such interest is ascertainable at the time of the gift, and hence severable from the interest transferred to his spouse. Section 86.19(*f*) indicates the principles to be applied in the valuation of annuities, life estates, terms for years, remainders and reversions.

(5) A consent signified for the calendar year 1948 is not effective with respect to gifts made on or before April 2, 1948.

The consent applies alike to gifts made by one spouse alone and to gifts made partly by each spouse, provided such gifts were to third parties and do not fall within any of the foregoing exceptions. The consent may not be applied only to a portion of the property interests constituting such gifts.

If consent to the application of the provisions of section 1000(f) is signified as provided in paragraph (*b*) for any calendar year and not revoked as provided in paragraph (*c*), the liability with respect to the entire gift tax of each spouse for such calendar year shall be joint and several.

(*b*) *Manner and time of signifying consent.*—Consent to the application of the provisions of section 1000(f) with respect to a calendar year shall, in order to be effective, be signified by both spouses. If both spouses file gift tax returns, Form 709, within the time for signifying consent it is sufficient if (1) the consent of both spouses is signified on one of such returns or (2) the consent of one spouse is signified on one such return and the consent of the other spouse is signified on the other return. If only one spouse files a gift tax return within the time provided for signifying consent, the consent of both spouses shall be signified on such return. However, wherever possible notice of the consent is to be shown on both returns. The consent may be revoked only as provided in paragraph (*c*) of this section. (As to whether one or both spouses are required to file returns, see section 86.20.) Where one spouse files more than one Form 709 for a calendar year on or before the 15th day of March following the close of such year, the last Form 709 so filed will, for the purpose of determining whether a consent has been signified, be considered as the return.

The consent may be so signified at any time after the close of the calendar year, subject to the following limitations—

(1) the consent may not be signified after the 15th day of March following the close of such year, unless before such 15th day no return has been filed for such year by either spouse, in which case the consent may not be signified after a return for such year is filed by either spouse; and

(2) the consent may not be signified after a notice of deficiency with respect to the tax for such year has been sent to either spouse in accordance with section 1012(a).

The executor or administrator of a deceased spouse or the guardian or committee of a legally incompetent spouse, as the case may be, may signify such consent.

As to the preparation of the return in case consent is signified, see section 86.23.

(*c*) *Revocation of consent.*—If the consent to the application of the provisions of section 1000(f) with respect to a calendar year was effectively signified on or before the 15th day of March following the close of such year, either spouse may revoke such consent by filing in duplicate with the collector of internal revenue a signed statement of revocation; but the right to revoke shall not exist after such 15th day. A consent which was not effectively signified until after the 15th day of March following the close of the calendar year to which it applies may not be revoked.

PAR. 5. Section 86.7 [26 CFR 86.7] is amended by inserting immediately after the sixth sentence thereof the following:

Where a consent under section 1000(f) was effectively signified with respect to any preceding calendar year, the aggregate sum of the net gifts for such preceding calendar year is to be determined pursuant to the provisions of such section.

PAR. 6. Section 86.9 [26 CFR 86.9] is amended by changing the last sentence thereof to read as follows: "(See sections 86.12 to 86.16d, inclusive.)"

PAR. 7. There is inserted immediately preceding section 86.12 [26 CFR 86.12] the following:

SEC. 372. MARITAL DEDUCTION. (REVENUE ACT OF 1948; ENACTED APRIL 2, 1948.)

Section 1004(a) of the Internal Revenue Code (relating to deductions in computing net gifts in the case of a citizen or resident of the United States) is hereby amended by adding at the end thereof a new paragraph to read as follows:

"(3) GIFT TO SPOUSE.—

"(A) In General.—Where the donor transfers during the calendar year (and after the date of the enactment of the Revenue Act of 1948) by gift an interest in property to a donee who at the time of the gift is the donor's spouse—an amount with respect to such interest equal to one-half of its value.

"(B) Life Estate or Other Terminable Interest.—Where, upon the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur, such interest transferred to the spouse will terminate or fail, no deduction shall be allowed with respect to such interest—

"(i) if the donor retains in himself, or transfers or has transferred (for less than an adequate and full consideration in money or money's worth) to any person other than such donee spouse (or the estate of such spouse), an interest in such property, and if by reason of such retention or transfer the donor (or his heirs or assigns) or such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse; or

"(ii) if the donor immediately after the transfer to the donee spouse has a power to appoint an interest in such property which he can exercise (either alone or in conjunction with any person) in such manner that the appointee may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse. For the purposes of this clause the donor shall be considered as having immediately after the transfer to the donee spouse such power to appoint even though such power cannot be exercised until after the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur.

An exercise or release at any time by the donor, either alone or in conjunction with any person, of a power to appoint an interest in property, even though not otherwise a transfer, shall, for the purposes of clause (i) of this subparagraph, be considered as a transfer by him. Except as provided in subparagraph (E), where at the time of the transfer it is impossible to ascertain the particular person or persons who may receive from the donor an interest in property so transferred by him, such interest shall, for the purposes of clause (i) of this subparagraph, be considered as transferred to a person other than the donee spouse.

"(C) Where the assets out of which, or the proceeds of which, the interest transferred to the donee spouse may be satisfied include a particular asset or assets with respect to which no deduction would be allowed if such asset or assets were transferred from the donor to such spouse, then the value of the interest transferred to such spouse shall, for the purposes of subparagraph (A), be reduced by the aggregate value of such particular assets.

"(D) Joint Interests.—If the interest is transferred to the donee spouse as sole joint tenant with the donor or as tenant by the entirety, the interest of the donor in the property which exists solely by reason of the possibility that the donor may survive the donee spouse, or that there may occur a severance of the tenancy, shall not be considered for the purposes of subparagraph (B) as an interest retained by the donor in himself.

"(E) Trust with Power of Appointment in Donee Spouse.—Where the donor transfers in trust an interest in property, if under the terms of the trust his spouse is entitled for life to all the income from the corpus of the trust, payable annually or at more frequent intervals, with power in the donee spouse to appoint the entire corpus free of the trust (exercisable in favor of such donee spouse, or of the estate of such donee spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the corpus to any person other than the donee spouse—

"(i) the interest so transferred in trust shall, for the purposes of subparagraph (A), be considered as transferred to the donee spouse, and

"(ii) no part of the interest so transferred in trust shall, for the purposes of subparagraph (B) (i), be considered as retained in the donor or transferred to any person other than the donee spouse.

This subparagraph shall be applicable only if, under the terms of the trust, such power in the donee spouse to appoint the corpus, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

"(F) Community Property.—

"(i) A deduction otherwise allowable under this paragraph shall be allowed only to the extent that the transfer can be shown to represent a gift of property which is not, at the time of the gift, held as community property under the law of any State, Territory, or possession of the United States, or of any foreign country.

"(ii) For the purposes of clause (i), community property (except property which is considered as community property solely by reason of the provisions of clause (iii)) shall not be considered as 'held as community property' if the entire value of such property (and not merely one-half thereof) is treated as the amount of the gift.

"(iii) If during the calendar year 1942 or after the date of the enactment of the Revenue Act of 1948, property held as such community property (unless considered by reason of clause (ii) as not so held) was by the donor and the donee spouse converted, by one transaction or a series of transactions, into separate property of the donor and such spouse (including any form of coownership by them), the separate property so acquired by the donor and any property acquired at any time by the donor in exchange therefor (by one exchange or a series of exchanges) shall, for the purposes of clause (i), be considered as 'held as community property'.

"(iv) Where the value (at the time of such conversion) of the separate property so acquired by the donor exceeded the value (at such time) of the separate property so acquired by such spouse, the rule in clause (iii) shall be applied only with respect to the same portion of such separate property of the donor as the portion which the value (as of such time) of such separate property so acquired by such spouse is of the value (as of such time) of the separate property so acquired by the donor."

SEC. 373. TECHNICAL AMENDMENT. (REVENUE ACT OF 1948; ENACTED APRIL 2, 1948.)

Section 1004(c) of the Internal Revenue Code is hereby amended to read as follows:

"(c) EXTENT OF DEDUCTIONS.—The deductions provided in subsection (a) (2) or (3) or in subsection (b) shall be allowed only to the extent that the gifts therein specified are included in the amount of gifts against which such deductions are applied."

PAR. 8. There is inserted immediately following section 86.16 [26 CFR 86.16] the following:

SEC. 86.16a. GIFTS TO SPOUSE AFTER APRIL 2, 1948.—(*a*) *Allowance of marital deduction.*—In determining the amount of net gifts for the calendar year 1949 or for any calendar year thereafter, in the case of a donor who was a citizen or resident of the United States at the time the gift was made, there may be deducted an amount equal to one-half the value of any property interest (except as otherwise provided herein or in sections 86.16b and 86.16c) transferred by gift to a donee who at the time of the gift was the donor's spouse. Such deduction is also authorized for the calendar year 1948, except with respect to gifts made on or before April 2, 1948. Such deduction is hereinafter referred to as the "marital deduction."

No marital deduction is authorized with respect to a gift in case the donor was, at the time of the gift, a nonresident not a citizen of the United States. However, if the donor was, at the time of the gift, a citizen or resident, he is not deprived of the right to the marital deduction by reason of the fact that his spouse was a nonresident not a citizen.

For convenience the donor's spouse is generally referred to in the feminine gender, but if the donor is a woman the reference is to her husband.

(*b*) *Trust with power of appointment in donee spouse.*—In the case of property interests transferred by the donor in trust, if the terms of the trust satisfy the five conditions stated in the next sentence, the donor's spouse is (for the purpose of determining the marital deduction) considered as the donee, not only of her beneficial interest therein, but also of the interest therein subject to her power to appoint. The five conditions which must be satisfied by the terms of the trust are as follows:

(1) The donee spouse must be entitled for life to all the income from the the corpus of the trust.

(2) Such income must be payable annually or at more frequent intervals.

(3) The donee spouse must have the power, exercisable in favor of herself or of her estate, to appoint the entire corpus free of the trust.

(4) Such power in the donee spouse must be exercisable by such spouse alone and (whether exercisable by will or during life) must be exercisable in all events.

(5) The corpus of the trust must not be subject to a power in any other person to appoint any part thereof to any person other than the donee spouse.

In determining whether the above-stated conditions (1) to (5), inclusive, are satisfied by the terms of the trust, regard is to be had to the applicable provisions of the law of the jurisdiction governing the administration of the trust. For example, silence of the trust as to the frequency of payment will not be regarded as a failure to satisfy condition (2) in case the applicable law requires payment to be made annually or more frequently.

The donor's spouse is "entitled for life to all the income from the corpus of the trust," within the meaning of section 1004(a)(3)(E), if the effect of the trust is to give her substantially that degree of beneficial enjoyment of the trust property during her life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust. Such degree of enjoyment is given only if it was the donor's intention, as manifested by the terms of the trust instrument and the surrounding circumstances, that the trust should produce for the spouse during her life such an income, or that the spouse should have such use of the trust property, as is consistent with the value of the trust corpus and with its preservation. The designation of the spouse as sole income beneficiary for life will be sufficient to qualify the trust unless the terms of the trust considered as a whole evidence an intention to deprive the spouse of the requisite degree of enjoyment. In determining whether a trust evidences such intention the treatment required or permitted with respect to individual items must be considered in relation to the entire system provided for the administration of the trust.

If the over-all effect of the trust is to give to the donor's spouse such enforceable rights as will preserve to her the requisite degree of enjoyment, it is immaterial whether such result is effected by rules specifically stated in the trust instrument, or, in their absence, by the rules for the management of the trust property and the allocation of receipts and expenditures supplied by the State law. For example, where the State law does not provide for amortization of bond premium, a provision in the trust instrument for such amortization by appropriate periodic charges to interest will not disqualify the trust.

The rules to be applied by the trustee in allocation of receipts and expenses between income and corpus must be considered in relation to the nature and expected productivity of the assets transferred in trust, the nature and frequency of occurrence of the expected receipts, and any provisions as to change in the form of investments. Where it is evident from the nature of the trust assets and the rules provided for management of the trust that the allocation to income of such receipts as rents, ordinary cash dividends and interest will give to the spouse the substantial enjoyment during life required by the statute, provisions that such receipts as stock dividends and proceeds from the conversion of trust assets shall be treated as corpus will not disqualify the trust. Similarly, provision for a depletion charge against income in the case of trust assets which are subject to depletion will not disqualify the trust, unless the effect is to deprive the spouse of the requisite beneficial enjoyment. The same principle is applicable in the case of depreciation, trustees' commissions, and other charges.

Provisions granting administrative powers to the trustee will not have the effect of disqualifying the trust unless the grant of such powers evidences the intention to deprive the spouse of the beneficial enjoyment required by the statute. Such intention will not be considered to exist if the entire terms of the instrument are such that the local courts will impose reasonable limitations upon the exercise of such powers. Among the powers which if subject to such limitations will not disqualify the trust are the power to allocate receipts between income and corpus, the power to determine the charges which shall be made against income and corpus, the power to apply the income for the benefit of the spouse, and the power to retain the assets transferred in trust. For example, a power to retain trust assets which consist substantially of unproductive property will not disqualify if the applicable rules for the administration of the trust require the trustee to either make the property productive or convert it within a reasonable time. Nor will such a power disqualify if such applicable rules require the trustee to use the degree of judgment and care in the exercise of the power which a prudent man would use if he were owner of the trust assets. A power to retain a residence for the spouse or other property for her personal use will not disqualify the trust.

A trust will not qualify if its primary purpose is to safeguard property without providing the spouse with the required beneficial enjoyment. Such trusts include not only trusts which expressly provide for the accumulation of the income but also trusts which indirectly accomplish a similar purpose. For example, assume that the corpus of a trust consists substantially of property which is not likely to be income producing during the life of the spouse and that such spouse cannot compel the trustee to convert or otherwise deal with the property as described above. Such a trust will not qualify unless the trustee is directed to provide the required beneficial enjoyment, such as by payments to the spouse out of other assets of the trust.

If the donee 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. However, such conditions may be satisfied by one or more of several separate trusts created by the donor. An undivided interest in property may constitute the corpus of a trust, and a single trust instrument may create more than one trust.

A trust fails to satisfy condition (1) if the income is required to be accumulated in whole or in part, or may be accumulated in the discretion of any person other than the donee spouse, if the consent of any person other than the donee spouse is required as a condition precedent to distribution of the income, if any person other than the donee spouse has the power to alter the terms of the trust so as to deprive such spouse of her right to the income, or if any person other than the donee spouse is entitled to any part of the income during the life of such spouse. A trust will not fail to satisfy condition (1) merely because its terms provide that the right of the spouse to the income shall not be subject to assignment, alienation, pledge, attachment or claims of creditors.

The terms "entitled for life" and "payable annually or more frequently," as used in conditions (1) and (2), require that under the terms of the trust the income referred to must be currently (at least annually) distributable to the spouse or that she must have such command over the income that it is virtually hers. Thus, conditions (1) and (2) are satisfied in this respect if, under the terms of the trust instrument, the spouse has the right exercisable annually (or more frequently) to require distribution to herself of the trust income, and otherwise the trust income is to be accumulated and added to corpus. Similarly, as respects the income for the period between the last distribution date and the date of the spouse's death, it is sufficient if such income is subject to the spouse's power to appoint. In the case of a trust which may be terminated during the life of the donee spouse, under her exercise of a power of appointment or by distribution of the corpus to her, the trust satisfies condition (1) if such spouse is entitled to the income until the trust terminates.

In order to satisfy conditions (3) and (4), the power of the donor's spouse to appoint the entire corpus free of the trust must fall within one of the following categories:

(i) a power so to appoint fully exercisable in her own favor at any time during life (as for example, an unlimited power to invade).

(ii) a power so to appoint exercisable in favor of her estate. Such power, if exercisable during life, must be fully exercisable at any time during life, or if exercisable by will, must be fully exercisable irrespective of the time of her death.

(iii) a combination of the powers described under (i) and (ii). For example, the donor's spouse may until she attains the age of 50 years have a power to appoint to herself and thereafter have a power to appoint to her estate. However, condition (4) is not satisfied unless irrespective of when the spouse may die the trust corpus will at the time of her death be subject to one or the other such power.

The power in the donee spouse must be a power to appoint the corpus to herself as unqualified owner or to appoint the corpus as a part of her estate; that is, in effect, to dispose of it to whomsoever she pleases. Thus, if the donee spouse entered into a binding agreement with the donor to exercise the power only in favor of their issue, condition (3) is not met. The trust will not be regarded as failing to satisfy condition (3) merely because takers in default of the donee spouse's exercise of the power are designated by the donor. The donor may provide that, in default of exercise of the power, the trust shall continue for an additional period.

In order for condition (4) to be satisfied, the power in the donee spouse to appoint the corpus to herself or to her estate must be exercisable without the joinder or consent of any other person. The power is not "exercisable in all events," as required by section 1004(a)(3)(E), if it can be terminated during the life of the donee spouse by any event other than her complete exercise or release thereof. For example, a power which is not exercisable in the event of the spouse's remarriage is not exercisable in all events. If the power in the donee spouse is in existence at all times following creation of the trust, limitations of a formal nature will not disqualify. Examples of formal limitations on a power exercisable during life are requirements that exercise must be in a particular form, that it must be filed with the trustee, that reasonable notice must be given or that resonable intervals must elapse between successive partial exercises. Examples of formal limitations on a power exercisable by will are that it must be exercised by a will executed by the donee spouse after the creation of the trust by the donor or that exercise must be by specific reference to the power.

The trust will fail to satisfy condition (5) if the donor created a power in the trustee, or in another person, to invade the corpus of the trust for the benefit of any person other than the donee spouse. However, only powers in other persons which are in opposition to that of the donee spouse will cause the trust to fail to satisfy condition (5). For example, assume that a donor created a trust, designating his donee spouse as income beneficiary for life and as donee of a power to appoint the corpus. The donor further provided that in the event the donee spouse should die without having evercised the power, the trust should continue for the life of his son with power in such son to appoint the corpus. Since the power in the son could become exercisable only after the death of the donee spouse, the trust is not regarded as failing to satisfy condition (5).

(*c*) *Remainder interests.*—Where the income from property is made payable to the donor or another individual for life, or for a term of years, with remainder absolutely to the donor's spouse or to her estate, the marital deduction is equal to one-half the present value of the remainder. It should be noted, however, that where such remainder is distributable to the estate of the donor's spouse (or to her executors or administrators) in the event of her death prior to the termination of a trust or of a precedent interest, the marital deduction is allowable only if under such circumstances the remainder interest would be includible in her gross estate under section 811(a). The present value of the remainder (that is, its value as of the date of the gift) is to be determined in accordance with the rules stated in section 86.19(*f*). For example, if the donor's spouse is to receive $50,000 upon the death of a person aged 31 years, the present value of the remainder is $15,631. (See example in section 86.19(*f*)(6).) If the remainder is such that its value is to be determined by a special computation (see section 86.19(*f*)(4)), a request for a specific factor accompanied by a statement of the date of birth of each person, the duration of whose life may affect the value of the remainder, and by copies of the relevant instruments may be submitted to the Commissioner who in his discretion may supply the factor requested. If the Commissioner does not furnish the factor, the claim for deduction must be supported by a full statement of the computation of the present worth made, in accordance with the principles set forth in section 86.19(*f*), by one skilled in actuarial computations.

(*d*) *Limitation on deduction.*—Under the provisions of section 1004(c), as amended by section 373 of the Revenue Act of 1948, the marital deduction is allowable only to the extent that the gifts with respect to which such deduction is authorized are included in the "total amount of gifts made during the calendar year" computed as provided in section 1003. (See section 86.10.) The limitation under section 1004(c) is effective where less than one-half of the gifts with respect to which the deduction is authorized is included in such "total amount of gifts."

Example. The only gifts made by a donor to his spouse during the calendar year 1948 were a gift of $3,000 in May and a gift of $2,000 in August. The first $3,000 of such gifts is excluded under the provisions of section 1003 in determining the "total amount of gifts made during the calendar year." The marital deduction of $2,500 (one-half of $3,000 plus one-half of $2,000) otherwise allowable is limited by section 1004(c) to $2,000.

SEC. 86.16b. GIFT OF LIFE ESTATE OR OTHER TERMINABLE INTEREST.—(*a*) *In general.*—The provisions of section 1004(a)(3)(B) generally prevent the allowance of the marital deduction with respect to certain property interests (referred to generally as "terminable interests") transferred to the donee spouse, in case the transfer was upon the terms described in paragraph (*b*), (*c*), or (*d*) of this section. In general, the provisions of section 1004(a)(3)(B) are applicable in case the donor transferred an interest in property to the donee spouse and also (1) transferred an interest in the same property to another donee, or (2) retained an interest in the same property in himself, or (3) retained a power to appoint an interest in the same property. Under such circumstances, if the other donee, the donor, or the possible appointee, may, by reason of such transfer or retention, possess or enjoy any part of the property after the termination or failure of the interest therein transferred to the donee spouse, no marital deduction may be taken with respect to such transfer to the donee spouse.

For the purposes of this section, a distinction is to be drawn between "property," as such term is used in section 1004(a)(3), and an "interest in property." The "property" referred to is the underlying property in which various interests exist; each such interest is not, for this purpose, to be considered as "property."

The expression "terminable interest" refers to a life estate, an estate for years, or any other property interest which, upon the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur, will terminate or fail.

(*b*) *Interest in property which another donee may possess or enjoy.*—Section 1004(a)(3)(B) provides that no marital deduction shall be allowed with respect to the transfer to the donee spouse of a "terminable interest" in property, in case—

(1) The donor transferred (for less than an adequate and full consideration in money or money's worth) an interest in the same property to any person other than the donee spouse (or the estate of such spouse), and

(2) By reason of such transfer, 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 transferred to the donee spouse.

The above-stated provision is applicable whether the transfer to the person other than the donee spouse was made at the same time as the transfer to such spouse, or at any earlier time.

Except as provided in paragraph (*b*) of section 86.16a, where at the time of the transfer it is impossible to ascertain the particular person or persons who may receive a property interest transferred by the donor, such interest shall, for the purpose of section 1004(a)(3)(B), be considered as transferred to a person other than the donee spouse. This rule is particularly applicable in the case of the transfer of a property interest by the donor subject to a reserved power. (See section 86.3.) Under this rule, any property interest over which the donor reserved a power to revest the beneficial title in himself, or over which the donor reserved the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves, is, for the purpose of section 1004(a)(3)(B), considered as transferred to a "person other than the donee spouse." Thus, if a donor transferred property in trust, naming his wife as income beneficiary for 10 years, and providing that, upon the expiration of such term, the corpus should be distributed among his wife and children in such proportions as he should determine, the right to the corpus is, for the purpose of the marital deduction, considered as transferred to a "person other than the donee spouse." Or, if the donor had provided that, upon the expiration of the 10-year term, the corpus was to be paid to his wife, but had reserved the power to revest such corpus in himself instead, the right to the corpus is, for the purpose of the marital deduction, considered as transferred to a "person other than the donee spouse."

Under the above-stated rule, the term "person other than the donee spouse" includes the possible unascertained takers of a property interest, as, for example, the members of a class to be ascertained in the future. As another example, assume that the donor created a power of appointment over a property interest, which does not come within the purview of paragraph (*b*) of section 86.16a. In such a case, the term "person other than the donee spouse" refers to the possible appointees and possible takers in default (other than the spouse) of such property interest.

An exercise or release at any time by the donor (either alone or in conjunction with any person) of a power to appoint an interest in property, even though not otherwise a transfer by him, shall, in determining for the purpose of section 1004(a)(3)(B) whether he transferred an interest in such property to a person other than the donee spouse, be considered as a transfer by him.

In the following examples it is assumed that the property interest which the donor transferred to a person other than the donee spouse was not for an adequate and full consideration in money or money's worth:

(i) H (the donor) transferred real property to W (his wife) for life, with remainder to A and his heirs. No marital deduction may be taken with respect to the interest transferred to W, since it will terminate upon her death and A (or his heirs or assigns) will thereafter possess or enjoy the property.

(ii) H transferred real property to W for life, and created in W a power, exercisable by will, to appoint the remainder interest to any person. In default of appointment by W, the remainder interest was to go to A and his heirs. Assuming that under the local law W did not take the real property as absolute owner, nor as trustee of a trust meeting the requirements of section 86.16a(*b*), no marital deduction may be taken with respect to the interest which passed from H to W, since such interest will terminate upon her death and A (or his heirs or assigns) may thereafter possess or enjoy the property. (As to cases in which a marital deduction may be taken where a life interest is coupled with a power to appoint under a trust, see paragraph (*b*) of section 86.16a.)

(iii) H transferred property in trust for the benefit of W and A. The trust income was payable to W for life, and upon her death the corpus was to be distributed to A or his issue. However, if A should die without issue, leaving W surviving, the corpus was then to be distributed to W. No marital deduction may be taken with respect to the interest transferred to W, since it will terminate in the event of her death if A or his issue survive, and A or his issue will thereafter possess or enjoy the property.

(iv) H purchased for $100,000 a life annuity for W. If the annuity payments made during the life of W should be less than $100,000, further payments were to be made to A. No marital deduction may be taken with respect to the interest transferred to W, since A may possess or enjoy a part of the property following the termination of such interest. If, however, the contract provided for no continuation of payments, and provided for no refund upon the death of W or provided that any refund was to go to the estate of W, then a marital deduction may be taken with respect to the gift.

(v) H transferred property to W and A as joint tenants with right of survivorship. No marital deduction may be taken with respect to the interest transferred to W, since, if the tenancy is not severed and A survives W, the interest of W will terminate and A will continue to possess or enjoy the property.

(vi) H transferred property to A for life with remainder to W provided W survives A, but if W predeceases A, the property is to pass to B and his heirs. No marital deduction may be taken with respect to the interest transferred to W.

(vii) H transferred real property to A, reserving the right to the rentals of the property for a term of 20 years. H later transferred the right to the remaining rentals to a trust. The terms of the trust satisfy the five conditions stated in paragraph (*b*) of section 86.16a, so that the interest transferred in trust is considered as transferred solely to W. No marital deduction may be taken with respect to such interest, since it will terminate upon the expiration of the balance of the 20-year term and A will thereafter possess or enjoy the property.

(viii) H transferred a patent to W and A as tenants in common. In this case, the interest of W will terminate upon the expiration of the term of the patent, but possession and enjoyment of the property by A must necessarily cease at the same time. Therefore, since A's possession or enjoyment cannot outlast the termination of W's interest, the provisions of section 1004(a)(3)(B) do not disallow the marital deduction with respect to such interest.

(*c*) *Interest in property which the donor may possess or enjoy.*—Section 1004(a)(3)(B) also provides that no marital deduction shall be allowed with respect to the transfer to the donee spouse of a "terminable interest" in property, in case—

(1) The donor retained in himself an interest in the same property, and

(2) By reason of such retention, the donor (or his heirs or assigns) may possess or enjoy any part of such property after the termination or failure of the interest therein transferred to the donee spouse.

However, section 1004(a)(3)(D) provides that if a property interest is transferred to the donee spouse as sole joint tenant with the donor or as tenant by the entirety, the interest of the donor in the property which exists solely by reason of the possibility that the donor may survive the donee spouse, or that there may occur a severance of the tenancy, is not for the purposes of section 1004(a)(3)(B), to be considered as an interest retained by the donor in himself. Under this provision, the fact that the donor may, as surviving tenant, possess or enjoy the property after the termination of the interest therein transferred to the donee spouse does not preclude the allowance of the marital deduction with respect to the latter interest.

In general, the principles illustrated by the examples under paragraph (*b*) of this section are applicable in determining whether the marital deduction may be taken with respect to a property interest transferred to the donee spouse subject to the retention by the donor of an interest in the same property.

Example. The donor purchased three annuity contracts for the benefit of his wife and himself. The first contract provided for payments to the wife for life, with refund to the donor in case the aggregate payments made to the wife were less than the cost of the contract. The second contract provided for payments to the donor for life, and then to the wife for life if she survived the donor. The third contract provided for payments to the donor and his wife for their joint lives, and then to the survivor of them for life. No marital deduction may be taken with respect to the gifts consummated by the purchase of the contracts since, in the case of each contract, the donor may possess or enjoy a part of the property after the termination or failure of the interest therein transferred to the wife.

(*d*) *Interest in property over which the donor retained a power to appoint.*—Section 1004(a)(3)(B) also provides that no marital deduction shall be allowed with respect to the transfer to the donee spouse of a "terminable interest" in property, in case—

(1) The donor had, immediately after such transfer, a power to appoint an interest in the same property, and

(2) Such power was exercisable (either alone or in conjunction with any person) in such manner that the appointee may possess or enjoy any part of such property after the termination or failure of the interest therein transferred to the donee spouse.

For the purposes of section 1004(a)(3)(B), the donor is to be considered as having, immediately after the transfer to the donee spouse, such a power to appoint even though such power cannot be exercised until after the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur. It is immaterial whether the power retained by the donor was a taxable power of appointment under section 1000(c).

In general, the principles illustrated by the examples under paragraph (*b*) of this section are applicable in determining whether the marital deduction may be taken with respect to a property interest transferred to the donee spouse subject to retention by the donor of a power to appoint an interest in the same property.

Example. The donor, having a power of appointment over certain property, appointed a life estate therein to his spouse. No marital deduction may be taken with respect to such transfer, since, if the retained power is exercised, the appointee thereunder may possess or enjoy the property after the termination or failure of the interest taken by the donee spouse.

(*e*) *Interest payable out of a group of assets.*—Section 1004(a)(3)(C) provides that where the assets out of which, or the proceeds of which, an interest transferred to the donee spouse may be satisfied include a particular asset or assets with respect to which no deduction would be allowed if such asset or assets were transferred from the donor to such spouse, then the value of the interest transferred to such spouse shall, for the purpose of the marital deduction, be reduced by the aggregate value of such particular assets.

In order for the foregoing provision to apply, two circumstances must coexist, as follows:

(1) The property interest transferred to the donee spouse must be payable out of a group of assets. An example of a property interest payable out of a group of assets is a right to a share of the corpus of a trust upon its termination.

(2) The group of assets out of which the property interest is payable must include one or more particular assets which, if transferred by the donor to the donee spouse, would not qualify for the marital deduction.

If the above circumstances are both present, the marital deduction with respect to such property interest may not exceed one-half of the excess, if any, of its value over the aggregate value of the particular asset or assets which, if transferred to the donee spouse, would not qualify for the marital deduction.

SEC. 86.16c. GIFT OF COMMUNITY PROPERTY.—(*a*) *General.*—The marital deduction is allowable with respect to any transfer by a donor to his spouse only to the extent that such transfer can be shown to represent a gift of property which was not, at the time of the gift, held as "community property," as defined in paragraph (*b*) of this section. The burden of establishing the extent to which a transfer represents a gift of property not so held rests upon the donor.

(*b*) *Definition of "community property."*—For the purpose of paragraph (*a*) of this section, the term "community property" is considered to include:

(1) Any property held by the donor and his spouse as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, except such property in which the donee spouse had at the time of the gift merely an expectant interest. The donee spouse is regarded as having, at any particular time, merely an expectant interest in property held at such time by the donor and herself as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, if, in case such property were transferred by gift into the separate property of the donee spouse, the entire value of such property (and not merely one-half thereof) would be treated as the amount of the gift.

(2) Separate property acquired by the donor as a result of a "conversion" (during the calendar year 1942 or after April 2, 1948) of property held by him and the donee spouse as community property under the law of any State, Territory, or possession of the United States, or of any foreign country (except such property in which the donee spouse had at the time of the "conversion" merely an expectant interest) into their separate property.

(3) Property acquired by the donor in exchange (by one exchange or a series of exchanges) for separate property resulting from such a "conversion."

The characteristics of property which acquired a noncommunity instead of a community status by reason of an agreement (whether antenuptial or postnuptial) are such that section 1004(a)(3)(F) classifies the property as community property of the donor and his spouse in the computation of the marital deduction. In distinguishing property which thus acquired a noncommunity status from property which acquired such a status solely by operation of the community property law, section 1004(a(3)(F) refers to the former category of property as "separate property" acquired as a result of a "conversion" of "property held as such community property." As used in section 1004(a)(3)(F), the phrase "property held as such community property" is used to denote the body of property comprehended within the community property system; the expression "separate property" includes any noncommunity property (whether held in joint tenancy, tenancy by the entirety, tenancy in common, or otherwise); and the term "conversion" includes any transaction or agreement which transforms property from a community status into a noncommunity status.

The separate property which section 1004(a)(3)(F) classifies as community property is not limited to that which was in existence at the time of the conversion. The following are illustrative of the scope of section 1004(a)(3)(F): A partition of community property between husband and wife, whereby a portion of such property became the separate property of each, is a conversion of such property; a transfer of community property into some other form of co-ownership, such as a joint tenancy, is a conversion of such property; an agreement (whether made before or after marriage) that future earnings and gains which would otherwise be community property shall be shared by them as separate property effects a conversion of such earnings and gains; a change in the form of ownership of property which causes the future rentals therefrom, which would otherwise have been acquired as community property, to be acquired as separate property effects a conversion of such rentals.

The rules of section 1004(a)(3)(F) are applicable, however, only if the conversion took place during the calendar year 1942 or after April 2, 1948, and only to the extent stated herein.

Where the value of the separate property acquired by the donor as a result of a conversion did not exceed the value of the separate property thus acquired by the donee spouse, the entire separate property thus acquired by the donor is to be considered, for the purposes of this section, as held by him and the donee spouse as community property. Where the value (at the time of the conversion) of the separate property so acquired by the donor exceeded the value (at such time) of the separate property so acquired by the donee spouse, only a part of the separate property so acquired by the donor (and only the same fractional part of property acquired by him in exchange for such separate property) is to be considered, for the purposes of this section, as held by him and the donee spouse as community property. The part of such separate property (or property acquired in exchange therefor) which is considered as so held is the same proportion thereof which the value (at the time of the conversion) of the separate property so acquired by the donee spouse is of the value (at such time) of the separate property so acquired by the donor.

Example. On November 1, 1942, the donor and his spouse partitioned certain real property held by them under community property laws. The real property then had a value of $224,000. A portion of such property, then having a value of $160,000, was converted into the donor's separate property, and the remaining portion, then having a value of $64,000, was converted into his spouse's separate property. On August 1, 1948, the donor made a gift to his spouse of the property acquired by him as a result of the partition, which property then had a value of $200,000. The portion of the property transferred by gift which is considered as "community property" is—

$$\frac{64{,}000}{160{,}000}\times\$200{,}000=\$80{,}000$$

The marital deduction with respect to the gift is, therefore, limited to one-half of the difference between $200,000 (the value of the gift) and $80,000 (the portion of the gift considered to have been of "community property"). The marital deduction with respect to the gift, is, therefore, $60,000.

SEC. 86.16d. PROOF REQUIRED.—The donor must submit such proof as is necessary to establish the right to the marital deduction, including any evidence requested by the Commissioner.

PAR. 9. Section 86.20 [26 CFR 86.20] is amended as follows:

(A) By striking the heading and by inserting in lieu thereof the following: "PERSONS REQUIRED TO FILE RETURN.—(*a*) *In general.*"

(B) By inserting at the end thereof the following paragraph:

(*b*) *In case of consent under section 1000(f).*—Except as otherwise provided herein, the provisions of paragraph (*a*) of this section are applicable with respect to the filing of a gift tax return or returns for the calendar year 1948 or any subsequent calendar year in the case of a husband and wife who consent (see section 86.3a) to the application of the provisions of section 1000(f) for such year. In such cases, if both of the consenting spouses are (without regard to the provisions of section 1000(f)) required under the provisions of paragraph (*a*) of this section to file returns for such year, returns must be filed by both spouses. If only one of the consenting spouses is (without regard to the provisions of section 1000(f)) required under the provisions of such paragraph (*a*) to file a return for such year, a return must be filed by such spouse. In the latter case, if after giving effect to the provisions of section 1000(f) the other spouse is considered to have made any gift (regardless of value) of a future interest in property or any gift or gifts to any one third-party donee exceeding $3,000 in value, then a return for such year must also be filed by such other spouse. Thus, if during any such calendar year the husband made a gift of $5,000 to a son and the wife made no gifts, only the husband is required to file a return for such year. However, if the wife had made a gift of $2,000 to the same son, or if the gift made by the husband had amounted to $7,000, each spouse would be required to file a return in the event consent is signified as provided under section 1000(f).

PAR. 10. Section 86.21, as amended by Treasury Decision 5608 [C. B. 1948–1, 131], approved March 19, 1948 [26 CFR 86.21], is further amended by inserting immediately preceding the last sentence thereof the following sentence:

Where a husband and wife consent (or contemplate consenting) that gifts made by either of them to third-party donees during the calendar year 1948 or any subsequent calendar year shall be considered as made one-half by each spouse, as provided by section 1000(f), the notice on Form 710 shall, nevertheless, identify the actual donor.

PAR. 11. Section 86.23 [26 CFR 86.23] is amended by inserting immediately after the sixth sentence thereof the following:

If the return is filed for the calendar year 1948 or for any calendar year thereafter and the donor and his spouse consent (see section 86.3a) to the application of the provisions of section 1000(f) for such year the return must set forth, to the extent provided thereon, information with respect to transfers made by each spouse.

PAR. 12. Section 86.34 [26 CFR 86.34] is amended by inserting immediately after the third sentence thereof the following:

If a husband and wife effectively signify consent (see section 86.3a) to the application of the provisions of section 1000(f) for any calendar year, the liability with respect to the entire gift tax of each spouse for such calendar year shall be joint and several.

(This Treasury Decision is issued under authority contained in sections 1029 and 3791 of the Internal Revenue Code (53 Stat. 157, 467; U. S. C. 1029, 3791) and pursuant to the provisions of Public Law 471, Eightieth Congress.)

FRED S. MARTIN,
Acting Commissioner of Internal Revenue.

Approved May 13, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register May 18, 1949, 8:50 a. m.)

STAMP TAXES

INTERNAL REVENUE CODE

SECTION 1802(a).—ORIGINAL ISSUE

REGULATIONS 71 (1941), SECTION 113.22: Issuance of stock. 1949–9–13077 M. T. 37

Liability for stamp tax imposed by section 1802(a) of the Internal Revenue Code on the original issue of stock attaches at the time the subscription for stock is unconditionally accepted, and it is not material that the stock certificates are issued at a later time or are not issued at all.

Advice is requested concerning the liability for stamp tax on the original issue of stock where the subscription for stock is unconditionally accepted but the stock certificates are issued at a later time or are not issued at all.

Under the provisions of section 113.22 of Regulations 71 stock is deemed to be issued when subscribed for and the subscription is accepted.

Accordingly, liability for stamp tax imposed by section 1802(a) of the Code on the original issue of stock attaches at the time the subscription for stock is unconditionally accepted. Where liability for the tax has been so incurred, it is not material that the stock certificates are issued at a later time or are not issued at all.

SECTION 1802(b).—SALES AND TRANSFERS

REGULATIONS 71 (1941), SECTION 113.33: Sales and transfers subject to tax. 1949–6–13048 M. T. 34

Application of the tax on the sale and transfer of stock imposed by section 1802(b) of the Internal Revenue Code to the sale of stock received as a dividend by a trustee.

Advice is requested whether the sale of stock by a trustee, under the circumstances stated herein, will incur only one transfer tax.

It is stated that under the terms of a trust instrument a stock dividend received by the trustee is apportioned to income and that the beneficiary, having power of disposition of income, directs that the stock dividend be sold.

It is held, under the circumstances stated, that the only tax incurred under section 1802(b) of the Code is on the sale of the stock by the trustee. However, in any case where the stock is first transferred by the trustee to the beneficiary and then sold by the beneficiary, two transfer taxes are incurred, one on the transfer of the stock to the beneficiary and the second on its sale by the beneficiary.

SECTION 1802(b).—SALES AND TRANSFERS

REGULATIONS 71 (1941), SECTION 113.35: Specific exemptions provided in Section 1802(b). 1949–8–13064 M. T. 36

The specific exemptions from tax provided by section 1802(b) of the Internal Revenue Code do not apply to a transfer of stock from the name of one nominee of a broker to the name of another nominee of the same broker.

Advice is requested whether the specific exemptions provided by section 1802(b) of the Internal Revenue Code are applicable to a transfer of stock from one nominee of a broker to another nominee of the same broker.

Under section 1802(b) of the Code the tax does not apply to deliveries or transfers (1) to a broker or his registered nominee for sale, (2) by a broker or his registered nominee to a customer for whom and upon whose order the stock was purchased, or (3) by a purchasing broker to his registered nominee if the shares so transferred are held for the same purpose as if held by the broker.

It is held, since the transfer of stock from the name of one nominee of a broker to the name of another nominee of the same broker does not fall within one of the foregoing specific exemptions, that such a transfer is taxable under section 1802(b) of the Code.

REGULATIONS 71 (1941), SECTION 113.127. 1949–9–13078 T. D. 5695

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 113.—DOCUMENTARY STAMP TAXES

Exemption of certain securities and conveyances of carriers

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

To Collectors of Internal Revenue and Others Concerned:

In order to conform Regulations 71 (1941 edition) [26 CFR, Part 113] to Public Law 478 (Eightieth Congress, second session), approved April 9, 1948 [C. B. 1948–1, 235], such regulations are hereby amended as follows:

PARAGRAPH 1. There is inserted immediately preceding section 113.120 [26 CFR 113.120] the following:

INTERSTATE COMMERCE ACT

SECURITIES AND CONVEYANCES OF CARRIERS

Section 20b(12) of Interstate Commerce Act, added by Act of April 9, 1948, Public Law 478 (Eightieth Congress, second session)

The provisions of sections 1801, 1802, 3481, and 3482 of the Internal Revenue Code and any amendments thereto, unless specifically providing to the contrary, shall not apply to the issuance, transfer, or exchange of securities or the making or delivery of conveyances to make effective any alteration or modification effected pursuant to this section.

PAR. 2. There is inserted immediately following section 113.126 the following:

SEC. 113.127. ALTERATION AND MODIFICATION OF SECURITIES UNDER THE INTERSTATE COMMERCE ACT.—Section 20b added to the Interstate Commerce Act by section 2 of the Act approved April 9, 1948, Public Law 478 (Eightieth Congress, second session), provides for alteration or modification of securities of a carrier as defined in section 20a(1). Paragraph (12) of section 20b, effective on and after April 9, 1948, renders sections 1801, 1802, 3481, and 3482 of the Internal Revenue Code and any amendments thereto, unless specifically providing to the contrary, inapplicable to the issuance, transfer, or exchange of securities or the making or delivery of conveyances to make effective any alteration or modification effected pursuant to such section 20b.

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

Because the purpose of this Treasury Decision is merely to conform the regulations to the provisions of section 20b(12) as added to the Interstate Commerce Act by the Act approved April 9, 1948, Public Law 478 (Eightieth Congress), granting immunity from stamp tax as to certain securities and conveyances, it is found that it is unnecessary to issue this Treasury Decision 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.

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved April 7, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register April 12, 1949, 8:49 a. m.)

SECTION 1807.—PLAYING CARDS

REGULATIONS 66, ARTICLE 8: Tax on playing cards. 1949–6–13047
M. T. 33

Playing cards removed from stamped packages and reassembled into trick decks cannot be returned to the packages and sold under a broken stamp. A new stamp must be affixed to each package and duly canceled.

Advice is requested whether playing cards, which have been removed from stamped packages and reassembled into trick decks, may be returned to the packages and sold without affixing a new stamp to each package.

Section 1807 of the Internal Revenue Code, as amended, imposes upon every pack of playing cards containing not more than 54 cards, manufactured or imported, and sold, or removed for consumption or sale, a tax of 13 cents per pack.

Article 8 of Regulations 66 provides in part that where packages of playing cards are sent out from the factory duly stamped and are thereafter opened and the stamp broken, the cards cannot be returned to the packages and sold under a broken stamp; a new stamp must be affixed to each package and duly canceled.

Article 5 of Regulations 66 includes in the definition of a manufacturer of playing cards a person who packs or repacks for sale playing cards upon which the tax had been previously paid. Such person is required by article 6 of the regulations to register on Form 277, appropriately modified, with the collector of internal revenue for his district.

Accordingly, a person who repacks for sale playing cards upon which the tax had been previously paid must register as a manufacturer of playing cards with the collector of internal revenue for his district, and such person incurs liability for the stamp tax on the cards so repacked which must be paid by the affixing of a new 13-cent playing card stamp on each such package.

TAXES ON ADMISSIONS, DUES, AND INITIATION FEES

INTERNAL REVENUE CODE

REGULATIONS 43 (1941), SECTIONS 101.5(*b*) AND 101.15(*b*). 1949–2–13011
T. D. 5682

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 101.—TAXES ON ADMISSIONS, DUES, AND INITIATION FEES

Hospitalized servicemen and veterans admitted free

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

To Collectors of Internal Revenue and Others Concerned:

In order to conform Regulations 43 (1941 edition) [26 CFR, Part 101] to Public Law 706 (Eightieth Congress), approved June 19, 1948 [C. B. 1948–2, 320], such regulations are amended as follows:

PARAGRAPH 1. There is inserted immediately preceding section 101.2 [26 CFR 101.2] the following:

PUBLIC LAW 706 (EIGHTIETH CONGRESS), APPROVED JUNE 19, 1948

* * * That section 1700(a)(1) of the Internal Revenue Code (relating to the tax on amounts paid for admission) is amended by adding at the end thereof a new sentence as follows: "Subject to such regulations as the Commissioner, with the approval of the Secretary, shall prescribe, no tax shall be imposed in the case of admission free of charge of a hospitalized member of the military, naval, or air forces of the United States or of a person hospitalized as a veteran by the Federal Government in a Federal, State, municipal, private, or other hospital or institution, except when such member or veteran is on leave or furlough."

SEC. 2. The amendment made by this Act shall be effective on and after the first day of the first month which commences more than twenty days after the enactment of this Act.

PAR. 2. Section 101.5(*b*), as amended by Treasury Decision 5611, approved March 16, 1948 [C. B. 1948–1, 137] [26 CFR 101.5(b)], is further amended by inserting immediately preceding the last paragraph thereof a new paragraph reading as follows:

Effective August 1, 1948, the tax does not apply to the admission free of charge of a hospitalized member of the military, naval, or air forces of the United States or of a person hospitalized as a veteran by the Federal Government in a Federal, State, municipal, private, or other hospital or institution, provided such member or veteran is not on leave or furlough. Where it is necessary for an attendant to accompany such member or veteran so admitted free of charge, the tax does not apply to the admission of the attendant if he is also admitted free of charge. Where the exemption is claimed on behalf of a hospitalized member or veteran properly entitled thereto, who is singly admitted, the right to the exemption shall be evidenced by a statement, personally signed, of an administrative officer of the hospital or institution, identifying by name such member or veteran (and attendant, if any) and certifying that the member or veteran (i) is a hospitalized member of the military, naval, or air forces of the United States or a veteran hospitalized by the Federal Government, and (ii) is not on leave or furlough. Where the exemption is claimed on behalf of hospitalized members or veterans who are collectively admitted the statement need not identify the members or veterans individually, but shall specify the number of such members or veterans (and attendants, if any) and certify that the members or veterans (*a*) are hospitalized members of the military, naval, or air forces of the United States or are veterans hospitalized by the Federal Government and (*b*) are not on leave or furlough. In either case the statement evidencing the right to the exemption shall be taken up by the proprietor of the place, and retained as part of his records. (See section 101.32 [26 CFR 101.32].)

PAR. 3. The following is inserted immediately preceding section 101.15 [26 CFR 101.15]:

PUBLIC LAW 706 (EIGHTIETH CONGRESS), APPROVED JUNE 19, 1948

* * * That section 1700(a)(1) of the Internal Revenue Code (relating to the tax on amounts paid for admission) is amended by adding at the end thereof a new sentence as follows: "Subject to such regulations as the Commissioner, with the approval of the Secretary, shall prescribe, no tax shall be imposed in the case of admission free of charge of a hospitalized member of the military, naval, or air forces of the United States or of a person hospitalized as a veteran by the Federal Government in a Federal, State, municipal, private, or other hospital or institution, except when such member or veteran is on leave or furlough."

SEC. 2. The amendment made by this Act shall be effective on and after the first day of the first month which commences more than twenty days after the enactment of this Act.

PAR. 4. Section 101.15(*b*), as amended by Treasury Decision 5611 [26 CFR 101.15], is further amended by adding at the end thereof a paragraph reading as follows:

Effective August 1, 1948, no tax is imposed when a hospitalized member of the military, naval, or air forces of the United States, or a person hospitalized as a veteran by the United States in a Federal, State, municipal, private, or other hospital or institution, is admitted free, provided such member or veteran is not on leave or furlough. (See section 101.5 [26 CFR 101.5].)

Because the sole purpose of this Treasury Decision is to relieve restriction, it is found that it is unnecessary to issue such 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 section 1700(a)(1) of the Internal Revenue Code as amended by section 1 of Public Law 706 (Eightieth Congress), approved June 19, 1948, and section 3791 of the Internal Revenue Code (53 Stat. 189, 467; 26 U. S. C. 1700(a)(1), 3791).)

FRED S. MARTIN,
Acting Commissioner of Internal Revenue.

Approved December 30, 1948.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 5, 1949, 8:47 a. m.)

SECTION 1700(e), AS AMENDED

REGULATIONS 43 (1941), SECTION 101.14: Scope of tax. 1949–8–13063 Ct. D. 1716

ADMISSIONS TAX—INTERNAL REVENUE CODE, AS AMENDED—DECISION OF COURT

1. CABARET—MUSIC AND DANCING PRIVILEGES—INTERPRETATION OF STATUTE—VALIDITY OF REGULATIONS.

Taxpayers operated a tavern where beer and wine were sold to patrons, and provided floor space for dancing to music furnished by a mechanical music playing device which was operated by the patrons by inserting their own nickels. Taxpayers did not own the "juke box," but permitted its installation and shared in the receipts therefrom. No admission was charged the patrons, and no cover charge was collected at any time. *Held:* Taxpayers were subject to the tax imposed by section 1700(e)(1) of the Internal Revenue Code, as amended by section 622 of the Revenue Act of 1942. Section 101.14 of Regulations 43, as amended by Treasury Decision 5192 [C. B. 1942–2, 249], does nothing more than amplify, clarify, and furnish a practical interpretation of section 622 of the Revenue Act of 1942. The regulation is not legislative in its nature and must be given application to the situation here presented.

2. CASE FOLLOWED.

Avalon Amusement Corp. v. *United States*, 165 Fed. (2d) 653 [Ct. D. 1700, C. B. 1948–2, 168], followed.

UNITED STATES DISTRICT COURT, WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

J. W. Baldwinson and William Becker, copartners, doing business under the name and style of Baldy's Tavern, plaintiffs, v. *United States of America, defendant*

[October 7, 1948]

MEMORANDUM DECISION

LEAVY, District Judge: Plaintiffs herein have filed an action for the recovery of taxes paid under protest during two periods of time: July 1, 1945, to December 31, 1945; and January 1, 1946, to August 31, 1946. The taxes were levied under the provisions of section 1700(e)(1) of the Internal Revenue Code, as amended by section 622 of the Revenue Act of 1942.

The defendant moved to dismiss the complaint on the ground and for the reason that the facts, as pleaded by the plaintiffs, do not entitle them to the relief they seek. Upon presentation of the motion to dismiss, the plaintiffs sought, and were granted, permission to file an amended complaint. The defendant has renewed its motion to dismiss on the same ground and for the same reason.

The facts, as alleged by the plaintiffs in their amended complaint, are:

That from July 1, 1945, to August 31, 1946, which period of time includes both causes of action, the plaintiffs served beer and wine and sold other merchandise to their customers in their place of business, which was known and designated as "Baldy's Tavern"; that the tavern consisted of a single large storeroom with booths situated along two sides and a bar on the third side;

That a mechanical music playing device, commonly known as a juke box, was located on the fourth side of the space which constituted the dance floor; that the juke box was not the property of the plaintiffs, but was owned by a third-party corporation, which corporation paid to the plaintiffs approximately one-half of the income from such device for the privilege of maintaining the instrument on their premises; that between the hours of 9 a. m. and 12 p. m., on the nights of Wednesday, Friday, and Saturday of each week, during the period herein involved, the patrons danced to music furnished by the coin-operated juke box. The dance floor consisted of a space approximately 13 feet wide and 20 feet long; that the only music furnished was from the juke box, which was operated by the patrons by inserting their own nickels and at their own expense;

that the plaintiffs inserted no nickels in the juke box to furnish music for the entertainment of the patrons during such times or period and no other type of music was supplied by the plaintiffs;

That the patrons at plaintiffs' tavern were charged no admission and there was no cover charge collected at any time; that the patrons paid only for such beer and wine as was served them on the premises; and that the prices charged for beer and wine were not increased during any period the tavern was open for business, whether or not dancing was allowed.

Since this matter comes on for hearing on defendant's motion to dismiss, the facts as alleged by the plaintiffs are accepted by the court, and there is no issue of fact left for determination, the sole issue being one of law.

It will serve no useful purpose to examine in detail the earlier congressional enactments covering the subject matter here in controversy, nor can we look to the earlier judicial decisions involving the legislative enactments or Treasury regulations. We must confine ourselves to the law as it existed during the period in question. We will also need to examine the Treasury regulation effective for the enforcement of this provision.

The law, as it existed during the time involved herein, 26 U. S. C. A., Appendix, section 1700(e)(1), and which appears in the Internal Revenue Code as section 622 of the Act of 1942, provides, among other things:

"The term 'roof garden, cabaret, *or other similar place*' shall include any room in any hotel, restaurant, hall, *or other public place where music and dancing privileges* or any other entertainment, except instrumental or mechanical music alone, are afforded the patrons in connection with the serving or selling of food, refreshment, or merchandise. A performance shall be regarded as being furnished for profit for purposes of this section *even though the charge made for admission, refreshment, service, or merchandise* is not increased by reason of the furnishing of such performance." [Italics mine.]

The Treasury regulation effective for the enforcement of this provision is Treasury Regulations 43 (1941 ed.), section 101.14, as amended by Treasury Decision 5192, C. B. 1942–2, 249, 250, entitled "Scope of Tax." It provides:

"*Where music*, whether by an orchestra, *a mechanical device or otherwise, and a space in which the patrons may dance is furnished* in the dining room of a hotel, or in a restaurant, bar, etc., the entertainment constitutes a *public performance* for profit at a roof garden, cabaret, or similar place, and the payments made for admission, *refreshment, service, and merchandise* are subject to the tax." [Italics mine.]

The plaintiffs attack the regulation on the ground that it is legislative rather than interpretative, and they rely on the cases of *United States* v. *Broadmoor Hotel Co.*, Colo., 1929, 30 Fed. (2d) 440; *Busey* v. *Deshler Hotel Co.*, 6th Cir., 1942, 130 Fed. (2d) 187, affirming 36 Fed. Supp. 392; *Schuster's Wholesale Produce Co., Inc.*, v. *United States*, La., 1943, 49 Fed. Supp. 909.

(A later case from this circuit, holding to the same effect, and relying upon the Busey and the Schuster cases, *supra*, is *Sir Francis Drake Hotel Co.* v. *United States*, Calif., 1947, 75 Fed. Supp. 668.)

An examination of these cases reveals that they deal with taxes levied prior to the effective date of the Revenue Act of 1942, and they are not controlling or a precedent in this controversy. They all concern themselves with original Treasury Regulation 101.14, and hold, in effect, that the regulation was legislative in its nature rather than interpretative, and, therefore, did not apply.

Congress, in passing the Revenue Act of 1942, overcame the objections to the regulation by enacting the substance of the regulation into law and furnishing a legislative definition of places where liability for taxes would arise, as well as a definition of when a performance should be regarded as being furnished for profit. It also eliminated the charge for admission. The effective Treasury regulation does nothing more than amplify, clarify, and furnish a practical interpretation of the statute, which by some may be considered ambiguous or doubtful. It is not legislative in its nature and must be given application to the situation we have here presented.

The Supreme Court of the United States, in *Brewster* v. *Gage*, 1930, 280 U. S. 327 [Ct. D. 148, C. B. IX-1, 274], supports the foregoing statement. That case is also authority for the conclusion that Congress, by the enactment of the 1942 Revenue Act, sought to offset the effect of judicial interpretation of the earlier revenue laws and regulations, the Court saying, page 337:

"The deliberate selection of language so differing from that used in the earlier Acts indicates that a change of law was intended."

The plaintiffs, in their amended complaint, further contend that they did not furnish music for dancing privileges, because, first, they were not the owners of the instrumentality used to furnish the music; and, second, the instrumentality was only brought into play by the act of the patron himself by his depositing the coin that produced the music.

It is admitted by the pleadings that the plaintiffs permitted the installation of the juke box, shared in the receipts therefrom, and furnished the place where the dancing occurred, thus bringing themselves clearly within the language of amended Treasury Regulation 101.14.

This case is not one of first impression interpreting the Revenue Act of 1942. We have the unreported case, cited in the defendant's brief, of *Rogers* v. *Stuart*, in the United States District Court for the District of Arizona, decided November 19, 1945, where the facts are almost identical with those we have here, which holds there is liability for the tax. While this is a district court case, and is not necessarily controlling as a precedent, still it is entitled to great consideration. There is, however, another late case that deals with the law here under consideration: *Avalon Amusement Corp.* v. *United States*, 7th Cir., 1948, 165 Fed. (2d) 653 [Ct. D. 1700, C. B. 1948-2, 168], affirming 73 Fed. Supp. 328. This case, coming from a court of appeals, is, I feel, controlling in the situation here presented, and must be accepted as a precedent. The court there says, page 655:

"The provision of the statute under consideration became effective in its present form October 21, 1942. * * * It is not free from ambiguity. Since the statute is ambiguous in its definition of a 'roof garden, cabaret, or other similar place' and does not attempt to define a 'public performance,' it was a proper subject for an interpretative regulation. * * * *This regulation is in accordance with our understanding of the statute and is valid.*" [Italics mine.]

I consider the pronouncement made in the Avalon case as authority and determinative of the issue here raised, and therefore grant the motion of the defendant to dismiss. An appropriate order may be submitted, allowing exceptions to the plaintiffs.

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TRANSPORTATION TAXES

INTERNAL REVENUE CODE

SECTION 3475, AS AMENDED.—TRANSPORTATION OF PROPERTY

REGULATIONS 113, SECTION 143.13: Application of tax. 1949–7–13057 M. T. 35

Application of tax imposed by section 3475 of the Internal Revenue Code to amounts paid for towing of vessels and for tugboat services rendered in assisting or maneuvering vessels to or from docks.

Advice is requested whether amounts paid for the towing of vessels and for tugboat services rendered in assisting or maneuvering vessels to or from docks are subject to tax under section 3475 of the Internal Revenue Code.

Section 3475 of the Code imposes a tax equivalent to 3 percent upon amounts paid within the United States, to a person engaged in the business of transporting property for hire, for the transportation of property by rail, motor vehicle, water, or air, from one point in the United States to another, except that, in the case of coal, the rate of tax is 4 cents per short ton.

Section 143.1 of Regulations 113 provides, in part, that the term "transportation" means the movement of property by a person engaged in the business of transporting property for hire, including interstate, intrastate, and intracity or other local movements, as well as towing, ferrying, switching, etc. However, under the provisions of section 143.13 of such regulations, the tax does not apply to an amount paid by a carrier, a freight forwarder, express company, or similar person for transportation with respect to which a tax is payable to such person.

It is held, in general, that the towing of a vessel not operating under its own power constitutes transportation of property by water within the meaning of section 3475 of the Code, and is accordingly taxable. However, the tax would not apply to amounts paid for towing a vessel which at the time is carrying cargo with respect to which transportation charges are being collected from a shipper or consignee by the person operating such vessel. Furthermore, the tax does not apply to amounts paid for tugboat services rendered in assisting or maneuvering a vessel to or from a dock, since such services do not constitute transportation of property within the meaning of the Code.

MANUFACTURERS' EXCISE TAXES

INTERNAL REVENUE CODE

REGULATIONS 46 (1940), SECTION 316.63.

1949–9–13079
T. D. 5697

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 316.—EXCISE TAXES ON SALES BY THE MANUFACTURER

Musical instruments sold for use for religious or educational purposes.

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

To Collectors of Internal Revenue and Others Concerned:

On December 22, 1948, notice of proposed rule making regarding the exemption from tax of musical instruments sold for use of religious or nonprofit educational institutions for exclusively religious or educational purposes was published in the Federal Register (13 F. R. 8221). After consideration of all such relevant matter as was presented by interested persons regarding the proposal, the following amendments to Regulations 46 (1940 edition) [26 CFR, Part 316] are hereby adopted. The amendments are designed to conform Regulations 46 (1940 edition) to sections 5 and 6 of Public Law 899 (Eightieth Congress), approved July 3, 1948 [C. B. 1948–2, 324].

PARAGRAPH 1. There is inserted immediately preceding section 316.60 the following:

PUBLIC LAW 899 (EIGHTIETH CONGRESS), APPROVED JULY 3, 1948

SEC. 5. That section 3404(d) of the Internal Revenue Code (relating to manufacturers' excise taxes on musical instruments) is hereby amended to read as follows:

"(d) Musical instruments, but the tax imposed by this section shall not apply to musical instruments sold for the use of any religious or nonprofit educational institution for exclusively religious or educational purposes. The right to exemption under this subsection shall be evidenced in such manner as the Commissioner, with the approval of the Secretary, may prescribe by regulations."

PAR. 2. Section 316.63, as amended by Treasury Decision 5189 [C. B. 1942–2, 226], approved November 30, 1942 [26 CFR 316.63], is further amended by adding at the end thereof the following new paragraphs:

By virtue of the provisions of section 5 of Public Law 899 (Eightieth Congress) no tax attaches to musical instruments sold by the manufacturer on or after July 4, 1948, for the use of any religious or nonprofit educational institution for exclusively religious or educational purposes, except that no sale of musical instruments may be made tax free by the manufacturer to a dealer for resale for the use of a religious or nonprofit educational institution even though it is known at the time of the sale that such resale will be made. However, where any dealer resells tax-paid musical instruments to a religious or nonprofit educational institution for exclusively religious or educational purposes, the manufacturer who paid the tax may secure a refund or credit in accordance with section 316.204.

To constitute a religious or nonprofit educational institution within the meaning of section 3404(d) of the Code (1) there must be a definite organization with officers, directors, or trustees, and the usual essential features (incorporation not being essential) of an organization of its class; (2) the organization must have a purpose which as put into practice is religious or educational, and (3) in the case of an educational institution its funds must be used solely in furtherance of such purpose, none of them being paid or otherwise distributed to any of its members or other persons except as reasonable compensation for services actually rendered or in furtherance of the educational purposes of the organization.

To establish the right to exemption from tax on the ground that a sale of musical instruments by the manufacturer is for the use of a religious or nonprofit educational institution for exclusively religious or educational purposes, it is necessary that (*a*) the manufacturer at the time of sale have definite knowledge that the purchaser is such an institution and that it intends to use the instruments exclusively for such purposes, and (*b*) he obtain from the purchaser and retain in his possession a certificate properly executed in the form prescribed by this section.

The manufacturer must be prepared to establish by further competent evidence that the purchaser is an institution to which tax-free sale may properly be made. However, in case of a church such further evidence is not necessary to establish the fact that it is a religious institution. A statement from the purchaser that it has received a ruling from the Commissioner holding it to be a religious or nonprofit educational institution entitled to exemption under section 101(6) of the Code (relating to income tax) which shows the date of the ruling and that it has not been withdrawn or revoked is generally acceptable to support tax-free sale thereto. Where the status of the institution as one to which tax-free sale may properly be made is not established by a ruling under section 101(6) or in some other manner as previously indicated in this section, the institution may apply to the Commissioner for a ruling. The application for a ruling may be made by filing with the collector Form 1023, relating to exemption under section 101(6). The collector will forward the application to the Commissioner for ruling. Copies of the form and instructions as to the procedure to be followed in filing it may be procured from the appropriate collector. In the absence of circumstances indicating a different use, the exemption certificate procured by the manufacturer from the religious or nonprofit educational institution may be accepted as prima facie proof that the musical instrument is purchased for exclusively religious or educational purposes.

Where a sale is otherwise exempt but the certificate is not obtained prior to the time the manufacturer files a return covering taxes for the month during which the sale is made, the manufacturer must include the tax on such sale in such return. However, if the certificate is later obtained, a claim for refund of the tax paid on such sale may be filed on Form 843, or a credit taken upon a subsequent return, but such action must be taken within the 4-year period of limitation prescribed by section 3313. See section 316.204.

The certificate must include an agreement that if the musical instruments are used otherwise than by a religious or nonprofit educational institution for exclusively religious or educational purposes, the person who signs the certificate will report such fact to the manufacturer. The tax applicable to the sale of the instruments shall be included by the manufacturer in his return for the month during which such report is received by him.

The following form of exemption certificate will be acceptable for the purposes of this section and must be adhered to in substance:

EXEMPTION CERTIFICATE

(For use by a religious or nonprofit educational institution purchasing musical instruments subject to tax under section 3404(d) of the Internal Revenue Code for exclusively religious or educational purposes.)

---, 19----.
(Date)

The undersigned purchaser hereby certifies that he is ------------------
(Title)

of --------------, ---;
(Religious or nonprofit educational institution)

that he is authorized to execute this certificate; and that the musical instruments specified in the accompanying order or on the reverse side hereof, are purchased by such institution for EXCLUSIVELY religious or educational purposes.

It is understood that this exemption certificate is for use only by a religious or nonprofit educational institution in the tax-free purchase of musical instruments for exclusively religious or educational purposes; and it is agreed that if the musical instruments purchased tax free under this exemption certificate are used otherwise, such fact will be reported to the manufacturer from whom they were purchased tax-free.

The organization claiming this exemption (has) (has not) received a ruling from the Bureau of Internal Revenue holding it to be an exempt religious or nonprofit educational institution under section 101(6) of the Internal Revenue Code. The date of such ruling is ____________________ and such ruling has not been withdrawn or revoked.

(Signature) ____.
(Title)

The fraudulent use of this certificate for the purpose of securing exemption from the payment or adjustment of taxes will subject the guilty party to a fine of not more than $10,000 or imprisonment for not more than 5 years or both.

Such certificates and proper records of invoices, orders, etc., relative to tax-free sales must be retained as provided in section 316.202 and must be readily accessible for inspection by internal revenue officers. If a manufacturer's records with respect to any sale claimed to be tax-free under this section do not include a proper certificate, as outlined above, with supporting invoices and such other evidence as may be necessary to establish the exempt character of the sales, tax is payable by the manufacturer on such sale.

PAR. 3. Immediately preceding section 316.204, as renumbered by Treasury Decision 5099 [C. B. 1941–2, 267], approved November 28, 1941 [26 CFR 316.204], there is inserted the following:

PUBLIC LAW 899 (EIGHTIETH CONGRESS), APPROVED JULY 3, 1948

SEC. 6. Section 3443(a)(3)(A)(i) of the Internal Revenue Code (relating to credits and refunds) is hereby amended to read as follows:

"(i) resold for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or of 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;".

PAR. 4. Section 316.204, as renumbered by Treasury Decision 5099, and as amended by Treasury Decision 5675 [C. B. 1948–2, 185], approved November 23, 1948 [26 CFR 316.204], is further amended by adding at the end of the fifth paragraph thereof the following sentence:

The refund or credit with respect to musical instruments resold to a religious or nonprofit educational institution for exclusively religious or educational purposes under section 3443(a)(3)(A)(i) of the Internal Revenue Code, as amended by Public Law 899 (Eightieth Congress), applies only to resales of such instruments on or after July 4, 1948, to the institutions named and for the purposes stated, and except for application of the statutory period of limitations upon credit or refund, the date of the original sale by the manufacturer is not material.

(This Treasury Decision is issued pursuant to the authority contained in section 5 of Public Law 899 (Eightieth Congress), and section 3791 of the Internal Revenue Code (53 Stat. 467; 26 U. S. C. 3791).)

Because the amendments to the Internal Revenue Code made by Public Law 899 (Eightieth Congress) became effective on July 4, 1948, the day after the date of the enactment of such public law, it is found that it is unnecessary to issue this Treasury Decision subject to the effective date limitation of section 4(c) of the Administrative Procedure Act, approved June 11, 1946.

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved April 7, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register April 12, 1949, 8:49 a. m.)

REGULATIONS 46 (1940), SECTION 316.70(*b*). 1949–9–13080
T. D. 5696

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 316.—EXCISE TAXES ON SALES BY THE MANUFACTURER

Definition of household type refrigerator modified

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

To Collectors of Internal Revenue and Others Concerned:

On January 13, 1949, notice of proposed rule making regarding the definition of the term "household type refrigerator" was published in the Federal Register (14 F. R. 183). No objection having been received, the following amendment to Regulations 46 [26 CFR, Part 316] is hereby adopted. The amendment is designed to conform Regulations 46 to the present manufacturing design in the refrigerator industry.

Section 316.70(*b*) as added by Treasury Decision 5189 [C. B. 1942–2, 226], approved November 30, 1942 [26 CFR 316.70(*b*)], is further amended by striking therefrom "20 cubic feet" and inserting in lieu thereof "14 cubic feet."

The amendment made by this Treasury Decision shall be applicable with respect to household type refrigerators sold on or after the date of filing of such Treasury Decision with the Federal Register.

(This Treasury Decision is issued pursuant to the authority contained in sections 3450 and 3791 of the Internal Revenue Code (53 Stat. 419, 467; 26 U. S. C. 3450, 3791).)

GEO. J. SCHOENEMAN,
Commissioner.

Approved April 7, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register April 12, 1949, 8:49 a. m.)

SECTION 3411(a), AS AMENDED

REGULATIONS 46 (1940), SECTION 316.190: Scope of tax. 1949–7–13056
Ct. D. 1714

TAX ON ELECTRICAL ENERGY—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. ELECTRICAL ENERGY SOLD TO DAIRY CUSTOMERS—COMMERCIAL CONSUMPTION.

Petitioner company sold electrical energy to certain dairy plants engaged primarily in the collection, pasteurization, and distribution of fresh milk. The electricity used by some of the plants is measured through a single meter, that of others through two or more meters, but in no case are the meters so connected to the incoming power line as to enable the energy supplied for one purpose to be differentiated from that supplied for another. *Held:* The electrical energy supplied to these dairy plants through single meters, or through more than one but without differentiation as to use, is energy sold for commercial consumption within the meaning of section 3411 of the Internal Revenue Code.

2. Decision Affirmed.

Decision of the United States Court of Appeals, Seventh Circuit [Ct. D. 1706, C. B. 1948–2, 188], 168 Fed. (2d) 285, affirmed.

Supreme Court of the United States

Wisconsin Electric Power Co., petitioner, v. *The United States of America*

On writ of certiorari to the United States Court of Appeals for the Seventh Circuit

[February 14, 1949]

OPINION

Mr. Justice Reed delivered the opinion of the Court.

Petitioner, engaged in the business of supplying electric energy to the public, seeks the refund of taxes paid by it pursuant to section 3411 of the Internal Revenue Code. That section, in pertinent part, provides for a tax "* * * upon electrical energy sold for domestic or commercial consumption * * * equivalent to 3 per centum [1] of the price for which so sold, to be paid by the vendor under such rules and regulations as the Commissioner, with the approval of the Secretary, shall prescribe." [2] Note that the statute taxes energy for domestic or commercial consumption. There is no provision for taxation of electrical energy used for industrial purposes.[3]

The purchasers of the electric power here involved are 27 dairy plants which are engaged primarily in the collection, pasteurization, and distribution of fresh milk. The sole question presented by the case is whether the use of electricity by these dairies is commercial consumption within the meaning of the statute or industrial consumption, a use not covered by the statute.

The functions of the dairy plants are sufficiently similar so that they can be treated as one for the purpose of describing their methods of operation. The plants are buildings equipped with milk-handling machinery and facilities located either off the dairy farms, or on the dairy farm itself as an activity apart from milk production. Contracts for the purchase of raw milk are negotiated with nearby farms.[4] This milk is delivered in trucks of the producers or of the dairy plant, as the case may be, to the plant where it is received, weighed, tested for butterfat content, cooled, and mixed and standardized so as to achieve the proper butterfat content. Next it is pasteurized. Pasteurization consists of heating the milk to 143° to 145° F., maintaining it at that level for about 30 minutes, and then subjecting it to sudden cooling to a point between 38° and 40° F.[5] The process is designed to kill pathogenic bacteria without destroying the natural creaming properties or the taste of the milk. Then the milk is drawn into bottles or cans which have been washed, sterilized, and cooled. Finally it is stored in refrigerated rooms to permit the cream line to form and to await delivery.[6] Most of it is delivered to customers in the dairy plant's trucks or wagons. In some instances a small proportion is sold at the plant itself.

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[1] Amended by the Revenue Act of 1941, c. 412, 55 Stat. 687, 707, section 521(a)(19), to change the 3 percent tax to 3⅓ percent.

[2] 26 U. S. C. section 3411.

[3] See, *infra*, page 4, et seq.

[4] A few of the consumers of electricity here involved produce their own milk.

[5] One of the plants pasteurizes by the so-called "flash method," heating the milk to 161° F. for 16 seconds and rapidly cooling it to 32° F.

[6] A minor proportion of the milk purchased by these plants is manufactured into butter, cheese, or other byproducts. An undisclosed amount of this milk is separated from the cream it contains; some is also homogenized.

Electric power is employed by the purchasing dairy plants in a number of ways. It is used to light the plants, including the garage space for the collecting and distributing trucks. It drives electric motors which pump refrigerants, deliver milk to and from the pasteurizer and to the bottling machines, operate the homogenizer, the bottling machine, the cream separator, and the machinery used in washing, sterilizing, and conveying bottles. The electricity used by some of the plants is measured through a single meter, that of others through two or more meters, but in no case are the meters so connected to the incoming power line as to enable the energy supplied for one purpose to be differentiated from that supplied for another. We do not have before us a situation where pasteurization utilizes electrical energy that is measured by a meter exclusively used for pasteurization.

Pasteurization is accomplished by the use of special equipment designed for that purpose. Most of the electricity attributable to the process is devoted to the ice machines which perform the rapid cooling of the milk after the initial heating. Since the same cooling units perform the cooling which is necessary before and after pasteurization, however, the electricity which they consume for pasteurization alone cannot be ascertained. Pasteurization equipment, including the increased cooling equipment necessary therefor, accounts for about 15 or 20 percent of the total cost of plant equipment, excluding trucks and other vehicles. About one-tenth of the cost of plant operation, excluding the cost of the raw milk and costs attributable to distribution, is attributable to pasteurization.

Petitioner paid the tax on electrical energy sold to the dairy plants during the period from April, 1940, to July, 1943, and then brought suit to recover it on the ground that such energy was sold not for commercial but for industrial consumption. The United States District Court for the Eastern District of Wisconsin held that the sales were for commercial consumption within the meaning of the statute, and therefore that the tax was valid. (69 Fed. Supp. 743.) The United States Court of Appeals for the Seventh Circuit affirmed. (168 Fed. (2d) 285.) It summarized its views as follows:

"We agree with [District] Judge Duffy that the wording and legislative history of the Act make it clear that the predominant character of the business carried on by a consumer of electrical energy is what determines whether the electricity sold has been sold for 'commercial consumption'; hence we are content to adopt his opinion as that of this court." (Id. at 286.)

The United States Court of Appeals for the Tenth Circuit had held in *United States* v. *Public Service Co. of Colorado* (143 Fed. (2d) 79), that electrical energy sold to dairy plants operating substantially as these was sold for industrial rather than commercial consumption, and consequently was not taxable under section 3411. We granted certiorari in this case in order to resolve the apparent conflict between circuits and to settle the meaning of the statute as it applies to the business of this general type of dairy plant. (335 U. S. 842.)

The tax now embodied in section 3411 was originally imposed upon the consumer of electricity by the Revenue Act of 1932. (47 Stat. 169, 266.) This Act was amended in 1933 to make the burden of the tax fall directly upon the vendor. (48 Stat. 254, 256.) No change of any significance for our purposes has occurred since the original enactment of this provision.

Although the language of the section does not include the word "industrial," it is clear from the legislative history that "commercial" was used in contradistinction to "industrial."[7] While electricity sold for commercial consumption is taxed, that sold for industrial consumption is not. Thus our task resolves itself to a determination of the category in which the consumption of electricity by these dairy plants should be classified. We shall not undertake the difficult and here needless task of general definition which differentiates for this statutory clause between industrial and commercial in other lines of business activity. That is a problem primarily for the administrators of the section, with knowledge of the specific and varying facts.

The legislative history indicates that the term "commercial" was meant to apply to the nature of the business in which the energy is consumed, and not to

[7] H. Conference Rept. No. 1492, 72d Cong., 1st sess., page 22; Senator Harrison, 77 Cong. Rec. 3212–14, 3215.

the specific purpose to which each measurable unit of electricity is devoted.[8] Where it is delivered through a single meter at one location, energy utilized to operate sewing machines for a minor manufacturing unit, e. g., shirts, in a department store, would be deemed power sold for commercial consumption, although it might fall within the industrial category if sold to a consumer who did nothing but manufacture shirts. Since any other interpretation of the section would entail the almost insurmountable administrative difficulty of classifying all the electricity sold to a plant according to the specific operations to which such power was devoted by the consumer, the conclusion that the controlling factor is the general nature of a business at a location accords with the natural meaning to be given the words employed by Congress to express its purpose.

The regulations interpret the section in line with the legislative history. U. S. Treasury Regulations 46 (1940 ed.), section 316.190 [as amended by T. D. 5099 (C. B. 1941-2, 267)], presently applicable, provides in pertinent part:

"*Scope of tax.*—The tax imposed by section 3411(a) of the Internal Revenue Code, as amended, applies, except as provided hereinafter, to all electrical energy sold for domestic or commercial consumption and not for resale.

"The term 'electrical energy sold for domestic or commercial consumption' does not include (1) electrical energy sold for industrial consumption, e. g., for use in manufacturing, mining, refining, shipbuilding, building construction, irrigation, etc., or (2) that sold for other uses which likewise cannot be classed as domestic or commercial, such as the electrical energy used by electric and gas companies, waterworks, telegraph, telephone, and radio communication companies, railroads, other similar common carriers, educational institutions not operated for private profit, churches, and charitable institutions in their operations as such. However, electrical energy is subject to tax if sold for consumption in commercial phases of industrial or other businesses, such as in office buildings, sales and display rooms, retail stores, etc., or in domestic phases, such as in dormitories or living quarters maintained by educational institutions, churches, charitable institutions, or others.

"Where electrical energy is sold to a consumer for two or more purposes, through separate meters, the specific use for which the energy is sold through each meter, i. e., whether for domestic or commercial consumption, or for other use, shall determine its taxable status. Where the consumer has all the electrical energy consumed at a given location furnished through one meter, the predominant character of the business carried on at such location shall determine the classification of consumption for the purposes of this tax." [9]

The last sentence of this regulation makes it clear that all electrical energy furnished to a predominantly commercial establishment through a single meter is subject to the tax although portions of such energy are devoted to purposes which, considered separately, might be classified as industrial.[10] While the regulation does not deal with the point, we think it obvious from the last quoted paragraph that where the energy is furnished at a single location through various meters, although none of them are shown to carry current for predominantly industrial uses, the same rule would be applied. The last sentence of the regulation adds a qualification, however, which directs our attention, not necessarily

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[8] The legislative explanations treat of business consumers as units and do not differentiate as to use within the units.

Senator Harrison, chairman of the Senate Finance Committee, which reported the bill, said:

"I am telling Senators nothing new when I remind them that we had a fight here in 1932 over the imposition of this tax. The Senate imposed a 3 percent electric-energy tax, and it was finally adopted, to be collected from the consumer of electric energy. We applied that only on domestic and commercial energy; that is, electric energy used in stores and dwellings that are classified as commercial and domestic. There was no tax in the 1932 act imposed upon energy employed in industry." (77 Cong. Rec. 3212-13.)

* * * * * * *

Senator Couzens, a member of a subcommittee of the Senate Finance Committee, which was constituted to consider the electrical energy tax, said: "I mean they eliminated that feature of the tax; they eliminated the tax on electrical energy sold to manufacturing plants and left the tax on electricity used commercially, that is by stores and on electricity used for domestic purposes * * *" (77 Cong. Rec. 3218.)

[9] This regulation was substantially the same in its earlier versions. U. S. Treasury Regulations 42, Art. 40 (1932); T. D. 4342, C. B. XI-2, 495 (1932); T. D. 4393, C. B. XII-2, 322 (1933). The quoted version, however, omitted the word "processing," which was formerly included in the list of activities exemplifying industrial consumption. We do not consider this deletion significant for purposes of this case.

[10] Cf. *St. Louis Refrigerating & Cold Storage Co.* v. *United States* (43 Fed. Supp. 476); *Fulton Market Cold Storage Co.* v. *United States* (43 Fed. Supp. 485).

to the nature of a business as a whole, but to the nature as a whole of the activities carried on "at a given location."

We accept the last sentence of the quoted regulation as proper under the statute.[11] As applied to these plants we think that the electricity furnished by the petitioner was "sold for commercial consumption" and consequently was properly taxed. Admittedly the activities of these consumers would be considered commercial if they did not pasteurize the milk prior to its sale. Such business would accurately be called the distribution of fresh milk. The butter and cream extraction appears incidental. We are not dealing with a "creamery" in the sense of a butter or cheese factory. We agree with the courts below that the addition of pasteurization to the other activities described above does not change the nature of the dairy plants' business from commercial to industrial any more than would the cooking of food for sale in a restaurant, or the cleaning of raw food products prior to distribution or sale. The district court found that "pasteurization plays a minor part in the total business of the dairies," and that "the predominant business of the dairies here involved * * * is, and was, that of fluid milk dealers and distributors."[12]

Petitioner argues that the test applied by the court of appeals, "whether the predominant character of the enterprise carried on by such consumer is commercial," is erroneous and contrary to the regulation in that it directs attention to the business as a whole rather than to the activities at a given location. While the language quoted is susceptible to this criticism, the variation is harmless because the plant itself is the location or the focal point of all the relevant activities of each of these consumers of electricity. Pasteurization does not occur at a separate location, but at the same plant where the milk is received, weighed, tested, cooled, homogenized, separated and bottled. The milk is brought to this plant when purchased, and from the plant it is distributed to customers. The fact that most of the sales or deliveries occur off the premises does not alter the essential fact that all activities occur in or pivot around the plant.

Thus, though pasteurizing, we assume, is processing and though processing separately viewed may be conceded to be industrial,[13] we conclude that the business conducted by these dairy plants is essentially commercial. The contrary conclusion reached in *United States* v. *Public Service Co. of Colorado* (143 Fed. (2d) 79), may be ascribed to the fact that there the court apparently looked to the use to which the electrical energy was devoted rather than to the nature of the business at a given location.[14]

Rulings of the Bureau of Internal Revenue support our conclusion. In 1932, S. T. 518 stated that, "Electrical energy furnished for consumption by bottling works, milk companies, or creameries engaged in the pasteurization and bottling of milk, and in the manufacture of butter, buttermilk, chocolate milk, and cottage cheese, is not furnished for domestic or commercial consumption * * *."[15] Apparently, however, the Bureau intended this ruling to apply only to those plants whose business was predominantly pasteurization and the manufacture of milk byproducts, because S. T. 637, issued the following year, contained the following statement:

"A dairy which obtains milk and converts it into use for retail purposes is held to be engaged in a business commercial in character. Electrical energy used in such operations will be subject to tax."[16]

In clarification of these two rulings the Bureau explained:

"Electrical energy furnished a commercial dairy or milk company which merely produces or purchases raw milk in bulk and pasteurizes it for sale

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[11] We do not intend by these words of limitation to approve or disapprove other provisions. There are ambiguities in this section of the regulation. In the second paragraph, without reference to separate meters, it holds that energy used in the commercial phases of an industrial business is taxable. The reverse would seem to follow as to industrial phases of a commercial business. Yet the third paragraph allows the avoidance of such a tax on industrial use only by the employment of separate meters.

[12] For State cases to the effect that this business is primarily commercial, see e. g. *City of Louisville* v. *Ewing Von-Allmen D. Co.* (268 Ky. 652, 105 S. W. 2d 801); *People ex rel. E. S. Dairy Co.* v. *Sohmer* (218 N. Y. 199, 112 N. E. 755); *Richmond* v. *Dairy Co.* (156 Va. 63, 157 S. E. 728). But see *Dairy Assn.* v. *Bd. of Tax Admin.* (302 Mich. 643, 5 N. W. 2d 516).

[13] See note 9, *supra*.

[14] "The electrical energy was not used in the commercial phase of the dairying enterprise, but in the processing or industrial phase of the enterprise." (143 Fed. (2d) 79, 82.)

[15] C. B. XI-2, 498 (1932).

[16] C. B. XII-1, 409, 410 (1933).

either in bulk or bottled quantities, whose activities consist principally in the handling, distribution and sale of milk, is also subject to the tax.

"It is only electrical energy that is furnished for direct consumption by dairies which in addition to pasteurizing and bottling milk are also engaged in all the essential manufacturing processes necessary for the production of dairy products, such as the manufacturing of butter, cheese and other dairy products, for sale on the open market as an article of commerce, that is not subject to the tax." [17]

Thus we hold that electrical energy supplied to these dairy plants through single meters, or through more than one but without differentiation as to use, is energy sold for commercial consumption.

Affirmed.

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[17] Bureau letter, dated May 13, 1933 (symbols MT : ST : BHF) (333 C. C. H. par. 6266), 4 C. C. H. Tax Serv. par. 2633G. 175 (1949).

RETAILERS' EXCISE TAXES

INTERNAL REVENUE CODE

SECTION 2406.—TAX-FREE SALES

REGULATIONS 51 (1941), SECTION 320.21: Sales for export. 1949–1–13004 S. T. 936

Applicability of the exemption from retailers' excise taxes provided by section 2406(b) of the Internal Revenue Code, in respect of exportations, to the sale of a taxable article to an alien going abroad, where the article is delivered directly by the retailer to the purser or other responsible official of a foreign-bound vessel or aircraft.

Advice is requested concerning the application of the exemption from retailers' excise taxes provided by section 2406(b) of the Internal Revenue Code, in respect of exportations, where articles taxable under Chapter 19 or 9A of the Code are sold to an alien going abroad and are delivered directly by the retailer to the purser of a foreign-bound vessel.

The proof of exportation required with respect to the exemption provided by section 2406(b) of the Internal Revenue Code may be (*a*) a copy of the export bill of lading issued by the delivering carrier, or, where the articles are mailed, a certificate signed by a postmaster that the articles have been received from the retailer in the post office for forwarding to the foreign address shown; (*b*) a certificate by a representative of a carrier showing actual foreign delivery of the articles; (*c*) a certificate of lading issued by customs officer of a foreign country; or (*d*) where such foreign country has no customs administration, a statement of the foreign consignee showing receipt of the articles.

Where articles, taxable under Chapter 19 or 9A of the Internal Revenue Code, are sold to an alien going abroad and are delivered directly by the retailer to the purser or other responsible official of a foreign-bound vessel, or to an official of a foreign-bound aircraft, for delivery outside the United States to the purchaser whose destination is a foreign port, a certificate subsequently furnished to the retailer by the purser or other responsible official of the carrier showing that the articles were delivered to the purchaser only after the carrier was outside the territorial limits of the United States will be considered as satisfactory proof of exportation of the articles prior to use. Such certificate is to be retained by the retailer for inspection by internal revenue officers.

MISCELLANEOUS RULINGS

SECTION 3 OF THE VINSON ACT (48 STAT. 503, 505), AS AMENDED

1949–1–13003
Mim. 6340

Applicability to the Secretary of the Air Force and the Department of the Air Force of Treasury Decision 4909 [C. B. 1939–2, 422] containing regulations under the profit-limiting provisions of the Vinson Act respecting excess profit on contracts and subcontracts for Army aircraft.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C., December 15, 1948.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, Heads of Field Divisions of the Technical Staff, and Others Concerned:

This mimeograph explains the applicability to the Secretary of the Air Force and the Department of the Air Force of Treasury Decision 4909 [C. B. 1939–2, 422], approved June 16, 1939, by the Acting Secretary of the Treasury and on June 28, 1939, by the Acting Secretary of War, which contains regulations under section 14 of the Act of April 3, 1939 (53 Stat. 555, at 560) and other provisions of law, respecting excess profit on contracts and subcontracts for Army aircraft.

The National Security Act of 1947 (61 Stat. 495), approved July 26, 1947, provides, among other things, for the designation of the Department of War as the Department of the Army, the change of the title of the Secretary of War to that of Secretary of the Army, the establishment of an executive department known as the Department of the Air Force, the establishment of the office of Secretary of the Air Force, and for the transfer of certain functions to the latter Department and official.

By Transfer Order 6, dated January 9, 1948 (13 F. R. 218), effective as of 12 m. (noon) January 15, 1948, the Secretary of Defense, acting under the National Security Act of 1947, ordered, among other things, the transfer to the Secretary of the Air Force and the Department of the Air Force of certain of the functions, powers, and duties vested in the Secretary of the Army and the Department of the Army by section 14 of the Act of April 3, 1939.

Section 305(a) of the National Security Act of 1947 provides:

SEC. 305. (a) All laws, orders, regulations, and other actions applicable with respect to any function, activity, personnel, property, records, or other thing transferred under this Act, or with respect to any officer, department, or agency, from which such transfer is made, shall, except to the extent rescinded, modified, superseded, terminated, or made inapplicable by or under authority of law, have the same effect as if such transfer had not been made; but, after any such transfer, any such law, order, regulation, or other action which vested functions in or otherwise related to any officer, department, or agency from which such transfer was made shall, insofar as applicable with respect to the function, activity, personnel, property, records or other thing transferred and to the extent not inconsistent with other provisions of this Act, be deemed to have vested such function in or relate to the officer, department, or agency to which the transfer was made.

In view of the foregoing, the provisions of Treasury Decision 4909 are, with respect to contracts and subcontracts coming within the scope of section 14 of the Act of April 3, 1939, applicable to contracts and subcontracts within the jurisdiction of the Secretary of the Air Force.

Accordingly, in the case of such contracts and subcontracts falling, pursuant to Transfer Order 6, within the jurisdiction of the Secretary of the Air Force, the references in Treasury Decision 4909 to the "Secretary of War" and the "Army" are to be construed, respectively, as references to the "Secretary of the Air Force" and the "Air Force."

Correspondence in regard to this mimeograph should refer to its number and the symbols IT: EIM.

GEO. J. SCHOENEMAN,
Commissioner.

SECTION 3 OF THE VINSON ACT (48 STAT. 503, 505), AS AMENDED BY THE ACT OF JUNE 25, 1936 (49 STAT. 1926), AND BY THE ACT OF APRIL 3, 1939 (53 STAT. 555, 560)

1949–8–13065
I. T. 3947

Effect of the renegotiation of Government contracts or subcontracts upon the determination of excess profit under the profit-limiting provisions of the Vinson Act (48 Stat. 503, 505), as amended.

Consideration has been given as to the effect, for the purposes of the profit-limiting provisions of the Vinson Act (48 Stat. 503, 505), as amended, of the renegotiation, under the Renegotiation Act of 1948 (62 Stat. 259; C. B. 1948–1, 238), of contracts or subcontracts for construction of aircraft and related procurement where the contractor or subcontractor is required to pay or repay excessive profits to the United States with respect to contracts or subcontracts which are also subject to the profit-limiting provisions of the Vinson Act, *supra*, as amended (hereinafter referred to as the Vinson Act).

For Federal tax purposes, section 3806(a) of the Internal Revenue Code requires that a payment or repayment within a taxable year ending after December 31, 1941, of excessive profits pursuant to renegotiation shall be treated as a reduction of the price of the contracts or subcontracts for the taxable year for which such price was received or accrued, and section 3806(b) of the Code requires that the decrease in Federal income taxes resulting from such contract price reductions be credited against the amount of excessive profits paid or repaid. (See I. T. 3611, C. B. 1943, 978.)

In case a renegotiation is made under the Renegotiation Act of 1948 and excessive profits paid or repaid by a contractor or subcontractor in respect of contracts or subcontracts which are also subject to the profit-limiting provisions of the Vinson Act, and if the contractor or subcontractor is required to pay excess profit under such Act, with respect to such contracts or subcontracts, the contractor or subcontractor would be in the position of being required to pay both the excessive profits under the Renegotiation Act of 1948 and the excess profit under the profit-limiting provisions of the Vinson Act with respect to the same amount of profits unless an adjustment is made to eliminate such double payments.

Section 3806(b) of the Internal Revenue Code provides for the allowance of a credit against excessive profits of certain Federal taxes specified in such section, but does not provide for a credit of the excess profit under the profit-limiting provisions of the Vinson Act. However, under a general rule of law, a person who has a legal or equitable claim against the United States is entitled to credit or offset such claim against his liability to the United States, whether such claim arises out of the particular transaction in which he incurred his liability to the United States or out of a distinct and separate transaction which would constitute a legal or equitable offset. (See House of Representatives Report No. 2586, Seventy-seventh Congress, second session, amendment No. 459, C. B. 1942–2, 701, 728–729, and I. T. 3577, C. B. 1942–2, 163.)

In view of the foregoing, it is held that if pursuant to a renegotiation under the provisions of the Renegotiation Act of 1948, the contractor is required to pay or repay to the United States excessive profits, the amount so paid or repaid shall not be treated as a part of the cost of performing the contract or subcontract. However, the contract or subcontract price for the purposes of the profit-limiting provisions of the Vinson Act shall be reduced by the amount of the excessive profits so paid or repaid. In such cases, the amount by which the contract or subcontract price is to be reduced shall be the portion of the total excessive profits for the income-taxable year which is properly applicable to the particular contract or subcontract. This rule is also applicable for the purposes of the Vinson Act in cases in which the contract or subcontract is performed in two or more income-taxable years, irrespective of whether under such Act the contract or subcontract is to be considered as completed within the income-taxable year of the contractor or subcontractor covered by the renegotiation.

In cases of renegotiation with respect to contracts or subcontracts for which an annual report for the purposes of the Vinson Act has not been filed under section 17.16 of Treasury Decision 4906 (C. B. 1939–2, 404, 419) or section 16.15 of Treasury Decision 4909 (C. B. 1939–2, 422, 434), the reduction in the contract or subcontract price as required by section 3806(a) of the Code with respect to such contracts or subcontracts shall be made and taken into account in filing such report and in determining the liability for the excess profit to be shown by such report.

In cases in which renegotiation with respect to contracts or subcontracts occurs after an annual report for the purposes of the Vinson Act has been made with respect to such contracts or subcontracts, if the excessive profits to be eliminated upon renegotiation are determined without making an allowance or deduction for the excess profit payable under the Vinson Act with respect to such contracts or subcontracts, any overpayment of excess profit under the Vinson Act resulting from the reduction of the contract or subcontract prices of such contracts or subcontracts, to give effect to the renegotiation, may be made the subject of a claim for refund which may be filed on Form

843 within the applicable period of limitation provided under section 322 of the Internal Revenue Code. In lieu of such claim, the amount of the overassessment resulting from such adjustment may be applied as a credit against the excessive profits determined upon the renegotiation, provided the credit is so made pursuant to procedures satisfactory to the Bureau of Internal Revenue and the renegotiating agency. If it is later determined that the credit allowed against the excessive profits determined upon renegotiation exceeds the amount allowable, the difference may be determined, assessed, and collected as a deficiency under the Vinson Act. (See *Baltimore Foundry and Machine Corp.* v. *Commissioner*, 7 T. C. 998.) No credit against excessive profits determined upon renegotiation shall be allowed or made of any portion of the excess profit paid or assessed under the Vinson Act which upon renegotiation is allowed as a cost or other deduction in determining the excessive profits to be eliminated upon renegotiation. Likewise, no credit, refund, or abatement shall be allowed or made of such portion, and no credit, refund, or abatement shall be allowed or made of any amount which is applied as a credit against the excessive profits determined upon renegotiation.

SECTION 67 OF THE BANKRUPTCY ACT, AS AMENDED

1949–5–13033
Ct. D. 1713

FEDERAL TAXES—INTERNAL REVENUE CODE—BANKRUPTCY ACT, AS AMENDED—DECISION OF SUPREME COURT

1. BANKRUPTCY—PRIORITY OF TAX CLAIM OF UNITED STATES—APPLICATION OF SECTION 67c, BANKRUPTCY ACT, AS AMENDED.

Where, at the time of the institution of a bankruptcy proceeding, the collector of internal revenue has actual possession of a bankrupt's personal property previously seized to effect collection of Federal taxes which are secured by a perfected tax lien, there has been compliance with the provisions of section 67c of the Bankruptcy Act, as amended, and the collector's subsequent voluntary relinquishment of such personal property to permit its sale by the trustee of the bankrupt's estate does not subordinate the payment of the aforementioned Federal taxes out of the proceeds of the trustee's sale to the payment of wage claims.

Section 67c of the Bankruptcy Act, as amended, deals with the situation existing at the time of the filing of the petition in bankruptcy. The validity of the lien for taxes as against wages being established, the collector's possession of the personal property of the bankrupt at the time of the filing of the petition in bankruptcy precluded the application of the provisions of section 67c of the Bankruptcy Act, as amended, which otherwise would have required the payment of the tax claims to be postponed to the payment of claims for the expenses of administration and wages specified in subsections (1) and (2) of section 64a of the Bankruptcy Act, as amended. Neither the provisions of section 67c of the Bankruptcy Act, as amended, nor its legislative history indicate an abandonment of the general purpose of Congress to safeguard interests under liens perfected before bankruptcy.

2. DECISION REVERSED.

Decision of the United States Court of Appeals, Ninth Circuit (165 Fed. (2d) 155), reversed.

SUPREME COURT OF THE UNITED STATES

George T. Goggin, Trustee in Bankruptcy of the Estate of Kessco Engineering Corp., petitioner, v. Division of Labor Law Enforcement, State of California, Statutory Assignee of Certain Prior Wage Claimants

On writ of certiorari to the United States Court of Appeals for the Ninth Circuit

[January 31, 1949]

OPINION

Mr. Justice BURTON delivered the opinion of the Court.

This case deals with the question whether section 67c of the Bankruptcy Act,[1] in determining priorities in the payment of claims, speaks as of the time of filing the petition in bankruptcy. The precise issue presented is whether a tax claim of the United States, secured by a lien perfected before the bankruptcy of the taxpayer and accompanied, at the time of the filing of the petition in bankruptcy, by the collector of internal revenue's actual possession of the bankrupt's personal property, is required by section 67c of the Bankruptcy Act to be postponed in payment to debts owed by the bankrupt for wages to claimants specified in clause (2) of section 64a of that Act,[2] because the collector later relinquished possession of such property to the trustee of the bankrupt's estate for sale by him. We hold that the lien was valid and entitled to priority of payment as against the wage

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[1] As section 67b is referred to in section 67c and is material to its interpretation, both subdivisions of section 67 are quoted below:

"SEC. 67. LIENS AND FRAUDULENT TRANSFERS.—* * *

"b. The provisions of section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under chapter X, XI, XII, or XIII of this Act, by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

"c. *Where not enforced by sale before the filing of a petition in bankruptcy* or of an original petition under chapter X, XI, XII, or XIII of this Act, *though valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States* or to any State or subdivision thereof, *on personal property not accompanied by possession of such property,* and liens whether statutory or not, of distress for rent *shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act,* and, except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act." [Italics supplied.]

* * * * * * *

Bankruptcy Act of 1898, c. 541, 30 Stat. 544, 564, as amended by the Chandler Act of June 22, 1938, c. 575, 52 Stat. 840, 875–877, 11 U. S. C. section 107 (b) and (c).

[2] Not only the portions of section 64a specifying the wages here in controversy but those otherwise related to the issues of this case are quoted below:

"SEC. 64. DEBTS WHICH HAVE PRIORITY.—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be *(1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition;* the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; *the costs and expenses of administration,* including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) *wages* not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, *due to workmen, servants, clerks, or traveling or city salesmen* on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further,* That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States in [is] entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy." [Italics supplied.]

* * * * * * *

Bankruptcy Act of 1898, c. 541, 30 Stat. 544, 563, as amended by the Chandler Act of June 22, 1938, c. 575, 52 Stat. 840, 874, and 60 Stat. 323, 330, 11 U. S. C. section 104(a).

claims at the date of bankruptcy and that the collector's relinquishment of possession of the bankrupt's property did not change the result.

The facts are undisputed. Before March 26, 1946, a collector of internal revenue of the United States perfected a statutory lien upon the personal property of the Kessco Engineering Corp., a California corporation, and took actual possession of such property pursuant to that lien. He attempted to sell such assets and received bids for them but did not complete the sale because the price obtainable was unsatisfactory to him. He instituted a second sale but abandoned it when he relinquished possession of the property to the trustee of the bankrupt's estate. On March 26, 1946, the corporation filed its voluntary petition in bankruptcy in the United States District Court for the Southern District of California, was adjudicated a bankrupt and George T. Goggin (who later became the trustee of the bankrupt's estate and is the petitioner herein) was appointed receiver. Having qualified as receiver on March 28, 1946, he communicated with counsel for the collector as to the collector's turning over to him the bankrupt's personal property. In this connection, the referee in bankruptcy later made a finding of fact which was adopted by the district court and is as follows:

"* * * the personal property of the bankrupt in the hands of the collector of internal revenue, * * * was turned over to the said George T. Goggin, who accepted the terms and conditions of a telegram from J. P. Wenchel, Chief Counsel of the Bureau of Internal Revenue, reading as follows:

" 'Reference to telephone conversation today with Mr. Webb [member of the Los Angeles office of internal revenue] relative to Kessco Engineering Corp., bankrupt, no objection by this office to collector relinquishing personal property to trustee for sale. Government's lien to attach to proceeds from sale subject to trustee's expenses including costs of sale.

J. P. Wenchel, *Chief Counsel.*' "

Goggin, in his final capacity as trustee for the bankrupt, caused these assets to be sold at public auction, pursuant to order of court. Having liquidated all assets which had come into his possession, he had on hand, on December 12, 1946, about $31,206.20, which the referee certified was insufficient to pay in full the expenses of administration, the lien claims, the prior labor claims and prior tax claims in the case. The gross amount of the amended claim of the collector for taxes, penalties and interest was $78,865.03. The prior wage claims totaled $3,424.87. The Department of Employment of the State of California also filed a tax claim for $15,135, which was recorded as a lien on or about December 24, 1945. Neither the validity nor the amount of any of these claims is in issue here.[3]

The present proceeding originated in a petition filed with the referee in bankruptcy by the trustee, seeking an order to show cause why the order of priority of the payment of the tax and prior wage claims and the expenses of administration should not be determined by the district court. The referee made findings of fact and reached conclusions of law upon the basis of which he ordered that, from the monies in the possession of the trustee, there first be paid the expenses of administration and that the balance of such funds then in the hands of the trustee be paid to the collector of internal revenue in partial payment of the Government's tax claims and the interest thereon as prescribed by law.[4] The district court adopted the findings of fact and conclusions of law of the referee and entered judgment thereon. The Court of Appeals for the Ninth Circuit reversed that judgment and held that, by virtue of the collector's relinquishment of his possession of the personal property of the bankrupt, the taxes due to the United States must be postponed, in payment, to the debts of the bankrupt for certain wage claims, pursuant to section 67c of the Bankruptcy

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[3] There is no issue here as to the amount of penalties or interest included in the collector's claim for taxes or as to the date to which interest on such claim shall be computed. There is no issue here as to any difference between statutory liens which were perfected more than four months before the filing of the petition in bankruptcy or those perfected within less than that time. As the lien claimed by the United States exceeds the funds available, it has filed its brief in this Court as the sole real party in interest and in opposition to the wage claims. The respondent, Division of Labor Law Enforcement of the State of California, appears on behalf of all of the labor claimants. There also is no issue here as to the amount to be paid for the expenses of administration or the items which such expenses may include in addition to the costs of the sale made by the trustee.

[4] Provision, not material here, was made that, if additional money came into the possession of the trustee, the court, upon notice to all necessary and proper parties, should determine the respective liens or priorities, if any there be, of the collector of internal revenue, the prior labor claimants, the Department of Employment of the State of California and other tax claimants entitled to be heard.

Act. (165 Fed. (2d) 155.) Because of the importance of the issue in the administration of the Bankruptcy Act, we granted certiorari. (333 U. S. 860.)

The bankrupt filed its petition and was adjudicated a bankrupt on March 26, 1946. The personal property of the bankrupt was then subject to the perfected statutory lien of the United States for taxes and that lien was accompanied by the actual physical possession of the property by a collector of internal revenue on behalf of the United States. Those facts completely satisfy section 67c of the Bankruptcy Act.[5] Subsequent events, such as the relinquishment of his possession by the collector in favor of the trustee of the bankrupt's estate for the purpose of facilitating a sale of the property by the trustee, are not material to the determination of the issue before us.[6] The terms under which the collector's possession was relinquished are consistent with and support this result but the Government's right to payment ahead of the wage claims was determined at the time of bankruptcy and did not arise out of the arrangement under which possession was relinquished to the trustee.

This general point of view in interpreting the Bankruptcy Act is one of long standing. In *Everett* v. *Judson* (228 U. S. 474, 479) this Court said:

"We think that the purpose of the law was to fix the line of cleavage with reference to the condition of the bankrupt estate as of the time at which the petition was filed and that the property which vests in the trustee at the time of adjudication is that which the bankrupt owned at the time of the filing of the petition."

See also, *Myers* v. *Matley* (318 U. S. 622, 626); *United States* v. *Marxen* (307 U. S. 200, 207–208); *Acme Harvester Co.* v. *Beekman Lumber Co.* (222 U. S. 300, 307).[7]

While section 67c was added to the Bankruptcy Act by the Chandler Act in 1938, we find nothing in it or in its legislative history to suggest an abandonment of the underlying point of view as to the time as of which it speaks and the general purpose of Congress to continue to safeguard interests under liens perfected before bankruptcy. (*City of Richmond* v. *Bird*, 249 U. S. 174; *In re Knox-Powell-Stockton Co.*, 100 Fed. (2d) 979; *In re Van Winkle*, 49 Fed. Supp. 711.)

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[5] See note 1, *supra*.

[6] See *Davis* v. *City of New York* (119 Fed. (2d) 559). In that case the city perfected its lien for retail sales taxes by seizure of assets of the taxpayer, May 16, 1939. An involuntary petition in bankruptcy was filed, June 7, 1939, against the taxpayer and it was adjudicated a bankrupt, June 17, 1939. The assets were thereafter sold in execution of the warrant issued by the city treasurer. The levy was held to be a valid statutory levy as against the trustee of the bankrupt's estate and the city was allowed to retain the proceeds of the sale, under sections 67b and 67c of the Bankruptcy Act, as amended in 1938. For a converse situation see *City of New York* v. *Hall* (139 Fed. (2d) 935). In that case the city perfected its lien on personal property of the taxpayer, arising out of long delinquent business and sales taxes, by the delivery of warrants on January 14, 1943, at 10:15 a. m., to the city's warrant agent for execution and levy on the property. The actual levy on, and inventory of, the property and the posting of notices of sale were not effected until shortly after 4:30 p. m. In the meantime, at 4:22 p. m., an involuntary petition in bankruptcy was filed against the taxpayer and upon this he was adjudicated a bankrupt. Pursuant to an order of the bankruptcy court, a receiver sold the property and the court declined to order the net proceeds to be turned over to the city. The city was the holder of a statutory lien but, at the time of the filing of the petition in bankruptcy, the lien was not accompanied by actual possession of the personal property to which it attached. It, therefore, was subordinated, under section 67c of the Bankruptcy Act, to the administration expenses and wages covered by clauses (1) and (2) of section 64a. "Notwithstanding the admonition of section 67, sub. c, the city chose to slumber on its rights. Congress intended to penalize such somnolence." (Id. at p. 936.)

[7] "SECTION 1. MEANING OF WORDS AND PHRASES.—The words and phrases used in this Act and in proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows:

* * * * * * *

"(13) 'Date of bankruptcy,' 'time of bankruptcy,' 'commencement of proceedings,' or 'bankruptcy,' with reference to time, shall mean the date when the petition was filed"; * * * (30 Stat. 544, as amended by 52 Stat. 840–841.)

"* * * the rights of creditors are fixed by the Bankruptcy Act as of the filing of the petition in bankruptcy. This is true both as to the bankrupt and among themselves. The assets at that time are segregated for the benefit of creditors. The transfer of the assets to someone for application to 'the debts of the insolvent, as the rights and priorities of creditors may be made to appear' [citing *Bramwell* v. *U. S. Fidelity & Guaranty Co.*, 269 U. S. 483, 490], takes place as of that time." (*United States* v. *Marxen*, 307 U. S. 200, 207–208.)

"The general rule in bankruptcy is that the filing of the petition freezes the rights of all parties interested in the bankrupt estate. Exceptions only emphasize the rule. Whatever disagreement in opinion there may have been on the matter prior to the Act of 1938, it is now clear that statutory liens may be valid if they arise before bankruptcy although they are perfected after bankruptcy, if the perfection is within the time permitted by and in accordance with the requirements of applicable law." (4 Collier on Bankruptcy 228–229 (14th ed. 1942).)

While section 64, as amended, somewhat readjusts priorities among unsecured claims, section 67 continues to recognize the validity of liens perfected before bankruptcy as against unsecured claims. Section 67b has clarified the validity of statutory liens, including those for taxes, even though arising or perfected while the debtor is insolvent and within 4 months of the filing of the petition in bankruptcy. It expressly recognizes that the validity of liens existing at the time of filing a petition in bankruptcy may be perfected under some circumstances after bankruptcy. Section 67c, as amended in 1938, does, however, introduce a new postponement in the payment of certain claims secured by liens to the payment of other claims specified in clauses (1) (for certain administrative expenses, etc.) and (2) (for certain wages) of section 64a. This subordination is, however, sharply limited. For example, it does not apply to statutory liens on real property, or to those actually enforced by sale before bankruptcy, or, in general, to liens on personal property when accompanied by actual possession of such property. The background of section 67c suggests a conscious purpose to give a narrowly limited priority to administrative expenses and to certain wage claims, at least in instances disclosing accumulations of unpaid taxes the priority of which wage earners had no good reason to suspect, and which might absorb the entire estate of the bankrupt unless postponed by these provisions.[8] The

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[8] These provisions apparently originated in amendments proposed by the National Bankruptcy Conference which were before Congress in a Committee Report Analysis of H. R. 12889 (74th Cong., 2d sess. (1936)). This report states that the bill was introduced by Mr. Chandler, May 28, 1936, containing amendments proposed by the National Bankruptcy Conference, and the several sections are accompanied by explanatory notes. Section 67c, as there proposed, resembles substantially the section as finally enacted. The note explanatory of it is attributed to Jacob I. Weinstein, a member of the Conference, includes the following statement:

"Section 64 [of the Bankruptcy Act before amendment by the Chandler Act] is declaratory of a policy that the costs and expenses in connection with a bankruptcy proceeding and its administration shall be first paid in distribution. It is a sound policy and is in accordance with the general principles well established in liquidation proceedings. But section 67 of the Act does not apply the same limitation with respect to valid liens. The Supreme Court, in the case of *City of Richmond* v. *Bird* (43 A. B. R. 260 (1919)), resolved the conflict in the lower court decisions by holding that the priority provisions of section 64 do not apply to liens valid under section 67. * * *

"It is significant that in recent years State legislatures have been enacting special legislation in favor of tax claims, public debts, and a variety of private claims. Statistics in the bankruptcy cases show that the effective administration of the bankruptcy law has seriously suffered therefrom. Such claims, particularly tax liens, often consume the entire estate, leaving nothing for the payment of the costs and expenses of administration incurred in reducing the assets to cash. In many such cases the tax liens represent an accumulation of delinquent items covering a long period of time, without any attempt on the part of tax collectors to enforce payment prior to the bankruptcy proceeding.

"There is therefore need for a provision to protect the administration costs and expenses; and similar considerations apply to wage claims. Accordingly we have selected, from among the priorities fixed by section 64 (as revised), these particular items for protection. However, by reason of the historical development and the inherent differences existing in the incidents attaching to real and personal property, it would seem advisable to restrict the remedy thus provided to liens on personal property, *where such liens have not been enforced by sale prior to bankruptcy.*" [Italics supplied.] (Id. at p. 212 n. 1.)

At that time the bill did not also except from subordination statutory tax liens on personal property "accompanied by possession of such property." The addition of that clause gives it special emphasis and suggests its appropriate effect as a warning to other claimants that the property, so possessed, will not be available in the first instance for the administrative expenses and wage claims specified in clauses (1) and (2) of section 64a.

The report filed by Mr. Chandler for the Committee on the Judiciary, July 29, 1937, to accompany the bill then known as H. R. 8046 merely stated: "In subdivisions b and c statutory liens are protected and permitted to be perfected if the time allowed by law for perfecting them has not expired." (H. R. Rep. No. 1409, 75th Cong., 1st sess. 34 (1937), and see references to sections 64 and 67c on pp. 9, 15–16.)

See also, Weinstein, The Bankruptcy Law of 1938 (1938):

"This subdivision is new and is designed to correct an inequitable condition which existed under the old Act, particularly with respect to tax liens allowed, through the inaction of tax authorities, to be accumulated over a long period of time. Frequently, such liens consumed the entire estate, even to the exclusion of the costs and expenses incurred in the proceeding. While subdivision a of section 64 provides for priority of payment of such costs and expenses, such payment is prior only to the other unsecured debts and does not affect or impair valid liens, whether statutory or otherwise. But tax claims may take the form of unsecured debts due to the sovereign, and thus payable by way of priority in the order as provided in section 64, or the form of liens created by local statutes. As indicated, if the tax claim takes the form of a lien, or is reduced to the form of a lien, it is not affected by the provisions of section 64. In view of the inequitable condition above referred to, there was need for a provision to protect the administration costs and expenses, and like considerations of public policy required a similar protection for wage claimants. However, the historical development, and the inherent differences in the incidents attaching to real and personal property, made it advisable to restrict the remedy provided by this paragraph to liens on *personal* property, but, in respect even to personal property, the provisions are *applicable only where the property has not been reduced to possession or where the liens have not been enforced by sale prior to bankruptcy.*" [Italics supplied in the second instance.] (At pp. 144–145.)

purpose of section 67 in requiring a public warning of the existence of an enforceable statutory lien for taxes was served in the instant case not only by the steps taken to perfect the Government's lien but by the collector's seizure and actual possession of the personal property of the taxpayer before the filing of the taxpayer's petition in bankruptcy.

The validity of the lien for taxes as against the wage claimants was thus established at the time of the filing of the petition in bankruptcy and the collector's possession of the personal property of the bankrupt excluded the application of section 67c which otherwise would have postponed the payment of the tax claims to the payment of the claims for administrative expenses and wages specified in clauses (1) and (2) of section 64a. By his subsequent arrangement with the trustee for the sale of the bankrupt's property, the collector did not lose the right to priority of payment accorded to the perfected tax liens, at the time of bankruptcy, as against the wage claims.

The arrangement between the collector and the trustee was a natural and proper one. While the amended claim for taxes, penalties and interest, dated August 28, 1946, amounted to $78,865.03, the original claim, filed with the notices of lien prior to March 26, 1946, amounted to only $40,921.94 (even including the interest and costs later computed to August 21, 1946). Of this sum the taxes themselves amounted only to $34,848.04. To meet this, the trustee of the bankrupt's estate, on December 12, 1946, had on hand $31,206.20, evidently derived from the sale of the property originally held by the collector. These figures, accordingly, suggest the possibility that, in March, 1946, it reasonably may have been supposed that a surplus above the amount of the Government's tax claim might be realized from the sale of the assets then in the possession of the collector. In that event, it would have been the obviously appropriate procedure for the trustee to sell that property free and clear of liens and encumbrances and then distribute the proceeds to the rightful claimants. Even though there was little or no prospect of realizing such a surplus, it was reasonable and appropriate for the trustee, with the consent of the lien holder, thus to sell the property and distribute its proceeds. See *Van Huffel* v. *Harkelrode* (284 U. S. 225); 6 Remington on Bankruptcy, sections 2577–2578 (4th ed. 1937).[9] The propriety of the present conclusion is emphasized by the fact, urged by the trustee, that the opposite conclusion would, in many other cases, operate to the detriment both of unsecured creditors and of the statutory lien holders. It would compel a lien holder to retain his actual possession of the property in order to be sure of his full priority in the payment of his tax claim. He would be compelled to do this, even though by doing so the bankrupt's property probably would yield a smaller sales price than if sold by the trustee. Furthermore, the lien holder would be brought into sharp conflict with the trustee whenever there was reason to suppose that the proceeds of the sale might equal or exceed the tax claims secured by the lien. Under such circumstances the bankruptcy court generally may order the sale of the bankrupt's property by the trustee, free and clear of liens and encumbrances. See 4 Collier on Bankruptcy, sections 70.97, 70.99 (14th ed. 1942); 6 Remington on Bankruptcy, section 2583 (4th ed. 1937). Accordingly, we find no substantial support for the argument that the lien holder's voluntary relinquishment of his possession of the bankrupt's property, in favor of the bankrupt's trustee for the purpose of permitting the trustee to sell the property in this case, must carry with it, as a matter of law, a postponement of the payment of the lien holder's tax claim to that of the claims for wages here presented.

For these reasons the judgment of the court of appeals is

Reversed.

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[9] The only question then arising would be as to the extent to which the trustee might deduct from those proceeds his general expenses of administration, as well as the costs of the sale itself. This question was touched upon in the agreement with the trustee but no issue is presented here as to it.

MERCHANT SHIP SALES ACT OF 1946

1949–6–13049
Mim. 6366

Adjustments under section 9 of the Merchant Ship Sales Act of 1946.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, D. C., February 18, 1949.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, Heads of Field Divisions of the Technical Staff, and Others Concerned:

1. Reference is made to the Merchant Ship Sales Act of 1946 (60 Stat. 41), hereinafter referred to as the "Act," enacted to provide for the sale of surplus war-built vessels and for other purposes.

2. Section 9 of the Act (C. B. 1947–2, 340, 342), entitled "Adjustment for prior sales to citizens," provides that upon proper application to the United States Maritime Commission (hereinafter referred to as the Commission), a citizen of the United States who, on March 8, 1946 (date of enactment of the Act), "(1) owns a vessel which he purchased from the Commission prior to such date, and which was delivered by its builder after December 31, 1940; or (2) is party to a contract with the Commission to purchase from the Commission a vessel, which has not yet been delivered to him; or (3) owns a vessel on account of which a construction-differential subsidy was paid, or agreed to be paid, by the Commission under section 504 of the Merchant Marine Act, 1936, as amended, and which was delivered by its builder after December 31, 1940; or (4) is party to a contract with a shipbuilder for the construction for him of a vessel, which has not yet been delivered to him, and on account of which a construction-differential subsidy was agreed, prior to such date, to be paid by the Commission under section 504 of the Merchant Marine Act, 1936, as amended; shall, except as hereinafter provided, be entitled to an adjustment in the price of such vessel under this section * * *" The term "citizen of the United States," as defined in section 3(g) of the Act, "includes a corporation, partnership, or association only if it is a citizen of the United States within the meaning of section 2 of the Shipping Act of 1916, as amended."

3. Section 9(b)(8) of the Act provides as follows:

> (8) There shall be subtracted from the sum of the credits in favor of the Commission under the foregoing provisions of this subsection the amount of any overpayments of Federal taxes by the applicant resulting from the application of subsection (c)(1), and there shall be subtracted from the sum of the credits in favor of the applicant under the foregoing provisions of this subsection the amount of any deficiencies in Federal taxes of the applicant resulting from the application of subsection (c)(1). If, after making such subtractions, the sum of the credits in favor of the applicant exceeds the sum of the credits in favor of the Commission, such excess shall be paid by the Commission to the applicant. If, after making such subtractions, the sum of the credits in favor of the Commission exceeds the sum of the credits in favor of the applicant, such excess shall be paid by the applicant to the Commission. Upon such payment by the Commission or the applicant, such overpayments shall be treated as having been refunded and such deficiencies as having been paid.

4. Section 9(c) of the Act provides in part as follows:

(c) An adjustment shall be made under this section only if the applicant enters into an agreement with the Commission binding upon the citizen applicant and any affiliated interest to the effect that—

(1) depreciation and amortization allowed or allowable with respect to the vessel up to the date of the enactment of this Act for Federal tax purposes shall be treated as not having been allowable; amounts credited to the Commission under subsection (b)(6) shall be treated for Federal tax purposes as not having been received or accrued as income; amounts credited to the applicant under subsection (b) (5) and (6) shall be treated for Federal tax purposes as having been received and accrued as income in the taxable year in which falls the date of the enactment of this Act;

(2) the liability of the United States for use (exclusive of service, if any, required under the terms of the charter) of the vessel on or after the date of the enactment of this Act under any charter party shall not exceed 15 per centum per annum of the statutory sales price of the vessel as of such date of enactment; and the liability of the United States under any such charter party for loss of the vessel shall be determined on the basis of the statutory sales price as of the date of the enactment of this Act, depreciated to the date of loss at the rate of 5 per centum per annum; * * *

5. The determination of the applicability of the Act to a specific vessel, the amount of the adjustment, and the responsibility for entering into the agreement with the applicant as to the application of section 9(c)(1) of the Act are matters within the jurisdiction of the Commission. The Act confers no authority to function in these matters upon the Bureau of Internal Revenue. However, upon the request of the Commission, accompanied by a statement of the amounts credited to the applicant and the Commission under section 9(b) (5) and (6) of the Act, the Bureau will furnish the Commission with advice as to the overpayments of, or deficiencies in, Federal taxes resulting from the application of subsection (c)(1).

6. A request by the Commission for advice as to the amount of the deficiency or overpayment resulting from the application of section 9(c)(1) of the Act should be addressed to the internal revenue agent in charge having jurisdiction of the applicant's income and excess profits tax returns and should set forth for each vessel involved (1) the amounts credited to the Commission under section 9(b)(6) of the Act and the amounts of charter hire, if any, accrued to March 8, 1946, which are unpaid and canceled under section 9(b)(6) of the Act; (2) the amounts credited to the applicant under section 9(b) (5) and (6) of the Act, and the amounts of interest on the original mortgage indebtedness, if any, accrued to March 8, 1946, which are unpaid and canceled under section 9(b)(5) of the Act; (3) the statutory sales price as of March 8, 1946; and (4) a copy of the applicant's application for an adjustment under section 9 of the Act. The amounts credited to the Commission under section 9(b)(6) of the Act should be shown by the Commission by years (income-tax taxable years of the applicant). The request for advice should include all vessels with respect to which the applicant has made application for adjustment under section 9 of the Act. Advice as to the amounts of overpayments and deficiencies resulting from the application of section 9(c)(1) of the Act will be furnished by the internal revenue agent in charge.

7. After an adjustment in the price of a vessel has been effected by the Commission under section 9 of the Act, the changes in the items of income and expense as required under subsection (c)(1) will be reflected in the taxable income of the applicant, for Federal tax pur-

poses. Since all overpayments and deficiencies resulting therefrom are required, under the provisions of section 9(b)(8) of the Act, to be absorbed in the adjustment determined by the Commission, and the amounts then are required to be treated as having been refunded or paid, as the case may be, upon payment by the Commission or the applicant of an adjustment under the provisions of section 9 of the Act, the Bureau will, in any further consideration of the applicant's Federal tax liability, treat any such overpayment as having been refunded and any such deficiency as having been paid. No interest will be paid or credited on any such overpayment, and no interest will be collected or charged on any such deficiency.

8. For Federal tax purposes, on and after March 8, 1946, the basis (unadjusted) under section 113(a) of the Internal Revenue Code, of a vessel on which an adjustment under section 9 of the Act has been made is the statutory sales price as determined by the Commission under the Act.

9. Correspondence regarding the contents of this mimeograph should refer to its number and to the symbols indicated: Collectors of internal revenue, A&C: Col; internal revenue agents in charge, IT: F; heads of field divisions of the Technical Staff, TS: ARM.

DANIEL A. BOLICH,
Acting Commissioner.

DISTILLED SPIRITS

INTERNAL REVENUE CODE

REGULATIONS 6, SECTION 188.99a: Record, Form 96. 1949–13–13114
T. D. 5702

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 188.—BOTTLING OF DISTILLED SPIRITS IN BOND

Amending Regulations 6

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

To District Supervisors and Others Concerned:

1. On March 8, 1949, notice of proposed rule making, regarding the reporting of bottled-in-bond stamps, was published in the Federal Register (14 F. R. 1039).

2. No objections to the proposed regulations having been received, section 188.99a is hereby added to Regulations 6 (26 CFR, Part 188), approved September 19, 1940, as follows:

SEC. 188.99a. RECORD, FORM 96.—Where the bottled-in-bond stamps are returned to the proprietor for filing a claim for exchange or redemption, the proprietor shall account for such stamps on Form 96, "Monthly Record and Report of Red Strip Stamps Purchased and Used by Importers and by Others Assigned Custody of Stamps," until the exchange or redemption has been effected. Appropriate modification of the form to specify bottled-in-bond stamps shall be made. The form will be prepared and disposed of in accordance with the applicable instructions thereon relating to "Other persons assigned custody of stamps." (Secs. 2903 and 3176, I. R. C.)

3. The purpose of this Treasury Decision is to require the accounting by proprietors of bottling-in-bond departments of internal revenue bonded warehouses for all bottled-in-bond strip stamps, which are released to them for exchange or redemption, until such disposition has been effected.

4. This Treasury Decision shall be effective on the thirty-first day following the date of its publication in the Federal Register.

5. This Treasury Decision is issued under the authority contained in sections 2903 and 3176, Internal Revenue Code (26 U. S. C. 2903 and 3176).

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved June 2, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Published in the Federal Register June 7, 1949)

REGULATIONS 11, SECTION 189.111a: Record, Form 96. 1949-13-13115 T. D. 5704

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 189.—BOTTLING OF TAX-PAID DISTILLED SPIRITS

Amending Regulations 11

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

To District Supervisors and Others Concerned:

1. On March 8, 1949, notice of proposed rule making, regarding the reporting of red strip stamps, was published in the Federal Register (14 F. R. 1039).

2. No objections to the proposed regulations having been received, section 189.111a is hereby added to Regulations 11 (26 CFR, Part 189), approved May 20, 1940, as follows:

SEC. 189.111a. RECORD, FORM 96.—Where the red strip stamps are returned to the proprietor for filing a claim for exchange or redemption, the proprietor shall account for such stamps on Form 96, "Monthly Record and Report of Red Strip Stamps Purchased and Used by Importers and by Others Assigned Custody of Stamps," until the exchange or redemption has been effected. The form will be prepared and disposed of in accordance with the applicable instructions thereon relating to "Other persons assigned custody of stamps." (Secs. 2803 and 3176, I. R. C.)

3. The purpose of this Treasury Decision is to require proprietors of tax-paid bottling plants to account for red strip stamps which are released to them for exchange or redemption, until such disposition has been effected.

4. This Treasury Decision shall be effective on the thirty-first day following the date of its publication in the Federal Register.

5. This Treasury Decision is issued under the authority contained in sections 2803 and 3176, Internal Revenue Code (26 U. S. C. 2803 and 3176).

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved June 2, 1949.
THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Published in the Federal Register June 7, 1949)

REGULATIONS 15, SECTIONS 190.13, ETC. 1949-2-13012 T. D. 5681

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 190.—RECTIFICATION OF SPIRITS AND WINES

Amending Regulations 15

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

To District Supervisors and Others Concerned:

1. On September 22, 1948, notice of proposed rule making, regarding the rectification of spirits and wines, was published in the Federal Register (13 F. R. 5507).

2. After consideration of all such relevant matter as was presented by interested persons regarding the proposal, the following amendments of sections 190.13, 190.14, 190.17, 190.19, 190.31, 190.39, 190.49, 190.94, 190.95, 190.98, 190.99, 190.105, 190.106, 190.115, 190.118(*c*), 190.119, 190.132, 190.138, 190.177, 190.262, 190.263, 190.332, 190.334, and 190.392 of Regulations 15, relating to the rectification of distilled spirits and wines, are hereby adopted; sections 190.41a and 190.471a are added to such regulations; and sections 190.15, 190.16, 190.110(*a*) (2), and 190.137 of such regulations are revoked.

3. These amendments are designed to simplify certain requirements relating to construction and equipment, and the preparation, filing, and approval of documents in connection with the establishment and operation of rectifying plants. It is not the purpose of the amendments to require the filing of new plats and plans, or changes in premises or equipment, where the existing documents and equipment conform essentially to the requirements of the regulations prior to these amendments. Where substantial changes are made in construction, equipment, and premises, the new requirements should be observed.

SEC. 190.13. WITHIN 600 FEET OF DISTILLERY.—The district supervisor may permit the carrying on of the business of rectifying spirits or wines at a distance of less than 600 feet in a direct line from a distillery, when he is of the opinion that the revenue will not be endangered thereby. (Secs. 2819, 2832, 3170, 3176, I. R. C.)

SEC. 190.14. SPECIAL APPLICATION.—A person desiring to establish a rectifying plant within 600 feet of a distillery shall file a special application, in triplicate, for such privilege with the district supervisor. The application shall state the location of the rectifying plant and the distillery, the distance between the premises, the name of the distiller, a description of any connecting pipe lines, the reason for locating the rectifying plant within 600 feet of the distillery, and any additional information which the district supervisor may require. The district supervisor will take action on such special application in accordance with the procedure prescribed in section 190.119. (Secs. 2819, 2832, 3170, 3176, I. R. C.)

SEC. 190.17. CHANGES REQUIRING APPROVAL.—Where there is to be a change in the distance between a rectifying plant and a distillery located within 600 feet of each other as a result of the extension or curtailment of either premises, a new special application, in triplicate, must be filed with the district supervisor by the proprietor of the premises which are to be extended or curtailed. Where a change occurs in the proprietorship of a rectifying plant or distillery located within 600 feet of each other, the new proprietor shall file with the district supervisor a new special application, in triplicate. Unless the rectifying plant premises are extended or curtailed as the result of such change, the change may be reflected in the next amended notice, Form 27–B, and plat filed by the rectifier. Such new special application shall be considered and disposed of in accordance with section 190.119. (Secs. 2819, 2832, 3170, 3176, I. R. C.)

SEC. 190.19. BUILDING OR ROOMS.—The rectifying plant must be so constructed and equipped as to be suitable for the rectification of spirits by the process, or processes, of rectification which the rectifier proposes to use. The room or building must be securely constructed of brick, stone, wood, concrete, or other substantial material, and must be completely separated from contiguous buildings or rooms by solid, unbroken partitions, or floors of substantial construction, except as hereinafter provided. Such partitions shall extend from the ground to the roof, or from the floor to the ceiling if a room is used, and if the rectifying plant is under the same roof or in the same building in which is located an internal revenue bonded warehouse or a tax-paid bottling house, the two premises must not have means of communication with each other within the building, except by approved pipe lines as herein authorized: *Provided*, That where a rectifying plant has heretofore been established under the same roof, or in the same building, with an internal revenue bonded warehouse or a tax-paid bottling house with interior communication between the two premises, it may continue to operate in such location if the revenue will not be jeopardized thereby. Where distilled water or tax-paid spirits are to be transferred by pipe line to, or from, the rectifying plant in accordance with these regulations, necessary openings for the passage of the required pipe lines may be permitted in the walls or partitions, and necessary openings for passage of approved water, steam, sewer, or similar lines may likewise be permitted in the walls or partitions. Where contiguous wholesale liquor dealer premises are used in lieu of a finished product room, the necessary doors or openings may be permitted in the walls or partitions for the transfer of filled cases. (Secs. 2801(e), 3176, I. R. C.)

SEC. 190.31. WEIGHING TANKS.—Where weighing tanks are used for gauging spirits, such tanks shall be constructed of metal, and shall be stationary and of uniform dimensions from top to bottom. Each such tank shall be equipped with a suitable measuring device whereby the contents will be correctly indicated. If the weighing tanks are to be used for gauging rectified spirits for determining the amount of tax, or gauging tax-exempt products prior to transfer of the spirits to a bottling tank, such weighing tanks must also conform to the requirements of section 190.39. The gauging of spirits in a weighing tank connected with a bottling tank shall be deemed to meet the requirements of these regulations for gauging the spirits in a bottling tank mounted on scales: *Provided*, That after gauging, the spirits may be transferred to the bottling tank for immediate taxpayment if subject to the rectification tax. Each weighing tank shall be mounted on accurate scales and shall have plainly and legibly painted thereon the words "Weighing tank," followed by its serial number and capacity in wine gallons. The beams or dials of the scales must indicate weight in 5-pound graduations for scales up to, and including, 25 tons capacity, in 10-pound graduations for scales exceeding 25 tons capacity but not exceeding 60 tons capacity, and in 20-pound graduations for scales having a capacity of more than 60 tons. (Secs. 2801(e), 2829, 3176, I. R. C.)

SEC. 190.39. BOTTLING TANKS.—Where spirits are bottled at the rectifying plant, the rectifier shall provide in the rectifying room, or bottling room if one is provided, one or more bottling tanks securely constructed of metal, and such tanks shall be of uniform dimensions from top to bottom. Each bottling tank shall be mounted on scales, or equipped with a suitable measuring device whereby the contents will be accurately and precisely indicated, and shall have plainly and legibly painted thereon the words "Bottling tank," followed by its serial number and capacity in wine gallons. A suitable board shall be provided on each bottling tank for the attachment of Forms 237 and 230, as hereinafter provided. Each bottling tank must be closed, and any necessary openings therein affording access to the interior, or to the contents, must be provided with a cover, which will be secured by a Government lock. Stopcocks must be provided and so arranged as to completely control the flow of spirits both into and out of the bottling tank, and so constructed that they may be locked with a Government lock. The pipe connections containing such stopcocks or valves must be brazed, welded, or otherwise secured to the tank in such a manner that they cannot be detached or altered without showing evidence of tampering, and the outlet pipe connection shall be equipped with a check valve. The pipe line connecting the bottling tanks with the bottling machine must conform to the requirements of section 190.45. Bottling tanks may be permanently connected with pipe lines for the conveyance thereto of air and distilled water, but the distilled water pipe line must be affixed to the top of the tank. Such pipe lines must be equipped with a control valve which may be locked with a Government lock. Pipe lines used for the conveyance of air must also be equipped with a check valve located near the point of entry to the tank in order to effectively prevent any abstraction of spirits from the tank. Other pipe lines, except those used for the conveyance of spirits, may not be permanently connected with such tanks. Bottling tanks shall be accurately and precisely calibrated. (Secs. 2801(e)(1), 2829, and 3176, I. R. C.)

SEC. 190.41a. ACCUMULATION TANKS.—Where the rectifier removes distilled spirits from the bottling line which contain sediment or foreign matter, or which otherwise require refiltering or rebottling, he may install suitable accumulation tanks in the bottling room for the accumulation of such spirits. Each such tank shall have plainly and legibly painted thereon the words "Accumulation tank," followed by its serial number and capacity in wine gallons. If the spirits accumulated in each tank are of the same class and type, they may be returned to the bottling tank system for refiltering and bottling with the same batch of spirits. The return of the spirits to the bottling tank system must be under the supervision of the storekeeper-gauger. Unless the spirits are refiltered and bottled with the same lot of spirits from which they were originally bottled, they must be returned for rerectification under an approved formula, or, in the case of spirits not subjected to taxable rectification, returned to the dumping and reducing tank for commingling with spirits without rectification within the limitation of section 190.351. In such case, appropriate notation will be made on the Form 230 or Form 237 relative to the return of the spirits. (Secs. 2801(e), 3176, I. R. C.)

SEC. 190.49. DISTANCE FROM DISTILLERY OR VINEGAR PLANT.—If the rectifying plant premises are situated more than 600 feet in a direct line from any premises authorized to be used for distilling spirits, or from a vinegar factory using the vaporizing process, such fact shall be stated on Form 27–B. If the distance between the rectifying plant premises and the premises of a distillery is less than 600 feet in a direct line, there must be stated in the notice, Form 27–B, the name of the proprietor of the distillery, the exact distance in feet and inches between the rectifying plant and distillery, and whether the location of the rectifying plant within such distance of the distillery has been approved by the district supervisor. If such location of the rectifying plant has been approved by the district supervisor, the date of such approval shall be given. If the distance between the rectifying plant premises and a vinegar factory using the vaporizing process is less than 600 feet in a direct line, such fact shall be stated on the form, and also whether or not the vinegar factory was established and operated as such prior to March 1, 1879. (Secs. 2801(e), 2812, 2819, 2834, 2835, 3170, 3176, I. R. C.)

SEC. 190.94. PREPARATION.—Every plat and plan shall be drawn to scale, and each sheet thereof shall bear a distinctive title, enabling ready identification. The cardinal points of the compass must appear on each sheet except the elevational plans. The minimum scale of any plat will not be less than one-fiftieth inch per foot. Each sheet of the original plat and plans shall be numbered, the first sheet being designated number 1, and the other sheets numbered in consecutive order. Plats and plans shall be submitted on sheets of tracing cloth, opaque cloth, or sensitized linen. The dimensions of plats and plans shall be 15 by 20 inches, outside measurement, with a clear margin of at least 1 inch on each side of the drawing, lettering, and writing. Plats and plans may be original drawings, or reproductions made by the "ditto process," or by blue- or brown-line lithoprint if such reproductions are clear and distinct. (Secs. 2801(e), 3176, I. R. C.)

SEC. 190.95. DEPICTION OF RECTIFYING PLANT PREMISES.—Plats must show the outer boundaries of the rectifying plant premises, in feet and inches, in a color contrasting with those used for other drawings on the plat, and must contain an accurate depiction of the building, or buildings, comprising the premises, and any driveway, public highway, or railroad right-of-way adjacent thereto or connecting therewith. The depiction of the premises shall agree with the description in the notice, Form 27–B. If the premises are separated by a public highway or railroad right-of-way, and the tracts of land comprising the premises, or parts thereof, abut on such highway or right-of-way opposite each other, the different tracts will be depicted separately, in feet and inches. If two or more buildings are to be used, the designated name of each shall be indicated, and all pipe lines or other connections, if any, between the same depicted. Where two or more buildings are used for the same purpose, the name of each such building shall include an alphabetical designation, beginning with "A," and they shall be so shown on the plat. All first floor exterior doors of each building on the premises will be shown on the plat. If the rectifying plant consists of a room or a floor of a building, an entire outline of the building, the precise location and dimensions of the room or floor, and the means of ingress and egress to a public street or yard shall be shown. Except as provided in section 190.104, all pipe lines leading to or from the premises, the purpose for which used, and the points of origin and termination will be indicated on the plat. (Secs. 2801(e), 3176, I. R. C.)

SEC. 190.98. FLOOR PLANS.—The plans shall include a floor plan of each building, showing the general dimensions of the rooms and floors, and the location of all doors, windows, and other openings, and how such openings are protected. If a portion of a building is used, such as a room or floor, the floor plans will include only that portion, and shall also show the means of ingress and egress to the street. All apparatus and equipment, except pipe lines, must be shown in their exact location on the floor plans and their designated use indicated. Pipe lines may also be shown, if desired. In the case of stills, tanks, and similar equipment, the serial number and capacity shall also be shown. (Secs. 2801(e), 3176, I. R. C.)

SEC. 190.99. ELEVATIONAL FLOW DIAGRAMS.—Elevational flow diagrams (plans) shall be submitted which shall depict all equipment in its approximate operating sequence and elevation by floors, with all connecting pipe lines, valves, flanges, measuring devices, and attachments for Government locks. The elevation by floors on the diagrams may be indicated by horizontal lines representing floor levels. All major equipment, such as stills and tanks, must be identified on the plans as to number and use. The elevational flow diagram must be so drawn that all fixed pipe lines, except those indicated by section 190.104, may be readily traced from beginning to end. Other types of drawings that clearly depict the information required herein may be submitted in compliance with this section. (Secs. 2801(e), 3176, I. R. C.)

SEC. 190.105. CERTIFICATE OF ACCURACY.—The plat and plans shall bear a certificate of accuracy in the lower right-hand corner of each sheet, signed by the rectifier, the draftsman, and the district supervisor, substantially in the following form:

___________________________________.
(Name of proprietor)

___________________________________.
(Address)

Approved __________________________.
(Date)

Accuracy certified by:

____
(District supervisor)

___________________________________.
(Name and capacity—for the proprietor)

___________________________________.
(Draftsman)

Rectifying Plant No. ______. ____________________ 19____, Sheet No. ____
(Date)

(Secs. 2801(e), 3176, I. R. C.)

SEC. 190.106. REVISED PLATS AND PLANS.—The sheets of revised plats and plans shall bear the same number as the sheets superseded, but will be given a new date. Any additional plats and plans shall be given a new number in consecutive order, or will be otherwise numbered and lettered in such manner as will permit the filing of the plats and plans in proper sequence. (Secs. 2801(e), 3176, I. R. C.)

SEC. 190.115. CHANGES IN PREMISES.—Where the rectifying plant premises are to be extended or curtailed, the rectifier must file with the district supervisor an amended notice, Form 27–B, and an amended plat of the premises as extended or curtailed. If the plans are affected by the extension or curtailment, they must also be amended. If the rectifying plant is within 600 feet of a distillery, the rectifier must also file a special application in accordance with section 190.14 or 190.17, if the changes are of such nature or extent as to require a special application. The additional premises covered by an extension may not be used for rectifying purposes, and the portion of the premises to be excluded by a curtailment may not be used for other than rectifying purposes, prior to approval of the notice, Form 27–B. (Secs. 2801(e), 3170, 3176, I. R. C.)

SEC. 190.118. QUALIFICATION.—* * *

* * * * * * *

(c) *Registry of stills.*—Register the stills on Form 26, in triplicate, in accordance with section 190.471a, if not previously registered.

* * * * * * *

SEC. 190.119. SPECIAL APPLICATION.—Where a special application for permission to operate a rectifying plant within 600 feet of a distillery is submitted by the rectifier, and such special application conforms to the requirements of these regulations, the district supervisor will cause an inspection to be made to determine whether the proposed operation of the rectifying plant within 600 feet of the distillery may be permitted without jeopardy to the revenue. The inspector will ascertain whether the application accurately describes the relative location of the two premises and all pipe lines and other connections, if any, between such premises. The inspector will also observe the surroundings, including all streets, roads, and driveways connecting the two premises, and any condition which might endanger the revenue, and will describe the same in his report. If the district supervisor finds, upon consideration of the inspection report, that the rectifying plant may be operated at the designated location without danger to the revenue, he will note his approval on all copies of the special application. He will then return one copy of the approved application to the applicant, retain the original for his files, and forward the remaining copy, together with a copy of the inspection report, to the Commissioner. Approval of the special application pertains to the location of the rectifying plant only, and does not authorize the operation thereof. The rectifying plant may not be operated until the rectifier's bond and other qualifying documents required by law and these regulations have been filed and approved by the Commissioner. If the special application is disapproved, the district supervisor will note his disapproval thereon and will return all copies of such application to the applicant, with advice as to the reasons for disapproval. (Secs. 2819, 2832, 3170, 3176, I. R. C.)

Sec. 190.132. Disposition of Qualifying Documents.—Where the rectifier's bond, Form 34, and notice, Form 27–B, are approved by the Commissioner, the district supervisor will, upon receipt of the approved copies of such documents from the Commissioner, as provided in section 190.138, forward one copy of the bond, notice, plat, plans, and other qualifying documents to the rectifier, and will retain one copy of such documents for the file. If the rectifier's bond is disapproved, the district supervisor will, upon receipt from the Commissioner of the disapproved copies of such bond and other qualifying documents submitted therewith, return all copies of the qualifying documents to the proprietor, with advice as to the reasons for such disapproval. (Secs. 2801(e)(1), 3176, I. R. C.)

Sec. 190.138. Qualifying Documents.—The Commissioner will review the notice, plat, plans, rectifier's bond, Form 34, and other qualifying documents, upon their receipt from the district supervisor. If the Commissioner approves the rectifying plant construction and equipment, and the plat, plans, bond, and notice, and other qualifying documents, he will assign a registry number to the rectifying plant in accordance with section 190.139, note his approval on all copies of the bond and notice, retain one copy of the bond and notice, and all copies of the other qualifying documents, and will return two copies of the approved bond and notice to the district supervisor with advice as to his action on the qualifying documents. If the Commissioner disapproves the bond, he will note his disapproval thereon, and will return all copies thereof to the district supervisor, accompanied by the other qualifying documents submitted therewith and a statement of the reasons for disapproval of the bond. (Secs. 2815(c)(d), 3176, I. R. C.)

Sec. 190.177. Application, Form 122.—When the rectifier desires to dump spirits for rectification, he will carefully gauge each package and prepare Form 122, in duplicate, giving a complete description of the packages and making application for permission to dump the spirits, except that where spirits are transferred to the rectifying plant directly upon taxpayment from a contiguous distillery or internal revenue bonded warehouse or a distillery or internal revenue bonded warehouse located in the immediate vicinity of the rectifying plant and owned by the proprietor of the rectifying plant or a subsidiary and dumped for rectification within 30 days after receipt, the withdrawal gauge will be considered as satisfying the requirement that the spirits shall be gauged when dumped for rectification. The supervisor will determine from all the circumstances in each case whether the distillery or warehouse and the rectifying plant are in the immediate vicinity. Where the spirits are so dumped on the withdrawal gauge, details of such gauge will be copied on Form 122 and in addition thereto, if the rectifying plant is equipped with processing tanks mounted on scales, the spirits may be dumped and gauged by weight in such processing tanks. In such case, the composite proof and proof gallons determined by such gauge shall also be reported on Form 122. The difference in proof gallons between the withdrawal (taxpayment regauge) and such tank gauge shall also be reported on Form 122. If the spirits are to be drawn from the storage tank, the rectifier will likewise execute Form 122 giving all the information applicable. Each Form 122 will be given a serial number beginning with "1" for the 1st day of January of each year and running consecutively thereafter to December 31, inclusive. (Secs. 2801(e)(1), 2813, 3176, I. R. C.)

Sec. 190.262. Application Required for Extension.—Where the rectifier desires to employ a process of rectification which will extend over more than 10 days, thus necessitating the holding of the spirits in the rectifying room for such longer period, application, in quadruplicate, for approval of such extended process must be incorporated in the Form 27–B Supplemental, and filed with the district supervisor as provided in section 190.152. The rectifier must set forth fully on such form, following the statement of process, the reason why the period of time specified for completion of the process is necessary. (Secs. 2801(e), 3176, I. R. C.)

SEC. 190.263. INQUIRY BY DISTRICT SUPERVISOR.—Upon receipt of a Form 27–B Supplemental requesting approval of a process requiring more than 10 days for completion, the district supervisor will make such inquiry as he may deem proper to determine the necessity for the extended period, and whether approval thereof will jeopardize the revenue. He will then forward all copies of the Form 27–B Supplemental to the Commissioner along with his findings and recommendation. The Form 27–B Supplemental will be disposed of in the manner prescribed by section 190.156. (Secs. 2801(e), 3176, I. R. C.)

SEC. 190.332. DISTRICT SUPERVISOR MAY AUTHORIZE.—The district supervisor may, in his discretion, authorize the installation of a pipe line for the transfer of rectified spirits from the bottling tanks in the rectifying plant to bottling tanks in a contiguous tax-paid bottling house or rectifying plant for bottling. (Secs. 2801(e)(1), 3176, I. R. C.)

SEC. 190.334. ACTION ON APPLICATION.—Upon receipt of the application, the district supervisor will make such inquiry as he may deem necessary to determine the propriety of granting the permission sought. He will then indicate his approval or disapproval on all copies of the application, and will return one copy to the applicant. Where the application is approved, the rectifier will, upon installation of the pipe line, file amended rectifier's notice on Form 27–B, and plans, as provided in section 190.117 in the case of major changes in equipment and an amended plat. These documents, together with a copy of the application to install the pipe line and a copy of the report of inspection relating thereto, will be forwarded to the Commissioner for appropriate action prior to use of the pipe line. If the application is disapproved, the district supervisor will return all copies of the application to the applicant with advice as to the reasons for disapproval. (Secs. 2801(e)(1), 3176, I. R. C.)

SEC. 190.392. SHIPMENT OF STAMPS.—Where the stamps are to be shipped, the collector will forward the stamps to the Government officer by registered mail or express. The expense of forwarding the stamps by registered mail or express will be borne by the proprietor. The collector may furnish the stamps directly to the proprietor for immediate delivery to the Government officer in accordance with section 190.391. (Secs. 2801(e), 3176, I. R. C.)

SEC. 190.471a. REGISTRY ON FORM 26.—Every person having in his possession or custody or under his control any still or distilling apparatus that is set up must register the same on Form 26, in triplicate, with the district supervisor for the district in which it is set up. Stills to be used for the rectification of any type of distilled spirits may be registered for "Rectification of distilled spirits," and the specific type need not be shown. Thereafter, when another type of distilled spirits is to be rectified, the still need not be reregistered. The temporary suspension of a rectifying plant will not necessitate reregistration of the stills. Furthermore, the operation of a rectifying plant by alternating proprietors, where no actual change in ownership occurs, will not require reregistration of the stills by the proprietors. Where there is a change in location or use, or an actual change in ownership of a still, the still must be registered to reflect the change. The district supervisor will, upon approving the registration of a still on Form 26, retain one copy of the form, forward one copy to the Commissioner, and return the remaining copy to the rectifier. (Secs. 2801(e), 2810, 3170, 3176, I. R. C.)

4. This Treasury Decision shall be effective on the thirty-first day after its publication in the Federal Register.

5. This Treasury Decision is issued under the authority contained in sections 2801(e), 2810, 2812, 2819, 2829, 2832, 2834, 2835, 3170, and

3176, Internal Revenue Code (26 U. S. C. 2801(e), 2810, 2812, 2819, 2829, 2832, 2834, 2835, 3170, and 3176).

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved December 28, 1948.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Published in the Federal Register December 31, 1948)

REGULATIONS 15, SECTION 190.403a: Record, Form 96. 1949–13–13116 T. D. 5703

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 190.—RECTIFICATION OF SPIRITS AND WINES

Amending Regulations 15

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

To District Supervisors and Others Concerned:

1. On March 8, 1949, notice of proposed rule making, regarding the reporting of red strip stamps, was published in the Federal Register (14 F. R. 1040).

2. No objections to the proposed regulations having been received, section 190.403a is hereby added to Regulations 15 (26 CFR, Part 190), approved May 20, 1940, as follows:

SEC. 190.403a. RECORD, FORM 96.—Where the red strip stamps are returned to the proprietor for filing a claim for exchange or redemption, the proprietor shall account for such stamps on Form 96, "Monthly Record and Report of Red Strip Stamps Purchased and Used by Importers and Others Assigned Custody of Stamps," until the exchange or redemption has been effected. The form will be prepared and disposed of in accordance with the applicable instructions thereon relating to "Other persons assigned custody of stamps." (Secs. 2803 and 3176, I. R. C.)

3. The purpose of this Treasury Decision is to require the accounting by rectifiers for all red strip stamps which are released to them for exchange or redemption, until such disposition has been effected.

4. This Treasury Decision shall be effective on the thirty-first day following the date of its publication in the Federal Register.

5. This Treasury Decision is issued under the authority contained in sections 2803 and 3176, Internal Revenue Code (26 U. S. C. 2803 and 3176).

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved June 2, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Published in the Federal Register June 7, 1949)

Regulations 18, Section 192.7: Brewery buildings.

1949–12–13105
T. D. 5700

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 192.—FERMENTED MALT LIQUOR

Amending Regulations 18

Treasury Department,
Office of Commissioner of Internal Revenue,
Washington 25, D. C.

To District Supervisors and Others Concerned:

1. Section 192.7 of Regulations 18 (26 CFR, Part 192), approved May 20, 1940, relating to fermented malt liquor, is hereby amended as follows:

Sec. 192.7. Brewery Buildings.—Brewery buildings must be securely constructed of substantial solid materials. If there are buildings, or parts of buildings, used in the conduct of another business (except as authorized by section 192.5) adjoining or constituting a part of the building on the brewery premises, such other buildings, or parts thereof, must be entirely separated from the brewery buildings by substantial, solid, and unbroken walls and floors. A similar separation shall be made in respect to bottling house buildings, where another business is conducted (except as authorized by section 192.6). If beer is conveyed from the brewery to the bottling house by pipe line, the brewery premises must be adjacent or contiguous to the bottling house premises. If the brewery and the bottling house are adjoining, there shall be no interior communication between the two premises, and such premises must be separated by solid and unbroken walls and floors, except for authorized conduits, tunnels, and pipe lines. All such buildings shall be so arranged and constructed as to afford adequate protection to the revenue and facilitate appropriate supervision by Government officers. (Secs. 3157, 3176, I. R. C.)

2. It is found that compliance with the notice, public rule-making procedure, and effective date requirements of the Administrative Procedure Act (5 U. S. C. 1001 et seq.) is unnecessary in connection with the issuance of these regulations for the reason that the changes made are of a liberalizing character.

3. The purpose of the amendment of section 192.7 is to liberalize the requirements for the separation of brewery buildings from buildings used for other purposes to the extent of deleting the provision for separation from the ground to the roof in a direct, vertical line. This amendment prescribes entire separation in such cases by substantial, solid, and unbroken walls and floors.

4. This Treasury Decision shall be effective immediately.

5. This Treasury Decision is issued under the authority contained in sections 3157, 3176, Internal Revenue Code (U. S. C., title 26, 3157 and 3176).

Geo. J. Schoeneman,
Commissioner of Internal Revenue.

Approved May 24, 1949.

Thomas J. Lynch,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register May 31, 1949, 8:52 a. m.)

REGULATIONS 20, SECTIONS 194.12(*b*), ETC.

1949-8-13066
T. D. 5693

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 194.—WHOLESALE AND RETAIL DEALERS IN LIQUORS

Amending Regulations 20

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

To District Supervisors, Collectors of Internal Revenue, and Others Concerned:

1. On October 1, 1948, notice of proposed rule making regarding wholesale and retail dealers in liquors was published in the Federal Register (13 F. R. 5681).

2. No objections to the rules having been received, amendments of subsection 194.12(*b*) and sections 194.26, 194.51, and 194.53 of Regulations 20, approved June 6, 1940 (26 CFR, Part 194), are hereby adopted.

3. These amendments are designed to reflect changes in procedure and interpretations of the regulations.

SEC. 194.12. LAWFUL SALES BY RETAIL DEALER IN LIQUORS.—* * *

(*b*) *Wholesale sales.*—Where a retail dealer in liquors accepts an order for 5 wine gallons or more of distilled spirits or wines, a transaction has been made in wholesale quantity, notwithstanding the order is filled and delivery is made in parcels of less than 5 wine gallons and on different dates. Except as provided in section 194.62, liability to special tax as a wholesale liquor dealer is incurred where two or more orders for 5 wine gallons or more are accepted under such conditions during a fiscal year, or where circumstances surrounding acceptance of a single order show the person is engaged in business as a wholesale liquor dealer. Similarly, liability to special tax as a wholesale dealer in malt liquors is incurred by a retail dealer in liquors when he accepts orders for 5 wine gallons or more of malt liquors. (Secs. 3254 and 3791, I. R. C.)

SEC. 194.26. SALES AT NATIONAL MILITARY ESTABLISHMENTS.—(*a*) *Exempt from special tax.*—Post exchanges, ship's stores, ship's service stores and commissaries established and conducted under regulations of a department of the National Military Establishment, and under the complete control of such department, are not subject to special tax for the sale of liquors, provided sales are not made to the general public but are restricted to members of the military establishment and their guests.

(*b*) *Subject to special tax.*—Special tax must be paid for the sale of liquors at canteens, clubs, messes, and similar places whether or not located on premises of the National Military Establishment. (Secs. 3254 and 3791, I. R. C.)

SEC. 194.51. MISSING STAMPS.—(*a*) *Lost or destroyed.*—If a special tax stamp has been lost or destroyed, the taxpayer should immediately notify the collector of internal revenue. A "Certificate in Lieu of Lost or Destroyed Special Tax Stamp" will be issued to the taxpayer who submits an affidavit showing to the satisfaction of the collector that the stamp was lost or destroyed. The certificate must be posted in place of the stamp; otherwise, liability for failure to post the stamp will be incurred.

(*b*) *Seized by State authorities.*—Where a stamp designated "Retail Dealer in Liquors" is seized by State authorities because it does not conform to the dealer's local license or permit (wine, or wine and beer), the collector will, upon request, issue a "Certificate in Lieu of Lost or Destroyed Special Tax Stamp" to show that the dealer has paid special tax as a "Retail Dealer in Wine" or "Retail Dealer in Wines and Malt Liquors," as the case may require. However, where a special tax stamp has been seized by State authorities because the dealer has operated in violation of local law, a "Certificate in Lieu of Lost or Destroyed Special Tax Stamp" will not be issued by the collector. (Sec. 3791, I. R. C.)

SEC. 194.53. CORRECTIONS OF ERRORS ON SPECIAL TAX STAMPS DISCOVERED ON INSPECTION.—When an inspector ascertains that an error appears on the special tax stamp as to the name, ownership, address, etc., he will require the taxpayer to prepare a new Form 11, designated "Amended Return," showing the proper name, address, or other correction. Where a special tax stamp is issued in the name of an individual and the business is owned and conducted by a partnership from the beginning of the period of liability covered by the stamp, the names and addresses of all partners will be shown on the amended Form 11. The body of the amended Form 11 must show the reasons for requesting the correction of the special tax stamp. The inspector should also obtain the special tax stamp from the taxpayer, giving him a receipt therefor on Form 1670 (which receipt shall be kept on the dealer's premises), and forward the amended Form 11, the special tax stamp, the duplicate copy of the Form 1670, and the inspection report to the district supervisor. Upon receipt of the amended Form 11, the special tax stamp, etc., the district supervisor will examine the amended Form 11 to determine whether correction of the stamp is in order and all necessary data appear on the amended Form 11. If the district supervisor is satisfied that the papers are in order, he will write or stamp the word "approved" followed by his signature, in any available space on the face of the amended Form 11 and on the inspection report and forward the amended form with the special tax stamp to the proper collector of internal revenue. Upon receipt of these documents, the collector will make the proper correction on the special tax stamp, amend his Record 10 accordingly, attach the amended Form 11 to the original Form 11, and return the special tax stamp to the taxpayer. (Sec. 3791, I. R. C.)

4. This Treasury Decision shall be effective on the thirty-first day after the date of its publication in the Federal Register.

(Sections 3254 and 3791 of the Internal Revenue Code (26 U. S. C. 3254 and 3791).)

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved March 25, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Published in the Federal Register March 30, 1949)

REGULATIONS 21, SECTIONS 191.8 AND 191.9. 1949–8–13067
T. D. 5694

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 191.—IMPORTATION OF DISTILLED SPIRITS AND WINES

Amending Regulations 21

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

To District Supervisors, Collectors of Internal Revenue, Collectors of Customs, and Others Concerned:

1. On October 29, 1948, notice of proposed rule making regarding the rates of tax applicable to liqueurs, cordials, and similar compounds; flavored wines; and other compounds and preparations, was published in the Federal Register (13 F. R. 6356).

2. After consideration of all such relevant matter as was presented by interested persons regarding the proposal, sections 191.8 and 191.9 of Regulations 21 (26 CFR, 191.8 and 191.9) are amended to read as follows:

SEC. 191.8. LIQUEURS, CORDIALS, AND SIMILAR COMPOUNDS.—Liqueurs, cordials, and similar compounds, *containing distilled spirits,* in customs bonded warehouse or imported into the United States are subject to an internal revenue tax, when withdrawn, at the rate of $9 per 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. Fortified or unfortified wines, containing not over 24 per centum of alcohol by volume, to which sweetening or flavoring materials, *but no distilled spirits,* have been added are not classified as liqueurs, cordials, or similar compounds, but are considered to be flavored wines only and are subject to internal revenue tax at the rates applicable to wines. (Secs. 2800 as amended, 3030 as amended, 3176, I. R. C.)

SEC. 191.9. RATE OF TAX ON OTHER COMPOUNDS AND PREPARATIONS.—Compounds and preparations, other than those specified in section 191.8, *containing distilled spirits,* which are fit for beverage purposes, in customs bonded warehouse or imported into the United States are subject to internal revenue tax at the rate of $9 per 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. Compounds and preparations, *containing fortified or unfortified wine, but no distilled spirits,* which are fit for beverage purposes and which are sold as wine, are subject to internal revenue tax at the rates applicable to wines. (Secs. 2800 as amended, 3030 as amended, 3176, I. R. C.)

3. These amendments are designed to correct the regulations to conform to the intendment of section 3030(a)(2) of the Internal Revenue Code (26 U. S. C. 3030(a)(2)). The effect of the amendments is that on and after the effective date thereof, internal revenue tax will be collected on imported liqueurs, cordials, flavored wines, compounds, and preparations (1) at the basic rate applicable to distilled spirits (namely, $9 per proof gallon, or wine gallon when below proof), *if the products contain distilled spirits* (as defined in section 191.3 of Regulations 21), or (2) at the basic rates applicable to wines (namely, 15 cents per wine gallon when containing not more than 14 per centum of alcohol by volume, 60 cents per wine gallon when containing more than 14 per centum and not exceeding 21 per centum of alcohol, $2 per wine gallon when containing more than 21 per centum and not exceeding 24 per centum of alcohol, and $9 per wine gallon, or proof gallon if over 100 proof, when containing more than 24 per centum of alcohol) *if the products contain fortified or unfortified wine, but no distilled spirits,* and are sold as wine.

4. This Treasury Decision shall be effective on May 1, 1949, or on the thirty-first day after the date of its publication in the Federal Register, whichever date is later.

(This Treasury Decision is issued pursuant to sections 2800 as amended, 3030 as amended, and 3176 of the Internal Revenue Code (26 U. S. C. 2800, 3030, and 3176).)

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

FRANK DOW,
Acting Commissioner of Customs.

Approved March 28, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Published in the Federal Register April 1, 1949)

REGULATIONS 28, SECTIONS 176.16, ETC.

1949-6-13050
T. D. 5691

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 176.—DRAWBACK ON DISTILLED SPIRITS AND WINES

Amending Regulations 28

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

To District Supervisors and Others Concerned:

1. Sections 176.16(*e*), 176.17(*e*), 176.17o, 176.21(*b*), 176.22, and 176.57 of Regulations 28, approved August 29, 1940 (26 CFR, Part 176), are hereby amended.

2. The purpose of these amendments is to eliminate the requirement for the preparation of Form 1600, Certificate of District Supervisor of Alcohol Tax Unit of Tax-Paid Spirits or Wines Bottled Especially for Export.

3. It is found that compliance with the notice, public rule-making procedure, and effective date requirements of the Administrative Procedure Act, approved June 11, 1946, is unnecessary in connection with the issuance of these regulations for the reason the changes made are of an administrative nature only.

SEC. 176.16. BOTTLING OF DISTILLED SPIRITS OR WINES WITHOUT RECTIFICATION BY RECTIFIERS AND PROPRIETORS OF TAX-PAID BOTTLING HOUSES.—* * *

(*e*) *Action by district supervisor.*—The district supervisor shall forward Form 230 to the Commissioner for use in connection with the examination of the claim for drawback on such spirits or wines.

SEC. 176.17. BOTTLING OF WINES BY WINEMAKERS OR PROPRIETORS OF BONDED STOREROOMS.—* * *

(*e*) *Action by district supervisor.*—The district supervisor shall forward Form 230 to the Commissioner for use in connection with the examination of the claim for drawback on such wines.

SEC. 176.17o. ACTION BY DISTRICT SUPERVISOR.—The district supervisor shall forward Form 1684 to the Commissioner for use in connection with the examination of the claim for drawback on such spirits or wines.

SEC. 176.21. APPLICATION, FORM 237.—* * *

(*b*) *Action by district supervisor.*—The district supervisor shall forward to the Commissioner a copy each of Forms 122 and 237 and Form 1583, if any, for use in connection with the examination of the claim for drawback on such spirits or wines.

SEC. 176.22. RECTIFICATION BY PERSON OTHER THAN THE BOTTLER.—Where distilled spirits or wines intended to be bottled especially for export with benefit of drawback are to be rectified by a person other than the bottler, the rectifier shall insert in each copy of Form 122, after the description of the packages to be dumped, a notice of intention as follows:

"The above-described spirits (or wines) will, after rectification, be packaged and shipped to ______________________________ (Name and address of bottler), for bottling especially for export."

When the spirits have been rectified and packaged, the rectifier shall insert in each copy of Form 237, before forwarding the same to the district supervisor, a notice of intention as follows:

"The above-described spirits (or wines) rectified pursuant to Form 122, Serial No. ______, dated ________________, 19____, are to be shipped to ______________________________ (Name and address of bottler) for bottling especially for export."

After the packages have been properly stamped, the rectifier shall stencil or mark thereon, in addition to the other required marks or brands, the words "for bottling especially for export." Such packages shall then be deposited in the export storage room pending release by the Government officer for shipment to the bottling plant, unless they are to be shipped immediately. The rectifier and the storekeeper-gauger, or designated officer, will proceed otherwise in accordance with the provisions of sections 176.18 to 176.21, inclusive, and in addition the rectifier will furnish the bottler with a copy of the Form 237. The district supervisor shall forward to the Commissioner a copy each of Forms 122 and 237 and Form 1583, if any, for use in connection with the examination of the claim for drawback on such spirits or wines. If the spirits or wines so rectified are to be transferred by pipe line to a contiguous tax-paid bottling house, the rectifier shall proceed in accordance with the provisions of this section, except that he shall insert in each copy of Form 237, before forwarding one copy to the bottler and two copies to the district supervisor, in lieu of the notice of intention above required, a notice of intention as follows:

> "The above-described spirits (or wines) rectified pursuant to Form 122, Serial No. ________, dated ______________, 19____, are to be transferred by pipe line to ________________________________ for bottling especially for
> (Name and address of bottler)
> export."

SEC. 176.57. ACTION ON CLAIM.—The Commissioner will, upon receipt of the claim, Form 1582 or Form 1582–A, from the district supervisor, examine the claim and the records of his office, Forms 122, 230, 237, 1583, and 1684 previously furnished him as provided by sections 176.16 to 176.23, inclusive, to determine whether the spirits or wines described in the claim have been fully tax-paid. If the Commissioner finds that such spirits or wines have been fully tax-paid he will approve the claim and schedule it for payment. If the claim is disallowed, the Commissioner will so notify the claimant and state the reasons therefor.

4. This Treasury Decision shall be effective on the date of its publication in the Federal Register.

5. This Treasury Decision is issued under the authority contained in section 3179(b), Internal Revenue Code (U. S. C., title 26, section 3179(b)) and sections 309 (a), (b), (c), (d) and 313(i) of the Tariff Act of 1930, as amended (19 U. S. C., 1309 (a), (b), (c), (d) and 1313(i)).

DANIEL A. BOLICH,
Acting Commissioner of Internal Revenue.

Approved March 3, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Published in the Federal Register March 9, 1949)

GAUGING MANUAL, SECTIONS 186.48, ETC.

1949–12–13107
T. D. 5701

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 186.—GAUGING MANUAL

Amending the Gauging Manual

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

To District Supervisors and Others Concerned:

1. On February 1, 1949, notice of proposed rule making regarding amendment of the Gauging Manual (26 CFR, Part 186), approved November 21, 1938, was published in the Federal Register (14 F. R. 412).

2. After consideration of all such relevant matter as was presented by interested persons regarding the proposal, section 186.61 of the

Gauging Manual (26 CFR, Part 186), approved November 21, 1938, is hereby revoked and the following amendments of sections 186.48, 186.62, 186.75 (*c*), 186.77, 186.80, 186.82, and 186.153 of such Gauging Manual are hereby adopted.

3. These amendments are for the purpose of insuring improved marking of packages of distilled spirits in order that they will be properly identifiable for tax purposes; and eliminating the requirement for marking on the Government head of each package the word "Inspected," and the name and title of the storekeeper-gauger, which data are considered unnecessary for proper identification of the spirits. The existing optional method of applying prescribed marks by means of stenciling is continued.

SEC. 186.77. WITHDRAWAL FOR BOTTLING IN BOND.—When distilled spirits are withdrawn for bottling in bond before or after taxpayment, or for bottling in bond for export, there will be stenciled on the head of each package withdrawn for bottling the words "Withdrawn for bottling," followed by the date of removal to the bottling house. No other marks will be required. Where the tax has been paid, the tax-paid stamp will be securely affixed to the package and canceled in accordance with the applicable provisions of sections 186.119 to 186.129, inclusive. (Secs. 2808, 3176, I. R. C.)

SEC. 186.153. MARKS AND BRANDS ON WOODEN PACKAGES OF DISTILLED SPIRITS.—The marks and brands required to be placed on wooden packages of distilled spirits by sections 186.20, 186.48, 186.56, 186.57, 186.58, 186.60, 186.75, 186.79, 186.82, and 186.145 shall, notwithstanding the particular methods specified therein, be plainly and durably burned, cut, imprinted, or stenciled on each package. Where the marks are applied by means of stenciling, the ink used shall be of a suitable quality to effect durability and legibility of the marks. The heads of the packages shall be sufficiently smooth and free from defects to permit the marks to be clearly and distinctively applied. The registry number and the State may be combined and abbreviated as "Calif–708." (Secs. 2808, 3176, I. R. C.)

4. Sections 186.48, 186.62, 186.75 (*c*), 186.80, and 186.82 are modified by eliminating from the illustrations therein the word "Inspected," and name and title of the storekeeper-gauger.

5. This Treasury Decision shall be effective on the thirty-first day after its publication in the Federal Register.

6. This Treasury Decision is issued under the authority contained in sections 2808 and 3176, Internal Revenue Code (26 U. S. C. 2808 and 3176).

GEO. J. SCHOENEMAN,
Commissioner of Internal Revenue.

Approved May 27, 1949.

THOMAS J. LYNCH,
Acting Secretary of the Treasury.

(Published in the Federal Register June 3, 1949)

OLEOMARGARINE [a]

1949–1–13006
MS. 330

Schedule of oleomargarine produced and materials used during the month of November, 1948, as compared with November, 1947

	November, 1948	November, 1947
	Pounds	*Pounds*
Total production of uncolored oleomargarine	62, 112, 430	74, 097, 688
Total withdrawn tax-paid	63, 597, 666	74, 262, 568
Ingredient schedule of uncolored oleomargarine:		
Butter flavor	2, 076	281
Coconut oil	7, 654	178, 934
Corn oil	1, 510	422, 890
Cottonseed oil	35, 321, 060	41, 717, 714
Derivative of glycerine	92, 203	126, 459
Diacetyl	331	165
Lecithin	96, 441	100, 360
Milk	10, 513, 352	12, 522, 033
Monostearine	57, 221	87, 941
Neutral lard	294, 320	244, 418
Oleo oil	247, 780	245, 628
Oleo stearine	271, 040	335, 586
Oleo stock	29, 290	57, 445
Peanut oil	281, 540	125, 456
Salt	1, 919, 122	2, 245, 680
Soda (benzoate of)	43, 019	57, 587
Sodium sulpho acetate	4, 183	5, 620
Soya bean flakes	430	------------
Soya bean oil	13, 821, 626	17, 101, 183
Vitamin concentrate	9, 632	11, 710
Total	63, 013, 830	75, 587, 090
Total production of colored oleomargarine	10, 264, 607	7, 708, 182
Total withdrawn tax-paid	9, 399, 449	3, 962, 373
Ingredient schedule of colored oleomargarine:		
Butter flavor	248	66
Coconut oil	1, 884	1, 811, 440
Color	6, 430	4, 162
Corn oil	528	169
Cottonseed flakes	------------	3, 013
Cottonseed oil	5, 654, 903	2, 427, 935
Derivative of glycerine	15, 640	9, 402
Diacetyl	65	66
Lecithin	16, 026	6, 760
Milk	1, 747, 974	1, 296, 751
Monostearine	5, 255	4, 404
Neutral lard	31, 071	3, 429
Oleo oil	17, 187	1, 714
Oleo stock	300	------------
Peanut oil	11, 828	6, 600
Salt	318, 453	247, 209
Soda (benzoate of)	5, 868	3, 206
Soya bean flakes	500	------------
Soya bean oil	2, 586, 025	1, 972, 561
Soya bean stearine	------------	10, 575
Vitamin concentrate	1, 355	921
Total	10, 421, 540	7, 810, 383

[a] All figures are subject to revision until published in the Commissioner's annual report.

1949–4–13027
MS. 331

Schedule of oleomargarine produced and materials used during the month of December, 1948, as compared with December, 1947

	December, 1948	December, 1947
	Pounds	*Pounds*
Total production of uncolored oleomargarine	63, 972, 729	72, 368, 115
Total withdrawn tax-paid	60, 593, 060	69, 095, 248
Ingredient schedule of uncolored oleomargarine:		
Butter flavor	2, 080	296
Citric acid		
Coconut oil		740
Corn oil	25, 259	178
Cottonseed flakes		
Cottonseed oil	33, 419, 577	40, 185, 133
Cottonseed stearine		27
Derivative of glycerine	96, 508	117, 811
Diacetyl	251	284
Lecithin	98, 904	96, 645
Milk	10, 720, 643	12, 290, 886
Monostearine	57, 658	76, 369
Neutral lard	350, 372	401, 437
Oleo oil	286, 230	340, 615
Oleo stearine	260, 995	289, 439
Oleo stock	30, 525	71, 100
Peanut oil	14, 033	51
Salt	1, 933, 010	2, 227, 410
Soda (benzoate of)	43, 956	55, 742
Sodium sulpho acetate	5, 749	5, 002
Soya bean flakes	430	
Soya bean oil	16, 614, 985	17, 447, 319
Vitamin concentrate	11, 564	14, 764
Total	63, 972, 729	73, 621, 248
Total production of colored oleomargarine	10, 335, 561	6, 652, 878
Total withdrawn tax-paid	9, 324, 490	3, 496, 230
Ingredient schedule of colored oleomargarine:		
Butter flavor	281	251
Coconut oil		1, 538, 544
Color	8, 695	4, 559
Corn oil	2, 093	147
Cottonseed oil	5, 149, 735	2, 182, 694
Derivative of glycerine	13, 910	9, 458
Diacetyl	44	60
Lecithin	15, 115	5, 914
Milk	1, 910, 934	1, 134, 414
Monostearine	6, 482	3, 387
Neutral lard	4, 825	22, 942
Oleo oil	6, 400	15, 346
Oleo stock	725	2, 400
Peanut oil	15, 072	1, 100
Salt	313, 516	215, 250
Soda (benzoate of)	6, 066	3, 322
Soya bean flakes		
Soya bean oil	3, 061, 613	1, 591, 384
Vitamin concentrate	1, 344	823
Total	10, 516, 850	6, 731, 995

1949-6-13051
MS. 332

Schedule of oleomargarine produced and materials used during the month of January, 1949, as compared with January, 1948

	January, 1949	January, 1948
	Pounds	*Pounds*
Total production of uncolored oleomargarine	69,655,755	80,082,790
Total withdrawn tax-paid	69,750,870	82,880,733
Ingredient schedule of uncolored oleomargarine:		
Butter flavor	2,121	313
Citric acid		
Coconut oil		1,730
Corn oil	98,020	32,899
Cottonseed flakes		
Cottonseed oil	37,641,842	44,046,835
Cottonseed stearine		
Derivative of glycerine	94,710	128,314
Diacetyl	56	7,230
Lecithin	123,187	112,553
Milk	11,609,762	13,632,009
Monostearine	65,507	94,395
Neutral lard	433,035	448,673
Oleo oil	317,849	416,810
Oleo stearine	242,477	296,986
Oleo stock	30,200	71,840
Peanut oil	8,211	389,376
Salt	2,133,309	2,437,200
Soda (benzoate of)	48,148	60,038
Sodium sulpho acetate	5,556	4,877
Soya bean flakes	368	
Soya bean oil	17,782,467	19,214,198
Vitamin concentrate	46,841	12,128
Total	70,683,666	81,408,404
Total production of colored oleomargarine	11,995,971	7,853,276
Total withdrawn tax-paid	10,585,514	5,025,877
Ingredient schedule of colored oleomargarine:		
Butter flavor	703	81
Coconut oil	29,900	2,135,532
Color	16,629	5,105
Corn oil	11,558	235
Cottonseed oil	6,422,971	2,671,170
Derivative of glycerine	17,359	7,988
Diacetyl	9	131
Lecithin	21,167	10,329
Milk	2,035,753	1,343,432
Monostearine	7,646	4,170
Neutral lard	30,347	33,353
Oleo oil	23,973	28,775
Oleo stock	1,600	5,400
Peanut oil	8,456	15,949
Salt	375,000	252,287
Soda (benzoate of)	7,858	3,947
Soya bean flakes	112	
Soya bean oil	3,302,703	1,418,434
Vitamin concentrate	1,805	986
Total	12,315,549	7,937,304

1949–8–13068
MS. 333

Schedule of oleomargarine produced and materials used during the month of February, 1949, as compared with February, 1948

	February, 1949	February, 1948
	Pounds	*Pounds*
Total production of uncolored oleomargarine	63, 226, 829	73, 770, 024
Total withdrawn tax-paid	63, 677, 255	70, 382, 717
Ingredient schedule of uncolored oleomargarine:		
Butter flavor	3, 568	305
Coconut oil		224, 115
Corn oil	95, 867	3, 306
Cottonseed oil	32, 632, 149	39, 980, 077
Cottonseed stearine		36
Derivative of glycerine	86, 475	126, 569
Diacetyl	176	362
Lecithin	109, 838	109, 729
Milk	10, 597, 842	12, 280, 277
Monostearine	50, 795	71, 286
Neutral lard	385, 404	413, 342
Oleo oil	321, 916	311, 217
Oleo stearine	215, 943	221, 794
Oleo stock	30, 530	27, 565
Peanut oil	1, 084	425, 899
Salt	1, 930, 325	2, 241, 710
Soda (benzoate of)	46, 658	56, 020
Sodium sulpho acetate	4, 345	4, 679
Soya bean flakes	405	
Soya bean oil	17, 744, 465	18, 404, 442
Vitamin concentrate	10, 110	12, 877
Total	64, 267, 895	74, 915, 607
Total production of colored oleomargarine	12, 813, 607	6, 653, 169
Total withdrawn tax-paid	11, 628, 202	4, 684, 220
Ingredient schedule of colored oleomargarine:		
Butter flavor	110	95
Coconut oil		1, 054, 265
Color	6, 648	6, 174
Corn oil	14, 851	284
Cottonseed oil	6, 003, 321	2, 799, 049
Derivative of glycerine	16, 496	8, 296
Diacetyl	674	20
Lecithin	22, 799	8, 627
Milk	2, 200, 519	1, 175, 372
Monostearine	8, 011	2, 147
Neutral lard	12, 750	19, 101
Oleo oil	17, 400	13, 949
Oleo stock	3, 750	2, 000
Peanut oil	1, 236	16, 203
Salt	396, 309	210, 744
Soda (benzoate of)	8, 103	3, 995
Soya bean flakes	130	
Soya bean oil	4, 231, 933	1, 457, 754
Vitamin concentrate	1, 920	827
Total	12, 946, 960	6, 778, 902

1949–10–13090
MS. 334

Schedule of oleomargarine produced and materials used during the month of March, 1949, as compared with March, 1948

	March, 1949	March, 1948
	Pounds	*Pounds*
Total production of uncolored oleomargarine	67, 435, 349	65, 815, 374
Total withdrawn tax-paid	67, 090, 617	68, 673, 002
Ingredient schedule of uncolored oleomargarine:		
Butter flavor	3, 210	208
Coconut oil	----------	82, 985
Corn oil	277, 235	79, 432
Cottonseed oil	34, 729, 674	35, 475, 931
Derivative of glycerine	92, 445	109, 235
Diacetyl	169	313
Lecithin	161, 732	94, 855
Milk	11, 319, 362	11, 066, 605
Monostearine	58, 984	64, 789
Neutral lard	388, 159	201, 318
Oleo oil	358, 057	141, 636
Oleo stearine	287, 967	252, 253
Oleo stock	42, 340	16, 152
Peanut oil	50, 769	873, 159
Salt	2, 032, 568	2, 000, 696
Soda (benzoate of)	46, 399	48, 314
Sodium sulpho acetate	5, 313	4, 056
Soya bean flakes	385	----------
Soya bean oil	18, 894, 432	16, 164, 918
Vitamin concentrate	10, 357	10, 208
Total	68, 759, 557	66, 687, 063
Total production of colored oleomargarine	12, 749, 411	6, 020, 032
Total withdrawn tax-paid	11, 873, 294	5, 640, 245
Ingredient schedule of colored oleomargarine:		
Butter flavor	1, 197	37
Coconut oil	----------	234, 220
Color	6, 033	4, 149
Corn oil	60, 294	4, 539
Cottonseed oil	6, 089, 058	3, 251, 946
Derivative of glycerine	15, 841	10, 498
Diacetyl	33	11
Lecithin	25, 209	7, 046
Milk	2, 131, 067	1, 016, 626
Monostearine	8, 884	2, 592
Neutral lard	9, 250	18, 280
Oleo oil	14, 800	10, 794
Oleo stock	1, 850	300
Peanut oil	1, 446	43, 304
Salt	401, 672	182, 509
Soda (benzoate of)	7, 103	3, 612
Soya bean flakes	150	----------
Soya bean oil	4, 269, 349	1, 289, 677
Vitamin concentrate	1, 982	569
Total	13, 045, 218	6, 080, 709

1949–12–13108
MS. 335

Schedule of oleomargarine produced and materials used during the month of April, 1949, as compared with April, 1948

	April, 1949	April, 1948
	Pounds	*Pounds*
Total production of uncolored oleomargarine	54, 678, 445	69, 408, 301
Total withdrawn tax-paid	54, 309, 399	70, 936, 056
Ingredient schedule of uncolored oleomargarine:		
Butter flavor	8, 835	220
Coconut oil	----------	13, 879
Corn oil	27, 576	74, 082
Cottonseed oil	27, 450, 368	33, 830, 072
Derivative of glycerine	85, 335	109, 838
Diacetyl	92	335
Lecithin	99, 139	104, 821
Milk	9, 089, 995	11, 718, 083
Monostearine	47, 000	62, 545
Neutral lard	371, 336	11, 177
Oleo oil	272, 145	19, 256
Oleo stearine	242, 345	175, 159
Oleo stock	40, 970	600
Peanut oil	576	1, 357, 664
Salt	1, 680, 789	2, 004, 704
Soda (benzoate of)	37, 109	52, 187
Sodium sulpho acetate	4, 117	1, 287
Soya bean flakes	480	----------
Soya bean oil	16, 171, 018	20, 822, 633
Vitamin concentrate	8, 437	10, 930
Total	55, 637, 662	70, 369, 472
Total production of colored oleomargarine	11, 075, 977	6, 641, 297
Total withdrawn tax-paid	10, 409, 194	6, 017, 811
Ingredient schedule of colored oleomargarine:		
Butter flavor	4, 184	35
Coconut oil	40, 069	193, 990
Color	6, 076	4, 444
Corn oil	425	4, 410
Cottonseed oil	5, 320, 583	3, 533, 996
Derivative of glycerine	13, 868	10, 784
Diacetyl	12	11
Lecithin	20, 383	7, 169
Milk	1, 892, 896	1, 110, 366
Monostearine	7, 594	3, 198
Neutral lard	9, 925	----------
Oleo oil	15, 750	----------
Oleo stock	2, 375	----------
Peanut oil	1, 721	41, 042
Salt	348, 629	209, 545
Soda (benzoate of)	6, 168	3, 947
Soya bean oil	3, 663, 587	1, 582, 860
Vitamin concentrate	1, 674	545
Total	11, 355, 919	6, 706, 342

TOBACCO [a]

1949-3-13020
T. 227

Statement of manufactured tobacco produced, by classes, during the month of November, 1948, as compared with November, 1947

	November, 1948	November, 1947
	Pounds	*Pounds*
Plug	3, 871, 678	3, 868, 411
Twist	476, 200	413, 689
Fine-cut chewing	268, 343	297, 557
Scrap chewing	3, 769, 686	3, 465, 318
Smoking	8, 721, 187	7, 887, 765
Snuff	3, 353, 741	2, 883, 105
Total	20, 460, 835	18, 815, 845

1949-5-13034
T. 229

Statement of manufactured tobacco produced, by classes, during the month of December, 1948, as compared with December, 1947

	December, 1948	December, 1947
	Pounds	*Pounds*
Plug	3, 131, 289	3, 220, 933
Twist	454, 751	403, 733
Fine-cut chewing	241, 789	329, 669
Scrap chewing	3, 324, 400	3, 200, 221
Smoking	6, 830, 029	6, 998, 433
Snuff	3, 534, 631	3, 130, 241
Total	17, 516, 889	17, 283, 230

1949-7-13058
T. 231

Statement of manufactured tobacco produced, by classes, during the month of January, 1949, as compared with January, 1948

	January, 1949	January, 1948
	Pounds	*Pounds*
Plug	3, 107, 865	3, 516, 378
Twist	475, 696	464, 117
Fine-cut chewing	227, 891	363, 354
Scrap chewing	3, 406, 115	3, 383, 002
Smoking	7, 385, 824	8, 016, 503
Snuff	3, 427, 486	3, 488, 974
Total	18, 030, 877	19, 232, 328

[a] All figures are subject to revision until published in the Commissioner's annual report.

1949–10–13088
T. 233

Statement of manufactured tobacco produced, by classes, during the month of February, 1949, as compared with February, 1948

	February, 1949	February, 1948
	Pounds	*Pounds*
Plug	3, 009, 434	3, 521, 797
Twist	454, 286	453, 913
Fine-cut chewing	206, 868	334, 305
Scrap chewing	3, 097, 003	3, 183, 326
Smoking	7, 548, 300	7, 791, 083
Snuff	3, 260, 161	3, 264, 989
Total	17, 576, 052	18, 549, 413

1949–11–13099
T. 235

Statement of manufactured tobacco produced, by classes, during the month of March, 1949, as compared with March, 1948

	March, 1949	March, 1948
	Pounds	*Pounds*
Plug	3, 729, 133	3, 910, 307
Twist	534, 368	473, 297
Fine-cut chewing	213, 076	322, 188
Scrap chewing	3, 141, 423	3, 560, 150
Smoking	9, 567, 237	8, 910, 408
Snuff	3, 695, 195	3, 878, 937
Total	20, 880, 432	21, 055, 287

1949–13–13118
T. 237

Statement of manufactured tobacco produced, by classes, during the month of April, 1949, as compared with April, 1948

	April, 1949	April, 1948
	Pounds	*Pounds*
Plug	3, 365, 920	4, 199, 537
Twist	457, 585	461, 587
Fine-cut chewing	201, 689	220, 184
Scrap chewing	2, 915, 108	3, 376, 808
Smoking	8, 534, 807	9, 692, 591
Snuff	3, 253, 556	3, 389, 562
Total	18, 728, 665	21, 340, 269

CIGARETTES [a]

1949–4–13028
T. 228

Preliminary statement of small cigarettes removed for consumption during the month of December, 1948, as compared with removals for the same month of 1947

Removals	December, 1948	December, 1947
	Number	*Number*
Tax-paid	24, 897, 350, 011	24, 945, 712, 201
Tax-free	3, 184, 757, 592	2, 997, 209, 786
Total	28, 082, 107, 603	27, 942, 921, 987

1949–5–13036
T. 230

Preliminary statement of small cigarettes removed for consumption during the month of January, 1949, as compared with removals for the same month of 1948

Removals	January, 1949	January, 1948
	Number	*Number*
Tax-paid	27, 967, 149, 235	27, 273, 180, 851
Tax-free	2, 207, 564, 607	3, 212, 577, 867
Total	30, 174, 713, 842	30, 485, 758, 718

1949–7–13059
T. 232

Preliminary statement of small cigarettes removed for consumption during the month of February, 1949, as compared with removals for the same month of 1948

Removals	February, 1949	February, 1948
	Number	*Number*
Tax-paid	25, 024, 281, 200	23, 472, 484, 851
Tax-free	2, 570, 416, 470	3, 577, 822, 404
Total	27, 594, 697, 670	27, 050, 307, 255

[a] All figures are subject to revision until published in the Commissioner's annual report.

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1949-10-13089
T. 234

Preliminary statement of small cigarettes removed for consumption during the month of March, 1949, as compared with removals for the same month of 1948

Removals	March, 1949	March, 1948
	Number	*Number*
Tax-paid	31, 447, 908, 600	29, 252, 186, 770
Tax-free	3, 168, 313, 697	3, 196, 672, 680
Total	34, 616, 222, 297	32, 448, 859, 450

1949-11-13100
T. 236

Preliminary statement of small cigarettes removed for consumption during the month of April, 1949, as compared with removals for the same month of 1948

Removals	April, 1949	April, 1948
	Number	*Number*
Tax-paid	27, 307, 056, 215	31, 617, 679, 245
Tax-free	3, 567, 880, 110	2, 422, 121, 631
Total	30, 874, 936, 325	34,039,800, 876

1949-13-13119
T. 238

Preliminary statement of small cigarettes removed for consumption during the month of May, 1949, as compared with removals for the same month of 1948

Removals	May, 1949	May, 1948
	Number	*Number*
Tax-paid	30, 690, 544, 811	29, 091, 662, 975
Tax-free	3, 172, 404, 347	2, 363, 442, 668
Total	33, 862, 949, 158	31, 455, 105, 643

LEGISLATION

1949–9–13081

H. R. 2313. PUBLIC LAW 33, EIGHTY-FIRST CONGRESS
[CHAPTER 44, FIRST SESSION]

An Act To suspend certain import taxes on copper

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the import tax imposed under section 3425 of the Internal Revenue Code shall not apply with respect to articles (other than copper sulfate and other than composition metal provided for in paragraph 1657 of the Tariff Act of 1930, as amended, which is suitable both in its composition and shape, without further refining or alloying, for processing into castings, not including as castings ingots or similar cast forms) entered for consumption or withdrawn from warehouse for consumption during the period beginning April 1, 1949, and ending with the close of June 30, 1950.

Approved March 31, 1949.

1949–9–13082

H. J. RES. 203. PUBLIC LAW 35, EIGHTY-FIRST CONGRESS
[CHAPTER 46, FIRST SESSION]

Joint Resolution To maintain the status quo with respect to the exemption, from the tax on transportation of persons, of foreign travel via Newfoundland.

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That section 3469(a) of the Internal Revenue Code (relating to the tax on transportation of persons) is hereby amended by inserting after the second sentence thereof a new sentence to read as follows: "A port or station within Newfoundland shall not, for the purposes of the preceding sentence, be considered as a port or station within Canada."

SEC. 2. The amendment made by this joint resolution shall apply to amounts paid for transportation on or after April 1, 1949.

Approved March 31, 1949.

1949–12–13106

H. J. RES. 186. PUBLIC LAW 50, EIGHTY-FIRST CONGRESS
[CHAPTER 82, FIRST SESSION]

Joint Resolution To extend the time for use of construction reserve funds established under section 511 of the Merchant Marine Act, 1936, as amended.

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That section 5 of an Act approved August 8, 1947 (Public Law 384, Eightieth Congress), relating to merchant marine construction reserve funds established under section 511 of the Merchant Marine Act, 1936, as amended, is hereby amended by striking out "March 31, 1948" and inserting in lieu thereof "March 31, 1951".

Approved April 20, 1949.

1949–13–13117

H. R. 3762. PUBLIC LAW 72, EIGHTY-FIRST CONGRESS
[CHAPTER 139, FIRST SESSION]

An Act To amend title 18, entitled, Crimes and Criminal Procedure, and title 28, entitled, Judiciary and Judicial Procedure, of the United States Code, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, * * *

* * * * * * *

SEC. 80. (a) Subdivision (1) of subsection (a) of section 1346 of title 28, United States Code, is amended by striking out the semicolon immediately following the words "internal-revenue laws", and by inserting in lieu thereof a comma and immediately following such comma the words and characters as follows: "(i) if the claim does not exceed $10,000 or (ii)".

* * * * * * *

SEC. 120. Section 2411 of title 28, United States Code, is amended to read as follows:

§ 2411. Interest

(a) In any judgment of any court rendered (whether against the United States, a collector or deputy collector of internal revenue, a former collector or deputy collector, or the personal representative in case of death) for any overpayment in respect of any internal-revenue tax, interest shall be allowed at the rate of 6 per centum per annum upon the amount of the overpayment, from the date of the payment or collection thereof to a date preceding the date of the refund check by not more than thirty days, such date to be determined by the Commissioner of Internal Revenue. The Commissioner is authorized to tender by check payment of any such judgment, with interest as herein provided, at any time after such judgment becomes final, whether or not a claim for such payment has been duly filed, and such tender shall stop the running of interest, whether or not such refund check is accepted by the judgment creditor.

(b) Except as otherwise provided in subsection (a) of this section, on all final judgments rendered against the United States in actions instituted under section 1346 of this title, interest shall be computed at the rate of 4 per centum per annum from the date of the judgment up to, but not exceeding, thirty days after the date of approval of any appropriation Act providing for payment of the judgment.

* * * * * * *

SEC. 128. Subsection (a) of section 1141 of the Internal Revenue Code (26 U. S. C., sec. 1141(a)), as amended, is amended by striking out the words "circuit courts of appeals and the United States Court of Appeals for the District of Columbia", appearing in such subsection, and substituting in lieu thereof "courts of appeals".

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Approved May 24, 1949.

INDEX

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